ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 29, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2017

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc

(Exact name of Registrant as specified in its charter)

United Kingdom

(Jurisdiction of incorporation)

RBS Gogarburn, PO Box 1000, Edinburgh EH12 1HQ, United Kingdom

(Address of principal executive offices)

Aileen Taylor, Chief Governance Officer and Board Counsel, Tel: +44 (0) 131 626 4099, Fax: +44 (0) 131 626 3081

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 2 ordinary shares, nominal value £1 per share	New York Stock Exchange*
Ordinary shares, nominal value £1 per share	
American Depositary Shares Series S and U each representing one Non-Cumulative Dollar Preference Share, Series S and U respectively	New York Stock Exchange*
Dollar Perpetual Regulatory Tier 1 Securities	New York Stock Exchange
4.70% Subordinated Notes due 2018	New York Stock Exchange
5.625% Senior Notes due 2020	New York Stock Exchange
6.125% Senior Notes due 2021	New York Stock Exchange
6.125% Subordinated Tier 2 Notes due 2022	New York Stock Exchange
6.000% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
6.100% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
3.875% Senior Notes due 2023	New York Stock Exchange
3.498% Senior Notes due 2023	New York Stock Exchange
Senior Floating Rate Notes due 2023	New York Stock Exchange
5.125% Subordinated Tier 2 Notes due 2024	New York Stock Exchange
Leveraged CPI Linked Securities due January 13, 2020	NYSE MKT

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares or non-cumulative dollar preference shares, as applicable, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2020	Irish Stock Exchange
Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2021	Irish Stock Exchange
Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2025	Irish Stock Exchange

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of December 31, 2017, the close of the period covered by the annual report:

(Title of each class)	(Number of outstanding shares)
Ordinary shares of £1 each	11,964,564,553
11% cumulative preference shares	500,000
5½% cumulative preference shares	400,000
Non-cumulative dollar preference shares, Series S and U	26,459,170
Non-cumulative euro preference shares, Series 1 to 3	2,044,418
Non-cumulative sterling preference shares, Series 1	54,442

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of large accelerated filer , accelerated filer, and emerging growth company in Rule 12b-2 of the Exchange Act.

x Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer

¨ Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.¨

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

o U.S. GAAP

x International Financial Reporting Standards as issued by the International Accounting Standards Board

¨ Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes x No

SEC Form 20-F cross reference guide

SEC Form 20-F cross reference guide continued

Item	Item Caption	Pages
PART II		
13	Defaults, Dividend Arrearages and Delinquencies	Not applicable
14	Material Modifications to the Rights of Security Holders and Use of Proceeds	Not applicable
15	Controls and Procedures	48, 65, 69, 106, 234, Exhibits 12.1 and 12.2
16	[Reserved]	
16a	Audit Committee financial expert	67
16b	Code of ethics	33, 111-112, 381
16c	Principal Accountant Fees and services	65-66, 265
16d	Exemptions from the Listing Standards	Not applicable
16e	Purchases of Equity Securities by the Issuer and Affiliated Purchasers	Not applicable
16f	Change in Registrant s Certifying Accountant	Not applicable
16g	Corporate Governance	49, 57-62, 99-100
16h	Mine Safety Disclosure	Not applicable
PART III		
17	Financial Statements	Not applicable
18	Financial Statements	232-331
19	Exhibits	415-416

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: 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 RBS s transformation programme, including the further restructuring of the NatWest Markets franchise; the satisfaction of the Group s residual EU State Aid obligations; the continuation of RBS 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; RBS 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 as interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promoter Score (NPS); sustainability matters, including targets; and 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 Group s strategy or operations, which may result in the Group 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 Group 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 our results or our ability to implement our strategy, cause us to fail to meet our 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 and other uncertainties set out on pages 349 to 379 of this document and other risk factors and uncertainties discussed in this document. These include the significant risks for RBS presented by the outcomes of the legal, regulatory and governmental actions and investigations that RBS is or may be subject to and any resulting material adverse effect on RBS 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; RBS s ability to satisfy its residual EU State Aid obligations and the timing thereof; RBS 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; RBS 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 RBS 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 Group s operations on its IT systems; the exposure of RBS to cyber-attacks and its ability to defend against such attacks; RBS s ability to achieve its capital, funding, liquidity and leverage requirements or targets which will depend in part on RBS s success in reducing the size of its 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; RBS s ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBS, RBS entities or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBS 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 our results, ability to implement our strategy, cause us to fail to meet our targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to RBS s business and will increase as a result of RBS s significant restructuring and transformation initiatives being concurrently implemented; the potential negative impact on RBS 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 RBS operates as well as divergences in regulatory requirements in the jurisdictions in which RBS operates; the risks relating to RBS s IT systems or a failure to protect itself and its customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBS s capital position, including on any requisite management buffer; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if its risk management framework is ineffective; RBS s ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, RBS s activities as a result of HM Treasury s investment in RBS; the value and effectiveness of any credit protection purchased by RBS;

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 RBS operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBS s financial statements or adversely impact its capital position; the impact of the recovery and resolution framework and other prudential rules to which RBS is 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 Group; and the success of RBS in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and RBS does 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.

Presentation of information

In this document, and unless specified otherwise, the term company Bank or RBSG means The Royal Bank of Scotland Group plc, RBS , RBS Group or the Group means the company and its subsidiaries, the Royal Bank or RBS plc means The Royal Bank of Scotland plc and NatWest means National Westminster Bank Plc.

The company publishes its financial statements in pounds sterling (£ or sterling). The abbreviations £m and £bn represent millions and thousands of millions of pounds sterling, respectively, and references to pence represent pence in the United Kingdom (UK). Reference to dollars or $ are to United States of America (US) dollars. The abbreviations $m and $bn represent millions and thousands of millions of dollars, respectively, and references to cents represent cents in the US. The abbreviation represents the euro , and the abbreviations m and bn represent millions and thousands of millions of euros, respectively.

Any information contained on websites linked or reports referenced in this annual report on Form 20-F is for information only and shall not be deemed to be incorporated by reference herein.

Segmental reporting

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime, the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed, for full details see the Report of the directors.

RBS Group ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019.

To comply with these requirements it is RBS s intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets Plc (NatWest Markets) will be a separate non ring-fenced bank and The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings) will also be placed outside the ring-fence, both as direct subsidiaries of RBSG.

On 1 January 2017, RBS made a number of key changes to the legal hierarchy of its subsidiaries to support the move towards a ring-fenced structure. As part of continuing preparation to deliver a fully compliant ring-fencing structure by 1 January 2019, it plans to undertake a further series of actions. For further details of these actions see the Report of the directors.

Non-GAAP financial information

RBS prepares its financial statements in accordance with IFRS as issued by the IASB which constitutes a body of generally accepted accounting principles (GAAP). This document contains a number of non-GAAP (or non-IFRS) financial measures. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP financial measure.

The non-GAAP financial measures used in this document generally exclude certain items which management believe are not representative of the underlying performance of the business and which distort period-on-period comparison.

These measures are used internally by management, in conjunction with IFRS financial measures, to measure performance and make decisions regarding the future direction of the business. Management believes these non-GAAP financial measures, when provided in combination with reported IFRS results, provide helpful supplementary information for investors. These non-GAAP financial measures are not a substitute for and should be read in conjunction with reported IFRS financial measures.

The main non-GAAP financial measures used in this document include:

- Adjusted measures of financial performance, principally operating profit, operating expenses, total income and other performance measures before: own credit adjustments; gain or loss on redemption of own debt; strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill;

- Certain performance ratios based on the adjusted performance measures described above, including the adjusted cost:income ratio (calculated using adjusted operating income and costs), adjusted return on equity ratio (calculated using adjusted operating profit) and the 2017 cost saving progress and targets (calculated using operating expenses excluding litigation and conduct costs, restructuring costs, write down of goodwill, the impairment of other intangible assets, the operating costs of Williams & Glyn and theVAT recovery)

- Personal & Business Banking (PBB) franchise results, combining the reportable segments of UK Personal & Business Banking (UKPBB) and Ulster Bank RoI, Commercial & Private Banking (CPB) franchise results, combining the reportable segments of Commercial Banking and Private Banking (see page 109 for further details on segmental reporting including business descriptions and details of segmental reorganisation and business transfers); and

Reconciliations of these non-GAAP financial measures to the closest equivalent GAAP measure are presented throughout this document and in the 2017 performance on page 6.

Key operating indicators

This document includes a number of operational metrics which management believes may be helpful to investors in understanding the Group s business, including the Groups position against its own targets. These metrics include performance, funding and credit metrics such as return on tangible equity and related RWA equivalents incorporating the effect of capital deductions (RWAes), total assets excluding derivatives (funded assets) and net interest margin (NIM) adjusted for items designated at fair value through profit or loss (non-statutory NIM), cost:income ratio, loan:deposit ratio and REIL/impairment provision ratios. These are internal metrics used to measure business performance.

Capital and liquidity measures

Certain liquidity and capital measures and ratios are presented in this document as management believes they are helpful for investors understanding of the liquidity and capital profile of the business and the Group s position against its own targets and applicable regulatory requirements. Some of these measures are used by management for risk management purposes and may not yet required to be disclosed by a government, governmental authority or self-regulatory organisation. As a result, the basis of calculation of these measures may not be the same as that used by the Group s peers. These capital and liquidity measures and ratios include: the liquidity coverage ratio, stressed outflow coverage and net stable funding ratio.

2

Presentation of information

Recent developments

Ring-fencing Transfer scheme

As announced on 22 March 2018, the Court of Session in Edinburgh has approved the application made in November 2017 to initiate the first Ring-fencing Transfer Scheme as detailed on page 108.

FX antitrust litigation

As previously disclosed, RBS is among the defendants in an FX-related antitrust class action on behalf of consumers and end-user businesses harmed by alleged collusion in the FX spot market. On 12 March 2018, the United States District Court for the Southern District of New York denied defendants motion to dismiss the plaintiffs amended complaint, holding that plaintiffs have adequately alleged antitrust standing, and denied defendants request to take an immediate appeal from that decision. On 23 March 2018, the same court denied a motion by RBS and certain other defendants to dismiss the complaint for lack of personal jurisdiction.

In addition, as previously disclosed, RBS is among the defendants in a separate consolidated FX-related antitrust class action on behalf of indirect purchasers who were allegedly indirectly affected by FX instruments that others entered into with the defendant banks. On 15 March 2018, the United States District Court for the Southern District of New York granted RBS and the other defendants motion to dismiss on a number of grounds, including failure to plead proximate cause and antitrust standing.

Interest rate hedging products litigation

As previously disclosed, Property Alliance Group (PAG) v The Royal Bank of Scotland plc was the leading case before the English High Court involving both interest rate hedging products (IRHP) mis-selling and LIBOR misconduct allegations. The amount claimed was £34.8 million and the trial ended in October 2016. In December 2016 the High Court dismissed all of PAG s claims. PAG appealed that decision, and the Court of Appeal s judgment was handed down on 2 March 2018. RBS was successful on all grounds. The decision (subject to any further appeal by PAG) may have significance for other similar IRHP and LIBOR-related cases currently pending in the English courts, some of which involve substantial amounts.

RMBS and other securitised products investigations

On 6 March 2018, the New York Attorney General announced that it had resolved its investigation of RBS s issuance and underwriting of residential mortgage-backed securities. RBS Financial Products Inc. will pay US $100 million to the State of New York, and provide US $400 million of consumer relief credits at a cost of approximately US $130 million. The cost of the settlement is covered by existing provisions.

Governance and risk management consent order

As previously disclosed, in July 2011, RBS, 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. On 8 March 2018, the Federal Reserve Board announced that it had terminated RBS entities   obligations to the Federal Reserve Board under the Order. On 23 March 2018, the Illinois Department of Financial and Professional Regulation also notified RBS that it had terminated RBS entities   obligations to it under the Order.

2017 performance highlights

RBS reported an operating profit before tax of £2,239 million for 2017 and its first profit attributable to shareholders in ten years, of £752 million.

RBS delivered against its targets to increase income, reduce costs and use less capital across its businesses. In addition, RBS made substantive progress on resolving its remaining legacy issues. Net loans and advances growth of 2.2% across PBB, CPB and RBSI(1,2,3) was lower than target, however, the bank made greater progress than anticipated on RWA reductions.

Common Equity Tier 1 (CET1) ratio of 15.9% increased by 2.5 percentage points during 2017 and remains ahead of our 13% target.

We retain our target of achieving a sub 50% cost:income ratio and above 12% return on equity by 2020(4).

Note:

(1) Including the impact of transfers. See notes on page 16 for further details.

(2) Net loans and advances UK PBB up from £132.2 billion, 6.9% to £141.3 billion, Ulster Bank RoI up from £18.9 billion, 3.2% to £19.5 billion, Commercial Banking down from £100.1 billion, 4.9% to £95.2 billion, Private Banking up from £12.2 billion, 12.3% to £13.7 billion and RBSI down from £8.8 billion, 3.4% to £8.5 billion.

(3) Personal & Business Banking consists of the reportable segments UK Personal & Business Banking (UK PBB) and Ulster Bank RoI and Commercial & Private Banking consists of the reportable segments Commercial Banking and Private Banking. RBSI is a separate reportable segment.

(4) 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 this document and in the Risk Factors section on pages 349 to 379. These statements constitute forward looking statements; refer to Forward Looking Statements on pages 1 to 2 of this document

Notes:

(1) Including the impact of transfers. See notes on page 16 for further details.

(2) Net loans and advances UK PBB up from £132.2 billion, 6.9% to £141.3 billion, Ulster Bank RoI up from £18.9 billion, 3.2% to £19.5 billion, Commercial Banking down from £100.1 billion, 4.9% to £95.2 billion, Private Banking up from £12.2 billion, 12.3% to £13.7 billion and RBSI down from £8.8 billion, 3.4% to £8.5 billion.

(3) Personal & Business Banking consists of the reportable segments UK Personal & Business Banking (UK PBB) and Ulster Bank RoI and Commercial & Private Banking consists of the reportable segments Commercial Banking and Private Banking. RBSI is a separate reportable segment.

(4) Based on end-point Capital Requirements Regulation (CRR) Tier 1 capital and leverage exposure under the CRR Delegated Act.

(5) Refer to income statement reconciliations on page 6.

(6) Criticality 1 incidents are defined as having an adverse impact on segment s customers, employees or third parties.

(7) Operating expenses excluding litigation and conduct costs £1,285 million (2016 - £5,868 million), restructuring costs £1,565 million (2016 - £2,106 million), and VAT recoveries of £86 million (2016 - £227 million).

(8) Operating expenses excluding litigation and conduct costs £1,285 million (2016 - £5,868 million), restructuring costs £1,565 million (2016 - £2,106 million). Operating lease depreciation included in income of £142 million (December 2016 - £141 million). Income excluding own credit adjustments £69 million loss (2016 £180 million gain), loss on redemption of own debt £7 million (2016 £126 million), and strategic disposals £347 million (2016 - £164 million).

(9) Includes people supported through the following enterprise programmes during 2017: The Prince s Trust, Skills & Opportunities Fund and Entrepreneurial Spark.

Segmental summary income statements

	PBB		CPB					
	UK	Ulster Bank			RBS	NatWest	Central items	Total
	PBB	RoI	Commercial Banking	Private Banking	International	Markets	& other	RBS
2017	£m	£m	£m	£m	£m	£m	£m	£m
Total income - statutory	6,477	604	3,484	678	389	1,050	451	13,133
Own credit adjustments		3				66		69
Loss on redemption of own debt							7	7
Strategic disposals						(26)	(321)	(347)
Total income - adjusted	6,477	607	3,484	678	389	1,090	137	12,862
Operating expenses - statutory	(3,829)	(676)	(2,014)	(529)	(219)	(2,201)	(933)	(10,401)
Restructuring costs - direct	79	27	48	20	5	319	1,067	1,565
- indirect	382	29	119	25	4	117	(676)	
Litigation and conduct costs	210	169	33	39	8	237	589	1,285
Operating expenses - adjusted	(3,158)	(451)	(1,814)	(445)	(202)	(1,528)	47	(7,551)
Impairment (losses)/releases	(235)	(60)	(362)	(6)	(3)	174	(1)	(493)
Operating profit/(loss) - adjusted	3,084	96	1,308	227	184	(264)	183	4,818
Additional information								
Return on equity (1)	23.7%	(5.0%)	6.6%	6.4%	11.2%	(9.0%)	nm	2.2%
Return on equity - adjusted (1,2)	30.7%	3.6%	8.2%	11.3%	12.6%	(3.7%)	nm	8.8%
Cost income ratio	59.1%	111.9%	56.0%	78.0%	56.3%	nm	nm	79.0%
Cost income ratio - adjusted (2)	48.8%	74.3%	50.0%	65.6%	51.9%	140.2%	nm	58.2%
2016								
Total income - statutory	6,127	576	3,415	657	374	1,212	229	12,590
Own credit adjustments		(3)				(187)	10	(180)
Loss on redemption of own debt							126	126
Strategic disposals						81	(245)	(164)
Total income - adjusted	6,127	573	3,415	657	374	1,106	120	12,372
Operating expenses - statutory	(4,276)	(669)	(2,467)	(549)	(174)	(2,824)	(5,235)	(16,194)
Restructuring costs - direct	46	38	25	7	2	75	1,913	2,106
- indirect	198	2	83	30	3	115	(431)	
Litigation and conduct costs	634	172	423	1		550	4,088	5,868
Operating expenses - adjusted	(3,398)	(457)	(1,936)	(511)	(169)	(2,084)	335	(8,220)
Impairment releases/(losses)	(125)	113	(206)	3	(10)	(253)		(478)
Operating profit/(loss) - adjusted	2,604	229	1,273	149	195	(1,231)	455	3,674
Additional information								
Return on equity (1)	16.2%	0.7%	4.1%	5.6%	13.8%	(12.5%)	nm	(17.9%)
Return on equity - adjusted (1,2)	25.1%	8.4%	8.4%	7.8%	14.2%	(8.7%)	nm	1.6%

Cost income ratio	69.8%	116.1%	71.0%	83.6%	46.5%	nm	nm	129.0%
Cost income ratio - adjusted (2)	55.5%	79.8%	54.8%	77.8%	45.2%	188.4%	nm	66.0%
2015								
Total income - statutory	6,033	550	3,254	644	367	2,066	9	12,923
Own credit adjustments						(295)	(14)	(309)
Loss on redemption of own debt							263	263
Strategic disposals						38	119	157
Total income - adjusted	6,033	550	3,254	644	367	1,809	377	13,034
Operating expenses - statutory	(4,564)	(429)	(1,921)	(1,101)	(160)	(5,241)	(2,937)	(16,353)
Restructuring costs - direct	66	12	52	7		424	2,370	2,931
- indirect	129	3	17	66	4	1,407	(1,626)	
Litigation and conduct costs	972	(13)	51	12		404	2,142	3,568
Write down of goodwill				498				498
Operating expenses - adjusted	(3,397)	(427)	(1,801)	(518)	(156)	(3,006)	(51)	(9,356)
Impairment (losses)/releases	(8)	141	(69)	(13)		730	(54)	727
Operating profit/(loss) - adjusted	2,628	264	1,384	113	211	(467)	272	4,405
Additional information								
Return on equity (1)	13.5%	10.6%	9.8%	(27.7%)	18.5%	(11.2%)	nm	(4.7%)
Return on equity - adjusted (1,2)	25.3%	10.6%	10.9%	4.9%	18.9%	(3.0%)	nm	11.0%
Cost income ratio (3)	75.7%	78.0%	57.2%	171.0%	43.6%	nm	nm	126.9%
Cost income ratio - adjusted (2,3)	56.3%	77.6%	53.3%	80.4%	42.5%	166.2%	nm	71.4%

Notes:

(1) RBS s CET 1 target is 13% but for the purposes of computing segmental return on equity (ROE), to better reflect the differential drivers of capital usage, segmental operating profit after tax and adjusted for preference dividends is divided by average notional equity allocated at different rates of 14% (Ulster Bank RoI - 11% prior to 2017), 11% (Commercial Banking), 14% (Private Banking - 15% prior to 2017), 16% (RBS International - 12% prior to November 2017) and 15% for all other segments, of the monthly average of segmental risk-weighted assets incorporating the effect of capital deductions (RWAes). Return on equity is calculated using profit for the period attributable to ordinary shareholders.

(2) Excluding own credit adjustments, (loss)/gain on redemption of own debt, strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill.

(3) Operating lease depreciation included in income (year ended December 2017 - £142 million; year ended 31 December 2016 - £152 million).

6

Chairman s statement

Howard Davies

Chairman

2017 was another year in which we saw the bank move closer to achieving sustainable profitability.

Our share price increased 20% in the year, outperforming other main UK banks. We also welcomed the UK Treasury announcement in November 2017 to potentially restart the privatisation process by the end of March 2019. This announcement showed confidence in our strategic approach, the progress that we have made in making the bank safer and in a position to succeed as we approach a new era of disruption in banking.

The bank made an operating profit before tax of £2,239 million, and an attributable profit of £752 million(1), the first full year profit since 2007.

Progress in resolving legacy issues

We resolved a number of major legacy issues during the year. The Competition Directorate of the European Commission announced that it had agreed a revised scheme to satisfy the remaining State Aid obligations which were imposed on the bank in 2009. The new scheme replaces the need to divest the business formerly described as Williams & Glyn, and involves the creation of a capability fund to benefit challenger banks, alongside incentivised transfers of some of our small business customers. The scheme is not only practical, it will enhance competition.

Another potentially damaging reputational risk was the 2008 Rights Issue litigation. That has now been resolved. The settlement announced in June 2017 brought the proceedings to an end.

In 2017 we continued with the run down of our non-core bank, with legacy risk weighted assets, excluding Alawwal(2), reducing by £12.6 billion in the year. Given its reduced scale, in December we announced the wind-up of this division, with the remainder of the assets now folded back mainly into NatWest Markets We also settled an action with the Federal Housing Finance Agency related to this bank s participation in the US subprime mortgage market in the run up to the financial crisis.

There is, however, one major piece of litigation we need to resolve in relation to our past subprime mortgage activity, with the Department of Justice in the United States. At this point we cannot say when that issue will be closed, as the timing is not in our gift, but we continue to hope to resolve it in the coming months.

The treatment of some of our small business customers between 2008 and 2013 has been under scrutiny, and has received significant political and media attention. The Financial Conduct Authority (FCA) published a summary report into the historical operation of our former Global Restructuring Group (GRG) and the full report by Promontory was published by the Treasury Select Committee on 20 February 2017. The most serious allegations made against the bank in an earlier report by Dr. Lawrence Tomlinson were not upheld. Promontory stated that they did not find that defaults were engineered to transfer business simply to generate revenue for RBS . However, the bank was strongly criticised in the report and we acknowledge that we could have done better for many small business customers in GRG. I again apologise for the mistakes that were made during that time. The attitudes to customers displayed by some staff were not acceptable, and communication with clients was often poor. We have, as a result, refunded complex fees to many customers and established a complaints

Notes:

(1) Profit attributable to ordinary shareholders.

(2) NatWest Markets legacy RWAs 2017 - £14.0 billion (2016 - £26.6 billion); Alawwal RWAs 2017 - £6.6 billion (2016 - £7.9 billion).

Chairman s statement

scheme which is overseen by an independent third party - retired High Court judge Sir William Blackburne, who is working through our cases. The FCA have described this as an appropriate response to these findings. We have provided a sum of £400 million for these redress schemes.

Economy and Regulation

In 2017 the UK economy continued to grow, albeit below its long-term trend rate. Inflation is currently running at around 3%, above the Bank of England s 2% target. In its latest outlook the Bank of England has indicated that rates may have to rise somewhat sooner, and to a somewhat greater extent that they had previously anticipated. The Monetary Policy Committee believes that inflation will still be above target three years from now when they expect price pressures to be mounting, necessitating a monetary tightening.

Surveys of business confidence increasingly point to longer term uncertainty over how businesses will structure their operations, once the UK leaves the EU. The depreciation of sterling pushed up inflation but provided a boost to UK exporters, giving them the opportunity to reduce prices in overseas markets or to boost margins. With the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) pointing to improving global growth prospects in 2018, the UK economy could gain from this favourable tailwind, albeit the scale of these gains is uncertain. In recent weeks, sterling has appreciated against the dollar, but remains weak against the euro.

In terms of regulation it was good to receive clarity on one of the most significant reforms following the financial crisis. The Basel Committee scrutinised the way in which banks assess risk on their balance sheet, with the aim of bringing more consistency and tighter controls. The impact on RBS of the package announced in December 2017 is likely to be small and we are well positioned for when the new rules come into force in 2022.

We are also on track to meet our ring-fencing obligations by 2019. The majority of the bank will be within the ring-fence, so I will chair the Boards of the Group and the ring-fenced bank. We are well advanced in the process of securing the legal permissions we need to transfer some of our customers to the most appropriate post ring-fenced legal entity. This will allow us to continue to serve them with little or no change to their day-to-day banking. The services they use (their local branch, sort code, account numbers and where relevant Relationship Manager) will not change as a result of the Ring-Fencing Transfer Scheme and they will not need to do anything differently.

Brexit

While there is some more clarity on the regulatory environment, the political context remains uncertain, especially in relation to Brexit. Since our business is largely UK-focused, the impact on RBS is not as significant as it is on many other banks. However, in common with them, we are preparing contingency plans to maintain our Western European business. One option is to use our existing banking licence in the Netherlands to provide continuity of service from NatWest Markets to our EU customers.

Changing customer behaviour and disruption

Our operating environment is also changing. The UK financial services sector is experiencing its most significant period of disruption for some time. More accessible data, cheaper technology, new competition regulation and shifting customer expectations are the key drivers of change and are creating new challenges and opportunities for incumbent banks. These drivers are enabling new challenger banks to compete more effectively, from a lower cost base, and we have to respond. There will be more external partnerships with others than we have seen before as we offer new products and services. In 2017 we created a Technology and Innovation Committee of the Board to oversee and monitor RBS s strategic direction in what has become one of the most important areas of focus for the bank. The Committee is chaired by Alison Davis. Frank Dangeard and a new Board member, Yasmin Jetha, have also been appointed as members.

We also announced a significant reduction in our branch network. The decision to close a branch is always a difficult one to make, and is never taken lightly. However, customer behaviour is changing, with more customers choosing mobile and online over traditional branch counters, and we must respond to these changes. This shift in behaviour, combined with our partnership with the Post Office, mobile branches and Community Bankers, means there are now more ways to bank than ever before.

Our branches will remain key outlets for customers and we are investing in those that remain, to reflect the way customers want to use them, typically for financial advice related to buying a home or starting a business rather than for routine transactional banking.

Colleague engagement, diversity and inclusion

We are making good progress in improving the culture of the organisation. Our annual colleague sentiment survey scores are the highest they have been in ten years and there is generally a more positive outlook from colleagues across the bank.

In 2017 we were recognised as the Diverse Company of the Year at the National Diversity Awards; a Top 10 Employer for Working Families; a Times Top 50 Employer for Women and retained a gold rating for our work on Race in Business in the Community s Race for Opportunity benchmark. We also have a Black, Asian and Minority Ethnic (BAME) focus on recruitment, talent identification and promotion, and have introduced explicit targets for BAME representation at senior levels in 2018.

Today, for the first time, we have also published details of the average pay gap between male and female colleagues in the bank, which is 37.2%. Gender pay is markedly different to equal pay which looks at the difference in pay between men and women for similar roles. We are confident that we pay our employees fairly and keep our HR policies and processes under regular review to ensure we do so.

Our gender pay gap reflects an under representation of women at senior levels. That is not a satisfactory position and we know that we still have much to do to narrow the gap. We are therefore putting more impetus behind our work to achieve a better gender balance.

We are strongly committed to having more female colleagues in senior positions across the organisation. In 2015 we set ourselves a target to have at least 30% of roles in the three most senior levels of each of our businesses filled by women by 2020. Our latest figures show we are now at 37% on aggregate, and on track to achieve 40% by 2020. Furthermore, 44% of our top 5000 roles are occupied by women and we are aspiring to achieve full gender balance at all levels of our business by 2030.

Building a sustainable bank

We are committed to running the bank as a more sustainable business, serving today s customers in a way that also safeguards future generations.

In 2017, RBS publicly committed to support the Financial Stability Board s Task Force on Climate-related Financial Disclosures (TCFD) a voluntary set of guidelines encouraging consistent climate-related disclosures in annual reporting. We also improved our position in a number of rankings for example achieving 13th in top 100 organisations in the Stonewall Workplace Equality Index and maintained inclusion in the FTSE4GOOD index and high scores in the CDP climate index.

Our volunteering and fundraising partnerships also continue to make a difference for the communities we serve. In 2017, our employees supported a wide variety of charities by raising £4.3m in giving through their giving and fundraising efforts. We also won the Platinum award for Payroll Giving and the Payroll Giving Award for the Most Successful Sustained Scheme; 3,454 charities received funding.

Shareholder engagement

This year, we have increased the overall level of our non-financial disclosures in our Strategic report by featuring our performance highlights against each of our key influences we have described. We have introduced a new section, entitled Our Stakeholders, which describes our stakeholder groups and our approach to managing key topics of interest such as climate change.

As well as encouraging a more open culture internally, the Board has also made a considered effort to listen to the views of all shareholders. In 2017 we hosted two retail shareholder events in London and Edinburgh. Those events provided shareholders with the opportunity to share their views on our progress and our future initiatives directly with members of the Board and executive committee. Individual shareholders views on our plans to build a better bank are important to us.

The Board has, during 2017, as in previous years, run a series of stakeholder engagement sessions with representatives from a wide variety of different organisations to discuss key topics such as financial capability and technological disruption with members of our Board and senior executives. This is helping us to make better informed decisions and ensure our future strategy addresses emerging sustainability risks and opportunities. We will continue to run these events in future years. Board members have also visited business customers, and will undertake more such visits around the country this year.

Board Changes

In 2017 Mark Seligman and Yasmin Jetha joined the Board and have already brought a wealth of experience and fresh perspectives to our discussions. Mark became the Senior Independent Director at the end of the year. Sadly, John Hughes, who joined in June 2017, had to step down in September 2017 for health reasons. Dr Lena Wilson was appointed as a non- executive director on 1 January 2018. Lena brings strong commercial and public sector experience to the Board, having previously served as Chief Executive of Scottish Enterprise and Senior Investment Advisor to The World Bank. With effect from 1 January 2018, Sandy Crombie stepped down from the Board and Penny Hughes has told us that she does not plan to stand for re-election at the 2018 Annual General Meeting. I would like to thank both Sandy and Penny for their outstanding commitment and huge contributions to RBS over a number of years. Sandy was, as Senior Independent Director, a great support to my predecessor and to me. Penny has led the Remuneration and, later, the Sustainable Banking Committee with great enthusiasm. We wish them both well for the future.

Conclusion

Overall, the Board believes that in 2017 we have made further progress in resolving the legacy issues which have hung over the bank for too long. We still have important issues to resolve and tough decisions to make, particularly on cost control, but in 2017 we made several important steps in the right direction. Thank you for your patience as we continue the bank s turnaround.

Chief Executive s review

Ross McEwan

Chief Executive

Putting the past behind us. Investing for the future.

In 2017 we continued to make good progress in building a simpler, safer and more customer focused bank. I am pleased to report to shareholders that the bank made an operating profit before tax of £2,239 million in 2017, and for the first time in ten years we have delivered a bottom line profit of £752 million(1).

We have achieved profitability through delivering on the strategic plan that was set out in 2014. The first part of this plan was focused on building financial strength by reducing risk and building a more sustainable cost base. So far, we have reduced our risk-weighted assets by £228 billion and today can report a Common Equity Tier 1 ratio of 15.9% up from 8.6% in 2013. Our financial strength is now much clearer. Over the same period we have reduced operating costs by £3.9 billion(2). We still have more to do on cost reduction, however this reflects the progress we have made in making the bank more efficient.

A clear indication of the outstanding progress we have made is that from the first quarter of 2018, we will no longer report adjusted financials.

At the same time as building financial strength, we have also made progress with the legacy of our past and improving our core bank. We have delivered on this by resolving a number of our litigation and conduct issues. This includes reaching settlements last year with FHFA in respect of our historical Retail Mortgage Backed Securities (RMBS) activities and with claimants in relation to our 2008 Rights Issue. In 2017 we also continued to run down our legacy assets. The wind-up of our non- core division, Capital Resolution in 2017, was an important moment.

As part of the support we received in 2008 and 2009, the bank was mandated to meet certain requirements under a State Aid restructuring plan. In 2017, we received approval for an alternative remedies package, which replaced our original plan to divest of the business formally known as Williams & Glyn. This is a good solution, both for improving competition in the UK SME banking market, and for shareholders.

With this solution in place and currently being implemented, the number of legacy issues the bank faces has reduced. However, we have one major legacy issue that we have yet to resolve which is with the US Department of Justice. The timing of the resolution of this issue is not in our control.

Notes:

(1) Profit attributable to ordinary shareholders.

(2) Operating expenses excluding litigation and conduct costs, restructuring costs, write-down of goodwill, restructuring costs associated with the business formerly described as Williams & Glyn.

The bank has received significant media attention for its treatment of some small business customers between 2008 and 2013. To those customers who did not receive the experience they should have done while in GRG we have apologised. We accept that we got a lot wrong in how we treated customers in GRG during the crisis. However, these were complex and subjective cases with each case having unique facts about what was the right thing to do. The bank welcomes the FCA s confirmation that the most serious allegations made against the bank have not been upheld and that the steps the bank announced in November 2016 to put things right for customers are appropriate.

We have made significant progress in improving our culture since then.

Today this bank is a simpler and safer organisation, with colleagues now fully focused on our customers.

I want to thank our colleagues for their commitment and resolve during what has been a difficult chapter in the bank s history. Our most recent colleague survey, Our View, reported the highest engagement levels in ten years. We also recently won the Employee Engagement Company of the Year at the UK Employee Engagement Awards. This shows that our culture is improving. This bank is now more open, less hierarchical and more focused on our customers. Our colleagues serve and support millions of customers across the UK and Republic of Ireland every day, it is vital to our success that they feel engaged and motivated.

Investing to transform our business

When I started as CEO in 2014 the bank was far too complex. We operated in 38 countries, with over 5,000 systems supporting hundreds of different products. In our credit card business alone we offered 55 different card designs, as the organisation had grown we had added complexity which distracted us from our key stakeholder, the customer. Our customers want a bank which protects their safety and security, and is also responsive to their needs.

Today we have exited 26 countries and now have a more focused product set, underpinned by almost half the number of systems we previously had. Simplification will continue to be a key focus for the organisation in 2018.

We are going through all of our end-to- end customer processes to ensure they are fit for purpose.

Our mortgage application journey is experienced by thousands of customers every day. With one of our strategic aims being to grow in this market, the benefits of simplification and automation in this area are vast. Given this, in 2017 NatWest was the first UK bank to offer paperless mortgages. Customers can now apply for a completely digital mortgage which uses the latest technology to securely share and verify documents online. With this new proposition, mortgage offers can now be made within 11 days, down from 23 days before. The process also eliminates close to 4.3 million sheets of paper a year, reducing our impact on the environment.

The opportunities created by greater simplification and automation, in terms of improved controls, cost reduction and a better customer experience, are significant for this bank.

As well as transforming our processes and products, in 2017 we continued to reap the benefits of refocusing our main customer-facing brands. With each now speaking to a unique constituency of customers, we are better placed to differentiate ourselves from our competitors. With NatWest for England and Wales, Royal Bank of Scotland, for Scotland and Ulster Bank for the island of Ireland we truly are a bank of brands in the UK and the Republic of Ireland.

Customer driven change

Listening and responding to our customers is helping us to get closer to meeting our goal to be No.1. In light of this we have continued with the roll out of Closed Loop Feedback in 2017. Today, within 24 hours of an interaction taking place, customers can provide specific, actionable feedback directly to the teams that serve them, empowering colleagues to listen, learn from and act on what our customers are telling us. With our complaints volumes down 9% on the previous year, and our Net Promoter scores improving in half of our chosen customer segments, we continue to see the benefits of customer driven change in this bank. We still have a lot of work to do to meet our 2020 ambition of being the number one bank for customer service, trust and advocacy.

Listening to our customers is not only reducing complaints, it s also driving product and service improvements. In our commercial bank for instance, in response to customers demand for greater speed and efficiency, we have developed self service account opening. Through this channel more than 90% of our new to bank commercial customers are able to initiate account openings themselves and, crucially, are doing it 30 minutes faster than if they used telephony. Customers told us this was a pain point for them and we have responded.

Listening to our customers and investing to simplifying our processes is helping us build a bank which is lower cost, and competitive in our target markets improving outcomes for both customers and shareholders.

We are committed to running the bank as a more sustainable business, serving today s customers in a way that also helps future generations. As technological, social and environmental changes shape the world, it s important to stay connected with evolving customer needs, our shareholders and the wider expectations of society. One of the ways in which we are doing this is through our Board-level stakeholder engagement programme where we proactively listen, learn and engage with our stakeholders to improve the way we do business.

Supporting the UK economy

While transforming the bank, we have continued to support the UK economy. In 2017 we extended £33.9 billion in new mortgage lending, helping grow our mortgage market share for the fifth consecutive year. We continue to target growth in our mortgage market share in 2018.

We are also the biggest supporter of UK business. Our commercial bank grew lending in our target markets, this commitment supported both recognised household names and fledgling start-ups. Our commitment to business goes beyond simple financing, our Entrepreneurial Spark programme continued to grow in 2017 and has supported over 3,800 new businesses since 2012 with award- winning facilities and an outstanding support network. Our work is also being recognised externally. In 2017 NatWest was awarded Best Business Bank in the UK by the National Association of Commercial and Finance Brokers.

Chief Executive s review

Throughout 2017 NatWest Markets has continued to deepen its customer relationships by providing global market access and innovative and tailored solutions. As well as increasing employee engagement and improving the control environment, the business has made material progress to realise cost and operating efficiencies.

Responding to technological change

The financial services industry is going through one of the most significant periods of change we have seen in many years, and we are responding.

Like other industries, the digital revolution has naturally led to lower footfall in our branches. Branch transactions are down 40% on 2013, as increasingly our customers prefer the convenience and ease of digital banking. Given this we have made some difficult, but necessary, decisions around the scale of our branch network in 2017. This does not mean we are not supporting our customers. In fact we are providing customers more ways to bank than ever before, be that through a visit to their local Post Office, a visit from one of our 39 mobile branches, which visit over 600 towns and villages on a weekly basis, meeting one of our 100 community bankers, a digital appointment with one of our video bankers, logging on to internet banking platform, or banking on the go with our market leading mobile app. Our customers have never had as many channels through which to undertake their banking.

For the first time we now have more active mobile users than users online, a clear indication of the direction of travel of our customers banking preferences.

Our ambition is for the standard of service we provide to always be outstanding, no matter how our customers choose to interact with us. In 2018 our branches will increasingly focus providing specialised expertise and advice as well as on helping customers tap into the wealth of ease and efficiency they can experience through using our digital channels.

In our commercial bank, we are supporting customers shift to mobile through building our online service Bankline service into an app. Currently, 90,000 commercial customers are active on Bankline. In the future we expect this to move increasingly to mobile. In 2018, we will also launch Bankline mobile for our larger commercial customers. This new service will act as a companion to our current Bankline on-line technology. Initially, customers will be able to view transactions and send payments with biometric approval. In the coming quarters we will further expand the scope of what Bankline Mobile offers.

Embracing the latest in digital innovation

We know that we cannot stand still on innovation as our competitors certainly are not. Over the last few years we have invested in building our partnerships and scouting networks across the globe to ensure we are at the cutting edge of technology. We have developed some excellent partnerships and one area we have advanced significantly in is Artificial Intelligence (AI).

By harnessing the latest in computer learning and speech recognition, in partnership with IBM, we have built an AI chatbot, called Cora. Cora is helping our customers with many of their most common queries. Crucially Cora is available 24/7, has no wait-time to serve a customer and can handle an unlimited number of queries at the same time. Since Q1 2017 Cora has handled over four hundred thousand conversations responding to over two hundred different questions.

In partnership with Soul Machines, we are investing now to build an evolution of Cora for 2018, giving her a visual avatar acting as the interface with our customers. Initial trials are proving a success with customers telling us that using Cora made them less concerned about converting to our other digital channels. While many customers felt empowered to be more direct in their questioning of Cora, as they felt much safer and more secure with her.

Through digital innovation we will serve customers more efficiently, be more responsive to their needs and at the same reduce costs in the business and build a more solid control environment.

Looking forward

In the past our legacy has dominated our corporate story. In 2017 our financial strength improved and we continued to put the past behind us. We are entering a new phase of transforming the core bank through technology innovation and end-to-end process re-engineering. Our future will be high tech and high touch, which means lower cost, high quality digital services with human expertise available when required.

Conclusion

I would like to thank shareholders for their continued support. We welcome the indication in the Chancellor s budget statement about the potential to restart share sales during the fiscal year 2018/2019, again this is a further proof of the progress we have made.

We recognise our responsibility towards the society we serve and operate in. It is only by supporting our customers and communities to succeed that we will be become a more sustainable bank. I, together with my management team, view this as a core part of our ambition to be No.1 for customer service, trust and advocacy.

As the number of our legacy issues reduces, and our business performance improves, the investment case for this bank is clearer, and the prospect of us rewarding our shareholders is getting closer.

In 2017 we continued to make good progress in building a simpler, safer and more customer focused bank.

2017 performance summary

RBS reported its first profit attributable to shareholders in ten years

- 2017 operating profit before tax of £2,239 million, an increase of £6,321 million compared with 2016.
- Adjusted operating profit before tax(1,2) increased by 31.1% to £4,818 million.
- 2017 profit attributable to shareholders of £752 million.
- 4.3% increase in income (4.0% increase in adjusted income(1)) and a 35.8% reduction in operating expenses (8.1% reduction in adjusted operating expenses(2)).
- Net interest margin (NIM) reduced by 5 basis points to 2.13% compared with 2016.
- Supported the UK economy through a £6.0 billion, or 2.2%(3,4), increase in net lending across PBB, CPB and RBSI(5). Whilst behind our 3% target, this represents strong growth in a competitive environment.

Delivery against our 2017 targets

Notes:

(1) Income excluding own credit adjustments £69 million loss (2016 - £180 million gain), loss on redemption of own debt £7 million (2016 - £126 million) and strategic disposals £347 million (2016 - £164 million).

(2) Operating expenses excluding litigation and conduct costs £1,285 million (2016 - £5,868 million), restructuring costs £1,565 million (2016 - £2,106 million) and VAT recoveries of £86 million (2016 - £227 million).

(3) Including the impact of transfers. See notes on page 16 for further details.

(4) Net loans and advances UK PBB up from £132.2 billion, 6.9% to £141.3 billion, Ulster Bank RoI up from £18.9 billion, 3.2% to £19.5 billion, Commercial Banking down from £100.1 billion, 4.9% to £95.2 billion, Private Banking up from £12.2 billion, 12.3% to £13.7 billion and RBSI down from £8.8 billion, 3.4% to £8.5 billion.

(5) Personal & Business Banking consists of the reportable segments UK Personal & Business Banking (UK PBB) and Ulster Bank RoI and Commercial & Private Banking consists of the reportable segments Commercial Banking and Private Banking. RBSI is a separate reportable segment.

Continued track record of delivery against our stated objectives

§ **Grow income:** Total income increased by £543 million or 4.3%. Adjusted income increased by £490 million(1), or 4.0%.

§ **Cut costs:** Operating expenses reduced by £5,793 million or 35.8%. Excluding VAT recoveries of £86 million (2016 - £227 million), adjusted operating expenses reduced by £810 million(1,2), or 9.6%.

§ **Reduce capital usage:** Taking into account the impact of volume growth, RWAs reduced by £20.8 billion across PBB (£0.6 billion), CPB (£12.9 billion), RBSI (£4.4 billion) and NatWest Markets core (£2.9 billion), already achieving our 2018 target.

§ **Resolve legacy issues:**

During 2017, RBS:

Wound up the former Capital Resolution business. Legacy RWAs now represent around 11% of total;

Received formal approval from the European Commission for its alternative remedies package in respect of the business previously described as Williams & Glyn; and

Reached settlement with the Federal Housing Finance Agency (FHFA) and the California State Attorney General in the US and resolved the 2008 rights issue shareholder litigation.

Significant capital build throughout 2017

§ CET1 ratio increased by 250 basis points to 15.9%, despite absorbing significant additional legacy costs.

§ IFRS 9 adoption on 1 January 2018 increased CET1 by a further 30 basis points.

Prioritising transformation acceleration

§ Increased investment and innovation spend focused on achieving higher levels of digitisation and automation.

§ Faster repositioning of the bank s existing distribution network and technology platforms towards mobile, cloud based platforms and virtualisation.

Building a more sustainable bank

§ Our Board Sustainable Banking Committee hosted four stakeholder engagement sessions, inviting a broad mix of stakeholders to share their perspective on key issues with us.

§ RBS is a founding partner with the National Trading Standards Scam Team on their Friends Against Scams initiative.

§ RBS was recognised by InfraDeals as the leading lender to the UK renewables sector by number of transactions over the past six years (2012- 2017).

§ We helped over one million customers with a free Financial Health Checks to help customers organise their finances and achieve their financial goals.

§ We supported over 3,830 people through our enterprise programmes. This includes the following enterprise programmes: Entrepreneurial Spark, Prince s Trust and Skills & Opportunities Fund.

Notes:

(1) Refer to income statement reconciliations on page 6.

(2) Operating expenses excluding litigation and conduct costs £1,285 million (2016 - £5,868 million), restructuring costs £1,565 million (2016 - £2,106 million) and VAT recoveries of £86 million (2016 - £227 million).

UK Personal & Business Banking

§ UK PBB now includes the business previously described as Williams & Glyn. Operating profit of £2,413 million was 40% higher than in 2016 including a £185 million debt sale gain. Adjusted operating profit(5) of £3,084 million was 18.4% higher than in 2016. Income increased by 5.7% to £6,477 million supported by a 5.9% increase in net loans and advances, which more than offset margin contraction. Operating expenses were 10.5% lower than 2016 reflecting lower litigation and conduct costs, down 67%, partially offset by restructuring costs, up 89%. Return on equity increased to 23.7% from 16.2% in 2016. Adjusted operating expenses(5) were 7.1% lower than 2016 reflecting reduced headcount and lower back-office operations costs. Adjusted return on equity(5) increased to 30.7% in 2017 from 25.1% in 2016. There are a range of variables that could impact near to medium term returns, including RWA inflation as a result of a change in Bank of England mortgage risk weighting.

§ Gross new mortgage lending was £31.0 billion, with market share of new mortgages at approximately 12%, supporting growth in stock share to approximately 10%. Mortgage approval share in Q4 2017 decreased to approximately 12%, from around 14% in Q3 2017, and mortgage new business margins were 14 basis points lower in the quarter, in part reflecting intense price competition in the market.

§ UK PBB continues to invest in its digital offering and now has 5.5 million customers regularly using its mobile app, 20% higher than December 2016, and in 2017 was the first bank to launch a paperless mortgage journey.

Ulster Bank RoI

§ Ulster Bank RoI reported an operating loss of £132 million (151 million), an adjusted operating profit(5) of £96 million (109 million) and a return on equity of (5.0%). Adjusted return on equity was 3.6 %(5) in 2017. Total income increased by £28 million, or 4.9%. In euro terms, total income decreased by 15 million, or 2.1%., primarily reflecting a reduction in income on free funds, partially offset by one-off items, higher lending income and reduced funding costs. Adjusted income(5) increased by £34 million or 5.9% and in in euro terms decreased by 8 million, or 1.1%

§ Gross new lending increased by 7.2% from £2.1 billion in 2016 to £2.3 billion (by 3.4% from 2.5 billion in 2016 to 2.6 billion in euro terms). Total expenses increased by £7 million (46 million decrease). Further cost efficiencies have been achieved, with adjusted expenses(5) reducing by £6 million (43 million) in 2017.

§ Ulster Bank RoI was amongst the first banks in Ireland to introduce Apple Pay and Android Pay, and now over 70% of our customers are actively using our digital proposition, increased from 58% of our active customer base in 2016. We continue to reposition capital, with REILs down by 5.7% to £3.3 billion (9.8% to 3.7 billion), representing 16.0% of gross customer loans, compared with 17.5% in 2016.

Commercial Banking

§ Commercial Banking includes selected assets from the former Capital Resolution business from 1 October 2017. Operating profit of £1,108 million was 49.3% higher compared to 2016 and return on equity was 6.6% compared to 4.1%. Adjusted operating profit(5) of £1,308 million was 2.7% higher than 2016 and adjusted return on equity(5) remained broadly stable at 8.2%. Income increased by 2.0% due to increased volumes in targeted segments and deposit re-pricing benefits.

§ Operating expenses decreased by £453 million to £2,014 million. Adjusted operating expenses(5), reduced by 6.3% reflecting operating model simplification and productivity improvements, including a 16.4% reduction in front office headcount. Commercial Banking net impairment losses of £362 million increased by £156 million and reflecting a small number of single name impairments.

§ Net loans and advances decreased by £3.1 billion to £97.0 billion. Adjusting for transfers (1) net lending decreased by £4.9 billion in 2017, as growth in targeted segments has been more than offset by active management of the lending book, achieving gross RWA reductions of £12.5 billion.

§ With the successful launch of our entrepreneur accelerator hub in London we now have 12 business accelerators throughout the UK. Across these hubs, over 3,800 start ups have benefitted from our support, which has helped them raise £255 million of investment while creating over 8,000 jobs.

Private Banking

§ Private Banking now includes the Collective Investment Funds business transferred from UK PBB on 1 October 2017. Operating profit increased by £32 million, or 28.8%, to £143 million compared with 2016 and return on equity increased from 5.6% to 6.4%. Adjusted operating profit(5), increased by £78 million, or 52.3%, to £227 million and adjusted return on equity(5) increased to 11.3% from 7.8%. Total income increased by £21 million to £678 million. Adjusting for transfers of £9 million, income increased by £12 million due to higher lending volumes and an £8 million gain on a property sale, partially offset by margin pressure.

§ Operating expenses decreased by 3.6%. A 12.9% reduction in adjusted operating expenses(5),was supported by an 11.8% reduction in front office headcount.

§ Net loans and advances increased by 10.7% to £13.5 billion and assets under management increased by 14.4%, after adjusting for transfers(2)

§ We continue to focus on delivering the best customer experience, including investing in digital by launching Coutts Invest and an enhanced mobile experience, and we were awarded Best Private Bank in the UK at the Global Private Banking Awards 2017.

RBS International (RBSI)

§ RBSI reported an operating profit of £167 million, 12.1% lower than 2016 and return on equity decreased to 11.2% from 13.8%. Adjusted operating profit(5), of £184 million, was 5.6% lower than 2016. Income increased by 4.0% driven by increased lending and deposit volumes and re-pricing actions on the deposit book.

§ Operating expenses increased by 25.9% compared with 2016. Return on equity decreased to 11.2% from 13.8%. Adjusted operating expenses(5), increased by 19.5% reflecting increased operational costs associated with becoming a non ring-fenced bank. Despite this, adjusted return on equity remained robust at 12.6%.

§ RWAs of £5.1 billion reduced by £4.4 billion compared with 2016 reflecting the benefit of receiving regulatory approval for RBSI to adopt an advanced internal ratings based approach on the wholesale corporate book.

NatWest Markets

§ Following the closure of the former Capital Resolution business in Q4 2017, NatWest Markets now includes legacy run-off assets alongside its core businesses. An operating loss of £977 million was reported in 2017, including a profit of £41 million in the core business. Adjusted operating loss(5) of £264 million, compared with £1,231 million in 2016. Total income decreased by £162 million, or 13.4%, to £1,050 million. Adjusted income(5) in the core business increased by 9.5% to £1,665 million, largely driven by Rates as the business navigated markets well.

§ Legacy disposal losses, other adjustments and impairments of £513 million were incurred in 2017, compared with £825 million in 2016. Operating expenses of £2,201 million were £623 million, or 22.1%, lower than 2016, whereas adjusted operating expenses(5) reduced by 26.7% reflecting a significant reduction in the legacy business, as it moved towards closure, and cost reductions in the core business. RWAs decreased by £15.3 billion, adjusting for transfers(3), to

§ £52.9 billion primarily reflecting legacy business reductions. At the end of 2017 the legacy business within NatWest Markets had RWAs of £14.0 billion, excluding RBS s stake in Alawwal Bank, a reduction of £10.9 billion, adjusting for transfers(3), over the course of the year.

Notes:

(1) Shipping and other activities which were formerly in Capital Resolution were transferred from NatWest Markets on 1 October 2017, including net loans and advances to customers of £2.6 billion and RWAs of £2.1 billion. Commercial Banking transferred whole business securitisations and relevant financial institution s (RFI) to NatWest Markets during December 2017, including net loans and advances to customers of £0.8 billion and RWAs of £0.6 billion. Comparatives were not re-presented for these transfers.

(2) UK PBB Collective Investment Funds (CIFL) business was transferred from UK PBB on 1 October 2017, including total income in Q4 2017 of £11 million and assets under management of £3.3 billion. Private Banking transferred Coutts Crown Dependency (CCD) to NatWest Markets during Q4 2017, including total income of £2 million and assets under management of £1.3 billion. Comparatives were not re-presented for

these transfers.

(3) Shipping and other activities which were formerly in Capital Resolution were transferred to Commercial Banking on 1 October 2017, including RWAs of £2.1 billion. Whole business securitisations and relevant financial institutions (RFI) were transferred from Commercial Banking during December 2017, including RWAs of £0.6 billion. Comparatives were not re-presented for these transfers.

(4) Transfers include £0.4 billion loans and advances transferred from Commercial Banking to UK PBB during 2017 to better align Business banking customers. Comparatives were not re-presented for these transfers.

(5) Refer to income statement reconciliations on page 6.

2017 performance summary

Looking forward

2018 Outlook(1)

We reiterate our medium term outlook on both return on tangible equity and cost:income ratio. We also now intend to accelerate the transformation of the bank which necessitates increased investment and innovation spend together with additional restructuring costs. As a result operating costs, excluding restructuring and litigation and conduct costs, will reduce compared with 2017, but the rate of cost reduction will be materially lower than in 2017. We expect to incur restructuring charges of around £2.5 billion across 2018 to 2019 cumulatively, of which c.£0.3 billion relates to the completion of the State Aid remedy and reintegration of the former Williams & Glyn (W&G) business into UK PBB. This is compared to previous guidance of around £1 billion excluding the impact of W&G, with around two thirds of the remaining c.£1.2 billion increase being driven by costs associated with the accelerated transformation.

RBS continues to deal with a range of significant risks and uncertainties in the external economic, political and regulatory environment and manage both conduct-related investigations and litigation, including relating to RMBS. Substantial additional charges and costs may be recognised in the coming quarters.

With the introduction of IFRS 9, impairments are expected to be more volatile and we continue to remain mindful of potential downside risks, particularly from single name and sector driven events. The consensus view of Brexit suggests a weaker UK economy in the short to medium term. With the current high level of UK household debt and real wage compression, any increases in unemployment and interest rates present a threat to retail impairment rates. In wholesale portfolios further softening of GDP growth would be expected to impact credit losses negatively. We retain our guidance that through the cycle losses would be in the range of 30-40bps.

By the end of 2018, we expect Bank RWAs to be lower by £5-10 billion. This is despite model uplifts in Commercial Banking in 2018 which are expected to drive some RWA inflation. The majority of the gross RWA reductions will be within NatWest Markets legacy assets, including the benefit of the anticipated merger between Alawwal Bank and Saudi British Bank, and Commercial Banking.

RBS Group capital and funding issuance plans for 2018 focus on issuing £4-6 billion MREL-compliant securities. We do not currently anticipate the need for either AT1 or Tier 2 issuances. As in 2017, we will continue to target other funding markets to diversify our funding structure. In support of the ring-fencing requirements and to build up RBS Plc (to be renamed NatWest Markets Plc) as a standalone non ring-fenced bank, we anticipate issuing £2-4 billion of senior unsecured issuance from this entity in addition to continued reliance on short term funding.

In the near to medium term, we would expect the bank to maintain a CET1 ratio in excess of our 13% target given a range of variables that are likely to impact us over the coming years. These include:

§ potential final costs of a resolution with the US Department of Justice;

§ future potential pension contributions and the interplay with capital buffers for the bank for investment risk being run in the pension plan;

§ RWA inflation as a result of IFRS 16, Bank of England mortgage floors and Basel 3 amendments;

§ expected increased and pro-cyclical impairment volatility as a result of IFRS 9; and

§ the collective impact of these items on our stress test results.

We remain committed to restarting capital distributions when permitted, with resolution with the US Department of Justice being a key milestone to enable this.

Medium term outlook

We retain our target of achieving a sub 50% cost:income ratio and above 12% return on equity by 2020.

While we expect operating costs to reduce each year from 2018 to 2020, given the increased level of investment and innovation spend expected over the coming years we are no longer guiding to an absolute 2020 cost base.

The NatWest Markets segment balance sheet as at end 2017 is broadly similar to the expected target balance sheet of the NatWest Markets Plc after the ring- fence transfer schemes to be carried out during 2018. In preparation for the UK ring-fencing regime, the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed. These changes included the NatWest Markets segment absorbing the former Capital Resolution segment (other than for certain shipping and portfolio assets). Notwithstanding a planned capital reduction exercise in July 2018, by 2020 this entity is targeting a capital base with a consolidated end state CET1 of 14%, a leverage ratio greater than 4% and a total capital ratio of at least twice the CET1 ratio, including the benefit of downstreamed internal MREL.

By 2020, NatWest Markets targets a RWA position of c.£35 billion including legacy assets, with the legacy assets generating minimal associated income, and an overall cost base of around £1 billion.

Trading update

Overall, RBS has had a positive start to 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 this document and in the Risk Factors on pages 349 to 379. These statements constitute forward looking statements, refer to Forward Looking Statements on pages 1 to 2.

Our business model and strategy

Our Strategy

Our ambition is to become number one for customer service, trust and advocacy as we meet the aspirations and needs of our retail, business, commercial, corporate and institutional customers. Our core businesses are centred around the UK and Republic of Ireland markets with a focused international capability.

We are building a better bank for our customers, and one that will deliver sustainable returns for shareholders. Our purpose is to serve customers well, and to do so, we are becoming a safe, simple, customer-focused UK and Ireland bank.

Our plan

Underpinning that ambition is our blueprint for success. This is our plan which drives our strategic decision making.

RBS is continuing to build a bank that is easy to do business with, and meets customers continually evolving needs.

Our plan focuses on delivering excellent customer service through all of our brands.

Creating lasting relationships with our customers, who advocate for our bank, is the key to generating sustainable value.

Note:

(1) The goals, 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 this document and in the Risk Factors section on pages 349 to 379. These statements constitute forward looking statements; refer to Forward Looking Statements on pages 1 to 2 of this document.

Our business model and strategy

Our 2020 vision

The bank of 2020 will be high tech and high touch, which means lower cost, high quality digital services with human expertise available when required. This will be underpinned by a clear commitment to our customers, shareholders and other stakeholders.

Our priorities

Strength and sustainability

We remain focused on building a strong and stable bank. We have continued to improve the fundamentals, by increasing our capital strength, building a robust liquidity position and balancing our loan to deposit ratio. As one of the UK s largest banks we understand the importance of supporting the UK s economic and social development.

Through our balance sheet lending and range of sustainable banking initiatives, we are working to improve outcomes for all stakeholders.

Customer experience

We are investing in our people, service, and product proposition to ensure we provide market leading technology and signature customer experiences, through a wide variety of channels.

Simplifying the bank

Streamlining of processes and removing unnecessary complexity lowers our operating costs, and makes our customer interactions more straightforward.

Supporting sustainable growth

A strong sustainable business grows with its customers. We continue to support our customers through offering products and services which meet their needs.

Employee engagement

Engaged colleagues lead to engaged customers. At RBS we are committed to investing in our colleagues and creating leaders who inspire and empower their teams.

Our Structure

We have four customer franchises, and each is underpinned by a range of distinct brands, which are the route through which we engage with our customers.

Our Brands

Our brands are our main connection with customers. Each takes a clear and differentiated position that will help us strengthen our relationships with our customers, stand out in the market, and build the value of our brands.

Our business model and strategy

Building a more sustainable bank

Our long term success is dependent on our ability to generate value for society by providing products, services and facilities that are useful to people and the communities in which we operate. Our value creation model is a simplified way of showing how this works, including the way we use resources, skills and relationships to deliver value for all our stakeholders.

One of the ways by which we meet the expectations of our shareholders is by delivering the best possible service for customers to meet their needs. At the same time, we recognise our responsibility towards society as a whole. It is only by supporting our customers and communities to succeed that we will be become a more sustainable bank.

Our key resources and relationships

RBS provides financial services to individuals and businesses, primarily in the UK and Ireland. We rely on financial, human and intellectual, social and relationship, infrastructure and natural capital to do so. We leverage these forms of capital through our expertise, technology and customer focus across our different brands. This helps to improve the quality of customer service. We also seek to create sustainable value for our shareholders and other stakeholders, including customers, employees, and civil society.

Our approach

Notes:

(1) Comprises £443 million corporate tax, £504 million irrecoverable VAT, £237 million bank levies and £273 million employer payroll taxes.

(2) Data relates to reported attempted fraud cases and prevented third party losses in the UK (not including policy declines for debit cards).

(3) Includes people supported through the following enterprise programmes during 2017: The Prince s Trust, Skills & Opportunities Fund and Entrepreneurial Spark.

(4) SME lending balances in over 9,854 postcode sectors across England, Scotland and Wales.

(5) Data is compiled by Project North East (PNE) and is based on the total spend allocated by each Regional Board.

Our approach

Our Values

Our Values guide our actions every day, in every part of our business. The values are the foundation of how we work at RBS.

Our Stakeholders

RBS exists to serve customers well and we put our customers at the heart of everything we do. This means having an understanding of our impact across all stakeholders of the bank. Understanding who our stakeholders are and their views helps inform our overall strategy. Below is an overview of some of our stakeholder groups.

We have provided three examples below of how we work with different stakeholder groups:

Shareholder engagement sessions

Individual shareholder views on our plans to build a better bank are important to us.

In 2017 we hosted events in Edinburgh and London for our retail shareholders. A diverse group, selected by postcode, were invited to learn more about our business and participate in an interactive Q&A session with a panel of senior management and Board members.

These events gave those in attendance the opportunity to hear from different parts of RBS, ask questions about progress so far and learn more about our plans for the future. We set up market stalls on topics of interest including customer experience, innovation and security. They could talk with employees from different parts of the bank on progress and our plans for the future.

Additionally, we held four external stakeholder engagement sessions with our Sustainable Banking Committee on Financial Capability, UK Housing, Climate Risks and Technology Innovation for Social Good.

Working together to tackle fraud and scams

To help our customers protect themselves against fraud and scams we have been working with various partners across the industry.

NatWest sponsored the production of a Code of Practice on protecting customers from financial harm. The specification, launched in November 2017, included input from Financial Fraud Action UK, the National Trading Standards Scams Team, the Office of the Public Guardian, the Metropolitan Police, and two other major UK banks.

NatWest continue to support Friends Against Scams run by National Trading Standards and in 2017 trained over 20,000 colleagues. In 2018 we will be the official bank partner of the One Million Friends Against Scams initiative.

Closed Loop feedback

We are listening, learning and acting on our customers feedback. We have taken customer feedback on board and acted on it. Closed loop feedback is about continuously seeking customer feedback and closing the loop on the issues that our customers raise with us.

Examples include:

It would be good if you could diarise payments . Customers can now make diarised payments via their mobile app.

Customers living abroad are unable to use the mobile app with an international number . Customers can now use our mobile app in various countries including Australia, Gibraltar, Hong Kong, New Zealand, Singapore and South Africa.

I want all audio statements to have a braille section that allows the customer to know who and what the audio tape is for and what month this relates to . All our audio statements now have a date so that customers can easily differentiate between them.

In addition, as part of our net promoter system in 2017 we sent out 11.5 million survey invites, with 875,500 responses.

Our approach

Changing face of banking

Since 2014, customers are choosing to do their banking in different ways that suit them and reflect what they do in everyday life. The number of customers using our branches across the UK has fallen by 40% and during the same period mobile banking transactions increased by 73%; in the first half of 2017, there were 1.1 billion mobile and online transactions carried out by our customers.

We are committed to ensuring that our customers have a wide range of ways in which they can bank with us. Every customer is individual and that is why customers can choose from a combination of digital, telephone and face-to-face banking options, each designed to suit their preferences and needs. Customers might carry out simple everyday transactions using our mobile app but still preferring to speak to someone over the phone or via webchat for other banking queries. For more complex needs, such as a Financial Health Check or mortgage advice, customers value having the option to discuss the matter face-to- face or by video.

We are working hard to develop new services to respond to the changing needs and expectations of our customers. All our personal customers can bank with us using our mobile app and online banking services and we have Bankline for business and commercial customers. We also provide a 24/7 webchat service for personal customers, telephony and secure text messaging for when customers want to contact us quickly, digitally and securely.

Closing branches is always a difficult decision and one we do not take lightly. When these decisions are made, we look at each branch and take into account a range of factors including, how customers are choosing to bank with us; how often customers are using the branch; the impact on customers who currently use the branch; other options available to customers including online, mobile, telephony, webchat, cash machines, video banking and local Post Offices and, the proximity of our other branches, including our network of mobile branches and local transport routes and timetables.

We know that for some customers, in particular vulnerable customers, closing branches can be unsettling. We are committed to ensuring that we support all customers with these changes. We aim to provide six months notice before we close a branch (the industry norm is 12 weeks) and we proactively contact our regular branch users and vulnerable customers to talk to them about our decision and the options available to them.

Our national contract with the Post Office means that customers can undertake everyday banking in any of the 11,500 Post Offices throughout the UK. In many areas, we operate mobile branches, which bring our banking services direct to local communities, many of which have not had a branch before.

We acknowledge that some of our customers are not comfortable with using online or mobile banking, and for those customers who would value some support we have created a specialist taskforce of TechXperts who are dedicated to supporting our customers with training and support with digital skills. Our TechXperts support customers with the varied ways to bank and for example accompany customers to the local Post Office to show them how their banking can be done.

We have introduced a number of roles to provide personal, face-to-face banking services in communities, assisting customers with access to our non-cash services, offering support with financial planning and education. Our Community Bankers base themselves in places like libraries, local businesses and community centres so as to best serve local communities. Business Growth Enablers focus on our small business customers. They are specially trained to help source advice that will help local businesses with banking support, as well as harnessing their own network to support business needs. Business Growth Enablers work with industry partners to run free events for customers on issues such as fraud, scams and digital tax returns.

Climate change

We recognise climate change is a significant global issue and we fully support the objectives of the Paris Climate Agreement and the emissions reductions strategies set by the UK and devolved governments. We have publicly pledged our support for the Financial Stability Board s (FSB) Taskforce on Climate-related Financial Disclosures (TCFD) and we have included more detail on our approach to the TCFD recommendations in the Additional Information section of the 2017 Annual Report on Form 20-F. We also plan to announce further details of our long term approach to climate change.

We believe there is a need to support our customers to reduce their emissions, save energy and manage their costs. Over the last decade, we have become one of the leading lenders to the UK Sustainable Energy market, with expertise and services designed for customers from small businesses up to large corporations. RBS was recognised by InfraDeals as the leading lender to the UK renewables sector by number of transactions over the past six years (2012- 2017).

As we have refocused our business on the UK, Ireland and Western Europe, we ve also substantially reduced our lending to carbon intensive parts of the global economy such as coal mining and oil extraction. Our total exposure to the oil and gas industry, for example, now accounts for just 0.5% of our lending exposures. In 2017 we did not directly finance any new coal mining or coal power projects. More details of our lending to the energy sector will be published on our Sustainable Banking webpages on rbs.com in April 2018.

Relative to our size, our operational footprint from serving our customers is quite small, but still significant. Our primary emissions impact comes from the energy used to heat, cool and power our buildings and data centres. We have set targets using a science-based method in order to align our efforts to reduce emissions with the climate science that sits behind the Paris Climate Agreement. Our target for 2020 is to reduce our direct carbon emissions by 45% from a 2014 baseline and at the end of 2017 we had already recorded a 39% reduction. The table below provides more detail.

We have also set 2020 targets to reduce water use by 10% and paper use by 60%, whilst continuing to target zero waste to landfill. We engage colleagues, suppliers and customers in these efforts and in 2017, 3,200 colleagues logged over 24,000 activities to reduce our environmental impact via our green reward app. More information on our targets and initiatives can be found on the Sustainable Banking webpages at rbs.com.

GHG Emissions	2014 (Baseline)	2016	2017	Change 2014 to 2017 (%)

Location-based CO2e emissions (Scope 1, 2 and Business Travel) (tonnes)	512,583	388,648	311,583	-39%
Scope 1* CO2e emissions (tonnes)	36,857	29,131	27,172	-26%
Scope 2** Market-based*** CO2e emissions (tonnes)	391,105	159,629	76,197	-81%
Scope 2 Location-based CO2e emissions (tonnes)	370,374	270,481	215,959	-42%
Scope 1 and 2 Location-based CO2e emissions per FTE (tonnes)	4.16	3.32	3.18	-24%
Scope 3**** CO2e emissions from business travel (tonnes)	105,352	89,036	68,452	-35%

We have reported on all emission sources under the Companies Act 2006 (Strategic Report and Directors Reports) Regulations 2013. To our knowledge there are no material omissions. Independent Limited assurance has been provided by Ernst & Young LLP over total reported CO2e emissions (tonnes) (Scope 1*,2** and 3*** location based emissions). Our reporting year runs from October 2016 to September 2017.

These emissions have been calculated using the methodology advised in the Greenhouse Gas Protocol revised edition (2004). The boundary of reporting is set as all entities and facilities either owned or under operational control. Emissions factors used are from UK Government s GHG Conversion factors (DEFRA), IEA, or relevant local authorities.

*Scope 1: Emissions from fluorinated gas loss and fuel combustion in RBS premises/vehicles. **Scope 2: Emissions from electricity, district heating and district cooling used in RBS premises. *** market-based emissions have been calculated using the GHG Protocol guidelines. ****Scope 3: Emissions associated with business travel (air, rail and road) by RBS employees.

Human rights and Modern Slavery Act

RBS takes a proactive approach to upholding our commitment to respect human rights and our approach is centred on identifying and mitigating potential human rights risks across our business and our wider sphere of influence. The Modern Slavery Act 2015 (MSA) forms part of our approach to human rights as this regulation brings together the serious criminal offences of slavery, servitude, forced or compulsory labour and human trafficking together under one piece of legislation. In 2017 we published our first annual statement on the MSA on rbs.com. This built upon our interim statement which was published in December 2016 and our existing policy framework.

Our approach is underpinned by Our Values and Our Standards. For employees this is via the RBS Code of Conduct Our Code . Our Code includes a clear commitment to respect human rights, supported by the Yes Check, a tool to guide good decision making. Employees are consulted on key aspects of their working environment, and they can utilise a confidential helpline to discuss any matters of concern.

Our commitment to the international progress of human rights includes upholding the principles of the United Nations Global Compact since 2003.

We are committed to the implementation of the United Nations Guiding Principles on Business and Human Rights and participate with our peers in groups such as the Thun Group and United Nations Environment Programme Finance Initiative. We have been adopters of the Equator Principles since their inception in 2003 to manage social and environmental risks, including human rights, in project- related transactions.

We have sector-specific Environmental, Social and Ethical (ESE) risk policies (available at rbs.com/sustainable) which include human rights considerations for high-risk sectors. For customers outside these sectors, our general ESE risk concerns policy ensures due diligence is carried out on clients when human rights risks are identified. We expect our customers to share our commitment to respecting human rights within their operations.

Our Customers

We are aware that as a High Street bank we come into contact with millions of customers, some of whom may be victims of modern slavery. Our relationship with our customers is governed by a wide range of risk considerations, including our Anti-Money Laundering (AML) and Environmental, Social, and Ethical (ESE) risk assessments on current or new customers, to consider whether any of their activities carry human rights infringements.

Our People

All of our people are recruited legally and must meet the 1998 Immigration Act requirements.

RBS is a fully accredited Living Wage Employer. We gained accreditation in 2014. RBS commitment as a Living Wage accredited employer applies to everyone working for the bank in the UK and has been extended to staff who are employed via suppliers (e.g. cleaning, security and catering staff). Employees are regularly consulted on their working conditions and a confidential helpline is available at all times.

Our Suppliers

We expect our suppliers to uphold the same values and commitments that we have made in relation to social and environmental impacts. Adherence to these policies is required as part of our supply chain tendering process and within our supplier contracts.

Our Sustainable Procurement Code sets out the international human rights commitments we expect of the companies that we work with, including labour standards and non-discrimination.

Our approach

Our Colleagues

Engaging our colleagues is critical to delivering on our strategy and ambition as a bank. Being better for our colleagues means we are better for our customers, and this makes us a better bank.

Creating a Healthy Culture

Building a healthy culture that embodies Our Values is one of our core priorities. Our Values guide the way we identify the right people to serve our customers well, and how we manage, engage and reward our colleagues.

Our Values are at the heart of both Our Standards, the bank-wide behavioural framework and Our Code, the bank- wide Code of Conduct.

Our values are integral to the way we behave and do business and we continue to reinforce them in our systems, policies and processes, communications training and leadership role modelling.

We set ourselves clear cultural priorities each year and manage these through our Executive Committee.

We monitor our progress against our goals. We gather feedback from our colleagues through our listening strategy, and through metrics and key performance indicators to assess our progress and respond accordingly. We do this along with feedback from regulators and industry bodies.

Almost 60,000 colleagues completed our most recent colleague opinion survey. The results were the most positive we ve seen in recent times and showed we re changing the culture of the bank for the better. Key measures of engagement, leadership and our culture have improved significantly, and we re now above the global financial services norm in the majority of our survey categories. The results are encouraging, and show that our hard work is paying off. However, we recognise that we have more to do to make this a stronger bank and a great place to work.

We encourage colleagues to tell us what they think via the annual colleague survey and our regular comments boards. When colleagues wish to report concerns relating to wrong doing or misconduct they can raise concerns via Speak Up, the bank s whistleblowing service. In 2017 289 cases were raised compared to 213 in 2016.

Performance and Reward

Our approach to performance management provides clarity for our colleagues about how their contribution links to our ambition and all our colleagues have goals set across a balanced scorecard of measures.

Further progress has been made in making sure employees are paid fairly for the work they do and are supported by simple and transparent pay structures. More employees have moved to a purely fixed pay construct during the year, allowing them to concentrate on providing excellent customer service. We will continue to make further changes in 2018 which will result in over half of our employees being on a purely fixed pay construct making their pay fairer and easier to understand.

We are confident that we pay our employees fairly. We keep our HR policies and processes under review to ensure we do so.

Our rates of pay continue to exceed the Living Wage and changes have been introduced to ensure people performing the same roles are paid more consistently.

More information on our remuneration policies can be found in the 2017 Annual Report on Form 20-F.

Learning

Determined to lead (Dtl), our core leadership programme is now embedded as business as usualDtl provides consistent tools to lead and engage our colleagues and is transforming the way we operate. In 2017 a further 3,000 leaders participated in the programme.

2017 saw over 16,000 colleagues undertake stage one of Service Excellence training, our customer service programme. This first module introduces our Core Service Behaviours and provides an awareness of the tools and techniques that will help us to deliver the best possible service, every time.

We continue to work closely with the Chartered Banker Institute and Chartered Banker Professional Standards Board (CB:PSB) to professionalise our colleagues. In 2017 we again achieved an Excel rating in the CB:PSB Foundation Standard review , and remain one of only two CB:PSB member firms to have secured Earned Autonomy .

We also offer a wide range of additional learning opportunities.

Health and Wellbeing

Wellbeing is a strong pillar in making the bank a great place to work. In 2017 our wellbeing programme successfully delivered against three wellbeing pillars; Physical, Mental, Social and we have started to put in place support against our fourth area of Financial Wellbeing. For the third year running we participated in the Global Challenge (formerly GCC) and with 34,000 colleagues taking part we won the Global Challenge 1st Most Active Organisation Financial Industry. Building on this success, we embraced the rapid acceleration of digital wellbeing and are one of the few large organisations to pilot a digital wellbeing platform.

During 2017 we have continued to support Time to Change (removing the stigma of mental health) and actively encouraged open dialogue across the bank to support Mental Health in the Workplace. We were successful in running bankwide major online campaigns to support Mental Health Awareness Week and World Mental Health Day.

As we continue to support our colleagues through change we have fully utilised the services of our Employee Assistance Programme.

Inclusion

Building a more inclusive RBS is essential for our customers and colleagues.

Our inclusion policy applies to all our colleagues globally to make sure everyone feels included and valued, regardless of their background.

- As at 31 December 2017, our permanent headcount was 71,924. 49% were male and 51% female.

- We continue to work towards our target of having at least 30% senior women in our top three leadership layers across each Function and Franchise by 2020. As at the 31 December 2017 we have, on aggregate, 37% women in our top three leadership layers, and our pipeline (around 5000 of our most senior roles) has 44% women. We are on track to have a fully balanced workforce at all levels of the organisation by 2030.

- RBS plc s gender pay gap in Great Britain is 37.2% (median 36.5%). The figures also show a gender bonus gap of 64.4% (median 36.6%).

- A key driver behind the gap is the fact that we have more men in senior roles (which attract higher pay) than women. In order to close the gender pay gap, we must continue to improve our gender balance in our most senior roles, and here we are making good progress. We have a positive action approach in place, tailored by business, according to the specific challenges they face. As we continue to increase the proportion of women working in senior roles, we expect our gender pay gap will lessen.

- During 2017, we continued to roll out unconscious bias learning to all our colleagues to create a solid platform for the wider inclusion agenda. 70% of colleagues have now participated in unconscious bias training since it was introduced in 2015.

- We have plans in place for all segments of our pan-bank disability plan. It addresses areas for improvement including branch access, accessible services, improving colleague adjustment processes and inserting disability checkpoints into our key processes and practices.

- We continue to focus on building an ethnically diverse RBS. Our plan focuses on positive action and includes reciprocal mentoring, targeted development workshops and leadership programmes and ensuring we have a Black, Asian and Minority Ethnic (BAME) focus on recruitment, talent identification and promotion. We will introduce explicit targets for BAME representation at senior levels in 2018.

- Our LGBT agenda continues to deliver a better experience for our LGBT colleagues and customers. We have processes in place to support updating gender and title on customers banking records and to support colleagues undergoing gender transition. And, we continue to support our c.20,000-strong colleague networks.

Grade	#Women	#Men	%Women
CEO 1	5	9	36
CEO 2	35	66	35
CEO 3	232	397	37
CEO 4	1,309	1,681	44
Target population (CEO 3 and above)	272	472	37

	Male	Female
Executive Employees	90 (76%)	28 (24%)
Directors of Subsidiaries	184 (80%)	45 (20%)

There were 347 senior managers (in accordance with the definition contained within the relevant Companies Act legislation), which comprises our executive population and individuals who are directors of our subsidiaries. The RBS Board of directors has fourteen members, consisting of nine male and five female directors.

Our Customers

RBS remains committed to achieving its target of being the number one bank for customer service, trust and advocacy by 2020.

Customer

In 2017 we made it our goal to significantly increase NPS or maintain number one in our chosen customer segments. This strategy was implemented to support the overall aim of being the number one bank for customer service, trust and advocacy by 2020.

We use independent surveys to track the progress we are making to achieve our goals in each of our markets and to also measure our customers experience.

To measure advocacy, customers are asked how likely they would be to recommend their bank to a friend or colleague, and respond based on a 0-10 scale with 10 indicating extremely likely and 0 indicating not at all likely . Customers scoring 0 to 6 are termed detractors and customers scoring 9 to 10 are termed promoters. The net-promoter score (NPS) is established by subtracting the proportion of detractors from the proportion of promoters.

We also use independent experts to measure our customers trust in the bank. Each quarter we ask customers to what extent they trust or distrust their bank to do the right thing. The score is a net measure of those customers that trust their bank (a lot or somewhat) minus those that distrust their bank (a lot or somewhat).

Our Commercial Banking NPS has remained stable during 2017 and remains ahead of its main competitors. In England & Wales, NPS for NatWest Personal Banking has also remained stable and we have met our target for customer trust. In Scotland, while we have not met our target for customer trust for Royal Bank of Scotland, it has increased strongly year on year. We do recognise that significant work is required to improve our customer experience and we continue our work to resolve the ongoing reputational and legacy issues.

		Q4 2016	Q3 2017	Q4 2017
	NatWest (England & Wales) (1)	13	12	12
NPS: Personal Banking	Royal Bank of Scotland (Scotland) (1)	(4)	(13)	(6)

	Ulster Bank (Northern Ireland) (2)	(16)	(4)	(5)
	Ulster Bank (Republic of Ireland) (2)	(7)	(6)	(7)
	NatWest (England & Wales) (3)	(2)	(10)	(7)
NPS: Business Banking	Royal Bank of Scotland (Scotland) (3)	(5)	(14)	(15)
NPS: Commercial Banking (4)		20	21	21
	NatWest (England & Wales)	55%	59%	57%
Trust(5)	Royal Bank of Scotland (Scotland)	13%	22%	27%

Notes:

(1) Source: GfK FRS 6 month rolling data. Latest base sizes: NatWest (England & Wales) (3361) Royal Bank of Scotland (Scotland) (440). Based on the question: How likely is it that you would recommend (brand) to a relative, friend or colleague in the next 12 months for current account banking? Base: Claimed main banked current account customers.

(2) Source: Coyne Research 12 month rolling data. Latest base sizes: Ulster Bank NI (294) Ulster Bank RoI (275) Question: Please indicate to what extent you would be likely to recommend (brand) to your friends or family using a scale of 0 to 10 where 0 is not at all likely and 10 is extremely likely .

(3) Source: Charterhouse Research Business Banking Survey, YE Q4 2017. Based on interviews with businesses with an annual turnover up to £2 million. Latest base sizes: NatWest England & Wales (1245), RBS Scotland (437). Question: How likely would you be to recommend (bank) . Base: Claimed main bank. Data weighted by region and turnover to be representative of businesses in Great Britain.

(4) Source: Charterhouse Research Business Banking Survey, YE Q4 2017. Commercial £2m+ in GB (RBSG sample size, excluding don t knows: (904). Question: How likely would you be to recommend (bank) . Base: Claimed main bank. Data weighted by region and turnover to be representative of businesses in Great Britain.

(5) Source: Populus. Latest quarter s data. Measured as a net of those that trust RBS/NatWest to do the right thing, less those that do not. Latest base sizes: NatWest, England & Wales (948), RBS Scotland (203).

Our operating environment

Key influences in our operating environment

Our ability to serve customers and create value for the long term is heavily influenced by the environment in which we operate. Every year we assess the importance of these influences both in terms of their relevance to our stakeholders (including customers, investors, UK government, employees and civil society) and their potential commercial impact on us.

An assessment of the most important influences in our operating environment are detailed below. The influences have been identified through various means, including, internal and external stakeholder engagement and review of internal and external sources. These considerations have the potential to influence our ability to serve customers and create value for the long term. They carry both risks and opportunities, driven by a mixture of direct commercial impact and stakeholder interest as a result of wider societal trends.

In the following pages, each influence is briefly described together with selected highlights in 2017 and with guidance on where you can find more information on that key influence.

Our operating environment

Influences explained and where to find out more.

Find out more

Chairman and CEO review	2017 Performance Summary	Business model and strategy	Our Stakeholders	Our Colleagues	Our Customers	Key economic indicators	Risk overview	Sustainable Banking report

Key Influences	**Definition**	**Selected highlights in 2017**	**Where to find out more**	
Critical considerations that support our ambition to be No.1 for customer service, trust and advocacy				
Customer service	Delivering excellent customer service is essential for the banking sector to build trust. Maintaining and growing a loyal and satisfied customer base requires an appropriate digital and physical presence and clear distribution strategy.	• Approximately 5.5 million active users regularly benefit from the speed and convenience of our mobile banking app with +51 net promoter score. • Closed Loop Feedback provides us real-time feedback from our customers which we are listening to, learning from and acting on every day. • Rolled out a Service Excellence programme, to further improve our customer service.		
Employee wellbeing & engagement	Employee engagement and satisfaction is highly correlated with overall performance. A key determinant of the bank s success will be ensuring all of its employees are clear on their roles and responsibilities, capable and feel motivated to do the best job possible.	• Our View, the bank s annual employee feedback survey showed that engagement is up by seven percentage points to 83% compared with 2016, the highest level since 2002. • Launched Building a great place to work to support our commitment to giving our employees a fulfilling career, fair pay, relevant training and good leadership. • Actively supported Mental Health Awareness Week, enabling employees to speak more openly about mental health and support each other.		

Ethics, culture and integrity	Professional integrity is a key governance consideration in the banking sector. Services provided must satisfy the highest professional standards, avoid conflicts of interest, bias, or negligence, and ensure that all stakeholders, including employees, contractors and business partners, are treated fairly and equally.	• Improved our position in the latest Banking Standards Board (BSB) survey, which seeks to promote high standards of behaviour and competence across the UK banking industry. RBS improved in all nine BSB survey categories compared with 2016 results and in quartile performance against its peer group. • Employed the greatest number of UK employees with professional banking qualifications. RBS employs more bankers with a professional banking qualification from the Chartered Banker Institute than any other UK financial institution. Members are required to comply with the annual CPD requirements of the professional body. The Chartered Banker Institute is the UK s only and world s oldest professional body for banking. • Speak Up , our whistleblowing service, received 289 reports compared to 213 reports in 2016. The service allows employees to raise concerns in a safe and supportive environment so that potential issues can be addressed quickly and effectively.		
Operational competence	Delivering appropriate digital infrastructure is important to ensure a technically-able bank that supports its long-term future. Cyber security is also a vital part of providing a safe and secure banking service. Banks need to proactively identify and manage risks and efficiencies in their operations and facilities.	• RBS is a founding partner of Friends Against Scams , the National Trading Standards Scams Team s fraud and scams awareness initiative. More than 20,000 colleagues have completed the relevant training. • Improved the in-branch digital experience with TechXperts in every branch to advise and support customers on how to have a secure online banking experience. The in-branch wi-fi capability has also been improved. • There has been a sustained improvement in the number of customers impacted by fraud with a 26% reduction compared with 2016. • Resilient, simple and efficient systems are critical to building the number one bank for customer service, trust and advocacy. Our systems are available 99.9% of the time.		
Strength and stability	Banks need to demonstrate their ability to survive financial stress arising from economic turmoil, and potential large scale fines and legal cases resulting from historic events. They must also demonstrate they have sufficient capital, liquidity and resilience as well as the ability to generate sufficient returns.	• The CET1 ratio increased by 250 basis points to 15.9% in 2017 despite absorbing significant additional legacy costs. • RWAs reduced by £27 billion (12%), ending the year at £201 billion (from £228 billion in 2016). This reduction was driven by NatWest Markets, where RWAs fell by £16.8 billion due to the continued run-off of the legacy business and mitigation activities in the core business, together with active management of the lending book in Commercial Banking.		

		• A key milestone in our ring-fencing journey was achieved through the application to the Court of Session in Edinburgh to initiate a Ring-Fencing Transfer Scheme so as to carry out a legal transfer of some of our business.		

40

Key Influences	Definition	Selected highlights in 2017	Where to find out more	
Current Priority Considerations				
Banking regulation	Banks continue to operate in an environment where regulatory change is frequent and increasingly complex requiring significant time and resources.	• RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime, the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed. Refer to the Report of the directors for further details. • NatWest Markets aligned the majority of Functions and Services employees in 2017 in preparation for operating as a non-ring-fenced bank. • RBS Group published a Tax Strategy. • Regulatory changes that RBS worked on in 2017 included MiFID II / MiFIR, Open Banking and reform of capital and liquidity regulations.		
Conduct	Banks remain focused on putting in place measures to prevent issues related to conduct. At the same time, legacy conduct issues, such as RMBS, continue to have major financial and reputational impacts.	• A settlement with the Federal Housing Finance Agency (FHFA) and the California State Attorney General in the US was reached. • The 2008 rights issue shareholder litigation was resolved.		
Competition and Innovation	The banking sector is going through a period of rapid change with regulatory and technological trends converging to increase competition. Together with accelerating innovation, the UK implementation of the Open Banking Standards raises the potential for significant disruption of the traditional banking business model.	• Partnered with FreeAgent, an Edinburgh-based Fintech that provides online accounting software, to help our small business customers track their finances and report their taxes digitally. • Introduced a chat bot called Cora that answers questions from customers 24/7, freeing up colleagues time so that they can help customers with more complex queries. Cora currently handles over 100,000 customer conversations per month across our web and online channels. • Plans are in place for Open Banking, including customer education around security awareness.		

Diversity, equality & inclusion	The inclusion agenda is quickly moving up the corporate agenda and driving the need to foster corporate cultures that value diversity, teamwork, quality leadership and training.	• Made progress against our 2020 targets on our four priorities: Lesbian, Gay, Bisexual, Transgender (LGBT), Gender Balanced, Disability Smart, Ethnically Diverse. • Supported the International Day of Persons with Disability sharing stories across the bank and with customers. • Recorded an increase in the total number of female leaders within our top three senior layers, including the appointment of two new female non-executive board directors. • RBS was named a Times Top 50 employer for Women and rated as a Stonewall Top Global Employer.		
Health of the UK and global economy	The outlook for the UK and global economy remains uncertain due to a number of factors including: the UK s vote to leave in the EU referendum, wider political instability, an extended period of low interest rates, high debt levels and delays in normalising monetary policy.	• The UK economy grew by 1.8% in 2017, down slightly from 1.9% in 2016, below the long-run average of more than 2%. • The main development in 2017 was higher inflation. Along with weak wage growth it meant that households incomes were squeezed. • The eurozone economy was 2.7% larger in the final quarter of 2017 than in the same period of 2016, up from 1.8% in 2016. Unemployment fell but remained high at 8.7%. • US growth accelerated to 2.3%. The job market remained buoyant with 1.8 million jobs added during the year and the unemployment rate falling to 4.1%.		
Political landscape	Political risks continue to evolve with the UK s vote to leave in the EU referendum creating significant economic, political and regulatory uncertainty. Heightened geopolitical tensions and rising populism in advanced economies have also contributed towards a rise in uncertainty.	• In 2017 NatWest Markets announced its plan to repurpose the existing licence in the Netherlands in the event of loss of EU passporting as a result of the UK s departure from the EU. • We engage the UK Government and opposition political parties to understand their priorities for the sector.		

Our operating environment

Key Influences	Definition	Selected highlights in 2017	Where to find out more	
Privacy	As a bank our customers not only trust us with their finances but also with their information. It is therefore important that we deal with their information the right way. By doing the right thing in meeting the privacy expectations of our employees, customers and shareholders we build confidence, which in turn builds trust and therefore has a tangible influence on delivering the bank s ambition to be No.1 for customer service, trust and advocacy.	• The bank takes privacy and the protection of customers and employee data very seriously, and has worked with other banks to make sure it is factored into the Open Baking architecture. • The new General Data Protection Regulation (GDPR) comes into effect on 25 May 2018 and brings a new era in safeguarding personal data by businesses. • The bank has been preparing for GDPR since April 2016. • The GDPR grants new and enhanced rights for individuals in relation to their personal information and, as 25 May approaches, the bank will communicate more fully with customers and clients about these changes and how they can exercise their rights.		
Skills and capability of staff	Financial services companies face competition for skilled employees, in particular with specific skillsets (e.g. IT). As the industry transforms to more digital banking, the need for such skills may become more acute.	• Delivered the Entrepreneurial Development Academy, a programme designed in partnership with E-Spark, specifically for RBS employees to develop an entrepreneurial mindset. Over 5,900 employees participated in the programme. • Over 64,600 employees underwent training by the Chartered Banker Professional Standards Board (CB:PSB) with 94% of applicable staff achieving the CB:PSB Foundation Standard. • Introduced a new tool to help our people learn and develop for example career development days and mobile learning. • RBS was recognised as a Top 5 Apprentice UK Employer.		

Support for enterprise	A healthy economy needs a pipeline of new and growing businesses to spur innovation and growth. Entrepreneurs, start-ups and small businesses require particular support in terms of financing and building market share.	• Rolled out ESME, a digital platform which offers SMEs the ability to digitally obtain loans quickly, potentially within an hour, on a 24/7 basis. • Launched Pitch App to help entrepreneurs communicate with impact. • Entrepreneurial Spark opened an accelerator hub in London, our 12 accelerators are now in every region of the UK.		
Trust in the banking sector	Trust in traditional large UK banks often lags behind smaller competitors and new market entrants. Rebuilding trust remains a key challenge.	• Customer trust in NatWest in England & Wales has met its 2017 target of 57%, improving from 55% at Q4 2016 to 57% at Q4 2017. • Trust in RBS in Scotland has increased strongly year on year (from 13% in Q4 2016 to 27% in Q4 2017) but remains behind its target of 38% for 2017. • Our Board Sustainable Banking Committee hosted stakeholder engagement sessions and two retail shareholder events.		
Housing	Demand for housing in some parts of the UK and Republic of Ireland outstrips supply, reducing affordability and harming family disposable incomes.	• Board Sustainable Banking Committee held a stakeholder engagement session on housing, inviting a variety of external stakeholder groups to share their perspectives with us. • Your Mortgage Awards 2016 - 2017: Best First-Time Buyer Mortgage Lender, Best Bank. • What Mortgage Awards 2017: Best National Bank, Best Lender Customer Service. • Gross new mortgage lending of £33.9 billion in UK PBB, Ulster Bank RoI, Private Banking and RBSI.		
Long term and emerging considerations				
Changing customer needs	Customer needs are changing and different types of customer often have significantly different banking needs. In order to be attractive and useful, financial products and services need to fit in with customers lives and be flexible to differing levels of digital and financial understanding.	• 68% of our personal customers are active across our mobile and online banking platforms. • Launched Strategic Account Opening meaning our personal customers can open an account in five minutes. • Launched the UK s first ever paperless mortgage - customers can now apply for a completely digital		

		mortgage which uses the latest technology to securely share and verify documents online. • Our Home Insurance Quote and Buy system gives customers cover in less than fifteen minutes. • One of the first large UK banks to launch robo-investment advice service through NatWest Invest.		

Key Influences	**Definition**	**Selected highlights in 2017**	**Where to find out more**	
Climate change	The Paris Agreement provides a framework by which the world will seek to prevent dangerous climate change but further challenges remain. Climate change presents both physical and transition risks. The transition to a low carbon economy is also presenting opportunities for low carbon sectors of the economy. There are also increasing regulatory and stakeholder expectations of banks to address climate change.	• RBS has pledged its support to the Task Force on Climate-related Financial Disclosures (TCFD). • Board Sustainable Banking Committee held a stakeholder engagement session on Climate risk, inviting a variety of external stakeholders groups to share their perspectives with us. • We have been recognised by InfraDeals as the leading lender to the UK renewables sector by number of transactions over the past six years (2012- 2017). • Set a new carbon reduction target using a science-based method, aligning our ambition with the Paris Climate Agreement.		
Executive pay	Shareholders, employees and the general public have shown increasing concerns about the inequality in pay in large companies between senior executives and the general workforce.	• Bonus pools have fallen by around 75% since 2010, aligned with the restructuring that has taken place and the actions taken by Group Performance and Remuneration Committee. Remuneration is allocated over a multi year basis, with the ability to apply malus and clawback to encourage good behaviours and a long-term focus. • Introduction of a new policy for Executive Directors in 2017, with significantly lower maximum award levels and with increased shareholding requirements.		
Financial capability	A customer s ability to manage money well, both day to day and through significant life events, and their ability to handle periods of financial difficulty. It focuses on developing financial skills and knowledge, attitudes, and motivation, which can help customers avoid falling into financial difficulty and can improve their financial health and well being.	• MoneySense, our financial education programme for 5 to 18 year olds, won Digital Information Product of the Year (PPA Digital Awards) in recognition of how it has adapted to the digital age with engaging and interactive content to support teachers and parents. • Completed over one million Financial Health Checks in 2017.		
Social inequality & financial exclusion	The increasing gap between rich and poor and the rising cost of living means many UK consumers find themselves in precarious financial situations and are struggling to manage their money day to day. This, with future economic uncertainty, may well lead to increased bad debt and over indebtedness. In addition millions do not have access to mainstream financial services such as free ATMs, credit, and banking products together with lack of digital footprint and skills and are forced to rely on	• Helped over 680,000 customers in financial hardship find a solution to their debt problem. • Provided over 27,500 customers with breathing space and extra time for them to find support and to put in place a repayment arrangement. • Innovative Citizens Advice partnership, where Citizens Advice colleagues are located within one of our Specialist Support teams providing independent advice to over 900 of our most vulnerable customers.		

	high-cost products.	• In partnership with the Money Advice Trust, we developed industry leading Addictions Training for our colleagues and use across the sector.		
UK infrastructure	The UK has a significant need for new infrastructure, such as energy, transport and project finance. Banks have an important role in supporting infrastructure investment across the UK.	• Banks like RBS have a key role supporting this investment, through lending and sourcing global capital markets financing.		

Independent assurance

The Royal Bank of Scotland Group plc appointed Ernst & Young LLP to provide limited independent assurance over selected sustainability content within the Strategic Report (the Report), as at and for the period ended 31 December 2017. The assurance engagement was planned and performed in accordance with the International Standard for Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information.

These procedures were designed to conclude on:

- The consistency of selected narrative claims on sustainability with underlying performance information, and;
- The accuracy and completeness of the sustainability performance indicators listed below:
- Value (£) of attempted fraud prevented in the UK
- Total gender balance in top 3 senior layers
- Total number of people supported through enterprise programmes
- % personal customers who are digitally active
- Total number of Financial Health Checks
- Banking Standards Board survey results
- % of staff who received CB:PSB standards certification
- Total scope 1 and 2 location based CO2e emissions Scope 3 emissions from business travel.

An unqualified opinion was issued and is available on rbs.com, along with further details of the scope, respective responsibilities, work performed, limitations and conclusions.

Our operating environment

Key economic indicators

The UK economy grew by 1.8% in 2017, down slightly from 1.9% in 2016. That was below the long-run average of more than 2%.

In a healthy job market, the number of people in work increased by around 400,000 and unemployment fell to 4.3%, the lowest rate since 1975. As a result of the 17% fall in the value of sterling that began in 2015, inflation accelerated, peaking at 3.1%. Higher inflation was one reason the Monetary Policy Committee (MPC) voted to increase Bank Rate to 0.5% in November. With wage growth of around 2.5%, households spending power was squeezed. Business profitability remained strong and business investment grew by 1.7% in the year to the third quarter. House price inflation remained around 5%.

Summary

The main development in 2017 was higher inflation. Along with weak wage growth it meant that households incomes were squeezed. As a result, household spending grew by 1.0% in the year to the third quarter and retail sales volumes increased by 1.4% in the year to December. While some households curbed their spending others ran down their savings the saving ratio reached a record low of 4.0% in the first quarter and consumer credit grew by 9.5% in the twelve months to December. Employment continued to rise strongly but wage growth remained modest for most of the year, meaning domestically- generated inflationary pressures were muted. However, the MPC judged that the pace of growth including the still-improving labour market combined believed that Bank Rate would be at or close to 0.75% in December 2018.

The Republic of Ireland appears to have grown strongly. Unemployment continued to fall, ending the year at 6.2%, its lowest rate since 2008. Consumer price inflation remained subdued at 0.4%. House price inflation accelerated to around 12% from 9.0% in 2016. This returned prices to their 2009 level and still almost one-quarter below the peak in nominal terms.

The eurozone economy was 2.7% larger in the final quarter of 2017 than in the same period of 2016, up from 1.8% in 2016. Unemployment fell but remained high at 8.7%. While inflation increased to 1.4% it remained short of the European Central Bank s target of at or below 2%. The ECB continued to provide stimulus through low interest rates and quantitative easing. It announced in October that it would reduce the amount of its monthly asset purchases while extending the period during which it will make purchases until at least September 2018.

US growth accelerated to 2.3%. The job market remained buoyant with 1.8 million jobs added during the year and the unemployment rate falling to 4.1%. However, wage growth remained modest and consumer price inflation was well below the Fed s 2% target. However, the central bank continued to tighten policy with three rate rises during the year, taking the Fed Funds with what it judges to be a slower rate of potential expansion would have resulted in higher than acceptable inflation had it not raised Bank Rate. In indicating that Bank Rate would rise further, the Committee emphasised that subsequent increases would be gradual and limited. At the year s end, markets Target Rate to 1.25% - 1.50%.

In China, growth was broadly stable at 6.9%. This was in part a consequence of continued stimulus, which resulted in a further rise in indebtedness. Recognising this, the authorities took steps to limit the growth of credit.

Our operating environment

Risk overview

Effective risk management is at the heart of the successful development and execution of the RBS strategy

An emphasis on strong risk management has a key role in positioning RBS to prepare for, and respond to, developments in the wider competitive, economic and regulatory environment. Risk appetite is set in line with overall strategy and approved by the Board. Current and emerging risks, that could materially affect the delivery of the strategy, are identified and managed through the risk management framework.

Progress in 2017

RBS continued to make progress against its strategic objectives by reducing risk and strengthening both the balance sheet and the capital position.

There was a strong focus during 2017 on developing an enhanced operating model for the risk management function. This work aims to ensure the function continues to meet the needs of our evolving business as well as the structural requirements of the UK s ring-fencing legislation.

The merger of parts of the former Conduct & Regulatory Affairs function with RBS s Risk function took effect on 1 January 2017. This integration was designed to take advantage of synergies between the two functions. Work continued through the year to optimise these. In addition, there continued to be an emphasis on refining the risk appetite framework throughout 2017. As well as consolidating the progress made in previous years, further advances were made to enhance the framework in line with RBS s structural reform. Significant emphasis was placed on reviewing the current measures, along with associated limits and triggers, for each of our material risks and further embedding the reporting of risk profile compared to risk appetite across RBS.

Risk culture continued to be at the forefront of our activity as RBS moves towards its aim of making risk simply part of the way colleagues work and think. In support of this, during 2017 the RBS-wide action plan focused on building clarity, and developing capability. Work to standardise risk culture assessment and reporting has enabled progress to be measured across RBS as well as at an individual franchise and function level. In turn, this informed the risk culture element of performance reviews for RBS s Executive Committee.

Throughout 2017, work continued to consolidate enhancements to the operational risk management framework. The framework plays a key role in helping RBS maintain a safe and secure environment for its customers and is central to the overall risk management strategy. There was an ongoing focus on risk and control assessment, particularly relating to the most material products, processes and services. Significant progress was made in strengthening the fraud defence framework and reducing fraud losses as a result of the successful implementation of various tactical and strategic solutions. The emphasis on understanding and managing the risks relating to RBS s transformation agenda remained a key theme during the year.

Cyber Security

In an increasingly digital landscape across the industry, cyber security continued to be a priority issue in 2017. RBS has a multi-layered defence approach and continues to invest in its defences as the external threat evolves. As part of this ongoing focus, a number of enhancements were made during the year ranging from improved protection of IT systems to mandatory awareness training for all employees. RBS has continued to participate in industry- wide initiatives to monitor and anticipate developments, identify vulnerabilities and share best practice. However, ongoing vigilance will be essential as the threat continues to evolve.

Open Banking

RBS welcomes the Competition & Markets Authority initiative to provide consumers with more choice and more control over their money and financial information by making it easier to compare the details of current accounts and other banking services. During 2017, oversight of the implementation programme was executed in parallel with a strategic assessment of the threats and opportunities in the mid- to long-term. Robust analysis and oversight will continue as the landscape evolves.

Innovation

RBS continues to embrace innovation in the field of financial technology. From the roll-out of the award-winning NatWest and Royal Bank of Scotland mobile app in 2011 to the launch, in 2017, of the NatWest Invest online investment advice service, developments with the potential to improve the banking experience are an integral element of the customer service proposition. Strong risk oversight has kept the security agenda at the forefront of these developments. Throughout the year RBS continued to focus on innovation while emphasising the importance of safety and protection for customers.

Financial Crime

Financial Crime was a key area of focus during 2017. The function continues to monitor the external environment and developments that could affect or change RBS s exposure to financial crime risk. In particular there was a focus on the anti-money- laundering control environment, with additional enhancements to policies and procedures to address the new regulatory requirements of the Fourth Money Laundering Directive. There was also a strong emphasis on the implementation of proportionate and risk-focused customer due diligence standards with an increased focus on the management of higher-risk customer segments. While progress was made during the year, more work is required and RBS continues on its journey of improvement in respect of these controls. Enhancements to sanctions screening were also introduced.

Anti-Bribery & Corruption (ABC) RBS is committed to ensuring it acts responsibly and ethically, both when

Our operating environment

pursuing its own business opportunities and when awarding business. Consequently it has embedded appropriate policies, mandatory procedures and controls to ensure its employees, and any other party it does business with, understand these obligations and abide by them, whenever they act for, or on behalf of, RBS. The requirements of RBS s ABC Policy apply to all RBS employees and non-employees, in every part of the business. All employees are required to complete ABC training on an annual basis, with targeted training appropriate for certain roles.

RBS considers ABC risk in its business processes where there could be a risk of offering an improper advantage or being perceived to do so. This includes, but is not limited to, corporate donations, charitable sponsorships, political activities and commercial sponsorships.

To mitigate against bribery and corruption risks, RBS s ABC policy and supporting mandatory procedures require employees to assess bribery and corruption risk, and conduct the appropriate level of ABC due diligence on business activities. Where appropriate, there is a requirement for ABC contract clauses in written agreements. In adopting this approach, RBS aims to protect the interests of its customers, shareholders and employees.

Reputational Risk

Reputational risk issues can develop from either strategic choices or conduct issues and may even arise from customer activity. RBS continues to remain alert to the reputational risk it is exposed to both in its day-to- day business and as a result of legacy issues. During 2017, further work was done to enhance the reputational risk framework and embed it across all business lines. This work will continue in 2018 as RBS continues to evolve its risk management practice to meet the challenges of the changing external environment.

Key Metrics

Risk-weighted assets (RWAs) RWAs reduced by £27 billion (12%), ending the year at £201 billion (from £228 billion in 2016). This reduction was driven by NatWest Markets, where RWAs fell by £16.8 billion due to the continued run-off of the legacy business and mitigation activities in the core business, together with active management of the lending book in Commercial Banking.

Common Equity Tier 1 ratio

The CET1 ratio increased by 250 basis points to 15.9% in 2017. This was well above the 13% target and reflected the profit in the year and the RWA reductions in NatWest Markets and Commercial Banking.

Leverage ratios

The leverage ratio increased by 20 basis points to 5.3% during 2017 reflecting the increase in the CET1 position. The Bank of England leverage ratio increased by 50 basis points as a result of increased central bank reserves which are excluded from the leverage exposure measure.

Stress testing

Under the hypothetical adverse scenario in the Bank of England 2017 stress test, RBS s low-point CET1 ratio was below the CET1 ratio hurdle rate and the systemic reference point. Calculated after the impact of management actions, RBS s CET1 ratio was above the minimum requirement. The Tier 1 leverage ratio remained above the minimum requirement throughout the test.

As a result of the steps RBS had already taken to strengthen its capital position, a revised capital plan was not required by the PRA.

Liquidity and funding

RBS maintained a robust liquidity and funding risk profile in 2017. Its loan-to- deposit ratio was 88% at 31 December 2017, compared with 91% in 2016. The latest Internal Liquidity Adequacy Assessment Process (ILAAP) showed that RBS is in a strong position to withstand liquidity stress scenarios. It suggested that RBS s liquidity portfolio was large enough to cover more than 168% of the expected outflows in the worst of three severe scenarios.

Litigation and conduct

Litigation and conduct costs of £1,285 million included a £664 million provision in relation to various investigations and litigation matters relating to RBS s issuance and underwriting of residential mortgage-backed securities (RMBS) and additional PPI provision of £175 million. In July 2017 RBS reached a settlement with the Federal Housing Finance Agency (FHFA), as a result of which the FHFA s outstanding litigation against RBS relating to those securities was withdrawn. Further details on these issues can be found in the Litigation, Investigations & Reviews section.

Climate risk

While no climate-related risks have been identified that would have a major impact on RBS s strategy over a five-year horizon, RBS manages and monitors a number of associated threats. These include physical impacts, such as flooding, as well as the impact of climate-related regulation, though exposure to the sectors most vulnerable to climate risks, or climate-related regulation, has significantly reduced (for example RBS exposure to the power and oil & gas sectors has fallen to 1.2% of total lending exposures in 2017). RBS supports the work of the Financial Stability Board s Task Force on Climate- Related Financial Disclosures (TCFD). Adoption of the TCFD recommendations is an important step forward in pricing climate-related risks and opportunities as the transition to a low-carbon economy under the terms of the Paris Climate Agreement progresses.

Top and emerging risks

RBS employs a continuous process for identifying and managing its top and emerging risks. These are defined as scenarios that could have a significant negative impact on RBS s ability to operate. A number of scenarios attracted particular attention in 2017. 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 RBS.

Refer to the Risk Factors section on pages 349 to 379.

Macro-economic and political risks

RBS remains vulnerable to changes and uncertainty in the external economic and political environment, which have intensified in the past year. Stress testing and scenario planning is used extensively to inform strategic planning and risk mitigation relating to a range of macroeconomic and political risks. Scenarios identified as having a potentially material negative impact on RBS include: the impact of the UK s exit from the EU; a second Scottish independence referendum; a UK recession including significant

Our operating environment

falls in house prices; global financial market volatility linked to advanced economy interest rate increases or decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in RBS s core markets; a eurozone crisis; and major geopolitical instability.

Risks related to the competitive environment

RBS s target markets are highly competitive, which poses challenges in terms of achieving some strategic objectives. Moreover, changes in technology, customer behaviour and business models in these markets have accelerated. RBS monitors the competitive environment and associated regulatory technological strategy development and makes adjustments as appropriate.

Impact of cyber attacks

Cyber attacks are increasing in frequency and severity across the industry. RBS has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a number of control enhancements have been delivered as part of a bank-wide security programme. This has improved the protection of IT systems and data for both employees and customers. Further enhancements are underway and planned to ensure RBS continues to maintain an effective control environment as the cyber threats evolve.

Regulatory and legal risks

Future litigation and conduct charges could be substantial. RBS is involved in a number of litigation and investigations matters, including: ongoing class action litigation, securitisation and mortgage- backed securities related litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, and investigations into the treatment of small and medium- sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products). Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material.

More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections of the 2017 Annual Report on Form 20-F. To prevent future conduct from resulting in similar impacts, RBS continues to embed a strong and comprehensive risk and compliance culture.

Failure of information technology systems

RBS s information technology systems are complex. As such, recovering from failure is challenging. To mitigate these risks, a major investment programme has significantly improved the resilience of the systems and further progress is expected. System sustainability has improved as we continue to simplify and modernise our infrastructure and applications.

An increase in obligations to support pension schemes

The value of pension scheme assets may not be adequate to fund pension scheme liabilities. The actuarial deficit in the RBS pension schemes may therefore increase, requiring RBS to increase its current and future cash contributions. An acceleration of certain previously- committed pension contributions was made in Q1 2016 to reduce this risk. Depending on the economic and monetary conditions and longevity of scheme members prevailing at that time, the actuarial deficit may increase at subsequent valuations and is also expected to be affected by ring-fencing.

Operational and execution risks

Increased losses may arise from a failure to execute major projects successfully. These currently include the transformation plan, the restructuring of NatWest Markets, compliance with structural reform requirements including the statutory ring-fencing requirements implemented as a result of the Independent Commission on Banking and the implementation of obligations under the policy framework for resolution (including Operational Continuity in Resolution). These support the delivery of a robust control environment and the embedding of a strong and pervasive customer-centred organisational and risk culture, which are essential to meet RBS s strategic objectives. These projects cover organisation structure, business strategy, information technology systems, operational processes and product offerings. RBS continues to work to implement change in line with its project plans while assessing the risks to implementation and is taking steps to mitigate those risks where possible.

Risks to income, costs and business models arising from regulatory requirements

RBS is exposed to the risk of further increases in regulatory capital requirements as well as risks related to new regulations that could affect its business models.

RBS considers and incorporates the implications of proposed or potential regulatory activities in its strategic and financial plans.

Inability to recruit or retain suitable staff

There is a risk that RBS lacks sufficient capability or capacity at a senior level to deliver or to adapt to change. RBS monitors people risk closely and has plans in place to support retention of key roles, with wider programmes supporting engagement and training for all employees.

Governance at a glance

Board of directors

Chairman	**Executive directors**
Howard Davies	Ross McEwan Ewen Stevenson
Non-executive directors Frank Dangeard Alison Davis Morten Friis Robert Gillespie Penny Hughes Yasmin Jetha	Brendan Nelson Baroness Noakes Mike Rogers Mark Seligman (Senior Independent Director) Dr Lena Wilson
Company Secretary Aileen Taylor	

Our Board

The Board has fourteen directors comprising the Chairman, two executive directors and eleven independent non-executive directors, one of whom is the Senior Independent Director. Biographies for each director can be found on pages 51 to 55.

The Board is collectively responsible for the long-term success of RBS and delivery of sustainable shareholder value. Its role is to provide leadership of RBS within a framework of prudent and effective controls which enables risks to be assessed and managed.

In 2017, the Board and committee evaluation process was conducted internally by the Deputy Secretary and Director, Corporate Governance, and overseen by the Company Secretary.

Our Board committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. The work of the Board committees is discussed in their individual reports. The terms of reference for each of these committees is available on rbs.com.

The full Governance report is on pages 50 to 105 of the 2017 Annual Report on Form 20-F.

Group Audit Committee

Assists the Board in discharging its responsibilities for monitoring the quality of the financial statements of RBS. It reviews the accounting policies, financial reporting and regulatory compliance practices of RBS and RBS s systems and standards of internal controls, and monitors the work of internal audit and external audit.

Board Risk Committee

Provides oversight and advice to the Board on current and potential future risk exposures of RBS and future risk strategy. It reviews RBS s compliance with approved risk appetite and oversees the operation of the RBS Policy Framework and submissions to regulators.

Sustainable Banking Committee Provides support to the Board in overseeing actions being taken by management to run a sustainable long term business, with specific focus on culture, people, customer, brand and environmental social and ethical issues.

Group Performance and Remuneration Committee Responsible for approving remuneration policy and reviewing the effectiveness of its implementation. It also considers senior executive remuneration and makes recommendations to the Board on the remuneration of executive directors.

Group Nominations and Governance Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and the membership and chairmanship of Board committees. It considers succession planning taking into account the skills and expertise which will be needed on the Board in future. Its remit also includes governance oversight.

Technology and Innovation Committee

The Technology and Innovation Committee was established in August 2017 and is responsible for assisting the Board in overseeing and monitoring execution of the Group s strategic direction in relation to technology and innovation.

Executive Committee

The Board is supported by the Executive Committee comprising the executive directors and other senior executives. It supports the Chief Executive in managing RBS s businesses. It reviews and debates relevant items before consideration by the Board. It is responsible for developing and delivering RBS s strategy and it monitors and manages financial performance, capital allocation, risk strategy and policy, risk management, operational issues and customer issues.

UK Corporate Governance Code

Throughout the year ended 31 December 2017, RBS has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated April 2016 except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. RBS considers that this is a matter which should rightly be reserved for the Board.

Governance

Our Board

Chairman

Howard Davies

Nationality: British

Date of appointment: 14 July 2015 (Board),

1 September 2015 (Chairman)

Experience: Howard was Deputy Governor of the Bank of England from 1995 to 1997 and Chairman of the UK Financial Services Authority from 1997 to 2003. Howard was Director of the London School of Economics and Political Science from 2003 until May 2011. He is also Professor of Practice at the Paris Institute of Political Science (Sciences Po).

Howard was chair of the UK Airports Commission between 2012 and 2015 and is also the author of several books on financial subjects.

External appointment(s):

Independent director of Prudential plc and chair of the Risk Committee

Member of the Regulatory and Compliance Advisory Board of Millennium Management LLC

Chair of the International Advisory Council of the China Securities Regulatory Commission

Member of the International Advisory Council of the China Banking Regulatory Commission

Committee membership(s):

Group Nominations and Governance Committee (Chairman)

UBI DAC Board Oversight Committee (Chairman)

Executive directors

Chief Executive

Ross McEwan

Nationality: New Zealand

Date of appointment: 1 October 2013

Experience: Ross became Chief Executive of The Royal Bank of Scotland Group in October 2013.

Between August 2012 and September 2013, he was Chief Executive Officer for UK Retail, joining from Commonwealth Bank of Australia where he was Group Executive for Retail Banking Services for five years. Prior to this he was Executive General Manager with responsibility for the

External appointment(s):

None

Committee membership(s):

Executive Committee (Chairman)

branch network, contact centres and third party mortgage brokers.

Ross has more than 25 years experience in the finance, insurance and investment industries. Prior to Commonwealth Bank of Australia, he was Managing Director of First NZ Capital Securities. He was also Chief Executive of National Mutual Life Association of Australasia Ltd/AXA New Zealand Ltd.

Chief Financial Officer

Ewen Stevenson

Nationality: British/New Zealand

Date of appointment: 19 May 2014

Experience: Prior to his current role, Ewen was at Credit Suisse for 25 years where he was latterly co-Head of the EMEA Investment Banking Division and co-Head of the Global Financial Institutions Group. He has over 20 years of experience advising the banking sector while at Credit Suisse.

Ewen has a Bachelor of Commerce and Administration majoring in Accountancy and a Bachelor of Law from Victoria University of Wellington, New Zealand.

External appointment(s):

None

Committee membership(s):

Executive Committee

Our Board

Independent non-executive directors

Frank Dangeard

Nationality: French

Date of appointment: 16 May 2016

Experience: Previously, Frank served as a non-executive director of Crédit Agricole CIB, EDF, Home Credit, Orange, Sonaecom SGPS, and as Deputy Chairman and acting Chairman of Telenor ASA. During his executive career he held various roles at Thomson S.A., including Chairman and Chief Executive Officer, and was Deputy Chief Executive Officer of France Telecom. Prior to that he was Chairman of SG Warburg France and a Managing Director of SG Warburg.

Frank is a graduate of HEC and IEP in Paris and of the Harvard Law School in the US.

External appointment(s):

Non-executive director of the RPX Corporation

Non-executive director of Symantec Corporation

Committee membership(s):

Board Risk Committee

Technology and Innovation Committee

Alison Davis

Nationality: British/USA

Date of appointment: 1 August 2011

Experience: Previously, Alison served as a director of City National Bank, First Data Corporation, Xoom, Presidio Bank, Diamond foods and a non-executive director and chair of the board of LECG Corporation. She has also worked at McKinsey & Company, AT Kearney, as Chief Financial Officer at Barclays Global Investors (now BlackRock) and as managing partner of Belvedere Capital, a private equity firm focused on buy-outs in the financial services sector.

External appointment(s):

Non-executive director and member of the audit and compensation committees of Unisys Corporation

Non-executive director, and member of the audit committee of Fiserv Inc

Non-executive director and chair of the audit committee of Ooma Inc

Committee membership(s):

Technology and Innovation Committee (Chairman)

Alison is a graduate of Cambridge University and Stanford Business School.

Group Performance and Remuneration Committee

Sustainable Banking Committee

Morten Friis

Nationality: Norwegian

Date of appointment: 10 April 2014

Experience: Previously, Morten had a 34 year financial services career and held various roles at Royal Bank of Canada and its subsidiaries including Associate Director at Orion Royal Bank, Vice President, Business Banking and Vice President, Financial Institutions. In 1997, he was appointed as Senior Vice President, Group Risk Management and served as the Chief Credit Officer then Chief Risk Officer from 2004 to 2014. He was also previously a Director of RBC Bank (USA), Westbury Life Insurance Company, RBC Life Insurance Company and of RBC Dexia Investor Services Trust Company.

External appointment(s):

Member of the Board of Directors of The Canadian Institute for Advanced Research

Member of the Board of Directors of the Harvard Business School Club of Toronto

Non-executive director of Jackson National Life Insurance Company

Committee membership(s):

Group Audit Committee

Board Risk Committee

Our Board

Independent non-executive directors

Robert Gillespie

Nationality: British

Date of appointment: 2 December 2013

Experience: Robert began his career with Price Waterhouse (now PricewaterhouseCoopers) where he qualified as a chartered accountant. He then moved into banking joining SG Warburg, specialising in corporate finance, and was appointed as Co-Head and Managing Director of its US investment banking business in 1989. Following the acquisition in 1995 of Warburg by Swiss Bank Corporation (which subsequently merged with UBS), he then held the roles of Head of UK Corporate Finance, Head of European Corporate Finance and Co-Head of its global business and CEO of the EMEA region. He relinquished his management roles at the end of 2005, and was appointed Vice Chairman of UBS Investment Bank. Robert left UBS to join Evercore Partners, from where he was seconded to the UK Panel on Takeovers and Mergers, as Director General, from 2010 to 2013.

External appointment(s):

Independent board director at Ashurst LLP

Chairman of Council at the University of Durham

Chairman of the Boat Race Company Limited

Director of Social Finance Limited

Committee membership(s):

Group Nominations and Governance Committee

Group Performance and Remuneration Committee (Chairman)

Sustainable Banking Committee

GRG Board Oversight Committee

Penny Hughes, CBE

Nationality: British

Date of appointment: 1 January 2010

Experience: Previously a non-executive director and chairman of the corporate compliance and responsibility committee of Wm Morrison Supermarkets plc. Other former non-executive directorships include Skandinaviska Enskilda Banken AB, Home Retail Group plc, Vodafone Group plc, Reuters Group PLC, Cable & Wireless Worldwide plc and The Gap Inc. Penny spent the majority of her executive career at Coca-Cola where she held a number of leadership positions, latterly as President, Coca-Cola Great Britain and

External appointment(s):

Non-executive Chairman of The Gym Group plc. Also chair of the nominations and member of the audit, risk and remuneration committees

Non-executive director, chairman of the remuneration committee and member of the audit and nomination committees of Superdry plc

Non-executive Chairman of IQSA Group Limited

Committee membership(s):

Sustainable Banking Committee (Chairman)

Ireland.	Board Risk Committee GRG Board Oversight Committee Group Nominations and Governance Committee

53

Our Board

Independent non-executive directors

Yasmin Jetha

Nationality: British

Date of appointment: 21 June 2017

Experience: Previously a non-executive director designate of Williams & Glyn. During her executive career, Yasmin held Chief Information Officer roles at Bupa and the Financial Times, where she became the Chief Operating Officer. She previously had a career spanning nearly 20 years at Abbey National PLC, latterly serving as an Executive Director on the board.

External appointment(s):

Non-executive director of Guardian Media Group plc

Non-executive director of Nation Media Group (East Africa)

Independent panel member of the Cabinet Office Major Projects Review Group

Committee membership(s):

Sustainable Banking Committee

Technology and Innovation Committee

Brendan Nelson

Nationality: British

Date of appointment: 1 April 2010

Experience: Brendan was global Chairman, financial services for KPMG. He previously held senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 to 2006 and as vice-Chairman from 2006 until his retirement in 2010. He was Chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland from 2005 to 2008. President of the Institute of Chartered Accountants of Scotland 2013/14.

External appointment(s):

Non-executive director and Chairman of the audit committee and member of the remuneration and chairman s committees of BP plc

Member of the Financial Reporting Review Panel

Committee membership(s):

Group Audit Committee (Chairman)

Group Nominations and Governance Committee

Board Risk Committee

GRG Board Oversight Committee (Chairman)

UBI DAC Board Oversight Committee

Baroness Noakes, DBE

Nationality: British

Date of appointment: 1 August 2011

Experience: Baroness Noakes is an experienced director on UK listed company boards with extensive and varied political and public sector experience. A qualified chartered accountant, she previously headed KPMG s European and International Government practices and has been President of the Institute of Chartered Accountants in England and Wales. She was appointed to the House of Lords in 2000 and has served on the Conservative front bench in various roles including as shadow treasury minister between 2003 and May 2010. Previously held non-executive roles on the Court of the Bank of England, Hanson, ICI, Severn Trent, Carpetright, John Laing and SThree.

External appointment(s):

Deputy Chairman, Ofcom

Committee membership(s):

Board Risk Committee (Chairman)

Group Audit Committee

GRG Board Oversight Committee

Group Nominations and Governance Committee

UBI DAC Board Oversight Committee

Our Board

Independent non-executive directors

Mike Rogers

Nationality: British

Date of appointment: 26 January 2016

Experience: Mike has extensive experience in retail banking and financial services. Mike joined Barclays in 1986 where he undertook a variety of roles in the UK and overseas across business banking, wealth management and retail banking. Mike was Managing Director of Small Business, Premier Banking and UK Retail Banking and was latterly Chief Executive of Liverpool Victoria Group for 10 years.

External appointment(s):

Non-executive Chairman of Aegon UK

Director of Experian plc and Chairman- designate of its Remuneration Committee

Committee membership(s):

Group Performance and Remuneration Committee

Sustainable Banking Committee

Mark Seligman

Nationality: British

Date of appointment: 1 April 2017

(Senior Independent Director since 1 January 2018)

Experience: Mark, is a former senior investment banker with broad financial services knowledge, has substantial FTSE 100 Board experience gained in various industry sectors, including as a Committee Chair and Senior Independent Director.

During his executive career, he held various senior roles at Credit Suisse/BZW (including Deputy Chairman, CSFB Europe and Chairman, UK Investment Banking, CSFB); and previously SG Warburg (ultimately as Managing Director, Head of Advisory).

External appointment(s):

Senior Independent Director of Kingfisher plc

Non-Executive Director and chairman of the audit committee of Smiths Group plc

Committee membership(s):

Group Nominations and Governance Committee

Group Performance and Remuneration Committee

UBI DAC Board Oversight Committee

He has also previously served as a non-executive Director of BG Group plc and as Deputy Chairman of G4S plc.

Dr Lena Wilson, CBE

Nationality: British

Date of appointment: 1 January 2018

Experience: Experience: Lena is an experienced CEO with an international career, who spent a significant proportion of her executive career with Scottish Enterprise, latterly as Chief Executive from 2009 until 2017. Prior to that, Lena held the role of Senior Investment Advisor to The World Bank in Washington DC. Dr Wilson is a visiting Professor at the University of Strathclyde and has previously served as a member of Scotland s Financial Services Advisory Board and as Chair of Scotland s Energy Jobs Taskforce. In June 2015 she received a CBE for services to economic development in Scotland.

External appointment(s):

Non-Executive Director of Intertek Group plc, and member of its audit and nomination committees.

Non-Executive Director of Scottish Power Renewables Limited

Committee membership(s):

Sustainable Banking Committee

Our Board

Chief Governance & Regulatory Officer and Board Counsel

Aileen Taylor

Nationality: British

Date of appointment: 1 May 2010

(Company Secretary)

Experience: A qualified solicitor, Aileen joined RBS in 2000. She was appointed Deputy Group Secretary and Head of Group Secretariat in 2007, and prior to that held various legal, secretariat and risk roles including Head of External Risk (Retail), Head of Regulatory Risk (Retail Direct) and Head of Legal and Compliance (Direct Line Financial Services).

Aileen is a fellow of the Chartered Institute of Bankers in Scotland and a member of the European Corporate Governance Council. She is also a member of the FCA s Listing Authority Advisory Panel.

Executive Committee

The Board is supported by the Executive Committee comprising the executive directors and other senior executives. Details of the composition of the Executive Committee and biographies of its members can be found at rbs.com>about us>board and governance>ceo and board>executive committee.

Corporate governance

Chairman s introduction

The corporate governance report provides an overview of key roles and responsibilities of the Board, how the Board spent its time in 2017 and how we communicate with shareholders. Board effectiveness and performance evaluation are also covered.

As mentioned in my Chairman s Statement on page 7, during 2017 the Board has considered a number of key strategic, financial, regulatory and risk matters together with legacy issues such as Williams & Glyn; Global Restructuring Group (GRG); and various litigation matters including the 2008 shareholders rights issue litigation. The Board has also been able to spend time focussing on forward-looking matters, including ring-fencing preparations; innovation; technology; and culture. The establishment of the Board s Technology and Innovation Committee will further support our focus on the Group s future strategic direction.

During 2017 we made a number of changes to our Board and committee composition, to support our preparations for ring-fencing and to ensure orderly succession planning. Further details are set out below under Board and committee changes.

On 28 July 2017, the Group Board Directors were appointed to the Board of Ulster Bank Limited (UBL) and the existing Directors of UBL stepped down. This common board and committee structure with Group, RBS plc and NatWest promotes simplification and efficiencies.

I and my fellow directors are committed to observing high standards of corporate governance, integrity and professionalism. Our statement of compliance with the UK Corporate Governance Code (the Code) can be found on page 106.

I would like to take this opportunity to thank my fellow Directors for their continued commitment and dedication throughout 2017.

Howard Davies, Chairman of the Board

The Board

The Board has fourteen directors comprising the Chairman, two executive directors and eleven independent non-executive directors, one of whom is the Senior Independent Director.

Biographies for each director and details of which Board committees they are members of can be found on pages 51 to 55. The Board considers that the Chairman was independent on appointment and that all non-executive directors are independent for the purposes of the Code.

Board and committee changes

A number of changes were made to Board and committee composition during 2017, as follows:

- Mark Seligman was appointed as a non-executive director on 1 April 2017.
- Yasmin Jetha was appointed as a non-executive director on 21 June 2017, and became a member of the Sustainable Banking Committee with effect from 3 August 2017.
- With effect from 3 August 2017 Baroness Noakes, Penny Hughes and Mark Seligman were appointed members of the Group Nominations & Governance Committee and Alison Davis stepped down.
- On 1 September 2017 the Technology and Innovation Committee was established with Alison Davis as Chairman and Yasmin Jetha and Frank Dangeard as members.

John Hughes was also appointed as a non-executive director on 21 June 2017, but unfortunately resigned on 1 September 2017 due to health reasons.

Also, with effect from 1 January 2018:

- Sandy Crombie stepped down as a non-executive director of RBS, and as Senior Independent Director and Chairman of the Group Performance & Remuneration Committee;
- Mark Seligman assumed the role of Senior Independent Director and became a member of the Group Performance & Remuneration Committee;
- Robert Gillespie assumed the role of Chairman of the Group Performance & Remuneration Committee; and
- Dr Lena Wilson joined the board as a non-executive director.

Dr Wilson became a member of the Sustainable Banking Committee with effect from 31 January 2018.

In addition, with effect from close of business of the 2018 Annual General Meeting, Penny Hughes will step down as a non-executive director of RBS and Chairman of the Sustainable Banking Committee. Mike Rogers will assume the role of Chairman of the Sustainable Banking Committee.

Roles and responsibilities

The Board

The Board is collectively responsible for the long-term success of RBS and delivery of sustainable shareholder value. The terms of reference include a formal schedule of matters specifically reserved for the Board s decision and are reviewed at least annually. They are available at rbs.com>about.

A number of Board members are designated as Senior Managers under the PRA and FCA s Senior Managers Regime The role profiles of relevant directors reflect their regulatory responsibilities and they receive ongoing support to ensure they can demonstrate the reasonable steps they have taken to meet their responsibilities. This support includes a practical handbook for non-executive directors on the Senior Managers Regime.

Chairman

The role of Chairman is distinct and separate from that of the Chief Executive and there is a clear division of responsibilities with the Chairman leading the Board and the Chief Executive managing RBS business day to day.

Corporate governance

The Chairman s key responsibilities are to:

- provide strong and effective leadership to the Board;
- ensure the Board is structured effectively, observes the highest standards of integrity and corporate governance, and sets the tone from the top in terms of culture and values;
- build an effective and complementary Board with an appropriate balance of skills and personalities, and as Chairman of the Group Nominations and Governance Committee consider succession planning for Board appointments;
- foster open and inclusive discussions at each Board / Committee meeting which challenge executives, where appropriate;
- in conjunction with the Chief Executive and Company Secretary, ensure that members of the Board receive accurate, timely and clear information to enable the Board to lead RBS, take sound decisions and monitor effectively the performance of executive management;
- ensure that the performance of individual directors and of the Board as a whole and its committees is evaluated regularly; and
- ensure RBS maintains effective communication with shareholders and other stakeholders.

Chief Executive

The Chief Executive has responsibility for all of RBS s business and acts in accordance with the authority delegated by the Board.

The Chief Executive s key responsibilities are to:

- exercise executive accountability for the RBS businesses delivering operational management and oversee the full range of activities of the customer businesses and functions;
- develop, drive and deliver the strategy approved by the Board;
- drive and deliver performance against financial plans, acting in accordance with authority delegated by the Board;
- consult regularly with the Chairman and Board on matters which may have a material impact on RBS;
- lead the culture and values of RBS, creating an environment where employees are engaged and committed to good customer outcomes;

- lead, manage and develop RBS s senior leadership team, ensuring professional capability is developed and that succession coverage meets the needs of RBS;
- ensure RBS has effective frameworks and structures to identify, assess and mitigate risks; and
- in conjunction with the Chairman and Company Secretary, ensure the Board receives accurate, timely and clear information.

Senior Independent Director

Throughout 2017 Sandy Crombie, as Senior Independent Director, acted as a sounding board for the Chairman and as an intermediary for other directors when necessary. He was also available to shareholders to discuss any concerns they may have, as appropriate. Mark Seligman assumed the role and responsibilities of Senior Independent Director with effect from 1 January 2018.

Non-executive directors

Along with the Chairman and executive directors, the non-executive directors are responsible for ensuring the Board fulfils its responsibilities under its terms of reference. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership across RBS s business activities.

The standard terms and conditions of appointment of non-executive directors are available on rbs.com or from RBS Corporate Governance and Regulatory Affairs.

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. Refer to page 49 of the Strategic Report for more details. The terms of reference are available on rbs.com.

The GRG Board Oversight Committee was established in 2015 in relation to the Financial Conduct Authority review of the treatment of SME customers and continued to meet during 2017. The Committee oversees and provides advice to the Board in relation to the review, the external independent review of GRG instigated by the Group and other matters generally related to GRG.

The US Risk Committee was disbanded in May 2017 following the closure of the Connecticut branch.

A Board Oversight Committee was established in September 2017 in order to provide oversight of required enhancements to the governance and risk management practices within Ulster Bank Ireland DAC (UBI DAC), reporting to the Board, as appropriate.

The NatWest Markets Working Group has continued to oversee the transition towards establishment of the board of NatWest Markets Plc which will be stood up in 2018.

Company Secretary

Aileen Taylor is the Company Secretary. Aileen also leads the Bank s Regulatory Affairs function.

The key responsibilities of the Company Secretary include:

- working closely with the Chairman to ensure effective functioning of the Board and appropriate alignment and information flows between the Board and its committees, including the Executive Committee. This includes Board succession planning, induction, and professional development;
- providing support and advice to the Board on a broad range of strategic, governance, legal and regulatory issues;
- executive responsibility for Chairman/non-executive director search and appointment process;
- management of RBS s profile with key stakeholders, including oversight of relations with key influencers and regulators;
- defining and delivering the corporate governance and regulatory affairs strategy across RBS; and
- the provision of professional support to the Board and its committees and leading on implementation of recommendations from the annual Board evaluation.

Corporate governance

Conflicts of interests

RBS has procedures in place to ensure that the Board s management of conflicts of interest and its powers for authorising certain conflicts are operating effectively. On appointment, each director is provided with RBS s guidelines for referring conflicts of interest to the Board. Each director is required to notify the Board of any actual or potential situational or transactional conflict of interest and to update the Board with any changes to the facts and circumstances surrounding such conflicts.

Situational conflicts can be authorised by the Board in accordance with the Companies Act 2006 and the company s Articles of Association. The Board considers each request for authorisation on a case by case basis and has the power to impose conditions or limitations on any authorisation granted as part of the process.

Details of all directors conflicts of interest are recorded in a register which is maintained by the Company Secretary and reviewed annually by the Board.

Board meetings

In 2017, 9 Board meetings were scheduled and individual attendance by directors at these meetings is shown in the table below.

In addition to the 9 scheduled meetings, 9 additional meetings and committees of the Board were held, including meetings to consider and approve financial statements. The Chairman and the non-executive directors meet at least once per year without executive directors present.

	Attended/ scheduled
Howard Davies	9/9
Ross McEwan	9/9
Ewen Stevenson	9/9
Frank Dangeard	9/9
Alison Davis	9/9
Morten Friis	9/9
Robert Gillespie	9/9
Penny Hughes	9/9
Yasmin Jetha (1)	5/5
Brendan Nelson	9/9
Baroness Noakes	9/9
Mike Rogers	9/9
Mark Seligman (2)	6/6
Former Directors	

Sandy Crombie (3)	9/9
John Hughes (4)	2/2

Notes:

(1) Appointed to the Board on 21 June 2017.

(2) Appointed to the Board on 1 April 2017.

(3) Stepped down from the Board with effect from 1 January 2018.

(4) Appointed to the Board on 21 June 2017 and stepped down from the Board on 1 September 2017.

Principal areas of Board focus during 2017

In advance of each Board meeting, the directors are provided with comprehensive papers.

At each scheduled Board meeting the directors received reports from the Chairman, Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Operating Officer, Chief Administration Officer, Franchise CEOs, General Counsel and the Board Committee Chairmen. Other relevant senior executives attend Board meetings to present reports to the Board as appropriate. This provides the Board with an opportunity to engage directly with management on key issues and supports the Board s succession planning activity.

An overview of the principal areas of Board focus during 2017 is set out below.

Customer & Culture

- customer service
- open banking and innovation
- branch network strategy
- payments strategy
- customer metrics
- branding, communications and marketing updates
- overseeing culture and quarterly culture updates
- external fraud update
- Banking Standards Board assessments

Finance

- annual financial budget and plan
- capital strategy and planning
- Internal Capital Adequacy Assessment Process
- Individual Liquidity Adequacy Assessment Process
- dividend planning and policy
- pension strategy
- tax strategy
- mergers and acquisition strategy
- recovery and resolution planning
- results and analysts presentations
- IFRS 9 accounting policies
- legal entity capability and plans

Corporate governance

Strategy

- annual Board strategy offsite and deep dives into each of the franchises
- Brexit implications and response planning
- structural reform, including ring-fencing and legal entity transfers
- transformation programme
- Williams & Glyn alternative remedies package and re-integration

Risk & Conduct

- stress testing
- risk appetite governance and framework
- annual review of strategic risk appetite
- preventing the facilitation of tax evasion

Legal, Regulatory & Governance

- Annual Report and Accounts
- AGM arrangements
- Board appointments
- Board policies, including Board Appointments and Boardroom Inclusion
- Board and Committee evaluations
- annual PRA presentation to the Board

- external auditor evaluation
- Individual Accountability Regime: embedding and ring-fencing implications
- internal audit evaluation
- Modern Slavery Act

Human Resources

- internal employee survey results
- executive director remuneration proposals
- executive director performance and pay review
- executive succession planning
- health and safety

The Board also visited the RBS International (RBSI) business in Jersey in September 2017. The agenda included a deep dive on the RBSI business, strategy, risks and challenges, and directors also met with key customers and local businesses.

In October 2017, an event for subsidiary non-executive directors provided a useful opportunity for subsidiary non-executive directors to gain a broader knowledge of the Group and education on areas of interest as well as providing a deeper understanding of their roles and responsibilities within the Group. A Board reception was also held at Gogarburn in October 2017, during which directors were able to meet and spend time with RBS customers, stakeholders and other influencers.

Board effectiveness

Skills and experience of the Board

The Board is structured to ensure that the directors provide RBS with the appropriate balance of skills, experience and knowledge as well as independence. Given the nature of RBS s businesses, experience of banking and financial services is clearly of benefit, and we have a number of directors with substantial experience in that area. The Board also benefits from directors with experience in other fields.

The table below illustrates the breadth of skills and experience on the Board.

• Retail banking	• Chief executive experience
• Broad financial services	• Finance and accountancy
• Commercial & Private Banking	• Risk

• Markets/investment Banking	• Technology (infrastructure)
• Government and regulatory	• Digital and innovation
• Mergers and acquisitions	• Operations
• Corporate restructuring	• Change management
• Stakeholder management	• Consumer facing

Board committees also comprise directors with a variety of skills and experience so that no undue reliance is placed on any individual.

Induction and professional development

Each new director receives a formal induction on joining the Board, which is co-ordinated by the Company Secretary. This includes visits to RBS s major businesses and functions and meetings with directors and senior management. Meetings with external auditors, counsel and stakeholders are also arranged as appropriate. An illustrative list of the meetings arranged during a new director s induction programme is set out below:

• Chairman	• Chief Human Resources Officer
• Chief Executive	• Chief Administrative Officer
• Chief Financial Officer	• Head of Investor Relations
• Senior Independent Director	• Head of Public and Consumer Affairs
• Other non-executive directors	• Head of Recovery and Resolution Planning
• Company Secretary	• Director of Strategy & Corporate Development
• Chief Risk Officer	• Director of Transformation
• Chief Marketing Officer	• Head of Restructuring
• Chief Operating Officer	• Chief Economist
• RBS Treasurer	• External Auditors
• Chief Audit Executive	• External Counsel
• Chief Legal Officer and General Counsel	• Regulators
• Chairmen and CEOs of principal subsidiaries	• Business visits (UK and
• Franchise Chief Executive Officers	
• Deputy Chief Financial Officer	

• Chief Accountant • Head of RBS Tax	overseas)

60

Corporate governance

The directors have access to a wide range of briefing and training sessions and other professional development opportunities. Internal training relevant to the business of RBS is also provided. Business visits are arranged as part of the Group Audit Committee and Board Risk Committee schedule (details of which can be found on pages 67 and 74) and all non-executive directors are invited to attend. Non-executive directors are also welcome to attend the stakeholder engagement sessions run by the Sustainable Banking Committee (further details of which are on page 82).

Directors undertake the training they consider necessary to assist them in carrying out their duties and responsibilities as directors. Directors may also request individual in-depth briefings from time to time on areas of particular interest.

During 2017, the directors received updates on a range of subjects to enhance their knowledge, including:

- RBS customer service excellence programme training
- Financial Crime and anti-money laundering training, including Criminal Finances Act 2017
- Embracing Innovation and Disruption
- Diversity and inclusion
- UK Corporate Governance Reform agenda
- Stakeholder engagement
- Remuneration developments
- General Data Protection Regulation
- Reporting on Payment Practices and Performance Regulations 2017
- Structural Reform

In addition, all directors have access to an online resources portal, which contains internal policy information and external briefing notes on topical subjects, to support their professional development and competence.

The Company Secretary maintains continuing professional development logs. These are reviewed regularly between the Chairman and each director individually, to assist in identifying future training and development opportunities that are specific to the individual director s requirements.

Information

All directors receive accurate, timely and clear information on all relevant matters and have access to the advice and services of the Company Secretary. In addition, all directors are able, if necessary, to obtain independent professional advice at the company s expense.

Time commitment

It is anticipated that non-executive directors will allocate sufficient time to RBS to discharge their responsibilities effectively and will devote such time as is necessary to fulfil their role. Directors have been briefed on the limits on the number of other directorships that they can hold under the requirements of the fourth Capital Requirements Directive (CRD IV).

Each director is required to advise RBS as early as possible and to seek the agreement of the Board before accepting additional commitments that might affect the time the director is able to devote to his or her role as a non-executive director of RBS. The Board monitors the other commitments of the Chairman and directors and is satisfied that they are able to allocate sufficient time to enable them to discharge their duties and responsibilities effectively. The time commitment currently required of our non-executive directors continues to be significant.

Election and re-election of directors

In accordance with the provisions of the Code, all directors stand for election or re-election by shareholders at the company s Annual General Meeting. In accordance with the UK Listing Rules, the election or re-election of independent directors also requires approval by a majority of independent shareholders.

Performance evaluation

In accordance with the Code, an external evaluation of the Board takes place every three years. An internal evaluation takes place in the intervening years. The most recent external evaluation of the Board was conducted in 2015.

Progress following the 2016 evaluation

A number of actions were progressed during 2017 in response to the findings of the 2016 performance evaluation, overseen by the Group Nominations & Governance Committee.

These included further enhancement of the Board s composition with the appointments of Mark Seligman and Yasmin Jetha, and the introduction of a Board Appointment Policy to support succession planning. Work continued on improving the quality of information provided to the directors and the 2017 Board agenda reflected directors feedback on agenda balance and priorities. The Board continued to dedicate significant time to culture and customers, and this focus will continue into 2018. In conclusion, the specific actions identified during the 2016 evaluation have been appropriately addressed, and where high level themes remain relevant, these have been appropriately incorporated into the 2017 action plan.

2017 Performance evaluation process

In 2017, the Board and committee evaluation process was conducted internally by the Deputy Secretary and Director, Corporate Governance, and overseen by the Company Secretary.

The Deputy Secretary and Director, Corporate Governance undertook a formal and rigorous evaluation by:

- preparing surveys that were completed by each director and holding interviews with each director;
- discussing the key themes and recommendations for action with the Chairman; and
- recommending the key themes and proposed actions to the Board.

Corporate governance

Outcomes of the 2017 performance evaluation

The conclusion of the 2017 performance evaluation was that the Board operated effectively throughout the year and fulfilled its remit as set out in its terms of reference.

Positive feedback was provided in relation to the operation of the Board, including its composition, focus of the agenda, the Chairman s leadership, meeting dynamics and the support the Board receives.

Key themes and findings arising from the evaluation included:-

Strategy

As legacy matters reach their conclusion, the Board has an opportunity to devote more of its time to discussing forward looking strategy.

Customers

Acknowledging the work of the Sustainable Banking Committee in this area, the general consensus was that there is scope for even greater focus on customers at Board level.

Risk

Noting the work of the Board Risk Committee, it was agreed that continued Board focus on major strategic risks should remain a priority.

Engagement with management

It was agreed that the Board provides effective challenge and oversight to management and the importance of continuing to balance the Board s challenge / oversight role with providing appropriate support to management was also highlighted.

Executive succession planning

There is appetite at Board level for greater focus on Executive Committee succession and talent development.

Board information and time commitment

Acknowledging the progress made during 2017, it was noted that there remains room for improvement in length and timeliness of papers. The length of committee meetings was also raised in the context of directors time commitment.

Next steps

A detailed action plan has been developed in response to the themes and findings during the 2017 evaluation, and its implementation will be overseen by the Group Nominations & Governance Committee during 2018.

Individual director and Chairman effectiveness reviews

The Chairman met with each director individually to discuss their own performance and ongoing professional development and also shared peer feedback provided as part of the evaluation process. Separately, the Senior Independent Director sought feedback on the Chairman s performance from the non-executive directors, executive directors and key external stakeholders and discussed it with the Chairman.

Relations with investors

The Chairman is responsible for ensuring effective communication with shareholders. The company communicates with shareholders through the Annual Report and Accounts and by providing information in advance of the Annual General Meeting. Individual shareholders can raise matters relating to their shareholdings and the business of RBS at any time throughout the year by letter, telephone or email via rbs.com/ir.

Shareholders are given the opportunity to ask questions at the Annual General Meeting and any General Meetings held or can submit written questions in advance. The Senior Independent Director and the chairmen of the Board committees are available to answer questions at the Annual General Meeting.

During 2017, RBS also held events in Edinburgh and London for our retail shareholders. Further details can be found on page 29 of the Strategic Report.

Communication with the company s largest institutional shareholders is undertaken as part of the Investor Relations programme:

- the Chief Executive and Chief Financial Officer meet regularly with UKFI, the organisation set up to manage the Government s investments in financial institutions, to discuss the strategy and financial performance of the business. The Chief Executive and Chief Financial Officer also undertake an extensive annual programme of meetings with the company s largest institutional shareholders;

- the Chairman independently meets with RBS s largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman and Senior Independent Director met with the governance representatives of a number of institutional shareholders during the year;

- the Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels; and

- the Chairman of the Group Performance and Remuneration Committee consults with major shareholders in respect of the Group s remuneration policy.

Throughout the year, the Chairman, Chief Executive, Chief Financial Officer and Chairman of the Group Performance and Remuneration Committee communicate shareholder feedback to the Board. The directors also receive reports reviewing share price movements and performance against the sector. Detailed market and shareholder feedback is provided to the Board after major public announcements such as a results release. The arrangements in place are to ensure that directors develop an understanding of the views of major shareholders.

The Investor Relations programme also includes communications aimed specifically at its fixed income (debt) investors. The Chief Financial Officer and/or the RBS Treasurer give regular presentations to fixed income investors to discuss strategy and financial performance. There is also a separate section on the RBS website for fixed income investors which includes information on credit ratings, securitisation programmes and securities documentation. Further information is available at rbs.com/ir.

Report of the Group Nominations and Governance Committee

Letter from Howard Davies

Chairman of the Group Nominations and Governance Committee

Dear Shareholder,

As Chairman of the Board and Chairman of the Group Nominations and Governance Committee I am pleased to present our report on the committee s activity during 2017.

Role and responsibilities

The Group Nominations and Governance Committee was constituted in January 2016 and assumed the responsibilities of the previous Group Nominations Committee to review the structure, size and composition of the Board, and membership and chairmanship of Board Committees. In addition, the Committee monitors the Group s governance arrangements to ensure that best corporate governance standards and practices are upheld and considers developments relating to banking reform and analogous issues affecting the Group in the markets where it operates. The Committee makes recommendations to the Board in respect of any consequential amendments to the Group s operating model.

The Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board.

The terms of reference of the Group Nominations and Governance Committee are reviewed annually, approved by the Board and are available at rbs.com.

Principal activity during 2017

As highlighted in the Board s 2016 performance review, the Committee acknowledges the tenure of a number of the current Board directors and therefore made succession planning a priority in 2017.

In addition to recruitment, the Committee continues to oversee the process to reach agreement with the PRA in respect of a governance model that is compatible with ring-fencing legislation. Ring-fencing also gives rise to a requirement to recruit additional non-executive directors to the boards of our material regulated subsidiaries, which the Committee has overseen.

The Committee has spent time considering the Group s arrangements in respect of legal entity governance. This work continues and is complementary to the Group s preparations for the implementation of ring-fencing legislation.

The Committee has overseen the establishment of the Group s Technology and Innovation Committee, which was constituted on 1 September 2017 with a remit to assist the Board in overseeing and monitoring execution of the Group s strategic direction in relation to technology and innovation.

Membership and meetings

For most of 2017, the Group Nominations and Governance Committee comprised the Chairman of the Board and four independent non-executive directors. In August 2017, the Committee composition was amended to include the Senior Independent Director, as well as the Chairmen of the Board Risk Committee, Group Audit Committee, Group Performance & Remuneration Committee and Sustainable Banking Committee. Alison Davis stood down from the Committee in August 2017, simultaneous with her appointment as Chairman of the Technology and Innovation Committee. Sandy Crombie stepped down from the Committee with effect from 1 January 2018.

The Committee holds at least four scheduled meetings per year and also meets on an ad hoc basis as required. In 2017, there were seven meetings. Individual attendance by directors at these meetings is shown in the tables below.

	Attended/ scheduled
Howard Davies (Chairman)	7/7
Robert Gillespie	7/7
Penny Hughes (1)	1/2
Brendan Nelson	7/7
Baroness Noakes (2)	2/2
Mark Seligman (3)	2/2
Former Members	
Sandy Crombie (4)	7/7
Alison Davis (5)	4/4

(1) Became a member of the committee on 3 August 2017. Did not attend meeting in September due to a clash with an external commitment in place prior to appointment.

(2) Became a member of the committee on 3 August 2017

(3) Became a member of the committee on 3 August 2017

(4) Stood down from the Board with effect from 1 January 2018.

(5) Stood down from the committee on 3 August 2017

Consideration of new non-executive directors

Both JCA Group and Spencer Stuart have been engaged during this year to support the search for new non-executive directors. JCA Group and Spencer Stuart do not provide search services to any other part of RBS. During 2017, the Committee considered a number of potential candidates. In April 2017, June 2017 and January 2018 respectively, Mark Seligman, Yasmin Jetha and Dr Lena Wilson, were appointed to the Board as non-executive directors.

Tenure of non-executive directors

The tenure of non-executive directors is set out below.

	Attended/ scheduled
0 3 years	46%
3 6 years	18%
6+ years	36%
	100%

Report of the Group Nominations and Governance Committee

Board and Committee membership

As previously mentioned, Mark Seligman joined the board as a non-executive director on 1 April 2017 and was subsequently appointed to the Group Nominations and Governance Committee on 3 August 2017. Mark brings broad financial services knowledge to the Board, having substantial FTSE 100 Board experience gained in various industry sectors. Mark assumed the role of Senior Independent Director with effect from 1 January 2018. Yasmin Jetha joined the Board as a non-executive director on 21 June 2017 and was subsequently appointed to the Sustainable Banking Committee on 3 August 2017 and the Technology and Innovation Committee on 1 September 2017. Yasmin brings a fresh skillset to the Board from her career as a Chief Information Officer in the consumer and media sectors coupled with extensive experience in financial services. Dr Lena Wilson was appointed to the Board as a non-executive director on 1 January 2018. Lena brings strong commercial and public sector experience to the Board, having previously served as Chief Executive of Scottish Enterprise and Senior Investment Advisor to The World Bank.

Performance evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Group Nominations and Governance Committee, was conducted internally in 2017. The Committee has considered and discussed the outcomes of the evaluation and accepts the findings. Overall the review concluded that the Group Nominations and Governance Committee operated effectively. However, certain recommendations for action were recognised including the need to: regularly engage with the external search firm to provide clarity and guidance on RBS s expectations of information to be provided to the Committee; and rebalance the agenda of the Committee to ensure greater focus on strategic issues, including director performance and board and senior management succession.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress during the year.

Boardroom diversity and inclusion

RBS values and promotes inclusion in all areas of recruitment and employment. We re proud to be building an inclusive bank. The Board understands the need for a diverse mix of talented directors to effective decision-making.

Boardroom Inclusion Policy

The Board approved a revised Boardroom Inclusion Policy in February 2018 which reflects the most recent industry targets and is aligned to the RBS Inclusion Policy and Principles applying to the wider bank. This Policy provides a framework to ensure that the Board attracts, motivates and retains the best talent and avoids limiting potential caused by bias, prejudice or discrimination. The Boardroom Inclusion Policy currently applies to the most senior RBS boards: The Royal Bank of Scotland Group plc, The Royal Bank of Scotland plc, National Westminster Bank Plc and Ulster Bank Limited. A copy of the Boardroom Inclusion Policy is available on rbs.com>about us.

Objectives and targets

The Boardroom Inclusion Policy contains a number of measurable objectives, targets and ambitions reflecting the Board s ongoing commitment to inclusion progress.

The Policy s objectives exist to ensure that the Board, and any Committee to which it delegates nominations responsibilities, follows an inclusive process when making nomination decisions. That includes ensuring that the nomination process is based on the principles of fairness, respect and inclusion, that all nominations and appointments are made on the basis of individual competence, skills and expertise measured against identified objective criteria and that searches for Board candidates are conducted with due regard to the benefits of diversity and inclusion.

Targets and ambitions

The Board aims to meet the highest industry standards and recommendations wherever possible. This includes, but is not limited to, aspiring to meet the targets set by the Hampton-Alexander Report: FTSE100 Women Leaders (33% female representation on the board) and the Parker Report: Beyond 1 by 21 (at least one director from an ethnic minority background on the board) by the recommended target dates, 2020/2021. The policy supports our bank-wide ambition to aim for a 50/50 gender balance across all levels of the organisation by 2030.

Monitoring and reporting

The Board currently meets the Parker target and, following the appointment of Dr Lena Wilson on 1 January 2018, now meets the Hampton-Alexander target with female representation on the Board reaching 36%. The Board s composition as at 31 December 2017 against the stated targets is set out below:

	2017
Female	29%
Male	71%
	100%
Ethnic minority background	1
Non-ethnic minority background	13
	14

Inclusion and diversity progress, including information about the appointment process, will continue to be reported in the Group Nominations and Governance Committee s report in the RBS Annual Report. The balance of skills, experience, independence, knowledge and diversity on the Board, and how the Board operates together as a unit is reviewed annually as part of the Board evaluation. Where appropriate, findings from the evaluation will be considered in the search, nomination and appointment process.

Further details on RBS s approach to diversity can be found on pages 110 and 111.

Howard Davies

Chairman of the Group Nominations and Governance Committee

22 February 2018

Report of the Group Audit Committee

Letter from Brendan Nelson,

Chairman of the Group Audit Committee

Our primary focus is the integrity and quality of RBS s financial statements

Dear Shareholder,

The Group Audit Committee (GAC) has responsibility for monitoring and reviewing RBS s financial reports and disclosures, its accounting policies and practices and standards of internal control. This report provides an overview of the issues considered and debated by the GAC during 2017 and our expected priorities for 2018.

Accounting and financial reporting

The GAC s primary focus is the integrity and quality of RBS s financial statements, comprising quarterly, interim and full year results announcements and supporting documentation, in addition to the 2017 annual report and accounts.

Throughout 2017 the GAC received detailed reports from management on the key assumptions and judgements underpinning RBS s financial results. The GAC also received quarterly reports from both the internal and external auditors. The GAC provided robust challenge and detailed feedback on the financial results and in my role as Chairman of the GAC I reported to the Board on the GAC s discussions. On behalf of the GAC, I also confirmed the GAC s recommendation of the financial results to the Board for approval.

RBS resolved a number of significant legacy issues during 2017, in particular the settlement of the UK shareholder litigation and the US Federal Housing Finance Agency litigation and reaching agreement with the EC and HMT regarding the bank s remaining state aid obligations. The GAC was closely engaged on all of these issues in order to ensure they were appropriately disclosed and provided for.

The GAC also reviewed judgements in relation to asset and credit impairments. The value of goodwill, deferred tax and RBS s investments in subsidiaries were all key areas of focus during 2017 and the impact of macro economic risks, including developments in relation to Brexit, on the credit environment was a discussion topic throughout the year.

The GAC invested considerable time during 2017 reviewing and discussing the key assumptions, judgements and processes behind RBS s IFRS 9 calculations, in anticipation of the accounting standard coming into effect on 1 January 2018. Significant work undertaken by management, together with close scrutiny from the GAC allowed RBS to disclose the estimated impact of IFRS 9 in its H1 2017 interim results announcement.

In H2 2017 we then provided guidance on the drafting of the IFRS 9 Transition Report, which is published alongside this report, and explains the pillars of IFRS 9 compared with IAS 39 and the updated impact on RBS.

The ring-fencing programme was a crucial work stream for the bank in 2017 and, in Q3, the GAC considered the basis of preparation of the financial information included within the Ring-fencing Transfer Scheme that was ultimately presented to Court and recommended this to the Board for approval. The GAC kept existing provisions for liabilities such as those in relation to PPI and GRG under close review throughout the year to ensure that they continued to be appropriate. Additional litigation and conduct charges were taken in Q4 2017 in relation to PPI, UBI DAC customer redress and RMBS (US residential mortgage-backed securities matters) with oversight from the GAC. We also considered the suitability of significant loan impairment charges in Q3 and Q4 2017 and a revised strategy for Non-Performing Lending Assets in UBI DAC.

Systems of internal control

RBS made substantial progress in improving its control environment during 2017. The GAC, in conjunction with the Board Risk Committee (BRC), oversees RBS s control environment. In particular, we monitor the systems of internal control relating to financial management, financial reporting and accounting issues. During the year we received bi-annual updates on the control environment certification process, quarterly reports on internal controls over financial reporting plus updates from the internal and external auditors on the control environment. Most areas of the bank succeeded in obtaining an improved control environment rating by the year end and the GAC will continue to oversee this work over the coming months.

In order to support a robust control environment and to ensure that RBS promotes a culture of doing the right thing, an effective and accessible whistleblowing process is vital. RBS has whistleblowing procedures in place and the GAC receives regular updates on the whistleblowing framework. As GAC chair, I act as RBS s whistleblowing champion and met regularly with the whistleblowing team to discuss developments, trends and proposed changes to RBS s whistleblowing framework. In March 2017, I issued a communication to all staff emphasising the importance of this process and encouraging staff to participate. An audit of the bank s internal whistleblowing service was completed during the year which concluded that the process is well controlled.

External audit

Having completed their first year as RBS s external auditors in 2016, Ernst & Young LLP (EY) have continued to build and embed their knowledge of the bank during 2017. EY attended each meeting of the GAC in 2017, providing quarterly audit reports and updates on various other bespoke topics. EY s input has been invaluable in assisting the GAC s deliberations throughout 2017 and the year-end audit period and I would like to thank them for their contributions.

Report of the Group Audit Committee

Key priorities for 2018

Looking forward to 2018, the GAC will continue to ensure the integrity of the financial statements of both RBS and its subsidiaries. The changes that will be introduced to reporting structures as a result of the ring-fencing programme will be a key focus and we will continue to monitor the impact of the economic environment on RBS s credit portfolio and financial results. The GAC will also review Internal Audit s validation of control environment ratings and will strive to ensure that recent improvements in the control environment are sustained.

As ever, I would like to thank all GAC members and attendees for their continued support and dedication during 2017, in particular Sandy Crombie who stepped down from the Board at the end of the year. I would personally like to thank Sandy for his extremely valuable contribution to the work of the GAC over the years.

Brendan Nelson

Chairman of the Group Audit Committee

22 February 2018

Report of the Group Audit Committee

Report of the Group Audit Committee

Membership

The Group Audit Committee is comprised of independent non-executive directors.

	Attended/ scheduled
Brendan Nelson (Chairman)	7/7
Morten Friis	7/7
Baroness Noakes	7/7
Former Member	
Sandy Crombie	7/7

John Hughes was also a member of the GAC during his tenure as a director from 21 June until 1 September 2017. During this period John Hughes attended one scheduled meeting of the GAC. Sandy Crombie stepped down from the Committee with effect from 1 January 2018.

Brendan Nelson, Morten Friis and Baroness Noakes are also members of the BRC. Sandy Crombie was Chairman of the Group Performance and Remuneration Committee throughout 2017. Brendan Nelson and Sandy Crombie were also members of the Group Nominations and Governance Committee. Baroness Noakes was also appointed as a member of the Group Nominations and Governance Committee with effect from 1 September 2017. This cross committee membership helps facilitate effective governance across all finance, risk and compensation issues. It also helps to ensure that agendas are aligned and that overlap of responsibilities is avoided where possible.

The members of GAC are selected with a view to the expertise and experience of the GAC as a whole and with proper regard for the key issues and challenges facing RBS.

The Board is satisfied that all GAC members have recent and relevant financial experience and that each member of the GAC is independent as defined in the SEC rules under the US Securities Exchange Act of 1934 (the Exchange Act) and related guidance. The Board has further determined that Brendan Nelson, Committee Chairman, and Baroness Noakes are both financial experts for the purposes of compliance with the Exchange Act Rules and the requirements of the New York Stock Exchange, and that they have competence in accounting and auditing as required under the Disclosure Guidance and Transparency Rules. Full biographical details of GAC members are set out on pages 51 to 56.

During 2017 GAC meetings were attended by: the Group Chairman; the Chief Executive; the Chief Financial Officer; the Deputy Chief Financial Officer; the Chief Accountant; the Chief Legal Officer and General Counsel; and the Internal and External Auditors. Other executives, subject matter experts and external advisers were also invited to attend, as required, to present and advise on reports commissioned by the GAC. The GAC also met privately with the external auditors and separately with Internal Audit management.

Purpose of the Group Audit Committee

The GAC s responsibilities are set out in more detail in its terms of reference which are reviewed annually by the Committee and approved by the Board. These are available on: rbs.com.

Meetings and visits

The GAC held seven scheduled meetings during 2017, four of which were held shortly in advance of submission of the quarterly financial statements to the Board.

During 2017, in conjunction with members of the BRC, members of the GAC took part in an annual programme of visits to businesses and control functions in order to gain a deeper understanding of the risks and issues they face. This programme comprised:

- two visits to Risk, Conduct and Restructuring;
- two visits to Internal Audit;
- a visit to each of Services CAO and Services COO;
- a visit to Commercial & Private Banking;
- a visit to NatWest Markets; and
- a visit to Finance.

In addition to these business and functional visits, the GAC and BRC also undertook a teach-in session on IFRS 9 and visited the bank s operations in Poland. During the visit to Poland the GAC and BRC received updates on the control environment in the Global Hub Europe, met with key leaders and talent and with the external audit team in Poland.

Allocation of Group Audit Committee agenda time during 2017 was as follows:

Financial affairs of the group	42%
Standards of internal control	19%
Internal audit	18%
External audit	13%
Regulatory relationships and compliance	4%
Governance and procedural	4%
Total	100%

Performance evaluation

The performance of the GAC is evaluated annually, and at least once every three years is facilitated by an external party. Following an externally facilitated evaluation in 2015, the evaluation of the GAC s performance in 2017 was conducted internally. The evaluation process involved the completion of questionnaires by both GAC members and members of management and follow up interviews to discuss the findings.

The Board and the GAC have considered and discussed the outcomes of this evaluation. Overall the evaluation concluded that the GAC operated effectively during 2017. A small number of recommendations for improvement were made in relation to the length and timeliness of Committee papers, the length of meetings and the schedule of visits, which were approved by the GAC and the Board. Progress against these actions will be tracked in 2018 and reported back to the GAC and the Board.

The GAC conducts an annual evaluation of both the external auditor and the Internal Audit function each year. The 2017 evaluations found that EY were performing the audit of RBS effectively and that Internal Audit continued to operate effectively during the year. Further details are provided in the report below.

Report of the Group Audit Committee

Matters considered by the Committee in 2017

Key area	Matters considered and action taken by the Committee
Accounting and financial reporting	
Accounting judgements and reporting issues considered in the preparation of financial reports	The Group Audit Committee focused on a number of salient judgements and reporting issues in the preparation of the financial results throughout 2017, including the quarterly, half year and full year results and the Annual Report and Accounts. In particular, the Committee considered, discussed and, where appropriate, challenged: • provisions and disclosures relating to ongoing regulatory, litigation and conduct issues including: US RMBS investigations and litigation; the UK shareholder action; Payment Protection Insurance claims including whether changes were required as a result of FCA advertising campaigns; the FCA s investigation into RBS former Global Restructuring Group; and the CBI s review of Irish Tracker mortgages. During 2017 RBS has recognised £1.3 billion of litigation and conduct provisions; • the adequacy of loan impairment provisions, focusing in particular on judgements and methodology applied to provisions. The Committee was satisfied that the overall loan impairment provisions and underlying assumptions and methodologies were reasonable and applied consistently; • the key judgements made in interpreting IFRS 9, the key features of the IFRS 9 impairment process and the impact of IFRS 9 on the bank s financial results, capital, stress testing and earnings volatility together with the IFRS 9 Transition Report, which is published alongside this report; • valuation methodologies and assumptions for financial instruments carried at fair value including RBS s credit market exposures and own liabilities assessed at fair value; • judgements made by management in relation to the carrying value of intangible assets including in particular goodwill, and RBS s investment in subsidiaries within the stand-alone parent company accounts. • management s assessment of the adequacy of internal controls over financial reporting, and identified deficiencies. The GAC noted significant deficiencies in relation to user-access to the general ledger system and the process around provisions for restructuring costs and action is being taken by management to improve these processes. There were no Material Weaknesses reported in relation to RBS Group at the year-end; • the quality and transparency of financial and risk disclosures;

	• the viability statement in the 2017 report and accounts and the going concern basis of accounting including consideration of evidence of RBS s capital, liquidity and funding position. The GAC considered the process to support the assessment of principal risks; assessed the company s prospects in the light of its current position and the identified principal risks; challenged the evidence to support some of the statements made; and reviewed the disclosure on behalf of the Board. The GAC supported the viability statement and the directors going concern conclusion. (Refer to the Report of the Directors for further information); and • the comprehensive review process which supports the GAC and the Board in reaching the conclusion that the disclosures in the annual report and accounts, taken as a whole, are fair, balanced and understandable and provided the information necessary for shareholders to assess the company s position and performance, business model and strategy. The review process included: central co-ordination of the annual report and accounts by the Finance function with guidance on requirements being provided to individual contributors; review of the annual report and accounts by the Executive Disclosure Committee prior to consideration by the GAC; and a management certification process which required members of the Executive Committee and other senior executives to provide confirmation following their review of the annual report and accounts that they considered them to be fair, balanced and understandable. This process was also undertaken in respect of the half year and quarterly results announcements. The External Auditor also considered the fair balanced and understandable statement as part of the audit process. Having considered the above, the Committee recommended the quarterly, interim and full year results announcements and the Annual Report and Accounts, together with supporting documentation (including Pillar 3 reports, financial supplements and investor presentations) to the Board for approval.
Ring-fencing	In Q3 2017, the Committee considered the basis of preparation and governance of the pro forma financial information, including the adjustments made, and forecast information that was included within the Ring-fencing Transfer Scheme and recommended this to the Board for approval.

Report of the Group Audit Committee

Key area	Matters considered and action taken by the Committee
Systems of internal control	
Annual Risk and Control report	Considered the effectiveness of RBS s internal control system, including any significant failings or weaknesses. The GAC also considered RBS s disclosure on internal control matters in conjunction with the related guidance from the Financial Reporting Council subsequent to review by the Board Risk Committee.
Control Environment Certification	Considered the outputs of bi-annual self-assessments of the robustness of the internal control environment for RBS s customer-facing businesses, and its support and control functions. This informs the control environment disclosure in the annual report and accounts. Most areas reported an improved Control Environment Certification rating by the year end and the remaining areas are expected to report an improved rating during 2018. Management s plans to address certain control issues are covered in more detail in the report of the Board Risk Committee on page 75.
Three lines of Defence	Received a report on RBS s three lines of defence model, including accountabilities under each of the lines of defence, the impact of ring-fencing governance and actions taken to improve the understanding and effectiveness of the model across RBS.
Whistleblowing	Received updates on whistleblowing activity and the performance of RBS s whistleblowing service, monitored the effectiveness of the whistleblowing framework and enquired as to any trends or themes. Also received updates on communications and awareness activity relating to whistleblowing and testing of the framework. The GAC Chairman acts as RBS s Whistleblowing Champion, in line with PRA and FCA regulations. This role carries the responsibility for ensuring and overseeing the integrity, independence and effectiveness of the firm s whistleblowing arrangements. As part of this role the GAC Chairman meets regularly with the internal whistleblowing team. During 2017 he also met with RBS s external whistleblowing supplier and with the internal resourcing team responsible for the RBS s relationship with that external supplier. An audit of RBS s internal whistleblowing service was completed during the year by Internal Audit which concluded that the process is well controlled and that management understand the risks they need to manage. A small number of improvements were also recommended and management has committed to address these by 31 October 2018.
Complaints	Updates were provided to the GAC on customer complaints, including the complaints process, compliance with complaints policy and any emerging themes. The GAC is focused in particular on complaints relating to accounting, internal accounting controls or auditing matters; or submitted directly to the Chief Executive Officer, his executive team, or the Chairman.
Ledger Transformation Programme	Received updates in relation to the delivery of RBS s new general ledger which was implemented in August 2017. The new ledger replaces previous legacy systems and supports new functionality such as discrete legal entity views and multi-currency accounting on a single ledger platform. The implementation of the new ledger was an important step in improving the Finance function s control environment.
Taxation	Reviewed RBS s tax position, including a deep dive in October 2017 which covered: UK corporate tax compliance; tax provisions; the status of RBS s relationship with HMRC; deferred tax assets; the RBS Tax operating model; and external tax developments including making tax digital.
Legal Reports	Considered quarterly reports on the most significant legal risks and developments affecting RBS, including the status of ongoing major litigation and investigations, privacy issues and relevant legislative and regulatory changes.
Notifiable Event Process	Received bi-annual reports on control breaches which are captured by RBS notifiable event process. Under this process all Board directors were alerted to the most significant

	breaches.
Sarbanes-Oxley Act of 2002	Considered RBS s compliance with the requirements of the Sarbanes-Oxley Act of 2002, and was satisfied in this respect. The GAC noted Significant Deficiencies in relation to user-access to the general ledger system and the processes around provisions for restructuring costs and action being taken by management to improve these processes. Remediation of a significant deficiency previously identified in relation to its subsidiary, NatWest Bank, in connection with legal entity recharge accounting was monitored during 2017 and downgraded in December 2017. No Material Weaknesses were reported in RBS Group at the year-end. Provided oversight of the drive to continue to improve SOX processes and received a number of updates in this regard.
Internal audit	
Reports and Opinions	Received quarterly reports and opinions from Internal Audit throughout 2017. These reports and opinions updated the GAC on Internal Audit s view of the progress made in improving RBS s risk and control environment and risk and control awareness by reference to the relevant ratings for each business and function, and the risks which may impact the bank achieving its targets. Internal Audit also provided updates on the audit plan and any anticipated changes to the plan and outlined material and emerging concerns identified through their audit work. In addition, Internal Audit reported on items including: Pillar 3 reporting; RBS s Global Systemically Important Bank status; and the whistleblowing process.

Report of the Group Audit Committee

Key area	Matters considered and action taken by the Committee
Internal audit continued	
Annual Plan and Budget	Considered and approved Internal Audit s plan for 2017, which is focussed on RBS s highest risks. An interim update on performance against the plan was provided to GAC at the end of H1 2017. The GAC also considered Internal Audit s budget and was satisfied that this was sufficient to allow Internal Audit to deliver the plan.
Internal Audit Charter and Independence	Updates to Internal Audit s charter were approved by GAC. The updates aligned the charter with the language of the October 2016 revisions to the Institute of Internal Auditors International Professional Practice Framework and the latest version of Internal Auditor s methodology, which was updated in April 2017. The GAC also confirmed the independence of Internal Audit.
Visits	During two visits to Internal Audit in 2017, the GAC received updates on a variety of issues impacting the Internal Audit function, including: resourcing; bench strength; succession planning; quality assurance; strategic priorities; changes to the function s structure and opinion approach in anticipation of ring-fencing; and the 2018 Audit Plan.
Chief Audit Executive	The Chief Audit Executive continued to report to the Chairman of the GAC, with a secondary reporting line to the Chief Executive for administrative purposes. The GAC assessed the annual performance (including risk performance) of the Chief Audit Executive.
Annual Evaluation	The annual review of the effectiveness of Internal Audit was undertaken internally in 2017. Feedback on Internal Audit was provided by GAC members and attendees (including the external auditors), chairmen of subsidiary audit committees, key members of franchise and function risk committees and other key members of management. The evaluation concluded that Internal Audit had operated effectively during the year. Certain recommendations were made to aid continuous improvement within the function including continuing to bolster succession planning and bench strength, increasing connectivity between Internal Audit teams and sharing best practice. These recommendations will be implemented during 2018 and progress will be tracked by the GAC.
Relationship with regulators	
Regulatory Relationships	Received regular reports on the status of RBS s relationships with its key regulators. The GAC Chairman also attended continuous assessment meetings with the PRA and FCA, a trilateral meeting with the PRA, a meeting with the FRC as well as two meetings with UK Financial Investments Limited during 2017.
External audit	
External Audit Reports	Jonathan Bourne has been EY s lead audit partner for RBS since EY assumed the role of external auditor in March 2016. Jonathan Bourne attended each meeting of the GAC throughout 2017 and reported to the GAC each quarter on their audit work and related conclusions, including the appropriateness of judgements made by management and their compliance with international financial reporting standards.
Audit Plan and fees	Received updates in relation to the external auditor s 2017 plan and approved the 2017 audit fees including the fee for the 2017 interim results. The GAC was authorised by shareholders at the last Annual General Meeting to fix the remuneration of the external auditors.
Annual Evaluation	Conducted an internal evaluation to assess the independence and objectivity of the External Auditor and the effectiveness of the audit process during 2017. Questionnaires were issued to the GAC members, attendees, the Finance Officers of the Franchises and Functions and key members of the Finance team. The evaluation assessed in particular the external auditor s mindset and culture, skills, character and knowledge, quality control and judgement. The evaluation highlighted that the objectivity, independence and integrity of the lead audit partner and the audit team is highly rated by both the GAC and management and concluded that the external auditor was operating effectively. A small

	number of recommendations for continuous improvement were identified including enhancements to reporting; adding value by analysis and suggested management actions; and the pre-planning of audits which will be reviewed by the external auditor. Following the evaluation the GAC recommended that the Board seek the reappointment of EY as external auditor at the next annual general meeting.
CASS Opinions	The external auditor presented the results of its assurance procedures on compliance with the FCA s Client Asset Rules for RBS regulated legal entities for the year ended 31 December 2016. The GAC also considered the CASS Audit plan for 2018, the findings of which will be reported to the GAC once the audit is complete.
External Audit Report to the PRA	The GAC considered EY s 2016 report to the PRA under supervisory statement SS1/16 which set out the PRA s expectation for auditors to provide written reports to the PRA concerning the audits of major banks and building societies, as set out in chapter 8 of the Auditors Part of the PRA rulebook. The report responded to specific questions posed by the PRA relating broadly to credit impairment, hedge accounting, trading/valuation, forecasting and conduct. GAC also discussed the questions received from the PRA in relation to the report required for 2017.
Independence of the previous external auditor	As RBS s previous external auditor, Deloitte LLP (Deloitte) have an ongoing role to consent to the release of their prior period audit opinions for US reporting purposes, the GAC considered the processes and procedures whereby Deloitte were able to re-establish their independence in order to do so.

Report of the Group Audit Committee

Key area	Matters considered and action taken by the Committee
Audit and non-audit services	
Non-audit service policy	In order to comply with the Sarbanes-Oxley Act of 2002 and the EU Audit Regulation, RBS has a policy in place in relation to the engagement of the external auditors to perform audit and non-audit services (the policy). The GAC reviews the policy at least annually to ensure it remains fit for purpose. In accordance with the policy, all audit services and permitted non-audit services must be approved before the engagement commences. Under the policy certain services are classed as Audit-Related Services and these may be approved by the Deputy Chief Financial Officer, on behalf of the GAC, up to a limit of £100,000 each financial quarter. Engagements for Audit-Related Services in excess of this quarterly limit require the approval of the GAC Chairman. All Audit-Related Services are reported to the GAC quarterly. The GAC has also delegated authority to the Deputy Chief Financial Officer to approve the provision of services by the external auditor to non-consolidated subsidiaries of RBS within an annual cap and to approve engagements with the external auditor where RBS has limited or no influence in the selection process. All such engagements are reported to the GAC each quarter. For all other permitted non-audit service engagements, where the fee is below £5,000 approval by the Deputy Chief Financial Officer is required. Where the fee is above £5,000 but below £100,000 approval by the GAC Chairman is required. For engagements where the fee is expected to exceed £100,000 a competitive tender process must be held and approval of the full GAC is required. In addition all engagements must be approved by the Deputy Chief Financial Officer and by Supply Chain Services. All such ad hoc approvals of non-audit services are ratified by the GAC each quarter. During 2017, the external auditors were approved under the policy to undertake the following significant engagements: • to carry out (i) a review of RBS s OFAC compliance policies and procedures and their implementation for RBS s global business lines; and (ii) and appropriate risk focussed sampling of U.S. dollar payments, as required in connection with the 2013 Cease and Desist Order issued to RBS by the by Board of Governors of the Federal Reserve; • the annual client money (CASS) audit as required by the FCA; • the annual audit of the bank s LIBOR submissions as agreed with the US Commodity Futures Trading Commission and the FCA; • the audit of note issuance in Scotland and Northern Ireland and in respect of notes in circulation as requested by the Bank of England;

- work in respect of reporting for RBS NV in respect of COREP and FINREP returns performed over and above normal regulatory reporting;
- reporting to the PRA on matters related to the audit;
- the sustainability audit; and
- overseas regulatory reporting.

The decision to approve the engagement of the external auditor for the services noted above was due to factors including synergies and efficiencies relating to the audit work, their existing knowledge of RBS which allowed work to commence quickly and with minimal disruption and the benefits in maintaining consistency between similar engagements. In each case the GAC was satisfied that the engagement did not impact the external auditor s independence. The total value of non-audit services fees during the year was 15.1% of the audit fee.

The policy also includes certain safeguards in relation to engagements with RBS s previous external auditor, Deloitte who have an ongoing role to consent to the release of their prior period audit opinions for US reporting purposes and may therefore require to re-establish their independence. During 2017 Deloitte were approved under the policy to carry out the following significant engagements:

- setting of a framework for documentation review to be undertake in connection with an attestation made to the National Futures Association in relation to record keeping and reporting;
- provision of financial advice in relation to the disposal of a business in which RBS held a shareholding;

Report of the Group Audit Committee

Key area	Matters considered and action taken by the Committee
Audit and non-audit services continued	
	• an independent review of UBI DAC compliance with the Code of Conduct Mortgage Arrears requested by the Central Bank of Ireland; • provision of resource support to help support RBS s Technology teams with understanding and implementing an end to end technology delivery framework and embed these new ways of working within Technology teams; • review of the financial position of a customer to allow Senior Lenders, including RBS, to work with the customer on a medium term restructuring solution; • support to the businesses and Finance Central SOX team in documenting the end to end processes underlying statutory financial reporting, confirming the associated risk and mitigating suite of SOX controls ; • to build an iOS application for an Entrepreneurial Spark concept; • quality assurance services for RBS s customer due diligence remediation programme; • development of an initial proposition and development roadmap for a new digital platform that will enable us to launch, test and refine innovative offerings for both customers and non-customers; • development of a risk assessment process, control framework and review framework in relation to new corporate tax offences under the Criminal Finances Act; • as the skilled person to continue to support the Bank s ring-fencing programme under ICB; and • to support the Bank in implementing new technologies to create excellent customer experiences, contribute to a strong cost:income ratio and simplify business processes. Further details of the non-audit services that are prohibited and permitted under the policy can be found on rbs.com. Information on fees paid in respect of audit and non-audit services carried out by the External Auditor can be found in Note 5 on the consolidated accounts.

Brendan Nelson
Chairman of the Group Audit Committee

Report of the Board Risk Committee

Letter from Baroness Noakes

Chairman of the Board Risk Committee

A key part of RBS becoming a simpler, safer and customer focused bank is excellent risk management

Dear Shareholder,

A key part of RBS becoming a simpler, safer and customer focused bank is excellent risk management. The Board Risk Committee (BRC) plays an important role in overseeing how well RBS manages its risks. The purpose of this report is to describe how the BRC discharged this responsibility during 2017.

2017 has been another busy year for the BRC and our detailed report, which follows, sets out the detail of what we have done. I would like to focus on two key areas, both of which are driven by regulatory requirements.

Ring-fencing and Resolution

RBS, in common with other large banks, is required to deliver both ring-fencing and key parts of its resolution plans by the beginning of 2019.

The separation of our core UK and European banking business from activities that are required to be outside the ring-fence involves many complex activities including: legal restructuring of the RBS group; detailed analysis and transfer arrangements for individual customers and products; and changes to the way in which we manage the business.

In parallel with this RBS needs to have plans acceptable to the regulators which allow RBS to be dealt with effectively in the event of financial failure. An important part of this is Operational Continuity in Resolution (OCIR) which is aimed at ensuring that the ring-fence bank has all the systems and resources it needs to operate. This in turn requires much more formality and structure around the way that individual parts of RBS trade with each other through inter-group agreements and these agreements are a key part of how we deliver ring-fencing as well.

The BRC has responsibility for overseeing the delivery of these programmes and the management of the associated execution and delivery risks on behalf of the Board. We reviewed the ring-fencing programme at every meeting and receive reports from an integrated assurance programme. In H2 2017, the BRC supported the incorporation of OCIR requirements within the ring-fencing programme in recognition of the interdependencies. We will monitor closely the delivery of the residual elements of RBS s Resolution Planning separately.

Capital and Liquidity

Capital and liquidity are important areas for risk management in any bank and the regulatory requirements are intensifying, particularly in the context of ring-fencing.

The Committee devoted considerable time this year to stress testing. The 2017 Bank of England exercise incorporated a requirement to undertake two stress scenarios (an Annual Cyclical Scenario (ACS) and a Biennial Exploratory Scenario (BES)) followed by a further two IFRS 9 exercises on non-credit card and credit card exposures. The BRC reviewed the various components and stages of these exercises and recommended that the Board approve them.

We also conducted detailed reviews of the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) returns for the Group. In preparation for ring-fencing, the Committee also oversaw the preparation of an ICAAP for the future ring-fenced bank and both an ICAAP and ILAAP for RBS s future NatWest Markets subsidiary which will sit outside the ring-fence.

Other Work

Our detailed report sets out what we have done in other areas during the year. The more material areas have been:

- Risk appetite: we continued the work of earlier years to oversee the extension and refinement of RBS s comprehensive risk appetite framework, including its cascade to our key franchises and preparation for ring-fencing.

- Control environment: Strengthening the control environment has been a key part of the RBS s transformation programme. Significant progress was made in almost all parts of RBS but not enough to get the overall control environment to where it needs to be.

- Transformation programme: we continued to oversee the complex programme of bank-wide initiatives. This includes the delivery of a number of key regulatory requirements. In recognition of the improvements made to the effectiveness of the programme, we were able to reduce our detailed involvement compared with prior years.

Key Priorities for 2018

Successful delivery of ring-fencing and OCIR will continue to be a key focus area in 2018 given the regulatory deadline of 1 January 2019. Our focus will shift from legal compliance to ensuring that we have the right risk management and oversight processes to underpin the new structures. I expect that we will continue to focus on the control environment in particular the parts of the business which still need to improve long term sustainability.

I would like to end by extending my gratitude to my fellow Committee members and to the bank s senior leadership team for their support and dedication to the business of the Committee during 2017.

Baroness Noakes

Chairman of the Board Risk Committee

22 February 2018

Report of the Board Risk Committee

Report of the Board Risk Committee

The role and responsibilities of the Board Risk Committee

The Board Risk Committee assumes responsibility on behalf of the Board to provide oversight of current and potential risk exposures and future risk strategy, including the determination of risk appetite and tolerance, and to promote a culture of risk awareness within RBS. A large part of the Board Risk Committee s work is the review of reports and regulatory submissions on behalf of the Board and recommending them for approval. Where this is the case, the Report below is annotated with an asterix (*).

The Committee s responsibilities are set out in more detail in its terms of reference which are reviewed annually by the Committee and approved by the Board. These are available on RBS s website: rbs.com.

Membership

The Board Risk Committee is comprised of independent non-executive directors. Details of the skills and experience of each of the Committee members are set out in their biographies on pages 51 to 55.

	Attended/ scheduled
Baroness Noakes (Chairman)	9/9
Frank Dangeard	9/9
Morten Friis	9/9
Penny Hughes	9/9
Brendan Nelson	9/9

Brendan Nelson is chairman of the Group Audit Committee of which Baroness Noakes and Morten Friis are also members. Penny Hughes is chairman of the Sustainable Banking Committee. This common membership across Committees helps to ensure effective governance across the committees.

Committee meetings are also attended by the RBS Chairman, relevant executives, (including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Conduct & Regulatory Affairs Officer, Chief Legal Officer and General Counsel and Chief Audit Executive), and the lead partner of the External Auditor. External advice is sought by the Committee, where appropriate.

Meetings and visits

Nine scheduled meetings and six ad hoc meetings were held in 2017. The ad hoc meetings were required to consider: the results of various phases of internal and external stress tests; review of ICAAP and ILAAPs and reverse stress testing results; and the processes supporting the formal documentation required for the Ring-fencing Transfer Scheme.

In 2017, members of the Committee undertook a programme of visits to various businesses and control functions including bi-annual visits to Risk, Conduct and Restructuring function in conjunction with members of the Group Audit Committee. The purpose and scope of this programme is discussed in detail in the Report of the Group Audit Committee on page 67.

The Committee also held in-depth sessions on risk reporting and held a teach-in on both capital and IFRS 9 requirements. A no formal agenda session was held with members of the BRC to enable open discussion about the key risks and threats to the organisation independently of the issue management and procedural matters which necessarily form a material component of the BRC agenda.

Performance Evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Board Risk Committee, was conducted internally in 2017. The Committee has considered and discussed the outcomes of this evaluation and accepts the findings. Overall the review concluded that the Board Risk Committee continued to operate effectively.

However, certain recommendations for enhancing the operation of the Committee were identified, including: increased legal entity focus; devolving greater oversight to executive fora to reduce the pressure on Committee time; and further enhancement in the quality of information presented to the Committee to ensure it is concise, with key matters of judgement clearly highlighted. Recognising that RBS has now addressed several legacy issues, it was agreed that the Committee should look to re-focus to be more forward looking, and dedicate less time to remediation and operational issues.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress on its 2018 priorities during the year.

Allocation of Board Risk Committee agenda time:

Current risk profile and issues	22%
Change agenda and large projects	10%
Process, policies and risk appetite	13%
Regulatory returns and stress testing	14%
Accountability and Remuneration	6%
Governance & Procedural	7%
Risk, conduct and regulatory affairs focus sessions	7%
Franchise and function focus sessions	21%
Total	100%

Report of the Board Risk Committee

Matters considered by the Committee in 2017

Key area	Matters considered and action taken by the BRC
Risk Profile	
Reporting	• The Committee provided oversight of RBS s risk profile relative to RBS s strategy and risk appetite through the review of key emerging and identified top risks impacting RBS s businesses and operations as presented in the Risk & Conduct Management Quarterly Report, and supplemented by short form reports at all other meetings. • Received verbal updates from the Chief Risk Officer at each meeting highlighting the most current and material risks impacting RBS. • A focused session on enhancement of risk reporting was held in October 2017 which resulted in a number of recommendations on content and presentation in the Risk & Conduct Management Quarterly Report. The Committee will monitor how the changes are being implemented through 2018. • Received updates from Executive Risk Forum (ERF) and Technical ERF and discussed any emerging risks and issues escalated, in particular those areas where BRC had devolved detailed oversight to those fora.
External developments	• Received reports from the Chief Risk Officer at each meeting highlighting external developments with the potential to affect the bank s ability to meet its strategic objectives or continue its operations. Particular focus was placed on political developments and stability, including Brexit preparedness and the potential impact of the UK and certain EU elections; prospective EU capital requirements; UK economic resilience - inflation, interest rates; unemployment and the level of consumer indebtedness; the UK base rate increase; and global sanctions. • BRC also received a report on new and emerging threats including established risks such as competition but also risks posed as a result of digitisation.
General Counsel s report	• The General Counsel reported to the Committee at each meeting on current and emerging key legal developments and significant litigation risks affecting the bank. RBS s plans to comply with the General Data Protection Regulation were kept under review.
Regulatory Affairs and Developments	• Introduced a new report during 2017 covering material regulatory interactions, communications and developments to ensure a stronger focus on the areas of key regulatory interest. Reviewed the governance and assurance supporting material regulatory representations and attestations and considered RBS s strategic plans against the key themes in the FCA Risk Outlook and Business Plan. • A Board Oversight Committee (BOC) has been established to oversee required enhancements to the governance and risk management practices in UBI DAC and, where appropriate, the BRC will work in conjunction with the BOC to understand implications for RBS processes.

Control Environment	• Received bi-annual reports on the control environment of the franchises and functions and monitored the route and achievability of being within appetite by end of 2017. Sought management s assurance that appropriate measures were in place to ensure that the businesses could continue to operate safely, where control weaknesses had been identified. • Particular focus has been placed on areas where the control environment requires enhancement. The BRC has devolved detailed review and challenge of management plans to remediate and strengthen the conduct and control environment across the NatWest Markets franchise to Technical ERF. We received reports on those discussions and actions being taken, paying particular attention to the robustness of issue closure and downgrade; interdependencies; and sustainability. • Technical ERF is also overseeing in detail, management s plans to return the control environment within UBIDAC to a within risk appetite position, ensuring identified best practices are applied as adopted and learned through Nat West Markets remediation. BRC will receive regular updates on those discussions through 2018. • The Committee is also monitoring closely the programme to deliver required improvements to customer due diligence processes as well as remediation work. We will review progress on a quarterly basis in 2018 given the programme s criticality to attaining a satisfactory control environment Bank-wide.
Business and subsidiary risk committees	• Received quarterly reports from the Chairman of the US Risk Committee to the point of its retirement in May 2017. The US Risk Committee was established to provide oversight of the risk management framework of RBS s combined US operations. Following closure of its Connecticut Branch, alternative governance processes, commensurate with the scale of RBS s residual US activity were established. The BRC retains oversight of key regulatory submissions. • Received quarterly reports from the chairmen of franchise risk committees and those of certain principal subsidiaries outlining risk profile relative to risk appetite and any control weaknesses and remediation plans. In 2018, this reporting mechanism will be extended to all material regulated subsidiaries.

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Major Programmes	
Transformation	• Kept the execution risk of the bank-wide transformation programme under review receiving regular updates from the programme team on progress, including independent opinions from Risk, Conduct and Restructuring function and Internal Audit. BRC encouraged the development of a reporting dashboard to track outcomes more effectively. • Reviewed management s lessons learned from oversight of the programme in 2016 and actions being taken to address findings. • Transitioned reporting to quarterly, reflective of the progress made to clearly report and track deliverables; the improving status of the programme; and the increased alignment between management, Risk, Conduct and Restructuring function and Internal Audit. • Where underlying programmes were reported to be losing traction, BRC took specific reports on delivery. Specifically, BRC received reports on the progress of RBS to achieve Merchant compliant position under the Payment Card Industry Data Security Standard (PCI DSS) and considered challenges to delivery of the Future Clearing Model programme.
Williams & Glyn	• Following the announcement of the European Commission s decision to approve HMT s alternative remedy package in September 2017, the BRC considered implementation plans to establish the required schemes, including critical path dependencies/progress towards operational readiness. • Reviewed plans to reintegrate the business previously described as Williams & Glyn into RBS s retail business including controls and safeguards to ensure appropriate oversight of the portfolio and the timing of transition.
Ring-fencing	• Developed a programme of detailed quarterly reporting on the ring-fencing implementation programme, supplemented by shorter updates at intervening meetings given the considerable volume of activity and criticality of the deliverable. • Considered the key execution risks in the programme and oversaw key regulatory deliverables. Reviewed the Ring Fence Transfer Scheme documentation and Skilled Person Report, including the required management representation letter and regulatory attestation. The Skilled Person also attended relevant meetings to update on its findings. Latterly, the BRC supported the integration of Operational Continuity in Resolution delivery within the programme given the interdependencies with ring-fencing activity. Throughout, the Committee sought to ensure the programme remained focussed on the delivery of ring-fencing over discretionary strategic deliverables. • Received opinions from Risk, Conduct and Restructuring function and Internal Audit on progress. Oversaw the appointment of KPMG as independent third party assurance provider and received the outputs of the work undertaken. An integrated assurance approach was adopted in the period, the scope of which was reviewed by the BRC to ensure effective assurance activity across Risk, Conduct and Restructuring

	function, Internal Audit and KPMG.
Recovery and Resolution Planning	• The Committee increased its oversight of Resolution Planning to quarterly and requested that this be classified as a major programme within risk reporting. This was reflective of the requirement to ensure adequate legal entity focus; pan-bank engagement; regulatory scrutiny and interdependency of elements with the ring-fencing deliverables. Latterly, the BRC supported management s decision to transfer OCIR elements to the ring-fencing programme so as to increase the pace of delivery and demonstrate congruence with ring-fencing. The Committee reviewed outputs of a third party benchmarking review of RBS s progress as compared to peers and will monitor actions being taken in response. A re-baselined plan will be reviewed in early 2018. • Reviewed the draft 2017 Recovery Plan in June 2017.*

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Enterprise Wide Risk	
Risk appetite	• Reviewed the risk appetite governance framework; provided feedback on the mechanism for managing and escalating breaches of risk appetite and providing oversight of the cascade of risk appetite.* • Considered an annual refresh of the Risk Appetite Framework and received an update on the guidance and support that would be provided to the business throughout 2017 to ensure that the Framework was consistently embedded across the organisation. • Following work undertaken in 2016 to transition to a position where the Board/BRC played a greater role in the approval of risk appetite for RBS s most significant risks, it was agreed that this would take place on a phased basis. The BRC reviewed qualitative risk appetite statements and certain quantitative risk appetite measures relating to Market Risk and Credit Risk, being those measures where the Board would wish to be informed if those limits were exceeded (Board Risk Measures).* • Considered a report on the approach to risk appetite under structural reform (reflecting the future legal entity status of the Group). The BRC reviewed the proposed cascade of strategic risk appetite limits for the legal entities within and outwith the future ring-fenced structure. It was noted that process and limits would continue to be refined in 2018.* • Reviewed escalated breaches of risk appetite and action being taken in response.* • Reviewed the annual refresh of risk appetite for strategic risks and made suggestions for refinements.* • Reviewed the cascade of risk appetite for strategic and material risks to franchises and functions and received a report on the alignment of risk appetite, top to bottom across the organisation. • Considered various detailed risk appetite statements and associated metrics for material risks.
Risk Culture	• Reviewed work being undertaken across RBS to improve risk culture including the status of the various ongoing bank-wide risk culture initiatives. Considered the outputs of a PwC review of progress in strengthening and embedding risk culture and discussed the actions identified that would have the greatest impact on risk culture. • Reviewed management s proposed framework to measure risk culture maturity against target state and considered the outcome of the assessment of progress against agreed performance criteria.
Client Pricing for Assets and Liabilities	• Undertook an annual review of the client pricing process against regulatory requirements to ensure that the pricing of liabilities and assets takes into account the

	bank s business model and risk strategy.
Three Lines of Defence	• Received an update on the work being undertaken to improve the effectiveness of the three lines of defence model within RBS, including actions being taken to improve understanding of roles and accountabilities under each of the lines of defence.
RDAR	• Monitored progress towards full compliance with the Basel Principles on Effective Risk Data Aggregation and Reporting (RDAR) and undertook an annual review of the RDAR framework.*
Risk Assurance	• Received quarterly reports from the Risk Assurance team, on issues highlighted by reviews conducted in each of the franchises.

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Operational, Credit and Market Risk	
Credit, Market and Operational risk MI	• Reviewed the bank s risk profile relative to credit, market and operational risk, and examined detailed management information (MI) within the quarterly Risk Management Report in this regard.
Operational Risk	• Change capacity - Discussed the change risk profile of the bank and the prioritisation and impact of mandatory change programmes and considered opinion as to whether RBS had the required resource, processes and systems to deliver its change portfolio within agreed timescales. Reporting on change capacity has now been incorporated within routine quarterly risk reporting. • Risk and Control Assessments - monitored management s progress to complete and refresh these assessments which are intended to provide an end to end perspective of the risk and control profile across the businesses. Considered scope of the exercise and impact of the outputs on risk profile. • Undertook a review of the adequacy and effectiveness of the Risk Policy Framework and considered work being undertaken to reduce the volume of exceptions to policy and remediation in areas of non-compliance. • Reviewed the statutory Annual Risk and Control Disclosure regarding the internal control system in RBS prior to its review by the Group Audit Committee.* • Received bi-annual reports on Resilience and Security which considered in particular, Cyber Risk; internal and external fraud and records management. • Considered the statement of risk appetite for operational risk together with a new suite of metrics.
Credit Risk	• Oversaw the Executive Credit Group (ECG) receiving a summary of the decisions made by the ECG in the period. Reviewed the most material credit decisions made in 2017 and examined trends in the market. The BRC requested more data on declined requests and explanation of risk/return relative to each decision. • Reviewed a revised governance framework for large credit exposure decisions, designed to enhance the level of Committee and Board oversight.* • Reviewed a suite of Credit Risk Board Risk Appetite Measures.* Undertook a deep dive on the mortgage portfolio with a focus on drivers of growth and controls and received a report on Non-Performing Loans and Provision Coverage.
Market Risk	• Held a teach-in on the impact of the Fundamental Review of the Trading Book and the impact of the new regulation. • Reviewed a suite of Market Risk Board Risk Appetite Measures.*

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Conduct and Financial Crime	
Financial Crime	• Reviewed the annual Group Money Laundering Reporting Officer s Annual Report.* • Received regular updates on financial crime risk, with a particular focus on the customer due **d**iligence remediation programme, including scope, accountability, the timescale to return to appetite and impact on bank-wide control environment. • Considered the Financial Crime risk appetite statement and associated limits and measures.
Conduct risk	• Assessed progress to meet the requirements of the European Deposit Guarantee Scheme and approved the required compliance statements for submission to the PRA.* • Received a report on how RBS surveillance processes and controls operated, in particular how these benchmarked to peers, and considered required enhancements. • Received reports on Conduct Risk Appetite and performance, including action being taken to improve bank-wide conduct risk profile. • Reviewed a revised statement of risk appetite and metrics which concentrated on customer outcomes as the Committee had previously requested. • While a Board Oversight Committee (BOC) had been established to oversee required enhancements to the governance and risk management practices in UBI DAC, where appropriate, the BRC will work in conjunction with the BOC to understand the implications for RBS processes. • Reviewed reports relating to the 2015 US Cease & Desist Order. • Received an annual report on oversight of operational compliance of RBS and NatWest with FCA Client Asset Rules (CASS) and compliance with CASS resolution pack rules.*
Capital and Liquidity Risk	
Stress Testing	• Considered the 2017 Bank of England Stress Tests, comprising, for the first time, two stress scenarios the Annual Cyclical Scenario (ACS) and the Biennial Exploratory Scenario (BES). The Committee reviewed the scenario expansion and expansion of market risk factors and considered key assumptions and judgements and reviewed the outputs and management actions.* • Reviewed the Bank of England IFRS 9 stress tests on non-credit card and credit card exercises including the assurance provided by Internal Audit and confirmation that management had undertaken robust review.*

	• Reviewed the 2017 budget and stress test results (including IFRS 9) and 2017 ICAAP Stress Test Scenarios together with opinions from Risk and Internal Audit.* • Considered 2018 budget and stress test results including Risk and Internal Audit opinions.* • Reviewed reverse stress testing results. • Oversaw enhancements to the bank s stress testing capability, in particular the remediation actions taken in response to the PRA review of stress testing capability. Work being undertaken to strengthen and validate models and improve supporting governance was a key focus.
ICAAP and ILAAP	• Reviewed the RBS Group and pro forma NatWest Markets Plc ILAAP and ICAAP, with particular focus on assumptions and areas of judgement and considered associated Risk and Internal Audit opinions.* • Reviewed the NatWest Markets ILAAP and ICAAP, and accompanying Internal Audit Report.* These are the first such regulatory submissions and the documents will continue to be refined and tailored during 2018.
Other capital and liquidity coverage	• Reviewed the risk profile of the Treasury Function in a focus session held to understand better its position relative to risk appetite, emerging trends, threats and regulatory developments over the following year. • Considered the bank s usage of the Bank of England Term Funding Scheme, noting that the Monetary Policy Committee decision to close the drawdown period on 28 February 2018 had no material impact on the bank s funding and liquidity plans. • Considered conduct liquidity stress scenario analysis in detail. • Undertook a teach-in on capital with a focus on legal entities (including the operation of external and internal MREL), future RWA developments and capital headwinds (Basel 3 amendments, PRA mortgage floors, IFRS 16). • Reviewed pension strategy and oversaw interactions with the Pension Trustees.

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Accountability and Remuneration	
Accountability and Remuneration	Continued to provide oversight over the risk dimension of performance and remuneration arrangements, working closely with the Group Performance and Remuneration Committee. The Report of the Group Performance and Remuneration Committee on pages 83 to 105 includes further detail on how risk is taken into account in remuneration decisions. Key matters considered by the Committee included: • accountability recommendations in respect of significant material events and high earners; • the risk and control objectives of members and attendees of the bank s Executive Committee, with additional focus on underlying objectives for the Chief Risk Officer; • an assessment of the risk/conduct performance of members and attendees of the Bank s Executive Committee, with recommendations made to the Group Performance and Remuneration Committee as appropriate to inform its decision on pay and awards; • an assessment of the risk/conduct performance of the Bank and its businesses, with recommendations made to the Group Performance and Remuneration Committee to inform its decision on adjustments to the annual bonus pools; • performance conditions for the bank s Long Term Incentive Plans and assessment of proposed vesting levels to ensure risk management/conduct performance is fairly reflected in vesting outcomes; and • the proposed Executive Director Future Remuneration Policy as detailed on pages 87 to 88 from a risk and control perspective.

* Items that were reviewed by BRC prior to recommendation to the Board

Baroness Noakes
Chairman of the Board Risk Committee

Report of the Sustainable Banking Committee

Letter from Penny Hughes

Chairman of the Sustainable Banking Committee

We remain committed to building a sustainable bank that is great for our stakeholders.

Dear Shareholder,

I am pleased to report on the progress made by the Sustainable Banking Committee (SBC) during another busy year for RBS.

The Committee has retained its forward looking, strategic outlook focusing on its five priority areas: culture; customers; people; brand & communications; and environmental, social and ethical (ESE) issues.

The Sustainable Banking Committee plays an important role on behalf of the Board in considering the long term challenges RBS will face, and how we can be proactive in tackling those as well as meeting our ambition for customers. With this remit, the areas the Committee focused its efforts on during 2017 were:

- technology and open banking;
- building a healthy culture;
- challenging management on progress towards reaching number one for customer service, trust and advocacy; and
- converting doing the right thing into good customer outcomes.

We have made good progress this year and below are some of the highlights of our achievements:

- an enhanced stakeholder engagement programme;
- a dedicated session on Personal & Business Banking s plan to improve Net Promoter Scores and reduce complaints;
- continuing the integration of sustainable banking into our core businesses and enhancing disclosure of integrated reporting elements in the Strategic Report;
- supporting and challenging management to make tangible progress on culture;
- development of a sustainable banking dashboard to provide the Committee with a consolidated view on RBS s performance in respect of key priorities such as the customer, culture and our reputation, to monitor progress against becoming a truly sustainable bank;
- supporting management in setting more ambitious environmental targets given the excellent progress RBS made in respect of previous targets set on carbon, paper and water;
- encouraging management to consider and understand external benchmarks, surveys and ratings and the insights those provide in terms of RBS s reputation and experience for customers;
- a focus on people, with the Committee holding a spotlight session on the wellbeing agenda, being engaged on our inclusion strategy and the employee value proposition; and
- being consulted on the Modern Slavery Act statement prior to it being published for the first time last year.

In August 2017 we were delighted to welcome Yasmin Jetha as a member of the Committee. Yasmin brings a fresh perspective and enthusiasm for the work that we do. In January 2018 we then welcomed Dr Lena Wilson as a member and with her strong public sector and commercial background is a valuable addition to the Committee.

The efforts to build a responsible and sustainable business are recognised through independent and external measures. Some examples include:

Culture

- Our own measurement surveys correlate with the progress being recognised by the Banking Standards Board culture assessment. We need to maintain momentum and be diligent in identifying and taking action in weaker areas.

Customers

- With clearer customer segmentation in place, good progress is being made in meeting the needs and expectations of NatWest and RBS Premier customers and those customers looking to buy a home. The significant trend to online is supported by our leading mobile app and digital banking propositions for business and commercial customers.

People

- It is pleasing that RBS is recognised for being an attractive employer and has been rated a Top Global Stonewall Employer. The Committee recognises the importance of making RBS a great place to work.

Brand & Communications

- The Committee recognises the importance of the brand strategy. It is pleasing to see the progress made in key metrics, with brand reputation of NatWest and Royal Bank of Scotland reaching a 5 year high in July 2017.

ESE Issues

- While we saw a drop in our Dow Jones Sustainability Index rating this year we have retained our place in the FTSE4GOOD index and achieved a leadership category listing in the Carbon Disclosure Project Index (A-) for the second year running.

My thanks go to the Committee members and attendees for their contribution and support throughout the year. I am also delighted that the proactive work being done by our Sustainable Banking team has been recognised externally, with the award of Sustainability Team of the Year at the Ethical Corporate Responsible Business Awards.

As you will have seen earlier in the report, I intend to stand down as a director of RBS in the coming months. I have thoroughly enjoyed my time as Chairman of SBC and have been pleased by the progress and positive changes that are underway as we remain committed to building a sustainable bank that is focused on delivering for a diversity of stakeholders. I look forward to handing over the role of Committee Chairman to Mike Rogers who has been an engaged and valuable member of SBC since 2016.

Penny Hughes

Chairman of the Sustainable Banking Committee

22 February 2018

Report of the Sustainable Banking Committee

Report of the Sustainable Banking Committee

Meetings

The Sustainable Banking Committee held six scheduled Committee meetings in 2017 which were attended by the Chairman, senior representatives from the customer-facing franchises as well as Human Resources, Sustainability, Risk, Conduct & Restructuring, Communications & Marketing, and the Chief Economist.

Stakeholder engagement

The Committee runs a proactive engagement programme and in 2017 met with twenty external stakeholders. The purpose is to listen and understand where RBS could do more.

In 2017 we held four such external engagement sessions covering the following topics:

- how digital tools and programmes can enhance financial capability and the opportunity for RBS to take a leadership role in this area;
- housing affordability and the role RBS could play in helping to address the housing crisis;
- how RBS could develop its approach and strategies to manage climate change risk; and
- the risks and opportunities that technological disruption brings.

We enhanced our engagement programme in 2017 gaining first hand insight into digital and FinTech centred transformation and its impact on customer behaviour. This was complemented by an additional session with management on open banking. This is an increasing area of interest and focus for RBS and it is important that SBC has a detailed understanding of the opportunities and issues this presents.

The Committee also recognises the importance of engaging with a wide range of stakeholders so members visited Business Banking and Mortgages during 2017, providing valuable frontline colleague and customer insight. We also hosted a lunch with representatives from our Employee Led Networks. This allowed the Committee to hear first hand what it feels like to work for RBS. The themes from this session were reported to the Board to provide insight into the issues facing our employees.

Following the sessions opportunities for follow up, further engagement and challenge to management are identified. In December, we welcomed back a number of our past stakeholders to share the progress made and to continue engagement.

Membership

During 2017 The Sustainable Banking Committee consisted of five independent non-executive directors. The Chairman and members of the SBC, together with their attendance at scheduled meetings in 2017, are shown below.

	Attended/ scheduled
Penny Hughes (Chairman)	6/6
Alison Davis	6/6
Robert Gillespie	6/6
Mike Rogers	6/6
Yasmin Jetha(1)	3/3

Note:

(1) Appointed to the Committee with effect from 3 August 2017.

Performance evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the SBC, was conducted internally in 2017. The SBC has considered and discussed the outcomes of this evaluation and accepts the findings. Overall the review concluded that the SBC continued to operate effectively.

The feedback from both members and attendees was very positive, although there was some room for improvement in the information received by the SBC. It was suggested that the scope of SBC could be reviewed to ensure its role is clearly defined and understood as its remit has evolved over the last year.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress during the year.

Role and responsibilities of the Sustainable Banking Committee

Authority is delegated to the SBC by the Board and the SBC reports and makes recommendations to the Board as required. The terms of reference of the SBC are available on rbs.com and these are reviewed annually and approved by the Board. A regular report on the activities of the SBC in fulfilling its responsibilities is provided to the Board.

The principal responsibilities of the SBC are shown below:

Culture and People

- to receive a regular culture measurement report to monitor progress of embedding the Board approved culture;
- to understand areas of the business where there is an opportunity to improve, supporting and challenging management on their plans;
- to receive updates on what RBS is doing in areas such as wellbeing and inclusion, which form part of how it feels to work here;

Customer

- to oversee customer centricity priorities and how RBS is supporting and engaging with key customer segments;
- to oversee progress being made to achieve the long term target of being number one for customer service, trust and advocacy in each of our chosen businesses;
- to receive updates on complaints including understanding how management is addressing the root causes and how that impacts the customer experience;

Brand & Communications

- to oversee the brand strategy in embedding the bank of brands approach focusing on building equity in our customer brands;
- to oversee actions being taken by management to manage RBS s reputation with reference to how RBS is viewed by our customers, consumers and related interest groups;

ESE Issues

- to consider RBS s environmental strategy and progress against its environmental targets;
- to understand what RBS is doing for financial capability and how we operate in our communities; and
- our wider sustainable banking strategy.

Directors Remuneration Report

Directors   Remuneration Report

Annual statement from Robert Gillespie
Chairman of the Group Performance and Remuneration Committee

the new policy creates a simpler way of aligning the interests of executives with shareholders

Dear Shareholder,

This is my first report as Chairman of the Committee and I would like to start by thanking my predecessor, Sandy Crombie, for all his hard work. Sandy joined the Committee in 2009 and served as Chairman from 2014 until the end of 2017, helping to oversee a great number of positive changes in remuneration practices at RBS. He was also instrumental in introducing a new directors   remuneration policy at the 2017 AGM.

I would also like to thank shareholders for their feedback during the development of the policy and for the high level of support received at the AGM. It is right that RBS should continue to be at the forefront of pay reforms and I believe the new policy creates a simpler way of aligning the interests of executives with shareholders. It continues our restrained approach to executive pay and is in line with the growing consensus for companies to develop more tailored remuneration arrangements.

We have moved to a long-term incentive structure with much lower maximum potential awards and where the performance of our executives is assessed on what they reasonably should be expected to achieve, while operating within our risk appetite. This helps to create more predictable outcomes and encourages safe and secure growth.

The policy also supports our cultural aim of making sure that remuneration encourages the right behaviours. Executives are required to build up larger shareholdings and retain them for longer. This creates stronger alignment with the experience of shareholders both during and after employment.

Implementation of policy for executive directors in 2018

No changes are being made at this time to the fixed pay arrangements for executive directors. Variable pay continues to be delivered entirely in shares as long-term incentive (LTI) awards with no annual bonus. Members of the Executive Committee are on a similar remuneration construct.

The first LTI awards under the new policy will be granted in early 2018, following an assessment of performance over 2017. The assessment determined that overall performance had been strong, particularly in relation to financial and people & culture measures, but a modest downwards adjustment was considered appropriate as the desired risk and customer performance had not been achieved in full. Details of the assessment against the objectives and the award levels can be found in the report.

A further assessment will be undertaken after three years to ensure that sustainable performance has been delivered prior to vesting. Subject to this assessment, the shares will vest in equal amounts over years three to seven from the date of grant, followed by an additional 12 month retention period post vesting.

Financial performance and pay decisions for 2017

It is clear we have a strong underlying business capable of generating profits and sustainable returns for shareholders. Income has risen, costs have fallen and our capital strength has improved further during the year. A number of legacy issues were settled in 2017 including the rights issue litigation and the Federal Housing Finance Agency settlement relating to RMBS. In addition, approval was obtained for the alternative remedies package for the business previously described as Williams & Glyn. Efforts continue to be made to resolve the outstanding RMBS litigation though the timetable for resolution is outside of the control of management.

For executive directors, performance has been assessed for the long-term incentive plan granted in 2015 following the end of the performance period. The vesting reflects improvements in the Economic Profit, CET1 ratio and people measures, with adjustments in areas where performance did not meet targets over the three year period, such as total shareholder return.

In terms of other pay decisions, the bonus pool for 2017 is £342m, which is £1m lower than 2016, reflecting our transition to simpler and more stable pay structures. The average bonus amounts remain relatively modest with 68% of all bonuses awarded amounting to £5,000 or less. Immediate cash bonuses continue to be limited to £2,000. Since 2010, the bonus pool has reduced by around 75% as a result of decisions taken by the Committee and the move towards a smaller bank with a culture focused on service excellence rather than sales.

Broader pay policy

The Committee also oversees the broader employee pay policy. We continue to make good progress in ensuring that employees are paid fairly and are supported by simple and transparent pay structures. Over the last two years we have removed variable pay for frontline and clerical employees with increases to their fixed pay instead, which provides greater certainty. As a result, 26,500 employees are compensated solely by fixed pay and benefits. Our rates of pay exceed the Living Wage and changes have been introduced so that people performing similar roles are paid more consistently.

We believe that having an engaged and inclusive workforce is a key part of a successful business. I am greatly encouraged by the latest employee engagement score which has risen significantly during 2017 and is now above the Global Financial Services norm. We are confident that we pay our employees fairly. We keep our HR policies and processes under review to ensure we do so. Gender Pay Gap information is also being included for the first time as part of the Strategic Report section, along with the steps we are taking to address the position.

Looking ahead

Arrangements will be put in place in 2018 to provide additional oversight of remuneration across key RBS entities post ring-fencing. In addition, the government s proposed governance and executive pay reforms are due to be finalised in the coming months. We welcome the proposals and are currently considering the most effective mechanisms to supplement our existing channels for the employee voice to be heard at Board level.

We remain strong supporters of reforms aimed at improving the effectiveness and transparency of pay structures. I look forward to working with the Committee in considering how we can continue to develop remuneration practices at RBS.

Robert Gillespie

Chairman of the Group Performance and Remuneration Committee

22 February 2018

Directors Remuneration Report

Summary of the remuneration policy for executive directors approved at the 2017 AGM

This page provides a summary of the key design features of the approved policy followed by an outline of how the policy will be implemented for executive directors in 2018.

Change in maximum remuneration opportunity under the new policy

Directors Remuneration Report

Policy implementation 2018 remuneration arrangements

The salary, benefits, pension and fixed share allowance arrangements remain unchanged from 2017. The LTI award to be granted in 2018 is the first award under the new policy, with a significantly lower maximum award level and a pre-grant assessment based on performance during 2017. A further assessment will also take place three years after grant to consider if sustainable performance has been delivered or if anything has come to light that would impact the vesting level or lead to a cancellation of the award.

	Salary	Standard benefits	Pension	Fixed share allowance	2018 LTI award (after pre-grant assessment set out below)
Ross McEwan	£1,000,000	£26,250	£350,000	£1,000,000	£1,575,000
Ewen Stevenson	£800,000	£26,250	£280,000	£800,000	£1,440,000

Pre-grant performance assessment for 2018 LTI awards

A summary of the assessment is set out below and further details can be found in the annual report on remuneration. The Committee assessed performance against pre-set objectives for 2017, across the core areas of Finance, Risk & Operations, Customers and People & Culture. The Committee considered whether the executive directors had achieved what would reasonably have been expected over the period and then applied its judgement without reference to formulaic targets and weightings.

Financial	Risk & Operations	Customers	People & Culture
Strong financial performance with all of the pre-grant objectives met for 2017. Cost savings of £810m were achieved against a target of £750m, the core franchises achieved adjusted RoTE that met the target of at least 11% and the CET1 ratio was 15.9% against the target of 13%.	Continued improvements in risk profile and culture. There was an increase in the number of franchises and functions achieving the desired control rating of 2, although this hadn t been reached across every area. Work is well underway in readiness for ring-fencing and the required legal entity changes. The programme remains on track with the critical path still delivering to plan.	NPS performance during 2017 was on-target in 4 of our 6 chosen customer segments. While progress had been made, there was still some room for improvement on NPS scores in certain segments. Customer Trust performance was ahead of target in 2 out of the 5 chosen segments with improvements in 2 further segments.	Employee engagement and leadership scores increased significantly in 2017, with RBS above the Global Financial Services norm. Employee engagement was up 7 points on 2016 and was our highest score to date. Improvements were also made in the assessment of culture under the Banking Standards Board survey together with satisfactory progress towards our target of >30% women in senior roles by 2020.
After considering all the factors above, and taking into account input provided by the Board Risk Committee and the Sustainable Banking Committee, the Committee determined that strong overall performance had been achieved in 2017. All financial objectives had been met or exceeded along with significant improvement across people & culture measures. However, while progress had been made across all areas, the			

Committee concluded that a modest reduction would be appropriate to recognise that the desired risk and customer performance had not been achieved in full. As a result, the Committee determined that a 10% reduction should be applied under the pre-grant assessment for the Chief Executive and the Chief Financial Officer.

Timing of remuneration payments

The percentage vesting boxes in the diagram above show when the share awards are released following the end of the applicable vesting and retention periods.

Directors Remuneration Report

Key features of the remuneration policy for executive directors

The Directors Remuneration Policy was approved by shareholders at the AGM on 11 May 2017. The policy will apply until the 2020 AGM unless changes are required which mandate a revised policy be submitted to shareholders for approval. The table below summarises the key features of the policy for executive directors. In the event of any conflict the approved policy, which can be found under the Board and Governance section of rbs.com, takes precedence over the information set out below.

Element of pay	Operation	Maximum potential value
Salary To provide a competitive level of fixed cash remuneration and aid recruitment and retention of high performing individuals.	Paid monthly in cash and reviewed annually. The rates for 2018 are unchanged: • Chief Executive - £1,000,000 • Chief Financial Officer - £800,000	Future salary increases will not normally be greater than the average salary increase for RBS employees over the period. Other than in exceptional circumstances, the salary will not increase by more than 15% over the course of this policy.
Fixed share allowance To provide fixed pay that reflects the skills and experience required and responsibilities for the role.	A fixed allowance paid entirely in shares. The shares vest immediately subject to any deductions for tax and are released in equal tranches over a three year retention period.	An award of shares with an annual value of up to 100% of salary at the time of award.
Benefits To provide a range of flexible and market competitive benefits that are valued and assist individuals in carrying out their duties effectively.	Executive directors can select from a range of standard benefits including: company car; private medical cover; life assurance; and critical illness insurance. Executive directors are also entitled to travel assistance in connection with company business including the use of a car and driver. RBS will meet the cost of any tax due on the benefit. Further benefits including relocation costs may be offered in line with market practice. RBS may also put in place certain security arrangements for executive directors.	Set level of funding for standard benefits (currently £26,250) which is subject to review. The total value of benefits provided is disclosed each year in the annual report on remuneration.
Pension		35% of salary for current executive directors.

To encourage planning for retirement and long-term savings.	Provision of a monthly cash pension allowance based on a percentage of salary. Opportunity to use the cash to participate in a defined contribution pension scheme.	25% of salary for new executive directors.
Variable pay award (long-term incentive) To support a culture where individuals are rewarded for the delivery of sustained performance, taking into account RBS s strategic objectives. Delivery in shares with the ability to apply malus adjustments and clawback further supports longer-term alignment with shareholders interests.	LTI awards are subject to: • a one year pre-grant performance period; • a pre-vest performance assessment at the end of a three year period, with vesting taking place from years three to seven after grant; • malus prior to vesting and clawback which applies for seven (and potentially up to ten) years from the date of award; and • a 12 month post-vesting retention period. Performance will be assessed in the areas of Finance, Risk & Operations, Customers and People & Culture to determine whether the executive has achieved what would reasonably have been expected in the circumstances. Risk & Control and Stakeholder Perception underpins will also apply which may lead to downwards adjustment.	The maximum award for current directors is: Chief Executive - 175% of salary. Chief Financial Officer - 200% of salary. Prior performance will be taken into account when determining the value of the award at the time of grant. The vesting level of the award can vary between 0% and 100% dependent on the delivery of sustained performance.
Shareholding requirements To ensure executive directors build and continue to hold a significant shareholding over the long term.	Unvested shares from LTI awards will count on a net of tax basis towards meeting the shareholding requirement once the pre-vest performance assessment has taken place. Directors can dispose of up to 25% of the net of tax shares received until the shareholding requirement is met.	Chief Executive - 400% of salary. Chief Financial Officer - 250% of salary.

Directors Remuneration Report

Remuneration for the Chairman and non-executive directors

Element of pay	Operation	Maximum potential value
Fees To reflect the required skills, experience and time commitment.	Fees are paid monthly in cash and reviewed regularly. Additional fees may be paid for new Board Committees provided these are not greater than fees payable for the existing Board Committees. No variable pay is provided so that the Chairman and non-executive directors can maintain appropriate independence.	The rates for the year ahead are set out in the annual report on remuneration. Other than in exceptional circumstances, fees will not increase by more than 15% over the course of the policy.
Benefits To provide a level of benefits in line with market practice.	Reimbursement of reasonable out-of-pocket expenses. The Chairman and non-executive directors are entitled to travel assistance in connection with company business including the use of a car and driver. RBS will meet the cost of any tax due on the benefit. Other benefits may be offered in line with market practice. The Chairman receives private medical cover.	The value of the private medical cover provided to the Chairman and any other benefits will be in line with market rates and disclosed in the annual report on remuneration.

Other policy elements

Provision	Operation
Recruitment policy	The policy on the recruitment of new directors aims to be competitive and to structure pay in line with the framework applicable to current directors, based on the elements of pay detailed in the policy table, recognising that some adjustment to quantum within that framework may be necessary to secure the preferred candidate. A buy-out policy exists to replace awards forfeited or payments foregone which is in line with regulatory requirements. The Committee will minimise buy-outs wherever possible and ensure they are no more generous than, and on substantially similar terms to, the original awards or payments they are replacing.
Notice and termination provisions	Executive directors RBS or the executive director is required to give 12 months notice to the other party to terminate the executive director s employment. There is discretion for RBS to make a payment in lieu of notice (based on salary only) which is released in monthly instalments. The executive director must take all reasonable steps to find alternative work and any remaining instalments will be reduced as appropriate to offset income from any such work. Chairman and non-executive directors

	The Chairman and the non-executive directors do not have service contracts, they have letters of appointment. They do not have notice periods and no compensation would be paid in the event of termination of appointment, other than standard payments payable for the period served up to the termination date. On an annual basis, all directors stand for election or re-election by shareholders at the company s AGM. Non-executive directors appointed prior to 2017 do not have a set term as the letter of appointment operates on a rolling basis. From 2017 onwards, new non-executive directors have been appointed for an initial term of three years, commencing from the first election by shareholders. At the end of this period, further terms may be agreed, subject to an overall maximum tenure of nine years. The non-executive directors with terms of appointment that will currently expire unless otherwise renewed at the end of three years are: Mark Seligman (2020 AGM), Yasmin Jetha (2021 AGM) and Dr Lena Wilson (2021 AGM).
Legacy arrangements	RBS can continue to honour any previous commitments or arrangements entered into with current or former directors that may have different terms, including terms agreed prior to appointment as an executive director.
Treatment of outstanding employee share plan awards on termination	Share awards will be treated in accordance with the relevant plan rules as approved by shareholders. In line with the remuneration policy approved by shareholders at the 2017 AGM, LTI awards made in 2018 onwards will involve a significant reduction in maximum opportunity and will not be subject to pro rating for time in good leaver circumstances, for the reasons set out below. RBS is unusual in having no annual bonus, and bonus awards would typically not be subject to pro rating for time. In addition, the impact of regulatory requirements effectively constrains the granting of LTI awards in the year of joining. The combination of these factors means that pro rating of time for good leavers results in executives potentially receiving no variable pay award either for the year of joining or in the final year of employment. This is not consistent with our aim of driving shareholder alignment within our pay construct. Removal of pro rating therefore helps to ensure that executive directors are motivated and retain an appropriate long-term focus up to the point of departure. It also creates higher levels of shareholding for up to eight years post departure meaning executives can be held accountable for, and are financially exposed to, the long-term consequences of their actions. Individuals will qualify for good leaver treatment if they leave due to ill-health, injury, disability, death, retirement (as agreed with RBS), redundancy, the employing company ceasing to be a member of RBS, transfer of the employing business, or any other reason if and to the extent the Committee decides in any particular case.

Directors Remuneration Report

Wider employee considerations

The group-wide remuneration policy applies to all employees. Consistent with our executive remuneration principles, the aim is to deliver a simple and transparent pay policy which promotes the long-term success of RBS. The policy supports a culture where employees are rewarded for delivering sustained performance in line with our risk appetite and for demonstrating the right conduct and behaviours. Further details on the group-wide policy can be found on page 102 to 103.

We are committed to building a motivated and inclusive workforce that is engaged and passionate about achieving our ambition. A summary is set out below on some of the initiatives that have taken place to: simplify pay; ensure fair pay; take employees views into account; and deliver a great place to work.

Simplifying pay

Providing a simple pay structure supports employees in doing the right thing for customers, allowing them to concentrate on providing excellent customer service.

Steps we have taken to simplify pay since 2015 include:

- the removal of incentives for frontline employees in UK PBB and Ulster Bank Republic of Ireland.
- the removal of discretionary bonus for all Clerical employees in the UK and Republic of Ireland in 2017 and extending this to equivalent roles in India and Poland from 1 January 2018.
- the removal of discretionary bonus for the vast majority of Appointed employees in the UK and the Republic of Ireland from 1 January 2018.
- in all the above cases, an appropriate adjustment has been made to fixed pay instead.
- reducing the number of salary ranges by around 50%.
- removing the long-term incentive element of pay for employees below Executive Committee level.

Fair pay

RBS will only achieve its ambitions if employees believe the pay they receive is appropriate for the work they do.

Steps we have taken to ensure fairness include:

- setting rates of pay that exceed the Living Wage Foundation Benchmarks.
- ensuring that people doing similar roles are paid consistently.
- implementing a more transparent approach by moving more employees to published salary ranges.
- investing in pay levels in recent years, focusing mostly on our junior employees, while not increasing fixed pay for our executive directors.

We are confident that we pay our employees fairly. We keep our HR policies and processes under review to ensure we do so.

Our Gender Pay Gap information has been published and can be found in the our colleagues section of the Strategic Report.

Great place to work

RBS provides a range of resources and supporting tools to make sure individuals are capable and motivated to perform at their best.

Some of the elements of great place to work include:

- inclusion - employee led groups play a key role in influencing our inclusion strategy. Over 70% of employees have been trained to tackle unconscious bias and the inclusion score from our employee opinion survey is significantly above the Global Financial Services norm.
- flexible working - supporting a positive attitude to flexible working patterns to reflect personal preferences where this can be accommodated.
- wellbeing - support for good physical, mental and financial health.
- excellent training - support with learning, professional development and further qualifications.
- good leadership - equipping managers to help their teams flourish - including our Determined to lead programme which won the Princess Royal training award in 2017.
- RBS*elect* - employees can choose from a range of flexible benefits to help with financial planning and lifestyle choices.
- share ownership - opportunity in the UK and Republic of Ireland to participate in employee share plans, with Sharesave 2017 seeing a 26% increase in participation.
- volunteering - employees are provided with time off to work with charities and local communities.

Further details on our employee initiatives and successes can be found in the our colleagues section of the Strategic Report.

Views of employees

Our main listening tool is the biannual employee opinion survey which collects views on a range of topics including pay, engagement, wellbeing, inclusion and leadership.

The 2017 results showed improvement in the majority of categories. The number of employees who believe they are paid fairly for the work they do increased significantly during the year and is above the Global Financial Services norm.

We also have a number of other mechanisms through which we communicate with employees such as:

- regular engagement with employee representatives including Unite in Great Britain and Offshore, the Financial Services Union in Ulster Bank and our European Employee Council.
- question and answer sessions throughout the year to allow employees to hear from, and provide feedback to, members of the Executive Committee and other senior staff.
- in November 2017, the Chief Executive held his first live streaming question and answer session with employees across RBS and over 150 questions were submitted.
- visits by Board members to business areas to hear directly from employees.
- support for employee-led networks which helps raise awareness and influence strategy in a number of areas.

Proposed reforms to the UK Corporate Governance Code build on the theme of ensuring the employee voice is heard at Board level. We are supportive of the proposals and are currently considering the most appropriate options to enhance our existing channels for employee engagement.

Directors Remuneration Report

How risk is reflected in our remuneration process

RBS 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 and reflective of performance and can be risk-adjusted. Fixed pay is set at an appropriate level to avoid incentives that are adverse to sound risk management.

Focus on risk is achieved through clear risk input into objectives, performance reviews, the determination of variable pay pools and incentive plan design as well as the application of malus and clawback. The Committee is supported in this by the Board Risk Committee (BRC) and the RBS Risk, Conduct and Restructuring function.

A robust process is used to assess risk performance. A range of measures are considered, specifically the overall Risk Profile; Credit, Regulatory and Conduct Risk; Operational Risk; Enterprise Risk; and Market Risk. Consideration is also given to overall Risk Culture. RBS s remuneration arrangements are in accordance with regulatory requirements and the steps we take to ensure appropriate and thorough risk adjustment are also fully disclosed and discussed with the PRA and the FCA.

Variable pay determination

For the 2017 performance year, RBS operated a robust multi-step process which is a control function led assessment to determine performance and therefore the appropriate bonus pool by franchise and function. At multiple points throughout the process, reference is made against Group-wide business performance (from both affordability and appropriateness perspectives) and the need to distinguish between go-forward franchises and resolution activities.

The process considers a balanced scorecard of performance assessments at the level of each franchise or support function. The assessments are made across financial, customer and people measures. Risk and conduct assessments at the same franchise or functional level are then undertaken to ensure that performance achieved without appropriate consideration of risk culture and risk and conduct controls is not inappropriately rewarded.

BRC reviews any material risk and conduct events and, if appropriate, an underpin may be applied to the individual business and function bonus pools or to the overall bonus pool. BRC may recommend a reduction of a bonus pool if it considers that risk and conduct performance is unacceptable or that the impact of poor risk management has yet to be fully reflected in the respective inputs.

Following further review against overall performance and conduct, the Chief Executive will make a final recommendation to the Committee, informed by all the previous steps in the process and his strategic view of the business. The Committee will then make an independent decision on the final bonus pool taking all of these earlier steps into account.

The assessment process for LTI awards to executive directors is founded on the balanced scorecard approach used for the multi-step bonus pool process, reflecting a consistent risk management performance assessment.

Accountability review process and malus/clawback

The accountability review process was introduced in 2012 to identify any material risk management, control and general policy breach failures and ensure accountability for those events. This allows RBS to respond in instances where new information would change the variable pay decisions made in previous years and/or the decisions to be made in the current year.

Under the accountability review process RBS can apply:

- Malus - to reduce (to zero if appropriate) the amount of any unvested variable pay awards prior to payment;
- Clawback - to recover awards that have already vested; and
- In-year reductions - to adjust variable pay that would have otherwise been awarded for the current year.

Any variable pay awarded to Material Risk Takers from 1 January 2015 onwards is subject to clawback for seven years from the date of grant. For awards made in respect of the 2016 performance year onwards, this period has been extended to ten years for executive directors and other Senior Managers under the Senior Managers Regime where there are outstanding internal or regulatory investigations at the end of the normal seven year clawback period.

Circumstances in which RBS may apply malus, clawback or in-year reduction include:

- the individual being culpable, responsible or ultimately accountable for conduct which results in significant financial losses for RBS;
- the individual failing to meet appropriate standards of fitness and propriety;
- reasonable evidence of an individual s misbehaviour or material error;
- RBS or the individual s relevant business unit suffering a material failure of risk management; and
- for malus and in-year reduction only, circumstances where there has been a material downturn in financial performance.

The above list of circumstances is not exhaustive and RBS may consider any further circumstances that it feels appropriate.

During 2017 a number of issues and events were considered under the accountability review framework. The outcomes covered a range of actions including: reduction and forfeiture of unvested awards through malus; dismissal with forfeiture of unvested awards; and suspension of awards pending further investigation. In addition, reductions have also been applied to current year variable pay awards.

Annual report on remuneration

Annual report on remuneration

The sections audited by the company s auditors, Ernst and Young LLP, are as indicated.

Total remuneration paid to executive directors for 2017 (audited)

	Ross McEwan		Ewen Stevenson	
	2017	2016	2017	2016
	£000	£000	£000	£000
Salary	1,000	1,000	800	800
Fixed share allowance (1)	1,000	1,000	800	800
Benefits (2)	113	127	26	26
Pension (3)	350	350	280	280
Total fixed remuneration	2,463	2,477	1,906	1,906
Annual bonus	n/a	n/a	n/a	n/a
Long-term incentive award (4)	1,024	1,225	1,418	
Total remuneration	3,487	3,702	3,324	1,906

Notes:

(1) The value of the fixed share allowance is based on 100% of salary and, as part of fixed remuneration, it is not subject to any performance conditions.

(2) Includes standard benefit funding of £26,250 per annum with the remainder for Ross McEwan in 2017 being travel assistance in connection with company business (£67,006), relocation expenses (£17,065) consisting of a flight allowance and assistance with tax return preparation, and home security arrangements. The 2016 benefits figure for Ross McEwan has been amended to include a value for tax return preparation and home security arrangements during that year.

(3) The executive directors receive a monthly cash allowance to help fund pension arrangements but do not participate in the company s defined benefit pension schemes. The executive directors can choose to participate in the company s defined contribution pension arrangements.

(4) The 2017 value relates to an LTI award granted in 2015. Performance has been assessed over the three year period to 31 December 2017 as set out below together with an estimate of the vesting value. The award will vest in two equal tranches in March 2019 and March 2020. The value for 2016 has been amended from the estimated value of £1,030,000 provided in the 2016 report to reflect the actual value on the vesting date in March 2017.

2015 LTI final assessment of performance measures (audited)

An assessment of performance of each relevant element was provided by internal control functions and PwC assessed relative Total Shareholder Return (TSR) performance against a peer group of comparator banks.

<table>
<tr><th>Performance Measures (and weightings)</th><th>Performance for minimum vesting</th><th>Vesting at minimum</th><th>Performance for maximum (100%) vesting</th><th>Actual Performance</th><th colspan="2">Vesting outcome</th><th>Weighted Vesting %</th></tr>
<tr><td>Economic Profit
(25%)</td><td>(£500 million)</td><td>25%</td><td>£500 million</td><td>£613 million</td><td colspan="2">100%</td><td>25%</td></tr>
<tr><td>Relative TSR
(25%)</td><td>TSR at median</td><td>20%</td><td>TSR at upper quartile</td><td>Below median</td><td colspan="2">0%</td><td>0%</td></tr>
<tr><td>Safe & Secure Bank
(25%)

CET1 ratio - 12.5%

Cost:income ratio 12.5%</td><td colspan="3">Vesting between 0% - 100%

can be qualified by Committee discretion

CET1 ratio target: 13% (or above)

Cost:income ratio target (go-forward bank basis): 56% (or below)</td><td>CET1 ratio: 15.9%

Cost:income ratio: 55%</td><td colspan="2">100%</td><td>25%</td></tr>
<tr><td>Customers & People

(25%)

Split across advocacy, trust and employee engagement

Net Promoter Score (NPS) 6.25%

Net Trust Score (NTS) 6.25%

Engagement Index (EI) 12.5%</td><td colspan="3">Vesting between 0% - 100%

can be qualified by Committee discretion

NPS target: Gap to number 1 of 6.0

NTS target: NatWest 55, RBS 42

EI target: within 2 points of Global Financial Services (GFS) norm</td><td>NPS Gap to number 1 of 15.5

NTS: NatWest 59 RBS 22

EI: 1 point above GFS norm</td><td>0%

70%

100%</td><td>68%</td><td>17%</td></tr>
<tr><td colspan="7">Initial vesting outcome</td><td>67%</td></tr>
<tr><td colspan="7">Final vesting outcome post application of underpin</td><td>60%</td></tr>
</table>

Economic Profit was based on the go-forward basis and defined as operating profit after tax and preference share charges less tangible net asset value multiplied by the cost of equity. The companies in the relative TSR group for this award were: Barclays, Lloyds Banking Group, HSBC, Standard Chartered, BBVA, BNP Paribas, Crédit Agricole, Credit Suisse Group, Deutsche Bank, Santander, Société Générale, UBS, Unicredito. For the Trust metric of the Customers & People section, the NatWest target was met while the RBS target had been missed. The 70% vesting for this element was calculated in line with the weightings of the brands, split 70%/30% for NatWest/RBS, based on the relative revenues of the respective brands.

In making its final judgement, the Committee considered the overall context of performance, noting positive progress on Economic Profit which had exceeded the stretch target and the strong CET1 ratio and took into account input received from the Board Risk Committee. Significant improvement had also been achieved in employee engagement scores which again had exceeded target. However, the Committee also noted that the NPS, Trust for the RBS brand and relative TSR targets had been missed. Taking all circumstances into account, the Committee determined it would be appropriate to apply the underpin and reduce the final vesting outcome from 67% to 60%.

Annual report on remuneration

2015 LTI vesting amounts included in the total remuneration table (audited)

The executive directors were granted an LTI award in March 2015. The performance conditions ended on 31 December 2017 and have been assessed as set out on the previous page. The average share price over the last three months of the financial year has been used to estimate the value. While the performance conditions have been assessed, the shares will not vest until March 2019 and March 2020.

Performance category	% vesting	Maximum shares (1)	Ross McEwan Shares due to vest	Estimated value (2)	Maximum shares (1)	Ewen Stevenson Shares due to vest	Estimated value (2)
Economic Profit	100%	154,624	154,624		214,121	214,121	
Relative TSR	0%	154,624			214,121		
Safe & Secure Bank	100%	154,624	154,624		214,121	214,121	
Customers & People	68%	154,624	105,145		214,121	145,602	
Maximum shares for performance assessment		618,496			856,484		
Initial outcome following assessment (67% vesting)			414,393			573,844	
Final outcome post application of underpin (60% vesting)			371,098	£1,024,230		513,890	£1,418,336

Notes:

(1) The maximum number of shares is calculated in line with the underlying award structure. Each performance category could vest up to 100% of the maximum number of shares subject to the approved policy and the regulatory cap. For the 2015 award, the number of shares capped at grant was 417,486 for Ross McEwan and 578,128 shares for Ewen Stevenson. In both cases the vesting outcomes fall within the respective cap.

(2) Based on a RBS share price of £2.76, the average over the three month period from October to December 2017.

2016 and 2017 LTI awards to executive directors current assessment (audited)

The table represents an early indication of potential vesting outcomes only based on the position at 31 December 2017. Details of the final performance assessment at the end of the three year period and any use of discretion will be disclosed in the remuneration report for the relevant year. The Committee may consider the proximity of legacy items to the executive directors when assessing the vesting level.

Performance measure	Weighting	Performance for minimum vesting	Vesting at minimum	Performance for maximum vesting	Vesting at maximum	2016 LTI award current assessment	2017 LTI award current assessment

Economic Profit	25%	Minimum economic profit targets	25%	Performance ahead of the Strategic Plan	100%	Currently tracking behind target	Currently favourable to target
Relative TSR	25%	TSR at median of comparator group	20%	TSR at upper quartile of comparator group	100%	Below median performance for vesting	Currently upper quartile performance for vesting
Safe & Secure Bank	25%	Target ranges set for: CET1 ratio and Cost:income ratio	Vesting between 0% 100% qualified by Committee discretion taking into account the margin by which targets have been missed or exceeded and any other relevant factors			CET1 ratio is in range for vesting. Cost:income ratio currently tracking behind target	CET1 ratio is in range for vesting. Cost:income ratio currently in range for vesting
Customers & People	25%	Target ranges set for: Net Promoter Score, Net Trust Score and Employee Engagement				Customer measures currently behind target with People measure in range for vesting	Customers & People measures broadly tracking in range for vesting

LTI awards granted during 2017 (audited)

	Grant date	Face value of award (£000s)	Number of shares awarded (1)	% vesting at minimum and maximum	Performance Requirements (2)
Ross McEwan	7 March 2017	2,870	1,188,800	Between 0% - 100% with minimum vesting as set out above	Conditional share awards subject to performance conditions, as set out above, measured over the three year period from 1 January 2017 to 31 December 2019
Ewen Stevenson	7 March 2017	2,305	954,768		

Notes:

(1) The number of shares awarded was calculated in line with the regulatory cap that limits variable pay to the level of fixed pay and for this award equated to approximately 287% of salary. The award price of £2.4142 was calculated based on the average share price over five business days prior to the grant date.

(2) Subject to the achievement of performance conditions, the awards are eligible to vest in four tranches with 50% vesting in 2021 and the remaining 50% split over 2022 to 2024. Malus provisions will apply up until vesting and clawback provisions will also apply for a period of seven years from the date of grant, extended to ten years if events are under investigation at the end of the seven year period.

Annual report on remuneration

Performance assessment framework for LTI awards granted from 2018 onwards

For each of the core performance areas, the Committee will consider whether the executive director has achieved what would reasonably have been expected over the relevant period. The Committee will follow a robust process to review performance against pre-set objectives relevant to RBS s strategic aims, but will apply its judgement without reference to formulaic targets and weightings. Performance will be assessed taking into account circumstances applying over the period. Risk & Control and Stakeholder Perception underpins will also apply under which the Committee, with input from the Board Risk Committee and Sustainable Banking Committee, can consider if there are any other factors that would lead to a downwards adjustment (for example if the achievements are not considered sustainable, or were achieved through excessive risk taking).

The majority of the performance variation will normally take place under the pre-grant assessment, with a further pre-vest assessment to check whether, taking all circumstances into account, a threshold level of sustainable performance has been delivered. Overall, the achievement of reasonable or target performance expectations will deliver full, or nearly full, payout of the LTI awards, as long as executives deliver good, sustainable performance. This approach reflects the significantly reduced level of awards compared to the previous policy, creating more predictable outcomes and encouraging safe and secure growth within risk appetite. Each year, the performance factors will be determined in light of RBS s priorities for that year.

Pre-grant assessment for LTI awards to be made in 2018

Core area	Objectives for 2017	Pre-grant assessment in January 2018
Financial	Achieve a cost reduction of at least £750 million.	Strong financial performance with all targets exceeded for 2017. Year on year cost savings of £810 million were achieved, adjusted RoTE was above the target and the CET1 ratio was 15.9%.
	Reasonable performance against budget for the core franchises with adjusted RoTE of at least 11%. CET1 ratio of 13% or more.	
Risk & Operations	RBS blended risk profile of 2; Franchise/ Function control environment rated within appetite at 2, or minimum 3 tracking to 2 within 12 months.	Continued improvements in risk profile with an increase in the number of franchises and functions rated at 2. While progress had been made, the ultimate desired control rating hadn t been reached across every franchise and function.
	Risk Culture to be rated at 3 (Proactive) on a blended basis, with strong tone from the top.	Risk Culture was assessed overall as Proactive with a small number of exceptions.
	Strong oversight of ring-fencing, ensuring timely remediation of issues and maintain delivery as planned.	Work is well underway in readiness for ring-fencing and the required legal entity changes. The programme remains in line with plan for delivery.

Customers	Increase or maintain number 1 for Net Promoter Scores and increase Trust Scores in our chosen segments.	NPS performance during 2017 was on-target in 4 out of 6 customer segments. While progress had been made, there was still room for improvement on NPS scores and on closing the gap to number 1 in certain segments. Trust was ahead of target in 2 out of the 5 segments with improvements in 2 further segments.
People & Culture	Improvement in employee engagement and leadership scores.	Engagement score increased 7 points and the leadership score increased 5 points since 2016, with both above the Global Financial Services norm. The employee opinion survey showed the best results for 10 years.
	Year on year improvement from the Banking Standards Board (BSB) assessment.	Scores from the BSB survey improved on all items compared to 2016, demonstrating an improved culture throughout the business.
	Progress towards target of >30% women in senior roles by 2020	Satisfactory progress had been made. The target population (top three leadership layers) had increased to 37%, representing an 8% increase since targets were introduced at the end of 2014.

Outcome of the assessment

The Committee also received advice from the Board Risk Committee and the Sustainable Banking Committee in making its final assessment. After considering all the factors above, the Committee determined that good performance and progress towards our long-term goals had been achieved in 2017. Performance had been very strong in relation to financial and people & culture measures but, on balance, a 10% reduction was considered appropriate as risk and customer performance was not fully at the desired level. The resulting award levels are set out below.

	Maximum LTI award level	2018 LTI award level after pre-grant assessment
Chief Executive	£1,750,000	£1,575,000
Chief Financial Officer	£1,600,000	£1,440,000

Annual report on remuneration

Pre-vest assessment for 2018 LTI awards

In addition to the pre-grant assessment detailed on the previous page, a further assessment of performance will take place three years after grant, in 2021, prior to vesting. It is intended to be a look-back at the performance year for which the LTI award was granted to consider whether anything has come to light that would impact the vesting level. The over-arching principle is that delivery of a threshold level of sustainable performance will result in no further adjustment prior to vesting. Once the vested amount has been approved, malus and clawback provisions will continue to apply.

The pre-vest assessment allows the Committee to make a balanced assessment of performance in the round rather than relying on formulaic adjustments. It is to provide comfort that sustainable performance has been delivered since the award, and that nothing new has come to light which might call into question the original award. Adjustments will also be made in the event of underperformance or required risk adjustment.

Factors considered in assessing pre-vest performance

Four core questions will be considered as part of the pre-vest assessment under the themes of Finance; Customers; People; and Risk & Control. When assessing the performance of the year for which the award was made, knowing what we know now and taking into account all circumstances, has RBS:

(1) Remained safe and secure, taking into account our financial results and capital position?

(2) Been a good bank for customers taking into account our customer and advocacy performance?

(3) Operated in an environment in which risk is seen as part of the way we work and think?

(4) Operated in a way that reflects our stated values?

In addition, the Committee will consider the potential application of Risk & Control and Stakeholder Perception underpins following advice from the Board Risk Committee and Sustainable Banking Committee. This provides scope to consider significant risk, stakeholder or reputational matters not already captured in the performance assessment.

In determining the final vesting level of the award, the Committee will consider both individual and collective performance which means that there may be different vesting levels by participant. If a threshold level of sustainable performance has been delivered then no further assessment is required and the award vests in full.

Objectives for Performance Year 2018 (for the pre-grant assessment of LTI awards to be made in 2019)

The table below forms the basis of the pre-grant assessment for LTI awards to be made in early 2019. Further details on the 2018 objectives and targets and the assessment of performance against these will be set out in the 2018 Directors Remuneration Report.

Core area	Description of 2018 Objectives	Measures for assessing pre-grant performance for 2019 LTI awards
Financial & Business Delivery	Run a safe and secure bank	Achieve planned reduction in operating expenses
		Reasonable performance against budget and RoTE target
		Achieve CET1 ratio target
	Implement ring-fencing	Delivery of ring-fencing requirements to satisfy the 1 January 2019 implementation, ensuring timely remediation of issues throughout.
Risk & Control	Improve governance and control environment	Franchise and function control environment to meet the required rating within appetite
	Material progress towards our desired risk culture	Achieve the desired Risk Culture rating with strong tone from the top
Customer & Stakeholder	Achieve planned progress towards becoming number 1 for customer service, trust and advocacy by 2020 in chosen customer segments and brands	Net Promoter Score to evidence progress towards or maintaining the number 1 position in our chosen segments and brands
People & Culture	Provide clarity, build capability and motivate our people	Year on year improvement in scores from employee engagement and leadership indices
	Build up and strengthen a healthy culture	Culture measured against position in Culture index
		Progress towards 2020 target of number of women in senior roles (at least 30% for each franchise and function)
		Progress towards 2025 target of number of Black Asian Minority Ethnic (BAME) UK employees in the top four layers of RBS (at least 14% for each franchise and function)

Annual report on remuneration

Payments for loss of office (audited)

No payments for loss of office were made to directors during 2017.

Payments to past directors (audited)

There are no payments to past directors to disclose for 2017.

Total remuneration paid to the Chairman and non-executive directors for 2017 (audited)

The US Risk Committee was stood down in May 2017. The Board established a Technology and Innovation Committee with effect from 1 September 2017. This demonstrates the importance the Board places on overseeing and monitoring RBS s strategic direction in relation to technology and innovation. Fees for non-executive directors sitting on the NatWest Markets Working Group, which considers transitional arrangements in preparation for the establishment of the NatWest Markets Board, were brought into line with the other main Board Committees. A Board Oversight Committee was established in September 2017 in order to provide oversight of required enhancements to the governance and risk management practices within Ulster Bank Ireland DAC reporting to the Board, as appropriate. Fees were payable for this Committee with effect from 1 October 2017.

The total fees paid during 2017 are set out below.

	Fees		Benefits		Total	
	2017	2016	2017	2016	2017	2016
Chairman (composite fee)	£000	£000	£000	£000	£000	£000
Howard Davies (1)	750	750	11	8	761	758

Non-executive directors (2)	Noms & Gov £000	GRG BOC £000	UBI DAC BOC	Fees 2017	Fees 2016	Benefits 2017	Benefits 2016	Total 2017	Total 2016
				£000	£000	£000	£000	£000	£000

	Board £000		GAC £000	RemCo £000	BRC £000	SBC £000	TIC £000	NWM £000		£000	Other £000						
Sandy Crombie (3)	77	15	30	60					15	4	30	231	223	30	38	261	261
Frank Dangeard	77				30		10	18				135	58	3	4	138	62
Alison Davis (4)	77	10		30		30	20					167	147	30	21	197	168
Morten Friis (3)	77		30		30						11	148	159	42	39	190	198
Robert Gillespie	77	15		30		30		30	15			197	210	11	10	208	220
John Hughes (5)																	
Penny Hughes (4)	77	5			30	60			15			187	178	11	8	198	186
Yasmin Jetha (5)	42					13	10					65		2		67	
Brendan Nelson	77	15	60		30				30	4		216	211	23	31	239	242
Baroness Noakes (3)(4)	77	5	30		60				15	4	5	196	192	16	8	212	200
Mike Rogers	77			30		30						137	88	16	11	153	99
Mark Seligman (4)(5)	59	5								4		68		4		72	

Notes:

(1) The benefits column for Howard Davies includes private medical cover.

(2) In line with market practice, non-executive directors are reimbursed expenses incurred in connection with travel and attendance at Board meetings. HMRC has confirmed that it deems these expenses as taxable where the Board meetings take place at the company s main offices in London and Edinburgh. The value in the benefits column above, including restated amounts for 2016, is the value of the assistance provided together with the associated tax liability which RBS settles on behalf of the non-executive directors.

(3) Under the Other column, Sandy Crombie received fees as the Senior Independent Director. Morten Friis and Baroness Noakes received fees in respect of the US Risk Committee until it was stood down on 11 May 2017.

(4) Alison Davis stepped down from the Nominations and Governance Committee and Penny Hughes, Baroness Noakes and Mark Seligman were appointed to the Nominations and Governance Committee during the year.

(5) Mark Seligman joined the Board on 1 April 2017 and Yasmin Jetha joined the Board on 21 June 2017. John Hughes joined the Board on 21 June 2017 but stepped down with effect from 1 September 2017 due to health reasons. Mr Hughes made a voluntary decision to repay the fees that he received for this period.

Key to table:

Noms & Gov	Group Nominations and Governance Committee
GAC	Group Audit Committee
RemCo	Group Performance and Remuneration Committee
BRC	Board Risk Committee
SBC	Sustainable Banking Committee
TIC	Technology and Innovation Committee
NWM	NatWest Markets Working Group
GRG BOC	Board Oversight Committee for the GRG business areas
UBI DAC BOC	Board Oversight Committee for the Ulster Bank Ireland business

Annual report on remuneration

Implementation of remuneration policy in 2018

Details of remuneration to be awarded in 2018 to executive directors are set out below. The salary, benefits, pension and fixed share allowance arrangements are unchanged from 2017. The LTI award is due to be granted in March 2018 following the pre-grant assessment of performance over 2017. Details of the assessment are set out on page 93. Subject to a further pre-vest assessment of performance at the end of three years, the award will vest in equal amounts between years three to seven from the date of grant. LTI awards are also subject to malus during the vesting period and clawback provisions for a period of seven years from the date of grant, extended to ten years if events are under investigation at the end of the normal seven-year clawback period.

Executive directors remuneration to be awarded in 2018

	Salary	Standard benefits	Pension 35% of salary	Fixed share allowance 100% of salary (1)	LTI award following pre-grant assessment
Chief Executive	£1,000,000	£26,250 (2)	£350,000	£1,000,000	£1,575,000
Chief Financial Officer	£800,000	£26,250	£280,000	£800,000	£1,440,000

Notes:

(1) Fixed share allowance will be payable broadly in arrears, currently in two instalments per year, and the shares will be released in equal tranches over a three year period.

(2) Amount shown relates to standard benefit funding. Executive directors are also entitled to benefits in line with the stated policy including assistance with travel and security arrangements and the Chief Executive is entitled to a flight allowance and assistance with tax return preparation as part of his relocation arrangements. The value of benefits will be disclosed each year in the total remuneration table.

Chairman and non-executive directors fees for 2018

The level of fees for attendance at Board and Board Committee meetings remains unchanged from 2017. A summary of the annual fees payable for 2018 is set out below.

Chairman (composite fee)		£750,000
Non-executive director basic fee		£80,000
Senior Independent Director		£30,000
Board Risk Committee		
Group Audit Committee		
Group Performance and Remuneration Committee	Member	£30,000
Sustainable Banking Committee	Chairman	£60,000
Technology and Innovation Committee		
NatWest Markets Working Group		
GRG Board Oversight Committee	Member	£15,000
	Chairman	£30,000
Ulster Bank Ireland DAC Board Oversight Committee	Member	£15,000
Group Nominations and Governance Committee	Member	£15,000

Other directorships

Agreement from the Board must be sought before directors accept any additional roles outside of RBS. Procedures are in place to make sure that regulatory limits on the number of directorships held are complied with. The Board would also consider whether it was appropriate for executive directors to retain any remuneration receivable in respect of any external directorships, taking into account the nature of the appointment.

Neither of the executive directors holds a non-executive director role at any other company at this time. Details of the directorships held by other directors can be found in the biographies section of the corporate governance report.

Directors interests in RBS shares and shareholding requirements

The shareholding requirement is to hold shares to the value of 400% of salary for the Chief Executive and 250% of salary for the Chief Financial Officer. Unvested shares from LTI awards will count on a net of tax basis towards meeting the shareholding requirement once the pre-vest performance assessment has taken place, at the end of the three year period. Once the respective retention periods have passed, directors are permitted to dispose of up to 25% of the shares received until the shareholding requirement is met. As set out below, the executive directors exceeded the shareholding requirement as at 31 December 2017. There are no shareholding requirements for non-executive directors.

Annual report on remuneration

Shareholding requirements for executive directors

Notes:

(1) Ross McEwan holds 201,189 shares from his 2015 and 2016 fixed share allowances that are included in the total shares beneficially owned below but these have been excluded from the shareholding requirements calculation as he will transfer these shares to charity at the end of the retention period.

(2) Value of shares held is based on the share price of £2.78 as at 31 December 2017. During the year ended 31 December 2017, the share price ranged from £2.15 to £2.86.

Share interests held by directors (audited)

	Shares owned at 31 December 2017 (or date of cessation if earlier)	% of issued share capital	Value (£) (1,2)	% of shareholding requirement met (3)	Unvested Long-term incentive awards	Unvested Deferral Plan awards
Ross McEwan	2,052,193	0.017152	£5,145,791	514.6%	2,793,493	
Ewen Stevenson	1,103,940	0.009227	£3,068,953	383.6%	2,485,320	
Howard Davies	41,000	0.000343				
Sandy Crombie	20,000	0.000167				
Frank Dangeard						
Alison Davis	20,000	0.000167				
Morten Friis (4)	20,000	0.000167				
Robert Gillespie	25,000	0.000209				
John Hughes						
Penny Hughes	562	0.000005				
Yasmin Jetha						

Brendan Nelson	12,001	0.000100
Baroness Noakes	41,000	0.000343
Mike Rogers		
Mark Seligman	20,000	0.000167

Notes:

(1) Ross McEwan holds 201,189 shares from his 2015 and 2016 fixed share allowances that are included in the total shares beneficially owned but these have been excluded from the shareholding requirements calculation as he will transfer these shares to charity at the end of the retention period.

(2) Value of shares held is based on the share price of £2.78 as at 31 December 2017. During the year ended 31 December 2017, the share price ranged from £2.15 to £2.86.

(3) The current shareholding requirement is to hold shares to the value of 400% of salary for the Chief Executive and 250% of salary for the Chief Financial Officer. Unvested shares from LTI awards will count on a net of tax basis towards meeting the shareholding requirement once the pre-vest performance assessment has taken place, at the end of the three year period. Once the respective retention periods have passed, directors are permitted to dispose of up to 25% of the shares received until the shareholding requirement is met. The executive directors exceeded the shareholding requirement as at 31 December 2017. There are no shareholding requirements for non-executive directors.

(4) Interest is 10,000 American Depository Receipts representing 20,000 ordinary shares.

The interests shown above include shares held by persons closely associated with the directors. As at 22 February 2018, there were no changes to the directors interests in shares shown above. John Hughes stepped down from the Board on 1 September 2017 and did not hold any RBS shares at the date of cessation. Sandy Crombie stepped down from the Board with effect from 1 January 2018. Dr Lena Wilson joined the Board with effect from 1 January 2018 and as at 22 February 2018 she did not hold any RBS shares.

Directors interests under the company s share plans (audited)

Long-term incentive awards

	Awards held at 1 January 2017	Awards granted in 2017	Award price £	Awards lapsed in 2017	Awards vested in 2017	Market price on vesting £	Value on vesting £	Awards held at 31 December 2017	Expected vesting date	
Ross McEwan	915,193		3.28	402,684	512,509	2.39	1,224,897			
	417,486		3.74					417,486	06.03.19	06.03.20
	1,187,207		2.26					1,187,207	08.03.20	08.03.21
		1,188,800	2.41					1,188,800	07.03.21	07.03.24
	2,519,886	1,188,800		402,684	512,509			2,793,493		
Ewen Stevenson	288,257(1)		3.27		288,257	2.39	688,934			
	578,128		3.74					578,128	06.03.19	06.03.20
	952,424		2.26					952,424	08.03.20	08.03.21
		954,768	2.41					954,768	07.03.21	07.03.24
	1,818,809	954,768			288,257			2,485,320		

Note:

(1) Award granted to Ewen Stevenson on appointment in May 2014 to replace awards forfeited on leaving Credit Suisse.

Annual report on remuneration

Total Shareholder Return (TSR) performance

The graph below shows the performance of RBS over the past nine years in terms of TSR compared with that of the companies comprising the FTSE 100 Index. This index has been selected because it represents a cross-section of leading UK companies. The TSR for FTSE UK banks for the same period has been added for comparison. *Source: Datastream*

Chief Executive pay over same period

	2009	2010	2011	2012	2013 (1)	2014	2015	2016	2017
Total remuneration (£000s)	1,647	3,687	1,646	1,646	393 (RM) 1,235 (SH)	1,878	3,492	3,702	3,487
Annual bonus against maximum opportunity	0%	85%	0%	0%	0%	n/a	n/a	n/a	n/a

LTI vesting rates against maximum opportunity	0%	0%	0%	0%	0%	73%	62%	56%	89%

Notes:

(1) 2013 remuneration includes Stephen Hester (SH) as Chief Executive for the period to 30 September and Ross McEwan (RM) for the period from 1 October to 31 December.

(2) Figures have been amended where appropriate to reflect any restatement of prior year amounts, for example, to reflect the actual rather than estimated value of LTI vestings as part of the total remuneration figure and any revisions to the value of benefits provided.

(3) The maximum opportunity is set according to the approved policy and, for LTI awards granted in 2015 and onwards, the regulatory cap.

Change in Chief Executive pay compared with employees

The table below shows the percentage change in remuneration for the Chief Executive between 2016 and 2017 compared with the percentage change in the average remuneration of RBS employees based in the UK. In each case, remuneration is based on salary, benefits and annual bonus. The Chief Executive also receives a fixed share allowance as part of his fixed pay and this remains unchanged over the period.

	Salary 2016 to 2017 change	Benefits 2016 to 2017 change	Annual Bonus 2016 to 2017 change
Chief Executive (1)	0%	0%	n/a
UK employees (2)	3.91%	3.32%	10.69%

Notes:

(1) Executive directors are not eligible for an annual bonus. Standard benefit funding for executive directors remained unchanged between 2016 and 2017. The benefits for the Chief Executive excludes other benefits such as travel assistance in connection with company business and relocation benefits, the value of which is disclosed each year in the total remuneration table.

(2) The data represents full year average salary costs of the UK based employee population, which covers the majority of RBS employees and is considered to be the most representative comparator group. The increase in the average annual bonus is driven in part by the one time impact of the removal of LTI eligibility for employees below the Executive Committee in 2017, with these employees now eligible for an annual discretionary bonus award only.

Annual report on remuneration

Relative importance of spend on pay

The table below shows a comparison of remuneration expenditure against other distributions and charges.

	2017 £m	2016 £m	change
Remuneration paid to all employees (1)	4,217	4,670	(10%)
Distributions to holders of ordinary shares			
Distributions to holders of preference shares and paid-in equity (2)	628	1,697	(63%)
Taxation and other charges recognised in the income statement:			
- Social security, Bank levy and Corporation tax	1,100	747	47%
- Irrecoverable VAT and other indirect taxes incurred by RBS (3)	533	697	(24%)

Notes:

(1) Remuneration paid to all employees represents total staff expenses per Note 3 to the Financial Statements, exclusive of social security and other staff costs.

(2) Includes final payment relating to the Dividend Access Share of £1,193 million in 2016.

(3) Input VAT and other indirect taxes not recoverable by RBS due to it being partially exempt.

The items above have been included as they reflect the key stakeholders for RBS and the major categories of distributions and charges made by RBS.

Consideration of matters relating to directors remuneration

Membership of the Group Performance and Remuneration Committee

All members of the Committee are independent non-executive directors. The Committee held seven scheduled meetings in 2017 and a further three ad hoc meetings.

	Attended/ scheduled
Alison Davis	7/7

Robert Gillespie	7/7
Mike Rogers	6/7
Former member	
Sandy Crombie (Chairman)	7/7

Mike Rogers was unable to attend one of the meetings due to personal reasons. Sandy Crombie stepped down from the Committee and the Board with effect from 1 January 2018. At the same time, Robert Gillespie assumed the role of Chairman of the Committee and Mark Seligman became a member of the Committee.

The role and responsibilities of the Committee

The Committee is responsible for:

- approving the remuneration policy for all employees and reviewing the effectiveness of its implementation;
- reviewing performance and making recommendations to the Board on remuneration arrangements for executive directors;
- approving remuneration arrangements for members and formal attendees of the Executive Committee (including control function heads) and employees with total annual compensation which exceeds an amount determined by the Committee, currently £1 million; and
- setting the remuneration framework and principles for employees identified as Material Risk Takers falling within the scope of UK regulatory requirements.

In mitigating potential conflicts of interest, directors are not involved in decisions regarding their own remuneration and remuneration advisers are appointed by the Committee rather than management. The terms of reference of the Committee are reviewed annually and available on rbs.com.

Summary of the principal activity of the Committee in 2017

In addition to its usual business activities, in 2017 the Committee was actively involved in developing the new directors remuneration policy with key stakeholders. Set out below is a summary of the Committee s other key considerations throughout the year.

First half of 2017

- 2016 performance reviews and remuneration arrangements for executive directors, Executive Committee members and attendees, and high earners.
- Executive Committee members 2017 objectives.
- Development of the future pay construct for Executive Committee members.
- Approval of variable pay allocations and the 2016 Directors Remuneration Report.
- Review of the vesting levels for LTI awards granted in 2014 and the interim assessment of 2015/16 LTI awards.
- Updates on changes in regulation and the regulatory attestation process.
- Review of domestic and international peer group pay and remuneration disclosures.

- Progress update on the Committee s performance evaluation.
- Review of pay outcomes for 2016.

Second half of 2017

- Half-year and year end performance reviews for executive directors, Executive Committee members and attendees.
- Executive Committee members annual common objectives for 2018.
- Simplification of the pay construct for individuals below Executive Committee level.
- Review of retirement and leaver policies.
- Annual review of external advisers to the Committee.
- Remuneration governance across legal entities, international locations and the impact of ring-fencing.
- External stakeholder engagement plan.
- Approval of the 2017 employee Sharesave offer.
- Review of draft Directors Remuneration Report for 2017.
- Risk / remuneration process review.
- The annual evaluation of the Committee s performance.

Annual report on remuneration

Performance evaluation process

The Committee has considered the findings of the annual review of the effectiveness of the Committee. This year the evaluation process was conducted internally by the Deputy Secretary and overseen by the Company Secretary.

The feedback was very positive with most issues being rated either excellent or good. Positive comments were received on the Committee s composition and how effective the Committee had been on focusing on big picture issues as well as external themes and developments. The new executive director pay construct was seen as a good example of the Committee being forward thinking and innovative.

While the quality of information was generally considered to be good, some responses indicated there was scope for better comparative data and context. A number of Committee members and attendees suggested that, while the right things were on the agenda and meetings were well run, further consideration should be given to the number of meetings during the year.

The overall conclusion was that the Committee operated effectively during 2017 and fulfilled its remit as set out in its terms of reference. Actions were agreed as part of the evaluation and progress will be tracked and reported to the Committee biannually.

Advisers to the Committee

PricewaterhouseCoopers LLP (PwC) was appointed as the Committee s remuneration advisers on 14 September 2010. A formal review of potential advisers was undertaken in 2017. This considered the ability of the providers to offer high quality advice and strategic thinking, the strength and depth of the personnel and the associated level of fees. Following the review, the Committee agreed to retain the services of PwC. The Committee will continue to review the performance of its advisers each year. PwC is a signatory to the voluntary code of conduct in relation to remuneration consulting in the UK.

As well as receiving advice from PwC in 2017, the Committee took account at meetings of the views of the Chairman; the Chief Executive; the Chief Financial Officer; the Chief HR Officer; the Director of Reward, Pension & Benefits; the Company Secretary; and the Chief Risk Officer. The Committee also received input from the Board Risk Committee, the Group Audit Committee and the Sustainable Banking Committee.

PwC also provides professional services in the ordinary course of business including assurance, advisory, tax and legal advice to RBS subsidiaries. There are processes in place to ensure the advice received by the Committee is independent of any support provided to management.

The fees paid to PwC for advising the Committee in relation to directors remuneration were charged on a time/cost basis until September 2017. A fixed fee structure has operated from October 2017 onwards to cover standard services with any exceptional items charged on a time/cost basis. The fees for 2017 in relation to directors remuneration amounted to £170,476 excluding VAT (2016 - £214,706).

Statement of shareholder voting

The tables below set out the voting by shareholders on the resolutions to approve the Annual Report on Remuneration and the Directors Remuneration Policy at the AGM on 11 May 2017.

Annual Report on Remuneration 2017 AGM

For	Against	Total votes cast	Withheld
43,612,488,456 (99.60%)	173,420,916 (0.40%)	43,785,909,372	14,256,744

Directors Remuneration Policy 2017 AGM

For	Against	Total votes cast	Withheld
42,143,861,332 (96.33%)	1,603,968,780 (3.67%)	43,747,830,112	40,411,396

Shareholder dilution

The company meets its employee share plan obligations through a combination of new issue shares and market purchase shares. In line with the Investment Association s Principles of Remuneration, RBS s employee share plans contain monitored limits that govern the number of shares that may be issued to satisfy share plan awards.

Robert Gillespie

Chairman of the Group Performance and Remuneration Committee

22 February 2018

Other Remuneration Disclosures

This section contains a number of voluntary disclosures on remuneration as well as disclosures which are required in accordance with Article 450 of the Capital Requirements Regulation. This section should be read in conjunction with both the Directors Remuneration Report and the Annual Report on Remuneration (pages 84 to 100).

Remuneration of the eight highest paid senior executives below Board (1)

	Executive 1	Executive 2	Executive 3	Executive 4	Executive 5	Executive 6	Executive 7	Executive 8
	£000	£000	£000	£000	£000	£000	£000	£000
Fixed pay (cash)	650	700	738	800	800	600	450	381
Fixed allowances	650	700	738	800	800	600	225	166
Annual bonus								
Long-term incentive awards (vested value)	638	437	346	109	109	365		73
Total remuneration (2)	1,938	1,837	1,822	1,709	1,709	1,565	675	620

Notes:

(1) Remuneration earned in 2017 for eight members of the Executive Committee.

(2) Disclosure includes prior year long-term incentive awards which vested during 2017. The amounts shown reflect the value of vested awards using the share price on the day the awards vested.

All staff total remuneration

the average salary for all employees is £32,785
12,445 employees earn between £50,000 and £100,000
5,025 employees earn between £100,000 and £250,000
934 employees earn total remuneration over £250,000

Total remuneration by band for all employees earning > 1 million

	Number of employees 2017
1.0m - 1.5m	50
1.5m - 2.0m	18
2.0m - 2.5m	9
2.5m - 3.0m	2
3.0m - 3.5m	1
3.5m - 4.0m	1
4.0m - 4.5m	1
4.5m - 5.0m	0
5.0m - 6.0m	1
Total	83

Notes:

(1) Total remuneration in the table above includes fixed pay, pension and benefit funding and variable pay.

(2) Executive directors are not included. The table is based on an exchange rate where applicable of 1.141 to £1 as at 31 December 2017.

Employees that earned total remuneration of over 1 million in 2017 represent just 0.1% of our employees. This number reduces to 68 employees if we exclude pension and benefit funding. These employees include those who manage major businesses and functions with responsibility for significant assets, earnings or areas of strategic activity and can be grouped as follows:

- The Chief Executives responsible for each area and their direct reports.
- Employees managing large businesses within a franchise.
- Income generators responsible for high levels of income including those involved in managing trading activity and supporting clients with more complex financial transactions, including financial restructuring.
- Those responsible for managing our balance sheet and liquidity and funding positions across the business.
- Employees who managed the successful disposal of assets in Capital Resolution, reducing RBS s capital requirements.

Other Remuneration Disclosures

Our remuneration policy for all employees

The remuneration policy supports the business strategy and is designed to promote the long-term success of RBS. It aims to reward employees for delivering good performance provided this is achieved in a manner consistent with our values and within acceptable risk parameters. The remuneration policy applies the same principles to all employees, including Material Risk Takers (MRTs), with some minor adjustments to the policy where necessary to comply with local regulatory requirements. The key elements of the policy are set out below.

Element of pay	Objective	Operation
Base salary	To provide a competitive level of fixed cash remuneration.	Base salaries are reviewed annually and should reflect the talents, skills and competencies that the individual brings to the business.
Role-based allowance	To provide fixed pay that reflects the skills and experience required for the role.	Role-based allowances are a fixed allowance which form an element of the employee s overall fixed remuneration for regulatory requirements and are based on the role the individual performs. The allowances are pre-determined, permanent, and can only be adjusted or cancelled if an employee relinquishes the role or responsibilities which made them eligible for the allowance. They are not intended to be adjusted other than where there is a change of role. They are delivered in cash and/or shares depending on the level of the allowance and the seniority of the recipient. Shares are subject to an appropriate retention period, not less than six months.
Benefits and pension	To provide a range of flexible and competitive benefits.	In most jurisdictions, employee benefits or a cash equivalent are provided from a flexible benefits account. Pension forms part of fixed remuneration and RBS does not as a rule award discretionary pension benefits.
Annual bonus	To support a culture where employees recognise the importance of serving customers well and are rewarded for superior performance.	The annual bonus pool is based on a balanced scorecard of measures including Financial, Customers, People and Risk & Conduct measures. Allocation from the pool depends on performance of the franchise or function and the individual.

		Individual performance assessment is supported by a structured performance management framework. This is designed to assess performance against longer term business requirements across a range of financial and non-financial metrics as well as an evaluation of adherence to internal controls and risk management.
		The performance measures are set in line with the business strategy and typically include: financial measures such as return on equity; cost:income ratio; expenses and headcount (dependent on the franchise / function); net promoter score and/or customer satisfaction to assess customer advocacy; and internal survey results to assess progress in employee engagement.
		Risk and conduct performance is also taken into account. Control functions are assessed independently of the business units that they oversee.
		For awards made in respect of the 2017 performance year, immediate cash awards continue to be limited to a maximum of £2,000. In line with regulatory requirements, a significant proportion of annual bonus awards for our more senior employees is deferred and includes partial delivery in shares.
		The deferral period varies from three years for standard MRTs, rising to five years for individuals identified as Risk Manager MRTs and seven years for Senior Managers under the UK s Senior Managers Regime. All awards are subject to malus and clawback provisions. For MRTs, a minimum of 50% of any annual bonus is delivered in shares and a twelve month retention period will apply post vesting in line with regulatory requirements.

Other Remuneration Disclosures

Long-term incentive awards	To support a culture where good performance against a full range of measures will be rewarded. To encourage the creation of value over the long term and to align rewards with the returns to shareholders.	RBS provides certain employees in senior roles with long-term incentive awards. For awards made in respect of the 2017 performance year, the population receiving long-term incentive awards will be limited to executive directors and members of the RBS Executive Committee. Awards will be subject to pre-grant and pre-vest performance assessments that consider progress against Financial, Risk & Operations, Customers and People & Culture measures, aligned with RBS s strategic aims. Vesting will take place over a three to seven year period following grant. The number of shares that vest under the award may vary between 0% -100% depending on the performance achieved. Awards are subject to malus and clawback provisions and a twelve month retention period applies post vesting.
Shareholding requirements	To promote long-term alignment between senior executives and shareholders.	Executive directors and members of the Executive Committee are required to build up and hold a shareholding equivalent to a percentage of salary. There is a restriction on the number of shares that individuals can sell until the requirement is met.
Other share plans	To offer employees in certain jurisdictions the opportunity to acquire shares.	Employees in certain countries are eligible to contribute to share plans which are not subject to performance conditions.

Criteria for identifying MRTs

The European Banking Authority has issued criteria for identifying MRT roles, those staff whose professional activities have a material influence over RBS s performance or risk profile. The criteria are both qualitative (based on the nature of the role) and quantitative (for example those who exceed the stipulated total remuneration threshold based on the previous year s total remuneration).

The qualitative criteria can be summarised as: staff within the management body; senior management; other staff with key functional or managerial responsibilities; staff, individually or as part of a Committee, with authority to approve new business products or to commit to credit risk exposures and market risk transactions above certain levels. The quantitative criteria are: individuals earning 500,000 or more in the previous year; individuals in the top 0.3% of earners in the previous year; individuals who earned more than the lowest paid identified staff per the qualitative criteria, subject to specific exceptions in the criteria. In addition to the qualitative and quantitative criteria, RBS has applied its own minimum standards to identify roles that are considered to have a material influence over its risk profile.

Personal hedging strategies

In accordance with UK regulatory requirements and internal dealing rules that apply to employees, the conditions attached to discretionary share-based awards prohibit the use of any personal hedging strategies to lessen the impact of a reduction in value of such awards. These conditions are explicitly acknowledged and accepted by employees when any share-based awards are granted.

Other Remuneration Disclosures

Remuneration of MRTs

The quantitative disclosures below are made in accordance with Article 450 of the EU Capital Requirements Regulation in relation to 637 employees who have been identified as MRTs.

1. Number of MRTs by business area

Number of beneficiaries	Senior management	Other MRTs	Total
Board Executive Directors	2		2
Board Non-Executive Directors		12	12
NatWest Markets	1	248	249
Personal & Business Banking	1	71	72
Commercial & Private Banking	1	91	92
Corporate Functions	2	96	98
Internal Control Functions	1	73	74
All Other Business Areas	2	36	38
Total	10	627	637

2. Aggregate remuneration expenditure

Aggregate remuneration expenditure in respect of 2017 performance was as follows:

	Senior management	Other MRTs	Total
Number of beneficiaries	10	627	637
	£m	£m	£m
Board Executive Directors	7.3		7.3
Board Non-Executive Directors		2.7	2.7
NatWest Markets	3.4	166.7	170.1
Personal & Business Banking	2.5	21.3	23.8
Commercial & Private Banking	3.1	34.2	37.3
Corporate Functions	2.7	37.8	40.5
Internal Control Functions	1.7	23.4	25.1
All Other Business Areas	5.9	20.0	25.9
Total	26.5	306.1	332.6

3. Amounts and form of fixed and variable remuneration

Fixed remuneration consisted of salaries, allowances, pension and benefit funding.

Fixed remuneration	Senior management	Other MRTs	Total
Number of beneficiaries	10	627	637
	£m	£m	£m
Board Executive Directors	4.3		4.3
Board Non-Executive Directors		2.7	2.7
NatWest Markets	1.9	101.1	103.0
Personal & Business Banking	1.4	15.7	17.2
Commercial & Private Banking	1.8	22.0	23.7
Corporate Functions	1.6	25.6	27.2
Internal Control Functions	1.7	17.3	18.9
All Other Business Areas	3.5	12.9	16.3
Total	16.1	197.2	213.3

Variable remuneration awarded for 2017 performance

Variable remuneration consisted of a combination of annual bonus and long-term incentive awards, deferred over a three to seven year period in accordance with regulatory requirements. Under the RBS bonus deferral structure, immediate cash awards are limited to £2,000 per employee.

Long-term incentive awards vest subject to the extent to which performance conditions are met and can result in zero payment.

Annual bonus	Senior management	Other MRTs	Total
Number of beneficiaries		515	515
		£m	£m
Board Executive Directors			
Board Non-Executive Directors			
NatWest Markets			
Variable remuneration (cash)		0.44	0.44
Deferred remuneration (bonds)		5.02	5.02
Deferred remuneration (shares)		60.15	60.15
		65.61	65.61
Personal & Business Banking			
Variable remuneration (cash)		0.19	0.19
Deferred remuneration (bonds)		1.11	1.11
Deferred remuneration (shares)		4.26	4.26
		5.55	5.55
Commercial & Private Banking			
Variable remuneration (cash)		0.14	0.14
Deferred remuneration (bonds)		1.52	1.52
Deferred remuneration (shares)		10.61	10.61
		12.27	12.27
Corporate Functions			
Variable remuneration (cash)		0.29	0.29
Deferred remuneration (bonds)		1.85	1.85
Deferred remuneration (shares)		10.02	10.02
		12.16	12.16
Internal Control Functions			
Variable remuneration (cash)		0.11	0.11
Deferred remuneration (bonds)		1.18	1.18
Deferred remuneration (shares)		4.88	4.88
		6.17	6.17

All Other Business Areas			
Variable remuneration (cash)		0.06	0.06
Deferred remuneration (bonds)		0.74	0.74
Deferred remuneration (shares)		6.34	6.34
		7.14	7.14
Total		108.90	108.90

Long-term incentives	Senior management	Other MRTs	Total
Number of beneficiaries	9		9
	£m		£m
Board Executive Directors	3.02		3.02
Board Non-Executive Directors			
NatWest Markets	1.50		1.50
Personal & Business Banking	1.05		1.05
Commercial & Private Banking	1.30		1.30
Corporate Functions	1.15		1.15
Internal Control Functions			
All Other Business Areas	2.40		2.40
Total	10.42		10.42

Other Remuneration Disclosures

4. Outstanding deferred remuneration through 2017

The table below includes deferred remuneration awarded or paid out in 2017 in respect of prior performance years. Deferred remuneration reduced during the year relates to long-term incentives lapsed when performance conditions are not met, long-term incentives and deferred awards forfeited on leaving and malus adjustments of prior year deferred awards and long-term incentives.

Category of deferred remuneration	Senior Management £m	Other MRTs £m	Total £m
Unvested from prior year	36.5	159.3	195.8
Awarded during year	16.2	122.5	138.7
Paid out	7.1	97.8	104.9
Reduced from prior years	3.9	16.5	20.4
Unvested at year end	41.7	167.5	209.2

5. Guaranteed Awards (including Sign-on awards) and Severance Payments

RBS does not offer Sign-on awards . Guaranteed awards may only be granted to new hires in exceptional circumstances in compensation for awards foregone in their previous company and are limited to the first year of service. No new hire guarantees were made in respect of the 2017 performance year.

Severance payments and / or arrangements can be made to employees who leave RBS in certain situations, including redundancy. Such payments are determined by a pre-determined formula set out within the relevant social plans, policies, agreements or local laws. Where local laws permit, there is a cap on the maximum amount that can be awarded.

No severance payments were made during the financial year in excess of contractual payments, local policies, standards or statutory amounts, other than two exceptions. One payment of £45,500 was made to a former employee in Corporate Functions as a payment in lieu of contractual pension entitlements and one payment of £3,600 was made to a former employee in Commercial & Private Banking as a small variation of standard terms. Where required, remuneration is constrained within the limit of variable to fixed remuneration in accordance with EBA rules.

6. Ratio between fixed and variable remuneration

The variable component of total remuneration for MRTs at RBS shall not exceed 100% of the fixed component. Based on the information disclosed below, the average ratio between fixed and variable remuneration for 2017 is approximately 1 to 0.56. The majority of MRTs are based in the UK.

Ratio of fixed to variable	Senior Management	Other MRTs	Total
Number of beneficiaries	9	515	524
	ratio	ratio	ratio
Board Executive Directors	1 to 0.7		1 to 0.7
Board Non-Executive Directors		1 to 0	1 to 0
NatWest Markets	1 to 0.79	1 to 0.65	1 to 0.65
Personal & Business Banking	1 to 0.73	1 to 0.35	1 to 0.38
Commercial & Private Banking	1 to 0.74	1 to 0.56	1 to 0.57
Corporate Functions	1 to 0.74	1 to 0.48	1 to 0.49
Internal Control Functions	1 to 0	1 to 0.36	1 to 0.33
All Other Business Areas	1 to 0.69	1 to 0.55	1 to 0.58
Consolidated	1 to 0.65	1 to 0.55	1 to 0.56

7. Discount Rate 2017

Under CRD IV regulations, a notional discount is available which allows variable pay to be awarded at a level that would otherwise exceed the 1:1 ratio, provided that at least 25% of variable pay is delivered in instruments (shares) and deferred over five years. The discount rate was not used for remuneration awarded in respect of the 2017 performance year.

Compliance report

Statement of compliance

RBS is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 December 2017, RBS has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated April 2016 (the Code) except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. RBS considers that this is a matter which should rightly be reserved for the Board and this is an approach RBS has adopted for a number of years. Remuneration for the executive directors is first considered by the Group Performance and Remuneration Committee which then makes recommendations to the Board for consideration. This approach allows all non-executive directors, and not just those who are members of the Group Performance and Remuneration Committee, to participate in decisions on the executive directors and the Chairman s remuneration and also allows the executive directors to input to the decision on the Chairman s remuneration. The Board believes this approach is very much in line with the spirit of the Code and no director is involved in decisions regarding his or her own remuneration. We do not anticipate any changes to our approach on this aspect of the Code. Information on how RBS has applied the main principles of the Code can be found in the Corporate governance report on pages 50 to 105. A copy of the Code can be found at www.frc.org.uk.

RBS has also implemented the recommendations arising from the Walker Review and complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in September 2012 and April 2016.

Under the US Sarbanes-Oxley Act of 2002, specific standards of corporate governance and business and financial disclosures and controls apply to companies with securities registered in the US. RBS complies with all applicable sections of the US Sarbanes-Oxley Act of 2002, subject to a number of exceptions available to foreign private issuers.

Internal control

Management of The Royal Bank of Scotland Group plc is responsible for the system of internal controls that is designed to maintain effective and efficient operations, compliant with applicable laws and regulations. The system of internal controls is designed to manage, or mitigate, risk to an acceptable residual level rather than eliminate it entirely. Systems of internal control can only provide reasonable and not absolute assurance against material misstatement, fraud or loss.

Management s report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for RBS.

RBS s internal control over financial reporting is a component of an overall system of internal control and is designed to provide reasonable assurance regarding the preparation, reliability and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS) and includes:

- Policies and procedures that relate to the maintenance of records that, in reasonable detail, fairly and accurately reflect the transactions and disposition of assets.

- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management.

- Controls providing reasonable assurance regarding the prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

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.

Management assessed the effectiveness of RBS s internal control over financial reporting as of 31 December 2017 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 publication of Internal Control - Integrated Framework .

Based on its assessment, management believes that, as of 31 December 2017, RBS s internal control over financial reporting is effective.

The effectiveness of RBS s internal control over financial reporting as of 31 December 2017 has been audited by Ernst & Young LLP, RBS s independent registered public accounting firm. The report of the independent registered public accounting firm to the directors of the Royal Bank of Scotland Group plc expresses an unqualified opinion on RBS s internal control over financial reporting as of the 31 December 2017.

Disclosure controls and procedures

Management, including RBS s Chief Executive and Chief Financial Officer, have conducted an evaluation of the effectiveness and design of RBS s disclosure controls and procedures (as such term is defined in the Exchange Act Rule 13a-15(e)). Based on this evaluation, RBS s Chief Executive and Chief Financial Officer concluded that RBS s disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Changes in internal control

There was no change in RBS s internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, RBS s internal control over financial reporting.

Compliance report

The New York Stock Exchange

As a foreign private issuer with American Depository Shares representing ordinary shares, preference shares and debt securities listed on the New York Stock Exchange (the NYSE), RBS is not required to comply with all of the NYSE standards applicable to US domestic companies (the NYSE Standards) provided that it follows home country practice in lieu of the NYSE Standards and discloses any significant ways in which its corporate governance practices differ from the NYSE Standards. RBS is also required to provide an Annual Written Affirmation to the NYSE of its compliance with the mandatory applicable NYSE Standards.

The Group Audit Committee fully complies with the mandatory provisions of the NYSE Standards (including by reference to the rules of the Exchange Act) that relate to the composition, responsibilities and operation of audit committees. In April 2017 RBS submitted its required annual written affirmation to the NYSE confirming its full compliance with those and other applicable provisions. More detailed information about the Group Audit Committee and its work during 2017 is set out in the Group Audit Committee report on pages 65 to 72.

RBS has reviewed its corporate governance arrangements and is satisfied that these are consistent with the NYSE Standards, subject to the following departures: (i) NYSE Standards require the majority of the Board to be independent. The NYSE Standards contain different tests from the Code for determining whether a director is independent. RBS follows the Code s requirements in determining the independence of its directors and currently has 9 independent non-executive directors, one of whom is the senior independent director. (ii) The NYSE Standards require non-management directors to hold regular sessions without management present and that independent directors meet at least once a year. The Code requires the Chairman to hold meetings with non-executive directors without the executives present and non-executive directors are to meet without the Chairman present at least once a year to appraise the Chairman s performance and RBS complies with the requirements of the Code. (iii) The NYSE Standards require that the nominating/corporate governance committee of a listed company be composed entirely of independent directors.

The Chairman of the Board is also the Chairman of the Group Nominations and Governance Committee, which is permitted under the Code (since the Chairman was considered independent on appointment). The terms of reference of the Group Nominations and Governance Committee differ in certain limited respects from the requirements set out in the NYSE Standards, including because the Group Nominations and Governance Committee does not have responsibility for overseeing the evaluation of management. (iv) The NYSE standards require that the compensation committee of a listed company be composed of entirely of independent directors. Although the members of the Group Performance and Remuneration Committee are deemed independent in compliance with the provisions of the Code, the Board has not assessed the independence of the members of the Group Performance and Remuneration Committee and the Group Performance and Remuneration Committee has not assessed the independence of any compensation consultant, legal counsel or other adviser, in each case, in accordance with the independence tests prescribed by the NYSE Standards.

The NYSE Standards require that the compensation committee must have direct responsibility to review and approve the Chief Executive s remuneration.

As stated at the start of this Compliance Report, in the case of RBS, the Board, rather than the Group Performance and Remuneration Committee, reserves the authority to make the final determination of the remuneration of the Chief Executive. (v) The NYSE Standards require listed companies to adopt and disclose corporate governance guidelines. Throughout the year ended 31 December 2017, RBS has complied with all of the provisions of the Code (subject to the exception described above) and the Code does not require RBS to disclose the full range of corporate governance guidelines with which it complies. (vi) The NYSE Standards require listed companies to adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. RBS has adopted a code of conduct which is supplemented by a number of key policies and guidance dealing with matters including , among others, anti-bribery and corruption, anti-money laundering, sanctions, confidentiality, inside information, health, safety and environment, conflicts of interest, market conduct and management records. This code of conduct applies to all officers and employees and is fully aligned to the PRA and FCA Conduct Rules which apply to all directors. The Code of Conduct is available to view on RBS s website at rbs.com.

This Compliance report forms part of the Corporate governance report and the Report of the directors.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2017.

Group structure

The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc, the principal direct operating subsidiary undertaking of the company.

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HMT in the form of B shares. HMT sold 630 million of its holding of the company s ordinary shares in August 2015. In October 2015 HMT converted its entire holding of 51 billion B shares into 5.1 billion new ordinary shares of £1 each in the company.

At 31 December 2017, HMT s holding in the company s ordinary shares was 70.5%.

RBS Group ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019.

To comply with these requirements it is RBS s intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets Plc (NatWest Markets) will be a separate non ring-fenced bank and The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings) will also be placed outside the ring-fence, both as direct subsidiaries of RBSG.

The final ring-fenced legal structure and the actions to be taken to achieve it, remain subject to, amongst other factors, additional regulatory, Board and other approvals as well as employee information and consultation procedures. All such actions and their respective timings may be subject to change, or additional actions may be required, including as a result of external and internal factors including further regulatory, corporate or other developments.

On 1 January 2017, RBS made a number of key changes to the legal hierarchy of its subsidiaries to support the move towards a ring-fenced structure. As part of continuing preparation to deliver a fully compliant ring-fencing structure by 1 January 2019, it plans to undertake a further series of actions as follows:

November 2017

On 21 November 2017, The Royal Bank of Scotland plc (RBS plc) applied to the Court of Session in Edinburgh (the Court) to initiate a Ring-Fencing Transfer Scheme (RFTS) under the Financial Services and Markets Act 2000, including:

- Transfer its UK retail & commercial banking business to Adam & Company PLC (Adam);
- Transfer its covered bonds in issue and Mentor business to National Westminster Bank Plc (NatWest); and
- Transfer branches and other properties to either NatWest or Adam.

The RFTS is expected to take effect over the weekend of 28-30 April 2018. At the same time, RBS plc will be renamed NatWest Markets Plc , Adam will be renamed The Royal Bank of Scotland plc and assume banknote-issuing responsibility.

May 2018

In May 2018, RBS intends to commence, in the Court, a second RFTS to transfer certain derivatives from NatWest to NatWest Markets Plc (former RBS plc). If approved by the Court, the transfers are expected to be implemented in August 2018.

July 2018

In July 2018, RBS plans to restructure the NatWest Markets Plc (former RBS plc) capital structure via a Court approved capital reduction. As part of this restructure, the shares in NatWest Holdings Limited, which owns the ring-fenced sub-group, will be distributed to RBSG. This will separate the ring-fenced sub-group from the non-ring-fenced entities, as required by the ring-fencing legislation.

January 2019

Once the RFTS, other restructuring and the ring-fencing legislation is in force:

Ring-fenced activities

- RBS plc (former Adam) will manage the RBS branded banking business in its UK branch network;
- NatWest will continue to manage NatWest branded banking business and its branch network in the UK and Western Europe;
- NatWest will operate as the shared service provider to the rest of the Group and will act as the market-facing arm for the ring-fenced banking group s payments and hedging activities;
- Adam will continue to be a trading name of RBS plc (former Adam) and will continue to operate its private banking and wealth management activities;
- Coutts & Company will continue its private banking and wealth management activities; and
- Ulster Bank Limited and Ulster Bank Ireland DAC will continue to operate in Northern Ireland and the Republic of Ireland respectively.

Non-ring-fenced activities

- NatWest Markets Plc (former RBS plc) will continue to undertake RBS s trading and investment banking activities; and

- RBS International Limited (RBSI), along with Isle of Man Bank, will continue to serve the markets and customers it serves today. In addition, RBSI becomes the focal point for funds banking activity through its recently opened London branch.

Report of the directors

Segmental reporting

Segmental reorganisation and business transfers

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime, the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed.

Segmental reorganisation

The previously reported operating segments are now realigned and comparatives have been re-presented as follows:

- The former Williams & Glyn reportable operating segment has been integrated into the UK PBB reportable segment;
- The former Capital Resolution reportable operating segment has been integrated into the NatWest Markets reportable segment, with the exception of the costs in relation to the RMBS claims, which have been transferred to the Central & Other items reportable segment; and
- The RBSI reportable operating segment is no longer presented within the CPB franchise.

Business transfers

On 1 October 2017 the following changes were made to RBS s businesses, which impacts its financial reporting but where comparatives have not been re-presented:

- Shipping and other activities, which were formerly in Capital Resolution, were transferred from the NatWest Markets reportable segment to the Commercial Banking reportable segment.
- UK PBB Collective Investment Funds (CIFL) business was transferred to the Private Banking reportable segment in order to better serve customers.
- The RBS International (RBSI) reportable operating segment was aligned to the legal entity The Royal Bank of Scotland International (Holdings) Limited. This predominantly involved transfers from Private Banking, and Services and Functions within Central items & other in preparation for the implementation of the UK ring-fencing regime.
- Commercial Banking whole business securitisations and relevant financial institutions (RFI) were transferred to NatWest Markets during December 2017. RFIs are prohibited from being within the ring-fence due to their nature and exposure to global financial markets. The move is in preparation for the implementation of the UK ring-fencing regime.

Reportable operating segments

Following the changes detailed the reportable operating segments are as follows:

Personal & Business Banking (PBB) comprises two reportable segments: UK Personal & Business Banking (UK PBB) and Ulster Bank RoI. UK PBB serves individuals and mass affluent customers in the UK together with small businesses (generally up to £2 million turnover). UK PBB includes Ulster Bank customers in Northern Ireland. Ulster Bank RoI serves individuals and businesses in the Republic of Ireland (RoI).

Commercial & Private Banking (CPB) comprises two reportable segments: Commercial Banking and Private Banking. Commercial Banking serves commercial and corporate customers in the UK and Western Europe. Private Banking serves UK connected high net worth individuals.

RBS International (RBSI) serves retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man and Gibraltar and financial institution customers in Luxembourg and London.

NatWest Markets offers corporate and institutional customers global market access, providing them with trading, risk management and financing solutions through its trading and sales operations in London, Singapore and Stamford and sales offices in Dublin, Hong Kong and Tokyo.

Central items & other includes corporate functions, such as RBS treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS capital resources and RBS-wide regulatory projects and provides services to the reportable segments. Balances in relation to legacy litigation issues and the international private banking business are included in the relevant periods.

Allocation of central balance sheet items

RBS allocates all central costs relating to Services and Functions to the business using appropriate drivers, these are reported as indirect costs in the segmental income statements. Assets (and risk-weighted assets) held centrally, mainly relating to RBS Treasury, are allocated to the business using appropriate drivers.

Results and dividends

The profit attributable to the ordinary shareholders of the Group for the year ended 31 December 2017 amounted to £752 million compared with a loss of £6,955 million for the year ended 31 December 2016, as set out in the consolidated income statement on page 235.

The company did not pay a dividend on ordinary shares in 2015, 2016 or 2017.

In the context of prior macro-prudential policy discussions, the Board decided to partially neutralise any impact on Core Tier 1 capital of coupon and dividend payments in respect of 2016 and 2017 Group hybrid capital instruments through equity issuances of c. £300 million. Consequently, approximately £300 million was raised each year in 2016 and 2017 through the issue of new ordinary shares and the Board has decided a further £300 million of new equity will be issued during the course of 2018 to again partially neutralise the CET1 impact of coupon and dividend payments.

Report of the directors

Business review

Activities

RBS is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of RBS, including the products and services provided by each of its operating segments and the markets in which they operate are contained in the Business review on pages 116 to 150. Details of the strategy for delivering the company s objectives can be found in the Strategic report.

Risk factors

RBS s future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Full details of these and other risk factors are set out on pages 349 to 379.

The reported results of RBS are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of RBS s critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 242 to 254.

RBS s approach to risk management, including its financial risk management objectives and policies and information on RBS s exposure to market, credit, liquidity and funding risk, is discussed in the Capital and risk management section.

Financial performance

A review of RBS s performance during the year ended 31 December 2017, including details of each operating segment, and RBS s financial position as at that date is contained in the Business review on pages 116 to 150.

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2017 NatWest Markets announced its plan to repurpose the existing 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, as a result of 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.

Business divestments

Following the change of terms in respect of the business previously described as Williams & Glyn and agreed with the European Commission in September 2017, RBS will make a £425 million contribution to a Capability and Innovation Fund to be established to support competition in UK SME banking. The agreed alternative remedy package also requires a £350 million Incentivised Switching Scheme which will provide funding for eligible challenger bodies to help them incentivise SME customers to switch their accounts and loans from RBS. Should the uptake within the Incentivised Switching Scheme not be sufficient, RBS may be required to make a further contribution, capped at £50 million.

HMT is establishing an Independent Body to administer the Capability and Innovation fund and oversee and control the incentivised switching scheme. Once established the Independent Body, HMT and RBS will enter into the Framework Agreement Deed and fund the remedies.

Employees

Our colleagues

As at 31 December 2017, RBS employed 71,200 people (full-time equivalent basis, including temporary workers) throughout the world. Details of related costs are included in Note 3 on the consolidated accounts. The Board has considered ring-fencing preparations during the year and in advance of the legislation taking effect on 1 January 2019.

Engaging our colleagues is critical to delivering on our strategy and ambition as a bank. Further details on our approach can be found on page 34 and 35 of the strategic report.

Building a healthy culture

Building a healthy culture that embodies Our Values is one of RBS s core priorities.

Our Values guide the way RBS identify the right people to serve our customers well, and how RBS manage, engage and reward colleagues. They are at the heart of both Our Standards (the bank wide behavioural framework) and Our Code (the bank wide Code of Conduct).

Engaging our colleagues

RBS know that building an engaged, healthy and inclusive workforce is crucial to achieving our ambition. Every year RBS asks colleagues to share their thoughts on what it s like to work here via our annual colleague survey.

The 2017 results were the most positive we ve seen in recent times. Key measures of engagement, leadership and our culture have improved significantly, and RBS are now above the global financial services norm in the majority of our survey categories.

Rewarding our colleagues

RBS s 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.

RBS have a focus on paying the right wage to colleagues and the RBS rates of pay continue to exceed the Living Wage Foundation Benchmarks.

Developing our colleagues

RBS continued to deliver Determined to Lead, which is the core management system for the bank. It provides consistent tools to lead and engage colleagues. This programme has continued in 2017 with over 3,000 leaders participating.

In 2017 we launched the next stage in Service Excellence training, our customer service programme and had over 16,000 colleagues complete Level one.

Report of the directors

Professionalising colleagues is important to RBS. We continue to work closely with the Chartered Banker Institute (CBI) and Chartered Banker Professional Standards Board (CB:PSB) to offer RBS colleagues professional qualifications. In 2017 over 3,000 of colleagues completed their CBI qualification and 94% achieved the CB:PSB Foundation Standard.

RBS also offer a wide range of additional learning opportunities.

Youth Employment

In 2017, we welcomed 471 people across the RBS Graduate and Apprenticeship schemes as well as around 150 Summer Interns.

Health and wellbeing of our colleagues

Wellbeing is a strong foundation for making RBS a great place to work. For the third year running RBS participated in the Global Challenge (formerly GCC) and with 34,000 colleagues taking part we won the Global Challenge 1st Most Active Organisation Financial Industry. Building on this success, we embraced the rapid acceleration of digital wellbeing and are one of the few large organisations to pilot a digital wellbeing platform.

During 2017 RBS has continued to support Time to Change (removing the stigma of mental health) and actively encouraged open dialogue across the bank to support Mental Health in the Workplace. RBS were successful in running bankwide major online campaigns to support Mental Health Awareness Week and World Mental Health Day.

As RBS continue to support our colleagues through change we have fully utilised the services of our Employee Assistance Programme.

Employee consultation

RBS recognise 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. 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 is essential for our customers and colleagues. Our inclusion policy standard applies to all colleagues globally.

During 2017, RBS continued to roll out unconscious bias learning to all colleagues (over 70,000 trained, to date) to create a solid platform for the wider inclusion agenda.

RBS continue to work 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. We have a positive action approach in place, tailored by business, according to the specific challenges they face.

The RBS disability plan for training, career development and promotion of disabled persons employed by the company will support us becoming a disability smart organisation, with upper quartile performance, by 2018.

We continue to focus on building an ethnically diverse RBS. We will introduce explicit targets for BAME representation at senior levels in 2018.

Our LGBTQ agenda continues to deliver a better experience for our LGBTQ colleagues and customers. RBS have processes in place to support updating gender and title on customers banking records and to support colleagues undergoing gender transition.

RBS have been recognised for our work on Equality, Diversity and Inclusion by retaining our Platinum ranking from Opportunity Now (gender), retaining our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; becoming a Top 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 we were 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. RBS continue to support our c.20,000 strong employee-led networks.

Sustainability

The Sustainable Banking Committee s role is to support the Board in overseeing, supporting and challenging actions being taken by management to run RBS as a sustainable business.

For more information on our approach and progress please read the RBS Strategic Report included herein.

Greenhouse gas emissions

Disclosures relating to greenhouse gas emissions are included in the Strategic Report. These form part of the metrics and targets of the RBS climate change strategy. This is reported in accordance with the recommendations from the Financial Stability Boards Task Force on Climate-related Financial Disclosures (TCFD) on page 380. The RBS climate change strategy is driven by a range of external and internal drivers with oversight of climate related risks and opportunities through the Sustainable Banking Committee.

Going concern

RBS s business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Business review. The risk factors which could materially affect RBS s future results are set out on pages 349 to 379. RBS s regulatory capital resources and significant developments in 2017 and anticipated future developments are detailed in the Capital, liquidity and funding section on pages 163 to 178. This section also describes RBS s funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

Report of the directors

Having reviewed RBS s forecasts, projections and other relevant evidence, the directors have a reasonable expectation that RBS and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of RBS and of the company have been prepared on a going concern basis.

BBA disclosure code

RBS s 2017 financial statements have been prepared in compliance with the principles set out in the Code for Financial Reporting Disclosure published by the British Bankers Association in 2010.The Code sets out five disclosure principles together with supporting guidance. The principles are that RBS and other major UK banks will provide high quality, meaningful and decision-useful disclosures; review and enhance their financial instrument disclosures for key areas of interest to market participants; assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; seek to enhance the comparability of financial statement disclosures across the UK banking sector; and clearly differentiate in their annual reports between information that is audited and information that is unaudited.

Enhanced Disclosure Task Force (EDTF)

The EDTF established by the Financial Stability Board, published its report Enhancing the Risk Disclosures of Banks in October 2012. All EDTF recommendations are reflected in the 2017 Annual Report on Form 20-F and Pillar 3 Report.

Corporate governance

The company is committed to high standards of corporate governance. Details are given in the Corporate governance report on pages 50 to 105. The Corporate governance report and compliance report (pages 106 to 107) form part of this Report of the directors.

Share capital

Details of the ordinary and preference share capital at 31 December 2017 and movements during the year are shown in Note 25 on the consolidated accounts.

During 2017, the company allotted and issued a total of 119 million new ordinary shares of £1 each for the purposes of ensuring 2017 coupon payments on discretionary hybrid capital securities were partly neutralised from a Core Tier 1 capital perspective.

The shares were allotted to UBS AG at the subscription prices determined by reference to the average market prices during the sale periods set out below.

Number of shares sold	Subscription price	Sale period	Gross proceeds	Share price on allotment
33,376,695	239.6882	24/2/17 - 24/4/17	£80 million	249.3p
29,000,000	259.0457	28/4/17 30/6/17	£75 million	247.2p
56,634,740	256.0266	04/8/17 27/9/17	£145 million	270.8p

In the three years to 31 December 2017, the percentage increase in issued share capital due to non-pre-emptive issuance (excluding employee share schemes) for cash was 2.94%. In addition the company issued 22 million new ordinary shares in connection with employee share schemes in 2017.

In October 2015, HMT converted its entire holding of 51 billion B shares into 5.1 billion new ordinary shares of £1 each.

In March 2016, the company paid a final dividend of £1.2 billion in respect of the Dividend Access Share (DAS) held by HMT, effecting the immediate retirement of the DAS which was redesignated as a single B share and subsequently cancelled.

Authority to repurchase shares

At the Annual General Meeting in 2017 shareholders authorised the company to make market purchases of up to 1,184,237,107 ordinary shares. The directors have not exercised this authority to date. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2018.

Additional information

Where not provided elsewhere in the Report of the directors, the following additional information is required to be disclosed by Part 6 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The rights and obligations attached to the company s ordinary shares and preference shares are set out in the company s Articles of Association, copies of which can be obtained from Companies House in the UK or can be found at rbs.com/about/board-and-governance.

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares or cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held. The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.008% of the total voting rights of the company, the remainder being represented by the ordinary shares.

Report of the directors

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws).

Pursuant to the Listing Rules of the FCA, certain employees of the company require the approval of the company to deal in the company s shares.

The rules governing the powers of directors, including in relation to issuing or buying back shares and their appointment are set out in the company s Articles of Association. It will be proposed at the 2018 Annual General Meeting that the directors be granted authorities to allot shares under the Companies Act 2006. The company s Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

The rights and obligations of holders of non-cumulative preference shares are set out in Note 25 on the consolidated accounts.

The company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company. A number of the company s employee share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank of Scotland plc as Trustees. Voting rights are exercised by the Trustees on receipt of participants instructions. If a participant does not submit an instruction to the Trustee no vote is registered.

The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of RBS s employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.

Awards granted under the company s employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company s employee benefit trusts.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company s employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

Directors

The names and brief biographical details of the current directors are shown on pages 50 to 55.

Howard Davies, Frank Dangeard, Alison Davis, Morten Friis, Robert Gillespie, Penny Hughes, Ross McEwan, Brendan Nelson, Baroness Noakes, Mike Rogers and Ewen Stevenson all served throughout the year and to the date of signing of the financial statements.

Mark Seligman was appointed on 1 April 2017. Yasmin Jetha was appointed 21 June 2017 and Dr Lena Wilson was appointed on 1 January 2018.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting and, in accordance with the UK Listing Rules, the election or re-election of independent directors requires approval by all shareholders and also by independent shareholders.

Directors interests

The interests of the directors in the shares of the company at 31 December 2017 are shown on page 97. None of the directors held an interest in the loan capital of the company or in the shares or loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2017 to 22 February 2018.

Directors indemnities

In terms of section 236 of the Companies Act 2006 (the Companies Act), Qualifying Third Party Indemnity Provisions have been issued by the company to its directors, members of the RBS Executive Committee, individuals authorised by the PRA/FCA and certain directors and/or officers of RBS subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of RBS pension schemes.

Post balance sheet events

Other than the matter disclosed on page 324, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Controlling shareholder

In accordance with the UK Listing Rules, the company has entered into an agreement with HM Treasury (the Controlling Shareholder) which is intended to ensure that the Controlling Shareholder complies with the independence provisions set out in the UK Listing Rules. The company has complied with the independence provisions in the relationship agreement and as far as the company is aware the independence and procurement provisions in the relationship agreement have been complied with in the period by the controlling shareholder.

Report of the directors

Shareholdings

The table below shows shareholders that have notified RBS that they hold more than 3% of the total voting rights of the company at 31 December 2017.

Solicitor For The Affairs of Her Majesty s Treasury as Nominee for Her Majesty s Treasury	Number of shares (millions)	% of share class held	% of total voting rights held
Ordinary shares	8,434	70.5	70.5

As at 22 February 2018, there were no changes to the shareholdings shown in the table above.

Listing Rule 9.8.4

In accordance with the UK Financial Conduct Authority s Listing Rules the information to be included in the Annual Report and Accounts under LR 9.8.4, is set out in this Directors report with the exception of details of contracts of significance under LR 9.8.4. (10) and (11) given in Additional Information on pages 346 and 347.

Political donations

At the Annual General Meeting in 2017, shareholders gave authority under Part 14 of the Companies Act, for a period of one year, for the company (and its subsidiaries) to make political donations and incur political expenditure up to a maximum aggregate sum of £100,000. This authorisation was taken as a precaution only, as the company has a longstanding policy of not making political donations or incurring political expenditure within the ordinary meaning of those words. During 2017, RBS made no political donations, nor incurred any political expenditure in the UK or EU and it is not proposed that RBS s longstanding policy of not making contributions to any political party be changed. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2018.

Directors disclosure to auditors

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

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

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company s auditors are aware of that information.

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

Auditors

EY LLP are the auditors. The auditors, EY LLP, have indicated their willingness to continue in office. A resolution to re-appoint EY LLP as the company s auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor

Company Secretary

22 February 2018

The Royal Bank of Scotland Group plc

is registered in Scotland No. SC45551

Statement of directors responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on pages 232 to 234.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the company. In preparing those accounts, the directors are required to:

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

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

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors report (incorporating the Business review) include a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, the directors are of the opinion that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company s position and performance, business model and strategy.

By order of the Board

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

22 February 2018

Board of directors

Chairman	**Executive directors**	**Non-executive directors**
Howard Davies	Ross McEwan	Frank Dangeard
	Ewen Stevenson	Alison Davis
		Morten Friis
		Robert Gillespie
		Penny Hughes
		Yasmin Jetha
		Brendan Nelson
		Baroness Noakes
		Mike Rogers
		Mark Seligman
		Dr Lena Wilson

Business Review

Presentation of information

Segmental reporting

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime, the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed, for full details see the Report of the directors.

Reportable operating segments

Following the Q4 2017 changes the reportable operating segments are as follows, for full business descriptions see page 109 of the Report of the directors and Note 37 on the accounts:

Franchise	Reportable operating segment
Personal & Business Banking (PBB)	UK Personal & Business Banking (UK PBB)
	Ulster Bank RoI
Commercial & Private Banking (CPB)	Commercial Banking
	Private Banking
Other reportable segments	RBS International (RBSI)
	NatWest Markets
	Central items & other

Allocation of central balance sheet items

RBS allocates all central costs relating to Services and Functions to the business using appropriate drivers, these are reported as indirect costs in the segmental income statements. Assets (and risk-weighted assets) held centrally, mainly relating to RBS Treasury, are allocated to the business using appropriate drivers.

RBS Group ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019.

To comply with these requirements it is RBS s intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets Plc (NatWest Markets) will be a separate non ring-fenced bank and The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings) will also be placed outside the ring-fence, both as direct subsidiaries of RBSG.

On 1 January 2017, RBS made a number of key changes to the legal hierarchy of its subsidiaries to support the move towards a ring-fenced structure. As part of continuing preparation to deliver a fully compliant ring-fencing structure by 1 January 2019, it plans to undertake a further series of actions. For further details of these actions see the Report of the directors.

Business divestments

Citizens

RBS sold the final tranche of its interest in Citizens Financial Group, Inc. during the second half of 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015 until the final tranche was sold in October 2015, Citizens was an associated undertaking.

Business review

Competition

Personal & Business Banking (comprising UK PBB and Ulster Bank RoI)

In the personal and small business banking business, RBS competes with a range of providers including UK banks and building societies, major retailers and life assurance companies, as well as the UK subsidiaries of major international banks. In the mortgage market, RBS competes with UK banks, building societies and specialist lenders. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms either through organic growth or in some cases by acquiring businesses made available through the restructuring of incumbents. Entrants with new business models such as peer-to-peer lending platforms, while currently small, continue to grow rapidly and are emerging as significant competitors. Such competitors often target specific elements of the value chain, providing specialised services to particular customer segments.

RBS distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market.

In the UK credit card market large retailers and specialist card issuers are active in addition to the UK banks. In addition to physical distribution channels, providers compete through direct marketing activity and digital channels.

In an environment in which central banks have maintained very low interest rates for an unusually long period or introduced negative rates, competitive dynamics have changed in some of the principal markets in which RBS operate. Although the interest rate outlook is beginning to change, with many central banks pointing to interest rate rises in the coming years. Other key competitive factors in this market segment include cost management, growing digital sales focus, branch network re-shaping, and product simplification. Cost management remains a key focus in the market, as banks seek to simplify their organisational and IT architectures while at the same time investing to ensure that they can meet customers evolving channel preferences. Customers have increasingly focused on the use of internet and mobile as sales and service channels for certain types of products. Therefore, competitive position and performance in the sector increasingly depends on the possession of user-friendly, diverse and efficient online solutions.

Although conveniently located branches are still important, RBS faces competitive pressure to adjust its branch formats to meet changing customer expectations and to manage its branch footprint as over-the-counter transaction volumes decline. In terms of product offering, the industry trend is to limit the number of products and present the product structure and costs in a clear and transparent manner.

Commercial & Private Banking (comprising Commercial Banking and Private Banking)

Competition for corporate and institutional customers in the UK is from UK banks, from specialised global and regional investment banks and from large foreign universal banks that offer combined investment and commercial banking capabilities as well as from new entrants and non-bank challengers. In asset finance and invoice finance, RBS competes with banks and specialist finance providers, both captive and non-captive. In the small business banking market, RBS competes with other UK banks, specialist finance providers and building societies. In all of these areas, entrants with new technology-based business model are also showing rapid growth. Coutts and Adam & Company compete as private banks with UK clearing and private banks, asset managers and with international private banks. Competition in wealth management remains strong as banks maintain their focus on competing for affluent and high net worth customers.

NatWest Markets

NatWest Markets offers corporate and institutional customers global market access, providing them with trading, risk management and financing solutions through its trading and sales operations in London, Singapore and Stamford and sales offices in Dublin, Hong Kong and Tokyo. NatWest Markets therefore competes with large domestic banks, major international banks and a number of investment banks that offer such products in these regions.

RBS product proposition is built around our core strengths: supporting customers across currencies, rates and financing. Key competitive factors in this market include the ability to develop automation across flow products as well as delivering value-adding bespoke solutions for our customers.

With an evolving regulatory landscape and continued pressure on margins, competition in this market remains strong. Many market participants are also revising their strategy in order to ensure they deliver sustainable returns.

RBS International

RBS International competes with other UK and international banks to offer offshore banking services as well as domestic banking services in the Channel Islands, Gibraltar and the Isle of Man. RBSI also supports financial institution customers through wholesale branches in Luxembourg and London, both opened in 2017.

Business review

Consolidated income statement for the year ended 31 December 2017

	2017 £m	2016 £m	2015 £m
Interest receivable	11,034	11,258	11,925
Interest payable	(2,047)	(2,550)	(3,158)
Net interest income	8,987	8,708	8,767
Fees and commissions receivable	3,338	3,340	3,742
Fees and commissions payable	(883)	(805)	(809)
Income from trading activities	634	974	1,060
Loss on redemption of own debt	(7)	(126)	(263)
Other operating income	1,064	499	426
Non-interest income	4,146	3,882	4,156
Total income	13,133	12,590	12,923
Staff costs	(4,676)	(5,124)	(5,726)
Premises and equipment	(1,565)	(1,388)	(1,827)
Other administrative expenses	(3,323)	(8,745)	(6,288)
Depreciation and amortisation	(808)	(778)	(1,180)
Write down of goodwill and other intangible assets	(29)	(159)	(1,332)
Operating expenses	(10,401)	(16,194)	(16,353)
Profit/(loss) before impairment (losses)/releases	2,732	(3,604)	(3,430)
Impairment (losses)/releases	(493)	(478)	727
Operating profit/(loss) before tax	2,239	(4,082)	(2,703)
Tax charge	(824)	(1,166)	(23)
Profit/(loss) from continuing operations	1,415	(5,248)	(2,726)
Profit from discontinued operations, net of tax			1,541
Profit/(loss) for the year	1,415	(5,248)	(1,185)
Attributable to:			
Non-controlling interests	35	10	409
Preference shareholders	234	260	297
Paid-in equity holders	394	244	88
Dividend access share		1,193	
Ordinary shareholders	752	(6,955)	(1,979)
	1,415	(5,248)	(1,185)
Memo:			
Total income - adjusted (1,3)	12,862	12,372	13,034
Operating expenses - adjusted (2,3)	(7,551)	(8,220)	(9,356)
Operating profit - adjusted (1,2,3)	4,818	3,674	4,405

Notes:

(1) Excluding own credit adjustments, loss on redemption of own debt and strategic disposals. Tax on these items was a £24 million charge in 2017 (2016 - £90 million charge; 2015 - £15 million charge).

(2) Excluding restructuring costs, litigation and conduct costs and write down of goodwill. Tax on these items was £369 million in 2017 (2016 - £286 million; 2015 - £563 million).

(3) See the following page for segmental income statement reconciliation.

Business review

Analysis of results

Segmental summary income statements

	PBB		CPB					
	UK	Ulster Bank			RBS	NatWest	Central items	Total
			Commercial	Private				
	PBB	RoI	Banking	Banking	International	Markets	& other	RBS
2017	£m	£m	£m	£m	£m	£m	£m	£m
Total income - adjusted	6,477	607	3,484	678	389	1,090	137	12,862
Own credit adjustments		(3)				(66)		(69)
Loss on redemption of own debt							(7)	(7)
Strategic disposals						26	321	347
Total income	6,477	604	3,484	678	389	1,050	451	13,133
Operating expenses - adjusted	(3,158)	(451)	(1,814)	(445)	(202)	(1,528)	47	(7,551)
Restructuring costs	(461)	(56)	(167)	(45)	(9)	(436)	(391)	(1,565)
Litigation and conduct costs	(210)	(169)	(33)	(39)	(8)	(237)	(589)	(1,285)
Operating expenses	(3,829)	(676)	(2,014)	(529)	(219)	(2,201)	(933)	(10,401)
Impairment (losses)/releases	(235)	(60)	(362)	(6)	(3)	174	(1)	(493)
Operating profit/(loss) - adjusted	3,084	96	1,308	227	184	(264)	183	4,818
Operating profit/(loss)	2,413	(132)	1,108	143	167	(977)	(483)	2,239
Return on equity (1)	23.7%	(5.0%)	6.6%	6.4%	11.2%	(9.0%)	nm	2.2%
Return on equity - adjusted (1,2)	30.7%	3.6%	8.2%	11.3%	12.6%	(3.7%)	nm	8.8%
Cost income ratio (3)	59.1%	111.9%	56.0%	78.0%	56.3%	nm	nm	79.0%
Cost income ratio - adjusted (2,3)	48.8%	74.3%	50.0%	65.6%	51.9%	140.2%	nm	58.2%
2016								
Total income - adjusted	6,127	573	3,415	657	374	1,106	120	12,372
Own credit adjustments		3				187	(10)	180
Loss on redemption of own debt							(126)	(126)
Strategic disposals						(81)	245	164
Total income	6,127	576	3,415	657	374	1,212	229	12,590
Operating expenses - adjusted	(3,398)	(457)	(1,936)	(511)	(169)	(2,084)	335	(8,220)
Restructuring costs	(244)	(40)	(108)	(37)	(5)	(190)	(1,482)	(2,106)
Litigation and conduct costs	(634)	(172)	(423)	(1)		(550)	(4,088)	(5,868)
Operating expenses	(4,276)	(669)	(2,467)	(549)	(174)	(2,824)	(5,235)	(16,194)
Impairment (losses)/releases	(125)	113	(206)	3	(10)	(253)		(478)
Operating profit/(loss) - adjusted	2,604	229	1,273	149	195	(1,231)	455	3,674
Operating profit/(loss)	1,726	20	742	111	190	(1,865)	(5,006)	(4,082)
Return on equity (1)	16.2%	0.7%	4.1%	5.6%	13.8%	(12.5%)	nm	(17.9%)
Return on equity - adjusted (1,2)	25.1%	8.4%	8.4%	7.8%	14.2%	(8.7%)	nm	1.6%

Cost income ratio (3)	69.8%	116.1%	71.0%	83.6%	46.5%	nm	nm	129.0%
Cost income ratio - adjusted (2,3)	55.5%	79.8%	54.8%	77.8%	45.2%	188.4%	nm	66.0%
2015								
Total income - adjusted	6,033	550	3,254	644	367	1,809	377	13,034
Own credit adjustments						295	14	309
Loss on redemption of own debt							(263)	(263)
Strategic disposals						(38)	(119)	(157)
Total income	6,033	550	3,254	644	367	2,066	9	12,923
Operating expenses - adjusted	(3,397)	(427)	(1,801)	(518)	(156)	(3,006)	(51)	(9,356)
Restructuring costs	(195)	(15)	(69)	(73)	(4)	(1,831)	(744)	(2,931)
Litigation and conduct costs	(972)	13	(51)	(12)		(404)	(2,142)	(3,568)
Write down of goodwill				(498)				(498)
Operating expenses	(4,564)	(429)	(1,921)	(1,101)	(160)	(5,241)	(2,937)	(16,353)
Impairment (losses)/releases	(8)	141	(69)	(13)		730	(54)	727
Operating profit/(loss) - adjusted	2,628	264	1,384	113	211	(467)	272	4,405
Operating profit/(loss)	1,461	262	1,264	(470)	207	(2,445)	(2,982)	(2,703)
Return on equity (1)	13.5%	10.6%	9.8%	(27.7%)	18.5%	(11.2%)	nm	(4.7%)
Return on equity - adjusted (1,2)	25.3%	10.6%	10.9%	4.9%	18.9%	(3.0%)	nm	11.0%
Cost income ratio (3)	75.7%	78.0%	57.2%	171.0%	43.6%	nm	nm	126.9%
Cost income ratio - adjusted (2,3)	56.3%	77.6%	53.3%	80.4%	42.5%	166.2%	nm	71.4%

Notes:

(1) RBS s CET 1 target is 13% but for the purposes of computing segmental return on equity (ROE), to better reflect the differential drivers of capital usage, segmental operating profit after tax and adjusted for preference dividends is divided by average notional equity allocated at different rates of 14% (Ulster Bank RoI - 11% prior to 2017), 11% (Commercial Banking), 14% (Private Banking - 15% prior to 2017), 16% (RBS International - 12% prior to November 2017) and 15% for all other segments, of the monthly average of segmental risk-weighted assets incorporating the effect of capital deductions (RWAes). Return on equity is calculated using profit for the period attributable to ordinary shareholders.

(2) Excluding own credit adjustments, (loss)/gain on redemption of own debt, strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill.

(3) Operating lease depreciation included in income (year ended December 2017 - £142 million; year ended 31 December 2016 - £152 million).

Business review

Analysis of results continued

Net interest income

	2017	2016	2015
	£m	£m	£m
Interest receivable (1,2)	11,034	11,258	11,925
Interest payable (1,2)	(2,047)	(2,550)	(3,158)
Net interest income	8,987	8,708	8,767
Yields, spreads and margins of the banking business	%	%	%
Gross yield on interest-earning assets of the banking business (3)	2.57	2.80	2.89
Cost of interest-bearing liabilities of the banking business	(0.70)	(0.95)	(1.14)
Interest spread of the banking business (4)	1.87	1.85	1.75
Benefit from interest-free funds	0.26	0.33	0.37
Net interest margin of the banking business (2,5)	2.13	2.18	2.12

Notes:

(1) Negative interest on loans and advances is classed as interest payable and on customer deposits is classed as interest receivable.

(2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(3) Gross yield is the interest earned on average interest-earning assets of the banking book.

(4) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.

(5) Net interest margin is net interest income of the banking business as a percentage of interest-earning assets (IEA) of the banking business.

2017 compared with 2016

Net interest income of £8,987 million increased by £279 million compared with 2016. The movement was principally driven by higher mortgage volumes in UK PBB, up £185 million or 3.7%, and deposit re-pricing benefits in Commercial Banking, up £143 million or 6.7%, partially offset by planned balance sheet reductions in NatWest Markets.

The net interest margin (NIM) was 2.13% for 2017, 5 basis points lower than 2016 reflecting increased liquidity, mix impacts and competitive pressures on margin.

UK PBB NIM of 2.86% was 11 basis points lower than 2016 reflecting lower mortgage margins, asset mix and reduced current account hedge yield, partially offset by savings re-pricing benefits from actions taken in 2016 and following the Q4 2017 base rate increase.

Ulster Bank RoI NIM increased by 5 basis points to 1.67% driven by a combination of improved deposit and loan margins, one-off income adjustments and successful deleveraging measures in 2016 which have reduced the concentration of low yielding loans.

Commercial Banking NIM decreased by 2 basis points as active re-pricing of assets and deposits has been more than offset by asset margin pressure in a low rate environment.

Private Banking NIM decreased by 19 basis points to 2.47% reflecting the competitive market and low rate environment, partially offset by higher funding benefits on deposits following the Q4 2017 base rate increase.

RBSI NIM remained stable at 1.36% as active re-pricing of deposits has been offset by the low rate environment.

Structural hedges of £129 billion generated a benefit of £1.3 billion through net interest income for the year.

2016 compared with 2015

Net interest income of £8,708 million reduced by £59 million compared with 2015 principally driven by a £126 million reduction in legacy NatWest Markets business, in line with the planned shrinkage of the balance sheet**.**

NIM was 2.18% for 2016, 6 basis points higher than 2015 as the benefit associated with reductions in low yielding non-core assets has been partially offset by modest asset margin pressure and mix impacts across PBB (comprising the reportable segments UK PBB and Ulster Bank RoI), CPB (comprising the reportable segments Commercial Banking and Private Banking) and RBSI.

Average interest earning assets(1) across the combined PBB, CPB and RBSI increased by 10% on 2015, compared with a 3% decline for RBS total, and represented 88% of total average interest earning assets (2015 - 77%). NIM across PBB, CPB and RBSI was 2.34%, 13 basis points lower than 2015.

UK PBB NIM decreased by 16 basis points to 2.97% reflecting the impact of the overall portfolio mix being increasingly weighted towards secured lending and mortgage customers switching from standard variable rate (SVR) to lower rate products. During the second half of 2016 SVR balances stabilised at approximately 12% of mortgage balances. Ulster Bank RoI NIM increased by 5 basis points to 1.62% driven by a continued reduction in the cost of deposits and a reduced volume of low yielding liquid assets, partly offset by reduced income on free funds.

Commercial Banking NIM fell by 12 basis points to 1.76% driven by asset margin pressure in a competitive market and low rate environment. Private Banking NIM reduced by 9 basis points to 2.66% principally driven by asset margin pressure. RBSI NIM fell by 12 basis points to 1.36% reflecting asset and liability margin pressures, partially offset by mitigating pricing actions.

Structural hedges of £123 billion generated a benefit of £1.3 billion through net interest income for the year. Around 73% of these hedges are part of a five year rolling hedge programme (with around 27% as part of a ten year hedge) that will progressively roll-off over the coming years.

Note:

(1) See table below for combined net interest income, average interest earning assets and NIM calculation.

Reportable segment	Net interest income		Average interest earning assets		NIM	
	2016	2015	2016	2015	2016	2015
UK PBB	4,945	4,810	166,778	153,642	2.97%	3.13%
Ulster Bank RoI	409	365	25,193	23,232	1.62%	1.57%
Commercial Banking	2,143	1,997	121,677	106,429	1.76%	1.88%
Private banking	449	436	16,887	15,835	2.66%	2.75%
RBSI	303	303	22,254	20,518	1.36%	1.48%
PBB, CPB & RBSI combined	8,249	7,911	352,789	319,656	2.34%	2.47%

Business review

Analysis of results continued

Non-interest income

The following table reconciles adjusted non-interest income (a non-GAAP financial measure) to the statutory basis.

	2017	2016	2015
	£m	£m	£m
Fees and commissions receivable - statutory basis	3,338	3,340	3,742
Fees and commissions payable - statutory basis	(883)	(805)	(809)
Own credit adjustments (1)			
- adjusted basis	(69)	180	309
- income from trading activities	69	(154)	(254)
- other non interest income		(26)	(55)
Statutory basis			
Income from trading activities			
- adjusted basis	703	820	806
- own credit adjustments	(69)	154	254
Statutory basis	634	974	1,060
(Loss)/gain on redemption of own debt - statutory basis	(7)	(126)	(263)
Strategic disposals (1)			
- adjusted basis	347	164	(157)
- other operating income	(347)	(164)	157
Statutory basis			
Other operating income			
- adjusted basis	717	309	528
- own credit adjustments		26	55
- strategic disposals	347	164	(157)
Statutory basis	1,064	499	426
Total non-interest income - adjusted basis	4,146	3,882	4,156
Total non-interest income - statutory basis	4,146	3,882	4,156

Note:

(1) Items reallocated to other income lines, not reconciling items.

Business review

2017 compared with 2016

Non-interest income of £4,146 million increased by £264 million, or 6.8%, compared with 2016, primarily reflecting a £185 million debt sale gain in UK PBB and a £183 million increase in strategic disposals gains, partially offset by an own credit adjustment loss of £69 million compared with a gain of £180 million in 2016.

Net fees and commissions decreased by £80 million, or 3.2%, compared with 2016 reflecting a £48 million reduction in UK PBB, driven by increased cash back payments as the Reward proposition continued to grow with customer accounts 26% higher than 2016, and lower income in NatWest Markets.

Income from trading activities decreased by £117 million, or 14.3%, compared with 2016 primarily reflecting lower income in NatWest Markets, down £247 million, or 29.8%, driven by increased losses in the legacy business. A gain of £2 million for volatile items under IFRS in 2017 compared with a charge of £510 million in 2016. This movement was broadly offset by FX losses of £183 million in 2017, compared with FX gains of £446 million in 2016, following the strengthening of sterling against the US dollar.

Other operating income increased by £408 million primarily reflecting increased NatWest Markets income and the debt sale gain in UK PBB.

2016 compared with 2015

Non-interest income was £3,882 million, a reduction of £274 million, or 6.6%, compared with 2015. The legacy NatWest Markets business non-interest income reduced by £775 million reflecting planned asset disposal, including £572 million of disposal losses compared with £367 million in 2015, and a funding valuation adjustment of £170 million. In addition, we recognised a charge of £510 million for volatile items under IFRS compared with a £15 million gain in 2015. Partially offsetting, we reported a strategic disposal gain of £164 million, compared with a loss of £157 million in 2015, a loss on redemption of own debt of £126 million, compared with £263 million in 2015, an FX gain of £349 million following the significant weakening of sterling against the dollar and a £97 million foreign exchange reserve recycling gain.

Net fees and commissions decreased by £398 million, or 13.6%, compared with 2015 reflecting the planned asset run-down in the legacy NatWest Markets business, £168 million, a reduction in NatWest Markets core business, £175 million, and a £33 million reduction in UK PBB, driven by lower credit card interchange fees and increased cash back payments following the launch of the Rewards account.

Income from trading activities increased by £14 million to £820 million as an £86 million increase in NatWest Markets income has been partially offset by an increased charge for volatile items under IFRS.

Other operating income reduced by £219 million principally reflecting planned asset disposals in the legacy NatWest Markets business.

Business review

Analysis of results continued

Operating expenses

The following table reconciles adjusted operating expenses (a non-GAAP financial measure) to the statutory basis.

	2017 £m	2016 £m	2015 £m
Staff costs			
- adjusted basis (1)	3,923	4,482	4,896
- restructuring costs	753	642	830
Statutory basis	4,676	5,124	5,726
Premises and equipment			
- adjusted basis (1)	1,218	1,297	1,483
- restructuring costs	347	91	344
Statutory basis	1,565	1,388	1,827
Other administrative expenses			
- adjusted basis (1)	1,710	1,619	2,124
- litigation and conduct costs	1,285	5,868	3,568
- restructuring costs	328	1,258	596
Statutory basis	3,323	8,745	6,288
Restructuring costs (2)			
- adjusted basis	1,565	2,106	2,931
- staff expenses	(753)	(642)	(830)
- premises and equipment	(347)	(91)	(344)
- other administrative expenses	(328)	(1,258)	(596)
- depreciation and amortisation	(124)	(73)	(402)
- write down of other intangible assets	(13)	(42)	(759)
Statutory basis			
Litigation and conduct costs (2)			
- adjusted basis	1,285	5,868	3,568
- other administrative expenses	(1,285)	(5,868)	(3,568)
Statutory basis			
Administratative expenses - non-statutory	9,701	15,372	15,002
Administratative expenses - statutory	9,564	15,257	13,841
Depreciation and amortisation			
- adjusted basis (1)	684	705	778
- restructuring costs	124	73	402
Statutory basis	808	778	1,180
Write down of goodwill (2)			
- adjusted basis			498
- write down of goodwill			(498)
Statutory basis			
Write down of other intangible assets			
- adjusted basis (1)	16	117	75
- write down of other intangible assets	(16)	(117)	(75)
Statutory basis			
Write-down of other goodwill and other intangible assets			

- adjusted basis (1)			
- write down of goodwill			498
- write off of intangible assets	16	117	75
- restructuring costs	13	42	759
Statutory basis	29	159	1,332
Operating expenses - adjusted basis	10,401	16,194	16,353
Operating expenses - statutory basis	10,401	16,194	16,353

Notes:

(1) Adjusted basis is calculated as operating expenses before restructuring costs and litigation and conduct costs.

(2) Items reallocated to other expense lines, not reconciling items.

Business review

2017 compared with 2016

Total operating expenses of £10,401 million were £5,793 million, or 35.8%, lower than 2016 reflecting a £4,583 million reduction in litigation and conduct costs, a £669 million, or 8.1%, reduction in adjusted operating expenses(1) which excludes a £541 million reduction in restructuring costs.

Excluding VAT recoveries of £86 million (2016 - £227 million), adjusted operating expenses(1) have reduced by £810 million for the year, ahead of our £750 million targeted reduction, with approximately 45% of the total cost reduction delivered across PBB (comprising the reportable segments UK PBB and Ulster Bank RoI), CPB (comprising the reportable segments Commercial Banking and Private Banking , RBSI and the NatWest Markets core business, adjusting for transfers.(1,2)

Staff costs of £3,923 million were £559 million, or 12.5%, lower than 2016 underpinned by a 6,600, or 8.5%, reduction in FTEs.

Restructuring costs of £1,565 million included: a £303 million charge relating to the reduction in the property portfolio; a £319 million charge in NatWest Markets principally relating to the run-down and closure of the legacy business; £221 million relating to the business previously described as Williams & Glyn; £194 million in respect of implementing ring-fencing requirements; and a £73 million net settlement relating to the RBS Netherlands pension scheme.

Litigation and conduct costs of £1,285 million included: additional charges in respect of settlement with Federal Housing Finance Agency (FHFA) and the California State Attorney General and additional RMBS related provisions in the US; a further provision in relation to settling the 2008 rights issue shareholder litigation; an additional £175 million PPI provision; and a £169 million provision in Ulster Bank RoI for customer remediation and project costs relating to tracker mortgages and other legacy business issues.

2016 compared with 2015

Operating expenses of £16,194 million were £159 million, or 1%, lower than 2015 reflecting a £1,136 million, or 12%, reduction in adjusted operating expenses(1) which excludes a £825 million, or 28%, reduction in restructuring costs. In addition, 2015 included a £498 million write down of goodwill relating to Private Banking. Partially offsetting the above, litigation and conduct costs increased by £2,300 million.

Adjusted operating expenses(1) reduced by £1,136 million, or 12%, compared with 2015 to £8,220 million. Excluding expenses associated with the business previously described as Williams & Glyn £393 million (2015 - £359 million), write down of intangibles £117 million (2015 - £75 million) and a £227 million VAT recovery, adjusted expenses(1) reduced by £985 million, or 11%, in excess of our £800 million target. RBS has achieved a cumulative cost reduction of £3.1 billion across 2014 - 2016.

Staff costs of £5,124 million were £602 million, or 11%, lower than 2015 underpinned by a 13,700, or 15%, reduction in FTEs and a reduction in restructuring costs of £188 million, or 23% to £642 million.

Restructuring costs were £2,106 million for 2016, compared with £2,931 million in 2015, and included a £750 million provision in respect of the 17 February 2017 update on RBS s remaining State Aid obligation regarding the business previously described as Williams & Glyn. In addition, £706 million of the remaining restructuring costs relate to the business previously described as Williams & Glyn, including £146 million of termination costs associated with the decision to discontinue the programme to create a cloned banking platform.

Litigation and conduct costs of £5,868 million included; a £3,107 million provision in relation to various investigations and litigation matters relating to RBS s issuance and underwriting of residential mortgage-backed securities (RMBS), £601 million of additional PPI provisions, a £400 million provision in respect of the FCA review of RBS s treatment of SMEs, an additional £169 million charge in respect of the settlement with the National Credit Union Administration Board to resolve two outstanding RMBS lawsuits in the United States relating to residential mortgage backed securities, a £172 million provision in Ulster Bank RoI, principally in respect of remediation and programme costs associated with an industry wide examination of tracker mortgages, and a provision in respect of the UK 2008 rights issue shareholder litigation.

Notes:

(1) Refer to income statement reconciliations on page 120.

(2) Including the impact of transfers. See notes on page 16 for further details.

Business review

Analysis of results continued

Impairment losses

	2017	2016	2015
	£m	£m	£m
New impairment losses/(releases)	649	587	(552)
Less: recoveries of amounts previously written-off	(156)	(109)	(175)
Losses/(releases) to income statement	493	478	(727)
Comprising:			
Loan impairment losses/(releases)	530	537	(853)
Securities	(37)	(59)	126
Losses/(releases) to income statement	493	478	(727)

2017 compared with 2016

A net impairment loss of £493 million, 15 basis points of gross customer loans, compared with £478 million in 2016.

UK PBB reported a net impairment charge of £235 million, or 14 basis points of gross customer loans, reflecting continued benign credit conditions.

Ulster Bank RoI reported a net impairment loss of £60 million (68 million) compared with a £113 million (138 million) release in 2016. The charge for the year included a provision relating to a change in the non performing loan strategy to allow for further portfolio sales whilst 2016 included gains arising from the impact of asset disposals.

Commercial Banking net impairment losses of £362 million were £156 million higher than 2016, reflecting a small number of single name impairments.

NatWest Markets net impairment release of £174 million compared with a net impairment loss of £253 million in 2016 and mainly comprised releases relating to the legacy business.

REIL reduced by £1,406 million during 2017 to £8,904 million principally reflecting reductions in NatWest Markets, as legacy portfolios are run-down, and reductions across UK PBB and Ulster Bank RoI. REIL represented 2.7% of gross customer loans, compared with 3.1% in 2016.

2016 compared with 2015

A net impairment loss of £478 million, 15 basis points of gross customer loans, compared with a net impairment release of £727 million in 2015.

UK PBB reported a net impairment loss of £125 million compared with £8 million in 2015.

Commercial Banking net impairment losses of £206 million were £137 million higher than 2015 and comprised a small number of single name impairments.

Ulster Bank RoI reported a net impairment release of £113 milion (138 million) compared with £141 million (194 million) in 2015. The 2016 impairment release included a write back associated with the sale of a portfolio of loans. REIL remained stable at £3.5 billion in 2016 due to the strengthening of the euro, but in euro terms REIL reduced by 0.6 billion driven by the portfolio sale, partially offset by a widening of the definition of loans which are considered to be impaired.

REIL reduced by £1,847 million during 2016 to £10,310 million reflecting Capital Resolution run-down and a portfolio sale in Ulster Bank RoI partially offset by an increase in the shipping portfolio, foreign exchange movements and the implementation of a revised mortgage methodology in Ulster Bank RoI.

REIL represented 3.1% of gross customer loans compared with 3.9% at 31 December 2015. Provision coverage was 43% compared with 59% at 31 December 2015, with the reduction largely driven by Ulster Bank RoI and the legacy NatWest Markets business.

Tax

	2017	2016	2015
	£m	£m	£m
Tax charge	(824)	(1,166)	(23)
UK corporation tax rate	19.25%	20.00%	20.25%

2017 compared with 2016

The tax charge for the year ended 31 December 2017 is higher than the UK statutory tax rate reflecting the impact of the banking surcharge, non-deductible bank levy and conduct charges for which no tax relief has been recognised, a reduction in the carrying value and impact of UK tax rate changes on deferred tax balances. These factors have been offset partially by the release of tax provisions that reflect the reduction of exposures in countries where RBS is ceasing operations.

2016 compared with 2015

The tax charge for the year ended 31 December 2016 reflects the impact of the banking surcharge, non-deductible bank levy and conduct charges for which no tax relief has been recognised, a reduction in the carrying value and impact of UK tax rate changes on deferred tax balances, and the release of tax provisions that reflect the reduction of exposures in countries where RBS is ceasing operations.

Business review

Consolidated balance sheet as at 31 December 2017

	2017	2016
	£m	£m
Assets		
Cash and balances at central banks	98,337	74,250
Net loans and advances to banks	16,254	17,278
Reverse repurchase agreements and stock borrowing	13,997	12,860
Loans and advances to banks	30,251	30,138
Net loans and advances to customers	323,184	323,023
Reverse repurchase agreements and stock borrowing	26,735	28,927
Loans and advances to customers	349,919	351,950
Debt securities subject to repurchase agreements	23,781	18,107
Other debt securities	55,152	54,415
Debt securities	78,933	72,522
Equity shares	450	703
Settlement balances	2,517	5,526
Derivatives	160,843	246,981
Intangible assets	6,543	6,480
Property, plant and equipment	4,602	4,590
Deferred tax	1,740	1,803
Prepayments, accrued income and other assets	3,726	3,700
Assets of disposal groups	195	13
Total assets	738,056	798,656
Liabilities		
Bank deposits	39,479	33,317
Repurchase agreements and stock lending	7,419	5,239
Deposits by banks	46,898	38,556
Customer deposits	367,034	353,872
Repurchase agreements and stock lending	31,002	27,096
Customer accounts	398,036	380,968
Debt securities in issue	30,559	27,245
Settlement balances	2,844	3,645
Short positions	28,527	22,077
Derivatives	154,506	236,475
Provisions for liabilities and charges	7,757	12,836
Accruals and other liabilities	6,392	6,991
Retirement benefit liabilities	129	363
Deferred tax	583	662
Subordinated liabilities	12,722	19,419
Liabilities of disposal groups	10	15
Total liabilities	688,963	749,252
Non-controlling interests	763	795
Owners equity	48,330	48,609
Total equity	49,093	49,404
Total liabilities and equity	738,056	798,656
Tangible net asset value per ordinary share (1)	294p	296p

Note:

(1) Tangible net asset value per ordinary share represents tangible equity divided by the number of ordinary shares in issue.

Business review

Commentary on consolidated balance sheet

2017 compared with 2016

Total assets of £738.1 billion as at 31 December 2017 were down £60.6 billion, 7.6%, compared with 31 December 2016. This was primarily driven by decreases in derivative assets, partly offset by increased central bank deposits and loan growth in UK PBB and Commercial Banking.

Cash and balances at central banks increased by £24.1 billion, 32.5%, to £98.3 billion. This was primarily due to increased deposits received from the Bank of England Term Funding Scheme (TFS).

Loans and advances to banks increased by £0.2 billion, 0.7%, to £30.3 billion. Excluding reverse repurchase agreements and stock borrowing (reverse repos), which were up £1.1 billion, 8.5%, to £14.0 billion, bank placings declined £1.0 billion, 5.8%, to £16.3 billion.

Loans and advances to customers decreased by £2.0. billion, 0.6%, to £349.9 billion. Within this, reverse repos were down £2.2 billion, 7.6%, to £26.7 billion. Customer lending increased by £0.2 billion, 0.1%, to £323.2 billion. This reflected increases across the retail and commercial business, in particular in UK PBB mortgage lending offset by the run-down of the NatWest Markets legacy business.

Debt securities were up £6.4 billion, 8.8%, to £78.9 billion, mainly due to increased holdings in UK and European government securities in RBS Treasury.

Equity shares decreased by £0.2 billion, 28.6%, to £0.5 billion, primarily due to the sale of RBS s holding in EuroClear.

Settlement balances decreased by £3.0 billion, 54.5%, to £2.5 billion, primarily as a result of the run-down in the NatWest legacy business.

Movements in the value of derivative assets, down £86.2 billion, 34.9%, to £160.8 billion, and liabilities, down £82.0 billion, 34.7% to £154.5 billion, due to maturities, derivative mitigation activities, buyouts in NatWest Markets and mark-to-market movement as US dollar weakened against the Euro and Sterling.

Deposits by banks increased by £8.3 billion, 21.8%, to £46.9 billion, with increases in inter-bank deposits, up £6.2 billion, 18.6%, to £39.5 billion, primarily driven by amounts received under the TFS, offset by reductions in the cash collateral held against derivatives. Repurchase agreements and stock lending (repos), increased by £2.2 billion, 42.3%, to £7.4 billion, primarily driven by increased process efficiencies and increased trading activity partially offset by netting benefits in RBS Treasury and NatWest Markets.

Customer accounts increased £17.0 billion, 4.5%, to £398.0 billion. Within this, repos increased £3.9 billion to £31.0 billion. Excluding repos, customer deposits were up £13.1 billion, 3.7%, to £367.0 billion, primarily reflecting growth in UK PBB, Ulster Bank RoI and RBSI offset by run-down in the NatWest Markets legacy business.

Debt securities in issue increased by £3.4 billion, 12.5%, to £30.6 billion reflecting new covered bond issuances offset by maturities in RBS Treasury along with mark-to-market and foreign exchange movements.

Short positions increased by £6.4 billion, 29.0%, to £28.5 billion as a result of the increase in debt securities held.

Provisions for liabilities and charges decreased by £5.1 billion, 39.6%, to £7.8 billion, reflecting settlements being reached in various litigation cases, most notably in relation to US residential mortgage-backed securities claims.

Subordinated liabilities decreased by £6.7 billion, 34.5% to £12.7 billion, primarily as a result of the net decrease in dated and undated loan capital with redemptions of £4.2 billion and £1.5 billion respectively, reflecting on-going liability management activities.

Owners equity decreased by £0.3 billion, 0.6%, to £48.3 billion, primarily driven by dividends paid and preference share redemptions offset by the £1.4 billion profit for the year.

Business review

Cash flow

	2017	2016	2015
	£m	£m	£m
Net cash flows from operating activities	38,741	(3,650)	918
Net cash flows from investing activities	(6,482)	(4,359)	(4,866)
Net cash flows from financing activities	(8,208)	(5,107)	(940)
Effects of exchange rate changes on cash and cash equivalents	(16)	8,094	576
Net increase/(decrease) in cash and cash equivalents	24,035	(5,022)	(4,312)

2017

The major factors contributing to the net cash inflow from operating activities of £38,741 million were an increase of £42,147 million in operating assets and liabilities, operating profit before tax of £2,239 million, other provisions charged net of releases of £1,930 million, depreciation and amortisation of £808 million and interest on subordinated liabilities of £572 million. These were partially offset by provisions utilised of £6,476 million, loans and advances written-off net of recoveries of £1,054 million and contributions to defined benefit pension schemes of £627 million.

Net cash outflows from investing activities of £6,482 million related to the net outflows from purchase and sale of securities of £5,556 million, the purchase of property, plant and equipment of £1,132 million and £199 million outflows from disposals, offset by net cash inflows from the sale of property, plant and equipment of £405 million.

Net cash outflows from financing activities of £8,208 million relate primarily to the redemption of subordinated liabilities of £5,747 million, redemption of debt preference shares of £748 million, redemption of paid-in equity of £720 million, interest paid on subordinated liabilities of £717 million and dividends paid of £612 million.

2016

The major factors contributing to the net cash outflow from operating activities of £3,650 million were the elimination of foreign exchange differences £6,518 million, contribution to defined benefit schemes of £4,786 million, loans and advances written-off net of recoveries of £3,586 million, operating loss before tax of £4,082 million and other provisions utilised of £2,699 million. These were partially offset by inflows from an increase of £8,413 million in operating assets and liabilities, other provisions charged net of releases of £7,216 million, interest on subordinated liabilities of £845 million and depreciation and amortisation of £778 million.

Net cash outflows from investing activities of £4,359 million related to the net outflows from purchase and sale of securities of £3,008 million, the purchase of property, plant and equipment of £912 million and £886 million outflows from disposals, offset by net cash inflows from the sale of property, plant and equipment of £447 million.

Net cash outflows from financing activities of £5,107 million relate primarily to the redemption of subordinated liabilities of £3,606 million, redemption of equity preference shares of £1,160 million, the final payment to retire the Dividend Access Share of £1,193 million and interest paid on subordinated liabilities of £813 million. These outflows were partly offset by the inflow from the issuance of Additional Tier 1 capital notes of £2,046 million.

2015

The major factors contributing to the net cash inflow from operating activities of £918 million were the increase of £8,589 million in operating assets and liabilities, other provisions charged net of releases of £4,566 million, write down of goodwill and other intangible assets £1,332 million and depreciation and amortisation of £1,180 million. These were partially offset by loans and advances written-off net of recoveries of £8,789 million, other provisions utilised of £2,202 million, elimination of foreign exchange differences of £1,501 million, profit on sale of subsidiaries and associates of £1,135 million, cash contribution to defined benefit pension schemes of £1,060 million, decrease in income accruals of £1,075 million and the operating loss before tax of £937 million.

Net cash outflows from investing activities of £4,866 million related to the net outflows from purchase of securities of £5,906 million and the purchase of property, plant and equipment of £783 million, offset by inflows of £391 million from disposals, primarily Citizens and net cash inflows from the sale of property, plant and equipment of £1,432 million.

Net cash outflows from financing activities of £940 million relate primarily to the redemption of subordinated liabilities of £3,047 million, redemption of preference shares of £1,214 million and interest paid on subordinated liabilities of £975 million partly offset by the proceeds of non-controlling interests issued of £2,537 million and the issue of Additional Tier 1 capital notes of £2,012 million

Business review

Financial summary

RBS s financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years is presented below.

Summary consolidated income statement	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Net interest income	8,987	8,708	8,767	9,258	9,017
Non-interest income (1,2,3)	4,146	3,882	4,156	5,892	7,720
Total income	13,133	12,590	12,923	15,150	16,737
Operating expenses (4)	(10,401)	(16,194)	(16,353)	(13,859)	(17,466)
Profit/(loss) before impairment (losses)/releases	2,732	(3,604)	(3,430)	1,291	(729)
Impairment (losses)/releases	(493)	(478)	727	1,352	(8,120)
Operating profit/(loss) before tax	2,239	(4,082)	(2,703)	2,643	(8,849)
Tax charge	(824)	(1,166)	(23)	(1,909)	(186)
Profit/(loss) from continuing operations	1,415	(5,248)	(2,726)	734	(9,035)
Profit/(loss) from discontinued operations, net of tax (5)			1,541	(3,445)	558
Profit/(loss) for the year	1,415	(5,248)	(1,185)	(2,711)	(8,477)
Attributable to:					
Non-controlling interests	35	10	409	60	120
Preference shareholders	234	260	297	330	349
Paid-in equity holders	394	244	88	49	49
Dividend access share		1,193		320	
Ordinary shareholders	752	(6,955)	(1,979)	(3,470)	(8,995)
	1,415	(5,248)	(1,185)	(2,711)	(8,477)

Notes:

(1) Includes profit on strategic disposals of £347 million (2016 - £164 million profit; 2015 - £157 million loss; 2014 - £191 million profit; 2013 - £161 million profit).

(2) Includes loss on redemption of own debt of £7 million (2016 - £126 million loss; 2015 - £263 million loss; 2014 - £20 million gain; 2013 - £175 million gain).

(3) Includes own credit adjustments of £69 million loss (2016 - £180 million gain; 2015 - £309 million gain; 2014 - £146 million loss; 2013 - £120 million loss).

(4) Includes no write down of goodwill in 2017 (2016 - nil; 2015 - £498 million; 2014 - £130 million; 2013 - £1,059 million).

(5) Includes a gain of £1,117 million relating to the sell-down of Citizens in 2015 (2014 - £3,994 million loss).

Summary consolidated balance sheet	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Loans and advances	380,170	382,088	364,538	421,973	494,793
Debt securities and equity shares	79,383	73,225	83,458	92,284	122,410
Derivatives and settlement balances	163,360	252,507	266,630	358,257	293,630
Other assets	115,143	90,836	100,782	178,505	116,989
Total assets	738,056	798,656	815,408	1,051,019	1,027,822
Owners equity	48,330	48,609	53,431	55,763	58,658
Non-controlling interests	763	795	716	2,946	473
Subordinated liabilities	12,722	19,419	19,847	22,905	24,012
Deposits	444,934	419,524	408,594	452,304	534,859
Derivatives, settlement balances and short positions	185,877	262,197	278,904	377,337	318,861
Other liabilities	45,430	48,112	53,916	139,764	90,959
Total liabilities and equity	738,056	798,656	815,408	1,051,019	1,027,822

Business review

Other financial data

Share information	2017	2016	2015	2014	2013
Basic and diluted earnings/(loss) per ordinary share from continuing operations - pence (1)	6.3	(59.5)	(27.7)	0.5	(85.0)
Share price per ordinary share at year end - £	2.78	2.25	3.02	3.94	3.38
Market capitalisation at year end - £bn	33.3	26.6	35.1	45.2	38.2
Net asset value per ordinary share - £	4.10	4.18	4.66	5.12	5.23
Capital ratios					
Return on average total assets (2)	0.1%	(0.8%)	(0.2%)	(0.3%)	(0.7%)
Return on average total equity (3)	2.0%	(10.2%)	(2.9%)	(4.6%)	(12.8%)
Return on average ordinary shareholders equity (4)	1.9%	(15.3%)	(4.0%)	(6.5%)	(14.7%)
Average total equity as a percentage of average total assets	7.0%	6.2%	6.0%	5.8%	5.5%
Risk asset ratio - Tier 1 (5)	19.7%	17.7%	19.1%	13.2%	13.1%
Risk asset ratio - Total (5)	23.9%	22.9%	24.7%	17.1%	16.5%
Earnings ratio					
Ratio of earnings to combined fixed charges and preference share dividends (6,7)					
- including interest on deposits	1.58	(0.45)	0.17	1.52	(0.51)
- excluding interest on deposits	2.25	(2.13)	(1.17)	2.61	(5.12)
Ratio of earnings to fixed charges only (6,7)					
- including interest on deposits	2.05	(0.53)	0.19	1.67	(0.55)
- excluding interest on deposits	4.37	(3.25)	(1.60)	3.58	(6.95)

Notes:

(1) None of the convertible securities had a dilutive effect in the years 2013 to 2017.

(2) Return on average total assets represents loss attributable to ordinary shareholders as a percentage of average total assets.

(3) Return on average total equity represents loss attributable to equity owners expressed as a percentage of average shareholder funds.

(4) Return on average ordinary shareholders equity represents loss attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders equity.

(5) 2017, 2016, 2015 and 2014 are calculated on a PRA transitional basis; 2013 is calculated on a Basel 2.5 basis.

(6) For this purpose, earnings consist of income before tax and non-controlling interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

(7) The earnings for the years ended 31 December 2016, 2015 and 2013 were inadequate to cover total fixed charges and preference share dividends. The coverage deficiency for total fixed charges and preference share dividends for the years ended 31 December 2016, 2015 and 2013 was £4,586 million, £3,088 million and £9,247 million respectively. The coverage deficiency for fixed charges for they years ended 31 December 2016, 2015 and 2013 was £4,082 million, £2,703 million and £8,849 million respectively.

Business review

Segment performance

UK Personal & Business Banking

	2017	2016	2015
Income statement	£m	£m	£m
Net interest income	5,130	4,945	4,810
Net fees and commissions	1,099	1,147	1,180
Other non-interest income	248	35	43
Non-interest income	1,347	1,182	1,223
Total income	6,477	6,127	6,033
Direct expenses			
- staff costs	(773)	(832)	(950)
- other costs	(259)	(320)	(297)
Indirect expenses	(2,126)	(2,246)	(2,150)
Restructuring costs			
- direct	(79)	(46)	(66)
- indirect	(382)	(198)	(129)
Litigation and conduct costs	(210)	(634)	(972)
Operating expenses	(3,829)	(4,276)	(4,564)
Operating profit before impairment losses	2,648	1,851	1,469
Impairment losses	(235)	(125)	(8)
Operating profit	2,413	1,726	1,461
Operating expenses - adjusted (1)	(3,158)	(3,398)	(3,397)
Operating profit - adjusted (1)	3,084	2,604	2,628
Analysis of income by product			
Personal advances	998	1,010	839
Personal deposits	841	732	817
Mortgages	2,641	2,560	2,534
Cards	743	653	666
Business banking	781	737	726
Commercial	417	415	394
Other	56	20	57
Total income	6,477	6,127	6,033
Analysis of impairments by sector			
Personal advances	167	105	84
Mortgages	(42)	(20)	1
Cards	82	36	14
Business banking	4	(11)	(79)
Commercial	24	15	(1)
Other			(11)
Total impairment losses	235	125	8
Loan impairment charge/(release) as a % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			

Personal advances	2.4%	1.5%	1.2%
Cards	2.1%	0.9%	0.3%
Business banking	0.1%	(0.2%)	(1.5%)
Commercial	0.3%	0.2%	
Other			(0.8%)
Total	0.1%	0.1%	

Performance ratios			
Return on equity (2)	23.7%	16.2%	13.5%
Return on equity - adjusted (1,2)	30.7%	25.1%	25.3%
Net interest margin	2.86%	2.97%	3.13%
Cost:income ratio	59.1%	69.8%	75.7%
Cost:income ratio - adjusted (1)	48.8%	55.5%	56.3%

Notes:

(1) Excluding restructuring costs and litigation and conduct costs.

(2) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 15% of the monthly average of segmental RWAes, assuming 28% tax rate.

Business review

UK Personal & Business Banking continued

Capital and balance sheet	2017 £bn	2016 £bn	2015 £bn
Loans and advances to customers (gross)			
- personal advances	7.1	6.9	6.9
- mortgages	136.8	128.0	115.3
- cards	4.0	4.2	4.4
- business banking	6.8	6.3	5.3
- commercial	8.3	8.8	8.7
- other			1.3
Total loans and advance to customers (gross)	163.0	154.2	141.9
Loan impairment provisions	(1.3)	(1.5)	(2.1)
Net loans and advances to customers	161.7	152.7	139.8
Total assets	190.6	181.4	168.0
Funded assets	190.6	181.4	168.0
Risk elements in lending	2.0	2.4	3.2
Provision coverage (1)	65%	65%	68%
Customer deposits			
- personal current accounts	49.6	45.3	40.9
- personal savings	92.8	88.5	86.6
- business banking	23.9	21.5	19.6
- commercial	14.3	14.7	12.7
- other			2.1
Total customer deposits	180.6	170.0	161.9
Assets under management (excluding deposits)	4.1	4.2	4.3
Loan:deposit ratio (excluding repos)	90%	90%	86%
Risk-weighted assets			
- Credit risk (non-counterparty)	33.7	33.0	33.9
- Operational risk	9.3	9.3	9.3
Total risk-weighted assets	43.0	42.3	43.2

Note:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

UK Personal & Business Banking continued

Serving our customers

UK PBB continues to invest in our digital channel offering and now has 5.5 million customers regularly using our mobile app, 20% higher than December 2016, representing 68% digital penetration of our active current account customers.

Digital sales volumes increased by 11% in 2017, while the number of digital service transactions rose by 7% in the year as the number of branch transactions fell by 9%, demonstrating the changing behaviour of our customers. Further enhancements were made during 2017, along with the introduction of a TechXpert in every branch to support customers in the use of digital banking tools. NatWest was awarded Best Banking App at the British Bank Awards in 2017 and we continue to receive very positive customer feedback.

Given the change in customer behaviour and expectations over the past few years, we recently announced further branch closures. We recognise that branch interactions are still important for some customers and we have a significant branch network, which we continue to upgrade and improve, as well as our investment in mobile branches and Community Bankers in addition to access to Post Office services to meet these customer requirements.

UK PBB continued to deliver strong support to personal customers with mortgage balance growth of 7.0% compared with 2016. We continued to drive improvements in our customer mortgage experience, including being the first bank to launch a paperless mortgage journey, with NatWest Intermediary Solutions named Best Overall Lender at the 2017 Mortgage Advice Bureau Awards. Personal unsecured loans also saw balance growth of 7% compared with 2016 supported by an improved customer experience, with increased mobile functionality and simplified application processing resulting in digital loan sales growth of 20% compared with 2016 and 50% of sales transacted via this channel. Our overall personal unsecured risk appetite remains consistent with 2016, with new business quality stable on 2016.

The Reward proposition continued to grow with more than 1,450,000 customer accounts, 26% higher than December 2016. We repositioned the Reward account proposition from 26 June 2017, including the introduction of minimum customer criteria, supporting improved returns in the second half of 2017.

Our free Financial Health Check continues to provide personal and business customers with advice on their financial position and what options are open to them, including adoption of digital banking. More than 1,300,000 Financial Health Checks have been completed in 2017.

Our business banking segment continues to deliver customer improvements with an enhanced digital offering, with 80% of accounts opened during the last quarter of 2017 using this channel, and a simplified new lending process for loans up to £50,000, delivering same day loan approval and supporting ongoing productivity improvements. Following a successful pilot the FreeAgent accounting software rollout was extended in Q4 2017, with more than 8,300 customers now registered users.

Our business banking risk appetite remains consistent with 2016 with new business quality broadly stable on 2016.

2017 compared with 2016

Operating profit was £2,413 million compared with £1,726 million in 2016. The increase was driven by higher income, lower adjusted operating expenses(1) and lower litigation and conduct charges, partially offset by higher restructuring costs, largely relating to the reduction in our property portfolio and costs associated with the business previously described as Williams & Glyn, and higher impairments. Return on equity increased to 23.7% from 16.2% in 2016.

Total income of £6,477 million was £350 million, or 5.7%, higher than 2016, principally reflecting strong balance growth, savings re-pricing benefits and a £185 million debt sale gain. Net interest margin declined by 11 basis points to 2.86% driven by lower mortgage margins, asset mix and reduced current account hedge yield, partially offset by savings re-pricing benefits from actions taken in 2016 and following the Q4 2017 base rate increase.

Operating expenses decreased £447 million, or 10.5%, to £3,829 million. Adjusted operating expenses(1) decreased by £240 million, or 7.1%, to £3,158 million compared with 2016 driven by a £59 million, or 7.1%, reduction in staff costs, with headcount down 8.3%, and a £181 million reduction in operational costs following process and productivity improvements in service operations and re-integration benefits in respect of the business previously described as Williams & Glyn(2). Cost:income ratio improved to 59.1% in 2017 compared with 69.8% in 2016. Adjusted cost:income ratio(1) improved to 48.8% in 2017 compared with 55.5% in 2016.

The net impairment charge of £235 million, or 14 basis points of gross customer loans, reflected continued benign credit conditions. 2017 had lower recoveries partly as a result of the debt sales undertaken, compared with 2016. Defaults remained at very low levels across all portfolios compared to historic trends, although slightly higher than in 2016.

Net loans and advances increased by £9.0 billion, or 5.9%, to £161.7 billion as UK PBB continued to deliver support for both personal and business banking customers. Gross new mortgage lending in 2017 was £31.0 billion with market share of new mortgages at approximately 12%, resulting in stock share of approximately 10% at 31 December 2017 compared with 9.7% at 31 December 2016. Positive momentum continued across business banking lending, with net balances up 3.0% compared with 31 December 2016, adjusting for transfers(4).

Customer deposits increased by £10.6 billion, or 6.2%, to £180.6 billion, driven by strong personal current account and business deposit growth.

UK PBB includes commercial income from the business previously described as Williams & Glyn of approximately £417 million, gross loans and advances of £8.3 billion and deposits of £14.3 billion. An estimated £70 million of the commercial income, £1.7 billion of gross loans and advances and £1.8 billion of deposits relates to mid-corporate customers not subject to the European Commission alternative remedies package. 120,000 of the remaining approximately 220,000 customers will be subject to the remedies package.

Business review

UK Personal & Business Banking continued

2016 compared with 2015

Operating profit was £1,726 million, compared with £1,461 million in 2015, and included a £634 million litigation and conduct charge, principally in respect of additional PPI provisions. Adjusted operating profit(1) of £2,604 million was £24 million, or 1%, lower than 2015 principally reflecting higher impairment losses, partially offset by net interest income.

Total income of £6,127 million increased by £94 million, or 2%, compared with 2015, despite the lower rate environment depressing earnings on current accounts and the impact of regulatory changes impacting interchange fees. Net interest income was robust, increasing by £135 million, or 3%, reflecting continued strong asset growth combined with the active repricing of our deposit book. This more than offset the impact of lower current account hedge returns and lower mortgage margins. Net interest margin declined by 16 basis points to 2.97% reflecting the change in the overall portfolio mix and reduced mortgage margins. During the second half of 2016 mortgage SVR balances stabilised at approximately 12%, broadly in line with historical levels.

Non-interest income reduced by £41 million, or 3%, principally reflecting lower credit card interchange fees, following regulatory changes introduced in 2015. In addition, cash back payments on the Reward account have impacted fee income, however, we have seen increased levels of customer engagement. Partially offsetting, we recognised a £19 million debt sale gain in 2016.

Operating expenses decreased £288 million, or 6.3%, to £4,276 million. Adjusted operating expenses(1) remained the same. Direct staff costs were £118 million, or 12%, lower driven by an 17% reduction in headcount reflecting the continued movement to digital channels, exiting of business lines with returns below required levels and some centralisation of administrative activities. This was partially offset by additional investment costs of £102 million, including one-off intangible asset write-downs of £56 million in 2016, together with a £21 million increase in regulatory charges and increase in costs related to the business previously described as Williams & Glyn.

The net impairment charge of £125 million reflects continued benign credit conditions and compared with a £8 million charge in 2015, with the increase principally reflecting reduced portfolio provision releases. The default driven charge was 13% lower, excluding the business previously described as Williams & Glyn(2), than 2015 with REIL 25% lower and provision coverage remaining strong at 65%.

Net loans and advances of £152.7 billion increased by £12.9 billion, or 9%, compared with 2015 principally driven by mortgage growth of 11%. We continue to see positive momentum across business and personal unsecured lending, up by 6%, excluding transfers(4), and 9% respectively.

We continue to build on our strong mortgage market position with gross balances increasing by 11% to £128.0 billion compared with 3% growth for the overall mortgage market. Gross new lending in 2016 was £31.9 billion, representing a market share of approximately 13% compared with a stock share of approximately 9.7% at 31 December 2016, up from 8.9% in 2015**.**

New business margins were stable over 2016 whilst margins on existing customers remortgaging have improved. Gross new business banking lending to small and medium-sized enterprises of £1.6 billion was up 43% compared with 2015. Personal loan gross new lending of £2.7 billion was up 25% supported by the launch of functionality for a customer to apply via the mobile app combined with improvements to customer experience. We have continued to take a cautionary risk approach to personal unsecured lending. As a result, personal unsecured cards and overdrafts balances have decreased by £0.3 billion, or 5%, compared with 2015, and margins have widened.

Deposit balances performed strongly, increasing by £8.1 billion, or 5%, to £170.0 billion driven by 11% growth in personal current account balances. Personal savings balances increased 2% despite repricing activity.

RWAs decreased by £0.9 billion, or 3%, to £33.0 billion due to asset mix benefits and overall improved credit quality, largely reflecting the current benign credit conditions, partly offset by increased lending.

Notes:

(1) Refer to income statement reconciliations on page 120.

(2) The business previously described as Williams & Glyn was integrated in to the reportable operating segment UK PBB in Q4 2017 and prior year comparatives re-presented.

(3) UK PBB Collective Investment Funds (CIFL) business was transferred to Private Banking on 1 October 2017. CIFL Business transfer included total income of £33 million and total expenses of £9 million. Comparatives were not re-presented.

(4) Transfers include £0.4 billion loans and advances transferred from Commercial Banking to UK PBB during 2017 to better align Business banking customers. Comparatives were not re-presented.

Business review

Ulster Bank RoI

	2017	2016	2015	2017	2016	2015
Income statement	m	m	m	£m	£m	£m
Net interest income	480	501	503	421	409	365
Net fees and commissions	107	100	116	94	82	85
Other non-interest income	106	100	139	92	82	100
Own credit adjustments	(4)	3		(3)	3	
Non-interest income	209	203	255	183	167	185
Total income	689	704	758	604	576	550
Direct expenses						
- staff costs	(218)	(252)	(220)	(191)	(207)	(160)
- other costs	(76)	(68)	(116)	(66)	(55)	(85)
Indirect expenses	(222)	(239)	(251)	(194)	(195)	(182)
Restructuring costs						
- direct	(31)	(46)	(17)	(27)	(38)	(12)
- indirect	(33)	(2)	(4)	(29)	(2)	(3)
Litigation and conduct costs	(192)	(211)	18	(169)	(172)	13
Operating expenses	(772)	(818)	(590)	(676)	(669)	(429)
Operating (loss)/profit before impairment (losses)/releases	(83)	(114)	168	(72)	(93)	121
Impairment (losses)/releases	(68)	138	194	(60)	113	141
Operating profit/(loss)	(151)	24	362	(132)	20	262
Total income - adjusted (1)	693	701	758	607	573	550
Operating expenses - adjusted (2)	(516)	(559)	(587)	(451)	(457)	(427)
Operating profit - adjusted (1,2)	109	280	365	96	229	264
Average exchange rate - /£				1.142	1.224	1.377
Analysis of income by business						
Corporate	214	215	202	187	176	147
Retail	473	479	443	415	392	321
Other	2	10	113	2	8	82
Total income	689	704	758	604	576	550
Analysis of impairments by sector						
Mortgages	83	35	(100)	72	29	(73)
Commercial real estate						
- investment	(7)	(30)	7	(6)	(24)	5
- development	(4)	(25)		(3)	(20)	(1)
Other lending	(4)	(118)	(101)	(3)	(98)	(72)
Total impairment (losses)/releases	68	(138)	(194)	60	(113)	(141)

Loan impairment charge/(release) as a % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Mortgages	0.5%	0.2%	(0.5%)	0.5%	0.2%	(0.5%)
Commercial real estate						
- investment	(0.7%)	(3.8%)	0.8%	(0.7%)	(3.4%)	0.7%
- development	(4.0%)	(8.3%)		(3.0%)	(10.0%)	(0.5%)
Other lending	(0.1%)	(2.6%)	(1.9%)	(0.1%)	(2.5%)	(1.8%)
Total	0.3%	(0.6%)	(0.8%)	0.3%	(0.6%)	(0.8%)
Performance ratios						
Return on equity (3)	(5.0%)	0.7%	10.6%	(5.0%)	0.7%	10.6%
Return on equity - adjusted (1,2,3)	3.6%	8.4%	10.6%	3.6%	8.4%	10.6%
Net interest margin	1.67%	1.62%	1.57%	1.67%	1.62%	1.57%
Cost:income ratio	111.9%	116.1%	78.0%	111.9%	116.1%	78.0%
Cost:income ratio - adjusted (1,2)	74.3%	79.8%	77.6%	74.3%	79.8%	77.6%

Notes:

(1) Excluding own credit adjustments.

(2) Excluding restructuring costs and litigation and conduct costs.

(3) Return on equity is based on segmental operating profit after tax adjusted for preference share dividends divided by average notional equity (based on 14% (11% prior to Q1 2017) of the monthly average of segmental risk-weighted assets incorporating the effect of capital deductions (RWAes)), assuming 15% tax rate up to and including FY 2016, nil tax thereafter.

Business review

Ulster Bank RoI continued

Capital and balance sheet	2017 bn	2016 bn	2015 bn	2017 £bn	2016 £bn	2015 £bn
Loans and advances to customers (gross)						
Mortgages	17.3	17.9	18.8	15.4	15.3	13.8
Commercial real estate						
- investment	1.0	0.8	0.9	0.9	0.7	0.7
- development	0.1	0.3	0.3	0.1	0.2	0.2
Other lending	4.9	4.5	5.3	4.2	3.9	3.9
Total loans and advances to customers (gross)	23.3	23.5	25.3	20.6	20.1	18.6
Loan impairment provisions						
Mortgages	(1.0)	(1.1)	(1.4)	(0.9)	(0.9)	(1.1)
Commercial real estate						
- investment			(0.2)			(0.1)
- development			(0.1)			(0.1)
Other lending	(0.3)	(0.3)	(0.9)	(0.2)	(0.3)	(0.6)
Total loan impairment provisions	(1.3)	(1.4)	(2.6)	(1.1)	(1.2)	(1.9)
Net loans and advances to customers	22.0	22.1	22.7	19.5	18.9	16.7
Total assets	27.7	28.2	29.0	24.6	24.1	21.3
Funded assets	27.6	28.0	28.8	24.5	24.0	21.2
Risk elements in lending						
- mortgages	3.4	3.7	3.5	3.0	3.1	2.6
- commercial real estate						
- investment			0.2			0.2
- development			0.1			0.1
- other lending	0.3	0.4	0.9	0.3	0.4	0.6
Total risk elements in lending	3.7	4.1	4.7	3.3	3.5	3.5
Provision coverage (1)	34%	34%	55%	34%	34%	55%
Customer deposits	19.8	18.8	17.8	17.5	16.1	13.1
Loan:deposit ratio (excluding repos)	111%	117%	127%	111%	117%	127%
Risk-weighted assets						
- Credit risk						
- non-counterparty	18.9	19.7	24.6	16.9	16.9	18.1
- counterparty	0.1	0.1	0.1	0.1	0.1	0.1
- Market risk	0.1			0.1		
- Operational risk	1.1	1.3	1.7	0.9	1.1	1.2
Total risk-weighted assets	20.2	21.1	26.4	18.0	18.1	19.4
Spot exchange rate - /£				1.127	1.168	1.362

Note:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

Ulster Bank RoI continued

Serving our customers

Gross new lending increased 7.2% (3.4% in euro terms) on prior year, primarily reflecting higher commercial lending. The bank s mortgage lending exceeded £0.9 billion (1 billion) in 2017 supported by successful home mover advertising campaigns and an improved customer proposition.

Ulster Bank RoI has continued its journey to become number one in the market for customer trust and advocacy. Investment in the digital platform has focused on providing enhancements that make it easier for customers to bank with us. Ulster Bank RoI was amongst the first banks in Ireland to introduce Apple Pay and Android Pay and now over 70% of our customers are actively using our digital proposition, increased from 58% of our active customer base in 2016.

In August, Ulster Bank RoI was the first in Ireland to launch Open Banking. Using market-leading technology, Ulster Bank RoI gives approved third parties limited access to a customer s account balance and transaction history, if the customer approves access.

The bank has proactively helped to protect customers from fraud and scams. Community Protection Advisers have run over 70 sessions across the country helping people understand how they can keep themselves safe online and outlining how to identify scams.

2017 compared with 2016

An operating loss of £132 million (151 million) compared with a £20 million (24 million) profit in 2016 primarily reflecting a £173 million (206 million) increase in impairment losses, largely relating to a change in the non performing loan strategy to allow for further portfolio sales.

Total income of £604 million (689 million) was £28 million, or 4.9% higher than in 2016 (15 million, or 2.1% lower in euro terms). Adjusted income(1) of £607 million (693 million) was £34 million, or 5.9% higher than 2016 (8 million, or 1.1%, lower than 2016 in euro terms), primarily reflecting a £46 million (53 million) reduction in income on free funds, partially offset by one off items, higher lending income and reduced funding costs. Net interest margin of 1.67% was 5 basis points higher than 2016 reflecting a combination of improved deposit and loan margins, one-off income adjustments and successful deleveraging measures in 2016 which have reduced the concentration of low yielding loans.

Operating expenses were £676 million, an increase of £7 million, or 1.0% compared with 2016 (a decrease of 46 million, or 5.6% to 772 million in euro terms). Adjusted operating expenses(1) decreased £6 million or 1.3% to £451 million; in euro terms adjusted operating expenses(1) of 516 million were 43 million, or 7.7%, lower than 2016. This was primarily due to continued progress in the delivery of cost saving initiatives, as evidenced by a 12.9% reduction in headcount, and lower pension costs. Cost:income ratio was 111.9% compared with 116.1% in 2016. Adjusted cost:income ratio(1) of 74.3% compared with 79.8% in 2016.

A litigation and conduct provision of £169 million (192 million) related to customer remediation and project costs associated with legacy business issues.

A net impairment loss of £60 million (68 million) compared with a £113 million (138 million) release in 2016. The movement was driven by a provision relating to a change in the non performing loan strategy to allow for further portfolio sales, gains associated with asset disposals in 2016 and refinements to the mortgage provision models in 2017. REILs were £3.3 billion, 5.7% lower than 2016 (3.7 billion, 9.8% in euro terms) reflecting credit quality improvements.

Ulster Bank RoI gross new lending was £2.3 billion in 2017, up 7.2% compared with 2016 (2.6 billion, up 3.4% in euro terms).

RWAs remained stable at £18.0 billion, compared with £18.1 billion in 2016. In euro terms, RWAs of 20.2 billion reduced by 0.9 billion, or 4.3%, compared with 2016.

2016 compared with 2015

Operating profit decreased by £242 milion (338 million) to £20 million (24 million) compared with 2015 primarily due to an increase in litigation and conduct costs of £185 million (229 million) and a £28 million (56 million) reduction in net impairment releases. Adjusted operating profit(1) of £229 million (280 million), was £35 million, or 13%, (85 million, or 23% in euro terms) lower than prior year. Excluding the impact of the strengthening euro, the decrease in adjusted operating profit was driven by a reduction in adjusted operating expenses which was more than offset by the non recurrence of certain income benefits in 2015 and lower impairment releases.

Net interest income increased by £44 million to £409 million compared with 2015 due to the strengthening of the euro but net interest income was stable year on year, in euro terms. Net interest margin increased by 5 basis points to 1.62%, compared with 2015, driven by a continued reduction in the cost of deposits and a reduced volume of low yielding liquid assets, partly offset by reduced income on free funds.

Non interest income decreased by £18 million, or 10%, (52 million, or 20% in euro terms), principally reflecting a £24 million (33 million gain) realised on the closure of a foreign exchange exposure in 2015 and an £11 million (13 million) interim adjustment to the pricing of FX transactions between Ulster Bank RoI and NatWest Markets in 2016, pending completion of a detailed pricing review.

Business review

Ulster Bank RoI continued

Operating expenses increased £240 million, or 56%, to £669 million (228 million, or 39%, to 818 million). Adjusted operating expenses(1) increased £30 million, or 7%, to £457 million due to the strengthening of the euro. In euro terms, adjusted operating expenses(1) reduced by 28 million, or 5%, to 559 million reflecting a combination of progress made on cost saving initiatives, the non recurrence of one off costs in 2015 and one off accrual releases in 2016.

A realignment of costs within direct expenses contributed to an increase in staff costs in 2016 with an offsetting reduction in other costs. This reflects the reallocation of 660 staff from UK PBB to align with current management responsibilities following the separation of the Northern Ireland and Republic of Ireland businesses. Excluding the reallocation from UK PBB and staff supporting the tracker mortgage examination and asset disposal programmes, headcount decreased by 9% year on year.

Litigation and conduct costs of £172 million (211 million) principally reflect a provision for remediation and programme costs associated with an industry wide examination of tracker mortgages. Restructuring costs increased by £25 million (27 million) to £40 million (48 million), primarily driven by costs associated with asset disposal activity.

A net impairment release of £113 million (138 million) comprised write-backs associated with asset disposals and benefited from improved macroeconomic conditions.

Risk elements in lending remained stable at £3.5 billion in 2016 due to the strengthening of the euro, but in euro terms the sale of a portfolio of loans contributed to a 0.6 billion, or 13%, reduction in risk elements in lending in 2016 to 4.1 billion. This was partially offset by a widening of the definition of loans which are considered to be impaired to include multiple forbearance arrangements and probationary mortgages. The provision coverage ratio reduced from 55% in 2015 to 34% in 2016 largely reflecting a further de-risking of the balance sheet following recent asset sales of largely non-performing loans.

Gross new lending increased 31% in 2016, net loans and advances increased £2.2 billion due to the strengthening of the euro but decreased 0.6 billion, or 3%, in euro terms as new lending was offset by asset disposals and repayments. The low yielding tracker mortgage portfolio increased by £0.6 billion or 7% including the impact of the euro exchange rate movement (declined by 1.0 billion, or 9%, in euro terms) to £9.2 million (10.8 billion) at 31 December 2016 supported by repayments and asset disposals.

RWAs reduced by £1.3 billion or 7% (5.3 billion or 20% in euro terms) during 2016 to £18.1 billion (21.1 billion) driven by the sale of a portfolio of loans combined with adjustments to the mortgage modelling approach and an improvement in the macro economic environment. RWAs on the tracker mortgage portfolio reduced by £1.5 billion, or 19% (3.3 billion or 31% in euro terms), during 2016 to £6.3 billion (7.4 billion).

Loan:deposit ratio decreased 10 percentage points to 117% in 2016 supported by a £3 billion (1.0 billion) growth in deposits and reduced net loans following recent asset sales.

Note:

(1) Refer to income statement reconciliations on page 120.

Business review

Commercial Banking

	2017	2016	2015
Income statement	£m	£m	£m
Net interest income	2,286	2,143	1,997
Net fees and commissions	1,030	1,031	984
Other non-interest income	168	241	273
Non-interest income	1,198	1,272	1,257
Total income	3,484	3,415	3,254
Direct expenses			
- staff costs	(467)	(522)	(483)
- operating lease costs	(142)	(141)	(141)
- other costs	(90)	(94)	(97)
Indirect expenses	(1,115)	(1,179)	(1,080)
Restructuring costs			
- direct	(48)	(25)	(52)
- indirect	(119)	(83)	(17)
Litigation and conduct costs	(33)	(423)	(51)
Operating expenses	(2,014)	(2,467)	(1,921)
Operating profit before impairment losses	1,470	948	1,333
Impairment losses	(362)	(206)	(69)
Operating profit	1,108	742	1,264
Operating expenses - adjusted (1)	(1,814)	(1,936)	(1,801)
Operating profit - adjusted (1)	1,308	1,273	1,384
Analysis of income by business			
Commercial lending	1,880	1,875	1,634
Deposits	508	474	477
Asset and invoice finance	662	712	710
Other	434	354	433
Total income	3,484	3,415	3,254
Analysis of impairments by sector			
Commercial real estate	29	4	18
Asset and invoice finance	57	35	9
Private sector services (education, health, etc)	22	8	9
Banks & financial institutions		2	
Wholesale and retail trade repairs	59	15	3
Hotels and restaurants	1	27	(2)
Manufacturing	5	3	1
Construction	187	18	6
Other	2	94	25
Total impairment losses	362	206	69
Loan impairment charge as a % of gross customer loans and advances by sector			
Commercial real estate	0.2%		0.1%
Asset and invoice finance	0.4%	0.2%	0.1%
Private sector services (education, health, etc)	0.3%	0.1%	0.1%
Wholesale and retail trade repairs	0.8%	0.2%	
Hotels and restaurants		0.7%	(0.1%)
Manufacturing	0.1%		
Construction	9.4%	0.8%	0.3%

Other		0.3%	0.1%
Total	0.4%	0.2%	0.1%

Note:

(1) Excluding restructuring costs and litigation and conduct costs.

Business review

Commercial Banking continued

	2017	2016	2015
Performance ratios	%	%	%
Return on equity (1)	6.6%	4.1%	9.8%
Return on equity - adjusted (1,2)	8.2%	8.4%	10.9%
Net interest margin	1.74%	1.76%	1.88%
Cost:income ratio	56.0%	71.0%	57.2%
Cost:income ratio - adjusted (2)	50.0%	54.8%	53.3%
Capital and balance sheet	£bn	£bn	£bn
Loans and advances to customers (gross)			
- Commercial real estate	15.4	16.9	16.7
- Asset and invoice finance	16.1	14.1	14.4
- Private sector services (education, health, etc)	6.9	6.9	6.7
- Banks & financial institutions	7.1	8.9	7.1
- Wholesale and retail trade repairs	7.8	8.4	7.5
- Hotels and restaurants	3.5	3.7	3.3
- Manufacturing	5.6	6.6	5.3
- Construction	2.0	2.1	2.1
- Other	33.8	33.3	28.9
Total loan and advances to customers (gross)	98.2	100.9	92.0
Loan impairment provisions	(1.2)	(0.8)	(0.7)
Net loans and advances to customers	97.0	100.1	91.3
Total assets	149.5	150.5	133.5
Funded assets	149.5	150.5	133.5
Risk elements in lending	3.2	1.9	1.9
Provision coverage (3)	36%	43%	39%
Customer deposits (excluding repos)	98.0	97.9	88.9
Loan:deposit ratio (excluding repos)	99%	102%	103%
Risk-weighted assets			
- Credit risk (non-counterparty)	65.4	72.0	65.3
- Operational risk	6.4	6.5	7.0
Total risk-weighted assets	71.8	78.5	72.3

Notes:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 11% of the monthly average of segmental RWAes, assuming 28% tax rate.

(2) Excluding restructuring costs and litigation and conduct costs.

(3) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

Commercial Banking continued

Serving our customers

Commercial Banking s customer focused strategy is progressing well, with our Commercial NPS standing at +21, significantly ahead of our major UK bank competitors.

We continue to improve customer experience by becoming easier to do business with through operational investment, process simplification and digitisation. Account Opening improvements have reduced the end-to-end process by approximately seven days and customers can now take advantage of pre-approved loans of up to £50,000 through a self-service application process.

Our existing Bankline platform is used by 90% of our active customer base with over 400,000 payments processed every day. We continue to upgrade our new best-in-class Bankline, and have migrated around 25% of customers to the improved platform

In supporting UK business growth, we have opened our 12th Business Accelerator hub in London with our award winning Entrepreneurial Spark partnership, supporting over 3,800 companies to date. For the ninth year running, Lombard won the Business Moneyfacts Best Leasing and Asset Finance Provider Award (2009 to 2017).

Commercial Banking is helping our customers achieve their goals through the continued expansion of our innovative digital offering. We continue to scale ESME, our digital 24/7 online lending platform for SMEs, which has consistently high NPS scores over 70; we are building out a platform to help customers better understand contracts; and we are deploying Artificial Intelligence, such as embedding the new chatbot Cora into Bankline.

2017 compared with 2016

Operating profit of £1,108 million compared with £742 million in 2016, primarily reflecting a reduction in litigation and conduct costs. Adjusted operating profit(3) of £1,308 million, was £35 million, or 2.7%, higher than 2016 reflecting lower adjusted operating expenses and higher income, partially offset by higher impairments. Return on equity was 250 basis points higher than 2016 at 6.6%. Adjusted return on equity(3) remained broadly stable at 8.2%.

Total income increased by £69 million, or 2.0%, to £3,484 million primarily reflecting increased volumes in targeted segments and re-pricing benefits on deposits. Net interest margin decreased by 2 basis points as active re-pricing of assets and deposits has been more than offset by wider asset margin pressure in a low rate environment.

Operating expenses decreased by £453 million to £2,014 million. Adjusted operating expenses(3) of £1,814 million, were £122 million, or 6.3%, lower than 2016, reflecting operating model simplification and productivity improvements, including a 16.4% reduction in front office headcount, and a £25 million intangible asset write-down in 2016. The cost:income ratio improved to 56.0% compared with 71.0% in 2016. Adjusted cost:income ratio(3) improved to 50.0% compared with 54.8% in 2016. Net impairment losses of £362 million were £156 million higher than 2016, reflecting a small number of single name impairments.

Net loans and advances decreased by £3.1 billion to £97.0 billion. Adjusting for transfers(1) of £1.8 billion, net loans and advances decreased by £4.9 billion to £97.0 billion, compared with 2016, as growth in targeted segments has been more than offset by active capital management of the lending book.

RWAs decreased by £6.7 billion to £71.8 billion. Adjusting for transfers(1) of £1.5 billion, RWAs decreased by £8.2 billion, or 10.4%, to £71.8 billion compared with 2016 reflecting active capital management of the lending book, achieving £12.5 billion of gross RWA reductions.

2016 compared with 2015

Operating profit was £742 million compared with £1,264 million in 2015 and included a £423 million litigation and conduct charge, principally relating to a provision in respect of the FCA review of RBS s treatment of SMEs. Adjusted operating profit(3) of £1,273 million, was £111 million, or 8%, lower than 2015, mainly reflecting increased impairments, partially offset by increased income.

Total income increased by £161 million to £3,415 million. Excluding the impact of transfers(2) , a benefit of £218 million (2015 - £79 million), income increased by £21 million, or 1%, reflecting higher asset and deposit volumes. Net interest margin fell by 12 basis points to 1.76% driven by asset margin pressure in a competitive market and low rate environment.

Operating expenses increased by £546 million to £2,467 million. Adjusted operating expenses(3), excluding business transfers of £109 million (2015 - £25 million), increased by £51 million reflecting a £25 million intangible asset write-down and increased investment spend.

Net impairment losses increased by £137 million to £206 million primarily reflecting a single name charge taken in respect of the oil and gas portfolio.

Net loans and advances of £100.1 billion increased by £8.8 billion, or 10%, compared with 2015 reflecting increased borrowing across a number of sectors.

RWAs were £78.5 billion, an increase of £6.2 billion compared with 2015 reflecting asset growth partially offset by reduced RWA intensity.

Notes:

(1) Shipping and other activities which were formerly in Capital Resolution, were transferred from NatWest Markets on 1 October 2017, including net loans and advances to customers of £2.6 billion and RWAs of £2.1 billion. Commercial Banking transferred whole business securitisations and relevant financial institution s (RFI) to NatWest Markets during December 2017, including net loans and advances to customers of £0.8 billion and RWAs of £0.6 billion. Comparatives were not re-presented for these transfers.

(2) The business transfers included impact on total income of £218 million (2015 - £79 million) and operating expenses of £109 million (2015 - £25 million).

(3) Refer to income statement reconciliations on page 120.

Business review

Private Banking

	2017	2016	2015
Income statement	£m	£m	£m
Net interest income	464	449	436
Net fees and commissions	179	181	186
Other non-interest income	35	27	22
Non-interest income	214	208	208
Total income	678	657	644
Direct expenses			
- staff costs	(145)	(154)	(176)
- other costs	(32)	(44)	(35)
Indirect expenses	(268)	(313)	(307)
Restructuring costs			
- direct	(20)	(7)	(7)
- indirect	(25)	(30)	(66)
Litigation and conduct costs	(39)	(1)	(12)
Write down of goodwill			(498)
Operating expenses	(529)	(549)	(1,101)
Operating profit/(loss) before impairment (losses)/releases	149	108	(457)
Impairment (losses)/releases	(6)	3	(13)
Operating profit/(loss)	143	111	(470)
Operating expenses - adjusted (1)	(445)	(511)	(518)
Operating profit - adjusted (1)	227	149	113
Analysis of income by business			
Investments	119	97	86
Banking	559	560	558
Total income	678	657	644
Performance ratios			
Return on equity (2)	6.4%	5.6%	(27.7%)
Return on equity - adjusted (1,2)	11.3%	7.8%	4.9%
Net interest margin	2.47%	2.66%	2.75%
Cost:income ratio	78.0%	83.6%	171.0%
Cost:income ratio - adjusted (1)	65.6%	77.8%	80.4%

	2017	2016	2015
Capital and balance sheet	£bn	£bn	£bn
Loans and advances to customers (gross)			
- Personal	2.3	2.3	2.7
- Mortgages	8.2	7.0	6.5
- Other	3.0	2.9	2.0
Total loans and advances to customers (gross)	13.5	12.2	11.2
Total assets	20.3	18.6	17.0
Funded assets	20.3	18.5	17.0
Assets under management (3)	21.5	17.0	13.9

Risk elements in lending	0.1	0.1	0.1
Provision coverage (4)	34%	30%	28%
Customer deposits (excluding repos)	26.9	26.6	23.1
Loan:deposit ratio (excluding repos)	50%	46%	48%
Risk-weighted assets			
- Credit risk (non-counterparty)	8.1	7.5	7.6
- Operational risk	1.0	1.1	1.1
Total risk-weighted assets	9.1	8.6	8.7

Notes:

(1) Excluding restructuring costs and litigation and conduct costs and write down of goodwill.

(2) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 14% (15% prior to Q1 2017) of the monthly average of segmental RWAes, assuming 28% tax rate.

(3) Comprises assets under management, assets under custody and investment cash.

(4) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

Private Banking continued

Serving our customers

Private Banking continues to focus on delivering the best customer experience, with pro-active customer contact levels up 5% in the year. Our proposition has been extended to meet wider customer needs with the launch of new products, including the offset and 10-year tracker mortgages. The customer-centric strategy is improving returns and enhancing service levels, and we were awarded Best Private Bank in the UK at the Global Private Banking Awards 2017. Coutts was also awarded the Best Benefits or Loyalty Programme of the year for our Silk Card proposition and Best Debit Card Programme of the Year for our multi-currency debit card at the Card and Payments Awards 2018.

Private Banking has delivered top quartile investment performance on the majority of discretionary portfolios and UK multi-asset funds over the one, three and five year performance periods. Coutts won Gold Awards at the Portfolio Adviser Wealth Manager Awards 2018 for our Absolute Return portfolios and Cautious portfolios.

Investing in digital has seen the launch of Coutts Invest, a cost-effective, online investment solution, and delivery of an enhanced mobile experience for clients. Coutts won the Service Innovation Award at the Private Asset Manager Awards for the second consecutive year for client security innovations such as CouttsID and Behavioural Biometrics.

2017 compared with 2016

Operating profit increased by £32 million, or 28.8%, to £143 million compared with 2016 and return on equity increased from 5.6% to 6.4%. Adjusted operating profit(2) of £227 million was £78 million, or 52.3%, higher than 2016 primarily reflecting lower adjusted operating expenses and higher income. Adjusted return on equity(2) increased to 11.3% from 7.8% in 2016.

Total income increased by £21 million to £678 million. Adjusting for transfers(1) of £9 million, total income increased by £12 million to £678 million due to increased lending volumes and an £8 million gain on a property sale, partially offset by ongoing margin pressure. Net interest margin fell 19 basis points to 2.47% reflecting the competitive market and low rate environment.

Operating expenses decreased by £20 million to £529 million. Adjusted operating expenses(2) of £445 million decreased by £66 million, or 12.9%, compared with 2016 largely reflecting management actions to reduce costs, including an 11.8% reduction in front office headcount. The cost:income ratio improved to 78.0% from 83.6% in 2016. Adjusted cost:income ratio(2) improved to 65.6% compared with 77.8% in 2016.

Net loans and advances of £13.5 billion were £1.3 billion, or 10.7%, higher than 2016 principally driven by growth in mortgages.

Assets under management were £4.5 billion higher than 2016 at £21.5 billion. Adjusting for transfers(1) of £2.1 billion, assets under management were £2.4 billion, or 14.4%, higher than 2016 at £21.5 billion, reflecting both organic growth and favourable market conditions.

RWAs of £9.1 billion were £0.5 billion, or 5.8%, higher than 2016 primarily due to increased mortgage lending.

2016 compared with 2015

An operating profit of £111 million compared with an operating loss of £470 million in 2015 which included a goodwill impairment of £498 million. Adjusted operating profit(2) was £36 million, or 32%, higher than 2015 reflecting increased income, lower adjusted operating expenses and lower impairments.

Total income increased by £13 million to £657 million primarily reflecting higher asset volumes. Net interest margin fell by 9 basis points to 2.66% reflecting asset margin pressures.

Operating expenses of £549 million were £552 million, or 50% lower than 2015. Adjusted operating expenses(2) were £7 million, or 1%, lower than 2015 driven by reductions in the direct cost base, with employee numbers down 10%, partially offset by increased infrastructure costs absorbed following the sale of the international business.

Net loans and advances of £12.2 billion increased by £1.0 billion compared with 2015 driven by mortgages. Assets under management of £17.0 billion were £3.1 billion higher compared with 2015 reflecting underlying growth and equity index inflation. In addition, investment cash balances were included in assets under management for the first time in Q3 2016, excluding this, growth was £2.0 billion.

Notes:

(1) The UK PBB Collective Investment Funds (CIFL) business was transferred from UK PBB on 1 October 2017, including total income in Q4 2017 of £11 million and assets under management of £3.3 billion. Private Banking transferred Coutts Crown Dependencies (CCD) to RBS International during Q4 2017, including total income of £2 million and assets under management of £1.2 billion. Comparatives were not re-presented for these transfers.

(2) Refer to income statement reconciliations on page 120.

Business review

RBS International

	2017	2016	2015
Income statement	£m	£m	£m
Net interest income	325	303	303
Net fees and commissions	42	50	40
Other non-interest income	22	21	24
Non-interest income	64	71	64
Total income	389	374	367
Direct expenses			
- staff costs	(61)	(45)	(42)
- other costs	(25)	(17)	(16)
Indirect expenses	(116)	(107)	(98)
Restructuring costs			
- direct	(5)	(2)	
- indirect	(4)	(3)	(4)
Litigation and conduct costs	(8)		
Operating expenses	(219)	(174)	(160)
Operating profit before impairment losses	170	200	207
Impairment losses	(3)	(10)	
Operating profit	167	190	207
Operating expenses - adjusted (1)	(202)	(169)	(156)
Operating profit - adjusted (1)	184	195	211
Performance ratios			
Return on equity (2)	11.2%	13.8%	18.5%
Return on equity - adjusted (1,2)	12.6%	14.2%	18.9%
Net interest margin	1.36%	1.36%	1.48%
Cost:income ratio	56.3%	46.5%	43.6%
Cost:income ratio - adjusted (1)	51.9%	45.2%	42.5%

	2017	2016	2015
Capital and balance sheet	£bn	£bn	£bn
Loans and advances to customers (gross)			
- Corporate	5.7	6.2	4.5
- Mortgages	2.7	2.6	2.5
- Other	0.3		0.4
Total loans and advances to customers (gross)	8.7	8.8	7.4
Loan impairment provisions			(0.1)
Net loans and advances to customers	8.7	8.8	7.3
Total assets	25.9	23.4	23.1
Funded assets	25.9	23.4	23.1

Risk elements in lending	0.1	0.1	0.1
Provision coverage (3)	35%	35%	34%
Customer deposits	29.0	25.2	21.3
Loan:deposit ratio (excluding repos)	30%	35%	35%
Risk-weighted assets			
- Credit risk (non-counterparty)	4.4	8.8	7.6
- Operational risk	0.7	0.7	0.7
Total risk-weighted assets	5.1	9.5	8.3

Notes:

(1) Excluding restructuring costs.

(2) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 16% (12% prior to November 2017) of the monthly average of segmental RWAes, assuming 10% tax rate.

(3) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

RBS International continued

Serving our customers

RBS International continues to focus on meeting more of our retail, commercial, corporate and financial institution customers needs. We are nearing the final stages of our transition to becoming a non ring-fenced bank, and during 2017 we opened new wholesale branches in Luxembourg and London, supporting our financial institution customers in these important funds banking jurisdictions.

Across our personal banking propositions we continue to maintain our position as market leader in the Isle of Man and top three market positions in Guernsey and Jersey. To better meet our personal customers savings needs, we delivered a new suite of fixed term deposits. At the same time we have supported over 1,900 customers buy new homes, exceeding £480 million of new mortgages.

Outside of our home jurisdictions, we have taken action to meet more of the international needs of our customers. Our mobile app now averages over one million log-ins per month, and has been upgraded to open access to international customers, assisting in our 14% increase in users.

For our commercial, corporate and financial institution customers, we invested into the next generation of our agile eQ multi-currency electronic banking platform, which brings enhanced payment functionality and product suite. To meet our non-personal customers savings needs, we delivered a new Notice Account at the beginning of August 2017, and our customers responded by depositing over £1 billion into the account.

2017 compared with 2016

Operating profit of £167 million decreased by £23 million, or 12.1%, compared with 2016 and return on equity decreased to 11.2% from 13.8%, reflecting increased operational costs associated with the creation of a bank outside the ring-fence, partially offset by higher income. Return on equity decreased to 11.2% from 13.8%. Adjusted return on equity**(1)** decreased to 12.6% from 14.2% in 2016 and adjusted cost:income ratio of 51.9% increased from 45.2% in 2016.

Total income increased by £15 million, or 4.0%, to £389 million driven by increased average lending balances in 2017 and re-pricing benefits on the deposit book.

Net loans and advances were broadly stable compared with 2016 and customer deposits increased by £3.8 billion to £29.0 billion primarily reflecting increased short term placements in the Funds sector. RWAs of £5.1 billion reduced by £4.4 billion, or 46.3%, compared with 2016, reflecting the benefit of receiving the Advanced Internal Rating Based Waiver on the wholesale corporate book in November 2017, in advance of becoming a bank outside the ring-fence.

From 1st Jan 2018 RBS International will include the funds and trustee depositary business transferred from Commercial Banking, which generated around £150 million of income and £60 million of costs in 2017.

2016 compared with 2015

Operating profit decreased by £17 million to £190 million principally reflecting increased impairment losses and operating expenses. Adjusted operating profit**(1)** was £195 million, £16 million lower than 2015.

Total income increased by £7 million to £374 million primarily reflecting higher asset volumes. Net interest margin fell by 12 basis points to 1.36% reflecting asset margin pressures.

Operating expenses of £174 million were £14 million, or 9% higher than 2015. Adjusted operating expenses**(1)** were £13 million, or 8%, higher than 2015, reflecting a number of one-off charges.

A net impairment loss of £10 million was reported in 2016.

Net loans and advances of £8.8 billion increased by £1.5 billion compared with 2015 reflecting balance draw-downs in the corporate lending portfolio, mainly within the Funds sector.

Customer deposits of £25.2 billion grew by £3.9 billion compared with 2015 principally reflecting the transfer of the Luxembourg branch into RBSI from former Capital Resolution during Q2 2016.

RWAs were £9.5 billion, an increase of £1.2 billion compared with 2015 reflecting asset growth.

Note:

(1) Refer to income statement reconciliations on page 120.

Business review

NatWest Markets

	2017	2016	2015
Income statement	£m	£m	£m
Net interest income	203	343	452
Net fees and commissions	114	141	484
Income from trading activities	582	829	743
Own credit adjustments	(66)	187	295
Strategic disposals	26	(81)	(38)
Other operating income/(loss)	191	(207)	130
Non-interest income	847	869	1,614
Total income	1,050	1,212	2,066
Direct expenses			
- staff costs	(677)	(358)	(644)
- other costs	(287)	(119)	(324)
Indirect expenses	(564)	(1,607)	(2,038)
Restructuring costs			
- direct	(319)	(75)	(424)
- indirect	(117)	(115)	(1,407)
Litigation and conduct costs	(237)	(550)	(404)
Operating expenses	(2,201)	(2,824)	(5,241)
Operating loss before impairment releases/(losses)	(1,151)	(1,612)	(3,175)
Impairment releases/(losses)	174	(253)	730
Operating loss	(977)	(1,865)	(2,445)
Of which:			
Core operating profit/(loss)	41	(386)	(837)
Legacy operating loss	(1,018)	(1,479)	(1,608)
Total income - adjusted (1)	1,090	1,106	1,809
Operating expenses - adjusted (2)	(1,528)	(2,084)	(3,006)
Operating loss - adjusted (1,2)	(264)	(1,231)	(467)
Analysis of income by product			
Rates	985	837	792
Currencies	470	551	391
Financing	456	344	363
Revenue share paid to other segments	(246)	(211)	(237)
Businesses transferred to Commercial Banking			98
Core income excluding OCA	1,665	1,521	1,407
Legacy	(575)	(415)	402
Total income - adjusted	1,090	1,106	1,809
Own credit adjustments	(66)	187	295
Strategic disposals	26	(81)	(38)
Total income	1,050	1,212	2,066
Performance ratios			
Return on equity (3)	(9.0%)	(12.5%)	(11.2%)
Return on equity - adjusted (1,2,3)	(3.7%)	(8.7%)	(3.0%)
Net interest margin	0.65%	0.91%	0.59%
Cost:income ratio	nm	nm	nm

Cost:income ratio - adjusted (1,2)	140.2%	188.4%	166.2%

nm = not meaningful

Notes:

(1) Excluding own credit adjustments and strategic disposals.

(2) Excluding restructuring costs and litigation and conduct costs.

(3) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity (based on 15% of the monthly average of segmental risk-weighted assets incorporating the effect of capital deductions (RWAes)), assuming 28% tax rate.

Business review

NatWest Markets continued

Capital and balance sheet	2017 £bn	2016 £bn	2015 £bn
Net loans and advances to customers (excluding reverse repos)	22.7	30.2	39.7
Loans and advances to banks (excluding reverse repos) (1)	7.5	7.9	12.8
Reverse repos	38.6	38.8	38.9
Securities	25.5	25.3	29.9
Cash and eligible bills	19.3	18.1	27.4
Other	5.1	8.2	8.0
Total assets	277.9	372.5	416.8
Funded assets	118.7	128.5	156.7
Customer deposits (excluding repos)	14.8	17.9	31.7
Bank deposits (excluding repos)	13.0	21.3	21.4
Repos	28.4	27.3	35.2
Debt securities in issue	5.1	6.7	7.6
Loan:deposit ratio (excluding repos)	153%	169%	125%
Risk-weighted assets			
- Credit risk			
- non-counterparty	16.1	23.7	32.3
- counterparty	15.3	22.8	23.3
- Market risk	16.2	16.4	19.5
- Operational risk	5.3	6.8	7.0
Total risk-weighted assets	52.9	69.7	82.1
Of which:			
Core RWAs	32.3	35.2	33.1
Legacy RWAs ex Alawwal	14.0	26.6	42.1
Alawwal	6.6	7.9	6.9

Note:

(1) Excludes disposal groups.

Business review

NatWest Markets continued

Serving our customers

NatWest Markets has put customers at the centre of the way it does business. Since 2015 NatWest Markets has focused on the core products and markets where it has a strong track record, longstanding relationships and market leading positions. NatWest Markets is making strong progress with its multi-year transformation to build a business focused on delivering sustainable returns.

Following the closure of the former Capital Resolution business in 2017, NatWest Markets now includes legacy run-off assets alongside its core businesses. The business continues to focus on customer service and trust in its core markets and technology is enhancing the way NatWest Markets provides financial solutions to its customers. This is demonstrated by a number of industry awards and rankings:

- No.1 for Gilts by Market Share EMEA FIs (Source: Greenwich Associates, European Fixed Income 2017 Government Bonds)
- No.1 for FX Service Quality UK Corporates (Source: Greenwich Associates, European FX 2017)
- Best bank for FX Prime Brokerage services (Source: FX Week Best Bank Awards 2017)
- Best bank for FX Post-Trade Services (Source: FX Week Best Bank Awards 2017)
- Top 2 for all European issuers in the Private Placement market (Source: Dealogic Private Placement Report, Full Year 2017)
- Top 3 for GBP Denominated DCM in EMEA (Source: Dealogic EMEA Review, Full Year 2017)

2017 compared with 2016

An operating loss of £977 million compared with £1,865 million in 2016. The core business operating profit increased by £427 million to £41 million reflecting lower litigation and conduct costs and higher income, partially offset by increased restructuring costs reflecting back office restructuring activity. Adjusted operating loss(1) of £264 million, compared with £1,231 million in 2016, reflecting lower adjusted costs(1) and a net impairment release of £174 million in 2017, compared with a charge of £253 million in 2016.

Total income of £1,050 million compared with £1,212 million in 2016. In the core business, total income increased by £42 million, or 2.7%, to £1,616 million, whereas adjusted income(1) increased by £144 million, or 9.5%, to £1,665 million, principally driven by Rates as the business navigated markets well despite a lower level of customer activity than in 2016, which benefited from favourable market conditions following the EU referendum.

Operating expenses of £2,201 million were £623 million, or 22.1%, lower than 2016, whereas adjusted operating expenses(1) of £1,528 million were £556 million, or 26.7%, lower than 2016. In the legacy business, operating expenses decreased by £238 million, or 27.5%, to £627 million, whereas adjusted operating expenses(1) decreased significantly reflecting a 77.7% reduction in headcount as the business moved towards closure. In the core business, operating expenses decreased by £383 million, 19.5%, to £1,577 million as the business continues to drive cost reductions, where as adjusted operating expenses(1) were £1,268 million compared to £1,320 million in 2016.

RWAs decreased by £15.3 billion, adjusting for transfers(2), to £52.9 billion primarily reflecting reductions in the legacy business. In the core business RWAs decreased by £3.1 billion to £32.3 billion reflecting lower counterparty credit risk through mitigation activities and business initiatives. At the end of 2017 the legacy business within NatWest Markets had RWAs of £14.0 billion, excluding RBS s stake in Alawwal Bank, a reduction of £10.9 billion, adjusting for transfers(2), over the course of the year.

Total assets fell by £94.6 billion to £277.9 billion, funded assets fell to £118.7 billion, a reduction of £7.3 billion, adjusting for transfers(2), mainly reflecting disposal activity.

2016 compared with 2015

An operating loss of £1,865 million compared with an operating loss of £2,445 million in 2015 primarily driven by lower income and increased impairments partially offset by lower operating expenses. The adjusted operating loss(1) was £1,231 million compared with a loss of £467 million in 2015.

Total income decreased by £854 million to £1,212 million. Total income in the Core business increased by £47 million, or 3.1%, to £1,574 million, whereas adjusted income(1) increased by £114 million, or 8.1%, to £1,521 million. The increase was driven by Rates and Currencies, reflecting sustained customer activity throughout the year and favourable market conditions following the EU referendum and subsequent central bank actions. Income in the legacy business decreased due to the disposal losses of £572 million, £205 million higher than 2015, including £259 million in respect of the shipping portfolio. In addition, the Legacy business also incurred a funding valuation adjustment charge of £170 million in 2016.

Operating expenses decreased from £5,241 million to £2,824 million in 2016, driven by lower restructuring costs, primarily reflecting a 1,000 reduction in headcount in the Legacy business.

Total assets decreased by £44.3 billion to £372.5 billion, funded assets decreased by £28.2 billion compared with 2015 to £128.5 billion, mainly reflecting disposal activity.

RWAs decreased by £12.4 billion compared with 2015 to £69.7 billion reflecting disposal activity partially offset by business movements and the impact of the weakening of sterling.

Notes:

(1) Refer to income statement reconciliations on page 120.

(2) Shipping and other activities which were formerly in Capital Resolution, were transferred to Commercial Banking on 1 October 2017, including total funded assets of £3.3 billion, net loans and advances to customers of £2.6 billion, and RWAs of £2.1 billion. Whole business securitisations and relevant financial institutions (RFI) were transferred from Commercial Banking during December 2017, including net loans and advances to customers of £0.8 billion, and RWAs of £0.6 billion. Comparatives were not re-presented for these transfers.

Business review

Central items & other

	2017 £m	2016 £m	2015 £m
Central items not allocated	(483)	(5,006)	(2,982)

Funding and operating costs have been allocated to operating segments based on direct service usage, the requirement for market funding and other appropriate drivers where services span more than one segment.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a segment.

2017 compared with 2016

Central items not allocated represented a charge of £483 million in 2017, compared with a £5,006 million charge in 2016, and included litigation and conduct costs of £589 million, compared with £4,088 million in 2016. Treasury funding costs were a charge of £58 million, compared with a charge of £94 million in 2016. Restructuring costs in the year included £94 million relating to the former Williams & Glyn business, compared with £1,399 million in 2016. In addition to a VAT recovery of £86 million, compared with £227 million in 2016, a £156 million gain on the sale of Vocalink and a £135 million gain in relation to the sale of EuroClear(1).

2016 compared with 2015

Central items not allocated represented a charge of £5,006 million in 2016, compared with a £2,982 million charge in 2015, and included restructuring costs of £1,482 million and litigation and conduct costs of £4,088 million. Restructuring costs included a £750 million provision in respect of the 17 February 2017 update on RBS s remaining State Aid obligation regarding the business previously described as Williams & Glyn. Treasury funding costs were a charge of £94 million, compared with a gain of £169 million in 2015, and included a £510 million charge for volatile items under IFRS, due to reductions in long term interest rates, and a £349 million foreign exchange gain, principally associated with the weakening of sterling against the US dollar. In addition, there was a £126 million loss on redemption of own debt in 2016. These were partially offset by a VAT recovery of £227 million and a £246 million gain on the sale of the stake in VISA Europe.

Note:

(1) The total gain in relation to the sale of Euroclear was £161 million, of which £135 million central items and £26 million NatWest Markets.

Capital and risk management

Presentation of information

Except as otherwise indicated, information in the Capital and risk management section (pages 151 to 330) is within the scope of the Independent auditor s report.

Business review Capital and risk management

Risk management framework (unaudited)

Introduction

RBS 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 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 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 RBS informs risk appetite and risk management practice.

Risk appetite, which is supported by a robust set of principles, policies and practices, defines our levels of tolerance for a variety of risks.

It is a key element of RBS 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 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 RBS is exposed to.

RBS 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.

Business review Capital and risk management

Risk management framework (unaudited) continued

RBS 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 RBS, including its capital position. In turn, the results of stress tests can be used to inform and shape strategy.

Given the evolving external landscape, including the structural reform required by the UK s ring-fencing requirements, in 2017 there was an emphasis on enhancing both the risk culture and risk appetite elements of the framework as well as the interconnectivity between framework components.

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

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

To achieve this, RBS 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 RBS 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-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.

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

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

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

Risk-based key performance indicators

RBS-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 s learning strategy.

RBS 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 safe. This is easily accessed online and is assigned to each person according to their role and business area. The system allows monitoring at all levels to ensure completion.

Code of Conduct

Aligned to RBS 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.

Business review Capital and risk management

Risk management framework (unaudited) continued

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.

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 RBS values guide day-to-day decisions:

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

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

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

Committee structure

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

Note:

(1) The 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.

Business review Capital and risk management

Risk management framework (unaudited) continued

Risk management structure

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

Notes:

(1) RBS risk management framework

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

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

Risk, Conduct & Restructuring was organised into 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 s relationships with its regulators. Regulatory Affairs is part of Corporate Governance & Regulatory Affairs. Remediation & Complaints reports to the Services Chief Operating Officer.

Business review Capital and risk management

Risk management framework (unaudited) continued

Three lines of defence

RBS 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, RBS Legal, and the financial control element of RBS s Finance function. Responsibilities include:

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

Third line of defence   Internal Audit

Responsibilities include:

- Providing assurance to the Group Audit Committee that the main business risks have been identified and effective controls are in place to manage these risks.
- Engaging with management to provide perspectives, insights and challenge in order to influence the building of a sustainable bank.
- Providing independent assurance to the Financial Conduct Authority, Prudential Regulation Authority, Central Bank of Ireland and other key jurisdictional regulators on specific risks and controls.

Risk appetite

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

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

Risk appetite framework

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

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

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

The Board approves the risk appetite framework annually.

Business review Capital and risk management

Risk management framework (unaudited) continued

Establishing risk appetite

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

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

RBS 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 Board and senior management.

Risk control frameworks and limits

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

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

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

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

RBS 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 RBS. 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.

Business review Capital and risk management

Risk management framework (unaudited) continued

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 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 RBS 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 156.

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.

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

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

RBS 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 RBS holds sufficient capital, even in stressed market scenarios.

Model Risk Governance

Model Risk Governance is responsible for setting policy and providing a governance framework for all of RBS 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, RBS 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.

Business review Capital and risk management

Risk management framework (unaudited) continued

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

Model Risk Management also monitors the performance of RBS 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 220.

Stress testing: capital management

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

- Scenario testing, which examines the impact of a hypothetical future state to define changes in risk factors; and
- Sensitivity testing, which examines the impact of an incremental change to one or more risk factors.

The process for stress testing consists of four broad stages:

Define scenarios	• Identify RBS-specific vulnerabilities and risks. • Define and calibrate scenarios to examine risks and vulnerabilities. • Formal governance process to agree scenarios.
i Assess impact	• Translate scenarios into risk drivers. • Assess impact to positions, income and costs.

i Calculate results and assess implications	• Impact assessment captures input from across RBS. • Aggregate impacts into overall results. • Results form part of risk management process. • Scenario results are used to inform RBS s business and capital plans.
i Develop and agree management actions	• Scenario results are analysed by subject matter experts and appropriate management actions are then developed. • Scenario results and management actions are reviewed and agreed by senior management through executive committees including Executive Risk Forum, Board Risk Committee and the Board.

Stress testing is used widely across RBS. Key areas are summarised in the diagram below:

Specific areas that involve capital management include:

1) *Strategic financial and capital planning:* through assessing the impact of sensitivities and scenarios on the capital plan and capital ratios.

2) *Risk appetite:* through gaining a better understanding of the drivers of and the underlying risks associated with risk appetite.

3) *Risk identification:* through a better understanding of the risks that could potentially impact RBS s financial strength and capital position.

4) *Risk mitigation:* through identifying actions that can be taken to mitigate risks, or could be taken, in the event of adverse changes to the business or economic environment. Risk mitigation is substantially supplemented through RBS s recovery plan.

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

Business review Capital and risk management

Risk management framework (unaudited) continued

Capital sufficiency: going concern forward-looking view

Going concern capital requirements are examined on a forward-looking basis including as part of the annual budgeting process by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states. A range of future states are examined. In particular, capital requirements are assessed:

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

The examination of capital requirements under normal economic and market conditions enables RBS to demonstrate how its projected business performance allows it to meet all internal and regulatory capital requirements as they arise over the plan horizon. For example, RBS will assess its ability to issue loss-absorbing debt instruments in sufficient quantity to meet regulatory timelines. The cost of issuance will be factored into business performance metrics.

The examination of capital requirements under adverse economic and market conditions is assessed through stress testing.

The results of stress tests are not only used widely across RBS but also by the regulators to set specific capital buffers. RBS takes part in a number of stress tests run by regulatory authorities to test industry-wide vulnerabilities under crystallising global and domestic systemic risks. In 2017, RBS took part in the Bank of England stress test. Details of the stress test are set out on page 162.

Internal assessment of capital adequacy

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

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

Capital allocation

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

The framework for allocating capital is approved by the Asset & Liability Management Committee.

Governance

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

The Board approves the capital plans, including those for key legal entities and businesses as well as the results of the stress tests relating to those capital plans.

Stress testing: liquidity

Liquidity risk monitoring and contingency planning

In implementing the liquidity risk management framework, a suite of tools is used to monitor, limit and stress test the risks on the balance sheet. Limit frameworks are in place to control the level of liquidity risk, asset and liability mismatches and funding concentrations.

Liquidity risks are reviewed at significant legal entity and business levels daily, with performance reported to the Asset & Liability Management Committee at least monthly. Liquidity Condition Indicators are monitored daily which ensures any build-up of stress is detected early and the response escalated appropriately through recovery planning.

Internal assessment of liquidity

Under the liquidity risk management framework, RBS maintains the Individual Liquidity Adequacy Assessment Process (ILAAP). This includes assessment of net stressed liquidity outflows. RBS considers a range of extreme but plausible stress scenarios on its liquidity position over various time horizons, as outlined below.

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

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

Business review Capital and risk management

Risk management framework (unaudited) continued

Stress testing: recovery and resolution planning

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

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

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

The recovery plan is prepared and updated annually and approved by the Board. Following Board approval it is also submitted to the PRA each year. The recovery plan is assessed for appropriateness on an ongoing basis, and is maintained in line with regulatory requirements.

Two significant legal entities, RBS Securities Inc. and The Royal Bank of Scotland International Limited, maintained separate recovery plans to address specific risks. These plans were aligned to the 2017 RBS recovery plan to ensure they operated consistently in the event of a stress scenario.

Resolution would be implemented if the RBS Group was assessed by the UK authorities to have failed and the appropriate regulator placed the RBS Group into resolution. The process of resolution is owned and implemented by the Bank of England (as UK Resolution Authority).

The RBS Group is working with UK and global regulators to ensure that it is compliant with the principles of resolution planning. This includes, but is not limited to, establishing appropriate loss-absorbing capacity and ability to maintain operational continuity in resolution, across all of RBS Group s main legal entities, including NatWest Bank Plc. Reflecting the degree of change required to ensure RBS Group is resolvable, a multi-year programme in place to develop resolution capability and meet regulatory requirements.

Stress testing: market risk

Non-traded market risk

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

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

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

Traded market risk

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

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

Historical stress tests form part of the market risk limit framework and their results are reported daily to senior management. Macroeconomic stress tests are carried out periodically as part of the bank-wide, cross-risk capital planning process. The scenario narratives are translated into risk factor shocks using historical events and insights by economists, risk managers and the first line.

Market risk stress results are combined with those for other risks into the capital plan presented to the Board. The cross-risk capital planning process is conducted once a year, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios and macroeconomic scenarios identified by RBS.

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

Business review Capital and risk management

Risk management framework (unaudited) continued

Regulatory stress testing

In 2017, the Group participated in a regulatory stress test conducted by the Bank of England. The scenario is hypothetical in nature and does not represent a forecast of the Group s future business or profitability. The results of the regulatory stress tests are carefully assessed by the Group and form part of the wider risk management of the Group.

	Bank of England stress test
Scenario	• Designed to assess the resilience of major UK banks to tail risk events. The severity of the test is related to policymakers assessments of risk levels across markets and regions. • The 2017 stress test examined the impact over five years of deep simultaneous recessions in the UK and global economies, large falls in asset prices and a separate stress of misconduct costs. The economic scenario in the test is more severe than the global financial crisis.
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Results	• Under the 2017 Bank of England stress test, CET1 ratio reached a low point of 6.4%, below the hurdle rate of 6.7%. • Post the impact of management actions and the conversion of AT1 capital, the Group s low point CET1 ratio increased from 6.4% to 7.0%, meeting the hurdle rate but remained below the Systemic Reference Point of 7.4%. • Tier 1 leverage ratio was projected to be 3.7% under stress, above the 3.25% leverage hurdle rate. Post the impact of management actions and conversion of AT1 capital, the Tier 1 leverage ratio would have been 4.0%. • The stress was based on an end of 2016 balance sheet starting position. Since then, RBS has taken a number of actions to improve its capital position stress resilience, including the on-going run-down of Capital Resolution RWAs, the continued reduction in certain credit portfolios and the resolution of various litigation cases and regulatory investigations. • In light of the steps that RBS has already taken to strengthen its capital position during 2017, the regulator did not require RBS to submit a revised capital plan.
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What does this mean?	• The 2017 Bank of England stress test results demonstrate that good progress has been made in transforming the balance sheet to being safe and sustainable. • The reduction in the CET1 ratio from the start point to the minimum stressed ratio before the impact of strategic management actions or AT1 conversion has improved from 1,000 basis points last year to 700 basis points this year (pre-strategic management actions).

Business review Capital and risk management

Capital, liquidity and funding risk

Definitions (unaudited)

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

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

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

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

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

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

Sources (unaudited)

Capital

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

- CET1 capital. CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings.

- AT1 capital. This is the second type of loss absorbing capital and must be capable of absorbing losses on a going concern basis. These instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached.

- Tier 2 capital. Tier 2 capital is the Group s supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years.

Minimum requirement for own funds and eligible liabilities (MREL)

In addition to capital, other specific loss absorbing instruments including senior notes issued by the Group may be used to cover certain gone concern capital requirements which, in the EU, is referred to as MREL. Gone concern refers to the situation in which resources must be available to enable an orderly resolution, in the event that the Bank of England (BoE) deems that the Group has failed.

Liquidity

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

- Primary liquid assets include cash and balances at central banks, treasury bills and other high quality government and US agency bonds.

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

Funding

RBS s primary funding sources are as follows:

Type	Description
Customer deposits	Licensed deposit-taking entities operating as PBB, CPB and RBSI franchises.
Wholesale markets	Short-term (less than 1 year) unsecured money markets and secured repo market funding.
Term debt	Issuance of long-term (more than 1 year) unsecured and secured debt securities.
Central bank funding facilities	The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the broader liquidity management and funding strategy.

For further details on capital constituents and the regulatory framework covering capital, liquidity and funding requirements, please refer to the RBS Pillar 3 Report 2017 on pages 4 and 8. For MREL refer to page 163.

Key developments in 2017 (unaudited)

- RBS continued to strengthen and de-risk its capital position; CET1 ratio remains ahead of the 13% target and increased by 250 basis points in the year end to 15.9% (40 basis points in Q4 2017), despite absorbing significant litigation and conduct costs, restructuring costs and disposal losses. IFRS 9 adoption on 1 January 2018 favourably impacts CET1 by 30 basis points. RWAs reduced by £27.3 billion to £200.9 billion reflecting the rundown of NatWest Markets legacy assets and reductions across other businesses. In addition, RBS was not required to submit a revised capital plan following the 2017 Bank of England (BOE) stress testing exercise.

Business review Capital and risk management

Capital, liquidity and funding risk continued

- CRR leverage ratio increased to 5.3% (2016 5.1%). UK leverage ratio improved to 6.1% (2016 5.6%) reflecting higher central bank balances which are excluded from the UK framework.

- During the year the BOE published indicative data on the minimum amount of loss-absorbing resources for the larger UK banks comprising MREL plus buffers. RBS is expected to require loss-absorbing resources of 24.0% of RWAs by 1 January 2020, rising to 27.8% by 1 January 2022. Total loss absorbing capital, based on RBS s interpretation of the rules and including the benefit of legacy securities, was 27.1% of RWAs at 31 December 2017.

- The liquidity portfolio increased by £22 billion in 2017 to £186 billion, mainly within primary liquidity which is now £124 billion (2016 £95 billion). This build up in liquidity is driven by TFS participation, increased deposits in the franchises and Treasury issuance, offset by funding maturities and calls of securities.

- The rise in primary liquidity resulted in higher liquidity coverage ratio (LCR) and stressed outflow coverage (SOC) of 152% (2016 123%) and 168% (2016 139%) respectively. The increase in LCR reflected preparations for the settlement of litigation, the rise in the minimum regulatory requirement from 90% to 100% on 1 January 2018 and preparations for ring-fencing.

- The net stable funding ratio rose to 132% (2016 121%), above the minimum target of 100%. The increase in NSFR was primarily driven by increased available stable funding.

- The regulatory agenda continues to rapidly evolve in the UK, Europe and internationally. RBS manages its capital, liquidity and funding to meet both current and future regulatory requirements whilst ensuring that we continue to serve customers well.

Capital management (unaudited)

Capital management ensures that there is sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite, maintaining its credit rating and supporting its strategic goals.

Capital management is critical in supporting the businesses and is enacted through an end to end framework across businesses and the legal entities.

Capital planning is integrated into the Group s wider annual budgeting process and is assessed and updated at least monthly. Regular returns are submitted to the PRA which include a two year rolling forward view. Other elements of capital management, including risk appetite and stress testing, are set out on pages 156 and 159.

Produce capital plans	• Capital plans are produced for the Group, its key operating entities and its businesses over a five year planning horizon under expected and stress conditions. Stressed capital plans are produced to support internal stress testing through the ICAAP or for regulatory purposes. • Shorter term forecasts are developed frequently in response to actual performance, changes in internal and external business environment and to manage risks and opportunities.
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Assess capital adequacy	• Capital plans are developed to maintain capital of sufficient quantity and quality to support the Group s business and strategic plans over the planning horizon within approved risk appetite, as determined via stress testing, and minimum regulatory requirements. • Capital resources and capital requirements are assessed across a defined planning horizon. • Impact assessment captures input from across the Group including from businesses.
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Inform capital actions	• Capital planning informs potential capital actions including managing capital through buy backs, redemptions or through new issuance to external investors or via internal transactions. • Decisions on capital actions will be influenced by strategic and regulatory requirements, the cost and prevailing market conditions. • As part of capital planning, the Group will monitor its portfolio of external capital securities and assess the optimal blend and most cost effective means of financing.

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 follows a similar process to that outlined above for capital.

Liquidity portfolio management (unaudited)

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.

Business review Capital and risk management

Capital, liquidity and funding risk continued

RBS categorises its liquidity portfolio, including its locally managed liquidity portfolios, into primary and secondary liquid assets. The majority of the portfolio is centrally managed by RBS Treasury, for which the RBS Treasurer is responsible. This portfolio is held in the PRA regulated UK Domestic Liquidity Subgroup (UK DoLSub) comprising RBS s five licensed deposit taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company PLC.

Two of RBS s significant operating subsidiaries, RBS N.V. and Ulster Bank Ireland DAC, hold locally managed portfolios that comply with local regulations that may differ from PRA rules.

The liquidity value of the portfolio is determined by taking current market prices and applying a discount or haircut, to give a liquidity value that represents the amount of cash that can be generated by the asset.

Separate from the liquidity portfolio, RBS holds high quality assets to meet payment systems collateral requirements; these are managed by RBS Treasury.

Ring-fencing implications

As a result of the legal entity restructuring in response to the UK government s ring-fencing legislation, the current Royal Bank of Scotland plc (expected to be renamed NatWest Markets plc at the time of the RFTS during the first half of 2018) will separately hold and manage its own liquidity portfolio outside of the ring-fenced group. It will cease to form part of the UK DoLSub at a point in time in the second half of 2018 (subject to regulatory agreement). RBS International will begin to hold its own liquidity portfolio and RBS N.V. and UBI DAC will continue to hold separate liquidity to meet local regulatory requirements.

Treasury has commenced the transfer of the existing liquidity portfolio from RBS plc into National Westminster Bank Plc (where the majority of the UK DoLSub liquidity portfolio will be held post ring-fencing) to ensure appropriate levels of liquidity are held in both RBS plc and the UK DoLSub.

The size of the liquidity portfolio to be held by the future NatWest Markets plc should not be considered comparable to that held by the current RBS plc.

For further information, please refer to RBS Group ring-fencing on page 108.

Funding risk management (unaudited)

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

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

Business review Capital and risk management

Capital, liquidity and funding risk continued

Minimum requirements (unaudited)

Capital adequacy ratios

The Group is subject to minimum requirements in relation to the amount of capital it must hold in relation to its RWAs. The table below summarises the minimum ratios of capital to RWAs that the Group is expected to have to meet once CRR is fully implemented by 1 January 2019. These ratios apply at the consolidated group level. Different minimum capital requirements may apply to individual legal entities or sub-groups.

Minimum requirements	Type	CET1	Total Tier 1	Total capital
System wide	Pillar 1 minimum requirements	4.5%	6.0%	8.0%
	Capital conservation buffer	2.5%	2.5%	2.5%
	UK countercyclical capital buffer (1)	1.0%	1.0%	1.0%
	G-SIB buffer (2)	1.0%	1.0%	1.0%
Bank specific	Pillar 2A(4)	2.1%	2.9%	3.8%
Total (excluding PRA buffer)(5)		11.1%	13.4%	16.3%

Notes:

(1) The countercyclical capital buffer (CCyB) applied to UK designated assets is set by the Financial Policy Committee (FPC). The UK CCyB may be set between 0% and 2.5% and is linked to the state of the UK economy. The Bank of England s Financial Policy Committee (FPC) increased the UK CCyB from 0.0% to 0.5%, with effect from June 2018; subsequently in November 2017 the FPC announced a further increase to 1.0% effective November 2018. The estimated own funds impact for the Group, based on the CCyB rate of 1.0% and 31 December 2017 exposures, was £1,343 million. Foreign exposures may be subject to different CCyBs depending on the CCyB rate set in the jurisdiction of the foreign exposure.

(2) Globally systemically important banks (G-SIBs), as designated by the Financial Stability Board (FSB), are subject to an additional capital buffer of between 1% and 3.5%. Based on the most recent determination of the FSB, the Group is subject to an additional capital requirement of 1.0%

(3) The Group will be subject to a systemic risk buffer (SRB) of between 0% and 3%. The SRB will apply from 1 January 2019 and will apply at the ring-fenced bank sub-group level rather than at the consolidated group level. The SRB may require the Group to hold a minimum amount of capital at the consolidated group level beyond the levels set out in the table above.

(4) From 1 January 2015, RBS has been required to meet at least 56% of its Pillar 2A capital requirement with CET1 capital and with balance with Additional Tier 1 and/or Tier 2 capital. Additional capital requirements under Pillar 2A may be specified by the PRA as a ratio or as an absolute value. The table sets out an implied ratio to cover the full value of Pillar 2A requirements. The PRA has recently determined that the Pillar 2A capital requirement for 2018 remains unchanged.

(5) The Group may be subject to a PRA buffer requirement as set by the PRA. The PRA buffer consists of two components:

- A risk management and governance buffer that is set as a scalar of the Pillar 1 and Pillar 2A requirements. The scalar could range between 10% and 40%.

- A buffer relating to the results of the BoE concurrent stress testing results.

The PRA requires that the level of this buffer is not publicly disclosed.

(6) The capital conservation buffer, the countercyclical capital buffer, the G-SIB buffer and systemic risk buffer (where applicable) make up the combined buffer. If the Group fails to meet the combined buffer requirement, it is subject to restrictions on distributions on CET1 instruments, discretionary coupons on AT1 instruments and on payment of variable remuneration or discretionary pension benefits. These restrictions are calculated by reference to the Group s Maximum Distributable Amount (MDA). The MDA trigger is below the PRA buffer and MDA restrictions are not automatically triggered if the Group fails to meet its PRA buffer. The MDA is calculated as the amount of interim or year-end profits not yet incorporated into CET1 capital multiplied by a factor ranging from 0 to 0.6 depending on the size of the CET1 shortfall against the combined buffer.

Leverage ratios

The table below summarises the minimum ratios of capital to leverage exposure under the PRA UK leverage framework that the Group must meet. In November 2016, the European Commission published a package of legislative proposals (CRR 2) for the adoption of a legally binding 3% of Tier 1 capital minimum leverage ratio with consideration of a leverage buffer ratio for G-SIBs once a final international agreement had been reached. Different minimum requirements may apply to individual legal entities or sub-groups.

Type	CET1	Total Tier 1
Minimum ratio	2.4375%	3.25%
UK countercyclical leverage ratio buffer	0.00%	0.00%
Additional leverage ratio buffer	0.35%	0.35%
Total	2.7875%	3.60%

Notes:

(1) The countercyclical leverage ratio buffer is set at 35% of the Group s CCyB. As noted above this buffer may be set between 0% and 2.5% and the Financial Policy Committee (FPC) increased the rate from 0.0% to 0.5% effective June 2018; subsequently in November 2017 the FPC announced a further increase to 1% effective November 2018. The applicable ratio for foreign exposures may be different. On 3 October 2017 the PRA, via revised policy statement (PS21/17), increased the Tier 1 leverage ratio requirement for UK banks by 25 basis points to 3.25% (CET1 requirement of 2.4375%). The PRA minimum leverage ratio requirement is supplemented with a G-SIB additional leverage ratio buffer, currently 0.175% under transitional arrangements (31 December 2016 0.13125%) increasing to 0.35% at the end point, and countercyclical capital buffer of 0.0%.

Liquidity and funding ratios

The table below summarises the minimum requirements for key liquidity and funding metrics, under the relevant legislative framework.

Type	From 1 January 2017	From 1 January 2018
Liquidity coverage ratio (LCR) (1)	90%	100%
Net stable funding ratio (NSFR) (2)	N/A	100%

Notes:

(1) On 1 October 2015 the LCR became the PRA s primary regulatory liquidity standard. It is a Pillar 1 metric to which the PRA apply Pillar 2 add-ons. The minimum ratio above excludes Pillar 2 add-ons.

(2) BCBS issued its final recommendations for the implementation of the net stable funding ratio in October 2014, proposing an implementation date of 1 January 2018 by which time banks are expected to meet and maintain a ratio of 100%. In November 2016, the European Commission (EC) included a net stable funding ratio of 100% as part of the CRR 2 package of legislative proposals. The timing of a binding NSFR coming into force in the European Union and United Kingdom remains subject to uncertainty. In the meantime, RBS uses the definitions from the BCBS guidelines, and its own interpretations, to calculate the NSFR. RBS s ratio may not be comparable with those of other financial institutions.

Business review Capital and risk management

Capital, liquidity and funding risk continued

Measurement

Capital and leverage: Key metrics (unaudited)

Capital, RWAs and capital adequacy ratios, on the basis of end-point Capital Requirements Regulation (CRR) and transitional rules, calculated in accordance with PRA definitions, are set out below.

	2017		2016	
	End-point CRR basis (1)	PRA transitional basis	End-point CRR basis (1)	PRA transitional basis
Capital	£bn	£bn	£bn	£bn
CET1	32.0	32.0	30.6	30.6
Tier1	36.0	39.6	34.7	40.4
Total	42.8	47.9	43.8	52.3
RWAs				
Credit risk				
- non-counterparty	144.7	144.7	162.2	162.2
- counterparty	15.4	15.4	22.9	22.9
Market risk	17.0	17.0	17.4	17.4
Operational risk	23.8	23.8	25.7	25.7
Total RWAs	200.9	200.9	228.2	228.2
Capital adequacy ratios	%	%	%	%
CET1	15.9	15.9	13.4	13.4
Tier 1	17.9	19.7	15.2	17.7
Total	21.3	23.9	19.2	22.9
Leverage ratios	2017		2016	
Tier 1 capital (£bn)	36.0	39.6	34.7	40.4
CRR leverage exposure (£bn)	679.1	679.1	683.3	683.3
CRR leverage ratio (%)	5.3%	5.8%	5.1%	5.9%
Average Tier 1 capital (£bn) (2)	36.4	40.0	38.0	43.7
Average leverage exposure (£bn) (2)	692.5	692.5	712.1	712.1
Average leverage ratio (%) (2)	5.3%	5.8%	5.3%	6.1%
UK leverage ratio	6.1%	6.7%	5.6%	6.6%

Notes:

(1) CRR as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full for both bases with the exception of unrealised gains on available-for-sale securities which has been included from 2015 under the PRA transitional basis.

(2) Based on 3 month average of month end leverage exposure and Tier 1 Capital.

Measures in relation to end-point CRR basis, including RWAs, are based on the current interpretation, expectations, and understanding, of the CRR requirements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities (end-point CRR basis).

Capital base:

Own funds are based on shareholders equity. The adjustment arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full. Additional valuation adjustments relating to unearned credit spreads on exposures under the advanced internal ratings approach has been included in the determination of the expected loss amount deducted from CET1. Where the deductions from AT1 capital exceed AT1 capital, the excess is deducted from CET1 capital. Based on our current interpretations of the Commission Delegated Regulation issued in December 2013 on credit risk adjustments, RBS s standardised latent provision has been reclassified to specific provision and is not included in Tier 2 capital.

RWAs:

Current securitisation positions are shown as risk-weighted at 1,250%. RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on large financial sector entities. RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation. Counterparties which meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges

Liquidity key metrics (unaudited)

The table below sets out the key liquidity and related metrics monitored by RBS.

	2017	2016
Liquidity portfolio	£186bn	£164bn
Liquidity coverage ratio (1)	152%	123%
Stressed outflow coverage (2)	168%	139%
Net stable funding ratio (3)	132%	121%
Loan:deposit ratio	88%	91%

Notes:

(1) On 1 October 2015 the LCR became the PRA s primary regulatory liquidity standard. It is a Pillar 1 metric to which the PRA apply Pillar 2 add-ons. The published LCR excludes Pillar 2 add-ons. RBS calculates the LCR using its own interpretations of the EU LCR Delegated Act, which may change over time and may not be fully comparable with those of other financial institutions.

(2) RBS s stressed outflow coverage (SOC) is measured by reference to the liquidity portfolio as a percentage of stressed contractual and behavioural outflows over three months under the worst of three severe stress scenarios of a market-wide stress, an idiosyncratic stress and a combination of both in RBS s ILAAP. This assessment is performed in accordance with PRA guidance.

(3) BCBS issued its final recommendations for the implementation of the net stable funding ratio in October 2014, proposing an implementation date of 1 January 2018 by which time banks are expected to meet and maintain a ratio of 100%. In November 2016, the European Commission (EC) included a net stable funding ratio of 100% as part of the CRR 2 package of legislative proposals. The timing of a binding NSFR coming into force in the European Union and United Kingdom remains subject to uncertainty. In the meantime, RBS uses the definitions from the BCBS guidelines, and its own interpretations, to calculate the NSFR. RBS s ratio may not be comparable with those of other financial institutions.

Business review Capital and risk management

Capital, liquidity and funding risk continued

Capital and leverage: Capital resources

	2017		2016	
	End-point CRR basis (1)	PRA transitional basis (1)	End-point CRR basis (1)	PRA transitional basis (1)
	£m	£m	£m	£m
Shareholders equity (excluding non-controlling interests)				
Shareholders equity	48,330	48,330	48,609	48,609
Preference shares - equity	(2,565)	(2,565)	(2,565)	(2,565)
Other equity instruments	(4,058)	(4,058)	(4,582)	(4,582)
	41,707	41,707	41,462	41,462
Regulatory adjustments and deductions				
Own credit	(90)	(90)	(304)	(304)
Defined benefit pension fund adjustment	(287)	(287)	(208)	(208)
Cash flow hedging reserve	(227)	(227)	(1,030)	(1,030)
Deferred tax assets	(849)	(849)	(906)	(906)
Prudential valuation adjustments	(496)	(496)	(532)	(532)
Goodwill and other intangible assets	(6,543)	(6,543)	(6,480)	(6,480)
Expected losses less impairments	(1,286)	(1,286)	(1,371)	(1,371)
Other regulatory adjustments	28	28	(8)	(8)
	(9,750)	(9,750)	(10,839)	(10,839)
CET1 capital	31,957	31,957	30,623	30,623
Additional Tier 1 (AT1) capital				
Eligible AT1	4,041	4,041	4,041	4,041
Qualifying instruments and related share premium subject to phase out		3,416		5,416
Qualifying instruments issued by subsidiaries and held by third parties		140		339
AT1 capital	4,041	7,597	4,041	9,796
Tier 1 capital	35,998	39,554	34,664	40,419
Qualifying Tier 2 capital				
Qualifying instruments and related share premium	6,396	6,501	6,893	7,066
Qualifying instruments issued by subsidiaries and held by third parties	369	1,876	2,268	4,818

Tier 2 capital	6,765	8,377	9,161	11,884
Total regulatory capital	42,763	47,931	43,825	52,303

Note:

(1) The Group s Tier 1 grandfathering cap is set at £4.8 billion for 2017 (2016 - £5.8 billion).

The table below analyses the movement in end-point CRR CET1, AT1 and Tier 2 capital for the year.

	CET1	AT1	Tier 2	Total
	£m	£m	£m	£m
At 1 January 2017	30,623	4,041	9,161	43,825
Profit for the year	752			752
Own credit	214			214
Share capital and reserve movements in respect of employee share schemes	139			139
Ordinary shares issued	300			300
Foreign exchange reserve	82			82
Available-for-sale reserves	17			17
Goodwill and intangibles deduction	(63)			(63)
Deferred tax assets	57			57
Prudential valuation adjustments	36			36
Expected loss over impairment provisions	85			85
Capital instruments issued				
Net dated subordinated debt/grandfathered instruments			(1,968)	(1,968)
Foreign exchange movements			(428)	(428)
Other movements	(285)			(285)
At 31 December 2017	31,957	4,041	6,765	42,763

Business review Capital and risk management

Capital, liquidity and funding risk continued

Leverage exposure (unaudited)

The leverage exposure is based on the CRR Delegated Act.

	End-point CRR basis 2017	2016
Leverage	£bn	£bn
Derivatives	160.8	247.0
Loans and advances	339.4	340.3
Reverse repos	40.7	41.8
Other assets	197.2	169.6
Total assets	738.1	798.7
Derivatives		
- netting	(161.7)	(241.7)
- potential future exposures	49.4	65.3
Securities financing transactions gross up	2.3	2.3
Undrawn commitments (analysis below)	53.1	58.6
Regulatory deductions and other adjustments	(2.1)	0.1
Leverage exposure	679.1	683.3

Note:

(1) The UK leverage ratio excludes central bank claims from the leverage exposure where deposits held are denominated in the same currency and of contractual maturity that is equal or longer than that of the central bank claims.

Weighted undrawn commitments (unaudited)

The table below provides a breakdown of weighted undrawn commitments.

	2017	2016

	£bn	£bn
Unconditionally cancellable credit cards	2.1	2.4
Other Unconditionally cancellable items	4.7	7.7
Unconditionally cancellable items (1)	6.8	10.1
Undrawn commitments <1 year which may not be cancelled	1.8	1.8
Other off-balance sheet items with 20% credit conversion factor (CCF)	0.6	0.9
Items with a 20% CCF	2.4	2.7
Revolving credit risk facilities	27.0	27.2
Term loans	3.6	3.1
Mortgages		0.1
Other undrawn commitments >1 year which may not be cancelled & off-balance sheet	2.1	3.3
Items with a 50% CCF	32.7	33.7
Items with a 100% CCF	11.2	12.1
Total	53.1	58.6

Note:

(1) Based on a 10% CCF.

Business review Capital and risk management

Capital, liquidity and funding risk continued

Loss absorbing capital (unaudited)

The following table illustrates the components of estimated loss absorbing capital (LAC) in RBSG plc and operating subsidiaries and includes external issuances only. The table is prepared on a transitional basis, including the benefit of regulatory capital instruments issued from operating companies, to the extent they meet MREL criteria. For further details regarding regulatory requirements in relation to MREL, refer to page 163.

The roll-off profile relating to senior debt and subordinated debt instruments is set out on the next page.

	2017				2016			
	Par value (1) £bn	Balance sheet value £bn	Regulatory value (2) £bn	LAC value (3) £bn	Par value (1) £bn	Balance sheet value £bn	Regulatory value (2) £bn	LAC value (3) £bn
CET1 capital (4)	32.0	32.0	32.0	32.0	30.6	30.6	30.6	30.6
Tier 1 capital: end-point CRR compliant AT1								
of which: RBSG (holdco)	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
of which: RBSG operating subsidiaries (opcos)								
	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Tier 1 capital: non end-point CRR compliant								
of which: holdco	3.5	3.6	3.5	2.6	5.5	5.6	5.5	4.0
of which: opcos	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.3
	3.6	3.7	3.6	2.7	5.8	5.9	5.8	4.3
Tier 2 capital: end-point CRR compliant								
of which: holdco	6.5	6.5	6.4	4.9	6.9	7.0	6.9	5.3
of which: opcos	2.3	2.4	0.5	0.5	6.0	6.4	4.0	5.6
	8.8	8.9	6.9	5.4	12.9	13.4	10.9	10.9
Tier 2 capital: non end-point CRR compliant								
of which: holdco	0.3	0.4	0.1	0.1	0.4	0.4	0.2	0.1
of which: opcos	2.1	2.3	1.5	2.0	2.5	2.7	2.1	2.1
	2.4	2.7	1.6	2.1	2.9	3.1	2.3	2.2
Senior unsecured debt securities issued by:								
RBSG holdco	9.3	9.2		8.3	6.9	6.8		5.0
RBS opcos	14.4	14.7			14.8	15.0		
	23.7	23.9		8.3	21.7	21.8		5.0
Total	74.5	75.2	48.1	54.5	77.9	78.8	53.6	57.0

RWAs	200.9	228.2
Leverage exposure	679.1	683.3
LAC as a ratio of RWAs	27.1%	24.9%
LAC as a ratio of leverage exposure	8.0%	8.3%

Notes:

(1) Par value reflects the nominal value of securities issued.

(2) Regulatory capital instruments issued from operating companies are included in the transitional LAC calculation, to the extent they meet the MREL criteria.

(3) LAC value reflects RBS s interpretation of the Bank of England s policy statement on the minimum requirements for own funds and eligible liabilities (MREL), published in November 2016. MREL policy and requirements remain subject to further potential development, as such RBS estimated position remains subject to potential change. Liabilities excluded from LAC include instruments with less than one year remaining to maturity, structured debt, operating company senior debt, and other instruments that do not meet the MREL criteria. Includes Tier 1 and Tier 2 securities prior to incentive to redeem.

(4) Corresponding shareholders equity was £48.3 billion (2016 - £48.6 billion).

(5) Regulatory amounts reported for AT1, Tier 1 and Tier 2 instruments are before grandfathering restrictions imposed by CRR.

Business review Capital and risk management

Capital, liquidity and funding risk continued

Roll-off profile (unaudited)

The following table illustrates the roll-off profile and weighted average spreads of RBS s major wholesale funding programmes.

Senior debt roll-off profile (1)	As at and for year ended 31 December	Roll-off profile					
RBSG	2017	H1 2018	H2 2018	2019	2020	2021 & 2022	2023 & later
- amount (£m)	9,208	59	25	1,289	3	7	7,825
- weighted average rate spread (bps)	202	172	171	205	162	224	201
RBS plc							
- amount (£m)	14,624	5,105	1,651	2,521	2,863	1,117	1,367
- weighted average rate spread (bps)	116	188	244	84	24	202	201
RBS N.V.							
- amount (£m)	24	22			2		