RBS

IFRS 9 Transition Report

February 2018

Contents | **Page**

1. Summary

1.1 What is IFRS 9? 2
1.2 Why is RBS publishing this transition report? 2
1.3 What are the three pillars in IFRS 9? 2
1.4 What are the key differences to IAS 39? 2
1.5 How do these differences impact RBS and what is the financial impact on RBS at 1 January 2018? 2
1.6 Has there been any change in governance? 5

2. What are the key elements of Classification and measurement? 5

3. What are the key elements of Impairment provisions? 6

4. Financial tables (audited)

4.1 IFRS 9 and IAS 39 impairment key performance indicators 8
4.2 IFRS 9 impairment methodology impact on RBS segments 9
4.3 IFRS 9 ECL scope exposure by balance sheet caption and stage 10
4.4 IFRS 9 ECL scope exposure: sector and asset quality analysis 10
4.5 IFRS 9 ECL provision by sector and stage 11
4.6 IFRS 9 ECL provision coverage by sector and stage 11

5. Opening balance sheet (audited)

5.1 IFRS 9 impact by balance sheet caption 12
5.2 Financial instruments: classification and changes 13
5.3 IFRS 9 impact on regulated legal entities 14

6. Accounting policies (audited) 15

7. Key IFRS 9 terms and differences to current accounting and regulatory framework (audited) 19

8. Critical judgements relating to impairment loss determination

8.1 What policy elections or simplifications have been made? 21
8.2 How does IFRS 9 Credit risk modelling work? 21
8.3 What is significant increase in credit risk? 23
8.4 How are asset lifetimes determined? 23
8.5 What are the primary economic loss drivers and base case scenarios used in IFRS 9 modelling? 24
8.6 What is RBS's approach for multiple economic scenarios (MES)? 24

9. EY audit opinion 25

Forward-looking statements, Presentation of information and Contacts 27

Abbreviations and acronyms 29

For definitions of terms used in this report, refer to the Glossary in the RBS 2017 Annual Report and Accounts.

1. Summary

1.1. What is IFRS 9?

IFRS 9 is an International Financial Reporting Standard (IFRS) set by the International Accounting Standards Board (IASB). It replaces the earlier accounting standard for financial instruments IAS 39, and is the conclusion of long running efforts to improve the existing framework and responds to concerns during the financial crisis about the timeliness of impairment recognition.

The new standard was published in July 2014 and is effective from 1 January 2018. There is no requirement to restate comparatives but the day one impact on implementation must be reflected in opening total equity.

1.2. Why is RBS publishing this transition report?

The accounting framework relating to financial instruments, and in particular impairment methodology, has changed significantly from the beginning of 2018. The quarterly results, going forward from Q1 2018 will be under this new accounting framework. Given the significant changes, RBS is publishing this report to explain the pillars of IFRS 9 compared with IAS 39 and the impact on RBS.

1.3. What are the three pillars in IFRS 9?

There are three significant pillars:

- Classification and measurement: the existing categories are replaced with new categories, based on business intent and product characteristics. It does not have a pervasive impact on RBS, but it does impact a small number of individual portfolios materially;
- Impairment: the incurred loss model is replaced by an expected credit loss (ECL) framework that incorporates forward-looking information. This represents a significant change. This is the main rationale for the publication of this transition report and is covered in more detail in the rest of this report; and
- Hedging: the existing framework is replaced with a new framework that is less rule-based and widens certain aspects of hedge eligibility. The benefits are expected to be particularly helpful to non-financial institutions. RBS has opted to continue to use IAS 39 at this time as permitted.

The new standard does not change the existing approach to the de-recognition of assets nor the recognition and measurement of financial liabilities.

1.4. What are the key differences to IAS 39?

1.4.1. Classification and measurement

The existing IAS 39 financial instrument classifications are replaced with the IFRS 9 classifications of amortised cost, fair value through other comprehensive income and fair value through profit and loss. In order to assess the classification of debt instruments, two tests are performed - to assess the intent of holding the instruments and assess the contractual characteristics of the instruments. As a result of the assessment performed by RBS, one material portfolio was reclassified from amortised cost and some business model choices were implemented, resulting in an increase to 2018 opening equity before tax of £0.6 billion.

1.4.2. Impairment

Cash flows and cash losses are unchanged by the change in impairment framework from IAS 39 to IFRS 9. IFRS 9 has changed the basis of loss calculation to expected loss (i.e. forward-looking), as opposed to the incurred loss model under IAS 39, which focused only on losses that had already occurred. There are a number of changes as well as judgements involved in measuring ECL. New elements include:

- Move from incurred loss model to expected loss model, including all performing assets having 12 month ECL on origination - £513 million increase in provision partly offset by the IAS 39 latent loss provision of £390 million;
- Determination of significant increase in credit risk - this moves a subset of assets from a 12 month ECL (Stage 1) to lifetime ECL (Stage 2) when credit risk has increased since origination - £356 million increase in provision;
- Change in scope of impaired assets (Stage 3) - £73 million increase in provision primarily reflecting assets that have defaulted but with expectation of full recovery under IAS 39; and
- Incorporation of forward-looking information, including multiple economic scenarios (MES) – MES are assessed in order to identify non-linearity in the portfolio - £64 million increase in provision.

1.5. How do these differences impact RBS and what is the financial impact on RBS at 1 January 2018?

1.5.1. Summary

- Equity and TNAV: The implementation of IFRS 9 resulted in a £71 million reduction in total equity. Consequently tangible net asset value (TNAV) per share was one pence lower at £2.93. The credit impairment provision increase of £616 million before tax was mostly offset by a fair value increase of £561 million before tax in respect of classification and measurement.
- CET 1: The impact of classification and measurement fair value changes drove an overall IFRS 9 increase in CET 1 ratio of 30 basis points and benefited leverage ratio by 10 basis points.
- ECL: The increase in credit provisions was fully offset by regulatory expected loss deduction.

1. Summary continued

The table below summarises the day one impact of the implementation of IFRS 9 on RBS at 1 January 2018.

1.5.2. What is the impact of IFRS 9 on the balance sheet and equity? (audited)

	31 December 2017	Impact of IFRS 9 Classification & measurement	Expected credit losses	Tax	1 January 2018
	£m	£m	£m	£m	£m
Cash and balances at central banks	98,337	—	(1)	—	98,336
Loans and advances to banks (net of provisions)	30,251	—	(44)	—	30,207
Loans and advances to customers (net of provisions)	349,919	517	(483)	—	349,953
Debt securities and equity shares	79,383	44	(3)	—	79,424
Other assets	19,323	—	—	25	19,348
Funded assets	577,213	561	(531)	25	577,268
Derivatives	160,843	—	—	—	160,843
Total assets	738,056	561	(531)	25	738,111
Total liabilities	688,963	—	85	41	689,089
Total equity	49,093	561	(616)	(16)	49,022
Total liabilities and equity	738,056	561	(531)	25	738,111
Contingent liabilities and commitments	136,050	—	—	—	136,050

1.5.3. What is the impact of IFRS 9 on the CET 1 ratio?

	31 December 2017	Impact of IFRS 9 Classification & measurement	Expected credit losses	Tax	1 January 2018
Capital adequacy ratios	%	%	%	%	%
CET 1ratio - end-point CRR basis	15.9	0.3	—	—	16.2
CET 1 ratio - transitional arrangement	15.9	0.3	—	—	16.2
Capital - end-point CRR basis	£m	£m	£m	£m	£m
Tangible equity	35,164	561	(616)	(16)	35,093
Expected loss less impairment provisions	(1,286)	—	613	—	(673)
Prudential valuation adjustment	(496)	(21)	—	—	(517)
Deferred tax assets	(849)	—	—	—	(849)
Own credit adjustments	(90)	—	—	—	(90)
Pension fund assets	(287)	—	—	—	(287)
Cash flow hedging reserve	(227)	—	—	—	(227)
Other regulatory adjustments	28	—	—	—	28
Total deduction	(3,207)	(21)	613	—	(2,615)
CET 1 capital	31,957	540	(3)	(16)	32,478
	£bn	£bn	£bn	£bn	£bn
Risk-weighted assets	200.9	—	—	(0.1)	200.8

RBS has elected to take advantage of the transitional capital rules in respect of ECL. While this has negligible impact on CET 1 capital in 2018, they would mitigate the impact on capital in adverse economic conditions. The transitional rules reduce the full CET 1 effect by 95%, 85%, 70%, 50% and 25% each in the first five years of IFRS 9.

1. Summary continued

1.5.4. What is the impact of IFRS 9 on Leverage ratio?

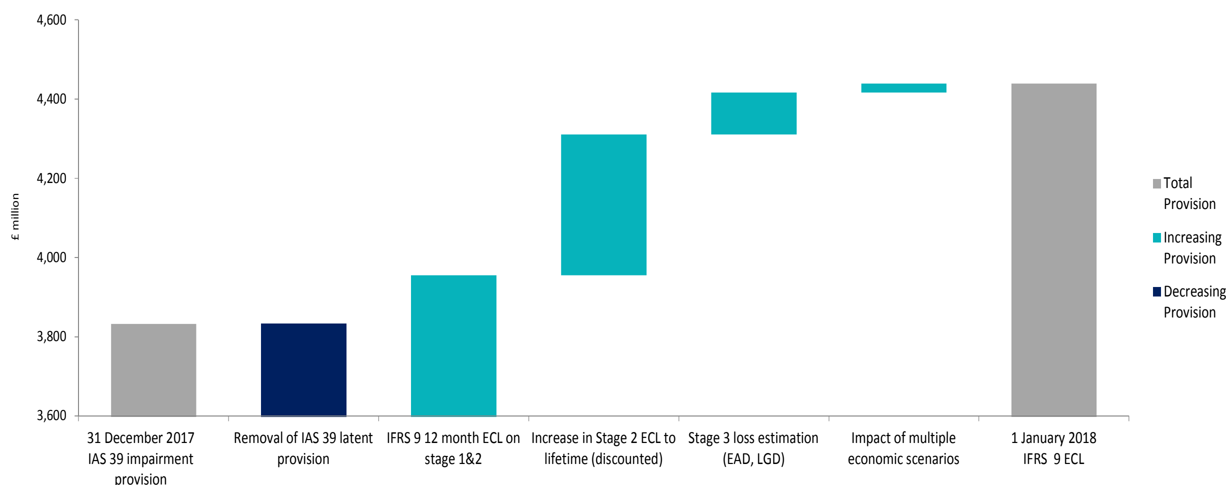
	31 December 2017	Impact of IFRS 9			1 January 2018
		Classification & measurement	Expected credit losses	Tax	
	%	%	%	%	%
CRR Leverage ratio - end point	5.3	0.1	—	—	5.4
UK Leverage ratio - end point	6.1	0.1	—	—	6.2
Leverage	£m	£m	£m	£m	£m
Cash and balances at central banks	98,337	—	(1)	—	98,336
Derivatives	160,843	—	—	—	160,843
Loans and advances (net of provisions)	380,170	517	(527)	—	380,160
Other assets	98,706	44	(3)	25	98,772
Total assets	738,056	561	(531)	25	738,111
Derivatives					
- netting and variation margin	(161,653)	—	—	—	(161,653)
- potential future exposures	49,429	—	—	—	49,429
Securities financing transactions gross up	2,262	—	—	—	2,262
Undrawn commitments	53,062	—	—	—	53,062
Regulatory deductions and other adjustments	(2,036)	(21)	613	—	(1,444)
CRR Leverage exposure	679,120	540	82	25	679,767
UK Leverage exposure	587,095	540	82	25	587,742
Tier 1 capital	35,998	540	(3)	(16)	36,519

1.5.5. What is the impact of adopting IFRS 9 classification and measurement?

As a result of the de-leveraging and efforts to simplify the business there are no significant areas that have changed their classification and measurement. The one significant portfolio is the lender option buyer options (LOBO) book, where interest terms do not qualify as straight-forward because RBS has the right to choose any basis to determine interest, including choices which are not related to a benchmark rate of interest. A number of individual assets also fail, but these are not material. Failing assets are typically junior notes in securitisation structures, complex elements within instruments and some bail-in-able notes, when down-streamed within RBS.

1.5.6. What are the key differences in moving from IAS 39 to IFRS 9 on impairment loss?

The chart below highlights the elements of the overall increase in impairment provision under IFRS 9 compared with IAS 39.



1. **Summary** continued

1.5.6. What are the key differences in moving from IAS 39 to IFRS 9 on impairment loss? (continued)

	Total £m
31 December 2017 - IAS 39 impairment provision (1)	3,832
Removal of IAS 39 latent provision	(390)
IFRS 9 12 month ECL on Stage 1 and 2	513
Increase in Stage 2 ECL to lifetime (discounted)	356
Stage 3 loss estimation (EAD, LGD)	73
Impact of MES	64
1 January 2018 - IFRS 9 ECL	4,448

Note:
(1) IAS 39 provision include £3,814 million relating to loans less £10 million on loans that are now carried at fair value and £28 million relating to AFS and LAR debt securities.

- The overall provisioning requirement under IFRS 9 increased by £616 million representing a 16% increase relative to IAS 39. The main driver of the increase is the requirement to hold a minimum of 12 months of ECL on performing assets and increasing to lifetime loss for assets that have exhibited a significant increase in credit risk.
- Compared with the latent loss provision held under IAS 39 of £390 million, the ECL requirement on performing assets (Stages 1 and 2) more than doubled, increasing by £493 million to £883 million.
- The IFRS 9 provisioning requirement on non-performing assets in Stage 3 is impacted less, the ECL requirement of £3,565 million is £123 million (4%) higher compared with IAS 39 impaired book provisions of £3,442 million principally on defaulted assets that did not carry a provision reflecting expectation of full recovery under IAS 39. At a business unit level:
  - UK Personal and Business Banking and Ulster Bank RoI combined: the exposures in these two segments are primarily personal in nature. The ECL provisioning requirement is £2,795 million, an uplift of £384 million relative to the IAS 39 provision. This was driven by the higher provisioning requirement on performing assets, principally on the UK credit card portfolio where provisions increased by £122 million (31% of the total increase).
  - Commercial and Private Banking and NatWest Markets: the assets in these segments are predominantly wholesale. The ECL provisioning requirement is £1,608 million, an uplift of £222 million relative to IAS 39. The uplift in Stage 3 assets of £83 million is principally driven by assets defaulted but with expectation of full recovery under IAS 39.

1.6. Has there been any change in governance?

The IFRS 9 programme was overseen by an Executive Steering Group which approved design and build decisions. Regular reporting to the Group Audit Committee was instituted from 2015 onwards. Existing committee structures are being utilised with one additional committee being introduced, the IFRS 9 Metrics Oversight Committee (MOC) which has delegated authority from RBS Provisions Committee. The committees involved in the IFRS 9 process, including Group Audit Committee, Board Risk Committee and Executive Risk Forum have received "educational sessions" during 2017 as part of the implementation of IFRS 9.

The remit of the IFRS 9 MOC is pan-Bank to ensure consistency of approach.

2. What are the key elements of Classification and measurement?

The classification and measurement of financial assets has been changed under IFRS 9 to more closely follow the product characteristics and business intent rather than being primarily influenced by asset class:

- Amortised cost is used only where products are relatively straight-forward (in this sense meaning the cash-flows represent principal and interest, being the time value of money) and where the business intends to hold the asset to collect those cash-flows.
- If the business intends to sell such assets from time to time (hold to collect and sell) they are amortised to profit and loss, but fair valued on the balance sheet (similar to available-for-sale under IAS 39).
- For financial assets that are more complex or where the business intends to trade them then they are fair valued with movements going to profit and loss.

Concluding on how individual business areas within RBS operate influences the choice of classification and subsequent measurement. In most cases, RBS has concluded on classifications that have similar measurement approaches to those that had been applied under IAS 39 and represent the intent to hold assets (amortised cost).

Some assets have component elements that are not straight-forward, such as leveraged products or those with embedded derivatives, where fair value must be applied. However, judgement is applied in considering structured interest and credit linked products to assess whether these features significantly influence future cash flows.

3. What are the key elements of Impairment provisions?

3.1. What are the main judgments that will have financial impact?

IFRS 9 introduces additional complexity into the determination of credit impairment provisioning requirements; however, the building blocks that deliver an ECL calculation already existed within the organisation. Existing Basel models have been used as a starting point in the construction of IFRS 9 models, which also incorporate term extension and forward-looking information.

There are five key areas that could materially influence the measurement of credit impairment under IFRS 9 – two of these relate to model build and three to their application:

Model build:

- The determination of economic indicators that have most influence on credit loss for each portfolio and the severity of impact (this leverages existing stress testing mechanisms).
- The build of term structures to extend the determination of the risk of loss beyond 12 months that will influence the impact of lifetime loss for assets in Stage 2.

Model application:

- The assessment of the significant increase in credit risk and the formation of a framework capable of consistent application.
- The determination of asset lifetimes that reflect behavioural characteristics whilst also representing management actions and processes (using historical data and experience).
- The determination of a base case (or central) economic scenario which has the most material impact (of all forward-looking scenarios) on the measurement of loss (RBS uses consensus forecasts to remove management bias).

See section 8 for more details.

3.2. When and how do assets move between Stages?

When a new asset is originated it is classified as Stage 1 (normal origination). Assets are not classified as Stage 2 on origination.

Moving from Stage 1 to Stage 2 is a key judgment, and is based on management defined criteria (as set out in section 8). IFRS 9 establishes the movement from Stage 1 (12 month loss) to Stage 2 (lifetime loss) as a matter of specific definition; if the definition of deterioration is met the asset is placed in Stage 2. RBS uses a primary mechanism based on its risk scoring (Probabilities of default measurement (PD)) to determine movement; this is supplemented by a series of qualitative assessments. RBS has established a framework whereby significant increase in credit risk represents either greater management scrutiny or an unexpected (and large by reference to starting point) movement in credit risk.

- At its simplest level RBS has developed criteria around a basic expectation that a doubling of the PD is the most appropriate threshold, with criteria varying by risk band. Other portfolio-specific thresholds are also used.
- Qualitative triggers follow existing practice and represent specific indicators that can be observed as a matter of fact (i.e. subject to heightened monitoring, forbearance support, days past due, adverse credit bureau scores on Retail assets).

If the definition of a significant increase in credit risk is no longer met then the asset returns from Stage 2 to Stage 1. There is no accounting concept of “cure”. RBS has specifically considered the risk of volatility within its reporting of movements between Stages 1 and 2 and concluded that for Retail assets the definition of “deteriorated” should incorporate a 3-month lookback on PD (so if the numeric threshold is breached in any of the three months prior to the reporting date the asset is deemed to remain in Stage 2). This approach is referred to as “persistence”.

The move from Stage 2 to Stage 3 is based upon “default”. The regulatory definition of default is used. Once an asset ceases to be “defaulted” then it will return to Stage 2. Increasingly regulators require that a “cure” period is satisfied before an asset ceases to be classed as defaulted and this would therefore apply for RBS assets.

Assets will not move directly from Stage 3 to Stage 1. When an asset ceases to be defaulted it will move to Stage 2 and then subsequently if it no longer is classed as “deteriorated” it will move to Stage 1. The two steps may happen in a short space of time, but the flow will always be from 3 to 2 to 1. In general it is expected that assets will always move to Stage 2 prior to moving to Stage 3, but in some instances an asset may move directly from Stage 1 to Stage 3 (an example would be a customer declaring financial hardship where there had been no evidence of financial difficulties in account behaviours).

3. What are the key elements of Impairment provisions? continued

3.3. Do large stage 2 balances mean poor credit quality?

Since the significant increase in credit risk test is relative, assets in Stage 2 may represent better credit quality than other assets that remain in Stage 1 – the boundary being specifically defined by reference to the origination circumstances for the individual asset. It is therefore inappropriate to conclude that a larger Stage 2 population indicates a worse quality credit portfolio. However, for an individual bank an increasing Stage 2 population over time would indicate that portfolio performance is below management expectation and this is likely to represent a deteriorating overall credit quality. The average credit risk of assets in Stage 2 allows the actual credit quality (and likely loss) of a bank to be understood.

3.4. What back-testing has taken place?

Full back-testing is not feasible since it is not possible to replicate the uncertainty that would have applied to economic forecasting and scenario selection historically.

For loss given default (LGD) where IFRS 9 models are an adaptation of our capital modes, back-testing leverages the annual Basel model validation process. Unlike the Stage 1 PD and exposure as default (EAD) models, where more rigorous validation has been feasible as part of the model development process, back-testing on some of our Stage 2 models has been limited by lengthy outcome periods.

3.5. What anchors exist to ground our ECL answer?

There are a number of specific anchor points that are valid for the purposes of assessing IFRS 9 ECL outcomes:

- Actual cash losses are unchanged under IFRS 9, so predicted losses can continue to be calibrated against actual losses.
- There is no material change in the definition of default or the identification of defaulted assets other than on assets that were previously categorised as potential problem loans but did not carry a provision reflecting expectation of full recovery.
- Even under IFRS 9 the majority of total ECL will be attributable to these cases. So Stage 3 provisions can be benchmarked against the current IAS 39 provisions.
- Basel expected loss is not calculated on the same basis, but uses a consistent, albeit conservative, view of loss. IFRS 9 conclusions can be benchmarked against this measure, noting that some divergence is likely, given that ECL is a function of the credit cycle (current conditions) and the economic outlook (benign or adverse).

3.6. How will IFRS 9 behave after day one?

Since cash losses are unchanged, it is anticipated that over the long run that the ECL charge will approximate to the IAS 39 normalised charge, typically estimated at 30-40 basis points. There remains, however, uncertainty as to how two specific elements will behave:

- The quarter-to-quarter reported volatility in response to changes in economic expectations; and
- The speed of recognition of loss in a downturn scenario.

3.7. How do IFRS 9 ECL outcomes behave under adverse economic conditions?

IFRS 9 increases the volatility of provisions and impairments compared with IAS 39. With IFRS 9, increases in losses due to a deterioration of the MES are recognised as provisions earlier than they would be under IAS 39. When the economy deteriorates provisions are taken in excess of the ultimate loss and are later released when it is observed that they exceeded the true loss rate (pro-cyclicality). This is due to two key drivers:

- A multiplier effect on expected losses – credit parameters used to compute provisions deteriorate during a recession implying higher provisions for both Stage 1 and Stage 2 assets; and
- The flow of exposures from Stage 1 into Stage 2 – during a recession exposures migrate from Stage 1 to Stage 2 with the requirement to provision for the entire lifetime of the loan, instead of just one year.

3.8. How has RBS used IFRS 9 in its capital management and planning?

RBS's normal annual and rolling capital planning forecasts make assumptions about a range of regulatory and accounting factors such as IFRS 9. These are linked to a number of factors including economic variables and impairments. These plans seek to demonstrate that the Group and its operating subsidiaries maintain sufficient CET 1 capital in these conditions.

Under stress testing, IFRS 9 volatility can have a more material impact. This is because the peak-to-trough change in CET 1 may be impacted by transitions from Stage 1 to Stage 2 in stress conditions. RBS uses stress and the peak-to-trough movements to help assess the amount of CET 1 capital we need to hold in stress conditions in accordance with the capital risk appetite framework. This internal CET 1 buffer may be higher than that assessed either through CRR buffers (which were set before the advent of IFRS 9) or the PRA buffer (as determined, in part, through regulatory stress tests).

4. Financial tables (audited)

4.1. IFRS 9 and IAS 39 impairment key performance indicators

The table below compares impairment key performance indicators (KPIs) under IAS 39 with those that are the closest proxies under IFRS 9. IAS 39 impairment KPIs have been adjusted to be on a like-for-like basis by excluding loans that are measured at fair value and including bank loans and debt securities within IFRS 9 ECL scope.

	IFRS 9						IAS 39				
1 January 2018	Stage 3 drawn exposure £m	Total ECL £m	Stage 3 ECL £m	Stage 3 as a % of total drawn exposure %	Stage 3 ECL as a % of Stage 3 exposure %	Total ECL as a % of total drawn exposure %	REIL £m	Impairment Provisions £m	REIL as a % of gross assets %	Provisions as a % of REIL %	Provisions as a % of gross assets %
UK PBB	3,202	1,606	1,110	2.0	34.7	1.0	1,975	1,280	1.2	64.8	0.8
Ulster Bank RoI	3,669	1,189	1,054	14.6	28.7	4.7	3,282	1,131	14.2	34.5	4.9
Commercial Banking	3,468	1,320	1,156	3.6	33.3	1.4	3,196	1,162	3.3	36.4	1.2
Private Banking	324	54	27	2.4	8.3	0.4	95	32	0.7	33.7	0.2
RBS International	119	38	28	1.4	23.5	0.5	103	35	1.2	34.0	0.4
NatWest Markets	501	234	190	3.8	37.9	1.8	263	192	2.1	73.0	1.6
Central Items and other	—	6	—	—	—	—	—	—	—	—	—
Total	11,283	4,447	3,565	3.0	31.6	1.2	8,914	3,832	2.4	43.0	1.0

Notes:
(1) IAS 39 loans and provisions have been adjusted to facilitate like-for-like comparison. Asset exclude those that are fair valued such as LOBOs and derivative collateral; bank loans and debt securities within IFRS 9 ECL scope have been included.
(2) Balances at central banks within Treasury are excluded so as to not distort the ratios as ECL is only £1 million on a £96.5 billion balance.
(3) IAS 39 provision includes £3,814 million relating to loans less £10 million on loans that are now carried at fair value (associated REIL is £18 million) and £28 million on AFS and LAR debt securities (associated REIL is £28 million).

- Total impairment provision under IFRS 9 is 1.2%, higher than adjusted IAS 39 coverage of 1.0%, primarily as all performing assets now carry a provision. Performing book provision increased from £390 million to £883 million whereas provision on defaulted assets only increased by £123 million to £3,565 million. Stage 3 ECL coverage on related assets is 31.6% but if 30 days past due Stage 2 were also included, the coverage on a comparable basis would be lower at 29.3%.
- REIL under IAS 39 did not include defaulted assets with expectation of full recovery and off-setting credit amounts; these are captured within Stage 3 under IFRS 9, thereby increasing coverage from 2.4% to 3.0%.
- For UK PBB, the inclusion of defaulted mortgages with expectation of full recovery within Stage 3 is a significant driver of the higher exposure relative to REIL. This feeds through to total exposure coverage at 2.0% (1.2% previously) and lower Stage 3 ECL to exposure coverage at 34.7% (from 64.8% previously) reflecting lower provision coverage rates on mortgages relative to unsecured lending.
- NatWest Markets' higher Stage 3 ECL to total exposure coverage at 3.8% primarily relates to legacy assets. Stage 3 exposure includes potential problem loans with no provisions, resulting in a lower provision coverage ratio compared with REIL coverage.
- In Ulster Bank RoI, coverage increased on a like-for-like population (bank loans included in both bases) from 14.2% to 14.6%. Stage 3 ECL to related exposure coverage on RoI residential mortgages is 26.0% but if 30 days past due Stage 2 exposures were also included, the provision coverage would be 25.3%.

4. Financial tables (audited) continued

4.2. IFRS 9 impairment methodology impact on RBS segments

The table below provides IFRS 9 ECL provision coverage by stage by segment. Drawn exposure includes bank loans and debt securities within the scope of IFRS 9 ECL.

	Drawn IFRS 9 ECL scope exposure				IFRS 9 ECL				IFRS 9 ECL coverage ratio				IAS 39			
1 January 2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 %	Stage 2 %	Stage 3 %	Total %	Impaired book provision £m	Latent provision £m	Total provision £m	REIL £m
UK PBB	145,650	14,490	3,202	163,342	144	352	1,110	1,606	0.1	2.4	34.7	1.0	1,069	211	1,280	1,975
Ulster Bank RoI	19,055	2,347	3,669	25,071	29	106	1,054	1,189	0.1	4.5	28.7	4.7	1,055	76	1,131	3,282
Commercial Banking	84,393	8,490	3,468	96,351	58	106	1,156	1,320	0.1	1.2	33.3	1.4	1,077	85	1,162	3,196
Private Banking	12,755	333	324	13,412	18	9	27	54	0.1	2.7	8.3	0.4	26	6	32	95
RBS International	7,791	307	119	8,217	5	5	28	38	0.1	1.6	23.5	0.5	28	7	35	103
NatWest Markets	11,762	995	501	13,258	2	42	190	234	—	4.2	37.9	1.8	187	5	192	263
Treasury	52,523	10	—	52,533	5	1	—	6	—	10.0	—	—	—	—	—	—
Total excluding balances at central banks	333,929	26,972	11,283	372,184	261	621	3,565	4,447	0.1	2.3	31.6	1.2	3,442	390	3,832	8,914
Balances at central banks	96,566	5	—	96,571	1	—	—	1	—	—	—	—	—	—	—	—
Total	430,495	26,977	11,283	468,755	262	621	3,565	4,448	0.1	2.3	31.6	0.9	3,442	390	3,832	8,914

4. Financial tables (audited) continued

4.3. IFRS 9 ECL scope exposure by balance sheet caption and stage

Certain amortised cost assets, such as cash in tills and ATMs, items in the course of collection and other very short term assets are outside the scope of IFRS 9 ECL and are not included in the table below. Undrawn commitments include reputationally committed exposures.

	Exposure within the scope of IFRS 9 ECL Framework (gross of ECL)			
	Total	Stage 1	Stage 2	Stage 3
1 January 2018	£m	£m	£m	£m
Balances at central banks	96,571	96,566	5	—
Loans and advances to banks	10,318	10,138	138	42
Loans and advances to customers	311,002	273,174	26,634	11,194
Debt securities	50,413	50,253	115	45
Other assets	451	364	85	2
Total assets	468,755	430,495	26,977	11,283
Undrawn commitments	136,259	130,004	5,600	655
Contingent liabilities	10,541	9,546	901	94
Total Contingent liabilities and commitments	146,800	139,550	6,501	749
Total exposure	615,555	570,045	33,478	12,032

4.4. IFRS 9 ECL scope exposure: sector and asset quality analysis

	Drawn exposure within IFRS 9 ECL scope (gross of ECL)							
	Exposure-weighted average 12 month PD Unaudited (1)(2)			Stage 2 (3)				
	IFRS 9 PD	Basel PD	Stage 1	Not 30 DPD	30 DPD	Total	Stage 3	Total
1 January 2018	%	%	£m	£m	£m	£m	£m	£m
Sector								
Personal	0.6	0.9	155,843	14,460	625	15,085	6,268	177,196
- UK mortgages	0.4	0.5	134,350	10,119	431	10,550	1,656	146,556
- RoI mortgages	1.5	2.6	10,674	1,351	127	1,478	3,397	15,549
- credit cards	3.8	3.7	3,097	999	11	1,010	140	4,247
- other unsecured	2.2	2.8	7,722	1,991	56	2,047	1,075	10,844
Wholesale	0.3	0.8	178,086	11,500	387	11,887	5,015	194,988
- property	0.4	1.0	33,884	1,942	87	2,029	1,964	37,877
- corporate	0.6	1.5	62,253	8,224	245	8,469	2,945	73,667
- financial institutions	0.1	0.5	32,923	981	55	1,036	105	34,064
- sovereign	—	—	49,026	353	—	353	1	49,380
Total excluding balances at central banks	—	—	333,929	25,960	1,012	26,972	11,283	372,184
Balances at central banks	—	—	96,566	5	—	5	—	96,571
Total	—	—	430,495	25,965	1,012	26,977	11,283	468,755
Financial assets - Asset quality								
AQ 1-4	0.1	0.1	223,789	6,883	101	6,984	—	230,773
AQ 5-8	0.9	1.7	109,962	17,449	660	18,109	743	128,814
AQ 9	14.0	32.0	178	1,628	251	1,879	855	2,912
AQ 10	—	—	—	—	—	—	9,685	9,685
Off-balance sheet								
Personal			36,502	2,133	12	2,145	294	38,941
Wholesale			103,048	4,255	101	4,356	455	107,859
Total			139,550	6,388	113	6,501	749	146,800

Notes:
(1) Both IFRS 9 12 month and regulatory Basel 12 month average PDs relate to Stage 1 and Stage 2 assets under IFRS. Undrawn are excluded in both PD bases.
(2) Undrawn exposures are excluded from both PDs.
(3) 30 DPD: 30 days past due, the mandatory 30 days past due backstop as prescribed by IFRS 9 guidance for significant increase in credit risk.

- Basel PDs are generally higher for Personal portfolios reflecting an element of in-built conservatism to comply with regulatory requirements in contrast to the IFRS 9 PDs which are unbiased forward-looking best estimates. Forward-looking information does not have much impact on most portfolios except for the credit card book which brought IFRS 9 12 month PD much closer to Basel PD.
- Wholesale Basel PD models are largely through the cycle in nature whereas IFRS 9 requires point-in-time estimates. Given the current low default environment and relatively benign outlook Basel PDs are considerably higher than IFRS 9 PDs over the same projection horizon.

4. Financial Tables (audited) continued

4.5 IFRS 9 ECL provision by sector and stage

The tables below shows IFRS 9 and IAS 39 impairment loss components by sector.

	IFRS 9 ECL						IAS 39 impairment provision		
	Total ECL	Stage 1	Stage 2			Stage 3	Good book	Impaired book	Total
			Not 30 DPD	30 DPD	Total				
1 January 2018	£m	£m	£m	£m	£m	£m	£m	£m	£m
Personal	2,316	135	367	30	397	1,784	237	1,757	1,994
- UK mortgages	262	12	57	7	64	186	50	137	187
- RoI mortgages	961	8	60	9	69	884	52	857	909
- credit cards	222	53	91	3	94	75	32	68	100
- other unsecured	871	62	159	11	170	639	103	695	798
Wholesale	2,131	126	216	8	224	1,781	153	1,685	1,838
- property	685	25	22	1	23	637	28	581	609
- corporate	1,325	87	156	7	163	1,075	120	1,042	1,162
- financial institutions	115	11	35	—	35	69	5	62	67
- sovereign	6	3	3	—	3	—	—	—	—
Total excluding balances at central banks	4,447	261	583	38	621	3,565	390	3,442	3,832
Balances at central banks	1	1	—	—	—	—	—	—	—
Total	4,448	262	583	38	621	3,565	390	3,442	3,832

4.6 IFRS 9 ECL provision coverage by sector and stage

The tables below show IFRS 9 ECL coverage by stage by sector.

	IFRS 9 ECL provision coverage on drawn exposure					
	Total ECL	Stage 1	Stage 2			Stage 3
			Not 30 DPD	30 DPD	Total	
	%	%	%	%	%	%
Personal	1.3	0.1	2.5	4.8	2.6	28.5
- UK mortgages	0.2	—	0.6	1.6	0.6	11.2
- RoI mortgages	6.2	0.1	4.4	7.1	4.7	26.0
- credit cards	5.2	1.7	9.1	27.3	9.3	53.6
- other unsecured	8.0	0.8	8.0	19.6	8.3	59.4
Wholesale	1.1	0.1	1.9	2.1	1.9	35.5
- property	1.8	0.1	1.1	1.1	1.1	32.4
- corporate	1.8	0.1	1.9	2.9	1.9	36.5
- financial institutions	0.3	—	3.6	—	3.4	65.7
- sovereign	—	—	0.8	—	0.8	—
Total	0.9	0.1	2.2	3.8	2.3	31.6

5. Opening balance sheet (audited)

5.1. IFRS 9 impact by balance sheet caption

The table below reflects the impact of IFRS 9 on implementation with effect from 1 January 2018 on the Balance sheet.

	31 December 2017 (IAS 39) £m	Impact of IFRS 9 Classification & measurement £m	Expected credit losses £m	Tax £m	1 January 2018 £m
Assets					
Cash and balances at central banks	98,337	—	(1)	—	98,336
Loans and advances to banks	30,251	—	(44)	—	30,207
Loans and advances to customers	349,919	517	(483)	—	349,953
Debt securities	78,933	(4)	(3)	—	78,926
Equity shares	450	48	—	—	498
Settlement balances	2,517	—	—	—	2,517
Derivatives	160,843	—	—	—	160,843
Intangible assets	6,543	—	—	—	6,543
Property, plant and equipment	4,602	—	—	—	4,602
Deferred tax	1,740	—	—	25	1,765
Prepayments, accrued income and other assets (1)	3,921	—	—	—	3,921
Total assets	738,056	561	(531)	25	738,111
Liabilities					
Deposits by banks	46,898	—	—	—	46,898
Customer accounts	398,036	—	—	—	398,036
Debt securities in issue	30,559	—	—	—	30,559
Settlement balances	2,844	—	—	—	2,844
Short positions	28,527	—	—	—	28,527
Derivatives	154,506	—	—	—	154,506
Provisions for liabilities and charges	7,757	—	85	—	7,842
Accruals and other liabilities	6,402	—	—	—	6,402
Retirement benefit liabilities	129	—	—	—	129
Deferred tax	583	—	—	41	624
Subordinated liabilities	12,722	—	—	—	12,722
Total liabilities	688,963	—	85	41	689,089
Total equity (1)	49,093	561	(616)	(16)	49,022
Total liabilities and equity	738,056	561	(531)	25	738,111

The table below reflects the impact of IFRS 9 on total equity	£m
At 31 December 2017 - under IAS 39	49,093
Classification & measurement	
- fair value adjustments following business model and sole payments of principal and interest reviews	579
- equity shares held at cost under IAS 39 – fair value adjustments through FVOCI reserve	48
- additional write-down of assets	(66)
	561
Expected credit losses	
- amortised cost assets	(531)
- contingent liabilities and commitments	(85)
	(616)
Tax	(16)
At 1 January 2018 - under IFRS on transition to IFRS 9	49,022

Note:
(1) The impact of IFRS 9 on interests in associates is considered immaterial.

5. Opening balance sheet (audited) continued

5.2. Financial instruments: classification and changes

The impact of IFRS 9 on asset classifications is set out below. There were no changes in classification of financial liabilities.

IAS 39 classification	IFRS 9 classification	31 December 2017 IAS 39 £m	1 January 2018 IFRS 9 £m
Cash and balances at central banks			
LAR	AC	98,337	98,336
Loans and advances to banks			
HFT	FVTPL (mandatory)	18,734	18,734
LAR	AC	11,517	11,473
Loans and advances to customers			
HFT	FVTPL (mandatory)	39,747	39,747
DFV	FVTPL (mandatory)	56	56
LAR	AC	307,991	307,442
LAR	FVTPL (mandatory)	2,125	2,708
Debt securities			
HFT	FVTPL (mandatory)	27,481	27,481
LAR	AC	3,571	3,568
LAR	FVTPL (mandatory)	72	68
HTM	AC	4,128	4,128
AFS	FVTPL (mandatory)	1	1
AFS	AC	391	391
AFS	FVOCI	43,289	43,289
Equity shares:			
HFT	FVTPL (mandatory)	29	29
DFV	FVTPL (mandatory)	134	134
AFS	FVOCI	287	335
Settlement balances			
LAR	AC	2,517	2,517

Notes:
LAR: loans and receivables
HFT: held-for-trading
DFV: designated as at fair value through profit and loss
HTM: Held to maturity
AFS: available-for-sale
AC: amortised cost
FVTPL: fair value through profit and loss
FVOCI: fair value through other comprehensive income

5. Opening balance sheet (audited) continued

5.3. IFRS 9 impact on regulated legal entities

RBS's subsidiaries also implemented IFRS 9 with effect from 1 January 2018. The estimated impact on total equity is set out below for the key regulated banks. The impact of Classification and measurement and ECL are shown separately. The impact on RBS is also shown for comparison purposes as well as the contribution to the third-party element by the key regulated banks.

		IFRS 9 third-party impact				IFRS 9 Intra-group impact					
	Total equity at 31 December 2017	Classification & measurement	ECL	Tax	Total	Classification & measurement	ECL	Tax	Total	Total IFRS 9 impact	Total equity at 1 January 2018
RBS Group £m	49,093	561	(616)	(16)	(71)	—	—	—	—	(71)	49,022
RBS plc (consolidated) £m	35,260	557	(617)	(16)	(76)	—	—	—	—	(76)	35,184
RBS plc £m	44,522	590	(137)	(121)	332	(44)	(42)	—	(86)	246	44,768
NatWest Plc (consolidated) £m	16,367	(7)	(347)	100	(254)	—	(17)	—	(17)	(271)	16,096
NatWest Plc £m	15,355	(46)	(307)	90	(263)	—	(7)	—	(7)	(270)	15,085
UBI DAC €m	6,403	(32)	(62)	—	(94)	—	—	—	—	(94)	6,309

Impact on RBS plc of the 2018 preparation for ring-fencing

In preparation for the implementation of ring-fencing legislation, which will take effect from 1 January 2019, RBS intends to transfer the majority of the RBS plc's retail and commercial banking business from RBS plc to Adam & Co (to be renamed RBS plc in April 2018). Accordingly, these activities are presented as discontinued operations in the RBS plc accounts.

Following the transfer, RBS plc will be renamed "NatWest Markets Plc". Accordingly the ECL impact above does not represent the future IFRS 9 risk profile of RBS plc but predominantly relates to Adam & Co.

6. Accounting policies (audited)

The RBS accounting policies that have been significantly changed as a result of the implementation of IFRS 9, applicable with effect from 1 January 2018, are set out below. The full description of accounting policies is set out in the 2017 Annual Report and Accounts.

1. Presentation of accounts

As set out in the 2017 Annual Report and Accounts the accounts are prepared on a going concern basis (see the Report of the directors, page 112) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The Group has opted to early adopt the IFRS 9 amendment on negative compensation with effect from 1 January 2018; this is expected to be endorsed for use in the EU in early 2018.

The company is incorporated in the UK and registered in Scotland. Its accounts are presented in accordance with the Companies Act 2006.

14. Financial instruments

On initial recognition, financial instruments are measured at fair value. Subsequently they are measured as follows: designated at fair value through profit or loss; amortised cost, the default class for liabilities; fair value through profit or loss, the default class for assets; or financial assets may be designated as at fair value through other comprehensive income. Normal purchases of financial assets classified as amortised cost are recognised on the settlement date; all other regular way transactions in financial assets are recognised on the trade date.

Designated as at fair value through profit or loss – a financial instrument may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an financial liability that contains an embedded derivative which is not evidently closely related to the host contract. Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Amortised cost assets – have to meet both the following criteria:

(a) the asset is held within a business model whose objective is solely to hold assets to collect contractual cash flows; and
(b) the contractual terms of the financial asset are solely payments of principal and interest on the outstanding balance.

Amortised cost liabilities – all liabilities that are not subsequently measured at fair value are measured at amortised cost.

Assets at fair value through other comprehensive income – assets have to meet both the following criteria:

(a) the asset is held within a business model whose objective is both to hold assets to collect contractual cash flows and selling financial assets; and
(b) the contractual terms of the financial asset are solely payments of principal and interest on the outstanding balance.

An equity instrument may also be designated irrevocably at fair value through other comprehensive income; realised gains and losses are not recognised in the income statement.

Fair value through profit or loss - a financial liability is measured at fair value if it arises from: a financial guarantee contract; a commitment to lend at below market rates; an obligation arising from the failed sale of an asset; or a contingent consideration for a business acquisition. Fair value through profit or loss is the default classification for a financial asset.

Reclassifications – financial liabilities cannot be reclassified. Financial assets are only reclassified where there has been a change in the business model.

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments.

Business model assessment – business models are assessed at portfolio level, being the level at which they are managed. This is expected to result in the most consistent classification of assets because it aligns with the stated objectives of the portfolio, its risk management, manager's remuneration and the ability to monitor sales of assets from a portfolio. The criteria for classifying cash flows as solely principal and interest are assessed against the contractual terms of a facility, with attention to leverage features; prepayment and extension terms; and triggers that might reset the effective rate of interest.

6. Accounting policies (audited) continued

15. Impairments

At each balance sheet date each financial asset or portfolio of advances measured at amortised cost or at fair value through other comprehensive income, issued financial guarantee and loan commitment is assessed for impairment. Loss allowances are forward-looking, based on 12 month expected credit losses where there has not been a significant increase in credit risk rating, otherwise allowances are based on lifetime expected losses.

Expected credit losses are a probability-weighted estimate of credit losses. The probability is determined by the risk of default which is applied to the cash flow estimates. On a significant increase in credit risk, credit losses are rebased from 12 month to lifetime expectations. A change in credit risk is typically but not necessarily associated with a change in the expected cash flows.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

The costs of loss allowances on assets held at amortised cost are presented as impairments in the income statement. Allowances in respect financial guarantees and loan commitments are presented as other liabilities and charges recorded within impairments. Financial assets held at amortised cost are presented net of allowances except where the asset has been wholly or partially written off.

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

19. Derecognition

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

Where contractual cash flows are modified, but there is no derecognition event, the gross carrying amount is recalculated using the original effective interest rate and a modification gain / loss is recognised. Where this modification arises on forborne or defaulted assets this is booked within impairments.

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

6. Accounting policies (audited) continued

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised.

Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

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

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

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

The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

6. Accounting policies (audited) continued

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

7. Key IFRS 9 terms and differences to current accounting and regulatory framework (audited)

Attribute	IFRS 9	IAS 39	Regulatory (CRR)
Default / credit impairment	To determine the risk of a default occurring, management applies a default definition that is consistent with the Basel/Regulatory definition of default. Assets that are defaulted are shown as credit impaired. RBS uses 90 days past due as a consistent measure for default across all product classes. The population of credit impaired assets is broadly consistent with IAS 39, though measurement differs because of the application of MES. Assets that were categorised as potential problems with no impairment provision are now categorised as Stage 3.	Default aligned to loss events, all financial assets where an impairment event has taken place - 100% probability of default and an internal asset quality grade of AQ10 - are classed as non-performing. Impaired financial assets are those for which there is objective evidence that the amount or timing of future cash flows have been adversely impacted since initial recognition.	A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place: - RBS considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; - the customer is past due more than 90 days. For Retail exposures, the definition of default may be applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.
Probability of default (PD)	PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.	Regulatory PDs adjusted to point in time metrics are used in the latent provision calculation.	The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. For Wholesale, PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels. For Retail, the prevailing economic conditions at the reporting date (point in time) are used.
Significant increase in credit risk (SICR)	A framework incorporating both quantitative and qualitative measures aligned to the Group's current risk management framework has been established. Credit deterioration will be a management decision, subject to approval by governing bodies such as the Group Provisions Committee. The staging assessment requires a definition of when a SICR has occurred; this moves the loss calculation for financial assets from a 12 month horizon to a lifetime horizon. Management has established an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined	Not applicable.	Not applicable.
Forward-looking and multiple scenarios	The evaluation of future cash flows, the risk of default and impairment loss should take into account expectations of economic changes that are reasonable. More than one outcome should be considered to ensure that the resulting estimation of impairment is not biased towards a particular expectation of economic growth.	Financial asset carrying values based upon the expectation of future cash flows.	Not applicable.

7. Key IFRS 9 terms and differences to current accounting and regulatory framework (audited) continued

Attribute	IFRS 9	IAS 39	Regulatory
Loss given default (LGD)	LGD is a current assessment of the amount that will be recovered in the event of default, taking account of future conditions. It may occasionally equate to the regulatory view albeit with conservatism and downturn assumptions generally removed.	Regulatory LGD values are often used for calculating collective and latent provisions; bespoke LGDs are also used.	An estimate of the amount that will not be recovered in the event of default, plus the cost of debt collection activities and the delay in cash recovery. LGD is a downturn based metric, representing a prudent view of recovery in adverse economic conditions.
Exposure at default (EAD)	Expected balance sheet exposure at default. It differs from the regulatory method as follows: - it includes the effect of amortisation; and - it caps exposure at the contractual limit.	Based on the current drawn balance plus future committed drawdowns.	Models are used to provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.
Date of initial recognition (DOIR)	The reference date used to assess a significant increase in credit risk is as follows. Term lending: the date the facility became available to the customer. Wholesale revolving products: the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer. Retail Cards: the account opening date or, if later, the date the card was subject to a regular three year review or the date of any subsequent limit increases. Current Accounts/ Overdrafts: the account opening date or, if later, the date of initial granting of overdraft facility or of limit increases.	Not applicable for impairment but defined as the date when the entity becomes a party to the contractual provisions of the instrument.	Not applicable.
Modification	A modification occurs when the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in derecognition. A modification requires immediate recognition in the income statement of any impact on the carrying value and effective interest rate (EIR) or examples of modification events include forbearance and distressed restructuring. The financial impact is recognised in the income statement as an impairment release/(loss).	Modification is not separately defined but accounting impact arises as an EIR adjustment on changes that are not derecognition or impairment events.	Not applicable.

8. Critical judgments relating to impairment loss determination

8.1. What policy elections or simplifications have been made?

In addition to the five critical judgments summarised in section 3, which are relevant from period to period, there is one further significant judgment that is made as a one-off exercise to support the day one implementation: this is the application of the new IFRS 9 models to the determination of origination date metrics. Since it is not possible to determine the economic forecasts and alternative scenarios going backwards in time it is necessary to use a series of assumptions to enable this process. RBS has assumed a flat forward view for all dates historically.

There are some other less significant judgments, elections and simplification assumptions that inform the ECL process; these are not seen as 'critical' in determining the appropriate level of impairment but represent choices taken by management across areas of estimation uncertainty. The main examples of these are:

- Models – e.g. in the case of some low default portfolios, Basel parameter estimates have been applied for IFRS 9.
- Discounting of future losses – the ECL calculation is based on expected future cash-flows. These are discounted using the EIR – for practical purposes, this is typically applied at a portfolio level rather than being established and operated at an individual asset level; and
- MES – it is the selection of the central (or base) scenario that is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities. Different approaches to model MES around the central scenario have all been found of low significance for the overall ECL impact.

8.2. How does IFRS 9 Credit risk modelling work?

IFRS 9 introduces lifetime ECL for the measurement of credit impairment. This requires the development of new models or the enhancement of existing Basel models. IFRS 9 ECLs are calculated using a combination of:

- Probability of default (PD);
- Loss given default (LGD); and,
- Exposure at default (EAD).

In addition, lifetime PDs (as at reporting date and at date of initial recognition) are used in the assessment of a significant increase in credit risk (SICR) criteria.

8.2.1.What were the IFRS 9 ECL model design principles?

To meet IFRS 9 requirements for ECL estimation, PD, LGD and EAD used in the calculations must be:

- Unbiased - material regulatory conservatism has been removed to produce unbiased model estimates;
- Point-in-time - recognise current economic conditions;
- Forward-looking - incorporated into PD estimates and, where appropriate, EAD and LGD estimates; and
- For the life of the loan - all models produce a term structure to allow a lifetime calculation for assets in Stages 2 and 3.

IFRS 9 requires that at each reporting date, an entity shall assess whether the credit risk on an account has increased significantly since initial recognition. Part of this assessment requires a comparison to be made between the current lifetime PD (i.e. the current probability of default over the remaining lifetime) with the equivalent lifetime PD as determined at the date of initial recognition.

For assets originated before IFRS 9 was introduced, comparable lifetime origination PDs do not exist. These have been retrospectively created using the relevant model inputs applicable at initial recognition. Due to data availability two practical measures have been taken:

- Where model inputs were not available at the point of initial recognition the earliest available robust metrics are used. For instance, since Basel II was introduced in 2008, the earliest available and reliable production Basel PDs range from between December 2007 and April 2008 depending on the portfolio; and
- Economic conditions at the date of initial recognition are assumed to remain constant from that point forward.

8. Critical judgments relating to impairment loss determination continued

8.2.2. The details of IFRS 9 ECL model design principles

PD estimates

Wholesale Models

Wholesale PD models use the existing CCI based point-in-time/through-the-cycle framework to convert one year regulatory PDs into point-in-time estimates that reflect current economic conditions across a comprehensive set of region/industry segments.

One year point-in-time PDs are then extrapolated to multi-year PDs using a conditional transition matrix approach. The conditional transition matrix approach allows the incorporation of forward-looking information by adjusting the credit state transition probabilities according to projected, forward-looking changes of credit conditions in each region/industry segment.

This results in forward-looking point-in-time PD term structures for each obligor from which the lifetime PD for a specific exposure can be calculated according to the exposure's residual contractual maturity.

Retail Models

Retail PD models use an EMV approach to model default rates by taking into account Exogenous (macro-economic), Maturity and Vintage (EMV) effects. This EMV methodology has been widely adopted across the industry as it enables forward-looking information to be modelled separately by isolating exogenous effects. Forward-looking information is incorporated by fitting the relevant stress testing model to the exogenous component and utilising forecasts of the relevant macro-economic factors.

The models produce quarterly PDs, which can be accumulated over four quarters to provide Stage 1 one year PDs and over the remaining lifetime to provide lifetime PDs for accounts in Stage 2.

LGD estimates

The general approach for the IFRS 9 LGD models has been to leverage the Basel LGD models with bespoke IFRS 9 adjustments to ensure unbiased estimates, i.e. use of effective interest rate as the discount rate and the removal of: downturn calibration, indirect costs, other conservatism and regulatory floors.

For Wholesale, current and forward-looking economic information is incorporated into the LGD estimates using the existing CCI framework. For low default portfolios (e.g. Sovereigns) loss data is too scarce to substantiate estimates that vary with systematic conditions. Consequently, for these portfolios, LGD estimates are assumed to be constant throughout the projection horizon.

For Retail, forward-looking information has only been incorporated for the secured portfolios, where changes in property prices can be readily accommodated. Initial analysis indicated minimal impact for the other Retail portfolios.

EAD estimates

For Wholesale, while conversion ratios in the historical data show temporal variations, these cannot (unlike in the case of PD and some LGD models) be sufficiently explained by the CCI measure and are presumed to be driven to a larger extent by exposure management practices. Therefore point-in-time best estimates measures for EAD are derived by estimating the regulatory model specification on a rolling five year window.

For loans in the Wholesale portfolio, amortisation profiles are applied to the outstanding balances, rather than modelling the future behaviour.

The IFRS 9 Retail modelling approach for EAD is dependent on product type.

- Revolving products leverage the existing Basel models, with appropriate adjustments and incorporating a term structure based on time to default.
- Amortising products use an amortising schedule, where a formula is used to calculate the expected balance based on remaining terms and interest rates.
- There is no EAD model for Personal loans; instead, debt flow (i.e. combined PD x EAD) is directly modelled.

Initial analysis has indicated that there is minimal impact on EAD arising from changes in the economy for all Retail portfolios except mortgages. Therefore, forward-looking information is only incorporated in the mortgage EAD model (through forecast changes in interest rates).

8. Critical judgments relating to impairment loss determination continued

8.3. What is significant increase in credit risk?

Exposures that are considered significantly credit deteriorated since initial recognition should be classified within Stage 2 and assessed for lifetime ECL measurement (exposures not considered deteriorated carry a 12 month ECL). RBS has adopted a framework to identify deterioration based primarily on movements in probability of default supported by additional backstops. The principles applied are consistent across the bank and align to credit risk management practices.

The framework comprises the following elements:

- IFRS 9 lifetime PD assessment (the primary driver) - on modelled portfolios the assessment is based on the relative deterioration in forward-looking lifetime PD.
- Qualitative high risk backstops - The PD assessment is complemented with the use of qualitative high risk backstops to further inform whether significant deterioration in lifetime risk of default has occurred. The qualitative high risk backstop assessment includes the use of the mandatory 30+ days past due backstop, as prescribed by IFRS 9 guidance, and other features such as forbearance support, heightened monitoring on Wholesale, adverse credit bureau on Retail.
- Persistence - Retail only: The persistence rule ensures that accounts that have met the criteria for PD driven deterioration are still considered to be significantly deteriorated for a set number of months thereafter. This additional rule enhances the timeliness of capture in Stage 2; it is a Retail methodology feature and is applied to PD driven deterioration only.

The criteria are based on a significant amount of empirical analysis and seek to meet three key objectives:

- Criteria effectiveness – the criteria should be effective in identifying significant credit deterioration and prospective default population.
- Stage 2 stability – the criteria should not introduce unnecessary volatility in the Stage 2 population.
- Portfolio analysis – the criteria should produce results which are intuitive when reported as part of the wider credit portfolio.

8.4. How are asset lifetimes determined?

The choice of initial recognition and asset duration (lifetime) is another critical judgement in determining quantum of lifetime losses that apply.

- The date of initial recognition should reflect the date that a transaction (or account) was first recognised on the balance sheet; the PD recorded at this time provides the baseline used for subsequent determination of SICR.
- For asset duration, the approach applied (in line with IFRS 9 requirements) are:
    - Term lending: the contractual maturity date, reduced for behavioural trends where appropriate (such as, expected pre-payment and amortisation);
    - Revolving facilities: for Retail portfolios (except credit cards), asset duration is based on behavioural life and this is normally greater than contractual life (which would typically be overnight). For wholesale portfolios, asset duration is based on annual counterparty review schedules and will be set to the next review date.

In the case of Credit Cards, the most significant judgement is to reflect the operational practice of card reissuance and the associated credit assessment as enabling a formal re-origination trigger. As a consequence RBS uses a 36-month fixed lifetime approach on credit card balances. If RBS uncapped its approach the ECL impact would be less than £75 million.

- The approach reflects RBS practice of a credit-based review of customers prior to credit card issuance and complies with IFRS 9.
- The lack of balance transfers helps RBS in adopting a three-year life. A return to this market would require a bespoke approach that would be likely to carry higher lifetimes.
- Benchmarking information indicates that peer UK banks use behavioural approaches in the main for credit card portfolios with average durations between 3-10 years. Across Europe durations are shorter and are, in some cases, as low as one year.

8. Critical judgments relating to impairment loss determination continued

8.5. What are the primary economic loss drivers and base case scenarios used in IFRS 9 modelling?

The forecasts applied for IFRS 9 are those used for financial planning. Portfolio segmentation and selection of economic loss drivers follow closely the approach already used in stress testing. To enable robust modelling, the two or three primary economic factors impacting loss for each portfolio are selected; this involves empirical analysis and expert judgment.

The typical primary economic loss drivers for Retail portfolios include UK and Irish GDP, Unemployment rate (UNP), House price index (HPI), and Base rate for UK and Irish portfolios as relevant. In addition to some of these loss drivers, for Wholesale portfolios, World GDP is a primary loss driver.

Alternative assumptions for the central base case scenario and related key economic variables would result in different ECL outcomes. To illustrate this potential for ECL variability, set out below are the average over the five year planning horizon (2018 to 2022 inclusive) used in the most recent planning cycle.

Table below provides summary of the average, minimum and maximum for some of these key economic variables:

Base case economic variables for 2018 - 2022	Average	Minimum	Maximum
UK GDP – % change year on year	1.7	1.2	2.0
UK unemployment (%)	5.3	5.0	5.5
UK HPI – % change year on year	3.1	1.5	4.6
BOE base rate (%)	0.77	0.50	1.00
Irish GDP – % change year on year	2.9	2.6	3.6
Irish unemployment (%)	5.6	5.4	5.9
Irish HPI – % change year on year	4.5	3.5	8.9
ECB base rate (%)	(0.28)	(0.40)	0.10
World GDP – % change year on year	2.6	2.4	2.9

Note:
(1) Unemployment rate (16 years and over seasonally adjusted).

8.6. What is RBS's approach for multiple economic scenarios (MES)?

The base scenario plays a greater part in the calculation of ECL than the approach to MES.

Retail

The approach to MES for Retail portfolios is based on using discrete scenarios, where the latest base case is applied to reflect the forward-looking element of the model (the Single economic scenario view, with a probability of c. 50%) and probability-weighting the outputs from a further four bespoke scenarios - a base case upside and downside (each with a c. 20% probability) - and an additional upside and downside (each with c. 5% probability) - are used to provide the MES view.

The initial modelled impact was negligible, and management agreed a small overlay was merited to account for the limited effect of non-linearity within the portfolios. The impact of overlay for MES was small (for UK PBB 3.3% of Stage 1 and Stage 2 ECL) on Retail portfolios.

Wholesale

As in Retail, the 'central scenario' is the bank's internal base case. The methodology to model the impact of MES around the central scenario is based on a Monte Carlo simulation approach. This involves simulating a large number of alternative scenarios around the CCI projection that corresponds to the central macro base case. The resulting forward-looking PD and ECL projections are then averaged across all simulated scenarios to form multi scenario expectations. To ensure tractability the simulations are performed off-line and applied in the form of adjustment scalars to the single base case results in implementation.

The impact of MES on Wholesale portfolios was small (2.5% of Stage 1 and Stage 2 ECL).

9. EY audit opinion

Special Purpose auditor's report on the Preliminary Statement of Financial Position of The Royal Bank of Scotland Group plc as at 1 January 2018.

To the Board of Directors of The Royal Bank of Scotland Group plc

Opinion

We have audited the accompanying information identified as audited in the Opening Balance Sheet, Financial Tables, the Accounting Policies and the Key IFRS 9 terms and differences to current accounting and regulatory framework (referred to as the "Preliminary Statement of Financial Position") of The Royal Bank of Scotland Group plc (the 'Group') as at 1 January 2018. The Preliminary Statement of Financial Position has been prepared as part of the Group's adoption of IFRS 9: *Financial Instruments* issued by the International Accounting Standards Board as adopted by the European Union.

In our opinion, the Preliminary Statement of Financial Position as at 1 January 2018 is prepared, in all material respects, in accordance with the accounting policies set out in Section 6.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Preliminary Statement of Financial Position section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the Preliminary Statement of Financial Position in England and Wales, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Emphasis of Matter – Basis of Accounting

Without qualifying our opinion, we draw attention to:

- section 6 of the Preliminary Statement of Financial Position, which describes the basis of accounting. As a result, the Preliminary Statement of Financial Position may not be suitable for another purpose.
- the fact that Section 6 refers to the accounting policies adopted and expected to be effective when the Group prepares its financial statements for the year ended 31 December 2018 and includes the adoption of the amendment on negative compensation issued by the IASB but awaiting adoption by the EU.
- the fact that, under IFRS only a complete set of financial statements comprising a statement of financial position, income statement, statement of comprehensive income, statement of changes in equity, and cash flow statement, together with the related notes thereto, can provide a fair presentation of the Group's financial position, results of operations, and cash flows in accordance with IFRSs.

Our opinion is not modified in respect of the above matters.

Use of our report

This report is made solely to the Group's directors, as a body, in accordance with our engagement letter dated 19 February 2018. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Group and the Group's directors as a body, for our audit work, for this report, or for the opinions we have formed.

Responsibilities of Management and Those Charged with Governance for the Preliminary Statement of Financial Position

Management is responsible for the preparation of the Preliminary Statement of Financial Position in accordance with Section 6, and for such internal control as management determines is necessary to enable the preparation of the Preliminary Statement of Financial Position is free from material misstatement, whether due to fraud or error.

In preparing the Preliminary Statement of Financial Position, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

9. EY audit opinion continued

Auditor's Responsibilities for the Audit of the Preliminary Statement of Financial Position

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

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

The engagement partner on the audit resulting in this independent auditor's report is Jonathan Bourne.
Ernst & Young LLP
London
22 February 2018

Notes:

1. The maintenance and integrity of the RBS web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Schedule since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of the Schedule may differ from legislation in other jurisdictions.

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 CET 1 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 Promotor Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements

These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the 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 in the Group's 2017 Annual Report 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 CET 1 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.

Forward-looking statements continued

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 aginst 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.

Abbreviations and acronyms

AC	Amortised cost
AFS	Available-for-sale
AQ	Asset quality
BoE	Bank of England
CCI	Credit cycle indices
CET 1	Common equity tier 1
CRR	Capital Requirements Regulation
DFV	Designated as at fair value through profit or loss
DOIR	Date of initial recognition
EAD	Exposure at default
ECL	Expected credit losses
EIR	Effective interest rate
EMV	Exogenous(macro-economic), maturity and vintage
EU	European Union
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GDP	Gross domestic product
HFT	Held-for-trading
HFT	Held-for-trading
HPI	House price index
HTM	Held-to-maturity
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LAR	Loans and receivables
LGD	Loss given default
LOBO	Lender option buyer option
MES	Multiple economic scenarios
MOC	Metrics Oversight Committee
NPE	Non-performing drawn exposure
PD	Probability of default
PRA	Prudential Regulation Authority
RBSG	The Royal Bank of Scotland Group plc
SICR	Significant increase in credit risk
TNAV	Tangible net asset value
UBI DAC	Ulster Bank Ireland Designated Activity Company
UK	United Kingdom
UNP	National unemployment
VaR	Value-at-risk

In this Report, unless specified otherwise, the terms 'company' and 'RBSG plc' mean The Royal Bank of Scotland Group plc; 'RBS', 'RBS Group' and the 'Group' mean the company and its subsidiaries; 'the Royal Bank' and 'RBS plc' mean The Royal Bank of Scotland plc; and 'NatWest Plc' means National Westminster Bank Plc. UBI DAC means Ulster Bank Ireland Designated Activity Company 'UBI DAC'.