RBS Holdings N.V.
Form 20-F
April 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2015

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

OR

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

Commission file number: 1-14624

RBS Holdings N.V.

(Exact name of Registrant as specified in its charter)

The Netherlands

(Jurisdiction of incorporation)

Gustav Mahlerlaan 350, 1082 ME Amsterdam, The Netherlands

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Guarantee of 5.90% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust V	New York Stock Exchange*
Guarantee of 6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VI	New York Stock Exchange**
Guarantee of 6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VII	New York Stock Exchange***
5.90% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust V	New York Stock Exchange
6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VI	New York Stock Exchange
6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VII	New York Stock Exchange
4.65% Subordinated Notes due 2018	Euronext Amsterdam

* The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust V.

** The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VI.

*** The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VII.

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

None

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

None

Indicate the number of outstanding shares of each class of common stock of the close of the period covered by the annual report

(Title of each class)	(Number of outstanding shares)
Ordinary shares, par value €0.56 per share	89,287

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

o Yes x No

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

o Yes x No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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

x Yes o No

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

o Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-Accelerated filer x

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

o U.S. GAAP

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

o Other

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

o Item 17 o Item 18

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

o Yes x No

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Chairman’s statement

In 2015 the Group continued to de-risk its balance sheet. Total assets reduced to €16.0 billion at the end of 2015 compared with €23.6 billion at the end of 2014. Plans for the further wind-down of the business were presented to the European Central Bank (ECB) and De Nederlandsche Bank (DNB), our regulators.

On 26 February 2015 RBS Group announced the restructuring of Corporate & Institutional Banking (CIB) to build a strong, safe and more sustainable business. Subsequently CIB is in the process of reducing its geographical footprint to approximately 13 countries, compared with 38 at the end of 2014.

This business restructuring is managed by RBS’s Capital Resolution. The impacted countries for the Group are China, India and Indonesia. In 2015 we started the wind-down of our businesses in Indonesia and China. At the beginning of 2016 it was decided to also wind-down the retail and corporate business in India as well.

The scope of Capital Resolution’s work includes the Group as most of the assets on the Group’s balance sheet were already managed by Capital Resolution. As a result, the reorganisation agenda of RBS Group and the Group are fully aligned with each other.

Results of operations in 2015

Operating loss before tax was €48 million compared with a loss of €57 million in 2014. This was largely due to lower expenses as a result of lower staff and non-staff costs, and was offset by higher impairment losses. Net interest income decreased as a result of the wind-down. Total equity as at 31 December 2015, was €3.7 billion, an increase of €0.2 billion compared with 31 December 2014.

Capital and RWAs

The Group continues to be well capitalised. At 31 December 2015, the Group’s Total capital ratio was 42.5%, the Tier 1 capital ratio was 30.1% and the Common Equity Tier 1 capital ratio was 21.1%. Within risk-weighted assets €9,350 million is included as a consequence of the proportional consolidation of a 40% interest in Saudi Hollandi Bank. This amount is comprises of €9,324 million in credit risk and €26 million in market risk.

Outlook

It is envisaged that in 2016 commercial activities will cease and that we will continue to execute the plans for the further de-risking of RBS N.V.. Ultimately, the objective is that RBS N.V. can relinquish its banking licence in the Netherlands.

On behalf of my fellow Managing Board members, I would like to thank all our employees and customers for their continued commitment and loyalty during 2015.

Idzard van Eeghen

Chairman of the Managing Board of RBS Holdings N.V.

Amsterdam, 28 April 2016

Financial review

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Presentation of information

In the Report and unless specified otherwise, the terms 'company' and 'RBS Holdings' mean RBS Holdings N.V.. RBS Holdings N.V. is the parent company of The Royal Bank of Scotland N.V. (RBS N.V.) consolidated group of companies and associated companies (‘RBSH Group’ or ‘the Group’). The Royal Bank of Scotland Group plc (RBSG) is the ultimate holding company of RBSH Group. RBS Group refers to RBSG and its consolidated subsidiaries and associated companies. RBS plc refers to The Royal Bank of Scotland plc. The terms 'Consortium' and 'Consortium Members' refer to RBSG, Stichting Administratiekantoor Beheer Financiële Instellingen (the Dutch State, successor to Fortis) and Banco Santander S.A. (Santander) who jointly acquired RBS Holdings on 17 October 2007 through RFS Holdings B.V. (RFS Holdings).

The company publishes its financial statements in 'euro', the European single currency. The abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively. Reference to '£' is to pounds sterling. The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds, respectively. Reference to '$' is to United States of America (US) dollars. The abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars, respectively.

Certain information in this report is presented separately for domestic and foreign activities. Domestic activities consist of transactions within the Netherlands. Geographic analysis has been compiled on the basis of location of office.

The results, assets and liabilities of individual business units are classified as trading or non-trading based on their predominant activity. Although this method may result in some non-trading activity being classified as trading, and vice versa, any resulting misclassification is not material.

All annual averages in this report are based on month-end figures. Management does not believe that these month-end averages present trends materially different from those that would be presented by daily averages.

International Financial Reporting Standards

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

Glossary

A glossary of terms is included on pages 197 to 203.

Forward-looking statements

Certain sections in this document contain ‘forward-looking statements’ as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘believe’, ‘should’, ‘intend’, ‘plan’, ‘could’, ‘probability’, ‘risk’, ‘Value-at-Risk (VaR)’, ‘target’, ‘goal’, ‘objective’, ‘may, ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: the winding-down of the RBSH Group’s operations and the transfer and sale of a substantial part of its business activities to RBS plc; the RBS Group’s restructuring, including the implementation of the UK ring-fencing regime and the potential impact thereof on the RBSH Group; divestments; capitalisation; portfolios; net interest margin; capital and leverage ratios and requirements; liquidity; risk-weighted assets (RWAs); minimum requirements for eligible liabilities (MREL); return on equity (ROE); profitability; cost:income ratios; loan:deposit ratios; funding and credit risk profile; discretionary coupon and dividend payments; litigation, regulatory and governmental investigations; RBS Group’s and RBSH Group’s future financial performance; the level and extent of future impairments and write-downs; RBS Group’s and RBSH Group’s exposure to credit rating risk and to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk; RBS Group’s and RBSH Group’s exposure to political risks, operational risk and conduct risk. These statements are based on current plans, estimates, targets and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain market risk disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could adversely affect RBSH Group’s results and the accuracy of forward-looking statements in this document include the risk factors and other uncertainties discussed in this document. These include those relating to: the winding-down of the RBSH Group’s operations and transfers or sales of assets to RBS plc; the RBSH Group’s reliance on the RBS Group; operational risks that are inherent in RBSH Group’s business and increased as a result of the implementation by the RBS Group of its strategic programme and the UK ring-fencing regime as well as the winding-down of the RBSH Group’s operations; the potential adverse impact on the RBSH Group resulting from the major ongoing restructuring carried out by the RBS Group through 2019; the potential adverse impact on the RBSH Group resulting from the implementation by the RBS Group of the UK ring-fencing regime; the political risks to which the RBS Group is exposed; the potential negative impact on RBSH Group’s business of actual or perceived global economic and financial market conditions and other global risks; uncertainties regarding RBSH Group’s exposure to any weakening of economies within the EU or emerging economies; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; the impact of unanticipated volatility or adverse movements in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices or equity prices; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in customer and counterparty credit quality as a result of prevailing economic and market conditions; RBSH Group's ability to achieve its capital targets; the achievement of capital and cost reduction targets; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity; the RBSH Group's ability to satisfy stress tests imposed by its regulators; the ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBSG, RBS NV or other entities of the RBS Group and RBSH Group; uncertainties and adverse outcomes relating to legal, regulatory and governmental actions and investigations that RBS Group and RBSH Group are subject to and any resulting material adverse effect on RBSH Group of unfavourable outcomes; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBSH Group operates; RBSH Group's ability to attract and retain qualified personnel; changes in laws, regulations, accounting standards and taxes; the high dependence of RBSH Group's operations on its information technology systems and its increasing exposure to cyber security threats; the reputational and conduct risks inherent in RBSH Group's operations and the RBSH Group's ability to implement and maintain an effective risk management culture; the risk that RBSH Group may suffer losses due to employee misconduct; the reliance on valuation, capital and stress test models which may be inaccurate; changes in accounting rules, policies, assumptions and estimates and changes to the valuation of financial instruments recorded at fair value; potential liabilities resulting from the legal demerger of ABN Amro Bank NV; and the success of RBSH Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, and the RBSH Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

Financial review

Description of business

Introduction

RBS Holdings offers a range of banking products and financial services, principally in Europe and Asia.

In 2007, RFS Holdings, which was jointly owned by RBSG, Fortis (succeeded by the Dutch State in 2008) and Santander (together, the 'Consortium Members') completed the acquisition of RBS Holdings.

RBS Holdings has one direct subsidiary, RBS N.V., a fully operational bank within RBSH Group. RBS N.V. is independently rated and regulated, effective from 4 November 2014 the Dutch Central Bank was replaced as the main regulator by the European Central Bank (ECB) in conjunction with the Dutch Central Bank.

The Group is regulated in the Netherlands by the European Central Bank (ECB) under the Single Supervisory Mechanism (SSM). As part thereof, a Joint Supervisory Team comprising of ECB and De Nederlandsche Bank (DNB) staff has been set up to conduct the day to day prudential supervision oversight. The Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten (AFM) is responsible for the conduct supervision.

The Group's regulatory system in the Netherlands is a comprehensive system based on the provisions of the Financial Supervision Act which came into effect on 1 January 2007 and in combination with applicable European legislation. The Financial Supervision Act has replaced, amongst others, the Act on the Supervision of the Credit System 1992 without affecting the existing supervisory system.

The Financial Supervision Act sets out rules regarding prudential supervision and supervision of conduct.

Prudential supervision focuses on the solidity of financial undertakings and contributes to the stability of the financial sector. Supervision of conduct focuses on orderly and transparent financial market processes, clear relations between market participants and due care in the treatment of clients (including supervision of the securities and investment businesses).

Since 31 December 2010, RBSG's shareholding in RFS Holdings has been 97.72%. RFS Holdings is controlled by RBSG, which is incorporated in the UK and registered at 36 St Andrew Square, Edinburgh, Scotland. RBSG is the ultimate parent company of RBSH Group. The consolidated financial statements of RBSH Group are included in the consolidated financial statements of RBS Group.

***interest is held by Stichting Administratiekantoor Beheer Financiële Instellingen**

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Financial review

The Group had total assets of €16.0 billion and owners' equity of €3.7 billion at 31 December 2015. The Group’s capital ratios were a Total capital ratio of 42.5%, a Tier 1 capital ratio of 30.1% and a Common Equity Tier 1 capital ratio of 21.1% as at 31 December 2015.

The Group total assets have reduced further from €23.6 billion to €16.0 billion in line with the Group's wind down strategy. The Groups main activities are limited to a small number of countries, including the UK, the Netherlands, China, India and Indonesia, and the Group has one significant associate, Saudi Hollandi Bank. Certain assets within RBS N.V. continue to be shared by the Consortium Members.

The Group has submitted a plan, the so-called target end state plan, to its regulators with the ultimate objective that RBS N.V. can relinquish its banking licence in the Netherlands.

RBS N.V. US branches

The RBS N.V. US branches were closed during 2015 as the remaining tail assets have been transferred and applicable regulatory approval has been received.

Competition

The Group faces strong competition in all the markets it serves.

Competition for corporate and institutional customers in the Netherlands and abroad is from Dutch banks and from foreign banks that offer investment and corporate banking services. In addition, the Group’s Corporate and Institutional Banking business faces competition from dedicated investment banks and from

The Group had total assets of €16.0 billion and owners' equity of €3.7 billion at 31 December 2015. The Group’s ca

non-bank institutions via disintermediation in credit and financing products. In European and Asian corporate and institutional banking markets the Group also competes with the large domestic banks active in these markets and with the major international banks.

The RBS N.V. US branches were closed during 2015 as the remaining tailassets have been transferred and applica

Financial review

Summary consolidated income statement			
	2015	2014	2013
	€m	€m	€m
Net interest income	(22)	187	238
Fees and commissions receivable	17	158	119
Fees and commissions payable	(9)	(16)	(49)
Other non-interest income	294	(56)	129
Non-interest income	302	86	199
Total income	280	273	437
Operating expenses	(225)	(319)	(537)
Profit/(loss) before impairment losses	55	(46)	(100)
Impairment losses	(103)	(11)	(42)
Operating loss before tax	(48)	(57)	(142)
Tax credit/(charge)	20	(58)	(12)
Loss from continuing operations	(28)	(115)	(154)
Profit from discontinued operations, net of tax	22	15	19
Loss for the year	(6)	(100)	(135)

The RBS N.V. US branches were closed during 2015 as the remaining tailassets have been transferred and applica

Financial review

2015 compared with 2014

Operating loss before tax was €48 million compared with a loss of €57 million in 2014. This improvement was due to higher income and lower operating expenses partially offset by higher impairment losses.

Total income increased by €7 million to €280 million. This was mainly due to higher non-interest income offset by a decrease in net interest income.

Net interest income decreased to a loss of €22 million compared with income of €187 million in 2014 reflecting a reduction in interest receivable following the repayment of a loan to a fellow subsidiary in December 2014, the sale of a substantial portion of the legacy debt securities portfolio in Treasury and the overall run-down of banking book assets outpacing the reduction in liabilities.

Non-interest income increased by €216 million to €302 million compared with €86 million in 2014. Other operating income increased by €323 million. This included an increase in the fair value of financial instruments designated at fair value through profit and loss of €109 million (2015 - €175 million; 2014 - €66 million), a lower loss on the sale of available-for-sale securities in Treasury of €273 million, (2015 - €49 million; 2014 - €322 million) and higher profits from interests in associates of €38 million, (2015 - €155 million; 2014 - €117 million). This was offset by a decline in other income of €136 million (2015 - €49 loss; 2014 - €87 million) and a decrease in net fees and commissions of €134 million to €8 million compared with €142 million in 2014, reflecting a fee in relation to business transfers in 2014.

Operating expenses decreased by €94 million to €225 million mainly due to reductions in staff costs of €12 million resulting from planned business reduction and non-staff costs of €82 million largely driven by a non-repeat of a litigation settlement in 2014.

Impairment losses increased by €92 million to €103 million driven by a small number of large exposures.

The RBS N.V. US branches were closed during 2015 as the remaining tailassets have been transferred and applica

Tax credit for 2015 was €20 million compared with a tax charge of €58 million in 2014.

2014 compared with 2013

Operating loss before tax was €57 million compared with a loss of €142 million in 2013. This decrease was due to lower operating expenses partially offset by lower income, reflecting the transfers of businesses to RBS plc.

Total income decreased by €164 million to €273 million. This is mainly due to lower non-interest income.

Net interest income decreased by €51 million to €187 million, mainly reflecting business transfers and the continued low interest rate environment.

Non-interest income decreased by €113 million to €86 million compared with €199 million in 2013. This included higher losses on the sale of available-for-sale securities in Treasury partially offset by higher profits from interests in associates and an increase in the value of own credit adjustments.

Operating expenses decreased by €218 million to €319 million mainly due to reductions in both staff and non-staff costs as a result of business transfers to RBS plc.

Impairment losses decreased by €31 million to €11 million driven by a smaller number of individual cases.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review

Analysis of results			
Net interest income			
	2015	2014	2013
	€m	€m	€m
Interest receivable	269	532	768
Interest payable (1)	(291)	(345)	(493)
Net interest income	(22)	187	275
Yields, spreads and margins of the banking business	%	%	%
Gross yield on interest-earning assets of the banking business (2)	2.1	2.1	1.8
Cost of interest-bearing liabilities of the banking business	(3.4)	(1.9)	(1.3)
Interest spread of the banking business (3)	(1.3)	0.2	0.5
Benefit from interest-free funds	1.1	0.5	0.2
Net interest margin of the banking business (4)	(0.2)	0.7	0.7
Gross yield (2)			
- Group	2.1	2.1	1.8
- Domestic	0.6	1.3	1.1
- Foreign	3.0	3.5	3.2
Interest spread (3)			
- Group	(1.3)	0.2	0.5
- Domestic	(3.0)	(0.2)	0.4
- Foreign	0.1	0.4	1.0
Net interest margin (4)			
- Group	(0.2)	0.7	0.7
- Domestic	(3.7)	—	0.5
- Foreign	2.1	2.1	1.0

Notes:

(1) Interest payable was decreased by €37 million in 2013 in respect of adjustments.

(2) Gross yield is the interest rate earned on average interest-earning assets of the banking business.

(3) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

(4) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

(5) The analysis into Domestic and Foreign has been compiled on the basis of location of the office in which the transaction takes place.

Financial review

Consolidated balance sheet at 31 December 2015		
	2015	2014
	€m	€m
Assets		
Cash and balances at central banks	543	1,135
Loans and advances to banks	6,931	7,696
Loans and advances to customers	2,193	3,539
Amounts due from ultimate holding company	138	123
Debt securities and equity shares	2,139	3,243
Settlement balances	71	40
Derivatives	2,221	4,432
Deferred tax	10	34
Interests in associates	1,201	947
Prepayments, accrued income and other assets	534	1,105
Assets of disposal groups	—	1,257
Total assets	15,981	23,551
Liabilities		
Bank deposits	2,976	4,542
Repurchase agreements and stock lending	—	636
Deposits by banks	2,976	5,178
Customer accounts	1,481	2,934
Debt securities in issue	403	1,017
Settlement balances and short positions	36	34
Derivatives	1,861	4,555
Provisions, accruals and other liabilities	1,048	1,122
Deferred tax	58	88
Subordinated liabilities	4,456	5,104
Liabilities of disposal groups	—	46
Total liabilities	12,319	20,078
Total equity	3,662	3,473
Total liabilities and equity	15,981	23,551

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review

Commentary on consolidated balance sheet

2015 compared with 2014

Total assets were €16.0 billion at 31 December 2015, a decrease of €7.6 billion, or 32%, compared with €23.6 billion at 31 December 2014.

Cash and balances at central banks decreased by €0.6 billion or 52% to €0.5 billion at 31 December 2015 reflecting reduced liquidity requirements.

Loans and advances to banks decreased by €0.8 billion, or 10%, to €6.9 billion at 31 December 2015, with the majority of the balance, €5.9 billion, being with fellow subsidiaries.

Loans and advances to customers declined €1.3 billion, or 38%, to €2.2 billion, mainly in China and India reflecting continued repayments and business run-down.

Debt securities and equity shares decreased by €1.1 billion, or 34%, to €2.1 billion at 31 December 2015, mainly reflecting the maturity and sale of available-for-sale securities in Treasury.

Derivative assets decreased by €2.2 billion, or 50%, to €2.2 billion, and derivative liabilities decreased by €2.7 billion, or 59%, to €1.9 billion. €1.3 billion of the assets and €1.5 billion of the liabilities are balances with fellow subsidiaries.

Prepayments, accrued income and other assets decreased by €0.6 billion, 52%, to €0.5 million, mainly reflecting continued business wind-down.

Deposits by banks decreased by €2.2 billion, or 43%, to €3.0 billion, with repurchase agreements and stock lending (repos), down to nil from €0.6 billion in 2014. Bank placings decreased €1.0 mainly due to a reduction in cash collateral reflecting the reduction in third party derivatives. €2.7 billion of the balance is with fellow subsidiaries.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Customer accounts were down €1.5 billion, 50%, to €1.5 billion, mainly in China and India reflecting continued balance sheet reduction.

Debt securities in issue declined €0.6 billion, 60%, to €0.4 billion reflecting decreases in medium-term-notes.

Owners' equity increased by €0.2 billion, 5%, to €3.7 billion.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review ***Capital and risk management***

Risk overview*

Presentation of information

Except as otherwise indicated by an asterisk (*), information in the Capital and risk management section (pages 15 to 71) is within the scope of the independent registered public accounting firm.

Capital and risk management are conducted on an overall basis within RBS Group. Therefore the discussion on Capital and risk management on pages 15 to 71 refer principally to policies and procedures in RBS Group that also apply to RBSH Group and RBS N.V..

Risk governance

Governance structure

Capital and risk management strategies are owned and set by the Managing Board of the Group and are implemented by the executive management. There are a number of committees and executives that support the execution of the business plan and strategy. Two of these committees are dedicated to the Group and report to the Group Managing Board. These are depicted and described in the structure chart and table below. Matters not specifically delegated are reserved for the Managing Board. The members of the Managing Board and Supervisory Board of RBS Holdings and RBS N.V. are the same.

There are also risk functions and committees that cover RBS Group and (parts of) the Group reflecting the integrated manner in which the business is managed within RBS Group. Service Level Agreements are in place between the Group and RBS Group to accommodate this integrated risk management oversight, including escalation procedures to the Group Managing Board as appropriate.

Risk management within the Group focuses on all material risks including credit, market, operational, regulatory and country risk and business activities. Liquidity risk and the day-to-day management of

Tax charge for 2014 was €58 million compared with €12 million in 2013.

liquidity and funding of the book are the responsibility of the Group Treasury.

For a summary of the main risk types faced by the Group and how it manages each of them, refer to page 25.

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Risk overview* continued

RBS Group governance structure

RBS Group is committed to achieving the highest standards of corporate governance in every aspect of its business, including risk management. A key aspect of the Board's responsibility as the main decision-making body is the setting of risk appetite (refer to page 24 for more information on risk appetite) to ensure that the levels of risk RBS Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood. The Board delegates authority for risk management to specific committees.

The risk governance structure and the main purposes of each of the committees is illustrated below:

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Risk overview* continued

The following table shows details of the key the Group Board and Committees and their responsibilities.

Board/Committee	Responsibilities
Supervisory Board Membership: Consists of four members. Two are executives of RBS Group.	The Supervisory Board is responsible for supervising the Group's management, its general affairs, and the business connected with it as well as for advising the Managing Board. The Supervisory Board is responsible for the review of all matters relative to accounting policies, internal control, financial reporting functions, internal audit, external audit, risk assessment, regulatory compliance and the product approval process.
Managing Board Membership: Three members led by the Group Chairman (who in addition performs the role of Chief Risk Officer (CRO)), Chief Administrative Officer (CAO) and the Chief Financial Officer (CFO).	The Managing Board reports to the Supervisory Board. It is the principal decision-making forum for the Group, setting policy framework, operating structure and yearly plan (including objectives and budgets). All members of the Managing Board have responsibility for the Group. As well as their overall corporate responsibilities, the members of the Managing Board manage one or more units, for which they have primary responsibility.
RBSH Group. Risk and Control Committee (RCC) Membership: Chaired by the Group CRO and the Chairman of the Managing Board. Members include the Senior Group Risk Manager, a Group delegate of RBS Group Credit Risk and Market Risk, the Group Head of Conduct & Regulatory Affairs, the Chief Risk Officer, Asia, and the RBS N.V. Head of Regulatory Reporting.	The responsibilities of the RCC include: • Advising the Managing Board on the risk appetite of the Group, and receiving direction from the Managing Board on the risk appetite; • Providing input to the Group risk-appetite-setting process in the context of the Group's overall risk appetite; • Overseeing the risk framework within the Group and reporting directly to the Managing Board on the performance of the framework and on issues arising from it; and

Tax charge for 2014 was €58 million compared with €12 million in 2013.

- Monitoring the actual risk profile of the Group ensuring that this remains within the boundaries of the agreed risk appetite or else escalating excesses to the Managing Board. Prior to escalation, the RCC can ask the appropriate risk committee in RBS Group or the business that normally monitors and controls the risk item to address any excess.

The remit of the Committee also includes credit, market, operational and regulatory risks within the Group. Changes to the Terms of Reference of the Group RCC must be approved by the Managing Board. To execute its authority the RCC has access to all relevant risk information relating to the Group available within RBS Group including escalations from and to Group or business committees.

RBSH Group Asset and Liability Committee (ALCo)

Membership:

Seven permanent voting members led by RBSH Group's CFO, the Chairman of the Managing Board, the Chief Risk Officer the CAO, the RBSH Group Treasurer, the RBS Group Treasurer and the Global Head of Capital Management.

The mandate of ALCo covers the following specific areas in respect of the Group:

- The overall governance responsibility for the strategic management of the Group balance sheet;
- The review, approval and allocation of balance sheet, capital, liquidity and funding limits;
- The liquidity, funding, foreign exchange and interest rate exposures of the Group's balance sheet;
- The balance sheet structure and risk-weighted assets position of the Group;
- Decisions on capital repatriation and loss coverage;
- Compliance with all regulatory requirements at all times;
- The implementation and maintenance of transfer pricing policies (although setting the liquidity spread curve remains the responsibility of the RBS Group ALCo;
- The approval and implementation within the Group of RBS Group Treasury policies and procedures; and
- The Group ALCo is responsible for oversight of retained business (shared assets) and the residual ABN AMRO business.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Risk overview* continued

Three lines of defence

The three lines of defence model is used industry-wide for the management of risk. It provides a clear set of principles by which to implement a cohesive operating model, one that provides a framework for the articulation of accountabilities and responsibilities for managing risk across the organisation.

First line of defence - Management and supervision

The first line of defence includes RBS Group's customer franchises, Technology and Operations and support functions such as HR, Communications and Financial MI. Responsibilities include:

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

Second line of defence - Oversight and control

The second line of defence includes RBS Group's Risk Management and Conduct & Regulatory Affairs functions, (see below for further information), Legal, and the financial control aspects of Finance. Responsibilities include:

- Working with the businesses and functions to develop the risk and control policies, limits and tools for the business to use to discharge its responsibilities.
- Overseeing and challenging the management of risks and controls.

- Leading the articulation, design and development of RBS Group's risk culture and appetite.

- Analysing the aggregate risk profile and ensuring that risks are being managed to the desired level (risk appetite).

- Providing expert advice to the business on risk management. Providing senior executives with relevant management information and reports and escalating concerns where appropriate.

- Undertaking risk assurance (see below for more information).

Third line of defence - Internal Audit

Responsibilities include:

- Designing and delivering a risk-based audit plan to provide assurance on material risks and report on whether RBS Group is managing its material risks effectively.

- Monitoring, evaluating and reporting on the remediation of material risks across RBS Group.

- Engaging with management and participating in key governance fora to provide perspectives, insights and challenge so as to influence the building of a sustainable bank.

- Advising the RBSH Group Supervisory Board, the RBS Group Audit Committee and executive management with respect to RBSH Group’s material risks and their associated controls.

- Reporting any matters which warrant escalation to the RBS Group Board, the RBS Group Board Risk Committee, the RBS Group Audit Committee and the RBS Group Executive Committee as appropriate.

- Providing independent assurance to the key jurisdictional regulators on both specific risks and control themes.

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Financial review *Capital and risk management*

Risk overview* continued

Risk management structure

RBS Group’s management structure and the main elements of each role are illustrated below.

Notes:

(1) RBS Group Risk Management

The RBS Group Chief Risk Officer (CRO) leads RBS Group Risk Management. The CRO reports directly to the RBS Group Chief Executive and has an indirect reporting line to the Chairman of the Board Risk

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Committee and a right of access to the committee's chairman.

RBS Group Risk Management is a function independent of the franchises, structured by risk discipline to facilitate the effective management of risk.

In 2015, Risk Management, which had previously been spread across the different businesses, re-organised itself into six functional areas: Credit Risk; Enterprise-Wide Risk; Risk Infrastructure; Operational Risk, Support Functions and Divested Businesses; Risk Assurance; and Market Risk. Directors of Risk were also appointed for each of the franchises and for Services. The streamlined structure consolidates risk information, allowing for more efficient decision-making.

The directors of risk functions are responsible for RBS Group-wide risk appetite and standards within their respective disciplines and report to the CRO.

CROs are in place for certain jurisdictions and legal entities to meet local regulatory and governance requirements. They lead the risk management teams locally in support of functional risk heads where teams follow a functional operating model. The key CRO roles report directly to the RBS Group CRO.

Risk committees in the customer businesses and key functional risk committees oversee risk exposures arising from management and business activities and focus on ensuring that they are adequately monitored and controlled.

(2) Conduct & Regulatory Affairs

Conduct & Regulatory Affairs (C&RA) is led by the Chief Conduct & Regulatory Affairs Officer, who reports directly to the Chief Executive and has an indirect reporting line to the Board Risk Committee and a right of access to the committee's chairman. It is responsible for providing oversight of conduct risk and regulatory risk at RBS Group, and does so by setting RBS-wide policy and standards, providing advice to each customer business, and ensuring that the mitigating controls are suitable. C&RA also provides leadership of RBS Group's relationships with its regulators.

The functional heads (the Directors of Financial Crime, Advisory, Remediation, Compliance Services and Regulatory Affairs), report to the Chief Conduct & Regulatory Affairs Officer. Each is responsible, where appropriate, for the RBS Group-wide risk appetite and standards of their respective areas.

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Risk overview* continued

Risk assurance

Risk assurance is a second line of defence function in which most of RBS Group’s risk assurance activities are centralised. These primarily comprise credit risk and market risk quality assurance, controls assurance and Model Risk Management, each of which is described below.

Credit risk and market risk quality assurance: These teams provide assurance to both internal and external stakeholders including the Board, senior management, risk functions, franchises, Internal Audit and the regulators.

Credit risk and market risk quality assurance undertake reviews which assess various aspects of risk as appropriate: including: the quality of risk portfolios; the completeness, suitability, accuracy and timeliness of risk measurements; the quality of risk management practices; policy compliance; and adherence to risk appetite. This includes monitoring RBS Group’s credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

RBS Group’s Risk Assurance Committee (RAC) provides governance to ensure a consistent and fair approach to all aspects of the review activities of credit and market risk assurance. Additionally, RAC monitors and validates the ongoing programme of reviews and tracks the remediation of review actions. The credit and market risk assurance teams also attend relevant committees run by the customer franchises and other risk functions to ensure strong communication channels are maintained.

Controls assurance: This team tests the adequacy and effectiveness of key controls relating to credit and market risk, including those within the scope of Section 404 of the US Sarbanes-Oxley Act of 2002.

Model risk management

Model governance

Model governance follows a three lines of defence approach, with model developers having primary accountability and Model Risk Management (MRM) acting in a second-line-of-defence capacity.

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MRM is responsible for setting policy, providing governance and insight for all of RBS Group's statistical, economic, financial or mathematical models and performing independent model validation where necessary.

MRM will be responsible for defining and monitoring model risk appetite in conjunction with model developers, monitoring the model risk profile and reporting on the model population and escalating issues to senior management.

The general approach to MRM's independent model validation for risk and pricing models is detailed below. For more specific information relating to market risk models and pricing models, refer to page 68.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Risk overview* continued

Models used within Risk

RBS Group uses a variety of models as part of its risk management process and activities. Key examples include the use of model outputs to support risk assessments in the credit approval process, ongoing credit risk management, monitoring and reporting, as well as the calculation of risk-weighted assets.

For more information on the use of models in the management of particular types of risk, notably credit and market risk, refer to the relevant section.

Independent model validation

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

Based on the review and findings from MRM, the RBS Group model or risk committees with appropriate delegated authority consider whether a model can be approved for use and whether any conditions need to be imposed, including those relating to the remediation of material issues raised through the review process. Once approved through internal governance, the new or amended model is implemented. Models used for regulatory reporting may additionally require regulatory approval before implementation.

MRM reassesses the appropriateness of approved risk models on a periodic basis according to the approved Periodic Review Policy.

MRM also monitors the performance of RBS Group’s portfolio of models.

Risk culture and appetite

Risk culture

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RBS Group seeks to create a strong risk culture that becomes part of the way people work and think. Such a culture should be supported by robust practices on risk identification, measurement and management, and on associated controls and governance. Risk competencies, mindsets and behaviours needed to support RBS Group's risk culture should be embedded across the organisation and made integral to performance reviews.

RBS Group's target risk culture is clearly aligned to its core values of "serving customers", "working together", "doing the right thing" and "thinking long term". They act as a clear starting point for a strong and effective risk culture.

Aligned to these values is the Code of Conduct. The Code provides guidance on expected behaviour and sets out the standards of conduct that support the values. It explains the effect of decisions that are taken and describes the principles that must be followed.

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Risk overview* continued

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

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

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

Each question is a prompt to think about the situation and how it fits with RBS Group's values. It ensures that employees can think through decisions that do not have a clear answer, guiding the judgements behind their decisions and actions.

If conduct falls short of RBS Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned.

RBS Group's policies require that risk behaviour assessment is incorporated into performance assessment and compensation processes for enhanced governance staff.

Risk-based key performance indicators

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RBS Group-wide remuneration policy requires remuneration to be aligned with, and to support, effective risk management. The policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the UK Remuneration Code. For further information refer to page 65 of the RBS Group Annual Report.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Risk overview* continued

Training

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

RBS Group offers a wide range of risk learning across the risk disciplines: Market Risk; Credit Risk; Operational Risk; Enterprise Risk; and Conduct and Regulatory Risk. This training can be mandatory, role specific or for personal development and includes technical and behavioural content.

There is mandatory learning that has to be completed by everyone and is focused on keeping employees, customers and the bank safe. This learning is accessed via the online learning system and is dependent on their role and business area. This makes it easy for employees to access and complete and allows monitoring at all levels to ensure completion.

Risk appetite

Risk appetite is the way in which RBS Group expresses the level of risk it is willing to accept in order to achieve its strategic, business and financial objectives.

It is key to ensuring overall safety and soundness and in embedding a strong risk culture throughout RBS Group.

Strategic risk appetite

RBS Group's risk appetite framework is designed to ensure RBS Group remains safe and sound and serves customers and wider stakeholders.

The RBS Group Board has set out four key strategic risk appetite objectives, aligned with the strategic plan, which provide the boundaries within which the risk appetite for all material risks is set. The strategic risk appetite objectives are:

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- Maintain capital adequacy.
- Deliver stable earnings growth.
- Designed to ensure stable and efficient access to funding and liquidity.
- Maintain stakeholder confidence.

Risk appetite measures

Risk appetite starts with the strategic goals set by the RBS Group Board and is set in a manner that:

- Is aligned to business and financial goals. The risk appetite framework ensures that risk is managed in a manner that aligns to and supports the attainment of business and financial objectives.
- Is meaningful, and where possible risk appetite is expressed quantitatively. Risk control frameworks and limits set detailed tolerances and limits for managing risk (such as credit risk and market risk) on a day-to-day basis. These limits support, and are required to be consistent with, the strategic risk appetite.
- Considers performance under stress. The establishment and monitoring of risk appetite considers potential risk exposures and vulnerabilities under plausible stress conditions

Effective processes exist for frequent reporting of RBS Group's risks against agreed risk appetite to the Board and senior management.

Risk appetite statements

Risk appetite statements provide clarity on the scale and type of activities permitted.

The Group has developed a framework that sets and implements an appropriate risk appetite supported by a regular monitoring and review process. A risk appetite statement setting out overall risk limits for different risk types is approved by the Supervisory Board. Risk appetite limits and risk exposures are reported regularly to the Risk & Control Committee, the Managing Board and the Supervisory Board. Any limit breach is reported to the Managing Board. The Managing Board may grant a temporary waiver or require the position to be adjusted to comply with the risk limit.

Risk control frameworks and limits

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

The RBS Group Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in RBS Group's risk control and governance. Its integrated approach is designed to ensure that appropriate controls, aligned to risk appetite, are set for each of the material risks it faces, with an effective assurance process put in place to monitor and report on performance. Risk appetite has its own policy within the RBS Group Policy Framework. This policy sets out clear roles and responsibilities to set, measure, cascade and report performance against risk appetite, and provides assurances that business is being conducted within approved risk limits and tolerances.

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Financial review *Capital and risk management*

Risk overview* continued

Risk coverage

The main risk types faced by the Group are presented below.

Risk type	How the risk arises	2015 overview
Capital adequacy risk	Capital adequacy risk arises from inefficient management of capital resources.	The Group's Common Equity Tier 1 ratio on a CRR transitional basis was 21.1%. The Group plans for and maintains an adequate amount and mix of capital consistent with its risk profile. The amount of capital required is determined through risk assessment and stress testing.
Liquidity and funding risk	Liquidity and funding risk arise through the maturity transformation role that the Group performs and arises from day-to-day operations.	As it is one of the operating entities of the RBS Group, the Group's liquidity risk is monitored and managed centrally by RBS Group in line with policies and processes set by the Group's Managing Board.
Business risk	Business risk arises from exposure to, and the ability to assess the impact of, changes in the macro-environment, competition, business operations and technology.	The Group reduced its business risk profile further as it made disposals and sold almost its entire liquidity portfolio.
Reputational risk	Reputational risk can arise from the conduct of employees; activities of customers and the countries in which they operate; provision of products and transactions; as well as operations and infrastructure.	The most material threat to the Group's reputation continued to originate from historical misconduct. The Group has been the subject of investigations and review in relation to legacy rate setting concerns involving former employees, some of which resulted in dismissals.
Conduct and regulatory risk	Conduct risk arises if customers are not treated in line with their and other stakeholders' expectations. Conduct risk also arises if the Group does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the Group's regulatory, business or operating environments and the Group's response to	RBS Group continued to remediate historical conduct issues, while also restructuring its customer-facing businesses and support functions around the needs of its customers. In the Group, rate setting was also the primary focus. Although the impact of conduct risk was less material than before, it remained a

Tax charge for 2014 was €58 million compared with €12 million in 2013.

	them.	high priority in 2015 due to its importance to RBS Group’s values. A new Conduct Risk Appetite Framework was also established.
Operational risk	Operational risk arises from a failure to manage operations, transactions and assets appropriately. It may arise from human error, an inability to deliver change on time or adequately, or the unavailability of technology services or the loss of customer data. Fraud and theft are sources of operational risk, as is the impact of natural and man-made disasters. It may also arise from a failure to take appropriate measures to protect assets or take account of changes in law.	The functional operating model for operational risk was embedded, with the aim of ensuring it is managed consistently across RBS Group. The threat to the security of RBS Group’s information from cyber attacks continued to be closely monitored. Further actions were taken to mitigate the risk such as improved user access controls and enhanced protection against malware. Operational Risk continued to oversee the execution of major projects, including the larger restructuring and divestments.
Credit risk	Credit risk arises from lending and AFS debt securities. Counterparty credit risk results from derivatives and securities financing transaction activities.	The Group managed credit risk based on a suite of credit approval and risk concentration frameworks and associated risk management systems and tools. Credit risk RWAs were €15.0 billion at 31 December 2015.
Market risk	The majority of the Group’s traded market risk exposure arises through transactions in financial instruments including debt securities, loans, deposits and equities, as well as securities financing and derivatives. The majority of its non-traded market risk exposure arises from assets and liabilities that are not classified as held for trading.	Market risk RWAs were reported at around €0.9 billion at 31 December 2015.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review ***Capital and risk management***

Capital management*

Definition

Capital management lies at the core of RBS Group's strength and sustainability goals. RBS Group defines capital as that part of the liability side of its balance sheet that has the capacity to absorb losses. The construction of capital starts with Common Equity Tier 1 (CET1) and other classes of capital such as Additional Tier 1 (AT1) and Tier 2. RBS Group will build up sufficient minimum requirements for eligible liabilities (MREL) over the coming years in line with regulatory requirements. Capital management involves the optimisation and efficient use of capital required by the Group's businesses, the outcomes of stress testing, the requirements of the market and the regulators and the supply of adequate forms of capital at acceptable prices.

All the disclosures in this section are unaudited.

2015 overview

The Group's Tier 1 capital ratio of 30.1% is higher than 2014 year end ratio of 24.5%, primarily reflecting further portfolio disposals and rundown of the Group's business during 2015. The amount of AT1 capital has declined when compared with the prior year, as a result of reduced eligibility of hybrid securities under the grandfathering rules of the CRR. The disallowed AT1 is added to the eligible Tier 2 capital that is also subject to its own grandfathering limits. Within the portfolio, there is an amount of €162 million that is lent to RBS Group as Tier 2. This is in addition to a part of the expected loss shortfall, being treated as a full Tier 2 capital deduction under the Capital Requirements Directive IV (CRD IV) rules.

Regulatory framework

Capital requirements regulation and directive

The European Union has implemented the Basel III proposals and a number of important changes to the banking regulatory framework through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) collectively known as the CRD IV package. The CRD IV package was implemented on 1 January 2014 with full implementation to be completed on 1 January 2019. As part of the implementation of the CRD IV package, the European Banking Authority's technical standards, which are legal acts specifying particular aspects of the CRD IV package, are either in progress to be finalised through adoption by the European Commission or now adopted.

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The CRD IV package continues to require a total amount of capital equal to at least 8% of risk-weighted assets but the share that has to be of the highest quality, that is CET1 capital, of at least 4.5%. The CRD IV package also introduces more stringent criteria for capital instruments, harmonised adjustments made to capital recognised for regulatory purposes and establishes new capital buffers to be phased in from 1 January 2014. Once fully implemented on 1 January 2019 the following minimum requirements must be met:

- Pillar 1 requirement of: CET1 of 4.5% of RWAs; Tier 1 of 6%; and total capital of 8%.

- Capital buffers: 'capital conservation buffer' of 2.5% of RWAs; 'countercyclical capital buffer' of up to 2.5%; an 'other systemically important institutions buffer' for domestically or EU important institutions and if required by a member state an additional 'systemic risk buffer'.

- Minimum Tier 1 leverage ratio of 3%.

The Group is managing the changes to capital requirements from new regulation (including model changes) and the resulting impact on the Common Equity Tier 1 ratio alongside its strategy of risk reduction and deleveraging. This is principally being achieved through the transfers/sales of countries and businesses to RBS plc and other interested parties, the continued run-off and disposal of assets and deleveraging in the Group's businesses.

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

Banking Union: Single Supervisory Mechanism

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

The European Central Bank has to ensure that credit institutions not only meet the minimum prudential capital requirements set by the CRR/CRD IV but also have an additional buffer reflecting their individual intrinsic risk profile. This is organised through the SSM. The SSM has to ensure that credit institutions have sufficient capital to cover unexpected losses or survive severe stressed economic and market conditions. The joint capital decision is the key outcome of the Supervisory Review and Evaluation Process. In this process, the supervisor reviews the governance and internal control arrangements used by each individual bank to manage its risks (i.e. the Internal Capital Adequacy Assessment Process).

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

Starting late in 2013 and prior to the adoption of the SSM on 4 November 2014 a comprehensive assessment of significant banks in the euro area (including the Group) was conducted by the ECB. The Group successfully passed the comprehensive assessment which was a rigorous “financial health check” that included a comprehensive risk assessment, a detailed asset quality review and a stress test. The results of the comprehensive assessment were made public by the ECB in October 2014.

*unaudited

Capital management* continued

Governance and approach

The Group Asset and Liability Management Committee (ALCo) is responsible for ensuring the Group maintains adequate capital at all times. The ALCo manages and plans the Group capital levels taking into account current and projected capital levels and provides input to and oversees capital levels agreed in the annual Internal Capital Adequacy Assessment Process (ICAAP).

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

Determining appropriate capital

The Group aims to maintain an appropriate level of capital to meet its business needs (which include requirements of its parent company RBS Group) and its regulatory requirements and to operate within an agreed risk appetite. Determination of appropriate capital levels involves regular ALCo capital monitoring and planning, budgeting cycle forecasts, and an annual ICAAP. Capital plans are subjected to governance reviews, Managing Board oversight and approval and the review by the appropriate supervisory authority.

Through the annual ICAAP process, the Group makes a determination of its desired capital levels based on maintaining a target external credit rating and risk appetite within both current and emerging regulatory requirements. Desired capital levels are evaluated through the application of both internally and externally defined stress tests that quantify changes in capital ratios under a range of scenarios. The stress tests are also used to identify management and recovery actions that the Group would expect to implement should such eventualities arise. These stress assessments are a key part of capital management and contingency planning and therefore complement agreed capital buffers.

Monitoring and maintenance

The Group operates a rigorous capital planning process via ALCo aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital position of the Group. In the event that the projected position deteriorates beyond acceptable levels, the Group would

Tax charge for 2014 was €58 million compared with €12 million in 2013.

revise business plans accordingly. The Group is managing the changes to capital requirements from new regulation and model changes and the resulting impact on the Common Equity Tier 1 ratio, focusing on risk reduction and deleveraging. This is principally being achieved through the transfers to RBS plc, the continued run-off and disposal of assets and deleveraging in the Group as it focuses on the most productive returns on capital.

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

Capital allocation

Capital resources are allocated to the Group's businesses based on both key performance parameters agreed by the RBS Group Board in an annual strategic planning process and the requirements of strategic asset transfer programmes and capital allocation requirements determined in consultation with RBS Group.

The Group has regard to the supervisory requirements of De Nederlandsche Bank (DNB) and the ECB under the SSM. The DNB/ECB uses the capital ratio as a measure of capital adequacy in the Netherlands and Eurozone banking sector, comparing a bank's capital resources with its RWAs (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks).

*unaudited

Financial review *Capital and risk management*

Capital management* continued

Capital ratios and risk-weighted assets

The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements. The Group's capital ratios and RWAs are set out below.

	2015	2014
	CRR	CRR
	transitional basis	transitional basis
Capital ratios	%	%
Common Equity Tier 1	21.1	16.2
Tier 1	30.1	24.5
Total	42.5	33.9
Risk-weighted assets	€m	€m
Credit risk	15,033	18,179
Market risk	897	1,182
Operational risk	463	732
Settlement risk	—	28
	16,393	20,121

With effect from 1 January 2014 the Group is regulated under the CRD IV package of Basel III. Since 2014 the Credit Valuation Adjustment RWA charge was part of credit risk. As from December 2015 this was captured within the market risk line in the above table, the amount is €139 million. The corresponding amount for 2014 was €298 million.

The Group has used the basic indicator approach since 2013 to calculate the operational risk capital charge. Within risk-weighted assets €9,350 million is included as a consequence of the proportional consolidation of the 40% interest in Saudi Hollandi Bank. This amount is made up of €9,324 million in credit risk and €26 million in market risk.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

*unaudited

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review *Capital and risk management*

Capital Management* continued		
Capital resources and flow statement		
The Group's regulatory capital resources were as follows:		
	2015	2014
	CRR	CRR
	transitional basis	transitional basis
	€m	€m
Tier 1		
Controlling interests	3,662	3,473
Adjustment for:		
- Goodwill and other intangible assets	(3)	(44)
- Unrealised losses on available-for-sale debt securities	9	54
- Unrealised gains on available-for-sale equities	(7)	(7)
- Other regulatory adjustments	(195)	(225)
Common Equity Tier 1	3,466	3,251
Trust preferred securities	3,006	2,686
Disallowed Tier 1 Capital	(1,538)	(1,008)
Total Tier 1 capital	4,934	4,929
Tier 2		
Subordinated debt	891	1,043
Disallowed Tier 1 Capital	1,538	1,008
Disqualified Tier 2 Capital	(237)	—
Deductions from Tier 2 capital	(166)	(153)
Total Tier 2 capital	2,026	1,898
Total regulatory capital	6,960	6,827

The table below analyses the movement in Common Equity Tier 1 capital during the year.	
	€m
At 1 January 2015	3,251
Regulatory adjustment: fair value changes in own credit spreads	29
Foreign currency reserves	87
Loss of non-controlling interest and reduction in goodwill	41

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Attributable loss	(6)
Other	64
At 31 December 2015	3,466
*unaudited	

Liquidity and funding risk

Definition

Liquidity risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as and when they fall due.

As one of the operating entities of the RBS Group, the Group's liquidity risk is monitored and managed centrally by the RBS Group in line with the policies and processes set by the Group's Managing Board.

Policy, framework and governance

Internal liquidity policies are designed to ensure that the Group:

- Has a clearly stated liquidity risk tolerance: Appetite for liquidity risk is set by the Board as a percentage of the Individual Liquidity Adequacy Assessment (ILAA) stressed outflows, and the Group monitors its liquidity position against this risk tolerance on a daily basis. In setting risk limits the Board considers the nature of the Group's activities, overall risk appetite, market best practice and regulatory compliance.

- Has in place strategies, polices and practices to ensure that the Group maintains sufficient liquidity: The risk management framework determines the sources of liquidity risk and the steps that can be taken when these risks exceed certain actively monitored limits. These actions include when and how to use the liquid asset portfolio, and what other adjustments to the balance sheet should be undertaken to manage these risks within the bank's risk appetite.

- Incorporates liquidity costs, benefits and risks in product pricing and performance management: The Group uses internal funds transfer pricing to ensure that these costs are reflected in the measurement of business performance, and to correctly incentivise businesses to source the most appropriate mix of funding.

The Asset and Liability Management Committee (ALCo) sets and reviews the liquidity risk management framework and limits within the risk appetite set by the Managing Board. ALCo oversees the implementation of liquidity management across the Group.

In setting risk limits the Group Board takes into account the nature of the Group’s various activities, the Group’s overall risk appetite and regulatory compliance.

Liquidity and funding risk continued

Regulatory oversight*

With effect from November 2014, the Group is subject to the European Central Bank's (ECB), supervisory regime for liquidity and each member of the Group also complies with their local regulatory framework for the assessment and management of liquidity risk as well as meeting internal standards.

Measurement and monitoring

In implementing the Group's liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. The limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

Monitoring, reporting and internal limits are under regular review, given the need to appropriately represent and control the business through its considerable changes over time.

The Group maintains a Contingency Funding Plan (CFP), which forms the basis of analysis and management actions to be undertaken in a liquidity stress. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. The CFP sets out the circumstances under which the plan would be invoked; this includes material worsening of early warning indicators. It also prescribes a communications plan, roles and responsibilities, as well as potential management actions to take in response to various levels of liquidity stress. The Group's CFP is fully integrated with the CFP of RBS Group.

Liquidity reserves

The Group's liquidity portfolio is managed centrally by RBS Group's Treasury. In addition, local liquidity reserves are the responsibility of local Treasurers who report to the Group Treasurer functionally.

Within the liquidity portfolio the Group holds cash at central banks €0.2 billion (2014 - €0.8 billion) and government securities of €3.3 billion (2014 - €1.8 billion).

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Funding markets

As part of the reduction in the Group’s balance sheet, funding is now concentrated with RBS Group, which has access to a broad funding base, thereby providing funding to meet the Group’s requirements.

Funding sources

The table below shows the Group's primary funding sources excluding repurchase agreements.

	2015			2014	
	€m	%		€m	%
Deposits by banks	2,976	32.0		4,542	33.4
Debt securities in issue - medium term notes and other bonds (including securitisations)	403	4.3		1,017	7.5
Subordinated liabilities	4,456	47.8		5,104	37.5
Wholesale funding	7,835	84.1		10,663	78.4
Customer deposits	1,481	15.9		2,933	21.6
Total funding	9,316	100		13,596	100

Tax charge for 2014 was €58 million compared with €12 million in 2013.

*unaudited

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Business risk*

Definition

Business risk is the risk that the Group suffers losses as a result of adverse variances in its revenues, costs or both as a result of its business plan and strategy.

Sources of risk

Business risk exists at all levels of the organisation and is generated at the transaction level. It is affected by other risks the Group faces, which could contribute to any adverse changes in revenues or costs.

Governance

The Managing Board has ultimate responsibility for business risk.

Risk management, measurement and mitigation

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

Reputational risk*

Definition

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

Sources of risk

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Reputational risk can arise from the conduct of either the Group. as a whole or that of the individuals it employs; from the activities of customers and the countries in which they operate; from the products the Group offers and the transactions it supports; and from its operations and infrastructure.

Governance

Managing reputational risk is taken very seriously, with RBS Group Board-level oversight reinforced by a Reputational Risk Policy, and by governance frameworks across business franchises. Reputational risk management at the Group relies on the reputational risk governance, appetite and risk mitigation of RBS Group and is entirely embedded into the RBS Group reputational risk management programme.

The RBS Group Board and the Executive Committee have the ultimate responsibility for managing RBS Group’s reputation although all staff have some responsibility. The RBS Group Board has set RBS Group’s Purpose, Vision and Values, which outline the objective, which is “to be trusted, respected and valued by our customers, shareholders and communities”. Refer to the Risk governance section on page 16.

The Sustainable Banking Committee is responsible for overseeing and challenging how management is addressing sustainable banking and reputation issues including risk appetite for environmental, social and ethical (ESE) issues.

The RBS Group Board’s oversight of reputational issues is supported by the senior RBS Group-wide Reputational Risk Forum (RRF) which opines on cases that represent a material reputational risk to the whole organisation. The RRF, which has delegated authority from the Executive Risk Forum, also acts as a central forum to review thematic issues and risk appetite positions.

Risk appetite

The Reputational and ESE Risk management team assists business franchises, as well as other control functions, to articulate risk appetite to manage reputational risk. Risk appetite positions for certain issues or markets, for example tax or money remitters, are developed through conducting research on legislation, regulation and potential reputational risk factors, undertaking peer analysis and engaging with internal and external stakeholders to discuss the issues. The risk appetite positions classify risks associated with a particular area into Normal, Sensitive and Prohibited. Customers or transactions designated Sensitive require enhanced due diligence and escalation to a reputational risk forum or individual while those rated Normal can be approved by the business without additional escalation. The team also helps set risk appetite to manage reputational risk related to business engagements and customer relationships in some sensitive industry sectors, such as mining and defence, through the ESE policy framework.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

A Reputational Risk Policy has also been developed to help employees, businesses and functions effectively identify, assess and manage issues that potentially represent a reputational risk. In addition, other policies, such as those related to conduct, address key sources of reputational risk. These policies are implemented in accordance with the Policy Framework through business and functional policy standard owners. The effectiveness of these policies within each franchise is reported on through the Control Environment Certification process (Refer to the Operational risk section on page 35). Reputational aspects also form a core part of the RBS Group conduct risk framework, with a series of enhanced policies developed in line with conduct risk appetite.

*unaudited

Reputational risk* continued

Risk monitoring and measurement

Emerging reputational issues are identified by the business and relevant teams, including RBS Group Sustainability and Enterprise Wide Risk, which assess new and emerging business, sector and country risks for RBS Group. The Risk Management Monthly Report, provided to the Executive Committee and BRC, may also discuss reputational risks facing RBS Group, and the annual Sustainability Report covers progress on sustainability principles.

ESE ratings of customers and transactions are captured and analysed centrally by the Reputational and ESE Risk Team.

Risk mitigation

Reputational risk is mitigated through governance frameworks and training of staff to ensure early identification, assessment and escalation of customers, transactions or products with potential reputational risk, if appropriate. This includes creating appropriate fora, for example reputational risk committees or individual reputational risk approvers.

Also important is the setting of clear reputational risk appetite criteria, ensuring higher risk cases are escalated for senior level approval. Effective communication channels and incident response planning also ensure that cases that result in reputational impact are appropriately managed, for example by declining or exiting business or by ensuring incident management plans are implemented to manage the impact of negative media coverage.

Conduct and regulatory risk*

Definition

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

All the disclosures in this section are unaudited.

Sources of risk

Conduct and regulatory risk exists across all stages of the Group's relationships with its customers, from the development of its business strategies, through governance arrangements, to post-sales processes. Activities through which conduct risk may arise are diverse and include product design, marketing and sales, complaint handling, staff training, and handling of confidential and non-public price sensitive information. Conduct risk also exists if the Group does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the regulatory, business or operating environment and from the Group's response to it.

Governance

Conduct & Regulatory Affairs (C&RA) is responsible for defining appropriate standards of conduct, and for driving adherence to them, for designing the framework for managing conduct and regulatory risk, and for overseeing remediation activity. It also provides appropriate controls, challenge and oversight to ensure good customer outcomes. In so doing, C&RA acts as a second line of defence control function.

Key elements of the governance structure are set out below:

- The C&RA Executive Committee considers emerging issues material to C&RA's strategy, and implements Board and Executive Committee risk management policy decisions;

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

- The Mandatory Change Advisory Committee (MCAC), reports to the Bank-Wide Investment Committee, and comprises representatives of the customer businesses and functions. The MCAC acts as the 'reception committee' for reviewing externally mandated changes that may affect RBS Group and recommending appropriate responses, including the timely mobilisation of change implementation activities. In doing so, it agrees business or function owners of individual risks; and commissions and reviews impact assessments from customer businesses and functions.

*unaudited

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Conduct and regulatory risk* continued

Controls and assurance

The RBS Group Policy Framework is designed to provide both high-level direction and RBS Group-wide requirements. The policies are designed to ensure RBS Group meets its regulatory obligations, and to provide the necessary clarity for staff on their conduct obligations.

C&RA's Regulatory Affairs department separately oversees the regulatory changes, interactions with regulators and regulatory approvals for individuals.

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

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

Scenario analysis is used to assess the impacts of extreme but plausible conduct risks including financial crime. The scenarios assess the exposures that could significantly affect RBS Group's financial performance or reputation and are an important

Risk appetite

Work to refine and embed the risk appetite framework and associated control processes continued in 2015. The risk appetite statements set the minimum standards.

Risk monitoring and measurement

C&RA works closely with the customer-facing businesses to assess business models, strategy and products and influence better outcomes for customers.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

The Group's senior boards and committees receive updates on conduct risk exposures and action plans through monthly C&RA-initiated reporting. The reporting is focused on the particular risks of RBSH Group and to ensure that the risks remain within RBS Group's risk appetite.

C&RA provides appropriate reporting of all material regulatory reviews and other regulatory developments relevant to the Group to the appropriate Group committees.

The RBS Group Anti Money Laundering Officer submits his annual Report to the Board and the FCA. Covering the operation and effectiveness of the systems and controls in place to comply with Anti-Money Laundering (AML) law and regulation, it also describes RBS Group's AML framework. In addition, it covers the systems and controls in place to prevent the financing of terrorism and to ensure compliance with sanctions as well as embargoes and export controls imposed by the UN, governments and other supranational bodies.

The RBS Group Audit Committee is provided with an annual Whistleblowing Update Report. It details cases by internal reporting categories based on the Public Interest Disclosure Act (1998); identifies underlying causal and subject trends; and highlights the outcome of investigations and actions taken.

C&RA is working with each business to enhance the management information linked to their risk appetite statements. This is required to ensure appropriate customer outcomes are delivered, and that the management information is compliant with the Basel Committee on Banking Supervision principles for effective risk data aggregation and risk reporting.

Risk mitigation

C&RA communicates information on regulatory developments, and follow-ups with regulators, to customer-facing businesses and functions, helping them identify and execute any required mitigating changes to strategy or business models.

Early identification and effective management of changes in legislation and regulation, are critical to the successful mitigation of conduct and regulatory risk. All regulatory and compliance changes are managed to ensure timely compliance readiness. Those changes assessed as having a 'High' or 'Medium-High' impact are managed especially closely, with the aim of mitigating the impact through, for instance, changes to strategy or business activities, or external engagement.

*unaudited

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Operational risk*

Definition

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

Operational risks may have a direct customer or reputational impact (for example, a major IT systems failure or fraudulent activity) or both. Operational risk failures may also have a link with conduct risk.

Sources of risk

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

Cyber risk

Cyber attacks are increasing in frequency and severity across the industry and their threat to the security of RBS Group’s information from continues to be closely monitored. During 2015 RBS Group participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a large-scale programme to improve user access controls is in progress, along with a number of other actions, including a reduction in the number of external websites, enhancement of protection against malware, and the implementation of a staff education programme on information protection.

Governance

A strong operational risk management function is vital to support profitability. Better management of operational risk directly supports the strategic objective of improving stakeholder confidence and is vital for stability and reputational integrity.

The operational risk function, an independent second line of defence, plays a leadership role and seeks to achieve a robust operational risk management framework and culture across RBS Group.

The operational risk function is responsible for the design, development, delivery and continuous improvement of the Operational Risk Management Framework. The Operational Risk Policy is incorporated in the RBS Group Policy Framework and provides direction for the consistent identification, assessment, management, monitoring and reporting of operational risk. Through a network of oversight teams, the function undertakes second line of defence oversight and challenge to ensure the integrity of the ORMF, and manages the overall operational risk profile.

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

*unaudited

Operational risk* continued

Controls and assurance

Control Environment Certification (CEC) is used to review and assess the internal control framework.

Risk appetite

The Group's operational risk appetite statement is agreed by the Managing and Supervisory Boards. It comprises a number of specific measures of risk. To confirm that RBS Group operates within the set risk appetite, the high-level statement is supplemented by specific tolerances for different types of operational risk. Operational risk appetite measures and frameworks are reviewed regularly and approved by the Supervisory Board.

The objective of operational risk management is not to remove operational risk altogether, but to manage it to an acceptable level, taking into account the customer journey and the cost of minimising the risk against the resultant reduction in exposure. Strategies to manage operational risk include avoiding undertaking a particular type of activity or operating in a particular market; transferring the risk to a third party; accepting the risk as a cost of doing business; or mitigating the risk by implementing controls.

Risk identification and assessment

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

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

During 2015 an enhanced end-to-end risk assessment

methodology was designed, which is now being implemented

Tax charge for 2014 was €58 million compared with €12 million in 2013.

across RBS Group. This approach enhances the understanding of the risk profile of RBS Group's key products and services, and it will be used to identify and quantify the most material risks. Subject matter experts and key stakeholders are engaged from across RBS Group to support management decision-making in line with RBS Group's financial and non-financial appetite statement.

The New Product Risk Assessment (NPRA) process aims to ensure that the risks represented by new products (and material variations to existing products) are identified and assessed before launch. There is now a requirement to demonstrate that all products provide fair outcomes to customers.

Risk mitigation

Risks are mitigated through the application of key preventative and detective controls as an integral step in risk assessment methodology, to enable a determination of the residual risk. Control owners are accountable for the design, execution, performance and maintenance of key controls.

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

*unaudited

Operational risk* continued

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

Risk monitoring

Monitoring and reporting are part of RBS Group’s operational risk management processes, which aim to ensure that risks and issues are identified, considered by senior executives, and managed effectively.

Risk measurement

The RBS Group uses the basic indicator approach to calculate its operational risk capital requirement. This is based on multiplying three years’ average historical gross income by co-efficients set by the regulator.

Event and loss data management

The event and loss data management process ensures the capture and recording of operational risk loss events that meet defined criteria. The loss data is used for regulatory and industry reporting and is included in the capital modelling, for the calculation of the regulatory capital for operational risk. The most serious events are escalated in a simple, standardised process to all senior management, by way of the Group Notifiable Event Process.

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2015 may relate to events that occurred, or were identified in, prior years.

Capital

The Group calculates the Pillar 1 capital requirement for operational risk using the basic indicator approach. For 2015, the Group’s minimum Pillar 1 capital requirement was €37 million (2014 - €58 million).

Tax charge for 2014 was €58 million compared with €12 million in 2013.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review ***Capital and risk management***

Credit risk: management basis

Risk management is conducted on an overall basis within RBS Group. Therefore the discussion on pages 38 to 53 refer principally to policies and procedures in RBS Group that also apply to the Group.

Definition

Credit risk is the risk of financial loss due to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts.

Sources of credit risk

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

Credit risk management function

Governance

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

- approving credit for customers;
- ensuring that credit risk is within the risk appetite set by the Board;
- managing concentration risk and credit risk control frameworks;
- developing and ensuring compliance with credit risk policies; and
- conducting RBS Group-wide assessments of provision adequacy.

The GCCO has overall responsibility for the credit risk function. The GCCO chairs the Credit Risk Committee and, with the RBS Group CRO, co-chairs the RBS Group provisions committee.

Credit risk in the Group is managed by the RBS Group credit risk function through a Group credit risk delegate who reports to the GCCO and has a functional line to the Group CRO. Group credit risk management activities include credit risk appetite setting, transaction and portfolio analysis, and ongoing credit risk monitoring and oversight.

Key trends in the credit risk profile of the Group, performance against limits and emerging risks are set out in the Risk Report provided to the Group Risk Controls Committee (RCC) and the Supervisory Board.

Financial review *Capital and risk management*

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

Tax charge for 2014 was €58 million compared with €12 million in 2013.

	Credit policy	
Controls and risk assurance	Control assurance Quality assurance Model risk management	Credit policy standards are in place for both Wholesale and Personal portfolios and are expressed as a set of mandatory controls. Assurance activities, as defined by credit policy, are undertaken by an independent assurance function.
Credit stewardship	Credit assessment standards Credit risk mitigation and collateral Credit documentation Regular portfolio/customer review Problem debt identification and management	Credit risk stewardship takes place throughout the customer lifecycle, from initial credit approval and on a continuous basis thereafter. The methodology applied for assessing and monitoring credit risk varies between customer types and businesses.
Customers	Segmentation	Customers are grouped by industry clusters and managed on an individual basis (including Corporates, Banks and Financial Institutions).

Credit risk: management basis continued

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

Note:

(1) Authority is delegated by Executive Risk Forum.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Risk appetite*

Risk appetite across all risk types is set by RBS Group using specific quantitative targets under stress, including earnings volatility and capital adequacy. The credit risk appetite frameworks have been designed to reflect factors that influence the ability to meet those targets. These include product and asset class, industry sector, single name and country concentrations. Any of these factors could generate higher earnings volatility under stress and, if not adequately controlled, undermine capital adequacy. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between credit risk appetite frameworks and risk appetite targets. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate. For further information of the specific frameworks for wholesale refer to page 45.

Risk measurements and models*

Credit risk assets

RBS Group uses a range of measures for credit risk exposures. The internal measure used, unless otherwise stated, is credit risk assets (CRA) consisting of:

- Lending exposure - measured using drawn balances (gross of impairments). Comprises cash balances at central banks as well as loans and advances to banks and customers.

- Counterparty exposures - measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and regulator-approved models but before the effect of collateral. Calculations are gross of credit value adjustments.

- Contingent obligations - measured using the value of the committed amount and including primarily letters of credit and guarantees.

CRA exclude issuer risk (primarily debt securities) and securities financing transactions. CRA take account of regulatory netting although, in practice, obligations are settled under legal netting arrangements that provide a right of legal set-off but do not meet the offset criteria under IFRS.

Risk models

RBS Group uses the output of credit risk models in the credit approval process - as well as for ongoing credit risk assessment, monitoring and reporting - to inform credit risk appetite decisions. These models may be divided into different categories:

Model	Calculation method	Wholesale
PD model	Individual counterparty	Each customer is assigned a probability of default (PD) rating and corresponding grade. PD is calculated using a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance and sector outlook.
LGD model	Individual counterparty	Loss given default (LGD) models estimate the amount that cannot be recovered in the event of a customer default. When estimating LGD, RBS Group's models assess both borrower and facility characteristics, as well as any credit risk mitigants. The cost of collections and a time-discount factor for the delay in cash recovery are also incorporated.
EAD model	Individual counterparty	Exposure at default (EAD) models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. Regulatory requirements stipulate that EAD must always be equal to, or higher, than current utilisation, though exposures can be reduced by a legally enforceable netting agreement.
EC model	Portfolio level	The credit economic capital model is a framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes. The model takes into account migration risk (the risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's credit worthiness has a significant impact on the creditworthiness of a business operating in that country).

Changes to credit models

RBS Group reviews and updates models on an ongoing basis in order to reflect the impact of more recent data, changes to products and portfolios, and new regulatory requirements. Extensive changes were made to wholesale models between 2012 and 2014. To a lesser extent, the impact of these changes continued through 2015, resulting in some downwards rating migrations across internal asset quality bands. For further information, refer to the Asset quality section on page 56.

*unaudited

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Risk mitigation

Risk mitigation techniques are used in the management of credit portfolios across RBS Group, typically to mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, customer credit balances are netted against obligations.

Mitigation tools applied can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties.

When seeking to mitigate risk, at a minimum RBS Group considers the following:

- The suitability of the proposed risk mitigation, particularly if restrictions apply;
- The means by which legal certainty is to be established, including required documentation, supportive legal opinions and the steps needed to establish legal rights;
- The acceptability of the methodologies to be used for initial and subsequent valuation of collateral, the frequency of valuations and the advance rates given;
- The actions which can be taken if the value of collateral or other mitigants is less than needed;
- The risk that the value of mitigants and counterparty credit quality may deteriorate simultaneously;
- The need to manage concentration risks arising from collateral types; and
- The need to ensure that any risk mitigation remains legally effective and enforceable.

The RBS Group business and credit teams are supported by specialist in-house documentation teams. RBS Group uses industry

standard loan and security documentation wherever possible. However, when non-standard documentation is used, external lawyers are employed to review it on a case-by-case basis. Mitigants (including any associated insurance) are monitored throughout the life of

the transaction to ensure that they perform as anticipated. Similarly, documentation is also monitored to ensure it remains enforceable.

For further information refer to the Wholesale credit risk management sub-section.

Counterparty credit risk

The Group mitigates counterparty credit risk arising from both derivatives transaction and repurchase agreements through the use of netting, collateral and market standard documentation.

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

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Collateral may consist of either cash or securities. In the case of derivatives, collateral generally takes the form of cash. In the case of securities financing transactions, collateral usually takes the form of debt securities and, to a much lesser extent, equity securities at the outset. However, if the value of collateral falls relative to the obligation, the Group may require additional collateral in the form of cash (variation margin). The vast majority of agreements are subject to daily collateral calls with collateral valued using RBS Group’s internal valuation methodologies.

Industry standard documentation - such as master repurchase agreements and credit support annexes accompanied by legal opinion - is used for financial collateral taken as part of trading activities.

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

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Risk assessment and monitoring

Practices for credit stewardship - includes credit assessment, approval and monitoring as well as the identification and management of problem debts. A key aspect of credit risk stewardship is ensuring that, when signs of impairment are identified, appropriate impairment provisions are recognised.

Impairment, provisioning and write-offs

In the overall assessment of credit risk, impairment, provisioning and write-offs are used as key indicators of credit quality. The impairment, provisioning and write-off processes are described in more detail below:

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected since its initial recognition. Refer to accounting policies on page 96 for details regarding the quantification of impairment losses.

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

Financial review ***Capital and risk management***

Credit risk: management basis continued

Provisioning

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

The Restructuring credit team will ultimately recommend or approve any provision that may be required.

Provision method	Customer type	Quantification method	Key factors considered
Individual	Impaired, individually significant	Case-by-case assessment of future cashflows	• Customer and guarantor performance. • Future value of collateral. • Future economic conditions based on factors available at the time.
Latent	Not impaired	PD% x LGD% x EAD x Emergence Period	• For wholesale customers PD, LGD and EAD values are used. • For personal, calculations are performed at portfolio level by product (e.g. mortgages, credit cards or unsecured loans). • Portfolio-level emergence periods are based on products or businesses with similar homogenous characteristics. Emergence periods range from 120 to 274 days.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

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Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Sensitivity of impairments to assumptions

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

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity. Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. For individual impairments greater than £1 million, oversight is provided by the RBS Group's Provisions Committee.

Available-for-sale portfolios

Available-for-sale portfolios are also regularly reviewed for evidence of impairment, including: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and increased likelihood that the issuer will enter bankruptcy or other financial reorganisation. Determining whether evidence of impairment exists requires the exercise of management judgement. It should be noted that the following factors are not, of themselves, evidence of impairment, but may be evidence of impairment when considered with other factors:

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

Write-offs

Impaired loans and receivables are written-off when there is no longer any realistic prospect of recovery of part, or the entire loan. For loans that are individually assessed for impairment, the timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs may be prompted by bankruptcy, insolvency, forbearance and similar events.

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

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Wholesale credit risk management

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

Through the overlay model, the Group's concentration risks are captured in and primarily governed by, the RBS Group's risk control frameworks. However, concentration risks are actively monitored from a the Group perspective through monthly reporting and appropriate action is taken if necessary.

A summary of the frameworks is set out below:*

Concentration framework	Single name (SNC)	Sector	Product and asset class	Country
Risk addressed	Outsized loss due to concentration on a single borrower or borrower group.	Concentration in a single sector or across sectors that are susceptible to similar stress events.	Concentration on certain products or asset classes.	Concentration on a particular country.
Basis for classification	Size or LGD - based on net customer exposure for a given probability of default.	Size - based on exposure; and Risk - based on Economic Capital and other qualitative factors.	Size - based on exposure to a product or asset class.	Size - based on exposure to a particular country.
Limit types	Customer exposure and LGD limits relative to PD.	Bank-wide sector and sub-sector exposure limits.	Bank-wide product/asset class exposure limits and sub-limits.	Bank-wide country limits.
Controls within the framework	Elevated approval requirements, monitoring and reporting, the requirement for regular reviews and for plans to address any exposures in excess of limit.			

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Exposure measure (net/gross)	Both net and gross of "eligible" mitigants. To be eligible under the framework, mitigants must be legally enforceable, structurally effective and of appropriate maturity.	Gross exposure to a sector/sub-sector.	Net/gross - dependent on type of product.	Net of provisions and risk transfer.

*unaudited

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Risk assessment

Before credit facilities are made available to customers a credit assessment is undertaken. The assessment process is the same for all customers. However, in RBS Group credit risk management is organised in terms of the complexity of the assessment rather than aligned to businesses. Capital Resolution is not managed separately but is shown in tables to aid understanding of the size of the exit portfolio. Credit is only granted to customers following joint approval by an approver from the business and the credit risk function.

These approvers act within a delegated approval authority under the wholesale Credit Authorities Framework (CAF) approved by the Executive Risk Forum.

The level of delegated authority held by approvers is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the CAF. Both business and credit approvers are accountable for the quality of each decision taken but the credit risk approver holds ultimate sanctioning authority.

In 2015, new Transaction Acceptance Standards (TAS) were introduced to provide more detailed transactional lending and risk acceptance guidelines which are one of the tools to control risk appetite at the customer/transaction level. TAS are supplementary to Credit Policy.

When assessing credit risk the following must be considered at a minimum:

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with relevant credit policies and transaction acceptance standards;
- The customer’s ability to meet obligations, based on an analysis of financial information and a review of payment and covenant compliance history;
- The customer’s risk profile, including sector, sensitivity to economic and market developments and management capability;

- Legal capacity of the customer to engage in the transaction;

- Credit risk mitigation including requirements for valuation and revaluation. The customer's credit grade and the loss given default estimate for the facilities;

- The requirement for the provision of financial information, covenants and/or monitoring formulae to monitor the customer's financial performance;

- Refinancing risk - the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;

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

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

Credit risk: management basis continued

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

At a minimum, credit relationships are reviewed and re-approved annually. The renewal process addresses borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; compliance with terms and conditions; and refinancing risk.

Risk mitigation

The Group mitigates credit risk through the use of netting, collateral and market standard documentation, depending on the nature of the counterparty and its assets. The most common types of collateral are:

- Physical assets - These may include stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of different ways, depending on the type of asset concerned and may rely on balance sheet valuations in certain cases.

- Receivables - These are amounts owed to the Group’s counterparties by their own customers. The Group values them after taking into account the quality of its counterparty’s receivable management processes and excluding any that are past due.

- Financial collateral - Refer to Counterparty credit risk section on page 41.

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

Problem debt management

Early problem identification

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

RBS Group has reviewed the Watchlist process and will implement a new Risk of Credit Loss framework in early 2016. This will ensure the problem debt portfolio is managed consistently and efficiently, with added focus on customers whose credit profiles have deteriorated outside original risk appetite.

Credit risk: management basis continued

*Watchlist**

There are three Watch classifications - Amber, Red and Black - reflecting progressively deteriorating conditions.

Watch Amber customers are performing customers who show early signs of potential financial difficulty, or have other characteristics that warrant closer monitoring.

Watch Red customers are performing customers who show signs of declining creditworthiness and so require active management. When a customer is classified as Watch Red, the Restructuring team is engaged to consider whether the relationship should be transferred to them. Watch Red customers who continue to be managed outside of Restructuring tend to be those requiring specialist subject matter expertise that is only available outside of Restructuring.

The Watch Black portfolio includes AQ10 exposures.

Once on the Watchlist a number of mandatory actions are taken, including a review of the customer's credit grade and facility and security documentation. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist credit risk or relationship management units in the relevant business or by Restructuring.

In more material cases, a forum of experienced credit, portfolio management and remedial management specialists in either the relevant business or Restructuring may reassess the customer relationship strategy.

Appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt. Such circumstances include deteriorating trading performance, imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Remediation strategies available in the business include granting a customer various types of concessions. Any decision to approve a concession will be a function of specific country and sector appetite, the credit quality of the customer, the market environment and the loan structure and security. For further information, refer to the Forbearance section below.

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

Customers managed in Capital Resolution are by their nature subject to heightened scrutiny and regular review against specific disposal plans. Capital Resolution customers are separately identified in RBS Group's internal Watchlist reporting, with their Watchlist classification based on asset quality.

Restructuring

The Restructuring team manages customer relationships with RBS Group's wholesale problem debt portfolio. The factor common to all customers with Restructuring involvement is that RBS Group's exposure is outside risk appetite. The primary function of Restructuring is to restore customers to an acceptable credit profile, minimise losses to RBS Group and protect RBS Group's capital.

*unaudited

Credit risk: management basis continued

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

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

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

Forbearance

Definition

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

Concessions granted where there is no evidence of financial difficulty, or where any changes to terms and conditions are within usual risk appetite (for a new customer), or reflect improving credit market conditions for the customer, are not considered forbearance.

The aim of forbearance is to restore the customer to financial health while minimising risk to RBS Group. To ensure that forbearance is appropriate for the needs and financial profile of the customer, RBS Group applies minimum standards when assessing, recording, monitoring and reporting forbearance.

Types of Wholesale forbearance

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

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

Credit risk: management basis continued

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

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

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

- Debt forgiveness/debt for equity swap

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

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

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

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

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

Credit risk: management basis continued

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

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

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

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

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

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

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: management basis continued

Country risk

Risk measurement*

In this section, country exposure includes wholesale net on-balance sheet exposure (drawn amounts under lending facilities, net of provisions, mark-to-market derivatives positions and issuer-risk debt securities positions in the banking book and trading book) together with off-balance sheet exposure (contingent obligations and undrawn commitments).

Basis of preparation*

The tables in this section show the Group's exposure at 31 December 2015 and 2014. Exposures are reported by country of operation of the obligor, except exposures to governments and individuals, which are shown by country of residence.

The country of operation is the counterparty's country of main operations, taking account of branches and subsidiaries.

Countries shown are those which had ratings of A+ or below from Standard and Poor's, Moody's or Fitch at 31 December 2015, and in which the Group's net balance sheet exposure to counterparties operating (or individuals residing) in them exceeded €0.5 billion. Selected eurozone countries are also included.

The exposures are stated before taking into account risk mitigants such as guarantees, insurance or collateral (with the exception of reverse repos) which may have been put in place to reduce or eliminate exposure to country risk events. The tables separately show CDS positions, as the Group may be either a net buyer or a net seller of protection.

Overview

The comments below relate to changes in country exposures in 2015 unless indicated otherwise*.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

- Net balance sheet and off-balance sheet exposures to nearly all countries were further wound down. The euro depreciated against sterling by 5.7% while the US dollar appreciated by 5.3%, impacting exposures.

- Total eurozone (excluding the Netherlands) - net balance sheet exposure decreased by €2.3 billion or 90%, to less than €0.3 billion. The depreciation of the euro played a significant role in the reduction.

- Eurozone periphery - Ireland is no longer considered part of this group because of its improved economic conditions. The remaining exposure to the eurozone periphery was less than €0.2 billion.

- Italy - exposure fell by €0.9 billion to €0.1 billion. This was the result of the maturity of a few large derivatives transactions with banks.

- India - net balance sheet exposure increased by €0.3 billion to €1.9 billion, reflecting higher AFS government bonds exposure. The remaining exposure is largely debt securities and corporate lending.

- China - net balance sheet exposure decreased by €0.6 billion to €0.9 billion, with reductions mostly in corporate lending, driven by RBS Group’s strategy. The remaining portfolio is focused on the largest banks.

*unaudited

Financial review *Capital and risk management*

Credit risk: management basis continued

Summary of country exposures

	Net balance sheet exposure				Analysis of net balance sheet exposures					Off-	
		Banks			Net	Debt securities		Net		balance	Total
	Sovereign	& other FI	Corporate	Total	lending	AFS/LAR	HFT	Derivatives	SFT	sheet	exposure
2015	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Eurozone periphery											
Italy	—	114	—	114	95	19	—	—	—	—	114
Cyprus	—	—	39	39	39	—	—	—	—	—	39
Portugal	—	5	1	6	—	—	—	7	—	—	7
Spain	—	—	3	3	3	—	—	—	—	—	3
Greece	—	—	1	1	1	—	—	—	—	—	1
Eurozone other											
Belgium	—	54	—	54	54	—	—	—	—	10	64
Ireland	—	—	33	33	33	—	—	—	—	—	33
Germany	—	4	3	7	3	—	—	4	—	1	8
France	—	3	—	3	—	—	—	3	—	—	3
Luxembourg	—	—	—	—	—	—	—	—	—	—	—
Total eurozone	—	180	80	260	228	19	—	14	—	11	272
Asia											
India	1,138	194	568	1,900	835	903	151	12	—	381	2,282
China	347	560	31	938	756	178	—	4	—	10	948

2014											

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Eurozone periphery													
Italy	135	869	1	1,005	138	161	—	706	—	—	1,005	(196)	707
Cyprus	—	—	42	42	42	—	—	—	—	—	42	—	—
Portugal	—	42	4	46	—	—	—	46	—	—	46	—	64
Spain	53	1	4	58	5	53	—	—	—	3	61	(4)	—
Eurozone other													
Belgium	324	155	9	488	17	333	—	138	—	4	492	(1)	140
Ireland	—	—	54	54	54	—	—	—	—	12	66	—	—
Germany	141	33	53	227	50	165	—	12	—	105	332	(14)	6
France	254	4	13	271	1	267	—	3	—	148	419	(28)	6
Luxembourg	—	3	—	3	3	—	—	—	—	—	3	(1)	4
Other	217	113	—	330	—	330	—	—	—	—	330	(2)	—
Total eurozone	1,124	1,220	180	2,524	310	1,309	—	905	—	272	2,796	(246)	927
Asia													
India	784	185	646	1,615	912	533	143	27	—	460	2,075	—	62
China	428	587	543	1,558	1,169	312	—	76	1	292	1,850	—	1

Notes:

(1) Net balance sheet exposure - Comprises net lending, debt securities, derivatives (net) and SFT (net) exposures, as defined below.

(2) Net lending - Comprises loans and advances net of provisions and includes cash balances.

(3) Debt securities - includes held-for-trading (HFT), designated as fair value through profit or loss (DFV), available for-for-sale (AFS) and loans and receivables (LAR). HFT debt securities, aggregated with DFV securities, are presented as long positions net of short positions.

(4) Derivatives (net) - Comprise the mark-to-market (mtm) value of such contracts after the effect of legally enforceable netting agreements in line with regulatory capital models, but before the effect of collateral.

(5) Securities financing transactions (SFT) (net) - Comprise the mtm value of the cash and securities that are due to the Group at a future date after the effect of collateral intrinsic to the transaction and legally enforceable netting agreements. Counterparty netting is applied in line with regulatory capital approach. Additional collateral called to offset mtm positions (variation margin) is not included.

(6) Off-balance sheet - Comprises letters of credit, guarantees, other contingent obligations and legally committed undrawn facilities.

(7) Total exposure - Comprises net balance sheet exposure and off-balance sheet exposure, as defined above.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

(8) Credit default swaps (CDSs) - Under a CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. ‘Fair value’ (or ‘mtm value’) represents the balance sheet carrying value of the resulting exposure. The mtm value of CDSs is included in derivatives against the counterparty of the trade, as opposed to the reference entity. The notional is the par value of the credit protection bought or sold and is included against the reference entity of the CDS contract. The column ‘CDS notional less fair value’ represents the net effect on exposure should the CDS contracts be triggered by a credit event, assuming a zero recovery rate on the reference exposure. This net effect would be the increase in exposure arising from sold positions netted against the decrease arising from bought positions. For a sold position, the change in exposure equals the notional less the fair value amount; this represents the amount the Group would owe to its CDS counterparties if the reference entity defaulted. Positive recovery rates would tend to reduce the gross components (increases and decreases) of those numbers.

(9) Other eurozone - Austria, Estonia, Finland, Latvia, Malta, Slovakia and Slovenia. The Netherlands, though a eurozone country, has been excluded in these country risk tables as the Group is based in the Netherlands.

Financial review ***Capital and risk management***

Credit risk: balance sheet analysis

Sector and geographic concentration

The analysis in this section is provided to support the discussion on credit risk on pages 38 to 53. All disclosures in this section are audited.

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

	Loans and				
	advances	Securities	Derivatives	Other (1)	Total
2015	€m	€m	€m	€m	€m
Central and local government	52	1,249	28	—	1,329
Financial institutions (2)	8,313	696	1,880	614	11,503
Personal	7	—	—	—	7
Corporate	976	215	313	—	1,504
Total gross of provisions	9,348	2,160	2,221	614	14,343
Provisions	(86)	(21)	—	—	(107)
Total	9,262	2,139	2,221	614	14,236
2014					
Central and local government	59	2,093	32	—	2,184
Financial institutions (2)	9,227	1,092	4,033	1,174	15,526
Personal	9	—	—	—	9
Corporate	2,177	77	367	1	2,622
Total gross of provisions	11,472	3,262	4,432	1,175	20,341
Provisions	(114)	(19)	—	—	(133)
Total	11,358	3,243	4,432	1,175	20,208

Notes:

(1) Includes settlement balances of €71 million (2014 - €40 million).

(2) Includes reverse repurchase agreements of €3.4 billion (2014 - €1.1 billion).

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Credit risk: balance sheet analysis continued

Loans and advances to banks and customers by geographical region		
The table below analyses loans and advances net of provisions by geographical region (location of office).		
	2015	2014
	€m	€m
Loans and advances to banks		
Netherlands	4,669	4,048
US	316	—
Rest of world	1,946	3,648
	6,931	7,696
Loans and advances to customers		
Netherlands	686	645
Rest of world	1,507	2,894
	2,193	3,539
Balances with ultimate holding company		
Netherlands	138	123
Total	9,262	11,358
Refer to Credit risk - Country risk for additional disclosures on lending and other exposures by country.		

Financial review ***Capital and risk management***

Credit risk: balance sheet analysis continued

Asset quality

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

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

	Probability of	Indicative
Internal AQ band	default range	S&P rating
Investment grades:		
AQ1 – AQ4	0% - 0.381%	AAA to BBB-
Non-investment grades:		
AQ5 – AQ10	0.0381% - 100%	BB+ to D

2015 compared with 2014

- €9.3 billion (2014 - €11.4 billion) of loans and advances comprised €6.4 billion (2014 - €6.6 billion) of balances with fellow subsidiaries and €2.9 billion (2014 - €4.8 billion) third party loans. Of the third party loans, €2.2 billion (2014 - €3.6 billion) were investment grade.

- Derivatives of €2.2 billion (2014 - €4.4 billion) included €1.3 billion (2014 - €2.2 billion) with fellow subsidiaries and €0.8 billion (2014 - €1.9 billion) investment grade third party balances.

- Contingent liabilities and commitments of €6.5 billion (2014 - €8.1 billion) were predominantly investment grade, with €0.6 billion of balances with fellow subsidiaries (2014 - €1.5 billion).

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review *Capital and risk management*

Credit risk: balance sheet analysis continued

Debt securities							
The table below analyses debt securities by issuer and external ratings. Ratings are based on the lowest of Standard and Poor's, Moody's and Fitch.							
	Central						
	and local		Other financial				Of which
	government	Banks	institutions	Corporate	Total	Total	ABS (1)
2015	€m	€m	€m	€m	€m	%	€m
AAA	4	—	—	—	4	0.2	—
AA to AA+	—	—	249	—	249	12.9	—
A to AA-	178	—	148	—	326	17.0	149
BBB- to A-	1,053	—	—	119	1,172	60.9	—
Non-investment grade	14	—	—	—	14	0.7	—
Unrated	—	1	158	—	159	8.3	—
Total	1,249	1	555	119	1,924	100	149
2014							
AAA	48	—	—	16	64	2.1	—
AA to AA+	462	—	92	—	554	18.6	—
A to AA-	700	164	154	—	1,018	34.1	154
BBB- to A-	811	—	—	133	944	31.7	—
Non-investment grade	72	15	146	—	233	7.8	—
Unrated	—	135	33	2	170	5.7	26
Total	2,093	314	425	151	2,983	100	180

Note:

(1) Asset-backed securities.

Refer to Credit risk - Country risk for additional disclosures by country.

Tax charge for 2014 was €58 million compared with €12 million in 2013.

Financial review *Capital and risk management*

Credit risk: balance sheet analysis continued

Sector and geographical regional analyses

The following tables analyse gross loans and advances to customers and the related debt management measures and ratios by sector and geography (by location of office). Gross loans, risk elements in lending (REIL) and provisions exclude amounts relating to businesses held for disposal, consistent with the balance sheet presentation required by IFRS.

				REIL	Provisions	Provisions		
	Gross			as a % of	as a %	as a % of	Impairment	Amounts
	loans	REIL	Provisions	gross loans	of REIL	gross loans	releases	written-off
2015	€m	€m	€m	%	%	%	€m	€m
Central and local government	52	—	—	—	—	—	—	—
Financial institutions	1,245	15	5	1.2	33	0.4	(8)	—
Personal	7	—	—	—	—	—	—	—
Corporate	975	118	79	12.1	67	8.1	(12)	19
Latent impairment	—	—	2	—	—	—	(7)	—
Total	2,279	133	86	5.8	65	3.8	(27)	19
Of which:								
- Netherlands	723	84	37	11.6	44	5.1	(12)	—
- Overseas	1,556	49	49	3.1	100	3.1	(15)	19
Total	2,279	133	86	5.8	65	3.8	(27)	19
2014								
Central and local government	59	—	—	—	—	—	—	—
Financial institutions	1,408	40	9	2.8	23	0.6	(4)	—
Personal	9	—	—	—	—	—	(22)	—
Corporate	2,177	163	100	7.5	61	4.6	(12)	30
Latent impairment	—	—	5	—	—	—	(10)	—
Total	3,653	203	114	5.6	56	3.1	(48)	30
of which:								
- Netherlands	686	130	41	19.0	32	6.0	(44)	3

Tax charge for 2014 was €58 million compared with €12 million in 2013.

- Overseas	2,967	73	73	2.5	100	2.5	(4)	27
Total	3,653	203	114	5.6	56	3.1	(48)	30

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Tax charge for 2014 was €58 million compared with €12 million in 2013.