Company Registered Number: 2304

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS

31 December 2018

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BOARD OF DIRECTORS AND SECRETARY

DIRECTORS:	John Philip Ward Brewster (Chairman) Lynn Ann Cleary Joanna Elizabeth Dentskevich Andrew Martin McLaughlin Louis Philip Chetwynd Taylor Stuart Porteous
SECRETARY:	Rachael Emma Pocklington
REGISTERED OFFICE:	Royal Bank House 71 Bath Street St Helier Jersey JE4 8PJ
AUDITOR:	Ernst & Young LLP Castle Street St Helier Jersey JE1 1EY

REPORT OF THE DIRECTORS

The directors of The Royal Bank of Scotland International Limited ("the Company"/"RBS International"/"The Bank") present their annual report, together with the audited financial statements of the Company for the year ended 31 December 2018. The financial statements are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

ACTIVITIES AND BUSINESS REVIEW

Principal activities

The main activity of the Company is the provision of banking services, including the taking of deposits and lending.

Management announced its intention to move the businesses and customers of the Isle of Man Bank Limited into RBS International during 2019. Both entities are already part of the wider RBS International Holdings Group of companies and the business will continue to trade as Isle of Man Bank.

Business review

The Company's financial performance is presented in the Income Statement on page 8.

The operating profit before tax for the year was £272m (2017: £185m), with improvement primarily driven by the benefit of customer migrations from elsewhere in RBS Group.

Key metrics for RBS International include -

	2018	2017
Loans and advances to customers	£12.6bn	£8.4bn
Customer deposits	£26.0bn	£27.9bn
Loan to Deposit ratio	49%	30%
Risk Weighted Assets (RWAs)	£7.4bn	£10.6bn
Core Equity Tier 1 (CET1)	£1.7bn	£2.0bn
CET1 capital ratio	23.6%	19.10%
Leverage ratio[1]	5%	n/a
Liquidity portfolio	£14.2bn	n/a
Return on equity	11.8%	8%
Liquidity Coverage Ratio[2] (LCR)	127%	n/a
Assets under Management	£3.0bn	£2.3bn

Notes:
1) Leverage exposure is capital as a percentage of on and off balance sheet exposures in line with Jersey Financial Services Commission (JFSC) guidance
2) On 1 January 2019 the LCR became the JFSC's primary liquidity standard, with a 100% ratio minimum

Loans and advances to customers grew by £4.2bn during the year to £12.6bn. During the year, the migration of the Funds Banking Business from RBS Plc Group to the London branch of RBSI has been completed. £3.3bn of Loans to Customers moved to the London branch of the company in 2018 as a result of such migration activity. Furthermore, a mortgage book of £0.8bn was transferred from RBS Plc branch in Isle of Man to RBSI International.

Customer deposits represent the Company's primary funding source. Year end balances comprised £6.1bn Retail deposits and £19.9bn wholesale deposits.

During the year, the Company moved from placing the majority of its excess funding with RBS Group, to a liquidity portfolio across Central & Correspondent Banks, alongside Sovereign Bond Holdings. These changes are designed to support the company to comply with incoming Basel III Liquidity Coverage Ratio rules.

Reflecting the change in the Company's position within RBS Group from 2018 the Company started contributing toward the RBS Group UK Bank Levy, which is an annual charge based on the total year end liabilities less certain allowable exemptions and deductions. The charge for the company in 2018 was £16m (2017: nil).

The Company's Core Equity Tier 1 (CET1) ratio improved to 24%, primarily supported by lower Risk Weighted Assets (RWAs).

Placing surplus deposits into a liquidity portfolio reduced RWA by £4.9bn during the year, while exposures that migrated from elsewhere in the RBS Group increased RWA by £2.0bn.

The reduction in CET1 capital from £2.0bn to £1.7bn primarily reflects the dividend of £470m (2017: 0). The Company's total regulatory capital comprised solely of CET1 at FY 2018. The Company may consider introducing additional forms of regulatory capital in 2019.

Assets under management are assets managed by the company on behalf of clients through our Coutts Crown Dependencies brand and Luxembourg branch.

RBS International obtained a credit rating with Standard and Poor's in January 2018, the rating was upgraded to BBB+/A-2, in May 2019. S&P's outlook on the Company was Positive at the end of 2018. Fitch has rated RBS International since 2009, the agency improved its outlook for the Company to stable in December 2018, with a rating of A/F1.

Accounting policies

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Company's accounting policies and key sources of estimation uncertainty are included within the Accounting policies on pages 13 to 18.

Risk management

The prevailing market and economic conditions pose risks for the Company. These include the level of defaults from customers on outstanding advances as well as the degree of uncertainty in the valuation of other financial assets and liabilities.

REPORT OF THE DIRECTORS

Risk management (continued)

The financial position of the Company, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 9 and 17 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities and its exposures to credit and liquidity risks.

The Board

The Board is collectively responsible for the long term success of the Company and delivery of sustainable shareholder value. The roles of Chairman and Chief Executive Officer (CEO) are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures effective engagement and contribution of all executive, non-executive and independent non-executive directors. The CEO has responsibility for all businesses and acts in accordance with authority delegated from the Board. The independent non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and leadership team.

In order to provide effective oversight and leadership the Board has established two Board Committees with particular responsibilities:

The Audit Committee assists the Board in discharging its responsibilities for monitoring the quality of the financial statements of the Company. It reviews the accounting policies, financial reporting and regulatory compliance of the Company and its systems and standards of internal controls, and monitors the work of internal and external audit.

The Board Risk Committee provides oversight and advice on current and potential future risk exposures of the Company and future risk strategy. It reviews compliance with risk appetite and oversees the operation of the policy framework and submission to regulators.

The Board is also supported by the Executive Committee comprising the CEO, Chief Financial Officer (CFO) and the Chief Risk Officer (CRO) and other business leaders. It supports the CEO in managing the Company's businesses. It is responsible for managing strategic, financial, capital, risk and operational issues.

The Board approves any changes in inter-bank lending lines and in limits governing currency and interest rate exposures. The Board policy is not to enter into derivative transactions for trading purposes, but to undertake such contracts to hedge or reduce the volatility in interest income and foreign exchange. The Company's actual derivative transactions are outlined in note 6 to these financial statements. Further details of the Company's risk management policies are highlighted in note 17 to the financial statements.

Outlook

The directors are satisfied with the financial position of the Company and believe that they are appropriately placed to manage their business risks successfully.

The purpose of this report is to provide information to the members of the Company and it is addressed to them as such. Forward looking statements by their nature involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such statements.

Uncertainties surrounding the UK's withdrawal from the European Union

Following the UK's EU Referendum in June 2016, and pursuant to the exit process triggered under Article 50 of the Treaty on the European Union in March 2017, the UK is scheduled to leave the EU on 29 March 2019.

The UK Government and Parliament is currently actively engaged in seeking to determine the terms of this departure, including any transition period, and the resulting economic, trading and legal relationships with both the EU and other counterparties currently remain unclear and subject to significant uncertainty.

As it currently stands, the UK's EU membership and all associated treaties will cease to apply at 23:00 on 29 March 2019, unless some form of transitional arrangement encompassing those associated treaties is agreed or there is unanimous agreement amongst the UK, other EU member states and the European Commission to extend the negotiation period.

The legal and political uncertainty and any actions taken as a result of this uncertainty, could have a significant impact on the Bank's operations and as a result may adversely impact the Bank's profitability, competitive position, business model and product offering.

The longer term effects of Brexit on the Bank's operating environment are difficult to predict, and are subject to wider global macro-economic trends and events, but may significantly impact the Bank and its customers and counterparties who are themselves dependent on trading with, or personnel from, the United Kingdom and may result in or be exacerbated by periodic financial volatility and slower economic growth in the Crown Dependencies, the UK, the rest of Europe and potentially the global economy.

GOING CONCERN

The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, notes 9 and 17 to the financial statements include the Bank's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

After making appropriate enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the Report of the Directors and the financial statements.

DIVIDENDS

The directors declared a dividend of £470m to The Royal Bank of Scotland International (Holdings) Limited (RBSIH) (2017: nil).

REPORT OF THE DIRECTORS

REGULATION

The Company is licensed in Jersey under the Financial Services (Jersey) Law 1998 to conduct deposit taker business, fund services business, general insurance mediation business, investment business and money services business, under classes A, C, Q, X, Z, DC and 02 of this law. The Company operates in different jurisdictions through its branches and is subject to the following laws and regulations:

Guernsey

- Banking Supervision (Bailiwick of Guernsey) Law 1994;
- Protection of Investors (Bailiwick of Guernsey) Law 1987;
- The Insurance Business (Bailiwick of Guernsey) Law 2002;
- The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law 2002;
- The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law 2000;
- Regulation 16 of the Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations 2007.

Isle of Man

- Financial Services Act 2008.
- Insurance Act 2008.

Gibraltar

- Financial services (Banking) Act;
- Financial services (Investment and fiduciary Services) Act;
- Financial services (Collective Investment Scheme) Act.

Luxembourg

- The branch is registered and supervised by the Commission de Surveillance du Secteur Financier;
- It is licensed as a bank under the Luxembourg law of 05 April 1993 of the Financial Sector in Luxembourg.

London

- Financial Services & Markets Act 2000;
- Financial Services & Markets Act 2000 (Regulated Activities) Order 2001;
- Financial Services Act 2012;
- The Financial Services and Markets Act 2000 (Financial Services Compensation Scheme) Order 2013;
- Money Laundering, Terrorist Financing & Transfer.

DIRECTORS AND SECRETARY

The present directors and secretary, who have served during the year, are listed on page 1. From 1 January 2018 the following changes have taken place:

Directors	Appointed	Resigned
Stuart Porteous	22 November 2018	-
Secretary		
Rachael Emma Pocklington	8 February 2019	-
Christopher Ian Nicol	-	8 February 2019

COLLEAGUES

The Company values the input of its employees and actively seeks opportunities to engage with all staff and invites them to contribute to on-going dialogue and activities to make the Bank a better bank for our customers and staff. The annual survey of employee opinions, known as 'Our View', provides valuable data to decision makers across the Company in support of improving employee engagement and satisfaction. We track our progress through pulse surveys during the financial year, utilising questions common across the financial services industry to compare ourselves against our peers.

In addition we run an annual 'Working Together' survey where a representative sample provides feedback on the services provided by our support functions.

Our employees across the Company continue to widely support, financially and through volunteering, many community and other worthy causes.

POST BALANCE SHEET EVENTS

The assets and the liabilities of Isle Of Man Bank Limited ("IOMB") will be transferred to The Bank during May 2019 as part of a wider business strategy of simplification. IOMB will surrender its banking license and cease trading. The court sanctioned scheme will be used to move the majority of IOMB commerce, all of which will continue to operate under the current IOMB branding.

Other than that there have been no significant events between the year end and the date of approval of the financial statements which would require a change or additional disclosure in the financial statements.

AUDITOR

Ernst & Young LLP has expressed its willingness to continue in office as auditor. A resolution to re-appoint Ernst & Young LLP as the Company's auditor will be proposed at the forthcoming AGM.

By order of the Board:

A M McLaughlin, Director

Date: 13 February 2019

L A Cleary, Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements the directors are required to:

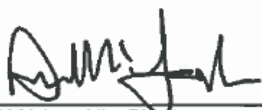
- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007 and the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007. They are responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

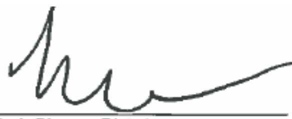
The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in Jersey governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

The directors are also responsible for compliance with the Banking Business (Jersey) Law 1991, the Financial Services (Jersey) Law 1998 and their Codes of Practice.

By order of the Board:



A M McLaughlin, Director



L A Cleary, Director

Date: 13 February 2019

Opinion

We have audited the financial statements of The Royal Bank of Scotland International Limited (the "Company") for the year ended 31 December 2018 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 23, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards.

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards;
- have been properly prepared in accordance with the requirements of the Companies (Jersey) Law 1991;
- have been prepared in accordance with the requirements of the Banking Business (Jersey) Law 1991;
- have been prepared in accordance with the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007;
- have been prepared in accordance with the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007; and
- have been prepared in accordance with the requirements of the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, 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.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the information included in the Report of the Directors, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters in relation to which the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Company, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the Company's accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of directors

As explained more fully in the statement of directors' responsibilities set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are 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 (UK) 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 these financial statements.

A further description of our responsibilities for the audit of the financial statements 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.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

David Robert John Moore ACA
for and on behalf of Ernst & Young LLP
Jersey, Channel Islands

14 February 2019

Notes:

1. The maintenance and integrity of the Royal Bank of Scotland International Limited's 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 financial statements since they were initially presented on the web site.

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

INCOME STATEMENT *for the year ended 31 December 2018*

Continuing operations	Note	2018 £m	2017 £m
Interest receivable		**448**	311
Interest payable		**(27)**	(6)
Net interest income	1	**421**	305
Fees and commission receivable		**71**	59
Fees and commission payable		**(21)**	(1)
Other operating (losses)/income		**(1)**	2
Non-interest income	2	**49**	60
Total income		**470**	365
Operating expenses	3	**(199)**	(180)
Operating profit before impairment gain		**271**	185
Impairment gains	10	**1**	-
Operating profit before tax		**272**	185
Tax charge	5	**(34)**	(15)
Profit for the year		**238**	170

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

STATEMENT OF COMPREHENSIVE INCOME *for the year ended 31 December 2018*

	Note	2018 £m	2017 £m
Profit for the year		**238**	170
Items that will not be reclassified subsequently to profit or loss:			
Actuarial gains on defined benefit schemes	4	**18**	43
Deferred taxation on actuarial movements on defined benefit schemes	5	**(5)**	(2)
Fair value through other comprehensive income (FVOCI) financial assets		**1**	-
Other comprehensive gains/(losses) for the year after tax		**14**	41
Total comprehensive income for the year		**252**	211

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

BALANCE SHEET *as at 31 December 2018*

	Note	2018 £m	2017 £m
Assets			
Cash and balances at central banks	9	**10,437**	479
Derivatives	6	**26**	25
Loans to banks - amortised cost	9	**483**	20
Loans to customers - amortised cost	9	**12,621**	8,382
Other loans	9	**2**	15
Amounts due from holding companies and fellow subsidiaries	9	**3,037**	21,685
Other financial assets	7	**3,731**	3
Intangible assets	12	**8**	9
Other assets	13	**104**	86
Total assets		**30,449**	30,704
Liabilities			
Banks deposits	9	**2**	-
Customer deposits	9	**25,998**	27,952
Derivatives	6	**37**	26
Other financial liabilities	8	**2**	15
Amounts due to holding companies and fellow subsidiaries	9	**2,282**	386
Other liabilities	14	**107**	82
Total liabilities		**28,428**	28,461
Equity			
Shareholder's equity:			
Called up share capital	15	**97**	97
Reserves		**1,924**	2,146
Total equity		**2,021**	2,243
Total liabilities and equity		**30,449**	30,704
Memorandum items			
Contingent liabilities and commitments	18	**15,102**	5,330

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

The financial statements were approved and authorised for issue by the Board of Directors on xx February 2019 and signed on its behalf by:

A M McLaughlin, Director

L A Cleary, Director

STATEMENT OF CHANGES IN EQUITY *for the year ended 31 December 2018*

	Note	2018 £m	2017 £m
Called up share capital			
At 1 January and 31 December		**97**	97
Share premium			
At 1 January and 31 December		**5**	5
Retained earnings			
At 1 January		**2,141**	1,930
Implementation of IFRS 9 on 1 January 2018 (1)	23	**(3)**	-
Actuarial gains recognised in defined benefit schemes	4	**18**	43
Deferred taxation on actuarial movements recognised on defined benefit schemes	5	**(5)**	(2)
Dividends paid		**(470)**	-
Profit attributable to ordinary shareholders and other equity owners		**238**	170
At 31 December		**1,919**	2,141
Shareholder's equity at 31 December		**2,021**	2,243

Notes:
(1) Refer to Note 23 for further information on the impact of IFRS 9 on classification and basis of preparation, year ended 31 December 2018 prepared under IFRS 9 and prior years under IAS 39.

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

CASH FLOW STATEMENT *for the year ended 31 December 2018*

	Note	2018 £m	2017 £m
Operating activities			
Operating profit for the year before tax		**272**	185
Adjustments for:			
Pension charge for defined benefit schemes	4	**4**	7
Cash contribution to defined benefit pension schemes	4	**(6)**	(5)
Amortisation of deferred fees	1	**(9)**	-
Loss/(gain) on sale of assets	2	**-**	(1)
Depreciation, amortisation and impairment of other assets	11,12	**6**	6
Other non-cash items		**(73)**	(20)
Net cash inflows from trading activities		**194**	172
Changes in operating assets and liabilities		**17,239**	201
Net cash flows from operating activities before tax		**17,433**	373
Tax paid	19	**(24)**	(23)
Net cash flows from operating activities	19	**17,409**	350
Investing activities			
Purchase of other financial assets	7	**(3,729)**	-
Purchase of other assets	11	**(12)**	(6)
Sale of other assets	11	**2**	2
Net cash flows from investing activities		**(3,739)**	(4)
Financing activities			
Dividends paid		**(470)**	-
Net cash flows used in financing activities		**(470)**	-
Effect of exchange rate changes on cash and cash equivalents		**65**	18
Net increase in cash and cash equivalents		**13,265**	364
Cash and cash equivalents 1 January		**547**	183
Cash and cash equivalents 31 December	20	**13,812**	547

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

ACCOUNTING POLICIES

1. Presentation of financial statements

The accounts are prepared on a going concern basis and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together IFRS).

The Company is incorporated and registered in Jersey, Channel Islands. With the exception of certain financial instruments as described in Accounting policy 11 and 15, the accounts are presented on a historical cost basis.

Adoption of IFRS 9

Refer to Note 23 for details of the adoption of IFRS 9.

Other amendments to IFRS

IFRS 15 ‘Revenue from Contracts with Customers’ has been adopted with effect from 1 January 2018 and replaces IAS 18 “Revenue”. The Accounting policy is updated to reflect the terminology in the new standard but it has had no effect on financial information reported in the current or comparative periods.

Interest revenue calculated using the effective interest method was previously in scope of IAS 39 'Financial instruments'. As such, the accounting policy for revenue recognition has been revised prospectively due to the adoption of IFRS 9 ‘Financial Instruments’. Interest income and expense continues to be recognised using the effective interest rate method for financial instruments measured at historical cost however, a credit adjusted effective interest rate is now applied to purchased or originated credit-impaired financial assets from initial recognition. There has been no restatement of profit or loss for comparative periods.

Other amendments to IFRS effective for 2018, including IFRS 2 ‘Share-based payments’ and IAS 40 ‘Investment Property’ have not had a material effect on the Company’s financial statements.

2. Revenue recognition

Interest income or expense on financial instruments that are measured at amortised cost is determined using the effective interest rate method. The effective interest rate allocates the interest income or interest expense over the expected life of the asset or liability at the rate that exactly discounts all estimated future cash flows to equal the instrument's initial carrying amount. Credit losses or reversals of credits losses do not change the carrying amount of a financial asset until impairment or reversal of impairment is recognised at which point the effective interest rate is recalculated. Reversals cannot exceed the impairment originally charged. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows. Negative effective interest accruing to financial assets is presented in interest payable.

Net interest income in the income statement only relates to financial instruments measured at amortised cost; the interest on debt instruments classified as fair value through OCI; and the effective part of any related accounting hedging instruments. Other interest relating to financial instruments measured at fair value is recognised as part of the movement in fair value.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

3. Employee benefits

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

The Bank provides post-retirement benefits in the form of pensions to eligible employees. Contributions to defined contribution pension schemes are recognised in the income statement when payable.

For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis using the projected credit unit method and discounted at a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities – the net defined benefit asset or liability – is recognised in the balance sheet with a charge to the statement of other comprehensive income. A defined benefit asset is limited to the present value of any economic benefits available to the Company in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:

- the current service cost
- interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
- past service cost resulting from a scheme amendment or curtailment
- gains or losses on settlement

A curtailment occurs when the Company significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Company introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the net defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligations for part or all of the benefits.

Actuarial gains and losses (i.e. gains or losses on re-measuring of the net defined benefit asset or liability) are recognised in other comprehensive income in full in the period in which they arise.

ACCOUNTING POLICIES

4. Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives.

The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated. The estimated useful lives are as follows:

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

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

5. Intangible assets

Intangible assets acquired by the Company are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and are included in Depreciation and amortisation. These estimated useful economic lives are:

i) Computer software (5 years)
ii) Other intangibles (unlimited, re-assessed annually)

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Other intangibles, including goodwill, are measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests) and any previous interest held over the net identifiable assets acquired and liabilities assumed. After initial recognition, other intangibles including goodwill are measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Bank's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquire are assigned to those units.

Asset transfers under common control

Business combinations involving businesses under common control are business combinations in which all of the combining businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. This will include Bank restructurings and reorganisations such as the transfer of subsidiaries or businesses between entities within a Bank.

IFRS 3 does not address the methods of accounting that may be appropriate when a business combination involves entities under common control. Accordingly management are able to develop an accounting policy that is relevant and reliable in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The following accounting policies have been adopted for business combinations under common control:
1) Assets and liabilities of the combining businesses are reflected at their carrying amounts
2) No goodwill is recognised because of the combination. Any difference between the consideration paid/transferred and the business acquired is reflected in equity
3) No restatement of comparatives occurs prior to the combination under common control.

6. Impairment of intangible assets and property, plant and equipment

At each reporting date, the Company assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

ACCOUNTING POLICIES

7. Foreign currencies

The Company's financial statements are presented in Sterling, which is the functional currency of the Company.

Transactions in foreign currencies are translated into Sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are recognised in the income statement except for differences arising on financial liabilities hedging net investments in foreign operations.

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

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into Sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into Sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on translation of foreign operations are recognised in other comprehensive income.

The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

8. Leases

As lessor

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

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

Rental income from operating leases is recognised in income on a receivable basis over the term of the lease. Operating lease assets are included within property, plant and equipment and depreciated over their useful lives. (see accounting policy 4).

As lessee

Lease expense is recognised as an expense on straight-line basis over the term of the relevant lease.

9. Provisions and contingent liabilities

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

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

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

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

10. Tax

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

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

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

ACCOUNTING POLICIES

11. Financial instruments

After 1 January 2018, on initial recognition, financial instruments are measured at fair value. Subsequently they are measured as follows: i) designated at fair value through profit or loss; ii) amortised cost, iii) fair value through profit or loss, or iv) financial assets may be designated as at fair value through other comprehensive income. Regular way 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.

i) Designated as at fair value through profit or loss – Equity instruments and derivatives are normally measured at FVPL. A financial asset may be designated as at fair value through profit or loss only if such designation eliminates or significantly reduces a measurement or recognition inconsistency.

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

ii) Amortised cost assets –
A debt instrument is normally measured at amortised cost if both of the following conditions are met:
(a) the instrument 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 instrument give rise to cash flows that are solely payments of principal and interest (SPPI) on the outstanding balance.

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

iii) 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.

iv) Designated at fair value through other comprehensive income – A debt instrument is normally measured at FVOCI if both of the following conditions are met:
(a) the instrument 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.

A debt instrument that is not measured at amortised cost or at FVOCI must be measured at FVPL.

An equity instrument may also be designated irrevocably at fair value through other comprehensive income. Other assets designated 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.

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

Fair value - the Bank's approach to determining the fair value of financial instruments measured at fair value is set out in note 9 on the accounts.

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, 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 an instrument, with attention to leverage features; prepayment and extension terms; and triggers that might reset the effective rate of interest.

The SPPI test
As a second step of its classification process, the Bank assesses the contractual terms of a financial asset to identify whether it meets the SPPI test.
'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).
The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.
In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Before 1 January 2018, the Bank classified its financial instruments as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Under IAS 39, the Bank recognised and measured financial instruments as follows:

Loans and receivables: Loans and receivables were initially recognised at fair value plus directly related transaction costs. They were subsequently measured at amortised cost using the effective interest method less any impairment losses.

Designated at fair value through profit or loss: Financial assets and liabilities were recognised at fair value with transaction costs being recognised in the income statement and were subsequently measured at fair value. Financial assets carried at fair value included advances to banks, asset backed and corporate debt obligations, corporate equity shares and derivatives.

Available-for-sale - *financial assets that were not classified as loans and receivables or designated at fair value through profit or loss were classified as available-for-sale. Available-for-sale assets were initially recognised at fair value plus directly related transaction costs and were subsequently measured at fair value. Impairment losses and exchange differences were recognised in the income statement whereas all other changes in fair value and any related tax was reported in other comprehensive income until disposal.*

ACCOUNTING POLICIES

12. Impairment of financial assets

At each balance sheet date each financial asset or portfolio of loans measured at amortised cost or at fair value through other comprehensive income, issued financial guarantees and loan commitments are 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 (SICR) rating (refer Note 17 for details), otherwise allowances are based on lifetime expected losses. Loss allowances for lease receivables are always made on a lifetime basis.

Expected credit losses (ECL) 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. In the absence of a change in credit rating, allowances are recognised when there is reduction in the net present value of expected cash flows. On a significant increase in credit risk, allowances are recognised without a change in the expected cash flows, although typically expected cash flows do also change; and expected credit losses are rebased from 12 month to lifetime expectations.

On restructuring a financial asset without causing derecognition of the original asset the revised cash flows are used in re-estimating the credit loss. Where restructuring causes derecognition of the original financial asset, the fair value of the replacement asset is used as the closing cash flow of the original asset.

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 Company's interest in equity shares following the exchange is such that the Company 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 in administrative expenses. Financial assets are presented gross of allowances except where the asset has been wholly or partially written off.

Before 1 January 2018, the Bank recognised impairment losses on loans and receivables or available-for-sale assets when there was objective evidence that an event since initial recognition of the asset had adversely affected the amount or timing or future cash flows from the asset. The Bank measured the amount of the loss as the difference between the carrying amount of the asset and the present value of estimated future cash flows from the asset discounted at the effective interest rate at initial recognition.

13. 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 Company 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 Company 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 Company assesses whether or not it has retained control of the asset. If the Company has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Company has not retained control of the asset, it is derecognised.

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires.

14. Netting

Financial assets and financial liabilities are offset and the net amounts presented in the balance sheet when, and only when, the Company 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 Company 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 and therefore the assets and liabilities concerned are presented gross.

15. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value through profit or loss. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models. The Company's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. Most of the Company's pricing models do not entail material subjectivity because the methodologies utilised do not incorporate significant judgement and the parameters included in the models can be calibrated to actively quoted market prices. Values established from pricing models are adjusted for credit risk and liquidity risk.

The Bank also enters into fair value hedges in order to hedge fixed interest rate loans with floating rate Interest Rate Swaps ("IRS").

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value through the income statement.

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 the income statement. There is no impact on hedge accounting, it continues to be accounted for as under IAS 39.

16. Cash and cash equivalents

Cash and cash equivalents comprise cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

17. Assets under administration

Assets and liabilities held in a fiduciary capacity are not included in these financial statements.

ACCOUNTING POLICIES

Critical accounting policies and key sources of estimation uncertainty

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

The judgements and assumptions involved in the Company's accounting policies that are considered by the Board of Directors to be the most important to the portrayal of its financial condition are discussed below.

The use of estimates, assumptions or models that differ from those adopted by the Company would affect its reported results.

Critical accounting policy	Note
Amortisation of fees	1
Pensions	4
Loan impairment provisions	10
Provisions for liabilities and charges	14

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2018 that would affect the Company from 1 January 2019 or later.

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

Effective 1 January 2019

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. The Bank will apply the standard with effect from 1 January 2019. Lessees will capitalise operating leases through the recognition of assets representing the contractual rights of use. The present value of contractual payments will be recognised as lease liabilities.

The Bank has new models and processes to implement IFRS 16. The most significant impact from initially applying IFRS 16 will be to recognise rights of use assets in respect of branches and office properties leased by the Bank under contracts classified as operating leases under IAS 17. The present value of other contracts is immaterial. The Bank will apply IFRS 16 on a modified retrospective basis without restating prior years and electing for the following exemptions on transition at 1 January 2019. The Bank will

- apply IFRS 16 to contracts previously identified as leases by IAS 17
- use the incremental borrowing rate as the discount rate
- not apply IFRS 16 to operating leases with a remaining lease term of less than 12 months or low value leases (non property leases)
- rely on the assessment of whether the lease contract is onerous under IAS 37 at 31 December 2018 as an alternative to performing an impairment review of the right of use assets created on 1 January 2019. Where this is the case the carrying amount of the assets will be adjusted by the onerous lease provision.
- exclude initial direct costs from the measurement of the right of use asset

The opening balance sheet of the Bank at 1 January 2019 will be adjusted to create a right of use asset of approximately £38m. A lease liability will also be recognised of £43m. Retained earnings will decrease by £5m after tax.

Application of IFRS 16 by the Group is not expected to have a significant impact on lessor accounting or for finance lease accounting by lessees.

Effective after 2019

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

In February 2018 the IASB amended IAS 19 'Employee Benefits' to clarify the need to update assumptions whenever there is a plan amendment, curtailment or settlement.

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

1. Net interest income

	2018 £m	2017 £m
Interest receivable from group undertakings	**142**	115
Interest receivable from banks	**8**	-
Interest receivable on Bond portfolio	**5**	-
Loans to customers - amortised cost	**293**	196
Interest receivable	**448**	311
Customer deposits	**(8)**	1
Interest payable to banks	**(12)**	-
Interest payable to group undertakings	**(7)**	(7)
Interest payable	**(27)**	(6)
Net interest income	**421**	305

Critical accounting policies: Amortisation of loan arrangement fees

Where a loan arrangement fee is over £50k, the contractual life of the loan is used to amortise the fees over the life of the loan. Until 31 December 2017, the Bank amortised the fees below £50K over period of 72 months. This changed during 2018 and the behavioural life of each portfolio is used to amortise the fees as this is considered a more accurate measure.
The average behavioural life of 33 months was used to amortise the fees below £50k in 2018.

The new approach was applied to all unamortised fees since 2015. This change in accounting estimate resulted in £8.9m additional income compared to the previous approach which has been recognised in the financial year.

2. Non-interest income

	2018 £m	2017 £m
Fees and commissions receivable		
- Payment Services	**20**	20
- Credit & Debit Card Fees	**1**	-
- Lending - (Credit Facilities)	**18**	10
- Trade Finance	**3**	3
- Investment Management	**4**	2
- Other services	**2**	3
Other commissions[(1)]	**23**	21
Fees and commissions payable[(2)]	**(21)**	(1)
Gain on the sale of Property, plant and equipment	**-**	1
Other non-interest income	**(1)**	1
Total non interest income	**49**	60

Note:
(1) Other commissions includes dealing profits.
(2) Fees and commissions payable include £20m of breakage fees due to breaking of fixed term deposits with RBS Group.

3. Operating expenses

	2018 £m	2017 £m
Staff costs		
Wages, salaries and other staff costs	90	77
Provision for restructuring costs (see note 14)	4	5
Pension costs:		
- defined benefit schemes (see note 4)	4	7
- defined contribution schemes (see note 4)	-	1
- (release)/contributions to RBS operated pension schemes (see note 4)	-	1
	98	91
Other expenses		
Premises and equipment	18	20
Release of provision for onerous leases (see note 14)	(1)	-
Administration[1]	78	63
	95	83
Depreciation		
Property, plant and equipment depreciation (see note 11)	5	3
Intangible assets (see note 12)	1	3
	6	6
Total operating expenses	199	180

(1) Administrative costs include provisions for possible product redress and litigation.

Auditors' remuneration	2018 £'000	2017 £'000
Statutory audit work	420	420
Regulatory audit work	48	48
	468	468

Staff

The average number of persons employed by the Company during the year, excluding temporary staff was 1,365 (2017: 1,365).

4. Pensions

The Company made contributions of £285k to its own defined contribution schemes in 2018 (2017: £625k).

Eligible employees of the Bank can participate in membership of RBS operated pension schemes. RBS operates a number of defined benefit pension schemes in the UK and overseas, which were closed to new entrants in October 2006 and since then employees have been offered membership of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. Detailed disclosure of the RBS pension schemes is available in the RBS Annual Report and Accounts 2018.

The Company operates two defined benefit pension schemes. The most significant of these is The Royal Bank of Scotland International Pension Trust (RBSIPT). The assets of these schemes are independent of the Company's finances, and the schemes are each overseen by a board of trustees.

The RBSIPT operates under Jersey trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and the Jersey legislation and, where applicable, that of its constituent plans (primarily in Guernsey and the Isle of Man). There is no pension Scheme funding legislation in Jersey, Guernsey or the Isle of Man. However, statutory debt rules do apply in respect of the Isle of Man plan of the RBSIPT such that a debt may be due on an employer if it becomes insolvent; the scheme winds up; or, in the case of a multi-employer scheme, stops participating in the scheme while the scheme continues.

The RBSIPT's corporate trustee is RBS International Employees' Pension Trustees Limited ("RBSIEPTL"), a subsidiary of The Royal Bank of Scotland International (Holdings) Limited. RBSIEPTL is the legal owner of the RBSIPT's assets which are held separately from the assets of the Company.

The Board of RBSIEPTL comprises two trustee directors nominated by members selected from eligible active staff and pensioner members who apply; three directors appointed by the Company; and one independent Trustee. The Board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Company, but who still have benefits in the scheme.

Full valuations of the Company's scheme are carried out every 3 years.

The Company's UK scheme is a fully segregated section of The Royal Bank of Scotland Group Pension Fund, which was established in 2018 as part of the Company's preparation for ring-fencing. The section only provides benefits to employees of the Company. For further information on the Fund, please refer to the RBS Annual Report and Accounts 2018.

Interim valuations of the Company's schemes were prepared to 31 December 2018 by independent actuaries, using the following assumptions:

Assumptions

Principal actuarial assumptions at 31 December (RBSIPT scheme)	2018	2017
Discount rate	**2.90%**	2.55%
Rate of increase in salaries	**1.75%**	1.75%
Rate of increase in pensions in payment	**2.90%**	2.90%
Inflation assumption	**3.15%**	3.10%

Post–retirement mortality assumptions (RBSIPT scheme)	2018	2017
Longevity at age 60 for current pensioners (years)		
Males	**28.7**	28.8
Females	**29.9**	29.9
Longevity at age 60 for future pensioners currently aged 40 (years)		
Males	**30.3**	30.3
Females	**31.4**	31.4

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

Discount rate

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

Investment strategy

The assets of the RBSIPT scheme are invested in a diversified portfolio of quoted equities, government and corporate fixed-interest and index-linked bonds. The Scheme's equity holdings are held in passive pooled funds managed by State Street. The Trustee's investment benchmark is for the majority to be invested in global developed markets, with a small proportion invested in emerging markets.

4. Pensions (continued)

Major classes of plan assets as a percentage of total plan assets	2018	2017
Quoted assets		
Equities	**31%**	33%
Index-linked bonds	**24%**	31%
Corporate and other bonds	**12%**	14%
Government fixed interest bonds	**19%**	11%
Unquoted assets		
Corporate and other bonds	**2%**	0%
Hedge funds	**0%**	2%
Property	**4%**	4%
Derivatives	**2%**	2%
Other	**6%**	3%
	100%	100%

Changes in value of net pension asset	Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset Ceiling	Net pension asset £m
At 1 January 2018	**653**	**(614)**	**-**	**39**
Income statement:				
Interest income	17	-	-	**17**
Interest expense	-	(15)	-	**(15)**
Current service cost	-	(5)	-	**(5)**
Expenses	-	(1)	-	**(1)**
	17	(21)	-	**(4)**
Statement of comprehensive income:				
Actuarial losses due to experience gains	(47)	32	-	**(15)**
Actuarial gains due to changes in financial assumptions	-	48	-	**48**
Actuarial losses due to changes in demographic assumptions	-	(15)	-	**(15)**
Inter Group transfer	74	(47)	(27)	**-**
	27	18	(27)	**18**
Contributions by employer	6	-	-	**6**
Benefits paid	(38)	38	-	**-**
At 31 December 2018	**665**	**(579)**	**(27)**	**59**

4. Pensions (continued)

Changes in value of net pension asset	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension asset £m
At 1 January 2017	653	(655)	(2)
Income statement:			
Interest income	18	-	18
Interest expense	-	(19)	(19)
Current service cost	-	(6)	(6)
	18	(25)	(7)
Statement of comprehensive income:			
Actuarial gains due to experience gains	38	7	45
Actuarial losses due to changes in financial assumptions	-	(17)	(17)
Actuarial gains due to changes in demographic assumptions	-	15	15
	38	5	43
Contributions by employer	5	-	5
Benefits paid	(61)	61	-
At 31 December 2017	653	(614)	39

Net pension surplus comprises	2018 £m	2017 £m
Net assets of schemes in surplus - IPT	**59**	39
Net assets of schemes in surplus - UK Scheme	**27**	-
Asset ceiling - UK Scheme	**(27)**	-
	59	39

Of the expense for the year, £4m (2017: £7m) has been included in the income statement within staff costs (see note 3).

The Company expects to contribute £6m to its defined benefit pension schemes in 2019.

The weighted average duration of the Company's defined benefit obligation is 25 years (2017: 28years).

History of defined benefit scheme	2018 £m	2017 £m
Funds assets at fair value	**665**	653
Present value of fund liabilities	**(579)**	(614)
Fund status	**86**	39
Asset ceiling	**(27)**	-
	59	39
Experience gains/(losses) on plan liabilities	**32**	7
Experience gains/(losses) on plan assets	**(47)**	38
Actual return on pension scheme assets	**(30)**	56

4. Pensions (continued)

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at the balance sheet dates to a change in the principal actuarial assumptions:

	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
0.25% increase in the discount rate	**(2)**	(2)	**(32)**	(42)
0.25% increase in inflation	**1**	1	**24**	27
0.25% additional rate of increase in pensions in payment	**1**	1	**14**	24
0.25% additional rate of increase in deferred pensions	**-**	-	**10**	11
0.25% additional rate of increase in salaries	**-**	-	**2**	5
Longevity increase of one year	**1**	1	**18**	30

Pension liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension liabilities is the difference between these calculations.

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Critical accounting policy: Pensions

The Company operates two benefit pension schemes: The most significant of these is The Royal Bank of Scotland International Pension Trust (RBSIPT). The assets of the defined benefit schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit credit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any surplus or deficit of scheme assets over liabilities is recognised on the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increase, earnings growth and the longevity of scheme members. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised on the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pensions schemes are set out in note 4 to the financial statements, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension asset of £59m was recognised on the balance sheet at 31 December 2018 (2017: asset £39m).

5. Taxation

	2018 £m	2017 £m
Current taxation:		
Charge for the year	34	17
Over provision in respect of prior periods	-	(2)
Tax charge for the year	34	15

The actual tax charge differs from the expected tax charge computed by applying the standard rate of income tax as follows: Jersey, Guernsey, Isle of Man and Gibraltar 10% (2017: 10%), London 27% (2017: 27%) and Luxembourg 26.01% (2017: 27.08%).

	2018 £m	2017 £m
Operating profit before tax	272	185
Expected tax charge	27	18
Factors affecting the charge for the year:		
Non-deductible items	3	-
Non-taxable items	3	-
Rate differences on current tax	1	(1)
Adjustments in respect of prior years	-	(2)
Actual tax charge for the year	34	15

Applicable tax rate for London branch is 10% and for Luxemburg branch is 26%.

Deferred tax

	Pension £m	Accelerated capital allowances £m	Total £m
At 1 January 2017	1	(2)	(1)
Charge to other comprehensive income	(2)	-	(2)
At 1 January 2018	(1)	(2)	(3)
Charge to other comprehensive income	(5)	-	(5)
At 31 December 2018	**(6)**	**(2)**	**(8)**

Total deferred taxation is analysed as follows:

	2018 £m	2017 £m
Deferred taxation assets	-	-
Deferred taxation liabilities	(8)	(3)
	(8)	(3)

6. Derivatives

The Company enters into various derivatives to manage foreign exchange and interest rate risks. Derivatives include swaps, forwards and options. They may be traded over-the-counter (OTC).

Swaps include currency swaps, interest rate swaps and equity and index swaps. A swap is an agreement to exchange cash flows in the future in accordance with a pre-arranged formula. Interest rate swap contracts generally involve exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts.

Forwards include forward foreign exchange contracts and forward rate agreements. A forward contract is a contract to buy or sell a specified amount of a physical or financial commodity, at an agreed price, on an agreed future date. Forward foreign exchange contracts are contracts for the delayed delivery of currency on a specified future date. Forward rate agreements are contracts under which two counterparties agree on the interest to be paid on a notional deposit of a specified maturity at a specific future date; there is no exchange of principal.

Options include OTC currency options, interest rate caps and floors and swap options. They are contracts that give the holder the right but not the obligation to buy or sell a specified amount of the underlying physical or financial commodity at an agreed price on an agreed date or over an agreed period. The CVA adjustment will not have a material impact on fair value.

Included in the table below are derivatives entered into during the normal course of business with customers and Group companies:

	2018			2017		
	Notional amounts	Assets	Liabilities	Notional amounts	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Exchange rate contracts						
Spots and forwards - RBS entities	1,979	18	21	1,558	12	11
Spots and forwards - third party	811	7	3	632	5	6
Interest rate contracts						
RBS entities	591	1	13	97	8	9
	3,381	**26**	**37**	2,287	25	26
Included in the above are fair value hedge accounting derivatives as follows:						
Interest rate contracts	**545**	**-**	**10**	-	-	-

Interest rate contracts are used to hedge the risk related to a fixed interest rate loans.

The table below shows the gains and losses in relation to interest rate swaps and fair value hedged items. These have gone through the income statement under other operating income.

	2018	2017
	£m	£m
Gains recognised on the hedge accounting interest rate contracts	**1**	-
Losses recognised on the item being hedged	**(1)**	-

7. Other financial assets

	Equity shares	Debt securities (1)	Total
2018	£m	£m	£m
Fair value through other comprehensive income	2	-	2
Amortised cost	-	3,729	3,729
Total	**2**	**3,729**	**3,731**
2017			
Available-for-sale	3	-	3

(1) Central and local government

7. Other financial assets (continued)

Other Financial assets at amortised costs are made of bonds in the following currencies:

Currency	S&P Risk Rating	Moody's Risk Rating	£m
GBP	AA	Aa2	3,345
EUR	AAA	Aaa	120
USD	AA+	Aa1	264
			3,729

8. Other financial liabilities

	2018 £m	2017 £m
Other deposits - at fair value through profit or loss	2	15

9. Financial instruments

IFRS 9 'Financial Instruments' came into effect on 1 January 2018. IFRS 9 replaces IAS39. The following table shows the financial assets and financial liabilities in accordance with the categories of financial instruments in IFRS 9. Assets and liabilities outside the scope of IFRS9 are shown within other assets and other liabilities.

2018	MFVPL [(1)] £m	FVOCI £m	Amortised cost [(2)] £m	Other assets/ liabilities £m	Total £m
Assets					
Cash and balances at central banks	-	-	10,437	-	10,437
Derivatives	26	-	-	-	26
Loans to banks - amortised costs [(3)]	-	-	483	-	483
Loans to customers - amortised costs	-	-	12,621	-	12,621
Other loans	2	-	-	-	2
Amounts due from holding companies and fellow subsidiaries	-	-	3,037	-	3,037
Other financial assets	-	2	3,729	-	3,731
Intangible assets	-	-	-	8	8
Other assets	-	-	-	104	104
	28	2	30,307	112	30,449
Liabilities					
Banks deposits	-	-	2	-	2
Customer deposits	-	-	25,998	-	25,998
Derivatives	37	-	-	-	37
Other financial liabilities	2	-	-	-	2
Amounts due to holding companies and fellow subsidiaries	-	-	2,282	-	2,282
Other liabilities	-	-	-	107	107
	39	-	28,282	107	28,428
Equity					2,021
					30,449

(1) Mandatory fair value through profit or loss ("MFVPL") - For the equity linked loans and deposits, the interest is based on the return of an underlying equity, which can be a single stock, basket of stocks, or an equity index. The value of the equity linked products will be based on the value of the underlying equity, time to maturity, volatility and interest rates.
(2) Amortised cost include cash and cash equivalents.
(3) Items relating to the Group including external nostro balances relating to correspondent bank accounts.

9. Financial instruments (continued)

The following table shows the financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

2017	Designated at at fair value through profit or loss [1] £m	Available-for-sale £m	Loans and receivables[2] £m	Other (amortised cost) £m	Other assets/ liabilities £m	Total £m
Assets						
Cash and balances at central banks	-	-	479	-	-	479
Derivatives	25	-	-	-	-	25
Loans to banks - amortised costs [3]	-	-	20	-	-	20
Loans to customers - amortised costs	-	-	8,382	-	-	8,382
Other loans	15	-	-	-	-	15
Amounts due from holding companies and fellow subsidiaries	-	-	21,685	-	-	21,685
Other financial assets	-	3	-	-	-	3
Intangible assets	-	-	-	-	9	9
Other assets	-	-	-	-	86	86
	40	3	30,566	-	95	30,704
Liabilities						
Customer deposits	-	-	-	27,952	-	27,952
Derivatives	26	-	-	-	-	26
Other financial liabilities	15	-	-	-	-	15
Amounts due to holding companies and fellow subsidiaries	-	-	-	386	-	386
Other liabilities	-	-	-	-	82	82
	41	-	-	28,338	82	28,461
Equity						2,243
						30,704

[1] For the equity linked loans and deposits, the interest is based on the return of an underlying equity, which can be a single stock, basket of stocks, or an equity index. The value of the equity linked products will be based on the value of the underlying equity, time to maturity, volatility and interest rates.

[2] Loans and receivables include cash and cash equivalents.

[3] Items relating to the Group including external nostro balances relating to correspondent bank accounts.

9. Financial instruments (continued)

The following tables show the financial instruments carried at fair value on the Balance Sheet by valuation hierarchy - Level1, Level 2 and Level 3. Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no transfers between levels occurring during 2018 or the comparative period.

	2018				2017			
	Level 1 (1)	Level 2 (2)	Level 3 (3)	Total	Level 1 (1)	Level 2 (2)	Level 3 (3)	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Derivatives	24	2	-	**26**	16	9	-	25
Other loans	-	2	-	**2**	-	15	-	15
Other financial assets								
Securities	-	**2**	-	**2**	-	3	-	3
Total financial assets at fair value	**24**	**6**	**-**	**30**	16	27	-	43
Liabilities								
Derivatives	24	13	-	**37**	16	10	-	26
Other financial Liabilities								
Deposits	-	**2**	-	**2**	-	15	-	15
Total financial liabilities at fair value	**24**	**15**	**-**	**39**	16	25	-	41

(1) Valued using unadjusted quoted prices in active markets for identical financial instruments.

(2) Valued using techniques based significantly on observable market data. Instruments in this category are valued using:

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

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

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

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from third party benchmarking services.
- Interest rates - these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.
- Equity and equity index prices – quoted prices are generally readily available for equity shares listed on the world's major stock exchanges major indices on such shares.

9. Financial instruments (continued)

The following table shows the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost: all assets and liabilities carried at amortised cost on the balance sheet other than the new other financial assets fall within level 2 of the valuation methodologies. The other financial assets fall under level 1.

	2018 Carrying value £m	2018 Fair value £m	2017 Carrying value £m	2017 Fair value £m
Financial assets				
Cash and balances at central banks	10,437	10,437	479	479
Loans to banks - amortised costs	483	483	20	20
Loans to customers - amortised costs	12,621	12,469	8,382	8,281
Amounts due from holding companies and fellow subsidiaries	3,037	3,037	21,685	21,685
Other financial assets	3,729	3,729	-	-
Financial liabilities				
Bank deposits	2	2	-	-
Customer deposits	25,998	25,998	27,952	27,952
Amounts due to holding companies and fellow subsidiaries	2,282	2,282	386	386

Differences between the carrying value and the fair value of loans and receivables to customers above relate specifically to certain advances that are at fixed interest rates and fixed maturity dates. There is no intention to break any of these advances prior to maturity and the difference between carrying value and fair value is never expected to be realised.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgements covering prepayments, credit risk and discount rates.

Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement. As a wide range of valuation techniques are available, it may be inappropriate to compare the Group's fair value information to independent markets or other financial institutions' fair values.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are set out below:

Short term financial instruments: The fair value of financial instruments that are of short maturity (3 months or less) approximate their carrying value. This applies mainly to cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks and demand deposits.

Loans and advances to banks and customers

In estimating the Fair value of loans and advances to banks and customers measured at amortised cost, loans are segregated into appropriate portfolios estimated by grouping loans into homogeneous portfolios reflecting the characteristics of the constituent loans and applying a discount rate to the cash flows. The discount rate is based on the market rate applicable at the balance sheet date for a similar portfolio with similar maturity and credit risk characteristics. Two principal methods are used to estimate fair value:

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where that is not observable, the spread for borrowers of a similar credit standing.

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products.

Deposits by banks and customer accounts

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

9. Financial instruments (continued)

Remaining maturity

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

2018	Less than 12 months £m	More than 12 months £m	Total £m
Assets			
Cash and balances at central banks	10,437	-	**10,437**
Derivatives	17	9	**26**
Loans to banks - amortised costs	483	-	**483**
Loans to customers - amortised costs	5,676	6,945	**12,621**
Other loans	-	2	**2**
Amounts due from holding companies and fellow subsidiaries	2,943	94	**3,037**
Other financial assets	921	2,810	**3,731**
Liabilities			
Banks deposits	2	-	**2**
Customer deposits	25,998	-	**25,998**
Derivatives	22	15	**37**
Other financial liabilities	-	2	**2**
Amounts due to holding companies and fellow subsidiaries	**2,282**	**-**	**2,282**

2017	Less than 12 months £m	More than 12 months £m	Total £m
Assets			
Cash and balances at central bank	479	-	479
Derivatives	15	10	25
Loans to banks - amortised costs	20	-	20
Loans to customers - amortised costs	4,055	4,327	8,382
Other loans	-	15	15
Amounts due from holding companies and fellow subsidiaries	18,745	2,940	21,685
Liabilities			
Banks deposits	-	-	-
Customer deposits	27,935	17	27,952
Derivatives	14	12	26
Other financial liabilities	-	15	15
Amounts due to holding companies and fellow subsidiaries	386	-	386

9. Financial instruments (continued)

On balance sheet assets/liabilities

The tables below show the contractual undiscounted cash flows receivable and payable, up to a period of 20 years, including future receipts and payments of interest of financial assets and liabilities by contractual maturity. The balances in the following tables do not agree directly with the consolidated balance sheet, as the tables include all cash flows relating to principal and future coupon payments, presented on an undiscounted basis.

2018	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m	>20 years £m
Assets by contractual maturity							
Cash and balances at central banks	10,437	-	-	-	-	-	-
Derivatives	8	9	8	1	-	-	-
Loans to banks - amortised costs	483	-	-	-	-	-	-
Loans to customers - amortised costs	2,554	3,300	3,371	1,566	713	1,192	794
Other loans	-	-	2	-	-	-	-
Amounts due from holding companies and fellow subsidiaries	2,908	35	94	-	-	-	-
Other financial assets	64	927	960	1,230	803	-	-
Liabilities by contractual maturity							
Bank deposits	2	-	-	-	-	-	-
Customer deposits	25,465	537	1	-	-	-	-
Derivatives	13	9	7	2	-	6	-
Other financial liabilities	-	-	2	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	1,850	432	-	-	-	-	-
Guarantees and commitments notional amount							
Guarantees[1]	418	-	-	-	-	-	-
Commitments[2]	14,664	-	-	-	-	-	-

Notes:
(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.

(2) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

9. Financial instruments (continued)

2017	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m	>20 years £m
Assets by contractual maturity							
Cash and balances at central banks	479	-	-	-	-	-	-
Derivatives	-	-	-	-	-	-	-
Loans to banks - amortised costs	20	-	-	-	-	-	-
Loans to customers - amortised costs	1,512	2,560	2,082	712	196	696	636
Other loans	-	-	15	-	-	-	-
Amounts due from holding companies and fellow subsidiaries	17,652	1,093	1,510	1,430	-	-	-
Liabilities by contractual maturity							
Bank deposits	-	-	-	-	-	-	-
Customer deposits	27,502	438	17	-	-	-	-
Derivatives	1	-	2	4	4	-	-
Other financial liabilities	-	-	15	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	360	26	-	-	-	-	-
Guarantees and commitments notional amount							
Guarantees [(1)]	203	-	-	-	-	-	-
Commitments[(2)]	5,104	-	-	-	-	-	-

Notes:
(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.

(2) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

10. Loan impairment provisions

Loan exposure and impairment metrics

The table below summarises loan exposures subject to the scope of the IFRS 9 expected credit loss framework and the related credit impairment and metrics.

	31 December 2018 £m
Loans	
Stage 1	**12,754**
Stage 2	**262**
Stage 3	**88**
Inter-group	**3,037**
Total	**16,141**
Loans impairment provisions	
ECL provisions	
- Stage 1	**5**
- Stage 2	**2**
- Stage 3	**17**
- inter-group	**-**
Total	**24**
ECL provision coverage	
- Stage 1 %	**0.04%**
- Stage 2 %	**0.76%**
- Stage 3 %	**19.32%**
- inter-group	**0.00%**
Total	**0.15%**
ECL charge	
- Third party	**-**
- inter-group	**1**
Total	**1**
Impairment losses	
ECL loss rate (%)	**0.01%**
Amounts written off	**8**

10. Loan impairment provisions (continued)

Critical accounting estimates

The Bank's 2017 loan impairment provisions were established in accordance with IAS 39 in respect of incurred losses. They comprised individual and collective components as more fully explained in the 2017 Accounts. In 2018 the loan impairment provisions have been established in accordance with IFRS 9. Accounting policy 12 sets out how the expected loss approach is applied. At 31 December 2018, customer loan impairment provisions amounted to £24m (2017: £8m). A loan is impaired when there is objective evidence that the cash flows will not occur in the manner expected when the loan was advanced. Such evidence includes changes in the credit rating of a borrower, the failure to make payments in accordance with the loan agreement; significant reduction in the value of any security; breach of limits or covenants; and observable data about relevant macroeconomic measures.

The stage 3 impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

IFRS 9 ECL model design principles

To meet IFRS 9 requirements for ECL estimation, Probability of default (PD), Loss given default (LGD) and Exposure at default (EAD) used in the calculations must be:

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

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, 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 Credit-Cycle Index ('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.

Approach for multiple economic scenarios (MES)

The base scenario plays a greater part in the calculation of ECL than the approach to MES. This is discussed further in Note 17.

11. Property, plant and equipment

2018	Freehold Premises £m	Long leasehold premises £m	Computers and other equipment £m	Total £m
Cost:				
At 1 January	21	3	84	108
Additions	2	-	10	12
Disposals	(1)	-	(1)	(2)
At 31 December	**22**	**3**	**93**	**118**
Accumulated depreciation and amortisation:				
At 1 January	3	2	71	76
Depreciation charge for the year	1	-	4	5
At 31 December	**4**	**2**	**75**	**81**
Net book value at 31 December 2018	**18**	**1**	**18**	**37**

2017	Freehold Premises £m	Long leasehold premises £m	Computers and other equipment £m	Total £m
Cost:				
At 1 January	18	3	89	110
Additions	4	-	-	4
Disposals	(1)	-	(2)	(3)
Transfers	-	-	(3)	(3)
At 31 December	21	3	84	108
Accumulated depreciation and amortisation:				
At 1 January	3	2	70	75
Disposals	-	-	(2)	(2)
Depreciation charge for the year	-	-	3	3
At 31 December	3	2	71	76
Net book value at 31 December 2017	18	1	13	32

12. Intangible assets

2018	Software development £m	Other[1] intangibles £m	Total £m
Cost:			
At 1 January and 31 December	**5**	**6**	**11**
Amortisation:			
At 1 January	**2**	**-**	**2**
Charge for the year	**1**	**-**	**1**
At 31 December	**3**	**-**	**3**
Net book value at 31 December 2018	**2**	**6**	**8**

2017	Software development £m	Other intangibles £m	Total £m
Cost:			
At 1 January	5	6	11
Additions	2	-	2
Disposals	(2)	-	(2)
At 31 December	5	6	11
Amortisation:			
At 1 January	1	-	1
Disposals	(2)	-	(2)
Charge for the year	1	-	1
Impairment losses	2	-	2
At 31 December	2	-	2
Net book value at 31 December 2017	3	6	9

The amortisation cost for the year was £910k (2017: £928k). The amortisation period for software development costs is 5 years. The amortisation is calculated using the straight line method.

Note:
[1] Intangible assets created through acquisition. Refer accounting policy 6.

13. Other assets

	2018 £m	2017 £m
Property plant and equipment (refer Note 11)	**37**	32
Prepayments, accrued income and other assets	**8**	15
Retirement benefit assets (refer Note 4)	**59**	39
	104	86

14. Other liabilities

	2018	2017
	£m	£m
Accruals and deferred income	**68**	51
Current tax	**19**	9
Deferred tax	**8**	3
Other liabilities	**12**	19
	107	82

Provisions of £12m (2017: £19m) are included in other liabilities.

The following amounts are included within provisions:

	Property[1]	Restructuring[2]	Customer redress[3]	Litigation and other regulatory[4]	Other	Total
	£m	£m	£m	£m	£m	£m
At 1 January 2017	5	1	8	-	-	14
Charge to the income statement	-	5	-	8	-	13
Release during the year	-	-	(1)	-	-	(1)
Utilised in year	(1)	(1)	(5)	-	-	(7)
At 1 January 2018	**4**	**5**	**2**	**8**	**-**	**19**
Implementation of IFRS 9 on 1 January 2018	-	-	-	-	2	**2**
Charge to the income statement	-	4	1	-	-	**5**
Release during the year	(1)	-	(1)	(8)	-	**(10)**
Utilised in year	-	(4)	-	-	-	**(4)**
At 31 December 2018	**3**	**5**	**2**	**-**	**2**	**12**

(1) **Property provision**
The property provisions principally comprise of provision related to a premium to be paid to a landlord on the surrender of an existing lease.

(2) **Restructuring provision**
The Company has reviewed its organisational design and how it is managed to ensure it has the most effective and efficient cost base. To this end £4m has been charged in the year.

(3) **Customer redress provision**
The Company has provided for customer redress in relation to payment protection insurance and other Personal products.

(4) **Litigation and other regulatory**
The Company is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Company incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made.

Critical accounting policy: Provisions for liabilities and charges

Judgment is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Company can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Estimates - Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably.

15. Called up share capital

	Allotted, called up and fully paid		Authorised	
	31 December 2018	31 December 2017	2018	2017
	£m	£m	£m	£m
Equity shares:				
Ordinary shares of £1	**97**	97	**300**	300
Total share capital	97	97	300	300

The whole of the issued share capital of the Company comprises one class of Ordinary Share held by its holding company, The Royal Bank of Scotland International (Holdings) Limited and its nominee, each share being entitled to one vote.

16. Leases

The Company provides asset finance to its customers through acting as a lessor. It purchases plant and equipment, renting them to customers under lease agreements that, depending on their terms, qualify as either operating or finance leases.

Finance leases are set out in the table below:

Amounts receivable under non-cancellable leases:

	Finance lease contracts					
	2018			2017		
Year in which receipt will occur:	Gross amounts	Present value adjustments	Present value	Gross amounts	Present value adjustments	Present value
	£m	£m	£m	£m	£m	£m
Within 1 year	7	-	7	7	-	7
After 1 year but within 5 years	44	(7)	37	37	(7)	30
After 5 years	29	(15)	14	46	(21)	25
	80	**(22)**	**58**	90	(28)	62

The finance lease agreements are all in the property sector. The average term of the finance lease entered into is 23 years.

The average effective interest rate in relation to finance lease agreements approximates 6.6%.

Unguaranteed residual values are estimated at nil.

Operating leases (lessee) are set out in the table below:

Minimum amounts payable under non–cancellable leases:

	Operating lease contracts							
	2018				2017			
Year in which payment will occur:	Within 1 year	After 1 year but within 5 years	After 5 years	Total	Within 1 year	After 1 year but within 5 years	After 5 years	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Operating lease obligations:								
Premises	4	15	29	**48**	4	16	31	51

	2018	2017
	£m	£m
Amounts recognised as income and expense		
Operating lease payables – minimum payments	**5**	5

17. Risk management

The major risks associated with The Royal Bank of Scotland International Limited are market, liquidity, credit, capital, operational and pension risk. A comprehensive framework has been established for managing these risks which is continually evolving as the Company's business activities change in response to market, credit, product and other developments. The Company is a wholly owned subsidiary of The Royal Bank of Scotland International (Holdings) Limited.

As discussed in the Report of the Directors, the Board is collectively responsible for the long term success of the Company and delivery of sustainable shareholder value. The roles of Chairman and Chief Executive Officer (CEO) are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures effective engagement and contribution of all executive, non-executive and independent non-executive directors. The CEO has responsibility for all businesses and acts in accordance with authority delegated from the Board. The independent non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and leadership team.

In order to provide effective oversight and leadership the Board has established two Board Committees with particular responsibilities:

The Audit Committee assists the Board in discharging its responsibilities for monitoring the quality of the financial statements of the Company. It reviews the accounting policies, financial reporting and regulatory compliance of the Company and its systems and standards of internal controls, and monitors the work of internal and external audit.

The Board Risk Committee provides oversight and advice on current and potential future risk exposures of the Company and future risk strategy. It reviews compliance with risk appetite and oversees the operation of the policy framework and submission to regulators.

The Board is also supported by the Executive Committee comprising the CEO, Chief Financial Officer (CFO) and the Chief Risk Officer (CRO) and other business leaders. It supports the CEO in managing the Company's businesses. It is responsible for managing strategic, financial, capital, risk and operational issues.

Market risk

Market risk is the risk that changes in interest rates, foreign exchange rates, prices, volatilities and correlations may have an adverse financial impact on the Company's financial condition or results.

Market risk includes:

Interest rate risk
Interest rate risk arises as a result of timing differences on the re-pricing of assets and liabilities, unexpected changes in the slope and shape of the yield curves and changes in the correlation of interest rates between different financial instruments.

In addition to interest rate risk positions managed within controlled risk limits by the Treasury unit, structural interest rate risk arises in the consolidated balance sheet as a result of fixed rate, variable rate and non-interest bearing assets and liabilities. Exposure to interest rate movements arises when there is a mis-match between interest rate sensitive assets and liabilities. The Company closely monitors interest rate movements, the interest rate and re-pricing maturity structure of its interest bearing assets and liabilities and the level of non-interest bearing assets and liabilities. In order to reduce the effect of fluctuating interest rates on net interest income, the composition of non-trading interest rate risk is assessed and funding positions or other derivative transactions are hedged with RBS.

Currency risk
Non-trading currency risk exposure arises principally due to investments in overseas operations. Movements in the exchange rates of the operational currency of the overseas investment will impact the balance sheet and the income statement unless the investment is financed by borrowings in the same currency.

All transactional (or non-structural) currency exposure risk is managed by the Treasury unit and there remains a small immaterial open position which is measured on a daily basis within set limits. The principal non-sterling currencies in which the Company has transactional currency exposure are US Dollar and the Euro.

Value-at-Risk ("VaR")

The Company manages market risk through VaR limits as well as stress testing, position and sensitivity limits. VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at a given confidence level. The table below sets out the VaR for the Company, which assumes a 99% confidence level and a one-day time horizon.

	31 December 2018	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	**0.08**	**0.18**	**0.07**	**0.10**

	31 December 2017	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.16	0.35	0.07	0.19

17. Risk management (continued)

Value-at-risk (continued)

VaR is a statistical estimate of the potential change in the market value of a portfolio (and, thus, the impact on the income statement) over a specified time horizon at a given confidence level. RBS's standard VaR metrics – which assume a time horizon of one trading day and a confidence level of 99% – are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations from the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities. Behavioural assumptions are applied as appropriate.

The non-traded interest rate risk VaR metrics for RBS's retail and commercial banking activities are included in the banking book VaR table above. The VaR captures the risk resulting from mismatches in the repricing dates of assets and liabilities.

It includes any mismatch between structural hedges and stable non and low interest-bearing liabilities such as equity and money transmission accounts as regards their interest rate repricing behavioural profile.

Liquidity risk

Liquidity risk is the risk that the Company does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost. The Company performs daily liquidity monitoring to ensure compliance with limits set by the regulators in the jurisdiction within which it operates. Quarterly reports are made to ALCO and the Board covering Sterling and currency liquidity.

The ultimate parent company, The Royal Bank of Scotland Group plc, is required by the Financial Conduct Authority to meet its Sterling obligations without recourse to the wholesale money market for a period of at least five business days. Bank manages its capital and liquidity, including drawing on support provided by the UK government and central banks in response to market conditions, in a responsible manner that continues to provide sufficient capital resources and liquidity for the Company to meet its obligations as they fall due.

Liquidity risk is monitored daily with performance reported to ALCO regularly.

The Bank's contractual maturity is covered in Note 9.

Financial assets have been reflected in the time band of the latest date on which they could be repaid unless earlier repayment can be demanded by the reporting entity; financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty.

If the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

17. Risk management (continued)

Contractual maturity

This table shows the residual maturity of financial instruments, based on contractual date of maturity. Mandatory fair value through profit or loss (MFVTPL) assets and liabilities have been excluded from the maturity analysis due to their short-term nature and are shown in total in the table below. Hedging derivatives are included in the relevant maturity bands.

	Other than MFVTPL												
	Less than 1 month	1–3 months	3–6 months	6 months-1 year	Subtotal	1–3 years	3–5 years	More than 5 years	Total excluding MFVTPL	MFVTPL	Impairment provisions	Amounts due from/to holding and fellow subsidiaries	Total
2018	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	10,437	-	-	-	10,437	-	-	-	10,437	-	-	-	10,437
Derivatives	-	-	-	-	-	-	-	-	-	26	-	-	26
Loans to banks	483	-	-	-	483	-	-	-	483	-	-	-	483
Loans to customers	1,396	1,115	745	2,420	5,676	3,196	1,444	2,329	12,645	-	(24)	-	12,621
Personal	730	53	11	43	837	82	103	2,136	3,158	-	-	-	3,158
Corporate	135	143	119	453	850	1,585	921	183	3,539	-	(24)	-	3,515
Financial institutions (excluding banks)	531	919	615	1,924	3,989	1,529	420	10	5,948	-	-	-	5,948
Other loans	-	-	-	-	-	2	-	-	2	-	-	-	2
Other financial assets	-	39	47	835	921	860	1,181	769	3,731	-	-	-	3,731
Total financial assets	12,316	1,154	792	3,255	17,517	4,058	2,625	3,098	27,298	26	(24)	3,037	30,337
2017													
Total financial assets	1,440	604	569	1,955	4,568	2,097	712	1,532	8,909	25	(10)	21,685	30,609
Bank deposits	2	-	-	-	2	-	-	-	2	-	-	-	2
Customer deposits	22,197	3,270	387	144	25,998	-	-	-	25,998	-	-	-	25,998
Personal	5,553	228	239	121	6,141	-	-	-	6,141	-	-	-	6,141
Corporate	4,646	1,176	24	14	5,860	-	-	-	5,860	-	-	-	5,860
Financial institutions (excluding banks)	11,998	1,866	124	9	13,997	-	-	-	13,997	-	-	-	13,997
Derivatives	-	-	-	-	-	-	-	-	-	37	-	-	37
Other financial liabilities	-	-	-	-	-	2	-	-	2	-	-	-	2
Total financial liabilities	22,199	3,270	387	144	26,000	2	-	-	26,002	37	-	2,282	28,321
2017													
Total financial liabilities	25,846	1,606	260	208	27,920	47	-	-	27,967	26	-	386	28,379

17. Risk management (continued)

Credit risk (including counterparty risk)

Credit risk is the risk that the Company will incur losses owing to the failure of customers to meet their financial obligations to the Company. The most important step in managing this risk is the initial decision whether or not to extend credit. The Company's strong credit culture extends to the management of resultant exposures via individual counterparty and concentration limits and the monitoring of counterparty credit worthiness as described below.

The Company has exposure to entities by making placements and advances to those counterparties. The Board of Directors reviews the placement of deposits to The Royal Bank of Scotland Group. The Group is majority owned by the UK Government and draws on support provided by central banks where required in order to meet its commitments including those to the Company.

The Company also has exposure to the Central Bank of England, and to the UK and US Governments through holding Government bonds in its liquid portfolio. These exposures are also reviewed by the Board of Directors.

The day-to-day management of credit risk is devolved to a specialist credit function, which perform regular appraisals of counterparty credit quality through the analysis of qualitative and quantitative information. Credit authority is based on defined limits. If the Company requires collateral, this may be cash, or more commonly, security over a customer's assets.

Impairment, provisioning and write-offs

Refer to Accounting policies – 12. Impairment of Financial assets.

Transition from IAS 39 to IFRS 9

The Bank implemented IFRS 9 with effect from 1 January 2018 with no restatement of comparatives other than the day one impact on implementation reflected in opening equity.

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.
- 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.
- Change in scope of impaired assets (Stage 3).
- Incorporation of forward-looking information, including multiple economic scenarios (MES) – MES are assessed in order to identify non-linearity in the portfolio.

Key differences in moving from IAS 39 to IFRS 9 on impairment loss

	Total £m
31 December 2017 - IAS 39 impairment provision	-
Impact of IFRS 9 – third party	2
Impact of IFRS 9 – intercompany	1
1 January 2018 - IFRS9 ECL	**3**

- The overall provisioning requirement under IFRS 9 increased by £3m 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, the ECL requirement on performing assets (Stages 1 and 2) more than doubled.
- The IFRS 9 provisioning requirement on non-performing assets in Stage 3 is affected less. The ECL requirement is higher compared with IAS 39 impaired portfolio provisions principally on defaulted assets that did not carry a provision reflecting expectation of full recovery under IAS 39.

The key elements of IFRS 9 impairment provisions

IFRS 9 introduced additional complexity into the determination of credit impairment provisioning requirements. However, the building blocks that deliver an ECL calculation already existed in Bank. Existing Basel models were used as a starting point in the construction of IFRS 9 models, which also incorporate term extension and forward-looking information.

Five key areas may 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 (Bank uses consensus forecasts to remove management bias).

17. Risk management (continued)

Credit risk (including counterparty risk) (continued)

Policy elections and simplifications relating to IFRS 9:

In addition to the five critical judgments above, which are relevant from period to period, there was one further significant judgment that was made as a one-off exercise to support the day one implementation: this was 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. The Bank has assumed a flat forward view for all dates historically. There were some other less significant judgments, elections and simplification assumptions that informed the ECL process; these were not seen as 'critical' in determining the appropriate level of impairment but represented choices taken by management across areas of estimation uncertainty. The main examples of these are:

- Models – for example 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
- Multiple Economic Scenario (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.

Economic loss drivers

The forecasts applied for IFRS 9 are those used for financial planning. The base case economic scenario is the primary driver of the calculation of ECL. 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.

Base case economic scenario

The base case economic scenario is the primary driver of the calculation of ECL, and is also an integral component within the bank's approach to MES. We summarise the key elements of our current economic base case:

- United Kingdom: Our central scenario projects modest growth in the UK economy, in line with the consensus outlook. Brexit related uncertainty results in subdued confidence in the near term, placing it in the lower quartile of advanced economies. Business investment is weak at the start of the forecast, improving only gradually. Consumer spending rises steadily as households benefit from falling inflation and rising wage growth, though it is a modest upturn. The central scenario assumes much slower job growth than seen in recent years, meaning unemployment edges up from its current historic lows. House price growth slows, extending the current slowdown, before picking up to low single digit growth in later years. Monetary policy follows the market implied path for Bank of England bank rate at the time the scenarios were set, thus we assume only two further hikes over the next five years.

Approach for multiple economic scenarios (MES)

The base case economic scenario is the primary driver of the calculation of ECL, and is an integral component within the bank's approach to MES.

RBSI Retail remains Basel standardised for Risk Weighted Assets, therefore modelled Probability of Default (PDs) and Loss Given Default (LGDs) are not available for calculating stage 1 and stage 2 ECLs. Instead this undertaken by the sourcing the equivalent product PD & LGD from within NatWest UK Personal, which was identified as the closest comparable portfolio to RBSI Retail. The PD and LGD benchmarks are then used, along with the known exposure, to calculate an account level ECL.

In order to identify accounts showing stage 2 credit deterioration the RBSI Retail Watch classification is applied where accounts are identified as having clear signs of credit deterioration, increased risk of default and/or loss or have been given forbearance, with days past due being checked as supplementary back stop.

In Retail, the approach to multiple scenarios is based on using discrete scenarios, where the latest central scenario or base case is applied to reflect the forward looking element of the model (the Single economic Scenario view) and probability-weighting the outputs from a further four bespoke scenarios – a base case upside downside – and an additional upside and downside

The Wholesale credit models framework utilises Credit Cycle Indices (CCI) to measure the point-in-time default rate conditions in a comprehensive set of region / industry groups. As in Retail, the 'central scenario' is RBS's internal base case but we apply an adjustment starting after the first projected year to enforce a gradual reversion long run average CCI conditions. The methodology to model the impact of multiple economic scenarios 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. For both Retail and Wholesale in terms of practical application, the impact from MES is factored in to account level PDs through a scalar. These MES adjusted PDs are used to assess whether a significant increase in credit risk has occurred.

17. Risk management (continued)

Credit risk (including counterparty risk) (continued)

Key economic loss drivers - average over the five year planning horizon (2018 to 2022 for 1 January 2018 and 2019 to 2023 for 31 December 2018) - in the most relevant planning cycle for the central base case and two upside and downside scenarios used for ECL modelling are set out below:

Probability weightings of scenarios
Our approach to IFRS 9 multiple economic scenarios involves selecting suitable scenarios to characterise the distribution of risks in the economic outlook and assigning appropriate probability weights to those scenarios. This has the following basic steps:

- Scenario selection – for the 2018 we have chosen two upside and two downside scenarios from Moody's inventory of scenarios. Our aim is to obtain downside scenarios that are not as extreme as stress tests, so typically have a severity of around 1 in 10 and 1 in 5 of approximate likelihood, along with corresponding upsides.
- Severity assessment – having selected the most appropriate scenarios we then assess their severity based on the behaviour of UK GDP by calculating a variety of measures such as average GDP growth deviation from base and peak to trough falls in GDP. These measures are compared against a set of 1,000 model runs and we establish what percentile in the distribution most closely corresponds with each scenario.
- Probability assignment – having established the relevant percentile points we assign probability weights to ensure that the scenarios produce an unbiased result. If the severity assessment step shows the scenarios to be broadly symmetric, then this will result in a symmetric probability weighting (same probability weight above and below the base case, as was used in the first half of 2018). However if the downsides are not as extreme as the upsides, then we allocate more probability weight to the downsides to ensure the unbiasedness requirement is satisfied (as was the case in the second half of 2018). This adjustment is made purely to restore unbiasedness, not to address any relative skew in the distribution of risks in the economic outlook, which is dealt with through overlays and covered in the section on UK economic uncertainty.

UK economic uncertainty
This analysis has been prepared during the run up to the UK leaving the European Union and as a result there is greater than usual uncertainty over the UK economic outlook. Our approach to capturing that elevated uncertainty is to apply an overlay to MES that is based on recognising a proportion of the ECL of a downside scenario that captures key elements of an alternative path the economy could take.

IFRS 9 Credit risk modelling
IFRS 9 introduced lifetime ECL for the measurement of credit impairment. This required the development of new models or the enhancement of existing Basel models. IFRS 9 ECLs are calculated using a combination of:

- Probability of default;
- Loss given default; and,
- Exposure at default.

IFRS 9 ECL model design principles
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 criteria.

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.
- For the life of the loan - all models produce a term structure to allow a lifetime calculation for assets in Stage 2 and Stage 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 did 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 were 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 have been assumed to remain constant from that point forward.

Wholesale Models
Wholesale PD models use the existing Credit-Cycle Index 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.

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.

17. Risk management (continued)

Credit risk (including counterparty risk) (continued)

PD estimates

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.

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 future behaviour.

Significant increase in credit risk

Exposures that are considered significantly credit deteriorated since initial recognition are classified in Stage 2 and assessed for lifetime ECL measurement (exposures not considered deteriorated carry a 12 month ECL). Bank 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 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 and is assessed monthly. To assess whether credit deterioration has occurred, the residual life-time PD at balance sheet date (which PD is established at Date of Initial Recognition) is compared to the current PD. If the current life-time PD exceeds the residual origination PD by more than a threshold amount deterioration is assumed to have occurred and the exposure transferred to Stage 2 for a life-time loss assessment. In broad terms, a doubling of PD would indicate significant credit deterioration. However, on wholesale, the PD uplift must be at least 0.1% and on retail the criteria varies by risk band with lower risk exposures needing to deteriorate more than higher risk exposures.
- 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, Wholesale exposures managed within the Risk of Credit Loss and heightened monitoring framework, adverse credit bureau on Retail.

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.

Asset lifetimes

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

- The date of initial recognition reflects 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) is:
  - Term lending-the contractual maturity date, reduced for behavioural trends where appropriate (such as, expected pre-payment and amortisation).

Retail Non Modelled portfolio

RBSI Retail remains Basel standardised for Risk Weighted Assets, therefore modelled Probability of Default (PDs) and Loss Given Default (LGDs) are not available for calculating stage 1 and stage 2 ECLs. Instead this is undertaken by the sourcing the equivalent product PD & LGD from within NatWest UK, which was identified as the closest comparable portfolio to RBSI Retail. The PD and LGD benchmarks are then used, along with the known exposure, to calculate an account level ECL.

In order to identify accounts showing stage 2 the RBSI Retail Watch classification is applied where accounts are identified as having clear signs of credit deterioration, increased risk of default or have been given forbearance, with days past due being checked as supplementary back stop.

Retail adjustments for legacy Spanish & UK Buy to Let currency mortgages

Within RBSI Retail we continue to manage down two legacy mortgage portfolios that closed for new business in 2009 and which provided currency mortgages on Spanish and UK Buy to Let (B2L) properties. The majority of these two legacy portfolios were provided on interest only repayment over terms ranging between 10 to 30 years and where sale of the property was considered as an acceptable repayment source.

The peak maturity period for Spanish mortgages occurred between 2016 and 2018, with a small proportion remaining with longer dated maturities running until 2032. However following the crash in the Spanish property market a large proportion of the portfolio has matured or is expected to mature with either higher Loan to Values (LTVs) above 75% or even negative equity.
UK B2L currency mortgages were also predominately lent on interest only with maturities running until 2036 and the majority of the portfolio (c70%) still has more than 5 years to run. Due to historic exchange rate volatility and the associated cross currency risk a proportion of the portfolio is now in excess of our normal B2L LTV appetite of 75%.

17. Risk management (continued)

Credit risk (including counterparty risk) (continued)

The Non Modelled portfolio ECL calculation applied to RBSI Retail does not take into account the increased risk of loss associated with interest only repayment and higher LTV profiles, resulting in an unrealistically small ECL for the Spanish and UK B2L currency mortgage books. As a result an adjustment is required to reflect the actual credit loss experience and is applied to accounts showing signs of credit deterioration through their Watch classification status (e.g. increased LTV, high risk of default or forbearance given) or through the days past due back stop.

Once the ECL adjustments are applied this results in combined stage 1 and 2 provision coverage ratios of 5.5% and 0.3% respectively for the Spanish (£1.8m) and UK B2L (£0.3m) currency mortgage books.

Measurement uncertainty and ECL sensitivity analysis

The recognition and measurement of expected credit losses ('ECL') is highly complex and involves the use of significant judgement and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9.
The ECL provision is sensitive to the model inputs and economic assumption underlying the estimate. Set out below are the impact of some of the material sensitivities considered for 2018 year end impairment provision.

We considered the following approaches:

- Economic uncertainty: reflecting the impact of alternative economic scenarios:
  - HPI (House Price index): is a key economic driver and we have evaluated a univariate scenario of a 5 % decrease in HPI across all secured portfolios.

    A univariate analysis using only HPI does not allow the interdependence across the other key primary loss drivers to be reflected in any ECL estimate. The simulated impact is based on 100% probability weighting to demonstrate the sensitivity of HPI on our central base case. The HPI scenario has been evaluated for secured portfolios only.

  - Downside 2 scenario: to complement the HPI shift impact, we used Downside 2 as a single scenario (100% weighted basis). This scenario reflects a severe economic recession. This scenario has been applied to all modelled portfolios in the analysis below. For some portfolios this creates a significant impact on ECL but for others less so but on balance the approach is deemed reasonable.

- Portfolio risk: evaluating the impact of one of the key metrics, PD. We implemented a relative 25% shift in PDs.

The ECL provision is sensitive to the ECL calculation inputs and economic assumptions underlying the estimate. Set out below is the impact of some of the material sensitivities considered for 2018 year end reporting. Given the current benign environment for impairments the focus is on downsides to the existing ECL provision levels and on performing Stage 1 and Stage 2 exposures. As default is an observed event at the balance sheet date, stage 3 provisions are not subject to the same level of measurement uncertainty, and therefore have not been considered in this analysis. We considered two approaches:

- Economic uncertainty: replacing the existing base case economic assumptions with the Downside 2 scenario, one of the five discrete scenarios used in RBSI's planning process and also in ECL calculation, resulted in an ECL uplift of 19.77% (£1.8m) .
- Portfolio risk: relative 25% upward shift in probability of default (PD), one of the key metrics in ECL calculation, resulted in a potential ECL uplift of 17.80% (£1.6m)

Key IFRS 9 terms and differences to current accounting and regulatory framework

Attribute	IFRS 9	IAS 39	Regulatory (CRR)[1]
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 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.

17. Risk management (continued)

Credit risk (continued)

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

Attribute	IFRS 9	IAS 39	Regulatory (CRR)[1]
Significant increase in credit risk	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 refer accounting policy 13; 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.
Loss given default	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	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.

17. Risk management (continued)

Credit risk (continued)

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

Attribute	IFRS 9	IAS 39	Regulatory (CRR)[1]
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.

(1) Capital Requirements Regulation (CRR) is a UK regulatory requirement, which has been included for reference purposes only.

ECL Flow Statement

The table below shows the key elements that drive the movement of ECL and related income statement over the reporting period, including the following key elements:

- ECL has increased during 2018 following the migration of a mortgage book with exposure to Spanish properties which was a ring - fencing related change.
- The ECL on the inter-group balance dropped due to significant decrease in the placement with the RBS Group Plc from £22bn to £3bn.
- The Other categories within the table reflects items that did not affect the ECL provision balance but which did have an impact on the impairment charge, for example, fortuitous recoveries on previously written-off debt.

	ECL Stage 1 and Stage 2	ECL Stage 3	Total
	£m	£m	£m
Opening balance as at 1 January 2018	5	5	10
Provision charge/(release)	-	(1)	(1)
Other movements including write offs	(1)	(9)	(10)
ICB transfer	3	22	25
Closing balance as at 31 December 2018	7	17	24

17. Risk management (continued)

Credit risk (continued)

Maximum credit risk exposure and significant concentrations of credit risk are illustrated in the table below:

2018	Gross loans and advances to banks and customers £m	Other financial assets £m	Derivatives £m	Total £m	Netting and offset (1)	Exposure post netting and offset £m
UK, Crown Dependencies and Gibraltar						
Central and local government	1	3,731	-	3,732	-	**3,732**
Manufacturing	13	-	-	13	-	**13**
Construction	53	-	-	53	-	**53**
Finance	9,437	-	26	9,463	-	**9,463**
Service industries and business activities	46	-	-	46	(9)	**37**
Agriculture, forestry and fishing	5	-	-	5	-	**5**
Property	2,215	-	-	2,215	-	**2,215**
Individuals	817	-	-	817	-	**817**
Home mortgages	2,137	-	-	2,137	-	**2,137**
Other	1,008	-	-	1,008	-	**1,008**
Total UK, Crown Dependencies and Gibraltar	**15,732**	**3,731**	**26**	**19,489**	**(9)**	**19,480**
Europe						
Central and local government	50	-	-	50	-	**50**
Manufacturing	-	-	-	-	-	**-**
Construction	-	-	-	-	-	**-**
Finance	5	-	-	5	-	**5**
Service industries and business activities	9	-	-	9	-	**9**
Agriculture, forestry and fishing	-	-	-	-	-	**-**
Property	88	-	-	88	-	**88**
Individuals	25	-	-	25	-	**25**
Home mortgages	180	-	-	180	-	**180**
Other	54	-	-	54	-	**54**
Total Europe	**411**	**-**	**-**	**411**	**-**	**411**
Total						
Central and local government	51	3,731	-	3,782	-	**3,782**
Manufacturing	13	-	-	13	-	**13**
Construction	53	-	-	53	-	**53**
Finance	9,442	-	26	9,468	-	**9,468**
Service industries and business activities	55	-	-	55	(9)	**46**
Agriculture, forestry and fishing	5	-	-	5	-	**5**
Property	2,303	-	-	2,303	-	**2,303**
Individuals	842	-	-	842	-	**842**
Home mortgages	2,317	-	-	2,317	-	**2,317**
Other	1,062	-	-	1,062	-	**1,062**
	16,143	**3,731**	**26**	**19,900**	**(9)**	**19,891**

Please refer footnote on next page

17. Risk management (continued)

Credit risk (continued)

2017	Gross loans and advances to banks and customers £m	Available for sale investments £m	Derivatives £m	Total £m	Netting and offset (1)	Exposure post netting and offset £m
UK, Crown Dependencies and Gibraltar						
Central and local government	2	-	-	2	-	2
Manufacturing	15	-	-	15	-	15
Construction	63	-	-	63	-	63
Finance	25,267	3	25	25,295	-	25,295
Service industries and business activities	39	-	-	39	(4)	35
Agriculture, forestry and fishing	4	-	-	4	-	4
Property	1,969	-	-	1,969	-	1,969
Individuals	587	-	-	587	-	587
Home mortgages	1,367	-	-	1,367	-	1,367
Other	402	-	-	402	-	402
Total UK, Crown Dependencies and Gibraltar	29,715	3	25	29,743	(4)	29,739
Europe						
Central and local government	50	-	-	50	-	50
Manufacturing	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Finance	30	-	-	30	-	30
Service industries and business activities	3	-	-	3	-	3
Agriculture, forestry and fishing	-	-	-	-	-	-
Property	68	-	-	68	-	68
Individuals	26	-	-	26	-	26
Home mortgages	180	-	-	180	-	180
Other	42	-	-	42	-	42
Total Europe	399	-	-	399	-	399
Total						
Central and local government	52	-	-	52	-	52
Manufacturing	15	-	-	15	-	15
Construction	63	-	-	63	-	63
Finance	25,297	3	25	25,325	-	25,325
Service industries and business activities	42	-	-	42	(4)	38
Agriculture, forestry and fishing	4	-	-	4	-	4
Property	2,037	-	-	2,037	-	2,037
Individuals	613	-	-	613	-	613
Home mortgages	1,547	-	-	1,547	-	1,547
Other	444	-	-	444	-	444
	30,114	3	25	30,142	(4)	30,138

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

Gross assets of £9m (2017: £4m) and gross liabilities of £9m (2017: £4m), are subject to netting arrangements. The asset balances included above consist of only Customer deposits and Loans and advances to banks and customers which have been offset with the full amount of the liability balances of £9m (2017: £4m) in accordance with the offsetting rules of IAS 32.

17. Risk management (continued)

Credit risk (continued)

Collateral and credit enhancement - Total

The table below summarises financial asset exposures within the scope of the ECL framework as well as credit mitigation and credit enhancements.

31-Dec-18	Gross exposure	ECL	Maximum exposure to credit risk	Maximum exposure to credit risk: of which stage 3	Credit enhancements					Total credit enhancements	Total credit enhancements: of which stage 3	Exposure post credit mitigation & enhancement	Exposure post credit mitigation & enhancement: of which stage 3
					Guarantees	Collateral							
								Real estate and other					
						Cash	Securities	Real estate commercial	Real estate residential				
Financial assets within scope of IFRS9 ECL													
Cash and Balances at central banks	10,437	-	10,437	-	-	-	-	-	-	-	-	10,437	-
Loans - amortised cost:													
Personal	2,632	17	2,615	77	-	-	-	-	4,738	4,738	60	-	17
Wholesale	10,472	7	10,465	11	254	135	6	4,722	459	5,576	4	4,896	7
Other Financial assets	3,729	-	3,729	-	-	-	-	-		-	-	3,729	-
Total Financial assets	**27,270**	**24**	**27,246**	**88**	**254**	**135**	**6**	**4,722**	**5,197**	**10,314**	**64**	**19,062**	**24**
Contingent Liabilities and commitments within scope of IFRS9 impairments													
Personal	-	-	-	-	-	-	-	-	-	-	-	-	-
Facilities with central banks and other correspondents banks	6,750	-	6,750	-	-	-	-	-	-	-	-	6,750	-
Wholesale	7,914	-	7,914	-	26	67	-	477	3	573	-	7,341	-
Total off balance sheet	**14,664**	**-**	**14,664**	**-**	**26**	**67**	**-**	**477**	**3**	**573**	**-**	**14,091**	**-**
Total within scope of IFRS9 impairments	**41,934**	**24**	**41,910**	**88**	**280**	**202**	**6**	**5,199**	**5,200**	**10,887**	**64**	**33,153**	**24**

17. Risk management (continued)

Credit risk (continued)

Credit risk asset quality

The asset quality analysis presented below is based on the Company's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Company map to both an asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios.

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

Internal asset quality band	Minimum %	Maximum %	Indicative S&P rating
AQ 1	0.000	0.034	AAA to AA
AQ 2	0.034	0.048	AA-
AQ 3	0.048	0.095	A+ to A
AQ 4	0.095	0.381	BBB+ to BBB-
AQ 5	0.381	1.076	BB+ to BB
AQ 6	1.076	2.153	BB- to B+
AQ 7	2.153	6.089	B+ to B
AQ 8	6.089	17.222	B- to CCC+
AQ 9	17.222	100.000	CCC to C
AQ 10	100.000	100.000	D

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

17. Risk management (continued)

Credit risk asset quality (continued)

Portfolio summary - sector analysis

The table below summarises financial assets and off-balance sheet exposures gross of ECL, related ECL provisions, impairment and past due by sector and asset quality.

31 December 2018	Personal £m	Wholesale £m	Total £m
Loans and advances by geography	2,632	10,472	13,104
- UK	2,632	8,268	10,900
- RoI	-	2	2
- Other Europe	-	1,596	1,596
- RoW	-	606	606
Loans and advances by asset quality			
- AQ 1 - 4	-	8,927	8,927
- AQ 5 - 8	2,555	1,531	4,086
- AQ 9	-	3	3
- AQ 10	77	11	88
Loans and advances by stage			
- Stage 1	2,499	10,255	12,754
- Stage 2	56	206	262
- Stage 3	77	11	88
Loans and advances - past due analysis			
Total	2,632	10,472	13,104
- Not past due	2,517	10,347	12,864
- Past due 1-29 days	22	116	138
- Past due 30-89 days	11	5	16
- Past due 90-180 days	43	4	47
- Past due > 180 days	39	-	39
Stage 2			-
Total	56	206	262
- Not past due	25	201	226
- Past due 1-29 days	22	-	22
- Past due 30 - 89 days	9	5	14
- Past due 90 - 180 days	-	-	-
- Past due > 180 days	-	-	-
ECL provision by stage (total)			
- Stage 1	2	3	5
- Stage 2	1	1	2
- Stage 3	14	3	17
ECL Provision coverage (total) - ECL/loans			
- Stage 1	0.08%	0.03%	0.04%
- Stage 2	1.79%	0.49%	0.76%
- Stage 3	18.18%	27.27%	19.32%
ECL charge (total)			-
- UK	(2)	1	- 1
- RoI	-	-	-
- Other Europe	-	-	-
- RoW	-	-	-
- i/G	-	1	1
ECL loss rate (total ECL on loans)	(0.08%)	0.02%	0.00%
Amounts written off (total)	8	-	8
Other financial assets by asset quality			
- AQ 1-4	-	14,142	14,142
- AQ 5-8	-	24	24
- AQ 9	-	-	-
- AQ10	-	-	-
Off balance sheet			
Loan commitments	283	14,381	14,664
Financial guarantees	-	438	438
Off balance sheet by asset quality			
- AQ 1 - 4	-	14,175	14,175
- AQ 5 - 8	283	643	926
- AQ 9	-	-	-
- AQ 10	-	1	1

17. Risk management (continued)

Credit risk asset quality (continued)

2017	Cash and balances at central banks £m	Derivatives £m	Loans to banks £m	Loans to customers £m	Commitments £m
AQ 1	479	25	21,696	2,724	2,403
AQ 2	-	-	-	628	668
AQ 3	-	-	4	998	664
AQ 4	-	-	20	1,059	740
AQ 5	-	-	-	659	282
AQ 6	-	-	-	2,101	307
AQ 7	-	-	-	113	29
AQ 8	-	-	-	32	8
AQ 9	-	-	-	34	3
AQ 10	-	-	-	5	-
Accruing past due	-	-	-	31	-
Impaired loans	-	-	-	6	-
Less impairment provision	-	-	-	(8)	-
Total	479	25	21,720	8,382	5,104

Capital risk

The Company manages its capital to ensure that branches will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of equity attributable to equity holders of the ultimate parent, comprising issued capital, reserves and retained earnings as disclosed in the Statement of Changes in Equity.

The Company has capital adequacy requirements imposed by the following regulators –
The Jersey Financial Services Commission (JFSC) – Lead regulator
The Guernsey Financial Services Commission,
The Financial Services Authority Isle of Man,
The Financial Services Commission Gibraltar
Commission de Surveillance du Secteur Financier
Prudential Regulation Authority.

The Company is required to report its risk asset ratio to the lead regulator on a periodic basis. The ratio is calculated as being the percentage of capital to assets. The JFSC has established in the Codes of Practice for Deposit-taking Business and includes that a registered person's minimum risk to asset ratio must be maintained at all times at or above 10%.

The Company has been in compliance with capital adequacy requirements in respect of the years ending 31 December 2018 and 2017. As at 31 December 2018, the Risk Asset Ratio was 23.6% (2017: 19.10%). Risk Weighted Assets (RWA) have reduced by £3.2bn with the Company increasing its placements with lower risk Central banks and bond holdings and increasing its lending book. It also reduced its placements with RBS Group. Core Tier 1 capital includes a reduction for dividends paid of £470m in 2018.

ALCO reviews the capital structure of the Company on a quarterly basis. As part of this review, the committee considers the cost of capital and the risks associated with each class of capital, along with considering compliance of regulatory requirements. Based on recommendations of the committee, the Company will balance its overall capital structure through the payment of dividends, new share issues and share buy-backs as well as the issue of new debt or the redemption of existing debt.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people, systems or from external events. The Company's business units manage this risk through appropriate risk controls and loss mitigation actions. These actions include a balance of policies, procedures, internal controls and business continuity arrangements.

Pension risk

Pension risk is the risk to the Group arising from its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees, for those of a related company or otherwise. It is also the risk that the Group will make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation or because the Bank considers that it needs to do so for some other reason.

The Group is exposed to pension risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates and, inflation as well as with, pensionable salaries and longevity of scheme members and changes in legislation. Pension scheme assets vary with changes in interest rates, inflation expectations, credit spreads, exchange rates, and equity and property prices. The Group is exposed to the risk that the schemes' assets, together with future investment returns and additional future contributions, are insufficient to meet the liabilities as they fall due. In such circumstances, the Group could be obliged, (or may choose) , to make additional contributions to the scheme, or be required to hold additional capital to mitigate such risk.

17. Risk management (continued)

Pension risk (continued)

The International Pensions Trust ("IPT") is the largest of the schemes and the main source of pension risk with £ 591m of assets and £532m of liabilities (2017 - £653m of assets and £614m of liabilities). It operates under a trust deed under which the corporate trustee is a subsidiary of the Bank. The trustee board comprises three directors selected by the Company, two directors nominated by members and one independent director.

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

The RBSI Pension Forum, acting as a sub-committee of the Company's Asset and Liability Committee (ALCO), formulates the Group view of pension risk and provides a governance framework for all Group pension schemes.

The trustee board is solely responsible for the investment of the scheme assets which are held separately from the assets of the Group. The Group and the trustee board discuss and agree on the investment principles and the funding plan. The scheme invested in diversified portfolios of equity, government and corporate fixed-interest and index-linked bonds. The IPT asset strategy is under review as part of the 31 March 2018 funding valuation.

The last funding valuation of the IPT was completed in 2017 with an effective date of 31 March 2015. Under the terms of the funding agreement, the Group agreed to pay a contribution of £75m in 2016 which, together with future investment returns, aims to remove the deficit on the agreed funding basis. A further valuation is currently underway with an effective date of 31 March 2018 and is expected to be finalised during 2019.

The RBSI Section of the RBS Group Pension Fund was created on 1 November, to which the liabilities and corresponding share of assets in relation to Group members were transferred. It was as part of the RBS Group's work to address the ring-fencing impact on its pension schemes. The Group ceased to participate in the Main Section of the RBS Group Pension Fund, with the RBSI Section being established to provide benefits to RBSI employees who were building up benefits in the Main Section at the date of change. An initial valuation of this section is due as at 31 December 2018.

Risk Factors – Replacement of LIBOR and EURIBOR

The Group may not manage risks associated with the replacement of LIBOR, EURIBOR and other benchmark rates effectively.

LIBOR, the Euro Interbank Offered Rate ('EURIBOR') and other interest rates or other types of rates and indices which are deemed to be "benchmarks" are the subject of ongoing national and international regulatory reform. The expected transition away from the use of, and potential replacement of, such benchmarks represents a number of risks for the RBS Group, including the Group, their clients and the financial services industry more widely. This includes risks related to: legal risks (as changes may be required to documentation for new or existing transactions);
Financial risks (which may arise from any changes in valuation of financial instruments linked to benchmarks rates); pricing risks (as changes to benchmark rates could impact pricing mechanisms on certain instruments); operational risks (due to the potential requirement to adapt IT systems, trade reporting infrastructure and operational processes); and conduct risks (which may relate to communication regarding the potential impact on customers, and engagement with customers during the transition period).
The replacement of the benchmarks, the timing thereof as well as the mechanisms for implementation, are subject to uncertainty. It is therefore difficult to determine to what extent the changes will affect the RBS Group, including the Group. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms and as to the continuation of LIBOR or EURIBOR may adversely affect financial instruments using LIBOR or EURIBOR as benchmark. The implementation of any alternative rates may be impossible or impracticable under the existing terms of such financial instruments and could have an adverse effect on the value of, return on and trading market for such financial instruments.

18. Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2018. Although the Company is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Company's expectation of future losses.

	2018 £m	2017 £m
Contingent liabilities:		
Guarantees	**418**	203
Other contingent liabilities	**20**	23
Total contingent liabilities	**438**	226
Commitments:		
Facilities with central banks and other correspondents banks	**6,750**	-
Undrawn formal standby facilities, credit lines and other commitments to lend	**7,914**	5,104
Total commitments	**14,664**	5,104

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

Contingent liabilities

These include standby letters of credit, supporting customer debt issues, contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities and obligations to The Royal Bank of Scotland plc.

Commitments

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

Commitments under non-cancellable operating leases are detailed in note 16.

Litigation

The Company is involved in litigation involving claims by and against it which arise in the ordinary course of business. The directors of the Company, after reviewing the claims pending and threatened against the Company, and taking into account the advice of the relevant legal advisers, are satisfied that the outcome of these claims are unlikely to have a material adverse effect on the net assets of the Company.

19. Net cash inflow from operating activities

	2018 £m	2017 £m
Net cash inflows from trading activities	194	172
Decrease/(increase) in loans & advances to banks & customers	(4,749)	(1,197)
Decrease/(increase) in derivatives	(1)	-
Decrease/ (increase) in other loans	13	(9)
Decrease/(increase) in other financial assets	39	-
Increase in other assets	7	26
Decrease/ (increase) in Amounts due from holding companies and fellow subsidiaries	21,971	(4,808)
Changes in operating assets	17,280	(5,988)
Increase in banks and customers deposits	(1,965)	3,546
(Decrease)/increase in derivatives	11	(26)
Increase/(decrease) in other liabilities	17	16
Increase/ (decrease) in Amounts due to holding companies and fellow subsidiaries	1,896	2,653
Changes in operating liabilities	(41)	6,189
Tax paid	(24)	(23)
Net cash inflow/(outflow) from operating activities	17,409	350

20. Analysis of cash and cash equivalents

	2018 £m	2017 £m
At 1 January		
Cash and balances at central banks	479	44
Cash equivalents	68	139
	547	183
Net cash flow	13,200	346
Effect of exchange rate changes on cash and cash equivalents	65	18
At 31 December	13,812	547
Comprising:		
Cash and balances at central banks	10,437	479
Amount due from holding companies and fellow subsidiaries and Loans to banks	3,375	68
	13,812	547

The Company is required by law or regulation to maintain balances with the Central banks which are excluded from Cash and cash equivalents. These are set out below.

	2018 £m	2017 £m
Central Bank of Luxembourg	53	-
Bank of England	5	-
Total	58	-

21. Other Cash flow information

	2018 £m	2017 £m
Interest received	417	320
Interest paid	(52)	(6)
	365	314

22. Related parties

The Company's immediate parent company is The Royal Bank of Scotland International (Holdings) Limited.

The Company's ultimate holding company, and the parent of the largest group into which the Company is consolidated into is The Royal Bank of Scotland Group plc.

UK Government

On 1 December 2018, the UK Government through HM Treasury is the ultimate controlling party of The Royal Bank of Scotland Group plc. Its shareholding is managed by UK Financial Investments Limited, a company it wholly-owns and as a result, the UK Government and UK Government controlled bodies are related parties of the Company.

(a) Transactions with key management

For the purposes of IAS 24 'Related Party Disclosure', key management comprise directors of the Company and members of the Executive Committee Offshore. The following amounts are attributable, in aggregate, to key management:

	2018 £'000	2017 £'000
Loans and advances to customers	2,116	2,239
Customer deposits	276	238
Interest received	37	40
Interest paid	3	1

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

(b) Related party transactions

	2018 £m	2017 £m
Assets		
Loans and advances to banks:		
RBS Group entities	3,037	21,685
Liabilities		
Deposits by banks:		
RBS Group entities	2,282	386
Income		
Interest received:		
RBS Group entities	142	115
Expenses		
Interest paid:		
RBS Group entities	7	7
Administration expenses paid to RBS Group entities	-	(1)
Total expenses	7	6

The loan balances transferred to RBSI branch in London from RBS Group entities were £3.3bn (2017: £1bn). A Mortgage book with a net book value of £800m (2017: nil) was transferred to RBSI from RBS Plc branch in Isle of Man. A total dividend of £470m was paid to RBSIH.

(c) Compensation of key management

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

	2018 £'000	2017 £'000
Short term benefits	3,665	2,578
Share-based payments	-	198
Long term benefits	1,091	261
	4,756	3,037

23. The adoption of IFRS 9

The Bank's accounting policies have significantly changed on the adoption of IFRS 9 'Financial Instruments' with effect from 1 January 2018. Prior years are re-presented but there has been no restatement of prior year data.

IFRS 9 changed the classification categories of financial assets from IAS 39. Held-for-trading assets were classified to mandatory fair value through profit or loss; loans and receivables were classified to amortised cost; and available-for-sale assets were classified as fair value through other comprehensive income unless they were deemed to be in a fair value business model or failed the contractual cash flow requirements under IFRS 9.

There were no changes in the classification and measurement of financial liabilities.

The day 1 net increase to loan impairments from IAS 39 to IFRS 9 was £3m under the expected credit loss requirements.

The impact on the Group's balance sheet at 1 January 2018 and the key movements in relation to the impact on classification and measurement are as follows:

	Changes to presentation			IFRS 9 impact				
	31 December 2017 (IAS 39)	New presentation	31 December 2017 re-presented	Classification & Measurement	Expected credit losses	Tax	1 January 2018 (IFRS 9)	
	£m	£m	£m	£m	£m	£m	£m	
Cash and balances at central banks	479	—	479	—	—	—	479	Cash and balances at central banks
Derivatives	25	—	25	—	—	—	25	Derivatives
Loans and advances to banks	21,720	(21,700)	20	—	—	—	20	Loans and advances to banks
Loans and advances to customers	8,382	—	8,382	—	(2)	—	8,380	Loans and advances to customers
Other loans	—	15	15	—	—	—	15	Other loans
Amounts due from holding companies and fellow subsidiaries	—	21,685	21,685	—	(1)	—	21,684	Amounts due from holding companies and fellow subsidiaries
Equity shares	3	(3)	—	—	—	—	—	Equity shares
Other financial assets	—	3	3	—	—	—	3	Other financial assets
Intangible assets	9	—	9	—	—	—	9	Intangible assets
Other assets	86	—	86	—	—	—	86	Other assets
Total assets	30,704	—	30,704	—	(3)	—	30,701	Total assets
Deposits by banks	379	(379)	—	—	—	—	—	Deposits by banks
Customer accounts	27,967	(15)	27,952	—	—	—	27,952	Customer accounts
Derivatives	26	—	26	—	—	—	26	Derivatives
Other financial liabilities	—	15	15	—	—	—	15	Other financial liabilities
Amounts due to holding companies and fellow subsidiaries	—	386	386	—	—	—	386	Amounts due to holding companies and fellow subsidiaries
Other liabilities	89	(7)	82	—	—	—	82	Other liabilities
Total liabilities	28,461	—	28,461	—	—	—	28,461	Total liabilities
Total equity	2,243	—	2,243	—	(3)	—	2,240	Total equity
Total liabilities and equity	30,704	—	30,704	—	(3)	—	30,701	Total liabilities and equity

23. The adoption of IFRS 9 (continued)

The table below reflects the impact of IFRS 9 on total equity

	Total £m
At 31 December - under IAS 39	2,243
Expected credit losses	**(3)**
At 1 January 2018 - under IFRS on transition to IFRS 9	**2,240**