ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 24, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015

OR

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

OR

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

Commission file number: 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc

(Exact name of Registrant as specified in its charter)

United Kingdom

(Jurisdiction of incorporation)

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

(Address of principal executive offices)

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

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ

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

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

Title of each class	**Name of each exchange on which registered**
American Depositary Shares, each representing 2 ordinary shares, nominal value £1 per share	New York Stock Exchange
Ordinary shares, nominal value £1 per share	New York Stock Exchange*
American Depositary Shares Series F, H, L, R, S, T nd U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, R, S, T and U respectively	New York Stock Exchange
Dollar Perpetual Regulatory Tier 1 Securities	New York Stock Exchange
Floating Rate Senior Notes due 2017	New York Stock Exchange
1.875% Senior Notes due 2017	New York Stock Exchange
4.70% Subordinated Notes due 2018	New York Stock Exchange
5.625% Senior Notes due 2020	New York Stock Exchange
6.125% Senior Notes due 2021	New York Stock Exchange
6.125% Subordinated Tier 2 Notes due 2022	New York Stock Exchange
6.000% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
6.100% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
5.125% Subordinated Tier 2 Notes due 2024	New York Stock Exchange
Leveraged CPI Linked Securities due January 13, 2020	NYSE MKT

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* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares pursuant to the requirements of the Securities and Exchange Commission.

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

None

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

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

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

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2015, the close of the period covered by the annual report:

(Title of each class)	(Number of outstanding shares)
Ordinary shares of £1 each	11,624,563,916
11% cumulative preference shares	500,000
5½% cumulative preference shares	400,000
Non-cumulative dollar preference shares, Series F, H, L and R to U	133,839,880
Non-cumulative convertible dollar preference shares, Series 1	64,772
Non-cumulative euro preference shares, Series 1 to 3	2,044,418
Non-cumulative convertible sterling preference shares, Series 1	14,866
Non-cumulative sterling preference shares, Series 1	54,442

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

Yes No

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

Yes 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.

Yes No

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

Yes 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 Accelerated filer Non-Accelerated filer

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

U.S. GAAP

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

Other

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

Item 17 Item 18

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

Yes No

SEC Form 20-F cross reference guide

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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 ‘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 Royal Bank of Scotland Group’s (RBS) restructuring, which includes the separation and divestment of Williams & Glyn, the proposed restructuring of RBS’s CIB business, the implementation of the UK ring-fencing regime, the implementation of a major development program to update RBS’s IT infrastructure and the continuation of its balance sheet reduction programme, as well as capital and strategic plans, divestments, capitalisation, portfolios, net interest margin, capital and leverage ratios and requirements liquidity, risk-weighted assets (RWAs), RWA equivalents (RWAe), Pillar 2A, return on equity (ROE), profitability, cost:income ratios, loan:deposit ratios, AT1 and other funding plans, funding and credit risk profile; litigation, government and regulatory investigations RBS’s future financial performance; the level and extent of future impairments and write-downs; including with respect to goodwill; future pension contributions and RBS’s exposure to political risks, operational risk, conduct risk and 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. 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 our results and the accuracy of forward-looking statements in this document include the risk factors and other uncertainties discussed in this document. These include the significant risks for RBS presented by the outcomes of the legal, regulatory and governmental actions and investigations that RBS is subject to (including active civil and criminal investigations) and any resulting material adverse effect on RBS of unfavourable outcomes (including where resolved by settlement); the uncertainty relating to the referendum on the UK’s membership of the European Union and the consequences of it; the separation and divestment of Williams & Glyn; RBS’s ability to successfully implement the various initiatives that are comprised in its restructuring plan, particularly the proposed restructuring of its CIB business and the balance sheet reduction programme as well as the significant restructuring required to be undertaken by RBS in order to implement the UK ring fencing regime; the significant changes, complexity and costs relating to the implementation of its restructuring, the separation and divestment of Williams & Glyn and the UK ring-fencing regime; whether RBS will emerge from its restructuring and the UK ring-fencing regime as a viable, competitive, customer focused and profitable bank; RBS’s ability to achieve its capital and leverage requirements or targets which will depend on RBS’s success in reducing the size of its business and future profitability; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; the ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBS or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBS's strategic refocus on the UK the impact of global economic and financial market conditions (including low or negative interest rates) as well as increasing competition.

In addition, there are other risks and uncertainties. These include operational risks that are inherent to RBS's business and will increase as a result of RBS's significant restructuring; the potential negative impact on RBS's business of actual or perceived global economic and financial market conditions and other global risks; the impact of unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBS operates; the risk of failure to realise the benefit of RBS's substantial investments in its information technology and systems, the risk of failing to prevent a failure of RBS's IT systems or to protect itself and its customers against cyber threats, reputational risks; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if its risk management framework is ineffective; risks relating to increased pension liabilities and the impact of pension risk on RBS's capital position; increased competitive pressures resulting from new incumbents and disruptive technologies; RBS's ability to attract and retain qualified personnel; HM Treasury exercising influence over the operations of RBS; limitations on, or additional requirements imposed on, RBS's activities as a result of HM Treasury's investment in RBS; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; the value and effectiveness of any credit protection purchased by RBS; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which RBS operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBS's financial statements; the impact of the recovery and resolution framework and other prudential rules to which RBS is subject the recoverability of deferred tax assets by the Group; and the success of RBS in managing the risks involved in the foregoing.

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

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

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Presentation of information

Presentation of information

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

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

Non-GAAP financial information

The directors manage RBS’s performance by class of business, showing certain items in separate lines, as is presented in the business review on pages 103 to 136 (the “non-statutory basis”).

The following items, which were previously reported separately after operating profit, are now reported within operating profit: Own credit adjustments; Gain/(loss) on redemption of own debt; Write-down of goodwill and Strategic disposals. RFS Holdings minority interest (RFS MI) was restated for periods up to and including 2014 only.

The non-statutory results continue to show: Own credit adjustments; Gain/(loss) on redemption of own debt; Write-down of goodwill; Strategic disposals; Restructuring costs; and Litigation and conduct costs as separate line items.

Discussion of RBS’s performance in this report presents RBS’s results on a non-statutory basis as management believes that such measures allow a more meaningful analysis of RBS’s financial condition and the results of its operations. These measures are non-GAAP financial measures. A body of generally accepted accounting principles such as IFRS is commonly referred to as ‘GAAP’. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Reconciliations of these non-GAAP measures to the closest equivalent GAAP measure are presented throughout this document and in the segment performance on pages 110 to

136. These non-GAAP financial measures are not a substitute for GAAP measures.

The presentation of operating profit, operating expenses, total income and other performance measures excluding the impact of: Own credit adjustments; Gain/(loss) on redemption of own debt; Write-down of goodwill; Strategic disposals; Restructuring costs; and Litigation and conduct costs are a non-GAAP financial measures and are not a substitute for the equivalent GAAP measure.

The presentation of Personal & Business Banking (PBB) combines the reportable segments of UK Personal & Business Banking and Ulster Bank RoI and is a non-GAAP financial measure. The presentation of Commercial and Private Banking (CPB) combines the reportable segments of Commercial Banking, Private Banking and RBS International (RBSI) and is also a non-GAAP financial measure.

The presentation of the cost savings against 2015 target as shown in the Strategic Report on pages 7, 17 and 20 which excludes litigation and conduct costs, restructuring costs, write down of goodwill and other intangible assets and other operating costs of William's & Glyn is a non-GAAP financial measure.

Lastly, the liquidity coverage ratio, stressed outflow coverage, net stable funding ratio, RWAes and further metrics included in the Business review and Capital and risk management section represent non-GAAP financial measures and are being presented for informational purposes given they are metrics that are not yet required to be disclosed by a government, governmental authority or self-regulatory organisation.

Recent Developments

Dividend Access Share

On 22 March 2016, the Royal Bank of Scotland Group plc paid the final dividend of £1.193 billion in respect of the Dividend Access Share to Her Majesty's Treasury ("HMT"). The dividend represents the final amount payable to HMT and effects the immediate retirement of the DAS.

This dividend payment will be reflected in our first quarter 2016 financial statements, reducing Tangible Net Asset Value per share by approximately 10 pence. The equivalent Common Equity Tier 1 impact as at FY 2015 would have been c.50bps.

On retirement, the DAS was re-designated as a single B share which will be subsequently cancelled. Following the conversion in 2015 of the B shares held by HMT into Ordinary Shares, the retirement of the DAS will complete the normalisation of RBS's capital structure.

Accelerated payments to the pension fund

Subsequently and pursuant to the Memorandum of Understanding, the bank agreed with the Trustee a Statement of Funding Principles in relation to an actuarial valuation as at 31 December 2015. The bank and Trustee also updated the existing Schedule of Contributions and Recovery Plan to reflect the £4.2 billion contribution, which was paid during March 2016.

Foreign exchange related investigations

As previously disclosed, on 21 July 2014, the Serious Fraud Office in the UK (SFO) announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions. On 15 March 2016, the SFO announced that it was closing its investigation, having concluded that, based on the information and material obtained, there was insufficient evidence for a realistic prospect of conviction.

2015 performance

Loss attributable to ordinary shareholders	(£1,979m)	Operating profit on a non-statutory basis(1)	£4,405m
Operating loss before tax	(£2,703m)	Common Equity Tier 1 ratio (2)	15.5%
Risk-weighted assets (RWAs)	£243bn	Loan:deposit ratio (3)	89%
Short-term wholesale funding (4)	£17bn	Liquidity portfolio	£156bn
Leverage ratio (5)	5.6%	Return on tangible equity (6)	(4.7%)
Cost:income ratio	127%	Net interest margin	2.12%
Cost:income ratio – on a non-statutory basis (1)	72%		

(1) Income excludes gains on own credit adjustments of £309 million, loss on redemption of own debt £263 million and loss on strategic disposals of £157 million, and expenses excludes restructuring costs of £2,931 million, litigation and conduct costs of £3,568 million and write-down of goodwill of £498 million

(2) End-point CRR basis.

(3) Includes disposal groups.

(4) Excludes repurchase agreements and stock lending and derivative collateral.

(5) Based on end-point CRR Tier 1 capital and leverage exposure based on CRR Delegated Act.

(6) Tangible equity is equity attributable to ordinary shareholders less intangible assets.

The Royal Bank of Scotland Group (RBS) continues to deliver on its plan to build a strong simple and fair bank for both customers and shareholders. RBS delivered against its 2015 targets.

RBS reported a loss attributable to ordinary shareholders of £1,979 million, compared with a loss of £3,470 million in 2014. This included elevated restructuring costs (£2,931 million), as the bank's repositioning accelerated, particularly in the Corporate & Institutional Banking (CIB) business. Litigation and conduct costs (£3,568 million) increased as further steps were taken to clear legacy obstacles from RBS's path to normalisation.

RBS continues to strengthen and reshape the balance sheet, building on a strong track record of delivery. Risk-weighted assets (RWAs) reduced 32%, or £113 billion, including £109 billion from the disposal of Citizens Financial Group and the accelerated run-down of Capital Resolution.

RBS intends to pay a final dividend on the Dividend Access Share (DAS) during the first half of 2016 subject to final Board and PRA approval, further normalising the capital structure of the bank and removing a constraint on the resumption of capital distributions.

2015 results included a charge for goodwill impairment of £498 million attributed to Private Banking; a loss on redemption of own debt of £263 million; and a gain of £1,147 million on loss of control of Citizens largely arising from the reclassification of foreign exchange reserves (£962 million).

Operating loss was £2,703 million compared with an operating profit of £2,643 million in 2014, primarily due to increased restructuring costs of £2,931 million (2014 - £1,154 million) and litigation and conduct costs of £3,568 million (2014 - £2,194 million). Operating profit excluding these restructuring costs and litigation and conduct costs, together with write down of goodwill charges of £498 million (2014 - £130 million) totalled £4,405 million compared with an operating profit of £6,056 million in 2014, lower primarily due to income attrition and disposal losses in the Capital Resolution business.

UK PBB recorded an operating profit of £1,030 million in 2015, a reduction of 9% or £103 million from 2014. This was primarily driven by lower non-interest income combined with increased restructuring costs and litigation and conduct costs. This was partially offset by a small net impairment release compared with a prior year charge. Operating profit excluding litigation and conduct costs (2015 - £972 million; 2014 - £918 million) and restructuring costs (2015 - £167 million; 2014 - £111 million) was £2,169 million, broadly stable compared with the prior year. There was a good performance in mortgages with net new lending totaling £9.3 billion, RBS's strongest performance since 2009, albeit at lower overall margins as customers shift from standard variable rate to fixed rate products. Operating expenses were £4,177 million, remaining broadly stable against 2014. Operating expense excluding litigation and conduct costs of £972 million (2014 - £918 million) and restructuring costs of £167 million (2014 - £111 million) were 3% lower, while credit quality remained good, with modest net impairment releases.

Commercial Banking recorded an operating profit of £1,264 million, compared with £1,256 million in 2014. Deposit and lending volumes (net new lending of £3.6 billion excluding business transfers, run-off and disposals), contributed to a 1% rise in net interest income. Operating profit excluding litigation and conduct costs of £51 million (2014 - £112 million) and restructuring costs of £69 million (2014 - £108 million) was down 6% at £1,384 million, driven by a marginal fall in income reflecting margin pressure and included a Q4 2015 loss

2015 performance

of £34 million on the sale of non-strategic asset portfolios.

Ulster Bank RoI recorded an operating profit of £262 million compared with an operating profit of £489 million in 2014; the decline was primarily due to considerably lower net impairment releases in 2015. Operating profit excluding litigation and conduct costs (2015 - £13 million credit; 2014 - £19 million credit) and restructuring costs (2015 - £15 million; 2014 - £13 million) declined 45% to £264 million as net impairment releases, though still substantial, were lower than in 2014. Private Banking operating loss was £470 million compared with a profit of £99 million in 2014, while RBS International (RBSI) recorded an operating profit of £207 million, down 13%.

CIB reported an operating loss of £837 million in 2015, compared with an operating loss of £710 million in 2014, driven by lower income in line with the business's reduced scale and risk appetite. Operating loss excluding £120 million relating to own credit adjustments (2014 - £9 million charge), restructuring costs of £524 million (2014 - £102 million) and litigation and conduct costs of £378 million (2014 - £832 million) was £55 million, compared with a profit of £233 million in 2014. Operating expenses were down 11% as CIB continues to move towards a more sustainable cost base.

Capital Resolution made an operating loss of £3,687 million, compared with a profit of £602 million in 2014. Operating loss excluding £175 million relating to own credit adjustments (2014 - £36 million charge), a loss on strategic disposals of £38 million, restructuring costs of £1,307 million (2014 - £185 million), together with litigation and conduct costs of £2,105 million (2014 - £162 million) and write-down of goodwill in 2014 of £130 million, was £412 million in 2015, compared with a profit of £1,115 million in 2014, reflecting increased disposal losses of £367 million, as it accelerated the run-down of its portfolios, reducing RWAs by almost half to £49.0 billion.

Common Equity Tier 1 (CET1) ratio improved 430 basis points to 15.5% in 2015, as RWAs declined by £113 billion, partially offset by the attributable loss and the accelerated recognition of previously committed contributions in relation to the The Royal Bank of Scotland Group Pension Fund following a change in accounting policy.

Delivering against our 2015 targets

Delivery against our 2015 targets

In 2015, RBS set out targets across its five strategic priorities, and continued its track record of delivery.

Strategy Goal	**2015 targets**	**2015**
	Reduce risk-weighted assets (RWAs) to <£300 billion	£243 billion, a reduction of £113 billion.
Strength & sustainabiliy	RCR exit substantially completed	Funded assets down 88% since initial pool of assets identified. Residual £4.6 billion of assets within Capital Resolution.
	Citizens deconsolidation	Sold full stake a year ahead of schedule, allowing full deconsolidation.
	£2 billion AT1 issuance	Successfully issued US$3.15 billion AT1 capital notes (£2 billion equivalent).
Customer experience	Improve NPS in every UK franchise	Year-on-year significant improvement in NatWest Business Banking, RBS Business Banking and Ulster Bank Personal Banking (NI).
Simplifying the bank	Reduce costs by £800 million, target exceeded and increased to >£900 million	Achieved £983 (1) million of cost savings.
Supporting growth	Lending growth in strategic segments ≥ nominal UK GDP growth	4.8% growth achieved in UK PBB and Commercial Banking in 2015, exceeding nominal UK GDP growth (2).
Employee engagement	Raise employee engagement index to within 8% of Global Financial Services (GFS) norm	Surpassed employee engagement goal, up six points to within three points of GFS.

Notes:

(1) Excluding litigation and conduct costs (2015 - £3,568; 2014 - £2,194 million), restructuring costs (2015 - £2,931 million; 2014 - £1,154 million), write down of goodwill and other intangible assets (2105 - £573 million; 2014 - £276 million) and other operating costs of Williams & Glyn (2015 - £261 million; £232 million).

(2) Preliminary estimate for nominal UK GDP growth in 2015 is 2.6% year-on-year.

Balance sheet progress

RBS continued to improve its capital strength, with the CET1 ratio increasing to 15.5% at 31 December 2015, up 430 basis points from 11.2% at 31 December 2014 and up 690 basis points from 8.6% at 31 December 2013. CET1 ratio benefited from the disposal of Citizens and Capital Resolution's performance in running off and disposing of capital intensive assets, partly offset by the attributable loss and the pension accounting policy change.

The leverage ratio rose to 5.6% at 31 December 2015, an improvement of 140 basis points from 4.2% at 31 December 2014 and 220 basis points from 3.4% at 31 December 2013, assisted by the successful issuance of Additional Tier 1 (AT1) capital notes in August 2015 and a substantial reduction in leverage exposure to £702 billion, down £237 billion from 31 December 2014 and £380 billion from 31 December 2013. Planned 2016 issuance of £2 billion AT1 capital notes, subject to market conditions, will provide further balance sheet resilience. In addition, issuance of £3-5 billion of senior debt, eligible to meet RBS's Minimum Requirement for Own Funds and Eligible Liabilities (MREL), is targeted from the RBS Group plc holding company, again subject to market conditions.

Progress was made in de-risking the balance sheet as the bank continued the run-down or sale of certain businesses and higher risk or capital intensive assets. RWAs decreased from £356 billion at 31 December 2014 to £243 billion at 31 December 2015.

In 2015 RBS:

- Completed the exit from Citizens a year ahead of schedule, reducing RWAs by £63 billion in the process and underlining our commitment to a UK market focus.
- Delivered strong progress in the first year of CIB Capital Resolution, reducing RWAs by £32.6 billion to 40.5 billion, exceeding its target RWA reduction of £25 billion. The business substantially exited the North American and Asia-Pacific (APAC) portfolios, and a partnership for our international customers was agreed with BNP Paribas as an alternative to the Global Transaction Services business. Agreed the sale of our Russian subsidiary which is due to complete in Q2 2016.

Delivering against our 2015 targets

- Achieved the run-down target of RCR a year ahead of schedule, reducing funded assets by 88% since the original pool of assets was identified, exceeding the targeted 85%, to £4.6 billion at 31 December 2015.
- Completed the first tranche of the international private banking business sale, with the final tranche due to complete in the first half of 2016.
- Improved the quality of its core loan books, primarily through the sale of commercial real estate and infrastructure portfolios in Commercial Banking and a buy-to-let portfolio in Ulster Bank RoI.
- Continued to progress the Williams & Glyn (W&G) divestment, submitting a banking license application to UK regulatory authorities in September 2015 and work continues on separation (although this will not now be achieved until after the previously announced Q1 2017). The Group remains committed to full divestment by the end of 2017.

Credit quality remained strong, with risk elements in lending (REIL) decreasing to £12.2 billion (3.9% of gross customer loans) at 31 December 2015, from £28.2 billion (6.8%) at 31 December 2014 and £39.4 billion (9.4%) at 31 December 2013. This reduction was primarily driven by disposals in Capital Resolution coupled with the recovering Irish economy.

In line with the progress to de-risk the balance sheet, committed exposures to the natural resources sectors have more than halved, with oil and gas in particular substantially reducing by 70% during 2015 to £6.6 billion. The majority of our emerging market exposures have declined following action on non-strategic activities, reducing by 75% our exposure to China and Russia. Reductions primarily reflected corporate loan portfolio disposal activity and the strategic direction of CIB.

Our funding and liquidity position remains strong, aided by the accelerated reduction of the Capital Resolution balance sheet. The liquidity coverage ratio was 136%, compared with 112% at 31 December 2014, whilst the net stable funding ratio was121% compared with 112% at 31 December 2014, both well above regulatory minima at the end of 2015.

The 2015 Bank of England stress test results concluded that RBS did not need to alter its capital plan, as sufficient steps had already been taken by RBS to strengthen its capital position.

Delivering for our customers

Delivering for our customers

Product proposition enhanced:

- Investing in building deeper customer engagement through the launch of a new current account, ‘Reward’, which enables customers to receive 3% cashback on household bills for a monthly account fee of £3.
- Launched an innovative new home insurance product offering customers a fixed premium for three years, which we believe is a positive departure from industry practice.
- Committed to fair banking through making overdrafts more accessible to one million customers who are now eligible for overdrafts of £100 and £250.
- One of the first UK banks to offer the Government-led Help to Buy: ISA as we continue to help first time buyers.

Continue to lead on collaboration and innovation:

- Launched Royal National Institute of Blind People (RNIB) approved cards, becoming the first bank to achieve RNIB accreditation.
- Became the first UK bank to enable customers to use only their fingerprint to log into their phone banking app via Touch ID.
- Real time registration of our mobile banking app enabling customers to log in as they open their current account.
- One of the first UK banks to launch Apple Pay and subsequently created an Apple Watch app.

Supporting UK entrepreneurs and businesses:

- Opened four Entrepreneur Hubs across the UK, increasing our involvement to seven, enabling entrepreneurs and small businesses to access free office space, mentoring and financial support, with a further five hubs to be opened in 2016.
- The Commercial Bank has issued 12,500 statements of appetite letters to our customers, offering up to £8 billion of new borrowing facilities.

Investing in our operational capabilities:

- Enhanced our mortgage operations, including an online mortgage tracker application to improve customer experience, whilst increasing mortgage advisors by 21% from 803 to 974.

- Employed a new automated account- opening system to improve our onboarding process, accelerating end- to-end account opening times by 50% for business customers and 30% for commercial customers.

- Launched a new customer relationship management tool, enabling a single view of the customer.

- Planned £3.5 billion IT investment spend committed from 2015 to 2017 to improve core infrastructure and resilience whilst addressing innovation capabilities.

- Core technology platforms continued to be simplified with 370 applications and over 6,000 servers decommissioned.

Upgrading our points of presence:

- Upgraded 322 branches and replaced 922 ATMs as the bank enhances customers' experience.

- Customers in Ireland are benefiting from a joint venture with 'An Post', accessing 1,140 new points of presence.

- Continued to evolve the NatWest mobile app through Touch ID and the ability to apply for loans and savings products whilst enhancing the PAYM feature and ability to use Apple Pay. Active mobile users have increased 27% to 3.7 million in 2015.

- Broke with tradition to open 34 of the busiest branches in the UK during bank holidays.

- Launched an 'online diary' where customers can book an appointment with an advisor from the comfort of their own home.

Investing in our people:

- Delivered leadership training to over 13,000 leaders through a comprehensive 'Determined to Lead' training programme.

- Around 5,500 front line staff completed certified banking skills programmes, with a further c.11,000 enrolled.

- Announced a target of having 30% female leaders in every business unit by 2020 and a further goal of a 50/50 spilt by 2030 across all levels of the business.

- Became the first bank to achieve Investing in Young People Accreditation.

Government shareholding

On 4 August 2015, HM Treasury (HMT) sold 630 million RBS ordinary shares, its first sale since its initial investment in 2008.

On 8 October 2015, HMT converted the 51 billion B shares it held into 5.1 billion ordinary shares, further normalising the ownership structure of RBS. These new ordinary shares were admitted to the London Stock Exchange on 14 October 2015. HMT's economic interest was 72.6% at 31 December 2015.

Our current plan assumes that we will pay the final Dividend Access Share (DAS) dividend of £1,180 million, plus interest, during the first half of 2016, subject to final Board and PRA approval. This thereby effects the conversion of the DAS into a single ordinary share. This will further normalise the capital structure of the bank and remove a constraint on the resumption of capital distributions. The retirement of the DAS demonstrates the strategic progress of the bank and follows an initial payment of £320 million in 2014. The pro forma impact, at 31 December 2015, is approximately 50 basis points to the CET1 ratio.

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2016 Targets

Pension Fund

On 27 January 2016, the bank announced a change to its pensions accounting policy; in particular, the policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. As a result of this accounting change, a minimum funding requirement of £3.3 billion in respect of the Main scheme was recorded as a liability at 31 December 2015 representing the present value of deficit reduction contributions for 2016 to 2023 (£3.7 billion) less an asset ceiling of £400 million. The net post tax impact of the policy change, together with updated IAS 19 year-end scheme valuations, is approximately £1.6 billion or approximately 70 basis points on the CET1 ratio.

Separately, RBS has signed a memorandum of understanding with the RBS Group Pension Fund trustee to make a payment of £4.2 billion into the scheme. The pro-forma 2016 impact at point of payment is a further £400 million and approximately 30 basis points on the CET1 ratio.

The accelerated payment improves capital planning and resilience, bringing forward the valuation date not later than 31 December 2015. The next valuation date will take place between 31 October 2018 and 31 December 2018, with any future funding arrangements needed to be agreed with the Trustee no later than Q1 2020. This provides increased certainty on contribution commitments and the pension balance sheet position. Subject to PRA approval, the bank expects the adverse core capital impact to be partially offset by a reduction in RBS's core capital requirements. Any such potential core capital offsets are likely to occur at the earliest 1 January 2017 and will depend on the PRA's assessment of RBS's core capital position at that time.

Current trading

PBB (consisting of the reportable segments UK PBB and Ulster Bank RoI) and CPB (consisting of the reportable segments Commercial Banking, Private Banking and RBSI), have traded in line with expectations in the first six weeks of 2016. CIB has had a difficult start to the year, given overall market conditions.

The net impact of lower long term yields and year to date sterling weakness have contributed to earnings volatility, reflected in certain line items such as IFRS volatility, own credit adjustments and foreign exchange gains/losses.

2016 Targets

Outlook

In our core PBB (consisting of the reportable segments UK PBB and Ulster Bank RoI) and CPB (consisting of the reportable segments of Commercial Banking, Private Banking and RBSI), we expect income to stabilise in 2016 as headwinds from low interest rates and the uncertain macroeconomic environment are balanced by strong planned volume growth, particularly in mortgages but also in core commercial lending. CIB may see some modest further income erosion. Cost savings of £800 million are planned in 2016 (in addition to the £2 billion achieved in 2014 and 2015). Our expectation is for cost reduction to exceed any income erosion across our combined core businesses.

Legacy credit portfolios have now been substantially disposed of, so we do not expect the considerable recoveries seen in 2014 and 2015 to be repeated and some portfolios may see net impairment charges. However, impairments on core portfolios are expected to remain low in 2016, with a modest overall net impairment charge for the year, though we recognise that the risk of larger single name events has increased, given the uncertain macroeconomic environment.

Previous guidance has indicated restructuring costs of approximately £5 billion and disposal losses of approximately £1.5 billion in the period 2015-19. Consistent with this, restructuring costs are expected to remain high in 2016, totalling over £1 billion. Most of the remaining signalled disposal losses are expected to be incurred in 2016 (2015 - £367 million). Capital Resolution is expected to reduce RWAs to around £30 billion by the end of 2016, ahead of our original plan, despite a more difficult economic environment for disposals, given the momentum we created in 2015, and continued substantial run-off activity.

We continue to deal with a range of uncertainties in the external environment, including those caused by the referendum on the UK's continuing membership of the European Union. We will also have to manage conduct-related investigations and litigation, including US RMBS, throughout 2016, and substantial incremental provisions may be recognised during the year.

Work continues on the separation of Williams & Glyn, but this will now not be achieved until after Q1 2017. The Group remains committed to full divestment by the end of 2017, although it continues to face significant challenges and risks in separating the Williams & Glyn business, some of which may only emerge as various separation process phases are progressed. The Williams & Glyn separation process is a high priority for the Group and involves the diversion of Group resources away from other key areas. The associated risks are discussed in more detail in the Risk Factors on pages 384 to 409.

RBS plans to return excess capital to shareholders through dividends or buybacks, subject to Board and PRA approval at the time. Key milestones before seeking such approval for capital distributions would include, among other considerations: passing the 2016 Bank of England stress test (including our Individual Capital Guidance hurdle); operating within our capital risk appetite; passing the peak of litigation and conduct costs including US RMBS; confidence in sustainable profitability; and an assured exit of Williams & Glyn. Given the challenges in separating Williams & Glyn and the potentially elongated period to resolve US RMBS- related litigation claims and regulatory investigations, we now consider it more likely that capital distributions will resume later than Q1 2017.

Our progress in 2015

Our progress in 2015

We have a clear ambition to become No.1 for customer service, trust and advocacy. In 2015, our focus has been on Cost, Capital, Restructuring and Resilience. We have also begun the process of making RBS a simpler place to work and an easier bank to do business with.

Reward Account 3%

New banking proposition launched: 'Reward' offering customers 3% cashback on their household bills.

Fair Banking

Launched an innovative new home product offering customers a fixed premium for three years, which we believe is a positive departure from industry practice.

Account opening efficiency

New automated account opening process has increased our onboarding process efficiency, with end-to-end account opening times falling by 50% for business customers and 30% for Commercial customers.

Simple IT

Core technology platforms continued to be simplified with 370 applications and over 6,000 servers decommissioned.

Financial inclusion

Launched the fee-free Foundation account to better support unbanked individuals in the UK.

Innovation

First UK bank to enable customers to login to their mobile banking app using only their fingerprint.

Determined to make a difference

Comprehensive campaign started in October 2015 placing emphasis on personal determination and accountability. 13,000 leaders went through our Determined to Lead training programme to ensure a consistent approach to decision making.

Real time registration

This enables customers to have access to mobile banking as they open their current account. Active mobile users have increased 27% to 3.7 million.

Branches refurbished

Branch Transformation programme – 322 branches refurbished, 922 ATMs replaced.

Independent Lending Review (ILR)

Progress is available on rbs.com

Supporting employment

Increased the number of apprentices from 50 to over 300.

Online diary

Launched an ‘online diary’ where customers can book an appointment with an advisor from the comfort of their own home.

Entrepreneurial Hubs

In partnership with Entrepreneurial Spark, RBS has opened four Entrepreneurial Hubs across the UK, increasing our involvement to seven, enabling entrepreneurs and small businesses to access free office space, mentoring and financial support, with a further five hubs to be opened in 2016.

Accessible banking

First banking product to be awarded ‘RNIB approved’ as RBS launched new cards specifically designed for blind and partially sighted customers.

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Chairman's statement

"The Board's strategy for this bank is straightforward: a simpler bank focused on doing fewer things, and doing them well, built around a low risk UK and Irish retail and commercial bank."

"Our brand franchises are strong and distinctive and there is much to build on as we refocus RBS on its core markets in the British Isles."

I took over as Chairman in September 2015, so much of the business transacted by the Board during the year predated my arrival.

For most of the year the Board was chaired by my predecessor, Philip Hampton; it is right, therefore, to begin by thanking him for his service to the company since 2009.

Philip would be the first to acknowledge that the period was not an easy one for the bank or its shareholders. The recovery from the financial crisis has taken longer than foreseen and there is still much work to be done. However, Philip led the Board with calm authority through many challenging episodes and earned the respect and gratitude of his colleagues and successive teams of executives. We all wish him well in his new role as chair of the GSK Board.

Strategy

The Board's strategy for this bank is straightforward: a simpler bank focused on doing fewer things, and doing them well, built around a low risk UK and Irish retail and commercial bank; a stronger bank with a long term target of at least 13% CET1 ratio; and a fair bank that meets customers' needs, with a target to be seen as the best UK bank for customer service, trust and advocacy by 2020.

I am therefore pleased to note the progress that management have made in delivering that strategy across all our businesses including the accelerated downsizing of the investment bank announced in February 2015. This reshaping exercise remains one of the foremost priorities for the Board, and while the disposal process is ahead of plan we continue to pay close attention to it. There are as many risks involved in exiting businesses as there are in entering them.

As part of the reshaping, RBS Capital Resolution (RCR) was established in 2013 to separate and wind down capital intensive assets. Rapid progress has continued during 2015, and the target of removing 85% of these assets from the balance sheet by the end of 2016 was achieved a year earlier than planned. The RCR Oversight Committee met for its final meeting in January 2016 to finalise the transfer of remaining assets and the closure of RCR.

Any company must have mixed feelings about a reduction of its activities on this scale but I note that a number of other banking groups, especially in Europe, have now reached similar conclusions about the need to cut back their investment banking activities faced with ever-increasing capital and leverage requirements and a challenging competitive environment.

I am pleased to report that one exit was successfully achieved during the year. The Board decided in 2013 that Citizens Financial Group (CFG) was not an integral part of the bank in the longer term and resolved to float it through an IPO, and eventually to sell all the equity. The sale was achieved in stages, with the final tranche sold at the end of October 2015. The outcome was a good one for the bank's shareholders and we wish the Board of CFG success as they embark on life as a wholly independent entity.

There is one other major divestment programme under way on which important progress was made during the year. As a condition of the state aid made available to RBS in 2008 the European Commission required the bank to divest over 300 branches in the UK as a standalone banking entity to be known as Williams & Glyn.

The necessary application for a new banking licence was made in September 2015, a major step on the route to separation. While our planned separation will not now be achieved until after the previously announced Q1 2017, we remain committed to full divestment by the end of 2017. The Board exercises close oversight of this programme, which is uniquely challenging, especially from an IT perspective.

Chairman’s statement

The strategy for the remainder of the bank, including The Royal Bank of Scotland, NatWest, Coutts, Ulster Bank in Ireland, RBS International in Jersey and other linked entities, remained essentially unchanged through the year. The responsible executives make regular presentations to the Board on progress against their objectives, and a strategy offsite was held in June 2015, at which progress was reviewed in greater detail. While the strategic direction for the core businesses is clear, the bank continues to execute a major transformation programme, designed to reduce costs and enhance IT capability. That is an essential element of strategic delivery.

Conduct, regulation, and litigation

Over the past seven years the global regulatory and supervisory environment for banks has changed beyond all recognition, a necessary reaction to the parlous state in which many in the industry, notably RBS, had found themselves in 2008.

Banks have responded to the changes, and capital levels and other loss absorbency tools have been transformed. The Board has provided detailed oversight of the bank’s capital management capacity, which involved reviewing the outputs of stress tests, recovery and resolution plans, and defining the bank’s continuing risk appetite. We are firmly committed to being a strongly capitalised entity, meeting the requirements imposed on us by our many regulators.

I would observe, however, that a period of stability and reflection on the new rules, alongside some assessment of their overall impact, will be welcome. That would also allow banks more opportunity to look at how we finance the rest of the economy and hence support growth.

As is the case for other major banks domiciled in the UK, our future operations will be materially affected by the requirement to ring-fence the retail and commercial banking activities, following the legislation to implement the recommendations of the Independent Commission on Banking. The restructuring will have an important impact on the way we serve our customers, so the Board has devoted considerable time to the oversight of the plans developed to erect the ring fence, which must be in place by the end of 2018.

Another key element of the Board’s role relates to the significant conduct issues which the bank has experienced, and continues to face. These costs have materially delayed our return to profitability. So a very high priority for the Board is to resolve legacy issues and oversee the implementation of strengthened control frameworks to guard against future misconduct.

Specifically, in May 2015 the Board authorised the bank's settlements with the Department of Justice and the Federal Reserve in relation to investigations into its foreign exchange business. We regret the conduct which led to those settlements. Appropriate remediation policies have since been put in place.

Throughout the year the Board has received regular reports on other litigation, and a number of settlements have been reached on terms which the Board regarded as acceptable. Particular attention has been paid to the claims and investigations related to the origination and trading of US mortgage-backed securities, dating back to 2007, raised by the Department of Justice, the Federal Housing Finance Agency, the National Credit Union Administration, and several state Attorneys General. Although we have put aside substantial provisions for mortgage-backed securities litigation claims we have not provided for the Department of Justice and state Attorneys General investigations. It is not possible at this point to forecast when these claims and investigations will be resolved or at what ultimate cost but further substantial provisions may be required.

The Board has also overseen the response to the action raised by the 2008 rights issue Shareholders Action Groups. That case is unlikely to come to court before the end of 2016.

In 2015 a Board oversight committee was established in relation to the Financial Conduct Authority review of the treatment of SME customers referred to the bank's Global Restructuring Group. As I write, that review is still under way.

The Future

Shareholders, including of course the UK government through UK Financial Investments, are well aware that it is now seven years since RBS posted a profit or paid a dividend. It would be good to be able to promise both in the near future, but while potentially large US settlements remain outstanding it would be imprudent to do so.

What I can say is that the future shape of the bank is now far clearer than it was a year ago. We are well on the way to exiting the non-core elements of the business, and the divestments are proceeding well. We can also see signs of progress in the core business, especially in the mortgage market, though all retail and commercial banks find a very low interest rate environment one in which margins and profits are under pressure.

The bank's ambition to be number one in our chosen markets for customer service, trust and advocacy is stretching, but it focuses the attention of all our staff on the right things, and there are promising signs that staff morale is responding positively to the challenge. Our brand franchises are strong and distinctive and there is much to build on as we refocus RBS on its core markets in the British Isles. At the same time, we need to reduce our cost base, and embed a new risk culture which will guard against a recurrence of the failings and bad behavior which have held us back in the past.

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Chairman's statement

The Board is firmly behind the strategy, and believes that we have the right management in place to deliver it. There are of course varying risks and uncertainties, which we set out in the accompanying company risk disclosures, so our role is to be supportive, while also exercising strong oversight of the risk appetite and control frameworks, to protect the long-term interests of shareholders.

I have been impressed by the focus on culture and diversity at RBS. To deliver on the strategy we need to have a culture that puts customers at the heart of the business and places a premium on integrity. This is a long-term journey but it is central to making RBS a bank that is growing and flourishing for its customers and shareholders. Central to culture is diversity, which drives innovation and improves decision making, and I am pleased to see the emphasis in the business on ensuring women take a significant number of roles throughout the bank and at all levels.

Looking forward into 2016 and beyond RBS, there are a number of macroeconomic and political risks and uncertainties which are set out in the accompanying risk disclosures. One key question for the UK electorate this year will be whether the UK should remain in the EU. We are a UK-focused bank, but we have good businesses operating in other EU countries such as Ulster Bank in Ireland and many of our business customers heavily depend on unfettered access to the European Single Market. Most economic forecasts therefore point to a slowdown in UK growth, at least in the short to medium term, which would be unwelcome. Therefore, like any prudent business we are preparing for various potential scenarios. However, our primary responsibility is to serve and support our customers, and we will continue to do this, whichever way the UK electorate ultimately decide to vote.

Our role in the Community

RBS is a core part of the communities it serves and undertakes a number of initiatives to support them and help them succeed. In 2015 the bank's MoneySense programme, which provides impartial financial education for young people, celebrated its 21s anniversary. To mark the occasion, MoneySense was redeveloped and relaunched on a new digital platform with brand new content.

In 2015, we also spent a great deal of effort and resource supporting small businesses and encouraging start-ups. In partnership with social enterprise Entrepreneurial Spark we opened four new entrepreneur hubs, with a further six to be launched throughout the UK in the next two years, including one in our HQ in Edinburgh opened in February. These business accelerators, which are based in our buildings, provide start-ups with free office space, mentoring and access to our networks. 7,000 entrepreneurs will be supported in this way over five years, helping to grow the economy and create jobs. In Scotland, we have also been supporting local charities and social enterprises through use of vacant space in our retained branch network.

I am also impressed with the zeal with which the staff of RBS got on their bikes to support our chosen charity, Sport Relief. Over 700 colleagues got involved, raising over £600,000 in just five days, making the event the largest corporate fundraising event in Sport Relief's history.

Conclusion

Apart from the departure of Philip Hampton, the composition of the Board has remained unchanged through the year, though we welcomed a new member early in 2016: Mike Rogers, the CEO of Liverpool Victoria, who brings valuable retail financial services experience to the Board.

The particular challenges of RBS impose heavy burdens on the Board of directors. Their time commitment is unusually high, even by the rising standards of European banking. I am very impressed by the dedication and skills which my colleagues bring to the role. They all serve on more than one committee, and their workloads are intense. I look forward to continuing to lead such a motivated and diligent team as we continue the recovery process through 2016.

Howard Davies

Chairman

Chief Executive's review

"RBS made progress again in 2015. We ended the year a simpler, stronger bank with a business anchored squarely in the UK and Ireland focused on retail and commercial markets."

Year one of our plan in 2014 was about getting cost out and improving our capital position. This gave us the platform to go further, faster in 2015 by exiting more businesses that didn't fit our strategy, and accelerating improvements in our core bank. We delivered on both.

Simpler and stronger

Over the last few years, RBS has built a good track record in restructuring and we reinforced that record in 2015. The sale of Citizens was completed early following the largest US bank IPO ever. We are well through the sale of our international private banking business, and are winding down our non-UK transaction services business. Major loan portfolios have been divested, and the progress continues on the complex process to exit 25 of the 38 countries in our international network. We also marked the end of RBS Capital Resolution (RCR), having substantially completed its run down one year ahead of schedule.

Our progress on exits and disposals has supported a substantial uplift in capital strength, with our CET1 ratio up by 430 basis points over the year to 15.5%.

Like other banks, we continue to look for opportunities to resolve legacy conduct issues on terms we believe to be acceptable. We have recently added to our provisions in relation to residential mortgage-backed securities in the US (RMBS) and Payment Protection Insurance (PPI). We hope to conclude many of the remaining substantial conduct and litigation issues over the coming year, but the timing of many of these matters is not in our hands.

An improving core bank

As well as exiting businesses that don't fit our strategy, we have made strong progress in improving our core retail and commercial franchises. Mortgage and commercial lending showed healthy growth over the year as we played a key role in supporting the UK economy.

Focus continues around simplifying processes as the scale and footprint of the bank is reshaped. At an operational level, we have reduced our London property footprint, further rationalised and simplified our systems, and increased stability across our core platforms. Simplification across the bank has helped reduce our cost base by £983[(1)]million this year.

We have also improved our products and service for customers. Our new current account proposition – Reward – is a further step forward in terms of our offering, with our customers receiving 3% cashback on their household bills. This product is geared toward building stronger and deeper customer relationships.

Across our franchises we demonstrated further commitment to becoming a fair bank that earns the trust and loyalty of its customers. We launched a progressive three year fixed premium rate home insurance product, made £100 and £250 overdrafts automatically available to an additional one million customers, and launched new cards for visually impaired customers that secured approval from the Royal National Institute of Blind People (RNIB).

Our underlying performance over the year shows the strength - and further potential - of our core businesses, but the conduct and restructuring issues mentioned have taken their toll on our bottom line. While adjusted operating profit for the year totalled £4,405[(2)] million, we recorded a full year loss attributable to ordinary shareholders of £1,979 million.

We went further, faster against our targets in 2015

We have consistently referred to five priorities, which have become a familiar framework for tracking performance. This management team is committed to a simple approach: we set out our priorities, we commit to targets against each of them, and then we deliver, as we have set out on page 7.

For the note refer to the following page

Chief Executive's review

2016 Targets

Each year, the bank moves toward delivering stronger returns from a lower risk profile; our strategic priorities are at the core of this. For 2016, we have a new set of targets which ultimately underpin achieving the long-term target of being number one for customer service, trust and advocacy:

Our long-term financial and customer targets remain unchanged, but we have stretched our employee engagement target further. The logic we are following is simple: more engaged employees have better customer conversations, which will drive better service and, as a result, higher returns.

Strength & sustainability:

maintain bank CET1 ratio of 13%.
Customer experience:

narrow the gap to No.1 for NPS in every primary UK brand.
Simplifying the bank:

reduce operating expenses by £800 million.
Supporting growth:

net 4% growth in PBB (consisting of UK PBB and Ulster Bank RoI) and CPB (consisting of Commercial Banking, Private Banking and RBSI) customer loans.
Employee engagement:

raise employee engagement to within two points of GFS norm.

Focus for 2016

We are looking to take another £800 million from our cost base. This is an area where we must continue to be disciplined given the uncertain macroeconomic and low interest rate environment our core businesses face. In two years, we have taken out £2 billion in costs and next year will see us move closer to a sustainable cost base that reflects the size and scale of this bank.

Our 'Reward' current account proposition and increasing share of the mortgage market give us a platform to be the main bank provider to more valuable customers.

In Commercial Banking, we will continue to shift capital toward business that delivers higher quality returns, and cement our position as the number one bank for UK business.

RBS International is another strong franchise. The solid returns in this business will become an increasing feature of our profit mix over the coming years.

We also have businesses that can and will do better.

Corporate & Institutional Banking (CIB) has plans through to 2020 to deliver acceptable returns and will now be focused on serving our largest and most valuable corporate clients.

We have repositioned Ulster Bank with Ulster Bank customers in Northern Ireland included in Personal & Business Banking and the Republic of Ireland (RoI) business separated into Ulster Bank RoI. The franchise is focused on improving returns by reducing its costs, given it is now a smaller but safer business.

The sale of our international private banking business in 2015 means we can accelerate the repositioning of our UK private bank so it delivers better returns.

The separation and eventual divestment of Williams & Glyn remains a top priority for us. We will not now achieve our planned separation until after the previously announced Q1 2017 but remain committed to full divestment by the end of 2017. Separation of this business is a complex process and we continue to invest sizeable resources.

Delivering for customers and shareholders

The UK government’s decision to start disposing of its majority stake in RBS during 2015 was a significant step forward, and underlined the progress we have made over the last two years.

We have previously said that we are in phase two of our plan, working through as many of the remaining conduct and restructuring issues as we can. This is a tough but important part of our plan and we are determined to get through it as quickly as possible.

We will then move to the third phase as a strong, simple and fair bank that delivers solidly on the needs of its customers and shareholders.

Ross McEwan

Chief Executive

Note:

(1) Excluding litigation and conduct costs (2015 - £3,568; 2014 - £2,194 million), restructuring costs (2015 - £2,931 million; 2014 - £1,154 million), write down of goodwill and other intangible assets (2015 - £573 million; 2014 - £276 million) and other operating costs of Williams & Glyn (2015 - £261 million; 2014 - £232 million).

(2) Income excludes gains on own credit adjustments of £309 million, loss on redemption of own debt £263 million and loss on strategic disposals of £157 million, and expenses excludes restructuring costs of £2,931 million, litigation and conduct costs of £3,568 million and write-down of goodwill of £498 million

Business model and strategy

Our major source of income in our retail and commercial banking businesses is net interest income. This is the difference between the income we earn from the loans and advances we have made to our personal, corporate and institutional customers and on our surplus funds and the interest we pay on deposits placed with us by our customers and on debt securities we have issued. We also earn fees from financial services and other products we provide to our customers as well as rental income from assets we lease to our customers.

Our Corporate & Institutional Banking business also earns income from trading activities supporting its provision of financing and risk management services to customers, particularly Rates, Currencies and Financing. We do business in competitive markets but we have strong franchises and good growth opportunities, and we aim to target our investment to maximise these opportunities.

Our Personal & Business Banking (consisting of reportable segments UK PBB and Ulster Bank RoI) and Commercial & Private Banking (consisting of reportable segments of Commercial Banking, Private Banking and RBSI) franchises provide services to over 17 million personal and business customers in the UK and to over 1 million personal and business customers in the Republic of Ireland. Our Corporate & Institutional Banking business focuses on large corporate clients operating in the UK and Western Europe, as well as serving global financial institutions.

Our Structure

We are organised to provide products and services to personal, commercial and large corporate and institutional customers. Our principal customer-facing businesses are supported by a central Services function and other support and control functions.

Our Strategy

Note:

(1) Earliest possible timing is likely to be later than Q1 2017, subject to Board and PRA approval. Key milestones before seeking PRA approval for capital distributions would include, among other considerations, maintaining the 13% CET1 ratio target, passing regulatory capital requirements, pass 2016 Bank of England stress test (including Individual Capital Guidance hurdle) and operating within capital risk appetite, peak of litigation and conduct costs passed including US RMBS, confidence in sustainable profitability, and Williams & Glyn exit assured

Our Priorities

We have a long way to go to be the bank that our customers deserve. But we are in a period of very significant, positive change. We have millions of great customers, tens of thousands of outstanding employees. By building on this foundation, we can achieve our ambition to be number one for customer service, trust and advocacy in all our chosen markets.

Our Plan

Our overarching ambition is to become the number one bank for customer service, trust and advocacy. We have set out how we track our progress towards this goal on page 22. We also track a number of other performance measures and have set long-term targets for these to keep us on track.

	Our long-term targets	**Our 2016 goals**
Strength and sustainability	CET1 ratio of 13% (1) RoTE ≥12%	Maintain bank CET1 ratio of 13%
Customer experience	No.1 for service, trust and advocacy	Narrow the gap to No.1 for NPS in every primary UK brand
Simplifying the bank	Cost:income ratio <50%	Reduce operating expenses by £800m (2)
Supporting growth	Leading market positions in every franchise	Net 4% growth in PBB and CPB customer loans
Employee engagement	Employee engagement index in upper quartile of GFS norm	Raise employee engagement to within two points of GFS norm

Notes:

(1) During the period of restructuring.

(2) Excluding litigation and conduct costs (2015 - £3,568; 2014 - £2,194 million), restructuring costs (2015 - £2,931 million; 2014 - £1,154 million), write down of goodwill and other intangible assets (2015 - £573 million; 2014 -

£276 million) and other operating costs of Williams & Glyn (2015 - £261 million; 2014 - £232 million).

Our Operating Model

We have a clear set of Organisation Design principles that underpin our operating model, structures and accountabilities.

Our Values

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

Serving customers
We exist to serve customers.

We earn their trust by focusing on their needs and delivering excellent service.

Working together

We care for each other and work best as one team.

We bring the best of ourselves to work and support one another to realise our potential.

Doing the right thing

We do the right thing.

We take risk seriously and manage it prudently.

We prize fairness and diversity and exercise judgment with thought and integrity.

Thinking long term

We know we succeed only when our customers and communities succeed.

We do business in an open, direct and sustainable way.

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Our customers

Our Customers

RBS remains committed to achieving its target of being number one bank for customer service, trust and advocacy by 2020. In recent years, RBS has launched a number of initiatives to make it a simple and fair bank to do business with, and it continues to deliver on the commitments that it made to its customers in 2014.

We use independent surveys to measure our customers' experience and track our progress against our goal in each of our markets.

Net Promoter Score (NPS)

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

The table below lists all of the businesses for which we have a NPS for Q4 2015. Year-on- year, NatWest Business Banking, RBS Business Banking and Ulster Bank Personal Banking (Northern Ireland) have seen significant improvements in NPS.

Customer trust

We also use independent experts to measure our customers' trust in the bank. Each quarter we ask customers to what extent they trust or distrust their bank to do the right thing. The score is a net measure of those customers that trust their bank (a lot or somewhat) minus those that distrust their bank (a lot or somewhat). Customer trust in RBS is at its highest in two years and NatWest has also improved.

Notes:

(1) Source: GfK FRS 6 month rolling data. Latest base sizes: NatWest (England & Wales) (3509) Royal Bank of Scotland (Scotland) (623). Based on the question: “How likely is it that you would recommend (brand) to a relative, friend or colleague in the next 12 months for current account banking?“

(2) Source: Coyne Research 12 MAT data. Latest base sizes: Ulster Bank NI (300) Ulster bank RoI (302) Question: “Please indicate to what extent you would be likely to recommend (brand) to your friends or family using a scale of 0 to 10 where 0 is not at all likely and 10 is extremely likely”.

(3) Source: Charterhouse Research Business Banking Survey, based on interviews with businesses with an annual turnover up to £2 million. Quarterly rolling data. Latest base sizes: NatWest England & Wales (1352), RBS Scotland (432). Weighted by region and turnover to be representative of businesses in England & Wales/Scotland.

(4) Source: PWC Northern Ireland Business Banking Tracker and PWC Republic of Ireland Business Banking Tracker. Data collected annually. Latest base sizes: Ulster Bank NI (377), Ulster Bank RoI (222). Weighted by turnover to be representative of businesses in Northern Ireland and Republic of Ireland.

(5) Source: Charterhouse Research Business Banking Survey, based on interviews with businesses with annual turnover between £2 million and £1 billion. Latest base size: RBSG Great Britain (872). Weighted by region and turnover to be representative of businesses in Great Britain.

(6) Source: Populus. Latest quarter’s data. Measured as a net of those that trust RBS/NatWest to do the right thing, less those that do not. Latest base sizes: NatWest, England & Wales (974), RBS Scotland (187).

Key economic indicators

Key economic indicators

The UK economy grew by 2.2% in 2015, its average of the last 40 years. In a healthy job market, the number of people in work rose by more than 500,000 and unemployment fell to 5.1%. For the first time in six years there was meaningful wage growth, averaging 2.0%. Businesses' profits were as strong as at any point since the 1990s, at least outside the oil and gas sector, and business investment continued to rise. House prices grew by around 8%.

Summary

Despite this generally positive environment, inflation hovered around 0% throughout the year. Most of the weakness in inflation was a consequence of falling commodity prices and the effects of the depreciation in sterling since 2013. However, some of it reflected spare capacity in firms and in the labour market that contained domestic cost growth. Low inflation was one important reason why Bank Rate remained unchanged throughout the year at 0.5%, where it has been since March 2009. During early 2016, the date at which markets expected Bank Rate to rise ranged from 2017 to 2020, materially later than expectations in mid-2015. During early 2016, the date at which markets expected Bank Rate to rise ranged from 2017 to 2020, materially later than expectations in mid-2015.

Driven by strong export performance, growth in Ireland accelerated sharply to around 7.0% in the first three quarters of 2015, its fastest rate since before the crisis. Unemployment fell to under 10%, which, while materially below the recession peak of 15% remains high by the standards of the past. House price inflation moderated from 16.3% in 2014 to 6.6%, reflecting a continuing imbalance between supply and demand.

Growth in the wider euro area accelerated modestly to more than 1.0%. However, with inflation close to zero and unemployment averaging more than 11%, the European Central Bank launched a programme of quantitative easing. That programme will continue until September 2016 at the earliest. In the US, growth was 2.4%, the same as in 2014, and unemployment fell to 5%. Inflation was close to zero throughout the year. In December, the Federal Open Market Committee voted to raise the Federal Funds Target Rate by 0.25% to a range of 0.25%-0.5%.

In emerging markets, notably China, growth slowed sharply during the year, although this was not always reflected in official data. During 2015 and again in early 2016, market volatility rose because of concerns about prospects in China and other emerging markets and the possible consequences of slower growth there for advanced economies. Weaker emerging market growth contributed to slow trade growth.

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Business review

RBS is structured around becoming number one for service, trust and advocacy as we meet the ambitions and needs of our retail, business, commercial and corporate customers. Organised under three customer-facing franchises, our core businesses are centred around the UK and Ireland markets with a focused international capability.

- Personal & Business Banking (PBB) comprises two reportable segments: UK Personal & Business Banking (UK PBB) and Ulster Bank RoI.
- Commercial & Private Banking (CPB) comprises three reportable segments: Commercial Banking, Private Banking and RBS International (RBSI).
- Corporate & Institutional Banking (CIB) serving our largest corporate and institutional clients.

In addition, RBS will continue to manage and report Capital Resolution separately until disposal or wind down.

Personal & Business Banking

Personal & Business Banking (includes reportable segments UK PBB and Ulster Bank RoI) – contribution to income of 45%

Les Matheson

CEO, Personal & Business Banking

Personal & Business Banking (PBB) serves individual and mass affluent customers together with small businesses (generally up to £2 million turnover). PBB's principal brands are NatWest in England and Wales, Royal Bank of Scotland in Scotland, and Ulster Bank RoI in the island of Ireland. The operations of Ulster Bank in Northern Ireland have been combined with the main UK business.

Performance overview

- PBB recorded an operating profit of £1,292 million in 2015, down 20% from 2014, (UK PBB £1,030 million, down 9% from 2014, Ulster Bank RoI £262, down 46% from 2014), with good asset growth offset by pressure on new business margins and higher costs for restructuring the business and remedying past conduct issues.

- Customer lending grew by 5% to £136.5 billion, with good growth also recorded in customer deposits, up 2% to £150.9 billion (In UK PBB customer lending grew by 7% to £119.8 billion, customer deposits, increased by 4% to £137.8 billion, Ulster Bank RoI customer lending declined 8% to £16.7 billion, customer deposits declined by 11% to £13.1 billion). While deposit margins widened, overall net interest margin was lower as competitive conditions and the increased proportion of lower margin mortgage lending reduced asset margins.

- Operating expenses of £4,606 million included £959 million of provisions for customer redress, principally in relation to Payment Protection Insurance, as well as £182 million of restructuring costs. Operating expenses excluding restructuring costs and litigation and conducts were £3,465 million, down 3% from 2014. (UKPBB operating expenses excluding restructuring costs of £167 million (2014 - £111 million) and litigation and conduct costs of £972 million (2014 - £918 million) were £3,038 million, down 3% from 2014, Ulster Bank RoI operating expenses excluding restructuring costs of £15 million (2014 - £13 million) and litigation and conduct recoveries of £13 million (2014 - £19 million) were £427 million, unchanged from 2014).

- Credit conditions remained benign, with modest net impairment releases in the UK and substantial releases in RoI, albeit lower than in 2014.

Building a better bank that serves customers well

- In 2015 PBB moved to build deeper customer engagement through the launch of a new current account, 'Reward', which enables customers to receive 3% cashback on their household bills for a monthly account fee of £3.

- Committed to fair banking through making overdrafts more accessible to one million customers who are now eligible for overdrafts of £100 and £250.

- PBB continued to improve and develop the NatWest mobile banking app, becoming the first UK bank to enable customers to log in using their fingerprint with Touch ID and adding enhanced functionality on real time registration, Apple Pay and PAYM.

	2015			**2014**		
Performance highlights	UK PBB	Ulster Bank RoI	PBB	UK PBB	Ulster Bank RoI	PBB
Return on equity (%)	11.7	10.6	11.4	11.9	18.6	13.7
Net interest margin (%)	3.18	1.57	2.93	3.32	1.92	3.10
Cost:income ratio (%)	80	78	80	76	70	76
Operating profit (£m)	1,030	262	1,292	1,133	489	1,622
Operating expenses (£m)	(4,177)	(429)	(4,606)	(4,157)	(421)	(4,578)
Restructuring costs (£m)	(167)	(15)	(182)	(111)	(13)	(124)
Litigation and conduct costs (£m)	(972)	13	(959)	(918)	19	(899)
Operating profit excluding restructuring and litigation and conduct costs (£m)	2,169	264	2,433	2,162	483	2,645
Operating expenses excluding restructuring and litigation and conduct costs (£m)	(3,038)	(427)	(3,465)	(3,128)	(427)	(3,555)
Net loans and advances to customers (£bn)	119.8	16.7	136.5	111.6	18.1	129.7
Customer deposits (£bn)	137.8	13.1	150.9	132.6	14.7	147.3
Loan:deposit ratio (%)	87	127	90	84	124	88
Risk-weighted assets (£bn)	33.3	19.4	52.7	36.6	21.8	58.4

Case studies

A new way to pay

With Apple Pay, customers can now shop using just their mobile phone. NatWest was one of the first banks to make the service available to UK customers, and thanks to this partnership between the bank and Apple, customers can now use their Apple devices to pay for goods in shops, make payments in apps and pay fares on the London transport system while travelling around the city.

Not only is Apple Pay convenient, but customers earn the same rewards they would get using their RBS or NatWest debit or credit cards.

So now if you leave your wallet at home, it need not ruin your day.

Very rewarding

Customers want banking to be simple and straightforward – and to be rewarded for their loyalty. It's never fair when new customers get all the best deals. Our new Reward account is benefiting customers old and new, who choose to do their everyday banking with us. There are no catches, or complicated terms and conditions. For a small fee all customers can earn 3% cashback on up to seven household bills paid by direct debit. That means anyone paying household bills of more than £100 a month will cover the monthly Reward fee, and the more you pay out for your bills, the more you earn. It really is that simple.

Commercial & Private Banking

Commercial & Private Banking (includes reportable segments Commercial Banking, Private Banking and RBSI) contribution to income of 33%

Alison Rose

CEO, Commercial & Private Banking

Commercial & Private Banking (CPB) serves commercial and corporate customers, operating principally through the NatWest and Royal Bank of Scotland brands, and high net worth individuals, through Coutts and Adam & Co. In Jersey, Guernsey, the Isle of Man and Gibraltar, RBS International serves a range of retail, commercial, corporate and financial institution customers. CPB aims to support the UK and Western European economies through its provision of credit and banking services to help businesses grow.

Performance overview

- CPB recorded an operating profit of £1,001 million, down £592 million or 4% (Commercial Banking – up £8 million, 1%, Private Banking – down £569 million, RBSI - down £31 million, 13%). Operating profit excluding restructuring, litigation and conduct costs and write down of goodwill was £1,708 million down 11%. (Commercial Banking – down £92 million, 6%, Private Banking – down £77 million, 41%, RBSI – down £34 million, 14%). CPB operating profit of £1,001 million was impacted by a goodwill impairment charge of £498 million attributed to Private Banking.

- In CPB total income declined by 3% to £4,265 million. In Commercial Banking total income declined by 2%, driven by a loss of £34 million from the sale of non-strategic asset portfolios and the transfer of the commercial cards business to UK PBB in 2014. In Private Banking total income declined by 7% to £644 million principally reflecting reduced fee income. In RBSI total income declined by 6% to £367 million principally reflecting lower deposit margins and lower return on free funds.

- Good growth was achieved in lending to UK businesses. Commercial Banking achieved net new lending of £1.4 billion, while continuing to run down some non-strategic portfolios. Pressure on new business lending margins was partially offset by deposit repricing.

- In CPB operating expenses of £3,182 million included £146 million of restructuring costs (up 26% from 2014), £63 million of conduct and litigation costs (down 69% from 2014) and write-down of goodwill of £498 million. This included restructuring costs of £69 million relating to Commercial Banking, down 36%, £73 million relating to Private Banking and £4 million relating to RBSI, down 43%, litigation and conduct costs of £51 million relating to

Commercial Banking down 54% and £12 million relating to Private Banking down 87% and write-down of goodwill of £498 million, all relating to Private Banking. Operating expenses excluding restructuring, litigation and conduct costs and write down of goodwill increased by 3% to £2,475 million. (Commercial Banking increased by 3% to £1,801 million, Private Banking increased by 3% to £518 million and RBSI increased by 2% to £156 million).

· Impairment losses were £82 million, in line with the modest impairments experienced in 2014, (Commercial Banking £69 million, Private Banking £13 million and RBSI - nil).

Building a better bank that serves customers well

· Commercial Banking made progress towards improving customer experience by becoming easier and simpler to do business with through operational investment and process simplifications.

· Continued enhancements within the business contributed to commercial lending growth in 2015.

· Opened four Entrepreneur Hubs across the UK, increasing our involvement to seven, enabling entrepreneurs and small businesses to access free office space, mentoring and fi support, with a further fi e hubs to be opened in 2016.

· Private Banking is being refocused on its UK connected customers, with a simpler operating model and new customer propositions for wealthy individuals and families. Closer links with Commercial Banking have driven an increase in client referrals.

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Commercial & Private Banking

	2015				2014			
Performance highlights	Commercial Banking	Private Banking	RBSI	CPB	Commercial Banking	Private Banking	RBSI	CPB
Return on equity (%)	9.8	(27.7)	18.5	5.8	10.2	4.1	24.2	10.6
Net interest margin (%)	1.88	2.75	1.48	1.92	1.91	2.89	1.65	1.99
Cost:income ratio (%)	59	171	44	75	59	86	41	62
Net loans and advances to customers (£bn)	91.3	11.2	7.3	109.8	84.9	11.0	7.2	103.1
Customer deposits (£bn)	88.9	23.1	21.3	133.3	84.9	22.3	20.8	128.0
Loan:deposit ratio (%)	103	48	35	82	100	49	35	80
Risk-weighted assets (£bn)	72.3	8.7	8.3	89.3	63.2	8.7	7.5	79.4
Operating profit (£m)	1,264	(470)	207	1,001	1,256	99	238	1,593
Operating expenses (£m)	(1,921)	(1,101)	(160)	(3,182)	(1,964)	(595)	(160)	(2,719)
Restructuring costs (£m)	(69)	(73)	(4)	(146)	(108)	(1)	(7)	(116)
Litigation and conduct costs (£m)	(51)	(12)	-	(63)	(112)	(90)	-	(202)
Write down of goodwill	-	(498)	-	(498)	-	-	-	-
Operating profit excluding restructuring, litigation and conduct costs and write down of goodwill (£m)	1,384	113	211	1,708	1,476	190	245	1,911
Operating expenses excluding restructuring, litigation and conduct costs and write down of goodwill (£m)	(1,801)	(518)	(156)	(2,475)	(1,744)	(504)	(153)	(2,401)

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Case studies

A campus fit for a king

Established in 1829, King's College London has an illustrious history, with alumni including John Keats and Florence Nightingale. The University wanted to raise £135 million to invest in its Strand campus, and returned to the private placement market to deliver. "Since our foundation we've banked with RBS, so we have a long and trusted relationship," explains Stephen Large, Director of Finance at King's College London. "I'm proud of the difference the redevelopment will make to the University, future generations of students and the local community."This strong relationship helped the bank and the University work together to raise the funding to redevelop the campus and create a new business school.

Home sweet home

Moving house can be stressful. Then, once you find the right home, you then need to switch energy supplier, set up your broadband and manage your home. Zoopla Property Group (ZPG) is a digital media and lead generation platform that owns and operates some of the UK's most widely recognised and trusted digital brands including Zoopla, uSwitch and PrimeLocation. Its mission is to be the most useful resource for consumers and the most effective marketing channel for related business partners. Acquiring price comparison website uSwitch in June 2015 allowed ZPG to develop its combined services and become the consumer champion at the heart of the home. RBS supported the acquisition by acting as Mandated Lead Arranger in a £150 million four-bank arrangement. Thanks to the successful deal, ZPG can now help its consumers make smarter decisions when finding, moving or managing their home.

Corporate & Institutional Banking

Corporate & Institutional Banking contribution to income of 12%

Chris Marks

CEO, Corporate & Institutional Banking

The Corporate & Institutional Banking (CIB) business has a core focus on UK and Western Europe corporates and global financial institutions, shaped around three product lines: Rates, Currencies and Financing. The business is undergoing a multi- year transformation, which was launched in 2015.

Performance overview

- CIB reported an operating loss of £837 million, compared with a loss of £710 million in 2014. Operating loss excluding restructuring costs of £524 million (2014 - £102 million), litigation and conduct costs of £378 million (2014 - £832 million) and own credit adjustments of £120 million (2014 - £9 million loss) was £55 million, compared with an operating profit of £233 million in 2014 as lower income was partially offset by a reduction in expenses, down 15%.

- Total income declined by £404 million, or 21%, to £1,527 million in 2015. Excluding £120 million relating to own credit adjustments (2014 - £9 million charge) and £98 million relating to the transfer of portfolio businesses to Commercial Banking, CIB income was £1,309 million, in line with previous guidance.

- Rates income declined, reflecting the reduced scale and risk appetite of the business. Currencies incurred losses when the Swiss Central Bank unexpectedly removed the Swiss Franc's peg to the Euro. Financing was impacted by the strategically reduced corporate footprint especially in the US and by lower levels of EMEA investment grade issuance.

- Operating expenses of £2,369 million (2014 - £2,650 million) included litigation and conduct costs of £378 million (2014 - £832 million) and restructuring costs of £524 million (2014 - £102 million). Operating expenses excluding litigation and conduct costs and restructuring costs were £249 million lower totalling £1,467 million (2014 - £1,716 million), principally due to considerable reduction in headcount as the business moves towards a more sustainable cost base.

- RWAs reduced by £8.8 billion to £33.1 billion compared with £41.9 billion, nearing the end-state target of c.£30 billion. The reduction was primarily driven by the transfer to Commercial Banking of the UK and Western European portfolio business.

Building a better bank that serves customers well

- CIB managed the largest liability management exercise in Europe in 2015 whilst raising approximately £50 billion for customers in debt capital markets in 2015.

- Steady state target for CIB is c.£1.4 billion of income with c.£30bn RWAs. Operating expenses are targeted at c.£0.7-0.8bn to deliver 8-10% return of equity.

Performance highlights	**2015**	**2014**
Return on equity (%)	11.1	7.9
Cost:income ratio (%)	155	137
Loans and advances to customers (£bn)	16.1	26.5
Customer deposits (£bn)	5.7	11.8
Risk-weighted assets (£bn)	33.1	41.9

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Case studies

Waste nothing

Rotterdam-based AVR handles public and commercial waste from across the Netherlands and surrounding countries, including the UK and Ireland. The waste is transformed into green energy for the Dutch power grid and district heating. A consortium, Cheung Kong Infrastructure Holdings and Power Assets Holdings, bought the business in 2013 and we recently helped them refinance part of that acquisition through the capital markets. The deal means the company can now operate more cheaply. This is good for AVR, and for Dutch communities as the company is now able to bid more competitively for public authority waste contracts.

Silver Service for Whitbread

RBS has a long-standing relationship with Whitbread, the UK's largest hospitality company, which owns a number of well known brands including Premier Inn, Costa Coffee, Beefeater and Brewers Fayre. The company wanted to raise £450 million, so turned to the bank for help to raise the funds in the debt capital markets. RBS acted as joint lead manager, documentation bank as well as billing and delivery agent on the benchmark 10-year deal, which had a coupon of 3.375 per cent.

The deal marked Whitbread's debut sterling bond issue and will help the hospitality company continue to grow its business.

Capital Resolution

Capital Resolution

Mark Bailie

CEO, Capital Resolution

Capital Resolution consists of CIB Capital Resolution and RBS Capital Resolution (RCR). At 1 January 2015, CIB Capital Resolution comprised £101 billion of funded assets consisting of non-strategic portfolios from the CIB segment. RCR was created on 1 January 2014 to de-risk the bank's balance sheet.

Performance overview

- Capital Resolution funded assets fell by £62.2 billion to £53.4 billion, primarily due to run off of the repo financing book and loan portfolio disposals.

- Within this RCR reduced funded assets by 88% since its formation to £4.6 billion, exceeding the targeted reduction of 85% a year ahead of schedule.

- Capital Resolution RWAs reduced from £95.1 billion to £49.0 billion, driven by signifi ant reductions across CIB Capital Resolution and RCR, which primarily reflected disposals and repayment activity.

- CIB Capital Resolution delivered on its commitment to reduce RWAs by £25 billion in 2015, with a reduction of £32.6 billion.

- Capital Resolution made an operating loss of £3,687 million, including income related disposal losses of £367 million, restructuring costs of £1,307 million together with litigation and conduct costs of £2,105 million primarily relating to additional provisions for mortgage- backed securities litigation in the US. Operating expenses excluding restructuring costs of £1,307 million (2014 - £185 million), litigation and conduct costs of £2,105 million (2014 - £162 million) and write-down of goodwill of £130 million in 2014, were reduced by £481 million, or 24% to £1,539 million, principally reflecting a fall in headcount of approximately 1,100. Net impairment releases of £725 million were recorded, primarily in RCR driven by the disposal strategy and favourable market and economic conditions.

Building a better bank that serves customers well

- CIB Capital Resolution consists of three regional businesses (Americas, EMEA and APAC), Shipping, Markets assets, Other legacy assets including Saudi Hollandi Bank and Global Transaction Services.

- RCR consisted of four asset groups: Ulster Bank (RCR Ireland), Real Estate Finance (ex. Ireland), Corporate and Markets. The remaining funded assets are included in Capital Resolution and RCR ceases to exist (following formal approval by the PRA).

Performance highlights	**2015**	**2014**
Risk-weighted assets (£bn)	49.0	95.1
Risk-weighted asset equivalent (£bn)	50.3	101.3
Total assets (£bn)	201.5	327.3
Funded asset (£bn)	53.4	115.6

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Case study

Pedalling ourselves proud

RBS became an official partner of Sport Relief in summer 2015, and September saw the first bank-wide fundraising event for the charity. Almost 750 colleagues from right across the business took part in the London to Edinburgh cycle challenge. Colleagues chose to cycle the full 500 miles, or 100 or 35 mile stretches, with hundreds more also taking part in static bike challenges, bake sales and other fundraising activities in our buildings across the UK. RBS employee Howard Fairclough shared his experience of the challenge: “Fantastic day, although my thighs might not agree. In terms of staff engagement this was the best event I’ve taken part in, in my 29 year career with the bank.”

Governance at a glance

Our Board

The Board has eleven directors comprising the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director. Biographies for each director can be found on pages 43 to 46.

In September 2015, Howard Davies was appointed Chairman of RBS, succeeding Philip Hampton. Mike Rogers was appointed to the Board on 26 January 2016.

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

An external evaluation of the effectiveness of the Board and its committees was conducted in 2015, led by Condign Board Consulting Limited.

Governance at a glance

Our Board committees

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

The full Governance report is on pages 42 to 89.

Group Audit Committee

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

Board Risk Committee

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

RBS Capital Resolution (RCR) Board Oversight Committee

Provides oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. The RCR BOC met for the final time in January 2016 to finalise the closure of RCR.

Sustainable Banking Committee

Provides support to the Board in overseeing actions being taken by management to run a sustainable long term business, with specific focus on culture, people, customer, brand and Environmental Social and Ethical issues.

Governance at a glance

Group Performance and Remuneration Committee

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

Group Nominations Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and the membership and chairmanship of Board committees. It considers succession planning taking into account the skills and expertise which will be needed on the Board in future. In 2016, the Nominations Committee will be replaced by the Nominations and Governance Committee, which has an expanded remit including governance oversight.

Executive Committee

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

UK Corporate Governance Code

Throughout the year ended 31 December 2015, RBS has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated September 2014 except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors.

RBS considers that this is a matter which should rightly be reserved for the Board.

Risk overview

Risk overview

Progress in 2015

- RBS made continued progress in 2015 on delivering its strategy to reduce risk and strengthen its balance sheet and capital position.

- Risk-weighted assets fell 32% in the year to £243 billion.

- The Common Equity Tier 1 (CET1) capital ratio increased by 430 bps to 15.5% and the leverage ratio increased by 140 bps to 5.6%.

- Risk elements in lending (REIL) fell to £12.2 billion, representing 3.9% of gross customer loans, down from 6.8% at 31 December 2014.

- RBS continued to reduce risk concentrations, notably in sectors such as Oil & Gas and Commercial Real Estate as well as in the Eurozone periphery countries.

- Good progress was made in de-risking the balance sheet as a result of the continued run-down or sale of certain businesses and higher-risk or capital- intensive assets.

- Citizens was fully divested resulting in a total RWA reduction of £63 billion.

- Capital Resolution reduced RWAs to £49 billion at 31 December 2015 from £95 billion at 31 December 2014, with substantial progress seen across exit portfolios. RCR reached its targeted run-down for 2015 with a total RWA reduction of £38 billion since launch and a £13.5 billion reduction in 2015.

- The first tranche of the international private banking business sale was completed with the second tranche due to be completed in the first half of 2016.

In the Bank of England (BoE) 2015 stress test, RBS's transitional Common Equity Tier 1 (CET1) capital ratio under the hypothetical adverse scenario was 6.1% after the impact of management actions, above the 4.5% post-stress minimum CET1 capital ratio threshold set by the BoE. Taking into account the capital actions achieved in 2015 and those planned in the future, RBS did not need to alter its current capital plan as a result of the stress test, including the requirements relating to its Individual Capital Guidance (ICG). RBS's Tier 1 leverage ratio under the hypothetical adverse scenario was 2.9%. After the impact of management actions, the ratio was 3.0%, which met the 3.0% post-stress minimum Tier 1 leverage ratio threshold set by the BoE.

RBS maintained a strong liquidity and funding risk profile in 2015. Its loan to deposit ratio was 89% at 31 December 2015, compared with 95% in 2014. The latest Individual Liquidity Adequacy Assessment (ILAA) showed that RBS is in a strong position to withstand liquidity stress scenarios. It suggested that RBS's liquidity portfolio was large enough to cover more than double (227%) the expected outflows in the worst of three severe scenarios.

Risk overview

Top and emerging risks

RBS employs a robust process for identifying and managing its top and emerging risks. Top risks are defined as scenarios that, while unlikely, may materialise, and which, if they did, would have a significant negative impact, such that RBS as a whole, or a particular business, could potentially fail to meet one or more of its strategic objectives. A number of scenarios attracted particular attention in 2015:

Macro-economic and other external risks

Risks related to the wider economy:

Like most other businesses, RBS remains vulnerable to changes in the external economic environment. Among potential scenarios considered, the following could have a material negative impact: a UK recession including large house price falls; vulnerabilities in emerging market economies, including China, resulting in contagion in RBS's core markets; global deflation; volatility in international markets linked to advanced economy interest rate increases or decreases; a resumption of the eurozone crisis, including a worsening of the situation in Greece; and major geopolitical instability. To mitigate these risks, RBS has strengthened its capital, liquidity and leverage positions. A number of higher-risk portfolios have been exited or reduced. Stress testing is used extensively to inform strategic planning and risk mitigation relating to these risks.

Risks related to the UK referendum on EU membership:

The referendum on the UK's membership of the EU during this parliament increases economic and operational uncertainty. The result may also give rise to further political uncertainty regarding Scottish independence. RBS actively monitors, and considers responses to, varying EU referendum outcomes to ensure that it is well prepared for all eventualities.

Risks related to the competitive environment:

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

An increase in obligations to support pension schemes:

If economic growth stagnates, and interest rates remain low, the value of pension scheme assets may not be adequate to fund pension scheme liabilities. The deficit in RBS pension schemes as determined by the most recent triennial valuations has increased, requiring RBS to increase its current and future cash contributions to the schemes. An acceleration of certain previously committed pension contributions in Q1 2016 will reduce this risk. Depending on the economic and monetary conditions and longevity of scheme members prevailing at that time, the deficit may increase at subsequent valuations.

Regulatory and legal risks

The impacts of past business conduct:

Future conduct and litigation charges could be substantial. RBS is involved in ongoing class action litigation, securitisation and mortgage-backed securities related litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, investigations into the treatment of small and medium- sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products), and other investigations. Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material. More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections. To prevent future conduct from resulting in similar impacts, RBS has embarked on a programme to embed a strong and comprehensive risk and compliance culture.

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

RBS is exposed to the risk of further increases in regulatory capital requirements as well as risks related to new regulations that could affect its business models. RBS considers the implications of proposed or potential regulatory activities in its strategic and financial plans.

Operational and execution risks

Increased losses arising from a failure to execute major projects successfully:

The successful execution of major projects, including the transformation plan, the restructuring of CIB, the divestment of Williams & Glyn and the embedding of a strong and pervasive organisational and risk culture, are essential to meet RBS's strategic objectives. The separation and eventual divestment of Williams & Glyn is a complex process and as such entails significant operational and execution risk. The Group remains committed to full divestment of Williams & Glyn by the end of 2017. These projects cover organisational structure, business strategy, information technology systems, operational processes and product offerings. RBS is working to implement change in line with its project plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.

Risk overview

Impact of cyber attacks:

Cyber attacks are increasing in frequency and severity across the industry. RBS has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a 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 anti-virus protections, and the implementation of a staff education programme on information protection.

Inability to recruit or retain suitable staff:

RBS is undergoing significant organisational change, the result ofa need to implement new business strategies and respond to a changing external environment. The pace of change, coupled with the associated uncertainty, may cause experienced staff to leave and prospective staff not to join. Although these risks concern all customer businesses, they particularly affect CIB. RBS has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses. It is also working to implement an enhanced recruitment strategy.

Failure of information technology systems:

RBS's information technology systems may be subject to failure. As such systems are complex, recovering from failure is challenging. To mitigate these risks, a major investment programme has significantly improved the resilience of the systems and more benefits are expected. Back-up system sustainability has improved, and a 'shadow bank' system, to provide basic services, if needed, has been created.

Full risk factors are discussed on pages 384 to 409.

Sustainable banking

Sustainable banking

Sustainable banking means serving today's customers in a way that also helps future generations. It requires us to put customers first, make RBS a great place to work, support our communities and be mindful of environmental impacts.

This section gives a short overview of our two main areas of focus: supporting enterprise and financial capability. It also provides details of our key disclosures on carbon emissions, inclusion and human rights. Our forthcoming Sustainable Banking Report, independently assured to AA1000 standards, provides a much more comprehensive overview of our approach to these areas and other material issues affecting the bank. Further information is available at rbs.com/sustainable.

Carbon emission disclosures

RBS has a set of five year environmental targets running from 2015-2020, which sit alongside our pre-existing 2012-2020 targets for business travel and paper. At the end of year one, we can report that due to efficiency initiatives across our UK property portfolio, we've continued to reduce our combined Scope 1 and 2 emissions, putting us well on track to meet our global 2020 energy reduction targets. Similarly, our Scope 3 business travel reductions remain on track, as a result of our internal policies to reduce cost and promote more sustainable modes of travel.

We continue to strive to reduce the energy and associated emissions of our data centres, whilst also ensuring the delivery of reliable and innovative services to our customers remains a key priority. We've made changes in our waste reporting, by expanding our data collection streams and working closely with suppliers to find innovative ways to meet targets.

Our ambitious 'Zero Waste to Landfill' target remains challenging and if we are to meet it, will require us to find new approaches to collaboration. The 2015 reporting year has seen the removal of Citizens from our environmental footprint, and so to remain in line with best practice, we've applied our re-baselining strategy to remove CFG emissions and normalise our environmental footprint. In 2014, CFG combined Scope 1, 2 and 3 footprint totalled 101,240tCO2e.

Inclusion

Building a more inclusive bank is essential for our customers and colleagues. Our inclusion policy standard applies to all our people globally.

During 2015 we continued our roll out of unconscious bias learning for all employees. We have introduced a gender goal to have at least 30% of women in the bank's top three leadership levels by 2020. Further, we aim to have 50/50 balance at all levels by 2030. This is supported by the launch of a female development proposition. An increased focus on disability has led to the development of a comprehensive plan to support our colleagues and customers with additional needs and will help RBS achieve its ambition of becoming a 'disability smart' organisation. From an LGBT perspective, we continue to deliver improvements to our people policies and customer operating procedures, including the introduction of guidance to support employees going through gender transition, introducing the 'Mx' honorific, and improving our customer gender change process. We are finalising plans to improve our ethnic representation within senior roles and are continuing to support our 15,000 strong employee-led networks.

RBS has been recognised for its work on Equality, Diversity and Inclusion by our Platinum ranking from Opportunity Now (gender); our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; and improving upon our ranking in the Stonewall Workplace Equality Index (LGBT). As at 31 December 2015, of our global population of 90,158 employees (actual headcount excluding temporary workers), 42,892 (48%) were male and 47,266 (52%) female. There were 701 'senior managers', which comprises our executive employee population and individuals who are directors of our subsidiaries. The RBS Board of directors has eleven members, consisting of eight male and three female directors.

Our approach to Human Rights

RBS recognises its corporate responsibility to respect and uphold human rights. We regularly review our policies and procedures to ensure that we avoid infringing on the human rights of others throughout our sphere of influence.

The RBS Code of Conduct 'Our Code' sets out the standards we expect our people to work to, including a clear commitment to respecting human rights. We conduct regular consultations with employees on key aspects of their working environment, and operate a confidential helpline facility that allows employees to discuss any matter of concern with regards to their wellbeing. We are an accredited living wage employer.

Sustainable banking

Our Sustainable Procurement Code sets out our expectations of the companies that we work with. It states that our suppliers should not engage in breaches of human rights or labour rights, or in discrimination. We are also committed to equal opportunities for suppliers, and we recognise that diversity strengthens our supply chain. During 2015 we conducted introductory training on sustainability to members of our procurement team.

Our Environment, Social, Ethical (ESE) Risk policies include sector-specific human rights risk screenings and are regularly reviewed and updated to ensure best practice. We conduct due diligence on clients relating to human rights standards, and expect our clients to share our commitment to respecting human rights within their operations. In all sectors, we will not provide financial services to companies involved in harmful child labour or forced labour.

We also participate in projects with our peers through the Thun Group and UNEP FI to better understand and implement the human rights responsibilities of banks as defined by the UN Guiding Principles on Business and Human Rights. We have adopted and contributed to a number of internationally accepted codes, notably the Equator Principles and the UN Global Compact, which specifically address the management of human rights issues.

RBS welcomes new legislation – the Modern Slavery Act 2015 – to combat slavery and human trafficking. We are obliged to produce a public statement under this Act for the reporting year 2016, and we are identifying the steps necessary to ensure there is no modern slavery within our organisation and supply chain.

Our areas of focus

Support for enterprise

RBS and NatWest support more businesses in the UK than any other bank, but we are determined to do more to get behind the entrepreneurs and businesses that power the UK economy. One of the ways we're doing this is through our partnership with Entrepreneurial Spark, the free business accelerator programme. By the end of 2015 there were seven business accelerator hubs in Brighton, Birmingham, Bristol, Leeds, Glasgow, Edinburgh and Ayr and we will open six more around the UK by 2017. These hubs offer free workspace, hands-on mentoring, a start-up 'bootcamp' and a free programme of up to 18-months of advice, support and funding clinics for entrepreneurs and high growth businesses. 2015 also marked the successful conclusion of our Inspiring Enterprise initiative. In 2012 we began supporting and helping to fund organisations that work with young people, women and social enterprises to help them develop and progress their business ideas. By the end of the three year period, our support had directly contributed to the creation of 2,173 new businesses across the UK and we exceeded our initial targets by assisting 114,059 young people, 28,365 women and 5,349 social enterprises to develop their ideas and take their next steps on their enterprise journey.

Financial capability

A cornerstone of our ambition to become No. 1 for customer service, trust and advocacy by 2020 is our commitment to help people manage their money better. This means supporting people's financial capability both day-to-day and through significant life events. One of our most established initiatives is MoneySense, which is one of the longest running financial education programmes for young people in the UK and Ireland. Over 60% of secondary schools were registered to use MoneySense in 2015, gaining access to a range of resources and interactive materials for teachers, staff volunteers and young people to help them get to grips with money and how to manage it. To celebrate the programme's 21st birthday, we re-launched MoneySense to open it up to primary schools for the first time and introduced new materials to make learning about money more real, relevant and fun for 5-18 year olds. The programme continues to empower young people to take control of their own financial journeys and build financial capability throughout their lives.

Governance report

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Our Board

Chairman

Howard Davies (age 65)

Nationality: British

Date of appointment: 14 July 2015 (Board),

1 September 2015 (Chairman)

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

Howard recently chaired the UK Airports Commission and is also the author of several books on financial subjects.

External appointment(s):

· Independent director of Prudential plc and chair of the Risk Committee

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

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

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

Committee membership(s):

Group Nominations and Governance Committee (Chairman)

Executive directors

Chief Executive

Ross McEwan (age 58)

Nationality: New Zealand

Date of appointment: 1 October 2013

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

External appointment(s):

None

Committee membership(s):

· Executive Committee (Chairman)

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

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

Ewen Stevenson (age 49)

Nationality: British/New Zealand

Chief Financial Officer

Date of appointment: 19 May 2014

External appointment(s):

None

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

Committee membership(s):

· Executive Committee

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

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Our Board

Independent non-executive directors

Sandy Crombie (age 67)

Nationality: British

Date of appointment: 1 June 2009

(Senior Independent Director)

Experience: Sandy spent his entire full-time career with Standard Life plc, retiring as group chief executive. An actuary, he has served his profession in a variety of roles and has also served as a director of the Association of British Insurers.

Sandy has had a variety of cultural and community roles, and was previously Chairman of Creative Scotland, Chairman of the Edinburgh World City of Literature Trust and vice Chairman of the Royal Conservatoire of Scotland.

External appointment(s):

· President of the Cockburn Association

Committee membership(s):

· Group Performance and Remuneration Committee (Chairman)

· Group Audit Committee

· Group Nominations and Governance Committee

· GRG Board Oversight Committee

Alison Davis (age 54)

Nationality: British/USA

Date of appointment: 1 August 2011

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

External appointment(s):

· Non-executive director and member of the compensation committee of Unisys Corporation

· Non-executive director, chair of the compensation committee and member of the audit committee of Diamond Foods Inc.

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

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

· Member of Advisory Board of Strategic Global Advisors, LLP

Committee membership(s):

· Group Nominations and Governance Committee

· Group Performance and Remuneration Committee

· Sustainable Banking Committee

Morten Friis (age 63)

Nationality: Norwegian

Date of appointment: 10 April 2014

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

External appointment(s):

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

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

Committee membership(s):

· Group Audit Committee

· Board Risk Committee

· CIB Board Oversight Committee

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Our Board

Independent non-executive directors

Robert Gillespie (age 60)

Nationality: British

Date of appointment: 2 December 2013

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

External appointment(s):

· Independent board director at Ashurst LLP

· Chairman of Council at the University of Durham

· Chairman of the Boat Race Company Limited

· Director of Social Finance Limited

Committee membership(s):

· Group Nominations and Governance Committee

· Group Performance and Remuneration Committee

· Board Risk Committee

· Sustainable Banking Committee

· CIB Board Oversight Committee (Chairman)

· GRG Board Oversight Committee

Penny Hughes, CBE (age 56)

Nationality: British

External appointment(s):

· Non-executive Chairman of The Gym

Date of appointment: 1 January 2010

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

Group plc. Also chair of the nominations and member of the audit, risk and remuneration committees

· Non-executive director and member of the audit and nomination committees of SuperGroup plc

Committee membership(s):

· Sustainable Banking Committee (Chairman)

· Board Risk Committee

· GRG Board Oversight Committee

Brendan Nelson (age 66)

Nationality: British

Date of appointment: 1 April 2010

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

External appointment(s):

· Non-executive director and chairman of the audit committee of BP plc

· Member of the Financial Reporting Review Panel

Committee membership(s):

· Group Audit Committee (Chairman)

· Group Nominations and Governance Committee

· Board Risk Committee

- GRG Board Oversight Committee (Chairman)

- CIB Board Oversight Committee

Our Board

Independent non-executive directors

Baroness Noakes, DBE (age 66)

Nationality: British

Date of appointment: 1 August 2011

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

External appointment(s):

· Deputy chairman, Ofcom

Committee membership(s):

· Board Risk Committee (Chairman)

· Group Audit Committee

· CIB Board Oversight Committee

· GRG Board Oversight Committee

Mike Rogers (age 51)

Nationality: British

Date of appointment: 26 January 2016

Experience: Has extensive experience in retail banking and financial services. Mike joined Barclays in 1986 where he undertook a variety of roles in the UK and overseas across business banking, wealth management and retail banking. Mike was Managing Director of Small Business, Premier Banking and UK Retail Banking. Mike is currently Chief Executive of Liverpool Victoria Group, a role he was appointed to in 2006.

External appointment(s):

· Chief executive, Liverpool Victoria Group

· Non-executive director of the Association of British Insurers.

Committee membership(s):

· Sustainable Banking Committee

Chief Governance Officer and Board Counsel

Aileen Taylor (age 43)

Nationality: British

Date of appointment: 1 May 2010

(Company Secretary)

Aileen is a fellow of the Chartered Institute of Bankers in Scotland and a member of the European Corporate Governance Council.

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

Executive Committee

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

Corporate governance

Chairman's introduction

I am pleased to introduce the Corporate Governance report, my first since being appointed Chairman of the Board. A brief review of the principal issues addressed by the Board during the year is included in my Chairman's Statement on page 13. The following report provides an overview of key roles and responsibilities of the Board, and sets out in greater detail how the Board spent its time in 2015. Board effectiveness and performance evaluation are also covered, as well as an overview of how we communicate with shareholders.

I and my fellow directors are committed to observing high standards of corporate governance, integrity and professionalism. Our statement of compliance with the UK Corporate Governance Code (the Code) can be found on page 90.

Howard Davies, Chairman of the Board

The Board

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

Biographies for each director and details of which Board committees they are members of can be found on pages 43 to 46. The Board considers that the Chairman was independent on appointment and that all non-executive directors are independent for the purposes of the Code.

Board changes

Philip Hampton stepped down from the Board on 31 August 2015.

Howard Davies was appointed as a non-executive director on 14 July 2015 and assumed the role of Chairman on 1 September 2015. Mike Rogers was appointed as a non-executive director and a member of the Sustainable Banking Committee on 26 January 2016.

Roles and responsibilities

The Board

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

Chairman

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

The Chairman's key responsibilities are to:

- provide strong and effective leadership to the Board;
- ensure the Board is structured effectively, observes the highest standards of integrity and corporate governance, and sets the tone from the top in terms of culture and values;
- build an effective and complementary Board with an appropriate balance of skills and personalities, and as Chairman of the Group Nominations Committee consider succession planning for Board appointments;
- manage the business of the Board and set the agenda, style and tone of Board discussions to promote effective decision-making and constructive debate;
- facilitate the effective contribution and encourage active engagement by all members of the Board;
- in conjunction with the Chief Executive and Chief Governance Officer and Board Counsel, ensure that members of the Board receive accurate, timely and clear information, to enable the Board to lead RBS, take sound decisions and monitor effectively the performance of executive management;
- ensure that the performance of individual directors and of the Board as a whole and its committees is evaluated regularly; and
- ensure RBS maintains effective communication with shareholders and other stakeholders.

Chief Executive

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

The Chief Executive's key responsibilities are to:

- exercise executive accountability for the RBS businesses delivering operational management and oversee the full range of activities of the customer businesses and functions;
- develop, drive and deliver the strategy approved by the Board;
- drive and deliver performance against financial plans, acting in accordance with authority delegated by the Board;
- consult regularly with the Chairman and Board on matters which may have a material impact on RBS;
- act as champion of the culture and values of RBS, creating an environment where employees are engaged and committed to good customer outcomes;
- lead, manage and develop RBS's senior leadership team, ensuring professional capability is developed and that succession coverage meets the needs of RBS;
- ensure RBS has effective frameworks and structures to identify, assess and mitigate risks; and
- in conjunction with the Chairman and Chief Governance Officer and Board Counsel, ensure the Board receives accurate, timely and clear information.

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Corporate governance

Senior Independent Director

Sandy Crombie, as Senior Independent Director, acts as a sounding board for the Chairman and as an intermediary for other directors when necessary. He is also available to shareholders to discuss any concerns they may have, as appropriate.

Non-executive directors

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

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

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. Please see page 34 of the Strategic Report for more details. The terms of reference are available on rbs.com.

During 2015, two additional temporary committees were established to support the Board's oversight of Global Restructuring Group ('GRG') and CIB.

Chief Governance Officer and Board Counsel

Aileen Taylor is the Chief Governance Officer and Board Counsel and is also the Company Secretary. Reporting directly to both the Chairman and the Chief Executive, she provides support and advice to the Board on a broad range of strategic and governance issues. She acts as a trusted advisor in the effective functioning of the Board, ensuring appropriate alignment and information flows between the Board and its committees, including the Executive Committee. As Board Counsel, she is responsible for delivery of commercial corporate governance support and related legal advice to the Board and overseeing the provision of legal advice to the Board by the General Counsel.

The Chief Governance Officer and Board Counsel's key responsibilities include:

- advising on Board skills and composition including induction, ongoing training and professional development;
- executive responsibility for Chairman/non-executive director search and appointment process;
- delivery of a global corporate governance strategy across RBS;
- the provision of professional secretariat support to the Board and its committees; and
- leading on implementation of recommendations from the annual Board evaluation.

Conflicts of interests

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

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

Details of all directors' conflicts of interest are recorded in a register which is maintained by the Chief Governance Officer and Board Counsel and reviewed annually by the Board.

Board meetings

In 2015, nine Board meetings were scheduled and individual attendance by directors at these meetings is shown in the table below.

In addition to the nine scheduled meetings, 25 additional meetings and committees of the Board were held, including meetings to consider and approve financial statements. The Chairman and the non-executive directors meet at least once per year without executive directors present.

	Attended/ scheduled
Howard Davies (1)	4/4
Ross McEwan	9/9
Ewen Stevenson	9/9
Sandy Crombie	9/9
Alison Davis	9/9
Morten Friis	9/9
Robert Gillespie	9/9
Penny Hughes	9/9
Brendan Nelson	9/9
Baroness Noakes	9/9
Mike Rogers (2)	—
Former director	
Philip Hampton (3)	6/6

Notes:

(1) Appointed to the Board on 14 July 2015.

(2) Appointed to the Board on 26 January 2016.

(3) Stepped down from the Board on 31 August 2015.

Corporate governance

Principal activities of the Board during 2015

In advance of each Board meeting, the directors are provided with comprehensive papers. During 2015 there has been an enhanced focus on organisational culture, including risk culture, and on continued enhancement of the risk appetite framework. These have been recurring themes underpinning Board discussions during the year. A revised approach to Board papers was adopted in 2015 in order to improve and enhance the quality, content and consistency of information presented to the Board which has been well received. An overview of the principal activities of the Board during 2015 is shown below.

Each meeting

- Chairman's report
- Chief Executive's report
- Chief Financial Officer's report including monthly results and update on capital, funding and liquidity
- Franchise updates
- Transactions update
- Risk report (including updates on conduct matters)
- Reports from Committee Chairmen
- Governance and Company Secretary's report (routine matters for approval/noting)

1st Quarter

- Budget
- Executive director remuneration proposals
- Annual results and AGM notice
- Board and committee evaluations
- Internal Audit evaluation
- External Auditor evaluation
- ICB design
- Risk appetite framework
- Stress testing
- RBS contingency funding plan

2nd Quarter

- Q1 results
- Risk culture
- Resolution plan
- Recovery plan
- Annual General Meeting preparations
- Citizens divestment
- Stress testing
- Internal Capital Adequacy Assessment Process
- Non-executive director's training proposals
- ICB update

- Restructuring update
- Employee survey results
- Litigation update
- Technology update
- Transformation Programme
- Digital update
- Technology update
- Transformation Programme
- Board strategy offsite
- Executive talent session

3rd Quarter

- Interim results
- Individual Liquidity Adequacy Assessment
- Citizens divestment
- Culture
- Executive talent session
- Brand hierarchy
- Board evaluation update
- Stress testing
- Williams & Glyn capital plan
- Litigation update
- Technology update
- Transformation Programme
- Banking Standards Board session
- Executive talent session
- Board session with PRA

4th Quarter

- Q3 results
- 2016 budget and 2017-20 plan
- ICB update
- CIB strategy review
- Dear Chairman Exercise II Feedback response
- Ulster Bank strategic review
- RBSI strategic review
- Data and analytics session
- Legal report
- Technology update
- Board and committee external evaluation
- Pension funding
- Senior Manager Regime responsibilities map
- Transformation Programme
- Williams & Glyn Programme

Executive Committee members attend part of each Board meeting to provide an update on the performance of each of the franchises and risk and conduct issues. Other relevant senior executives attend Board meetings to present reports to the Board as appropriate. This provides the Board with an opportunity to engage directly with management on key issues and supports the Board’s succession planning activity.

Board effectiveness

Skills and experience of the Board

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

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

· Retail Banking	· Chief Executive experience
· Other Financial Services	· Finance & Accountancy
· Markets/Investment Banking	· Risk
· Government & Regulatory	· Technology/Digital
· Mergers & Acquisitions	· Operations
· Corporate Restructuring	· Change Management
· Stakeholder Management	· Consumer Facing

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

Corporate governance

Induction and professional development

Each new director receives a formal induction on joining the Board, which is co-ordinated by the Chief Governance Officer and Board Counsel. This includes visits to RBS's major businesses and functions and meetings with directors and senior management. Meetings with external auditors, counsel and stakeholders are also arranged as appropriate. Each induction programme has a core element that the director is required to complete, with the remainder of the programme tailored to the new director's specific requirements. A list of example meetings arranged during an induction programme for a new director is set out below:

	Franchise Chief Executives
Chairman	Business visits (UK and overseas)
Chief Executive	Finance
Chief Financial Officer	Risk
Senior Independent Director	Internal Audit
Other non-executive directors	Tax
Chief Governance Officer and Board Counsel	Chief Human Resources
Chief Risk Officer	Officer
Chief Conduct & Regulatory Affairs Officer	Chief Administration
Chief Marketing Officer	Officer
RBS Treasurer	Investor Relations
RBS General Counsel	Strategy & Corporate
External Auditor	Development
External Counsel	Regulators
	Institutional Investors

The Chairman continues to progress his tailored and comprehensive induction programme, which includes all of the above, together with additional customer, employee, shareholder and governmental engagement sessions, to support the nature and scope of the Chairman's role.

The directors have access to a wide range of briefing and training sessions and other professional development opportunities. Internal training relevant to the business of RBS is also provided. Business visits are arranged as part of the Group Audit Committee and Board Risk Committee schedule (details of which can be found on pages 56 and 62) and all non-executive directors are invited to attend. Directors undertake the training they consider necessary to assist them in carrying out their duties and responsibilities as directors.

During 2015, the directors received updates on a range of subjects to enhance their knowledge, including:

- ICB/ring-fencing.
- Client Money and Asset rules.
- Senior Managers' Regime.
- Cyber security.
- The Banking Standards Board.
- Digital technology.
- PRA consultation on board responsibilities.
- PRA policy statement on the implementation of ring-fencing.
- EBA consultation on guidelines on sound remuneration policies.
- FRC discussion paper on UK board succession planning.
- New RBS leadership programme.
- Davies Report on gender balance on British boards.
- EU Market Abuse Regulations.
- The Investment Association Principles of Remuneration 2015.
- Institutional and Shareholder Services UK & Ireland Proxy Voting Guidelines.
- EBA report on the use of Role Based Allowances.
- European Commission consultation on the impact of the bonus cap, October 2015.

- Pensions.
- PRA/FCA Report into the failure of HBOS plc and report by Andrew Green QC assessing the FSA's enforcement actions in relation to the failure of HBOS plc.

The Chief Governance Officer and Board Counsel maintains continuing professional development logs. These are reviewed regularly between the Chairman and each director individually, to assist in identifying future training and development opportunities that are specific to the individual director's requirements.

Information

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

Time commitment

It is anticipated that non-executive directors will allocate sufficient time to RBS to discharge their responsibilities effectively and will devote such time as is necessary to fulfil their role. Directors have been briefed on the limits on the number of other directorships that they can hold under the requirements of the fourth Capital Requirements Directive (CRD IV). Each director is required to seek the agreement of the Chairman before accepting additional commitments that might affect the time the director is able to devote to his or her role as a non-executive director of RBS. The Board monitors the other commitments of the Chairman and directors and is satisfied that they are able to allocate sufficient time to enable them to discharge their duties and responsibilities effectively. The time commitment currently required of our non-executive directors continues to be significant.

Election and re-election of directors

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

Corporate governance

Performance evaluation

In accordance with the Code, an external evaluation of the Board takes place every three years. An internal evaluation takes place in the intervening years.

The 2013 and 2014 evaluations were conducted internally by the Chief Governance Officer and Board Counsel. In 2014, an evaluation of the Board's effectiveness was also carried out by the PRA. Following the 2014 evaluations, a number of initiatives were implemented, aimed at improving the overall performance and effectiveness of the Board. These included improving the quality and volume of information provided to the Board, ensuring sufficient time on Board agendas for customer matters and RBS's priorities, enhancing the professional development provided to directors and a focus on succession planning. Work continues to address these topics and will be kept under regular review as a matter of good practice.

In 2015, the Board and committee evaluation process was externally facilitated by Condign Board Consulting Limited, a specialist board evaluation consultancy which was selected following a competitive tender process. The Board is satisfied that Condign has no other connection with RBS.

Performance evaluation process

The external facilitator undertook a formal and rigorous evaluation by:

- using a tailored discussion guide to structure individual meetings held with each director, as well as the Chief Governance Officer and Board Counsel, the Chief Risk Officer and the Chief Conduct & Regulatory Affairs Officer;
- discussing outcomes and recommendations with the Chairman and Chief Governance Officer and Board Counsel; and
- outlining outcomes and suggesting areas for improvement through a written report and oral presentation to the Board.

Amongst the areas reviewed were Board dynamics, culture and engagement; Board and committee meetings and processes (including information quality and flows and the balance between Board and committee agendas); Board and committee composition and structuring, external relationships with regulators, shareholders and stakeholders; and overall Board effectiveness.

Outcomes of the 2015 performance evaluation

The 2015 performance evaluation concluded that the Board was strong and operated effectively and within its terms of reference.

Key strengths identified included the following:

- the Board was exceptionally hard-working, engaged, and appropriately composed throughout the year;
- the group dynamic between Board members was good and on the whole members continued to work well together, creating effective challenge, considerable debate and detailed oversight; and
- the Board's committees also operated effectively within their terms of reference throughout the year providing a great deal of support to the Board.

A summary of the key themes arising from the 2015 performance evaluation is set out below, together with an overview of the key actions proposed:

Key themes

Board resourcing and succession planning

The need to plan for rotation in the Board's membership was highlighted, as a number of directors reach or exceed the six year point in their tenure. The review highlighted the importance of regularly reviewing Board and Board Committee composition, according to business and staffing needs, with scope also identified to streamline Nominations Committee processes.

Agenda planning

The evaluation highlighted the continuing need to ensure the right preparations take place before a paper reaches the Board. It also highlighted the challenge of achieving an appropriate balance between Board and Committee agendas to ensure the best use of directors' time and to support effective decision-making.

Tone from the top and ensuring Board/executive alignment

The evaluation also acknowledged the continuing importance of the Board's role in developing the appropriate performance and behavioural culture which is shared with the organisation, and ensuring appropriate alignment between the Board and the executive as remediation issues reduce and the forward agenda develops.

Proposed actions

The full performance evaluation report set out a series of recommendations which have been carefully considered by the Board. An action plan has been agreed to progress these recommendations, as appropriate, during 2016. Key actions include:

- Creation of a Nominations and Governance Committee, adding a governance oversight function, and streamlining processes and membership.

In January 2016 the Board approved proposals to establish a Nominations and Governance Committee. The committee report on page 53 contains more detail on the remit of the new Committee and areas of focus for 2016.

- A focused review of Board and committee agendas and their supporting information and processes.

The priorities for this exercise are to minimise duplication, optimise the use of directors' time, and to engage directors' insights and experience fully. This in turn will allow sufficient space for focus on RBS's onward priorities, particularly its customers.

- A number of actions to improve alignment between the board and executives which were identified in light of the review's findings, and will be progressed during 2016 to ensure a consistent 'tone from the top'.

Corporate governance

These actions include undertaking post-decision reviews to pinpoint learnings for future Board development and continuing to ensure appropriate Board involvement in executive succession planning. The forward agenda planner will also be discussed bi-annually to ensure that business needs, the Board's expectations and executive support are aligned.

Individual director and Chairman effectiveness reviews

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

Relations with investors

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

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

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

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

- the Chairman independently meets with RBS’s largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman, Senior Independent Director and chairmen of the Board committees met with the governance representatives of a number of institutional shareholders during the year;
- the Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels; and
- the Chairman of the Group Performance and Remuneration Committee consults extensively with major shareholders in respect of the Group’s remuneration policy.

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

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

Report of the Group Nominations Committee

Letter from Howard Davies

Chairman of the Group Nominations Committee

Dear Shareholder,

As Chairman of the Board and Chairman of the Group Nominations Committee I am pleased to present our report on the committee's activity during 2015.

Role and responsibilities

The Group Nominations Committee reviews the structure, size and composition of the Board, and membership and chairmanship of Board Committees. The Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board. The terms of reference of the Group Nominations Committee are reviewed annually, approved by the Board and are available at rbs.com.

Principal activity during 2015

In 2015, discussions principally focused on the Chairman search and the search for new non-executive directors. The Committee also continued to monitor succession planning taking into account business requirements and industry developments.

Membership and meetings

All non-executive directors are members of the Group Nominations Committee which is chaired by the Chairman of the Board. The Chief Executive and the Chief Financial Officer are invited to attend meetings.

The Group Nominations Committee holds at least two scheduled meetings per year, and also meets on an ad hoc basis as required. In 2015, there were four Group Nominations Committee meetings, three of which were chaired by Philip Hampton, and individual attendance by directors at these meetings is shown in the table below. In addition a number of ad hoc meetings were held to discuss Chairman succession prior to my appointment.

	Attended/ scheduled
Howard Davies (Chairman) (1)	2/2
Sandy Crombie	4/4
Alison Davis	4/4
Morten Friis	4/4
Robert Gillespie	4/4
Penny Hughes	4/4
Brendan Nelson	4/4
Baroness Noakes	4/4
Mike Rogers (2)	—
Former member	
Philip Hampton (3)	3/3

Notes:

(1) Appointed to the Committee on 14 July 2015.

(2) Joined the Committee on 26 January 2016.

(3) Stepped down from the Committee on 31 August 2015.

Chairman search

In September 2014, it was announced that Philip Hampton would step down as Chairman in 2015 and Egon Zehnder International (EZ) was engaged to support the search process for his successor. EZ does not provide services to any other part of RBS. On 26 February 2015, it was announced that I would be appointed as Chairman with effect from 1 September 2015, and I joined the Board as a non-executive director on 14 July 2015.

Consideration of new non-executive directors

EZ has continued to support the search for new non-executive directors during 2015 and to support the future Board succession planning. The Committee has considered the skills and experience required to complement the Board and these have been incorporated into the search process.

During 2015, the Committee considered a number of potential candidates and in December it was announced that Mike Rogers would join the Board as a non-executive director with effect from 26 January 2016. Mike's extensive experience of retail banking and financial services will strengthen the Board.

In December 2015, following a rigorous tender process, JCA Group was appointed to support the search for further non-executive directors in future and the EZ engagement will come to an end. JCA Group does not provide search services to any other part of RBS.

Tenure of non-executive directors

The chart below sets out the tenure of non-executive directors.

Board and Committee membership

My appointment as successor to Philip Hampton aside, there have been no other material changes made to the Board or its Committee membership during 2015. As previously mentioned Mike Rogers joined the Board and was appointed to the Sustainable Banking Committee in January 2016.

During 2015, two temporary Board oversight committees were formed in relation to CIB and the bank's Global Restructuring Group (GRG).

The CIB Board Oversight Committee first met in March 2015 to oversee the strategic change programme for the Bank's CIB business, including monitoring execution risk and external stakeholder management. Robert Gillespie chairs the Committee. Morten Friis, Brendan Nelson and Baroness Noakes are members. It is anticipated that the Committee will be stood down in the first half of 2016.

The GRG Board Oversight Committee first met in May 2015 to provide oversight in relation to matters related to GRG including the Group's response to the FCA's Section 166 Review.

Report of the Group Nominations Committee

Brendan Nelson chairs the Committee. Sandy Crombie, Robert Gillespie, Penny Hughes and Baroness Noakes are members. It is anticipated that this Committee will be stood down once the FCA has confirmed the outcome of its Section 166 Review.

Following my appointment as Chairman and the output of the Board Evaluation, I intend to lead a review of the Board Committee membership during 2016.

Performance evaluation

The 2015 performance evaluation was independently facilitated by Condign Board Consulting Limited, a specialist board evaluation consultancy. The Committee has considered and discussed the outcomes of this evaluation.

Overall the evaluation concluded that the Group Nominations Committee continued to operate effectively although some areas for potential improvement were identified.

A summary of the key themes arising from the evaluation is set out below together with an overview of the key actions proposed:

Key themes

- consideration should be given to expanding the Committee's remit to include a governance oversight function;
- the search and nomination process for new non-executive directors should be reviewed and further streamlined as appropriate;
- non-executive director recruitment remains challenging for a number of reasons, including the significant time commitment expected of RBS non-executive directors;
- Group Nominations Committee membership should be reviewed, as part of a wider review of Board Committee composition; and
- succession planning should receive particular focus in the next few years, as a number of non-executive directors reach or exceed the six year point in their tenure.

Key Actions

In January 2016, the Board approved proposals to expand the Committee's remit, adding a governance oversight function and changing its name to the Nominations and Governance Committee.

Areas of focus for the Committee during 2016 will include the key themes identified during the external evaluation process, as set out above.

The review included a small number of general recommendations which are relevant for both the Board and its senior committees. Key themes and actions arising from these general recommendations are set out in the Board report on pages 51 and 52 and will be considered, and addressed as appropriate, at Board level.

The review also recommended that all Committee chairmen should ensure continued focus on agenda planning and streamlined reporting to the Board, which will also be a priority for the Group Nominations and Governance Committee during 2016.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress on its 2016 priorities during the year.

On 26 January 2016, the Board approved changes to the remit of the Group Nominations Committee which now includes responsibility for monitoring the Group's governance arrangements, in order to ensure best corporate governance standards and practices are upheld.

As part of this extended remit, the Committee will consider developments relating to banking reform and analogous issues affecting the Group in the markets where it operates, and will make recommendations to the Group Board on any consequential changes to the Group's governance model. In order to reflect the revised remit, the Group Nominations Committee has been renamed as the Group Nominations and Governance Committee. The Board also approved changes to the composition of the Committee, effective as at 26 January 2016. I continue in my role as chairman of the Committee with membership now comprising Sandy Crombie, Alison Davis, Robert Gillespie and Brendan Nelson. The Group Nominations and Governance Committee held its first meeting in February 2016.

Boardroom diversity

The Board currently exceeds the target of 25 per cent female board representation as set out in Lord Davies' 2011 report on women on Boards. We also acknowledge the additional recommendations that have recently been published and await with interest the next steps to be taken in this regard.

The chart below details the gender diversity of the Board.

The Board operates a boardroom diversity policy and a copy of the Board's diversity statement is available on rbs.com>about us.

RBS understands the importance of diversity and, with regard to gender diversity, recognises the importance of women having greater representation at key decision making points in organisations. The search for Board candidates will continue to be conducted, and nominations/appointments made, with due regard to the benefits of diversity on the Board. However, all appointments to the Board are ultimately based on merit, measured against objective criteria, and the skills and experience the individual can bring to the Board.

The balance of skills, experience, independence, knowledge and diversity on the Board, and how the Board operates together as a unit is reviewed annually as part of the Board evaluation. Where appropriate, findings from the evaluation will be considered in the search, nomination and appointment process. If appropriate, additional targets on diversity will be developed in due course.

Further details on RBS's approach to diversity can be found on page 95.

Howard Davies

Chairman of the Group Nominations Committee

25 February 2016

Report of the Group Audit Committee

Letter from Brendan Nelson,

Chairman of the Group Audit Committee

Dear Shareholder,

2015 has been another significant year for the bank as it progresses on its journey to becoming number one for customer service, trust and advocacy. I am pleased to report that the Group Audit Committee has supported the bank in its ambitions and has carried out its responsibilities effectively in the period, as confirmed by the annual effectiveness review. A fuller summary of the outcomes of that review, and a description of the activity of the Committee during the year, is set out in the report that follows.

Accounting and financial reporting

A key role of the Group Audit Committee is to satisfy itself that the accounting policies, risks and significant management judgements which underpin the bank's financial disclosures are reasonable and transparent. During 2015, the Committee reviewed and challenged management on material judgements, in particular those relating to accounting for provision for litigation and regulatory investigations and the treatment of committed pension obligations in light of accounting developments during 2015. Other key matters debated included: loan impairments; valuation of financial instruments; conduct provisions, including Payment Protection Insurance; goodwill; and deferred taxation. The Committee received independent views from the external auditor on these topics and was satisfied that the accounting judgements applied were appropriate.

Following consideration of these matters ahead of the 2015 results, it was determined that a public announcement was appropriate and the Group Audit Committee recommended that the Board release a trading statement to the market on 27 January 2016. The Committee also supported the proposal to change the bank's reporting segments based on the six segments within the bank's three core franchises, plus Capital Resolution and Williams & Glyn. This re-segmentation reflects the manner in which the bank is now managed.

As part of our overall assessment of the Annual Report and Accounts, we assisted the Board in determining that the disclosures taken as a whole were fair, balanced and understandable, and provided the information necessary for shareholders to assess RBS's position and performance, business model and strategy.

Systems of internal control

In line with the requirements of the Code and related FRC Guidance on Risk Management, Internal Control and Related Financial & Business Reporting, the Committee has reviewed and reported to the Board on the effectiveness of RBS's internal controls. While there has been increased focus and attention during 2015 from management on addressing and closing identified deficiencies, some known issues continued to impact internal controls during 2015 as set out in the report that follows. Timely and sustainable remediation will remain a focus of the Committee in 2016.

While it is clear that execution of the bank's simplification strategy will deliver benefits, the transformation programme is unprecedented in scale and the Committee has monitored the impact of such significant change upon the control environment of the organisation during the year. The Committee has reviewed reports from Internal Audit assessing progress of the bank's major change programmes and where appropriate has challenged management regarding the associated impact on controls.

Embedding robust controls, driving the correct risk behaviours and ensuring the effectiveness of the three lines of defence remains a work in progress across RBS and, in conjunction with the Board Risk Committee, will continue to be priority areas for the Group Audit Committee during 2016.

External audit

While Deloitte continued as RBS's external auditor throughout 2015, we supervised the transition period of the new auditors, Ernst & Young LLP (EY), who were selected in 2014 following a competitive tender process. The Committee reviewed the processes followed to ensure EY's independence and extended our policy on non-audit services to the firm to ensure that there was no impact on the audit service or EY's independence. EY shadowed the audit process in 2015 and I am confident that they will be well-positioned and appropriately informed to commence as the external auditor in 2016.

I would like to thank Deloitte for their work as auditor of RBS and its subsidiaries over the past 16 years and for their professionalism in securing an orderly handover to EY.

Key priorities for 2016

2016 is set to be no less challenging for the bank and the Committee will continue to balance support to management with independent oversight and challenge. Focus will be placed on maintaining appropriate oversight over financial reporting, preparedness for accounting and regulatory changes including IFRS 9, monitoring systems of control and ongoing remediation programmes through a period of continued change and embedding the correct culture and behaviours across the bank.

More detailed information on the topics considered are set out in the report that follows. This demonstrates the breadth and scale of the matters considered and I would like to thank my fellow members for their continued support and focus during 2015.

Brendan Nelson

Chairman of the Group Audit Committee

25 February 2016

Report of the Group Audit Committee

Report of the Group Audit Committee

Membership

The Group Audit Committee (GAC) is comprised of the following four independent non-executive directors.

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

Brendan Nelson, Morten Friis and Baroness Noakes are also members of the Board Risk Committee. Sandy Crombie is Chairman of the Group Performance and Remuneration Committee. This common membership helps facilitate effective governance across all finance and risk issues, including compensation decisions, and that agendas are aligned and overlap of responsibilities is avoided where possible.

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

The Board is satisfied that all GAC members have recent and relevant financial experience and that each member of the Committee is independent as defined in the SEC rules under the US Securities Exchange Act of 1934 (the “Exchange Act”) and related guidance. The Board has further determined that Brendan Nelson, Committee Chairman, and Baroness Noakes are both ‘financial experts’ for the purposes of compliance with the Exchange Act Rules and the requirements of the New York Stock Exchange. Full biographical details of GAC members are set out on pages 43 to 46.

Meetings were attended by the Chief Executive and Chief Financial Officer; the Group Chairman; the Internal and External Auditors; and Finance, Legal and Risk Management executives. Other executives, subject matter experts and external advisers were also invited to attend, as required, to present and advise on reports commissioned by the Committee. The Committee also met privately with the external auditors and separately with Internal Audit management.

Purpose of the Group Audit Committee

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

Meetings and visits

The Committee held seven scheduled meetings during 2015, four of which were held immediately prior to the submission of the quarterly financial statements to the Board. The Committee also convened three ad hoc meetings to consider the outputs and required affirmations relating to the annual external audit of benchmark interest rate submissions, to finalise the H1 company announcement prior to publication and the selection and approval of the external auditor for Williams & Glyn.

During 2015, in conjunction with members of the Board Risk Committee, members of the Committee took part in an annual programme of visits to businesses and control functions in order to gain a deeper understanding of the risks and issues they face. This value-adding programme included two visits to Risk; C&RA and Internal Audit plus visits to: PBB; CPB; CIB; Services; Finance; and Restructuring.

In October 2015, the Committee, in conjunction with the Board Risk Committee, undertook a visit to India which has over 14,000 staff and contractors engaged in significant back office activities. During the week-long trip the Committee spent time in both Delhi and Chennai meeting with local management teams to discuss key risk and control matters in the country. Specific sessions were held with the following local teams: Internal and External Audit, Finance functions, Risk infrastructure, Services and Technology.

Allocation of Group Audit Committee agenda time:

Performance evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Group Audit Committee, was conducted by Condign Board Consulting Limited, an external consultant, in 2015. The Committee has considered and discussed the outcomes of this evaluation. Overall the review concluded that the Group Audit Committee continued to operate effectively.

A small number of general recommendations which are relevant for both the Board and its senior committees were made. Key themes and actions arising from these general recommendations are set out in the Board report on pages 51 and 52 and will be considered, and addressed as appropriate, at Board level.

The Committee also tracked progress on the implementation of the recommendations from the 2014 Committee effectiveness evaluation during the year to ensure successful delivery.

Report of the Group Audit Committee

Matters considered by the Committee in 2015

Key area	**Matters considered and action taken by the GAC**
Accounting and financial reporting	
Accounting judgments and reporting issues considered in the preparation of financial reports	The Group Audit Committee focused on a number of salient judgements and reporting issues in the preparation of the 2015 accounts, in particular, the Committee considered: · the capital impact and accounting treatment of committed pension obligations in light of accounting developments during 2015, including the issue of exposure draft amendments to IFRIC 14. In light of these changes, the Committee supported the decision to amend the accounting policy for pensions and to apply this retrospectively leading to the recognition of an additional liability in the 2015 year end accounts in relation to committed future pension payments; · provision and disclosure for ongoing regulatory and litigation actions: including foreign exchange trading; retail mortgage backed securities litigation in the US; UK shareholder actions; and Payment Protection Insurance (PPI). Following discussion, the Committee was satisfied that it would be appropriate to take further incremental provisions against both retail mortgage backed securities litigation and PPI in the 2015 year end accounts; · the going concern basis of accounting including considering evidence in relation to RBS's capital, liquidity and funding position. The Committee supported the directors' going concern conclusion. Further information is set out on page 96; · the adequacy of loan impairment provisions, focusing in particular on judgements and methodology applied to provisions. The Committee was satisfied that the overall loan impairment provisions and underlying assumptions and methodologies were reasonable and applied consistently; · valuation methodologies and assumptions for financial instruments carried at fair value including RBS's credit market exposures and own liabilities assessed at fair value; · the level of goodwill and other intangible assets to be carried. Following discussion and based on year end testing, the Committee supported recognition of an impairment in goodwill attributed to Private Banking driven primarily by weaker forecast future profitability for Private Banking; · the judgements that had been made by management in assessing the recoverability of deferred tax assets, in light of continued execution of the bank's strategy and changes to the UK corporate tax system; · the assessment by management of the adequacy of internal controls over financial reporting, and assessment of identified deficiencies. Weaknesses had been identified in user access controls

relating to certain IT applications within the bank; the Committee monitored remediation plans to address the issue; and

· the quality and transparency of financial and risk disclosures contained within the Annual Report and Accounts.

The Committee recommended the quarterly and interim results announcements and the Annual Report and Accounts to the Board for approval. Consideration was given to the comprehensive review process that supports both the Group Audit Committee and ultimately the Board in reaching the conclusion that the disclosures taken as a whole were fair, balanced and understandable and provided the information necessary for shareholders to assess the company's position and performance, business model and strategy. The review process included: central co-ordination of the Annual Report and Accounts by the Director of Finance with guidance on requirements being provided to individual contributors; review of the Annual Report and Accounts by the Executive Disclosure Committee prior to consideration by the Audit Committee; and a management certification process which required members of the Executive Committee and other senior executives to provide confirmation following their review of the Annual Report and Accounts that they considered them to be fair, balanced and understandable. This process was also undertaken in respect of the half year and quarterly results announcements. In addition, the External Auditor considered the Board's statement as part of its audit requirements.

Report of the Group Audit Committee

Key area	Matters considered and action taken by the GAC
Systems of internal control	The Committee reviewed the effectiveness of RBS's internal controls at both Group-wide and business/functional levels. This was undertaken via scrutiny of the first line of defence's actions and plans in respect of internal controls and consideration of reports from the second and third lines of defence.
FRC Guidance on Risk Management, Internal Control and Related Financial & Business Reporting	Detailed consideration was also given to disclosure contained within the Annual Report and Accounts concerning relevant internal control matters.
Control Environment Certification	The Committee considered the outputs of bi-annual self-assessments of the robustness of the internal control environment for the bank's customer-facing businesses, and customer support and control functions.
	In conjunction with the Board Risk Committee, the Committee also continued to monitor the remediation of the Markets Control Environment to address some of the deficiencies as set out in the report of the Board Risk Committee report. The Committee received separate reports from management on progress in this area.
Three Lines of Defence	Reports on the work underway to fully embed the three lines of defence model within the organisation were considered by the Committee. Particular attention was given to the articulation of responsibilities and accountabilities of the first and second lines of defence. This will remain a focus of the Committee in 2016.
Credit Risk Assurance	The Committee received quarterly updates on risk assurance activities and monitored the deliverables of the credit risk assurance team.
Whistleblowing	The Committee received updates on whistleblowing activity including reports on incidents reported and investigated. It monitored the development by C&RA of an enhanced whistleblowing regime for employees, including the outputs of a benchmarking exercise.
Ledger Transformation Programme	The Committee considered the plan and approach to align data for Risk, Finance, and Treasury, under the Ledger Transformation Programme. Key dependencies and risks to delivery were debated and oversight of the programme will remain a key focus of the Committee in 2016.
Coutts Control Remediation Programme	The Committee monitored progress of the Coutts Control Remediation Programme, established to drive improvements to the control environment in Private Banking; progress was made on the delivery of the end-to-end credit process.
Taxation	The Committee reviewed the bank's tax position and the tax audits being conducted across various jurisdictions including an in-depth session on tax compliance in October 2015.
Litigation and Regulation	

	The Committee considered regular reports on material litigation and regulatory investigations and on the work of the Sensitive Investigations Unit.
Notifiable Event Process	The Committee received bi-annual reports on the bank's notifiable event process. Each Board member was alerted to each major event.
Fraud	In line with the Committee's terms of reference, consideration was given to management's processes for identifying and responding to the risk of fraud.
Sarbanes-Oxley Act of 2002	The Committee considered RBS's compliance with the requirements of the Sarbanes-Oxley Act of 2002, and was satisfied in this respect. Deficiencies were identified in the review processes over user-access to certain IT applications within the bank; these deficiencies did not lead to the identification of any errors in the financial statements. Action is being taken by Management to improve these processes.

Report of the Group Audit Committee

Internal audit

Reports and Opinions	The Committee received quarterly reports and opinions from Internal Audit throughout 2015 on the overall effectiveness of the governance, risk management and internal control framework, its control environment ratings, details of emerging and iterative issues and the adequacy of remediation activity. Reports also included assessments of the bank's management control approach (being a measure of how management ensures that risks are understood, assessed and mitigated in a transparent and efficient manner). The Committee requested an additional report from Internal Audit on matters which could potentially cause the bank's overall control environment rating to deteriorate.
Annual Plan	A refreshed audit plan for 2015 was approved in H2 following the bank's extensive strategic changes to ensure appropriate focus on the highest risks and change initiatives. The Committee considered and approved Internal Audit's plan for 2016. The Committee also challenged resourcing levels for the revised plan and approved budget and resource for 2016.
Internal Audit Charter	Minor changes to Internal Audit's charter were approved by the Committee and it confirmed the independence of Internal Audit.
Visits	During two visits to Internal Audit in 2015, the Committee reviewed resourcing and recruitment, strategy and internal quality assurance.
Chief Audit Executive	The Chief Audit Executive continued to report to the Chairman of the Audit Committee, with a secondary reporting line to the Chief Executive for administrative purposes. The Committee assessed the annual performance (including risk performance) of the Chief Audit Executive.
Evaluation	The Committee received regular updates on the actions taken by Internal Audit following the external review by EY the previous year. The annual review of effectiveness of Internal Audit was undertaken internally in 2015. The evaluation concluded that Internal Audit had operated effectively during the year. Certain recommendations were made to enhance particular practices within the function. These will be implemented during 2016, with progress tracked by the Committee.

Relationship with regulators

Regulatory investigations and enforcements	The Committee received regular reports on the status of ongoing regulatory investigations and the progress of mandatory and remediation projects. It challenged the management of individual business areas and functions on their ability to meet regulatory expectations and the level of resource required to do so.

External audit

External audit summary reports	Considered reports from the External Auditor on its observations and conclusions from the year-end audit and half-year review of RBSG plc, RBS plc and NatWest Plc, work in connection with the first and third quarter financial results and any recommendations for enhancements to RBS's reporting and controls.
Audit Agreement and Plan and fees	Approval of Deloitte's 2015 Audit Agreement, audit engagement plan and 2015 audit fees including its fee for the review of the 2015 interim results, as authorised by shareholders at the Annual General Meeting.
Williams & Glyn	The Committee approved the appointment of both an auditor and a reporting accountant for Williams & Glyn.

Annual Evaluation	The Committee conducted an internal evaluation to assess the independence and objectivity of the External Auditor during 2015 and the effectiveness of the audit process including seeking the views of Committee members and attendees and other key members of management. Regard was had to: experience of the audit engagement team; scope of audit work planned and executed; standards of communication and reporting; quality of insights on the internal control environment; and independence.
Transition of auditors	The Committee made recommendations to the Board on the transition of external auditors and appointment of EY with effect for the financial year ending 31 December 2016. The Committee supervised the transition of the external auditor from Deloitte to EY during 2015 and reviewed EY's initial Audit engagement plan for 2016. EY achieved the requisite independence from RBS in June 2015. The Board will recommend the appointment of EY as external auditor to shareholders for approval at the Annual General Meeting.

Report of the Group Audit Committee

Audit and non-audit services

Non-audit services policy	To help safeguard the objectivity and independence of the external auditor, the Committee maintains a policy that sets out the circumstances in which the external auditor is permitted to supply audit and non-audit services. The policy is reviewed annually and audit services and permitted non-audit services are approved in advance. As mentioned above, since the start of EY's transition towards becoming the external auditor the firm has been subject to the policy in full.

Categories of permitted non-audit services not covered by the annual pre-approval, require ad-hoc approval in advance on a case-by-case basis. Engagements below £100,000 may be approved by the Committee Chairman. A competitive tender process is required for all proposed non-audit services engagements where the fees are expected to exceed £100,000 and approval of the full Committee is required. As an additional governance control all engagements have to be approved by the Director of Finance and Supply Chain Services. Where the engagement is tax related, approval must also be obtained from the Director of RBS Tax. Ad hoc approvals of non-audit services are ratified by the Group Audit Committee each quarter.

As EY transitions towards being appointed the bank's external auditor, it has been subject to the full audit/non-audit services policy since reaching the point of independence from the bank in June 2015. Prior to that, all engagements of EY for non-audit services work were approved by either the Financial Controller or Committee Chairman.

During 2015, the current and incoming external auditors were approved to undertake the significant engagements set out below:

· assurance testing in relation to RBS's 2014 and 2015 Sustainability Report. The External Auditor was selected given its significant experience in specialist sustainability reporting (Deloitte and EY);

· review of financial statements of certain defined benefit funds within RBS Americas. The External Auditor was selected as it was already responsible for reviewing the financial statements of the existing defined benefit funds, and there were clear synergies to ensuring continuity of service (Deloitte); and

· as part of the preparations for a possible future sale of HM Treasury's shareholding in RBS, it is possible that a prospectus would be prepared for which the Group and Directors would have statutory responsibility and uncapped liability. In order to comply with relevant UKLA rules on such activities, a working capital report from an independent reporting accountant on RBS's financial projections was required to be included in a circular to shareholders. The appointment of the External Auditor offered significant synergies in undertaking the reporting accountant role and preparing the working capital report having undertaken audit procedures on the Group's forecasts and budgets for the five years ending 31 December 2019 (Deloitte).

Further details of the non-audit services that are prohibited and permitted under the policy can be found on rbs.com. Information on fees paid in respect of audit and non-audit services carried out by the External Auditor can be found in Note 5 to the consolidated accounts on page 294.

Brendan Nelson

Chairman of the Group Audit Committee

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Report of the Board Risk Committee

Letter from Baroness Noakes

Chairman of the Board Risk Committee

Dear Shareholder,

I would like to begin by thanking my colleagues on the Board Risk Committee for their contribution and support during 2015. It has been another challenging year. The report which follows describes how the Committee discharged its responsibilities in 2015 and provides details of the key issues considered and debated during the year. I will also highlight some of the key themes below.

Transformation

The bank’s extensive programme of transformation has continued throughout 2015 in line with the strategy to be a smaller, simpler UK focused bank. The transformation programme has been a primary focus for the Board Risk Committee and we dedicated significant time to monitoring execution risk on behalf of the Board. During 2015, we received regular updates from the project team and considered the impact of the programme on the bank’s change risk profile and control environment. We made recommendations to management in relation to governance and prioritisation and requested focus sessions on the key work streams under the programme.

Another key deliverable is the planned separation and disposal of Williams & Glyn and we examined the risks and challenges to meeting the delivery target in some detail during the year. In September 2015, acting under delegated authority from the Board, we approved the main regulatory filings for the Williams & Glyn Banking Licence Application.

Remediation and Conduct

Regrettably, customer experience was impacted again by an IT issue in June resulting in a delay in transactions being posted to customer accounts. We oversaw the exchange of correspondence with the regulator explaining how the matter had been resolved, considered the outputs of the post implementation review exercise and examined the residual risks following the incident. IT resilience and the stability of the bank's payments infrastructure will remain a priority of the Board and the Committee during 2016.

The conduct issues that have impacted the bank's recovery and reputation continued to be of concern in 2015. We oversaw the remaining internal and regulatory investigations into the manipulation of foreign exchange markets and were kept appraised of the negotiations that culminated in the announcement of settlements with two US regulators in May 2015.

We will continue to monitor discussions with regulators in other jurisdictions over the coming months and make recommendations to the Group Performance and Remuneration Committee on accountability matters as appropriate.

Risk Culture

A strong culture risk is fundamental to achieving our strategic objectives for our customers, employees and wider stakeholders and was a key focus of the Committee this year. We reviewed the outputs of benchmarking surveys by both McKinsey and PwC in this area and discussed and agreed the dimensions of the bank's target risk culture prior to consideration by the full Board. Risk culture standards will ultimately be linked to the bank's people and leadership standards and wider industry standards. We will keep this under close review and plan to examine the next steps to achieving our target risk culture state in the first quarter of 2016.

Other

Other material areas of Committee focus during the year have included:

- internal and external stress testing exercises and capability;
- the risk appetite framework of RBS and individual risk appetite statements for material risks, franchises and functions;
- improvements to the Operational Risk Management Framework and preparedness for compliance with the Basel Risk Data Aggregation and Reporting (RDAR) Standards;
- the capital and liquidity position of RBS and related regulatory submissions;
- improvements to risk reporting; and
- oversight of the bank's risk profile through monitoring the risks inherent in the bank's operations and portfolios.

More detailed information on each of these areas is set out in the Board Risk Committee report that follows.

Key priorities for 2016

Management remains committed to the reduction of risk within the organisation and demonstrated real progress in many areas during 2015. The Committee will continue to oversee the work being undertaken to ensure that the bank progresses towards operating within risk appetite and that historic issues are fully and sustainably remediated. Oversight of the Williams & Glyn separation and disposal process will be a key focus for the Committee in 2016 and, as the bank advances its strategic ambitions, it will be essential that the heightened change agenda does not adversely impact on the control environment and this will be closely monitored. Other areas of focus will include continued supervision of the embedding of the three lines of defence model, data quality, cyber risk, further evolution and enhancement of the risk appetite framework and the implementation of the Senior Managers Regime across the organisation.

Baroness Noakes

Chairman of the Board Risk Committee,

25 February 2016

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Report of the Board Risk Committee

Report of the Board Risk Committee

The role and responsibilities of the Board Risk Committee

The Board Risk Committee assumes responsibility on behalf of the Board to provide oversight of current and potential risk exposures and future risk strategy, including the determination of risk appetite and tolerance, and to promote a culture of risk awareness within RBS.

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

Membership

The Board Risk Committee comprises independent non-executive directors. Details of the skills and experience of each of the Committee members are set out in their biographies on pages 43 to 46.

	Attended/ scheduled
Baroness Noakes (Chairman)	9/9
Morten Friis	9/9
Robert Gillespie (1)	8/9
Penny Hughes	9/9
Brendan Nelson	9/9

Note:

(1) The BRC meeting in March 2015 had to be rescheduled at short notice, meaning Mr Gillespie was unable to attend owing to a clash with a Citizens Financial Group Inc. Board meeting.

Baroness Noakes, Morten Friis and Brendan Nelson are also members of the Group Audit Committee. Robert Gillespie is also a member of the Group Performance and Remuneration Committee and the Sustainable Banking Committee, and Penny Hughes chairs the Sustainable Banking Committee. This common membership across Committees ensures effective governance across all risk, finance, reputational and remuneration issues, that agendas are aligned and that overlap of responsibilities is avoided where possible.

Committee meetings are also attended by relevant executive directors, including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Conduct & Regulatory Affairs Officer, Chief Legal Officer and General Counsel and Chief Audit Executive. The lead partner of the External Auditor also became a regular attendee of all meetings from January 2015 onwards. External advice is sought by the Committee, where appropriate.

Meetings and visits

Five scheduled meetings and four ad hoc meetings were held in 2015. The ad hoc meetings were required to consider: the preliminary 2015 Bank of England regulatory stress test results; the final 2015 Bank of England regulatory stress test results; and the key elements of the Williams & Glyn Banking Licence Application and regulatory submissions.

In 2015, members of the Committee undertook a programme of visits to various businesses and control functions in conjunction with members of the Group Audit Committee. The purpose and scope of this programme is discussed in detail in the Report of the Group Audit Committee above.

The Committee also held in-depth sessions on risk reporting, risk appetite, economic capital and an education session on stress testing.

Performance Evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Board Risk Committee, was conducted by Condign Board Consulting Limited, an external consultant, in 2015. The Committee has considered and discussed the outcomes of this evaluation. Overall the review concluded that the Board Risk Committee continued to operate effectively. However, it was recognised that the agenda of the Committee was substantial and complex, and that meetings were lengthy as a result. It was acknowledged that the situation would also be expected to improve as the bank's simplification programme progressed.

A small number of general recommendations which are relevant for both the Board and its senior committees were made. Key themes and actions arising from these general recommendations are set out in the Board report on pages 51 and 52 and will be considered, and addressed as appropriate, at Board level.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress on its 2016 priorities during the year.

Allocation of Board Risk Committee agenda time:

Report of the Board Risk Committee

Matters considered by the Committee in 2015

Key area	**Matters considered and action taken by the BRC**
Risk strategy and policy	
Transformation	Consideration of execution risk of the bank-wide transformation programme and the impact of mandatory change programmes on the programme. The Committee requested regular updates from the transformation team on progress including independent opinions from Risk Management, Internal Audit, HR and C&RA. Focus sessions were provided at the Committee's request on the key workstreams under the transformation programme including: control; the RAG assessment framework; people risk; and technology.
Williams & Glyn	Detailed examination of the risks and challenges to the timely separation of physical assets in advance of the planned divestment, confirming appropriate governance was in place to support the programme. The Committee will oversee delivery closely during 2016 and that appropriate contingency arrangements are in place. The Committee reviewed and approved the key documents for the Banking Licence and Consumer Credit Permission Applications (namely the Regulatory Business Plan, Business Strategy including five year financials, ILAAP, ICAAP and RRP) and oversaw the governance and assurance processes in place for the whole of the applications.
Change risk profile	Consideration of the change risk profile of the bank's transformation programme and recommendations from Risk regarding prioritisation and Board and management oversight. The Committee asked management to map transformation initiatives and in-flight programmes to the bank's risk and control environment for use in future prioritisation considerations.
Recovery plan and resolution planning	Review and recommendation of the 2015 Recovery Plan to the Board for approval prior to submission to the PRA in June 2015. The Committee considered feedback from the regulator in Q4 2015 and will oversee enhancement plans throughout 2016. The Committee also reviewed the major milestones and responsibilities aimed at improving the bank's resolvability. The Committee considered the work already underway and further steps that may be required as regulatory expectations evolve over the coming years. The Committee also considered proposed enhancements to the management, governance and alignment of recovery and resolution planning. Regular updates on progress against plan will be provided to the Committee.
RBS Policy Framework	Consideration of the operation of the RBS Policy Framework, including plans to simplify the structure in line with the bank's strategic aims. The Committee requested that management continue to improve the process for exceptions to policy.
Risk profile	
Macroeconomic and geopolitical developments	Received updates on macroeconomic and geopolitical risks including developments in Russia, China, the removal of the Swiss Franc floor and the possible UK exit from the EU. The Committee also considered the implications of reduced secondary market liquidity, driven by changing market conditions, on the bank's risk profile and control environment.
Reporting	The Committee dedicated considerable meeting time to providing oversight of the bank's risk profile through the review of emerging risks and changes in the bank's most significant portfolios and operations, presented within the monthly risk report. This was supplemented by oral updates,

provided by the Chief Risk Officer and Chief Conduct and Regulatory Affairs Officer on current and material risks at each Committee meeting.

An in-depth session on risk reporting in July 2015 led to further recommendations for improvements to the monthly risk report. In response to a Committee request, the monthly MI pack will transition to a quarterly report during 2016, enabling more strategic insights to be highlighted. Management will continue to refine the data provided during 2016.

During 2015, the General Counsel was also invited to provide a report at each meeting on current and emerging legal and litigation risks facing the bank.

Focus sessions on key risk types

Detailed overviews of key risk types were provided to the Committee on a rotational basis. Topics covered in 2015 included reputational risk, market risk, operational risk, credit risk and country risk.

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Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Enterprise wide risk	
Risk appetite	Considerable time was spent reviewing the bank's risk appetite framework. The Committee recommended the proposed risk appetite for the bank's strategic objectives (earnings volatility, capital adequacy, stakeholder confidence and liquidity) to the Board for approval. The Committee held two deep dive meetings to consider the risk appetite statements for material risks and for each of the franchises and Services, placing a particular focus on: how the statements aligned with business plans and how deeply risk appetite was embedded within each area. In 2016, the Committee will look at all of these areas in greater depth including in particular the coherence of top down strategic risk appetite statements with the lower level business and risk level statements.
Risk culture	The Committee discussed and agreed the dimensions of the bank's target risk culture before this was considered further by the full Board. A further report covering franchise and functional action plans will be presented to the Committee in Q1 2016.
Stress testing	Considerable time was dedicated to stress testing throughout 2015. In Q1, the Committee considered the outputs of the 2014 reverse stress testing exercise and made recommendations to the Board. It has since recommended the reverse stress test thresholds that will underpin the 2015 exercise and will review outputs in the first quarter of 2016. The Committee discussed and agreed the underlying assumptions and scenario selection for both internal and external (Bank of England) stress tests (including Internal Audit's opinion) and monitored the results. Recommendations were made to the Board where formal Board approvals were required for regulatory purposes. A key focus of the Committee has been overseeing enhancements to the bank's stress testing capability as well as meeting internal and external regulatory milestones and requirements. Capability enhancement will remain a priority during 2016.
Three lines of defence	Oversight of progress to fully embed the Three Lines of Defence model and checking the project had an appropriate plan to deliver targeted results. The Committee is aware of the importance of staff understanding their roles and accountability and in conjunction with the Group Audit Committee, will oversee that the model continues to be reinforced across the organisation, placing particular emphasis on management's identification and control of risk within the first line of defence.
RDAR	Monitored ongoing preparations for the new Basel Principles on Effective Risk Data Aggregation and Reporting (RDAR), which come into effect in January 2016, and recommended to the Board approval of the bank's RDAR programme scope and approach to compliance.
Model risk	Continued to monitor model risk management and oversaw the redesign of the model governance structure. The Committee requested the articulation of a model risk appetite statement and risk rating methodology and for a full inventory of models to be prepared. Progress will be reviewed by the Committee in Q1 2016.
Risk assurance	The Committee received its first quarterly report on risk assurance which highlighted the emerging issues and any deteriorating trends in the control framework for Credit and Market Risk.
Regulatory, conduct and remediation	
Regulatory reviews	Oversaw ongoing investigations into foreign exchange manipulation. The Committee was kept appraised of the negotiations of settlements with the United States Department of Justice and US Federal Reserve System that were announced in May 2015.

Reviewed the progress of the Skilled Person's review of the Global Restructuring Group (GRG) early in 2015. This is now being overseen by a temporary GRG Board Oversight Committee and the Committee has received updates on progress.

Also monitored the outcomes of the Skilled Person's review into anti-money laundering compliance, the independent consultant's report on the bank's sanctions regime (following the December 2013 Cease & Desist Order issued by the Federal Reserve Bank of Boston) and the status of the investigation into the alleged mis-selling of Interest Rate Hedging Products.

IT Incident remediation

The remediation programme established in response to the IT incident in June 2012 was closed in H1 2015 following completion of the major deliverables and based upon assurances from Risk, Internal Audit and also independent advice from PwC, that the work undertaken had been appropriate and sustainable. Residual issues will be monitored by Internal Audit and reported to the Committee by exception.

Considered the regulatory response to a systems incident in June 2015. A systems issue delayed a number of customer transactions over a two day period, as a result of software failure. Remedial actions have been taken following a post-incident review. The Committee considered its root causes and mitigation and will keep the residual risks under review.

Report of the Board Risk Committee

Key area	Matters considered and action taken by the BRC
Regulatory, conduct and remediation	
Conduct and regulatory issues	The Committee also received reports on other conduct and regulatory issues including: · the remediation of issues arising within the former Markets Division, as part of the Markets Standards Portfolio Programme, which draws together a number of work streams to remediate broader risk and control issues, including regulatory and conduct risk, to strengthen the control environment. · the remediation of identified trade and transaction reporting compliance and collateral management issues in CIB; · the implementation of the bank's strategy to reduce the volume of customer complaints; · tax risk and European tax-related investigations; and · status reports on Americas remediation issues. In particular, the Committee considered section 12 of the US Bank Holding Company Act (BHCA) and its implementing rules (the "Volcker" rule) and approved the bank's Volcker compliance programme
FCA Firm Evaluation	An FCA Presentation in June 2015 on its strategic approach to regulation, the evolving risk landscape for banking groups and the areas of focus for the next 12 months. The FCA also presented the outcome of its firm evaluation, covering cultural change at the bank, root cause analysis, the scale and complexity of the bank's transformation programme and the challenges of simplification.
Representations to Regulators	The Committee requested a full inventory of key representations to regulators and sought assurances on the processes and governance in place to support submissions. This work is ongoing and will be kept under regular review.
Senior Managers Regime	The Committee exercises oversight of implementation of the new Senior Managers Regime across the bank and received reports on preparation and progress.
Market, credit and operational risk	
Credit, market and operational risk	Consideration of credit, market and operational risks formed an integral part of the agenda of each meeting, with detailed MI demonstrating the impact on risk profile, presented within the monthly risk report.
Operational risk management framework	Monitored progress of plans to improve the bank's Operational Risk Management Framework (ORMF) including the work underway to complete risk and control assessments across the businesses. The Committee noted that significant progress had been made and agreed that the programme could move to reporting only by exception if any major issues arise.
IT resilience and cyber risk	Received a bi-annual report on Security & Resilience risks and internal controls in place across the bank. The Committee also separately received a report on Information Security and insights from an external industry expert on cyber risk. It reviewed the responses to the PRA and FCA Dear Chairman II Exercises and the subsequent letters from the PRA and FCA and made recommendations to the Board for approval prior to

	submission.
Payments	Examined the stability and operational risks inherent within the bank's payments environment and considered resilience, the adequacy of resource and controls. The Committee received reports on the changing regulatory environment.
Data quality	Exercised oversight of the bank's data quality programme, which aims to measure the quality of the most important data in the bank and to remediate data quality issues. The Committee noted the progress made. A detailed plan will be presented to the Committee in Q1 2016.
Capital and Liquidity	
ICAAP and ILAA	The Committee regularly reviewed the capital and liquidity position of the bank. This included reviewing the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA) and Internal Audit's assurance opinion on the adequacy of the processes supporting their preparation and recommending that the Board approve these submissions to the PRA.
Contingency Funding Plan	Considered the bank's contingency funding plan and recommended it to the Board for approval.

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Report of the Board Risk Committee

Risk and C&RA

Conducted visits to Risk and C&RA and considered people engagement, resources and budget, bench strength and succession planning and the control environment of both functions.

Assessed and made recommendations to the Group Performance and Remuneration Committee on the performance of the Chief Risk Officer and Chief Conduct & Regulatory Affairs Officer.

Accountability and Remuneration

Continued to provide strategic risk oversight over performance and remuneration arrangements, working closely with the Group Performance and Remuneration Committee (RemCo). RemCo's report on pages 70 to 89 includes further detail on how risk is taken into account in remuneration decisions. Key matters considered by the Committee included:

- the risk and control objectives of members and attendees of the bank's Executive Committee, with additional focus on underlying objectives for the Chief Risk Officer and the Chief Conduct & Regulatory Affairs Officer;

- an assessment of the risk/conduct performance of members and attendees of the bank's Executive Committee, with recommendations made to RemCo as appropriate to inform its decision on pay and awards;

- an assessment of the risk/conduct performance of the bank and its businesses, with recommendations made to RemCo to inform its decision on adjustments to the annual bonus pools;

- accountability recommendations in respect of significant material events and high earners, including those current and former employees identified as part of the investigation into the manipulation of foreign exchange markets; and

- consideration of the performance conditions for the bank's Long Term Incentive Plans and assessment of proposed vesting levels to ensure risk management/conduct performance is fairly reflected in vesting outcomes.

Baroness Noakes
Chairman of the Board Risk Committee

Report of the RBS Capital Resolution (RCR) Board Oversight Committee

Letter from Baroness Noakes,

Chairman of the RCR Board Oversight Committee

Dear Shareholder,

The RBS Capital Resolution Board Oversight Committee was established following the creation of RBS Capital Resolution (RCR) on 1 January 2014.

RCR was established to separate and wind down RBS's high capital intensive assets. Targets were set to remove 55-75% of these assets from the balance sheet by the end of 2015 and 85% by the end of 2016.

Key principles are:

- removing risk from the balance sheet in an efficient, expedient and economic manner;
- reducing the volatile outcomes in stressed environments; and
- accelerating the release of capital through management and exit of the portfolio.

I was appointed Chairman of the Committee on 1 April 2014 and am pleased to present the report on the Committee's activity during 2015.

The role and responsibilities of the RCR Board Oversight Committee

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

The Committee's role is to:

- oversee the actions of RCR's management, including implementation of RCR's strategy;
- review and report to the Board on RCR's progress against and compliance with the primary objective (to eliminate the bank's exposure to RCR assets) and the asset management principles (criteria for taking decisions on the reduction of capital and assets);
- agree in consultation with the Group Performance and Remuneration Committee specific incentives for RCR management, aligned to the objectives of RCR;
- consider financial disclosures in respect of RCR; and
- report to the Board on the Committee's activities and recommend changes to RCR strategy.

Membership and meetings

The Chairman of the Committee is the Chairman of the Board Risk Committee. The Senior Independent Director, the Chairman of RBS and the Chairman of the Group Audit Committee are members. Attendance at meetings is shown below.

	Attended/ scheduled
Baroness Noakes (Chairman)	4/4
Sandy Crombie	4/4
Howard Davies (1)	0/1
Brendan Nelson	4/4
Former member	
Philip Hampton (2)	3/3

Notes:

(1) Howard Davies joined the Committee on 1 September 2015 when he succeeded Philip Hampton as Group Chairman. He did not attend the meeting in October 2015 as he was on business in the US.

(2) Stepped down from the Committee on 31 August 2015.

Principal activities during 2015

At each meeting during the year the Committee considered RCR's financial performance, outlook and delivery against the targets and asset management principles. There is a well established framework for quarterly reporting which includes impact on RBS's capital levels and impairment releases. Market conditions allowed for exits to be accelerated and the Committee received regular updates on progress and market conditions, as well as RCR's ability to execute and complete transactions efficiently. The Committee also received quarterly updates on key transactions and the exit strategy for assets deemed to pose higher operational risk. Customer, conduct and control environment considerations were also discussed regularly. The Committee also received reports on activities of the RBS Ireland Capital Resolution Board Oversight Committee.

In April 2015, the Committee discussed the RCR transfer/closure plan, noting requirements for the completion of RCR and how this would be evidenced to the relevant stakeholders. At the later meetings more detailed plans were considered, including regulatory expectations, internal audit approach and arrangements for reporting to the Board.

Committee meetings are attended by senior RCR managers and also representatives from the control functions, in particular from the Risk function.

RCR substantially completed its work by the end of 2015. The Committee met for its final meeting in January 2016 to finalise the transfer/closure of RCR. The RBS Board agreed closure of RCR on the recommendation of the Committee, which confirmed its satisfaction that RCR had met its 85% asset reduction target. This conclusion was supported by an external audit opinion from Deloitte on RCR's statement of assets as at 31 December 2015 and an opinion from Internal Audit. The relevant confirmations and information were provided to the PRA at the end of January 2016.

Baroness Noakes,

Chairman of the RCR Board Oversight Committee

25 February 2016

Report of the Sustainable Banking Committee

Letter from Penny Hughes

Chairman of the Sustainable Banking Committee

Dear Shareholder,

Having now completed my first full year as Chairman of the Sustainable Banking Committee, I am pleased with the progress made under the Committee's refocused strategic direction. There has been broader, strategic debate and ownership from the executive to drive forward sustainability in their businesses, aligned to customer priorities.

RBS continues to have a clear ambition to be number one for customer service, trust and advocacy in each of our chosen business areas. Delivery of this ambition depends in large part on our ability to demonstrate beyond question that we are a responsible company doing business in a sustainable way.

We will rebuild our reputation and earn our customers' trust by putting customers first, making RBS a great place to work, supporting our communities, and being mindful of environmental impacts.

The Sustainable Banking Committee is primarily concerned with overseeing, supporting and challenging actions taken by management to run the bank as a sustainable business, capable of generating long term value for its shareholders.

Some good progress was made in 2015 under our core themes:

- considering what is being done to foster a sustainable business for customers and understanding the needs of particular customer groups;
- oversight of how management is embedding culture and standards including engagement, motivation, living the values and leadership;

- oversight of the brand strategy and building on our legacy as a bank of brands, developing our brands to build on the connection with our customers;
- development of the Sustainability agenda, meeting the needs of all our stakeholders whilst aligning with the Bank's overall strategy;
- ongoing commitment to stakeholder engagement through face to face sessions with advocacy groups on key topics;
- considering sustainability positioning on environmental targets, climate change, sustainable energy and the social economy; and
- transparent reporting through the annual Sustainability Report which describes our performance and approach to making RBS a more sustainable business.

Although there is still much to be done to rebuild trust, it is pleasing that the efforts to build a responsible and sustainable business are being recognised through independent and external measures. We have successfully retained our place in the Dow Jones World Sustainability Index with a score of 80 and have also been included in the Carbon Disclosure Project's FTSE 350 Climate Disclosure Leadership Index with a score of 99/100 for disclosure and 'B' for performance. RBS has also been reselected for inclusion in the FTSE4Good index which measures the performance of companies against globally recognised responsibility criteria.

The Committee will continue to operate at a strategic level, supporting and challenging the executive on their key priority of turning RBS into a customer centric bank. The work to strengthen our customer and employer brands will continue and culture will be a key focus, with the Committee reviewing actions being taken to deliver on the goals agreed by the Board.

My thanks go to the Committee members and attendees for their contribution and support in steering the work of the Committee through another challenging year.

Penny Hughes

Chairman of the Sustainable Banking Committee

25 February 2016

Report of the Sustainable Banking Committee

Report of the Sustainable Banking Committee

Meetings

The Sustainable Banking Committee held six scheduled Committee meetings in 2015 which were attended by senior representatives from the customer-facing franchises as well as Human Resources, Sustainability, Risk, C&RA, Communications and Marketing, and Strategy.

Stakeholder engagement sessions

In addition to ongoing engagement which takes place across our business each day, the Sustainable Banking Committee runs a proactive engagement programme to which we invite external stakeholders to meet with, and challenge, the most senior decision makers in RBS. These discussions help shape future policies, influence strategic priorities and inform decision making across the Bank and will continue to play a key role. To date we have met with over 50 different groups of NGOs, civil society groups, government bodies, consumer groups and investors in this way. In particular, in 2015 we held four such stakeholder engagement sessions covering the following topics:

- financial inclusion including the issue of debt and access to affordable credit;
- the issues the Bank should prioritise to become number one for customer service, trust and advocacy;
- the disintermediation of the banking sector and the increasing availability of alternative sources of finance; and
- stakeholders’ views on RBS India’s sustainable development programs.

In addition, the programme of UK-based events aimed at individual shareholders continued in the first half of 2015 and provided an opportunity for shareholders to meet directors and senior management to learn more about the business.

Membership

The Sustainable Banking Committee comprises three independent non-executive directors. The Chairman and members of the Committee, together with their attendance at meetings, are shown below.

	Attended/ scheduled
Penny Hughes (Chairman)	6/6
Alison Davis	6/6
Robert Gillespie (1)	5/6
Mike Rogers (2)	—

Notes:

(1) Required to attend Citizens Financial Group, Inc meeting.

(2) Appointment with effect from April 2016.

Performance evaluation

The annual review of the effectiveness of the Board and its senior committees, including the Sustainable Banking Committee, was conducted by Condign Board Consulting Limited. The Committee has considered the findings of the review. Overall the review concluded that the Sustainable Banking Committee continued to operate effectively. Whilst no specific recommendations were made in relation to the Committee, the review highlighted the importance of maintaining focus around the remit of the committee.

The review also included a small number of general recommendations which are relevant for both the Board and its senior committees. Key themes and actions arising from these general recommendations are set out in the Board report on pages 51 and 52 will be considered, and addressed as appropriate.

The review also recommended that all Committee Chairs should ensure continued focus on agenda planning and streamlined reporting to the Board, which will be a priority for the Committee during 2016.

The Committee recently conducted a review of its terms of reference to reflect the Committee's strategic role of overseeing, supporting and challenging actions being taken by management to run the bank as a sustainable business. During 2016, the Committee will structure its meetings around five key drivers: culture, people, customer, brand & communications and Environmental, Social & Ethical issues.

The outcomes of the evaluation have been reported to the Board and the Committee will track progress on its 2016 priorities during the year.

Role and responsibilities of the Sustainable Banking Committee

Authority is delegated to the Sustainable Banking Committee by the Board and the Committee reports and makes recommendations to the Board as required. The terms of reference of the Committee are available on rbs.com and these are reviewed annually and approved by the Board. A report on the activities of the Committee in fulfilling its responsibilities is provided to the Board following each meeting. The principal responsibilities of the Committee are shown below and during 2015 were grouped under three core themes of work: Bank-wide Reputation and Trust; Serving Customers; and Sustainability/Emerging Issues.

Bank-wide reputation and trust led by the Chief Executive

Oversight of:

- management of reputation and delivery of commitments on trust, advocacy and customer service;
- reputational challenges relating to people agenda including embedding values and cultural change activity;
- development of brand strategy in line with RBS's purpose, vision and values;
- sustainable growth of business and measures taken to support economic development and how banks can better serve society;
- community programmes and employee engagement in charitable partnerships;

Serving customers

- provide challenge on how well RBS is integrating sustainable banking into its business strategy and what is being done to foster a sustainable business for customers;
- oversee customer centricity priorities including receiving reports on key customer metrics;
- consider product sustainability, transparency and fairness;
- receive reports on how RBS is supporting SMEs and oversee the approach to responsible lending and financial inclusion;

Sustainability/emerging issues

- oversight of Environmental, Social and Ethical risk policies;
- engage with key internal and external stakeholder groups on emerging sustainability issues;
- approve the annual Sustainability Report and receive the external auditors' assurance report; and
- oversee priorities, targets and reputational challenges on key emerging sustainable banking issues and consider best practice benchmarking.

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Directors' Remuneration Report

Annual statement from Sandy Crombie
Chairman of the Group Performance and Remuneration Committee

Dear Shareholder,

I am pleased to set out the Directors' Remuneration Report for 2015. This report details the remuneration policy for the year ahead as well as our pay decisions for 2015 and the reasons behind them. The Committee's aim is to make sure the remuneration policy supports RBS' strategy, a key element of which is to deliver our ambition of becoming the number one bank in the UK for customer service, trust and advocacy.

Developments in 2015

It has been a year of continuing progress. On the one hand, good progress has been made against our strategic targets. We believe the focus on culture and encouraging good behaviours will, in time, make a significant contribution to driving sustainable returns for shareholders. On the other hand, while we continue to make progress in addressing and resolving legacy and conduct issues, these continue to drag on financial results and the Committee appreciates the impact this has on all our stakeholders.

In November, changes were announced to the pay arrangements for customer-facing employees in Personal & Business Banking. These changes are intended to reinforce the message that our employees should offer services and advice solely on the basis of what best meets the needs of the customer. Accordingly, we have removed incentives based on sales and other criteria from these employees, and instead have made a modest increase to their fixed pay. I believe this is a bold and significant step in our efforts to rebuild trust in RBS.

While pay remains an important and sensitive topic, an encouraging sign is that pay is not dominating discussions with shareholders in the way that it used to. I hope this reflects the efforts of the Committee in recent years to implement a remuneration policy that is simpler than before and strongly aligned to shareholders' interests over the long term.

Market context

Variable pay at RBS remains restrained in a market context, reflecting both our ownership structure and the transition to a smaller bank, centred in the UK and Ireland. Decisions by the Committee on variable pay are driven by a thorough step by step process with adjustments for performance, risk and conduct events in order to determine appropriate outcomes.

I know that bonuses remain an emotive issue, particularly when RBS is posting losses and continuing to deal with conduct and litigation issues from the past. Against this background, bonuses have fallen by over 72% across RBS and by over 90% in the investment bank since 2010. While the bonus pool has been coming down year on year, including a further reduction in 2015, it is important that RBS does not become too disconnected from industry norms. The Committee recognises the need to maintain a commercial approach to pay and reward the hard work by those employees who are helping to turn around RBS.

Pay decisions for 2015

I know that it is in the public interest to show restraint on remuneration while at the same time there is a need to deliver fair and reasonable pay outcomes for employees. Average annual salary increases are in line with the financial services market. There is a focus on paying the right wage to employees and our rates of pay exceed the Living Wage Foundation Benchmarks.

The bonus pool has fallen from £421 million in 2014 to £373 million in 2015, a reduction of 11%. In order to ensure there is a balanced distribution, over 90% of this pool will be directed to those below the most senior RBS employees. Where employees do receive a bonus, the average bonus amounts remain relatively modest with 52% of employees receiving £2,000 or less and a further 21% receiving less than £5,000.

No changes are being made to the remuneration structure for executive directors at this time. Executive directors are not eligible for annual bonuses. Instead, for them and their most senior colleagues, variable pay continues to be delivered in long-term incentives, aligning to shareholder value over the long term. One change to the performance measures for long-term incentive awards is a slight amendment to the comparator group for Total Shareholder Return performance to more accurately reflect RBS' strategic direction. Further details are set out on page 81.

Considerations for the year ahead

In accordance with UK regulatory requirements, further amendments will be made to the variable pay awarded to individuals identified as Senior Managers under the PRA regime. Variable pay to Senior Managers for performance years starting on or after 1 January 2016 will be subject to deferral over seven years and the potential clawback period will be extended to ten years.

Further guidance on remuneration practices has been published by the European Banking Authority (EBA) which will also be considered by the Committee when reviewing policy in 2016. The Directors' Remuneration Policy will then be presented to shareholders for approval at the 2017 AGM, at the end of its current three year cycle.

I would like to conclude by thanking my fellow Committee members and those who support the Committee for their commitment and guidance over the year. I am also grateful for the input received from shareholders which plays an important part in developing responsible pay practices.

Sandy Crombie

Chairman of the Group Performance and Remuneration Committee

25 February 2016

Directors' Remuneration Report

Remuneration and the business strategy

To provide customers with the best possible service, RBS is building a strong, simple and fair bank. Performance and pay management is part of that process and good progress was made on all three fronts during 2015.

Strong

RBS needs to build an engaged and inclusive workforce, capable of providing excellent customer service.

- Senior leaders have collective performance objectives that target financial strength as well as customer experience improvements through net promoter and trust scores.

- Employee engagement is also targeted and 2015 results show an improvement of six points on 2014. RBS is now within three points of industry peers.

- In 2015, RBS announced its intention to increase the proportion of women in the top three leadership layers to 30% by 2020 and to have an approximate 50/50 balance at all levels by 2030.

- Pay is not the only lever and employees are supported by wider people initiatives with over 13,000 employees undertaking the 'Determined to Lead' programme in 2015. This programme is aimed at ensuring stronger and more consistent leadership.

- Building on established processes and ways of working, new professional Standards Frameworks set out the relevant knowledge, skills, attitudes and behaviours expected of RBS employees in their role, to embed good conduct and an appropriate culture.

Simple

Simplifying RBS and the way it operates will reduce costs and our senior leaders are measured on this as part of their LTI performance targets.

- RBS is simplifying how employees get paid. In PBB, pay is linked to supporting customers, rather than short-term incentive schemes.

- Any variable pay for executive directors is delivered as an LTI award not bonus, with future looking performance measures linked to the strategic plan.

· Shareholder support was strong for last year's Directors' Remuneration Report with over 99% voting in favour. No changes are being made to the remuneration policy, approved at the 2014 AGM, at this time.

Fair

The Committee must ensure that good behaviours are encouraged and that conduct issues are accounted for.

· Being fair is grounded in paying people appropriately for their work and commitment to serve customers well.

· 2015 is the first full year that RBS has been operating as a fully accredited living wage employer.

· If conduct falls short of the standard expected, the Committee can apply malus (reduction or cancellation of variable pay awards prior to payment) or clawback (recovering awards that have already been paid).

· In 2015, malus has been applied to remuneration outcomes as part of the accountability review process.

· The Committee aims to strike a fair balance between adjustments to variable pay as a targeted measure to change behaviour whilst not disproportionately penalising employees who are not directly responsible for events.

· Bonuses have continued to shrink at RBS, aligned with the restructuring that has taken place and the actions taken by the Committee, but a certain level is considered necessary in order to run a commercial and sustainable business.

Bonus pool levels have been transformed since 2010

Directors' Remuneration Report

At a glance summary for executive directors

Remuneration outcomes for 2015

	Ross McEwan £000s	Ewen Stevenson £000s
Salary	1,000	800
Fixed share allowance	1,000	800
Benefits (1)	88	26
Pension allowance	350	280
Bonus	n/a	n/a
Vesting of 2013 LTI award (2)	1,347	—
Total	3,785	1,906

Notes:

(1) Amount for Ross McEwan includes standard benefit funding and relocation benefits.

(2) Estimated value of the LTI award due to vest in March 2016. A summary of the performance assessment is set out below and full details can be found on page 79.

2013 LTI award

Ross McEwan was granted an LTI award in March 2013 while CEO of UK Retail and became Chief Executive in October 2013. His change in role over the three year vesting period has resulted in 25% of the award being based on UK Retail measures and 75% based on RBS-wide measures.

Vesting outcome for UK Retail performance measures

Vesting outcome for RBS-wide performance measures

Combined vesting outcome for 2013 LTI award

Number of shares under award	Final vesting outcome (weighted 25%:75%)	Number of shares to vest in March 2016	Estimated value before tax
696,152	62%	431,614	£1,346,636

Implementation of remuneration policy in 2016

The LTI shown above is the award to be granted in March 2016. The notional value at 48% of the grant reflects an estimate of the potential value in light of the stretching performance conditions and risk of forfeiture over the five year vesting period.

Linking remuneration to the business strategy

Further details on the performance measures for the LTI award to be granted in March 2016 are set out on page 81.

Directors' Remuneration Policy

Directors' Remuneration Policy

The full Directors' Remuneration Policy was approved by shareholders at the AGM on 25 June 2014 and is available at rbs.com/about/board-and-governance.html. No changes are being made that would require shareholder approval at the AGM in 2016. An extract of the policy, updated to ensure it is relevant for the current year, is set out below. In the event of any conflict, the approved policy (available on rbs.com) takes precedence over the information set out in this section.

Fixed pay elements for executive directors

Fixed pay elements are intended to provide a level of competitive remuneration for performing the role with less reliance on variable pay in order to discourage excessive risk-taking and with partial delivery in shares to align with long-term shareholder value.

Element of pay	**Purpose and link to strategy**	**Operation**	**Maximum potential valu**
Base salary	To aid recruitment and retention of high performing individuals whilst paying no more than is necessary. To provide a competitive level of fixed cash remuneration, reflecting the skills and experience required, and to discourage excessive risk-taking.	Paid monthly and reviewed annually. The rates for 2016 are unchanged: Chief Executive - £1,000,000 Chief Financial Officer - £800,000	Determined annually. Any future salary increase considered against peer co and will not normally be g the average salary increase employees over the period policy.

		Further details on remuneration arrangements for the year ahead are set out in the annual report on remuneration.	
Fixed share allowance	To provide fixed pay that reflects the skills and experience required for the role. This will be delivered in shares which must be retained for the long term.	A fixed allowance, paid entirely in shares. Individuals will receive shares that vest immediately subject to any deductions required for tax purposes and a retention period will apply. Shares will be released from the retention period in equal tranches over a five year period. The fixed share allowance will broadly be paid in arrears, currently in two instalments per year.(1)	An award of shares with a[n] value of up to 100% of sal[ary at] time of award. The fixed share allowance pensionable.
Benefits	To provide a range of flexible and market competitive benefits to further aid recruitment and retention of key individuals.	A set level of funding is provided and	Set level of funding for be[nefits] (currently £26,250) which to review.

executive directors can select from a range of benefits including: · company car · private medical insurance · life assurance · ill health income protection Also entitled to the use of a car and driver on company business and standard benefits such as holiday and sick pay. Further benefits including allowances when relocating from overseas may be provided to secure the most suitable candidate for the role.	Further benefits such as re allowances and other bene tax advice, housing and fli allowances and payment o fees) may be offered in lin market practice. The value of benefits paid disclosed each year in the report on remuneration.

Pension	To encourage planning for retirement and long-term savings.	Provision of a monthly cash pension allowance based on a percentage of salary. Opportunity to participate in a defined contribution pension scheme.	Pension allowance of 35%

Note:

(1) The company believes that delivery in shares is the most appropriate construct for a fixed allowance to executive directors, qualifying as fixed remuneration for the requirements imposed under CRD IV. If regulatory requirements emerge that prohibit allowances being delivered in shares, or deem that such allowances will not qualify as fixed remuneration, then the company reserves the right to provide the value of the allowance in cash instead in order to comply with the requirements. In 2015 the shares were awarded in August and November, during open periods for directors' share dealings.

Directors' Remuneration Policy

Variable pay

Variable pay is intended to incentivise superior long-term performance and promote the success of RBS, with rewards aligned with shareholders' interests and adjusted for risk, based on the achievement of stretching performance measures.

Element of pay	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics and period
Variable pay award (long-term incentive)	To support a culture where good performance against a full range of measures will be rewarded. To incentivise the delivery of stretching targets in line with the Strategic Plan. The selection of performance metrics will be closely aligned with key performance indicators. Performance is assessed against a range of financial and non-financial measures to encourage superior long-term value creation for shareholders.	Any variable pay award made will be delivered in the form of a long-term incentive, paid in shares (or in other instruments if required by regulators) and subject to a combination of time and performance-based vesting requirements. A minimum three year performance period will apply. The award will have an overall five year vest period, vesting equally in years four and five. As a minimum, shares will be subject	The maximum level of award is subject to any limit on the ratio of variable to fixed pay as required by regulators. This currently limits variable pay to the level of fixed pay (i.e. base salary, fixed share allowance, benefits and pension). A higher ratio, up to 200% of fixed pay, is possible with shareholder approval. RBS is not intending to seek any such approval at the 2016 AGM. For these purposes, awards will be valued in line with the EBA rules, including any available discount for long-term deferral. In addition to the regulatory ratio which currently limits variable pay to the level of fixed pay, awards for executive directors are subject to a maximum of 300% of	Any award made will be subject to performance conditions measured over a minimum three year period. Typical measures may fall under the following categories (weighted 25% each): · Economic Profit · Relative TSR · Safe & Secure Bank · Customers & People An underpin gives the Committee discretion

	Delivery in shares with the ability to apply malus adjustments and clawback further supports longer-term alignment with shareholders' interests.	to deferral and retention periods as required by UK regulators. Provisions for malus adjustment of unvested awards and clawback of vested awards. The long-term incentive award will be delivered under the RBS 2014 Employee Share Plan, as approved by shareholders at the 2014 AGM.	base salary [1]. The vesting level of the award could vary between 0% and 100% dependent on the achievement of performance conditions.	to reduce vesting amounts in light of underlying financial results, or conduct and risk management effectiveness. These or similar measures and weightings will be applied to reflect the strategy going forward. Details of the performance measures for awards to be granted in 2016 are set out as part of the implementation of remuneration policy on page 81.

Note:

(1) Adjustments will be made to award levels where necessary to ensure that executive directors remain within the variable to fixed limit.

Other pay elements

Element of pay	**Purpose and link to strategy**	**Operation**	**Maximum potential value**
Shareholding requirements	To ensure executive directors build and continue to hold a significant shareholding to align interests with shareholders.	A period of five years is allowed in which to build up shareholdings to meet the required levels.	Chief Executive - 250% of salary. Chief Financial Officer - 125% of salary.

	Any unvested share awards are excluded from the calculation.	Requirements may be reviewed in future.

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Directors' Remuneration Policy

Recruitment remuneration policy

- RBS considers both internal and external candidates and assesses the skills and experience required for each role. Pay is generally set at no more than is required to attract the most suitable candidate for the role.

- A buy-out policy exists to replace awards forfeited or payments foregone. The Committee will seek to minimise buy-outs wherever possible and will seek to ensure they are no more generous than, and on substantially similar terms to, the original awards or payments they are replacing. No sign-on awards or other payments will be offered.

- The maximum level of variable pay which may be granted to new executive directors is the same as that applicable to existing executive directors, excluding any buy-out arrangements.

- The Chairman and non-executive directors do not receive variable pay.

Service contracts and termination

- RBS or the executive director is required to give 12 months' notice to the other party to terminate the executive director's employment.

- There are no pre-determined provisions for compensation on termination.

- There is discretion for RBS to make a payment in lieu of notice (based on salary only) which is released in monthly instalments. The executive director must take all reasonable steps to find alternative work and any remaining instalments will be reduced as appropriate to offset income from any such work.

- Any incentive awards will be treated in accordance with the relevant plan rules as approved by shareholders. Any outstanding share awards held by 'good leavers' will vest, normally on the original vesting dates, and shares from the fixed share allowance will continue to be released over the applicable five year retention period in order to ensure former executive directors maintain an appropriate interest in RBS shares.

- Non-executive directors do not have service contracts or notice periods although they have letters of appointment reflecting their responsibilities and time commitments. No compensation would be paid to any non-executive director in the event of termination of appointment.

Arrangements for the Chairman

Under his letter of appointment, Howard Davies or RBS can terminate his appointment by giving notice, such notice to take immediate effect. In the event that his election or re-election is not approved by shareholders, the appointment will terminate automatically with immediate effect. No compensation or payment in lieu of notice will be payable upon termination of his appointment.

Election or re-election of directors

In accordance with the provisions of the UK Corporate Governance Code, all directors of the company stand for election or re-election annually by shareholders at the company's AGM.

Neither of the current executive directors hold a non-executive director role at any other company.

Consideration of employment conditions elsewhere in the company

The Committee retains oversight of remuneration policy for all employees to ensure there is a fair and consistent approach throughout the organisation. The policy uses deferral, malus and clawback to promote effective risk management and alignment with shareholders' interests.

Consultation on remuneration generally takes place with our social partners, including representatives from UNITE. RBS is a fully accredited Living Wage employer and we set our minimum pay (including benefit funding) higher than required for this.

An annual employee opinion survey takes place which includes a number of questions on pay and culture. This includes questions on how pay is determined and evaluated, including the need to consider both 'what' and 'how' outcomes have been achieved, and whether employees believe they are paid fairly for the work they do.

While employees are not directly consulted on the directors' remuneration policy, around 28,000 of our employees are shareholders through our incentive and all-employee share plans and have the ability to express their views through voting on the Directors' Remuneration Report.

Directors' Remuneration Policy

Remuneration policy for the Chairman and non-executive directors

Element of pay	**Purpose and link to strategy**	**Operation**	**Maximum potential value**	**Performance metrics and period**
Fees	To provide a competitive level of fixed remuneration that reflects the skills, experience and time commitment required for the role. No variable pay is provided so that the Chairman and non-executive directors can maintain appropriate independence, focus on long-term decision making and constructively challenge performance of the executive directors.	Fees are paid monthly. The level of remuneration reflects their responsibility and time commitment and the level of fees paid to directors of comparable major UK companies. The Chairman and non-executive directors do not participate in any incentive or performance plan. Fees are reviewed regularly.	The rates for the year ahead are set out in the annual report on remuneration on the next page. Any future increases to fees will be considered against fees paid to directors of comparable companies and will not normally be greater than the average inflation rate over the period under review, taking into account that any change in responsibilities, role or time commitment may merit a larger increase. Additional fees may be paid for new Board Committees provided these are not greater than fees payable for the existing Board Committees as detailed in the annual report on remuneration.	n/a
Benefits	Any benefits offered would be in line with market practice.	Reimbursement of reasonable out-of-pocket expenses incurred in performance of duties. The Chairman also receives private medical	The value of the private medical cover provided to the Chairman will be in line with market rates and disclosed in the annual report on remuneration.	n/a

cover.

Annual report on remuneration

Annual report on remuneration

The sections audited by the company's auditors, Deloitte LLP, are as indicated.

Implementation of remuneration policy in 2016

No changes have been made to the underlying policy for 2016.

Executive directors

	Salary	Benefits	Pension 35% of salary	Fixed share allowance 100% of salary (1)	Long-term incentive (LTI) award calculated in line with regulatory cap (2)
Chief Executive	£1,000,000	£26,250 (3)	£350,000	£1,000,000	£2,680,000
Chief Financial Officer	£800,000	£26,250	£280,000	£800,000	£2,150,000

Notes:

(1) Fixed share allowance will be payable broadly in arrears, currently in two instalments per year, and the shares will be released in equal tranches over a five year period.

(2) The LTI that can be awarded in 2016 is limited to the level of fixed remuneration. Before applying the discount factor for long-term deferral, calculated in line with EBA rules, the face value for the LTI is approximately 113% of fixed remuneration. The performance measures and targets are set out on page 81.

(3) Also entitled to a flight allowance as part of his relocation arrangements, the value of which will be disclosed in the total remuneration table.

Chairman and non-executive directors' fees for 2016

Chairman (composite fee)		£750,000
Non-executive director basic fee		£72,500
Senior Independent Director		£30,000
Group Audit Committee (GAC), Group Performance and Remuneration Committee (RemCo),	Member	£30,000
Board Risk Committee (BRC) and Sustainable Banking Committee (SBC)	Chairman	£60,000
Board Oversight Committee (BOC) for RCR, CIB and GRG	Member	£15,000
US Risk Committee	Chairman	£30,000
Group Nominations Committee (until January 2016)	Member	£10,000
Group Nominations and Governance Committee (from February 2016)	Member	£15,000

Morten Friis is the RBS Board nominated member of the Steering Group to oversee compliance remediation activities in respect of RBS' US businesses for which he receives fees of £15,000 per annum. In terms of changes for 2016, the RCR BOC held its final meeting in January 2016 and has been disbanded. The expectation is that the GRG BOC will be stood down during the course of 2016. A US Risk Committee has been established to comply with Enhanced Prudential Standards and to oversee risk management of our US operations. The first meeting of the US Risk Committee will take place during 2016. The Group Nominations Committee has been replaced by the Group Nominations and Governance Committee, with an expanded remit and a reduced number of members. This is to deliver a more streamlined nominations process and a stronger overall governance framework for the Board and its Committees.

Total remuneration paid to executive directors for 2015 (audited)

	Ross McEwan		Ewen Stevenson	
	2015	2014	2015	2014
	£000s	£000s	£000s	£000s
Salary	1,000	1,000	800	497
Fixed share allowance	1,000	—	800	497
Benefits (1)	88	143	26	16
Pension	350	350	280	174
Total fixed remuneration	2,438	1,493	1,906	1,184
Annual bonus	n/a	n/a	n/a	n/a
Long-term incentive award (2)	1,347	324	—	—
Other awards (3)	—	—	—	1,911
Total remuneration	3,785	1,817	1,906	3,095

Notes:

(1) Benefits figure includes standard benefit funding of £26,250 per annum with the remainder being relocation expenses provided to Ross McEwan.

(2) The value in 2015 for Ross McEwan relates to an LTI award granted in 2013. The performance conditions ended on 31 December 2015 and have been assessed as set out on the next page. The value for 2014 has been restated from the estimated value of £358,000 provided in the 2014 report to reflect the value on the vesting date in August 2015.

(3) The amount shown for Ewen Stevenson in 2014 relates to an award made on appointment to replace the value of awards forfeited on leaving Credit Suisse. The award was delivered entirely in shares and subject to deferral, on terms that are no more generous than the terms of the awards replaced.

Annual report on remuneration

LTI vesting amount included in the total remuneration table (audited)

Ross McEwan was granted an LTI award in March 2013 while CEO of UK Retail, prior to becoming Chief Executive in October 2013. His change in role during the three year vesting period has resulted in a weighting of 25% based on performance of UK Retail and 75% based on RBS-wide measures. The performance conditions ended on 31 December 2015 and the award is due to vest in March 2016. The average share price over the last three months of the financial year has been used to estimate the vesting value.

Number of shares under award	Vesting outcome for UK Retail measures (1)	Vesting outcome for RBS-wide measures (2)	Final vesting outcome (weighted 25%:75%)	Number of shares to vest in March 2016	Average share price October – December 2015	Value for total remuneration table
696,152	80%	56%	62%	431,614	£3.12	£1,346,636

Notes:

(1) The performance measures applicable for UK Retail were based on: Financial targets (weighted 50%) covering risk weighted assets, RWAe, nominal assets, loan:deposit ratio, return on equity, operating profit, cost:income ratio; Customer measures (weighted 10%); People measures (weighted 10%); and Risk measures (weighted 30%). All financial targets were deemed to have been met in full other than the cost:income ratio which was considered partially met at 54% versus a 51% target. The customer, people and risk measures were also ranked as partially met. The Committee also considered recommendations from the BRC in determining the final outcome.

(2) This element follows the performance conditions applicable to the overall RBS-wide measures for the 2013 LTI awards and the assessment is detailed below.

2013 LTI – final assessment of RBS-wide performance measures (audited)

An assessment of performance of each relevant element was provided by the control functions and PwC assessed relative TSR performance against a peer group of comparator banks. The Committee determined overall vesting based on these assessments including consideration of the drivers of performance and the context against which it was delivered.

Performance Measure	Weighting	Performance for minimum vesting	Vesting at minimum	Performance for maximum (100%) vesting	Actual Performance	Vesting outcome	Weighted Vesting %
Economic Profit	25%	(£3.5 billion)	25%	£1 billion	(£1.2 billion)	62%	16%
Relative TSR	25%	TSR at median	20%	TSR at upper quartile	31st percentile ranking	0%	0%
Balance Sheet & Risk	25%	Half objectives met	25%	Objectives met or exceeded in all material respects	10/11 targets met (1)	90%	22%
Strategic Scorecard	25%		25%		6/8 targets met (2)	72%	18%
Overall vesting outcome (3)							56%

Notes:

(1) The following ten targets were all met or exceeded over the performance period to 31 December 2015: Core Tier 1 capital >10%; leverage ratio <18x; wholesale funding <10%; liquidity reserves >1.5x short-term wholesale funding; loan:deposit ratio c.100%; non-core run down and cumulative non-core loss before tax of c£3.6bn; Core Tier 1 capital on fully loaded Basel 3 basis >=10%; leverage ratio based on tangible equity <18x; liquidity coverage ratio >100%; net stable funding ratio >100%. Some improvement was still needed in the conduct risk target which was deemed not to have been met.

(2) The following six targets were met or exceeded: lending growth to be in line with market share and, for 2015, lending growth >= nominal UK GDP growth; retaining place in the Dow Jones Sustainability Index; leadership index to be within 5% of Global Financial Services (GFS) norm; engagement index to be within 5% of GFS norm; embedding the Group's values; succession planning in place across the franchises and functions. The two targets that were not met were the cost:income ratio of 55% and customer targets where performance has improved but over the three year period the performance was not considered sufficient.

(3) In determining the outcome above, the Committee reviewed financial and operational performance against the Strategic Plan and risk performance with input from the BRC.

Annual report on remuneration

2014 and 2015 LTI awards to executive directors – current assessment (audited)

The table represents an early indication of potential vesting outcomes only based on the position at 31 December 2015. The 2014 LTI award is due to vest in March 2017 and the 2015 LTI award will vest equally in March 2019 and March 2020. Details of performance against targets and any use of discretion will be disclosed once the awards vest.

Performance measure	Weighting	Performance for minimum vesting	Vesting at minimum	Performance for maximum vesting	Vesting at maximum	2014 current assessment	2015 current assessment
Economic Profit	25%	Minimum economic profit targets	25%	Performance ahead of the Strategic Plan	100%	Good progress and broadly in line with target set	Good progress and favourable to target set
Relative TSR	25%	TSR at median of comparator group	20%	TSR at upper quartile of comparator group	100%	Between median and upper quartile vesting	Below median performance for vesting
Safe & Secure Bank	25%	Target ranges set for: CET1 ratio and Cost:income ratio	Vesting between 0% – 100% qualified by Committee discretion taking into account the margin by which targets have been missed or exceeded			CET1 ratio is in range for vesting. Cost:income ratio is broadly in line with target	CET1 ratio is in range for vesting. Cost:income ratio is broadly in line with target
Customers & People	25%	Target ranges set for: Net Promoter Score, Net Trust Score (for 2015 awards) and Employee Engagement				Customer measures behind target range with People measures on target	Measures currently tracking behind target range

LTI awards granted during 2015 (audited)

	Grant date	Face value of award (£000s)	Number of shares awarded (1)	% vesting at minimum and maximum	Performance requirements
Ross McEwan	6 March 2015	1,560	417,486	Between 0% - 100% with minimum vesting as set out above	Conditional share awards subject to performance conditions, as set out above, measured over the three year period from 1 January 2015 to 31 December 2017
Ewen Stevenson	6 March 2015	2,160	578,128		

Note:

(1) The number of shares awarded is based on a multiple of salary, 156% for Ross McEwan and 270% for Ewen Stevenson, in line with the regulatory cap that limits variable pay to the level of fixed pay. The award price of £3.7362 was calculated based on the average share price over five business days prior to the grant date.

Annual report on remuneration

LTI awards to be granted to executive directors in 2016

Performance criteria
The performance measures are designed to be stretching and to support delivery of the business strategy. A three year performance period will apply until 31 December 2018. Subject to the achievement of the performance conditions, shares will then vest in equal tranches in years four and five. Any awards that vest will be subject to a retention period in line with regulatory requirements.

Awards granted to executive directors in March 2016 will be subject to four equally weighted performance categories, each able to vest up to 100% of base salary, subject to the maximum award that is possible under the approved policy and the regulatory cap. Details of the performance measures and the Committee's rationale for selecting them are set out below.

Economic Profit (25%)
Reason: Economic Profit, being a risk-adjusted financial measure, is consistent with regulatory requirements and provides a balance between measuring growth and the cost of capital employed in delivering that growth.

Measure: Economic Profit for the Group defined as profit after tax less preference share charges less tangible net asset value multiplied by the cost of equity.

Performance target and weightings

Weighting	Performance target	Vesting range
25%	Target consistent with the achievement of RBS' strategic long term return on equity target of 12%+	25% - 100%

Details of the actual targets, and performance against these, will be disclosed retrospectively after any vesting has been determined, in the annual report on remuneration for 2018.

Relative Total Shareholder Return (25%)

Reason: Relative TSR provides a direct connection between executive directors' awards and relative returns delivered to shareholders.

Measure: The measure compares performance against a group of comparator banks. The TSR comparator group has been updated for awards made in 2016 to more accurately reflect the business strategy with less focus on investment banking. This has resulted in Credit Suisse, Deutsche Bank and UBS being replaced by ING, Intesa San Paolo and Nordea. The weighting of Standard Chartered has been reduced to be in line with continental European banks given its international focus.

Relative TSR Comparator Group

1	Barclays
2	Lloyds Banking Group
3	HSBC
4 to 13	BBVA, BNP Paribas, Credit Agricole, ING, Intesa San Paolo, Nordea, Santander, Societe Generale, Standard Chartered

Performance target and weightings

Weighting	Performance target	Vesting range
25%	TSR between median and upper quartile	20% - 100%

Safe & Secure Bank (25%)

Reason: The Safe & Secure Bank measures have a particular focus on risk reduction and the building of a safer, sustainable business.

Measure: The key measures in this category are the achievement of pre-determined Common Equity Tier 1 (CET1) and Cost:income (C:I) ratios.

Performance target and weightings

Category	Metrics	Performance target
Safe & Secure Bank	CET1 ratio (12.5%)	Target consistent with RBS' strategic long term CET1 ratio target of 13%
	C:I ratio (12.5%)	Target consistent with RBS' strategic long term C:I ratio target of <50%

Details of the actual targets, and performance against these, will be disclosed retrospectively after any vesting has been determined, in the annual report on remuneration for 2018.

Customers & People (25%)
Reason: These measures reward management for building a customer-focused business with strength in terms of trust, reputation and the engagement of employees.

Measure: Net Promoter Scores (NPS) and Net Trust Scores (NTS) will be used, measured against a defined peer group. Employee engagement will be measured against the Global Financial Services (GFS) norm.

Performance target and weightings

Category	Metrics	Performance target
Customers & People	Advocacy (7.5%)	NPS gap to #1 of 2.3 (1)
	Trust (5%)	NTS: NatWest 63, RBS 50
	Engagement (12.5%)	Employee Engagement Index one point above GFS norm

Note:

(1) The NPS metric adopted is a bank-wide measure of the gap to #1 bank, which RBS plans to close to zero by 2020. It is calculated using the gap to #1 leading competitor in each customer segment, weighted by the revenue contribution of each segment.

The overall vesting under the above categories will be qualified by the Committee's discretion taking into account changes in circumstances over the performance period, the margin by which individual targets have been missed or exceeded, and any other relevant factors.

Underpin
The Committee will also review financial and operational performance against the business strategy and the risk environment prior to agreeing vesting of awards. In assessing the risk considerations, the Committee will be advised independently by the BRC. If the Committee considers that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect underlying financial results, or if the Committee is not satisfied that conduct and risk management during the performance period has been effective, then the terms of the awards allow for an underpin to be used to reduce vesting or lapse the award.

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Annual report on remuneration

Payments for loss of office (audited)
Philip Hampton stood down from the Board on 31 August 2015. No remuneration payment or payment for loss of office was made in connection with his departure.

Payments to past directors (audited)
Stephen Hester and Bruce Van Saun received shares on 9 March 2015 on the vesting of the LTI award granted in 2012 as set out below. The assessment of RBS-wide performance measures is detailed on page 85 of the 2014 Annual Report and Accounts.

Value of payments on vesting (audited)

		Stephen Hester			Bruce Van Saun		
Performance category	% vesting	Maximum RBS shares (2)	Vested RBS shares	Value (3)	Maximum CFG shares (2)	Vested CFG shares	Value (3)
Economic Profit	53%	261,998	138,859		72,528	38,440	
Relative TSR	68%	261,998	178,158		72,528	49,319	
Balance Sheet & Risk	100%	261,998	261,998		72,528	72,528	
Strategic Scorecard	25%	261,998	65,499		72,528	18,132	
Initial vesting outcome based on above	61.5%		644,514			178,419	
				£2,131,747			$4,089,180
Final outcome post application of underpin (1)	55.25%		579,279			160,360	
Check within maximum shares available to vest			*785,995*			*217,586*	

Notes:

(1) The Committee also considered recommendations from the BRC and concluded it would be appropriate to apply the risk and financial performance underpin in respect of the above awards. This resulted in downward discretion being applied to reduce the final vesting outcome from 61.5% to 55.25%.

(2) The maximum number of shares is calculated in line with the underlying award structure where each of the four performance categories could give rise to shares worth 100% of salary at grant but with the overall maximum capped at 300% of salary. The number has been reduced on a pro rata basis to reflect time served by Stephen Hester. The interests for Bruce Van Saun's award were converted to shares in Citizens Financial Group, Inc. as part

of the IPO of that business.

(3) Based on a RBS share price of £3.68 and Citizens Financial Group, Inc. share price of $25.50 on the date of vesting.

Total pension entitlements – Bruce Van Saun (audited)
Bruce Van Saun's Unfunded Unapproved Retirement Benefit Scheme (UURBS) operated as a cash balance plan. Under the rules of his UURBS, the benefit paid out on 1 April 2015 and there is no further entitlement to benefits from the scheme. The current executive directors do not participate in RBS defined benefit pension arrangements but receive a cash allowance instead.

	2015	2014
	£000s	£000s
Balance at 1 January	1,071	1,030
Investment return	7	41
Paid to Bruce Van Saun on 1 April 2015	1,078	
Total value of fund at 31 December	—	1,071

Total remuneration paid to the Chairman and non-executive directors for 2015 (audited)
While no changes were made to the fee structure during 2015, two additional Board Oversight Committees (BOCs) were established and fees are payable in line with those for the RCR BOC. The CIB BOC was established in March 2015 with a mandate to oversee the implementation of the CIB strategy without placing additional burdens on the existing Committee framework. The GRG BOC was established in May 2015 in order to provide oversight of the work and findings of the expert panel engaged to conduct an independent review of customer files and to provide advice in relation to matters generally related to GRG. The total fees paid are set out below.

Chairman (composite fee)		Fees 2015	Benefits 2015	Total 2015	Fees 2014	Benefits 2014	Total 2014
		£000s	£000s	£000s	£000s	£000s	£000s
Howard Davies (1)	c	260	2	262	—	—	—
Philip Hampton (2)		500	1	501	750	1	751

Non-executive directors (3)	Board	Noms	GAC	RemCo	BRC	SBC	RCR BOC	CIB BOC	GRG BOC	Other	Fees 2015	Benefits 2015	Total 2015	Fees 2014	Benefits 2014	Total 2014
											£000s	£000s	£000s	£000s	£000s	£000s
Sandy Crombie (4)	73	10	30	60			15		9	30	227	—	227	213	—	213
Alison Davis	73	10		30		30					143	—	143	141	—	141
Morten Friis (4)	73	10	30		30			11		15	169	—	169	112	—	112

Robert Gillespie (4)	73	10		30	30	30		23	9	100	305	—	305	184	—	184
Penny Hughes	73	10			30	60			9		182	—	182	178	—	178
Brendan Nelson	73	10	60		30		15	11	18		217	—	217	183	—	183
Baroness Noakes	73	10	30		60		30	11	9		223	—	223	186	—	186

Notes:

(1) Howard Davies joined the Board on 14 July 2015 and became Chairman with effect from 1 September 2015. The Benefits column includes private medical cover.

(2) Philip Hampton stepped down from the Board on 31 August 2015. The Benefits column includes private medical cover.

(3) In line with market practice, non-executive directors are reimbursed expenses incurred in connection with their attendance at Board meetings. To the extent that HMRC determines that any amounts are taxable, RBS will settle the associated tax liability on behalf of the non-executive director.

(4) Under the ‘Other’ column, Sandy Crombie received fees as the Senior Independent Director and Morten Friis received fees for his work on the US steering group. Robert Gillespie was the RBS nominated director of Citizens Financial Group, Inc. (CFG) until 3 November 2015 for which he received fees, delivered in cash and in restricted stock units in CFG. The value shown has been converted using an average exchange rate during 2015 of $1.528:£1.

Annual report on remuneration

Directors' interests in shares and shareholding requirements (audited)
The target shareholding requirement is to hold shares to the value of 250% of salary for the Chief Executive and 125% of salary for the Chief Financial Officer and members of the Executive Committee, excluding any unvested share awards in the calculation. A period of five years is allowed in which to build up shareholdings to meet the required levels. Shareholding requirements will be considered when relevant individuals request permission to sell shares and the Committee receives annual updates on progress towards meeting these requirements.

Notes:

(1) Ross McEwan holds 159,393 shares from his 2015 fixed share allowance that are included in the total shares beneficially owned but these have been excluded from the shareholding requirements calculation as he will transfer these shares to charity at the end of the retention period.

(2) Value of shares held is based on the share price on 31 December 2015, which was £3.02. During the year ended 31 December 2015, the share price ranged from £2.83 to £4.04.

Share interests held by directors

	Shares owned at 31 December 2015 (or date of cessation if earlier)	% of issued share capital	Value (£) (1,2)	% of shareholding requirement met	Unvested Long-term incentive awards	Unvested Deferral Plan awards
Ross McEwan	974,781	0.008386	£2,462,472	98.5%	2,028,831	18,797
Ewen Stevenson	277,300	0.002385	£837,446	83.7%	1,013,739	—
Howard Davies	1,000	0.000009				
	20,000	0.000172				

Sandy Crombie		
Alison Davis	20,000	0.000172
Morten Friis (3)	20,000	0.000172
Robert Gillespie	25,000	0.000215
Penny Hughes	562	0.000005
Brendan Nelson	12,001	0.000103
Baroness Noakes	21,000	0.000181
Former Chairman		
Philip Hampton	27,630	0.000238

Notes:

(1) Ross McEwan holds 159,393 shares from his 2015 fixed share allowance that are included in the total shares beneficially owned but these have been excluded from the shareholding requirements calculation as he will transfer these shares to charity at the end of the retention period.

(2) Value is based on the share price at 31 December 2015, which was £3.02. During the year ended 31 December 2015, the share price ranged from £4.04 to £2.83.

(3) Interest is 10,000 American Depository Receipts representing 20,000 ordinary shares.

No other director had an interest in the company's ordinary shares during the year or held a non-beneficial interest in the shares of the company at 31 December 2015, at 1 January 2015 or date of appointment if later. The interests shown above include connected persons of the directors. As at 25 February 2016, there were no changes to the directors' interests in shares shown in the table above.

Directors’ interests under the Group’s share plans (audited)

Long-term incentive awards

Awards held at 1 January 2015	Awards granted in 2015	Award price £	Awards vested in 2015	Market price on vesting £	Value on vesting £	Awards lapsed in 2015	Awards held at 31 December 2015	Expected vesting date

Ross McEwan	130,841 (1)		2.14	95,318	3.40	324,081	35,523	—	
	696,152		3.09					696,152	08.03.16
	915,193		3.28					915,193	07.03.17
		417,486	3.74					417,486	06.03.19 – 06.03.20
	1,742,186	417,486		95,318			35,523	2,028,831	
Ewen Stevenson	584,506 (2)		3.27	148,895	3.78	562,823		435,611	07.03.16 – 07.03.17
		578,128	3.74					578,128	06.03.19 – 06.03.20
	584,506	578,128		148,895				1,013,739	

Deferred awards

	Awards held at 1 January 2015	Awards granted in 2015	Award price £	Awards vested in 2015	Market price on vesting £	Value on vesting £	Awards lapsed in 2015	Awards held at 31 December 2015	Expected vesting date
Ross McEwan	37,596		3.09	18,799	3.78	71,060		18,797	08.03.16

Notes:

(1) Relates to an award made to Ross McEwan on joining RBS as CEO UK Retail in September 2012 to replace awards forfeited on leaving Commonwealth Bank of Australia.

(2) Award granted to Ewen Stevenson on appointment in May 2014 to replace awards forfeited on leaving Credit Suisse.

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Annual report on remuneration

Total Shareholder Return (TSR) performance
The graph below shows the performance of RBS over the past seven years in terms of TSR compared with that of the companies comprising the FTSE 100 Index. This index has been selected because it represents a cross-section of leading UK companies. The TSR for FTSE UK banks for the same period has been added for comparison. *Source: Datastream*

Chief Executive pay over same period

	2009	2010	2011	2012	2013 (1)	2014	2015
Total remuneration (£000s)	1,647	3,687	1,646	1,646	1,235 (SH) 378 (RM)	— 1,817	— 3,785
Annual bonus against maximum opportunity	0%	85%	0%	0%	0%	n/a	n/a
LTI vesting rates against maximum opportunity	0%	0%	0%	0%	0%	72.85%	62%

Note:

(1) 2013 remuneration includes Stephen Hester (SH) as CEO for the period to 30 September and Ross McEwan (RM) for the period from 1 October to 31 December 2013.

Change in Chief Executive pay compared with employees
The table below shows the percentage change in remuneration for the Chief Executive between 2014 and 2015 compared with the percentage change in the average remuneration of RBS employees based in the UK. In each case, remuneration is based on salary, benefits and annual bonus.

	Salary 2014 to 2015 change	Benefits 2014 to 2015 change	Annual Bonus 2014 to 2015 change

Chief Executive (1)	0%	0%	n/a
UK employees (2)	3.15%	3.71%	(8.1%)

Notes:

(1) Executive directors are not eligible for an annual bonus. Standard benefit funding for executive directors remained unchanged between 2014 and 2015. The benefits for the Chief Executive excludes the relocation expenses provided to Ross McEwan as part of his recruitment as CEO UK Retail in 2012. The value of relocation benefits is disclosed each year in the total remuneration table. In 2015, Ross McEwan also received a fixed share allowance as part of his fixed pay.

(2) Data represents full year salary costs of the UK based employee population, which covers the majority of RBS employees and is considered to be the most representative comparator group.

Relative importance of spend on pay
The table below shows a comparison of remuneration expenditure against other distributions and charges.

	2015 (1)	2014 (1)	change
	£m	£m	
Remuneration paid to all employees (2)	5,208	5,225	(0.3%)
Distributions to holders of ordinary shares	—	—	
Distributions to holders of preference shares and paid-in equity (3)	385	699	(45%)
Taxation and other charges recognised in the income statement:			
- Social security, Bank levy and Corporation tax	597	2,538	(76%)
- Irrecoverable VAT and other indirect taxes incurred by RBS (4)	691	665	3.9%

Notes:

(1) Numbers exclude discontinued operations, principally CFG.

(2) Remuneration paid to all employees represents total staff expenses per Note 3 to the Financial Statements, exclusive of social security and other staff costs.

(3) Includes initial payment relating to the initial dividend on the Dividend Access Share in 2014.

(4) Input VAT and other indirect taxes not recoverable by RBS due to it being partially exempt.

The items above have been included as they reflect the key stakeholders for RBS and the major categories of distributions and charges made by RBS.

Annual report on remuneration

Consideration of matters relating to directors' remuneration
Membership of the Group Performance and Remuneration Committee

All members of the Committee are independent non-executive directors. The Committee held nine scheduled meetings in 2015 and a further two ad hoc meetings.

	Attended/ scheduled
Sandy Crombie (Chairman)	9/9
Alison Davis	9/9
Robert Gillespie	9/9

The role and responsibilities of the Committee

The Committee is responsible for:

- approving the remuneration policy for all employees and overseeing its implementation;
- reviewing performance and making recommendations to the Board in respect of the remuneration arrangements of the executive directors;
- approving remuneration arrangements for members and formal attendees of the Executive Committee and employees with total annual compensation which exceeds £1 million; and
- setting the remuneration framework and principles for Material Risk Takers falling within the scope of UK regulatory requirements.

In mitigating potential conflicts of interest, directors are not involved in decisions regarding their own remuneration and remuneration advisers are appointed by the Committee rather than management. The terms of reference of the Committee are reviewed annually and available on rbs.com.

Summary of the principal activity of the Committee in 2015
The Committee considered issues under the accountability review process at every meeting. Future pay construct and people proposition was considered at the majority of meetings. Set out below is a summary of other key activities

considered by the Committee.

First quarter

- 2014 performance reviews and remuneration arrangements for members and attendees of the Executive Committee and high earners.
- Approval of variable pay pools and the Directors' Remuneration Report.
- Assessment of the performance to date of unvested LTI awards and performance targets for 2015 awards.
- Executive Committee members' 2015 objectives.

Second quarter

- Key external trends.
- Group Sales and Service Incentive Committee annual incentive report.
- Divestment principles and leaver treatment.
- Strategic direction of incentives.

Third quarter

- Removal of incentives for customer-facing employees in PBB.
- Review of the implementation of the remuneration policy.
- External environment including PRA changes to the Remuneration Code.
- Remuneration Policy Statement for the PRA.
- Remuneration proposals for specific business areas including Williams & Glyn, RCR, PBB and CIB.

Fourth quarter

- 2015 preliminary pay elements including bonus pool, deferral and LTI awards.
- Executive Committee members' annual objectives for 2016.
- Review of pay construct for executive directors.
- Stakeholder engagement and remuneration disclosures.

Performance evaluation process
The Committee has considered the findings of the annual review of the effectiveness of the Committee which was conducted by Condign Board Consulting Limited, an external consultant.

Overall the review concluded that the Committee continued to operate effectively. Executives and non-executives continued to develop effective working relationships, supported by a more consistent operating rhythm. In particular, the Masterclasses, where in-depth consideration is given to specific matters, continued to make a positive impact and the Committee had provided strong and consistent leadership of the remuneration agenda. The review also identified scope for improvements in paper quality in some instances with the addition of more comparative data and analysis.

The review included a small number of general recommendations which are relevant for both the Board and its senior committees. Key themes and actions arising from these general recommendations are set out in the Board report on pages 51 and 52 and will be considered, and addressed as appropriate, at Board level. The review also recommended that all Committee Chairs should ensure continued focus on agenda planning and streamlined reporting to the Board, which will be a priority for the Committee during 2016. The review did not include any specific recommendations relating solely to the Group Performance and Remuneration Committee.

Annual report on remuneration

Advisers to the Committee
The Committee reviews its selection of advisers annually. PricewaterhouseCoopers LLP (PwC) was appointed as the Committee's remuneration advisers on 14 September 2010 following a review of potential advisers, and the appointment was reconfirmed by the Committee in July 2015 after an annual review of the quality of the advice received and fees charged. PwC is a signatory to the voluntary code of conduct in relation to remuneration consulting in the UK.

PwC also provide professional services in the ordinary course of business including assurance, advisory, tax and legal advice to RBS subsidiaries. The Chairman of the Committee is notified of other remuneration work that is being undertaken by PwC. In addition, there are processes in place to ensure the advice received by the Committee is independent of any support provided to management. As well as receiving advice from PwC in 2015, the Committee took account at meetings of the views of the Chairman; Chief Executive; Chief Financial Officer; Chief HR Officer; the Director of Organisation and Performance; the Chief Governance Officer and Board Counsel; the Chief Risk Officer; and the Chief Conduct and Regulatory Affairs Officer. The fees paid to PwC for advising the Committee in relation to directors' remuneration are charged on a time/cost basis and in 2015 amounted to £121,358 excluding VAT (2014 - £137,749).

Statement of shareholding voting
The tables below set out the voting by shareholders on the resolution to approve the Annual Report on Remuneration at the AGM held in June 2015 and the resolution at the AGM in June 2014 when the Directors' Remuneration Policy was last approved.

Annual Report on Remuneration – 2015 AGM

For	Against	Total votes cast	Withheld
21,832,926,636 (99.32%)	149,116,116 (0.68%)	21,982,042,752	37,397,980

Directors' Remuneration Policy – 2014 AGM

For	Against	Total votes cast	Withheld
20,893,215,888 (99.66%)	70,382,756 (0.34%)	20,963,598,644	170,307,216

Shareholders' views on the remuneration policy
An extensive consultation is undertaken every year with major shareholders including UKFI and other stakeholders on our remuneration approach. The process takes place in sufficient time for shareholders' views to be considered prior to the Committee making any final decisions on remuneration and variable pay awards.

Discussions during the latest consultation covered a range of topics including strategic direction, employee engagement, IT resilience and cyber security. Shareholders asked a number of questions including the process for making adjustments to the bonus pool in relation to conduct and litigation costs. The Chairman of the Committee explained the bonus adjustment process and the need to consider the proximity of current employees when making such adjustments.

The Chairman noted during discussions that, while bonus pool levels have been coming down year on year, it was important that RBS did not become too disconnected from industry norms and that a commercial approach was required.

Shareholders also asked if RBS was experiencing any difficulties in hiring employees in light of pay levels. The Chairman of the Committee noted that, while RBS operates under a slightly different pay construct to some competitors, this may help to ensure employees that do join want to be part of RBS in the longer term.

In addition to the annual consultation process, two shareholder events took place in 2015 outside of the AGM to allow directors to engage with private shareholders, regardless of the size of their shareholding.

Shareholders continue to play a vital role in developing remuneration practices that support the long-term interests of the business and the Committee is grateful and greatly encouraged by their involvement in the process.

Shareholder dilution
During the ten year period to 31 December 2015, awards made that could require new issue shares under the company's share plans represented 4.8% of the company's issued ordinary share capital, leaving an available dilution headroom of 5.2%. The company meets its employee share plan obligations through a combination of new issue shares and market purchase shares.

Sandy Crombie

Chairman of the Group Performance and Remuneration Committee

25 February 2016

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Other Remuneration Disclosures

Remuneration of eight highest paid senior executives below Board (1)

(£000s)	Executive 1	Executive 2	Executive 3	Executive 4	Executive 5	Executive 6	Executive 7	Executive 8
Fixed pay (cash)	725	725	600	638	550	575	600	600
Fixed allowances	959	959	600	638	550	288	600	300
Annual bonus	—	—	—	—	—	—	—	—
Long-term incentive awards (vested value)	458	458	735	513	363	494	—	—
Total remuneration (2)	2,142	2,142	1,935	1,789	1,463	1,357	1,200	900

Notes:

(1) Remuneration earned in 2015 for eight members of the Executive Committee. Full year earnings have been reported including those individuals promoted to the Executive Committee part way through 2015.

(2) Disclosure includes prior year long-term incentive awards which vested during 2015. The amounts shown reflect the value of vested awards using the share price on the day the awards vested.

How risk is reflected in our remuneration process
The RBS remuneration policy explicitly aligns remuneration with effective risk management. Focus on risk is achieved through clear risk input into objectives, performance reviews, the determination of variable pay pools and incentive plan design as well as the application of malus and clawback. The Committee is supported in this by the BRC and the RBS Risk function.

A robust process is used to assess risk performance. A range of measures are considered, specifically the overall Risk Profile; Credit, Regulatory and Conduct Risk; Operational Risk; Enterprise Risk; and Market Risk. The steps we take to ensure appropriate and thorough risk adjustment are also fully disclosed and discussed with the PRA and the FCA.

Variable pay pool determination
For the 2015 performance year, RBS has operated a multi-step process which is a control function led assessment to determine performance and therefore the appropriate bonus pool by franchise and function.

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

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

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

Accountability review process and malus/clawback

An accountability review process is operated that allows RBS to respond in instances where new information would change the variable pay decisions made in previous years and/or the decisions to be made in the current year. Under the accountability review process, RBS can apply malus and clawback.

Malus can be applied to reduce (if appropriate to zero) the amount of any variable pay awards prior to payment taking place. Clawback provisions can also be applied to recover awards that have vested. Any variable pay awarded to Material Risk Takers from 1 January 2015 onwards is subject to clawback for seven years from the date of grant. For the 2016 performance year this period can be extended to ten years for executive directors and other Senior Managers under the PRA Senior Manager regime. Malus and clawback can be applied to current and former employees.

There are a number of trigger events under which malus and clawback will be considered including:

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

How have we applied this in practice?

During 2015 a number of issues and events were considered under the accountability review framework. The outcomes covered a range of actions including: reduction and forfeiture of unvested awards through malus; reduction of current year variable pay awards; dismissal with forfeiture of unvested awards; and suspension of awards pending further investigation.

Remuneration regulatory requirements

As in previous years, we have received the required regulatory confirmation in order to conclude our year end remuneration process.

Other Remuneration Disclosures

Our remuneration policy for all employees

The remuneration policy supports the business strategy and is designed to promote the long-term success of RBS. It aims to reward employees for delivering good performance against targets provided this is achieved in a manner consistent with our values and within acceptable risk parameters. The remuneration policy applies the same principles to all employees including Material Risk Takers (MRTs) subject to UK regulatory requirements (1). The current key elements underpinning the remuneration policy are set out below.

Element of pay	**Objective**	**Operation**
Base salary	To aid recruitment and retention of high performing individuals whilst paying no more than is necessary. To provide a competitive level of fixed cash remuneration, reflecting the skills and experience required, and to discourage excessive risk taking.	Base salaries are reviewed annually and should reflect the talents, skills and competencies that the individual brings to the business.
Role-based allowance	To provide fixed pay that reflects the skills and experience required for the role.	Allowances are provided to certain employees in key roles in line with market practice and qualify as fixed remuneration for regulatory requirements. They are delivered in cash and/or shares depending on the level of the allowance and the seniority of the recipient. Shares are subject to an appropriate retention period, not less than six months.
Benefits (including pension)	To provide a range of flexible and market competitive benefits. To encourage planning for retirement and long-term savings.	In most jurisdictions, employee benefits or a cash equivalent are provided from a flexible benefits account.
Annual bonus	To support a culture where employees recognise the importance of serving customers well and are rewarded for superior performance.	The annual bonus pool is based on a balanced scorecard of measures including customer, financial, risk and people measures. Allocation from the pool depends on performance of the franchise or function and the individual. Individual performance assessment is supported by a structured performance management framework. Immediate cash awards are limited to a maximum of £2,000. Under the deferral arrangements a significant proportion of annual

		bonus awards for our more senior employees are deferred over a minimum three year period. Awards are subject to malus and clawback provisions. For MRTs, a minimum of 50% of any annual bonus is delivered in shares and subject to a minimum six month retention period post vesting in line with regulatory requirements. Guaranteed awards are only used in very limited circumstances in accordance with regulatory requirements.
Long-term incentive awards	To support a culture where good performance against a full range of measures will be rewarded. To encourage the creation of value over the long term and to align further the rewards of the participants with the returns to shareholders.	RBS provides certain employees in senior roles with long-term incentive awards. Awards are structured as performance-vesting shares. Performance is typically measured over a three year period. The amount of the award that vests may vary between 0% -100% depending on the performance achieved. Awards are subject to malus and clawback provisions and a minimum six month retention period applies to MRTs post vesting.
Other share plans	To offer employees in certain jurisdictions the opportunity to acquire shares.	Employees in certain countries are eligible to contribute to share plans which are not subject to performance conditions.

Note:

(1) The EBA has issued criteria for identifying MRT roles i.e. staff whose professional activities have a material influence over RBS' performance or risk profile. The criteria for identifying MRTs are both Qualitative (based on the nature of the role) and Quantitative (i.e. those who exceed the stipulated total remuneration threshold based on the previous year's total remuneration).

The Qualitative criteria can be summarised as: staff within the management body; senior management; other staff with key functional or managerial responsibilities; staff, individually or as part of a Committee, with authority to approve new business products or to commit to credit risk exposures and market risk transactions above certain levels.
The Quantitative criteria are: individuals earning €500,000 or more in the previous year; individuals in the top 0.3% of earners in the previous year; individuals who earned more than the lowest paid identified staff per the Qualitative criteria, subject to specific exceptions in the criteria.

In accordance with UK regulatory requirements and the RBS Staff Dealing Rules, the conditions attached to discretionary share-based awards prohibit the use of any personal hedging strategies to lessen the impact of a reduction in value of such awards.

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Other Remuneration Disclosures

Remuneration of MRTs
The quantitative disclosures below are made in accordance with Article 450 of the EU Capital Requirements Regulation in relation to 707 employees who have been identified as MRTs.

1. Aggregate remuneration expenditure

Aggregate remuneration expenditure in respect of 2015 performance was as follows:

PBB	CPB	CIB	Rest of RBS	Total
£m	£m	£m	£m	£m
17.9	35.4	118.1	198.9	370.3

2. Amounts and form of fixed and variable remuneration

Fixed remuneration for 2015

Consisted of salaries, allowances, pensions and benefits.

	Senior management	Other MRTs	Total
Number of beneficiaries	11	696	707
	£m	£m	£m
Total fixed remuneration	16.5	225.2	241.7

Variable remuneration awarded for 2015 performance

Consisted of deferred awards payable over a minimum three year period. Under the RBS bonus deferral structure cash awards are limited to £2,000 per employee.

	Senior management	Other MRTs	Total
Number of beneficiaries	—	482	482
	£m	£m	£m
Variable remuneration (cash)	—	1.8	1.8
Deferred remuneration (bonds)	—	10.6	10.6
Deferred remuneration (shares)	—	82.1	82.1

Long-term incentive awards for 2015 performance

Long-term incentive awards vest subject to the extent to which performance conditions are met and can result in zero payment.

	Senior management	Other MRTs	Total
Number of beneficiaries	11	104	115
	£m	£m	£m
Long-term incentive awards	17.5	16.6	34.1

The variable component of total remuneration for MRTs at RBS shall not exceed 100% of the fixed component. Based on the information disclosed above, the average ratio between fixed and variable remuneration for 2015 is approximately 1:0.5

3. Outstanding deferred remuneration through 2015

The table below includes deferred remuneration awarded or paid out in 2015 in respect of prior performance years. Deferred remuneration reduced during the year relates to long-term incentives lapsed when performance conditions are not met, long-term incentives and deferred awards forfeited on leaving and malus of prior year deferred awards and long-term incentives.

Category of deferred remuneration	Senior management £m	Other MRTs £m
Unvested from prior year	28.5	304.9
Awarded during the financial year	14.8	140.5
Paid out	8.1	134.9
Reduced from prior years	1.1	54.0
Unvested at year end	34.2	256.9

4. Sign-on and severance payments

RBS does not operate 'Sign-on awards'. Guaranteed variable remuneration may be used for new hires in compensation for awards foregone in their previous company. One such payment of £320,000 is included in the tables above. This relates to a commitment on recruitment made in respect of one new employee. These awards are still subject to deferral.

No severance payments were made outside of contractual payments or standard policy entitlements related to termination of employment such as pay in lieu of notice and benefits.

Notes on the presentation of remuneration

In the relevant tables above, assumptions have been made for the notional value of LTI (verified by external advisors) and forfeitures through resignation for deferred awards. In addition, the share price relevant to the date of the event or valuation point has been used.

All staff total remuneration

- The average salary for all employees is £37,000.
- 14,200 employees earn between £50,000 and £100,000.
- 6,000 employees earn between £100,000 and £250,000.
- 1,100 employees earn total remuneration over £250,000.

Total remuneration by band for all employees earning >€1 million	Number of employees 2015	Number of employees 2014
€1.0m - €1.5m	59	67
€1.5m - €2.0m	33	32
€2.0m - €2.5m	13	17
€2.5m - €3.0m	7	4
€3.0m - €3.5m	4	4
€3.5m - €4.0m	1	1
€4.0m - €4.5m	2	0
€4.5m - €5.0m	0	1
€5.0m - €6.0m	1	4
€6.0m - €7.0m	1	1
Total	121	131

Notes:

(1) Total remuneration in the table above includes fixed pay, pension and benefit funding and variable pay (including actual value of LTI vesting in 2015) after the application of malus.

(2) Executive directors and employees of CFG are not included in the table.

The table is based on an exchange rate where applicable of €1.377 to £1 as at 31 December 2015 and amounts disclosed for 2014 have been restated using the same exchange rate so that comparison can be made on a like for like basis.

Employees that earned total remuneration of over €1 million in 2015 represent just 0.1% of our employees. This number reduces to 105 employees if we exclude pension and benefit funding. These employees include those who manage major businesses and functions with responsibility for significant assets, earnings or areas of strategic activity and can be grouped as follows:

- The CEOs responsible for each area and their direct reports.
- Employees managing large businesses within a franchise.
- Income generators responsible for high levels of income including those involved in managing trading activity and supporting clients with more complex financial transactions, including financial restructuring.
- Those responsible for managing our balance sheet and liquidity and funding positions across the business.
- Employees managing the successful disposal of assets in RCR and reducing RBS' capital requirements.

Compliance report

Statement of compliance

RBS is committed to high standards of corporate governance, business integrity and professionalism in all its activities. Throughout the year ended 31 December 2015, RBS has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated September 2014 (the "Code") except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. RBS considers that this is a matter which should rightly be reserved for the Board and this is an approach RBS has adopted for a number of years. Remuneration for the executive directors is first considered by the Group Performance and Remuneration Committee which then makes recommendations to the Board for consideration. This approach allows all non-executive directors, and not just those who are members of the Group Performance and Remuneration Committee, to participate in decisions on the executive directors' and the Chairman's remuneration and also allows the executive directors to input to the decision on the Chairman's remuneration. The Board believes this approach is very much in line with the spirit of the Code and no director is involved in decisions regarding his or her own remuneration. We do not anticipate any changes to our approach on this aspect of the Code. Information on how RBS has applied the main principles of the Code can be found in the Corporate governance report on pages 47 to 89. A copy of the Code can be found at www.frc.org.uk

RBS has also implemented the recommendations arising from the Walker Review and complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in September 2012.

Under the US Sarbanes-Oxley Act of 2002, specific standards of corporate governance and business and financial disclosures and controls apply to companies with securities registered in the US. RBS complies with all applicable sections of the US Sarbanes-Oxley Act of 2002, subject to a number of exceptions available to foreign private issuers.

Internal control

Management of The Royal Bank of Scotland Group plc is responsible for the system of internal controls that is designed to maintain effective and efficient operations, compliant with applicable laws and regulations. The system of internal controls is designed to manage, or mitigate, risk to an acceptable residual level rather than eliminate it entirely. Systems of internal control can only provide reasonable and not absolute assurance against material misstatement, fraud or loss.

Management's report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for RBS Group.

RBS Group's internal control over financial reporting is a component of an overall system of internal control and is designed to provide reasonable assurance regarding the preparation, reliability and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS) and includes:

- Policies and procedures that relate to the maintenance of records that, in reasonable detail, fairly and accurately reflect the transactions and disposition of assets.
- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management.
- Controls providing reasonable assurance regarding the prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

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

Management assessed the effectiveness of RBS Group's internal control over financial reporting as of 31 December 2015 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 publication of "Internal Control – Integrated Framework".

Based on its assessment, management believes that, as of 31 December 2015, RBS Group's internal control over financial reporting is effective.

The effectiveness of RBS Group's internal control over financial reporting as of 31 December 2015 has been audited by Deloitte LLP, RBS Group's independent registered public accounting firm. The report of the independent registered public accounting firm to the directors of the Royal Bank of Scotland Group plc expresses an unqualified opinion on the effectiveness of RBS Group's internal control over financial reporting as of 31 December 2015.

Compliance report

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc

We have audited the internal control over financial reporting of The Royal Bank of Scotland Group plc and subsidiaries (“the Group”) as of 31 December 2015, based on criteria established in “Internal Control - Integrated Framework (2013)” issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Group’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of 31 December 2015, based on the criteria established in "Internal Control - Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended 31 December 2015 of the Group and our report dated 25 February 2016 (24 March 2016 as to the consolidating financial information included in Note 41 of the financial statements) expressed an unqualified opinion on those financial statements.

Deloitte LLP

London, United Kingdom

25 February 2016

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Compliance report

Disclosure controls and procedures

Management, including RBS's Chief Executive and Chief Financial Officer, conducted an evaluation of the effectiveness and design of the Group's disclosure controls and procedures (as such term is defined in Exchange Act Rule 13a-15(e)). Based on this evaluation, RBS's Chief Executive and Chief Financial Officer concluded that the Group's disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Changes in internal control

There was no change in the Group's internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Group's internal control over financial reporting.

The New York Stock Exchange

As a foreign issuer with American Depository Shares representing ordinary shares, preference shares and debt securities listed on the New York Stock Exchange (the "NYSE"), RBS is not required to comply with all of the NYSE standards applicable to US domestic companies (the "NYSE Standards") provided that it follows home country practice in lieu of the NYSE Standards and discloses any significant ways in which its corporate governance practices differ from the NYSE Standards. RBS is also required to provide an Annual Written Affirmation to the NYSE of its compliance with the applicable NYSE Standards (including by reference to the rules of the Exchange Act) following the filing of its annual report on Form 20-F.

The Group Audit Committee fully complies with the mandatory provisions of the NYSE Standards (including by reference to the rules of the Exchange Act) that relate to the composition, responsibilities and operation of audit committees. More detailed information about the Group Audit Committee and its work during 2015 is set out in the Group Audit Committee report on pages 55 to 60.

The Group has reviewed its corporate governance arrangements and is satisfied that these are consistent with the NYSE Standards, subject to the following departures: (i) the Chairman of the Board is also the Chairman of the Group Nominations Committee, which is permitted under the Code (since the Chairman was considered independent on appointment) (ii) although the members of the Group Performance and Remuneration Committee are deemed independent in compliance with the provisions of the Code, the Board has not assessed the independence of the members of the Group Performance and Remuneration Committee and of its compensation committee advisers in accordance with the independence tests prescribed by the NYSE Standards (iii) the NYSE Standards require that the compensation committee must have direct responsibility to review and approve the Chief Executive's remuneration. As stated at the start of this Compliance report, in the case of RBS, the Board, rather than the Group Performance and Remuneration Committee, reserves the authority to make the final determination of the remuneration of the Chief Executive. RBS's Group Audit, Board Risk, Sustainable Banking and Group Nominations Committees are otherwise composed solely of non-executive directors deemed by the Board to be independent.

This Compliance report forms part of the Corporate governance report and the Report of the directors.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2015.

Group structure

The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc, the principal direct operating subsidiary undertaking of the company.

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HMT in the form of B shares. HMT sold 630 million of its holding of the company's ordinary shares in August 2015. In October 2015 HMT converted its entire holding of 51 billion B shares into 5.1 billion new ordinary shares of £1 each in the company.

At 31 December 2015, HMT's holding in the company's ordinary shares was 72.6%.

Organisational change

On 26 February 2015, RBS announced its commitment to becoming a leaner, less volatile business based around its core franchises of Personal & Business Banking (PBB) and Commercial & Private Banking (CPB). To support this, a number of initiatives have been announced which include but are not limited to:

- the restructuring of Corporate & Institutional Banking (CIB) into go-forward CIB and CIB Capital Resolution;
- the divestment of Citizens;
- the sale of the international private banking business; and
- the run down of RBS Capital Resolution (RCR), one year ahead of schedule.

Business structure

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this and reflect the progress made on the initiatives above the previously reported operating segments will now realign as follows:

Personal & Business Banking (PBB) comprises two reportable segments:

- UK PBB serves individuals and mass affluent customers in the UK together with small businesses (generally up to £2 million turnover). UK PBB includes Ulster Bank customers in Northern Ireland.
- Ulster Bank RoI serves individuals and businesses in the Republic of Ireland (RoI).

Commercial & Private Banking (CPB) comprises three reportable segments:

- Commercial Banking serves commercial and corporate customers in the UK and Western Europe.
- Private Banking serves UK connected high net worth individuals.
- RBS International (RBSI) serves retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man and Gibraltar.

CIB serves UK and Western European corporate customers, and global financial institutions, supported by trading and distribution platforms in the UK, US and Singapore.

Capital Resolution includes CIB Capital Resolution and the remainder of RBS Capital Resolution (RCR).

Williams & Glyn (W&G) comprises RBS England and Wales branch-based businesses, along with certain small and medium enterprises and corporate activities across the UK. During the period presented W&G has not operated as a separate legal entity. The perimeter of the segment currently reported does not include certain portfolios that are ultimately intended to be divested as part of W&G, for example, certain NatWest branches in Scotland.

Central items & other includes corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS capital resources and RBS-wide regulatory projects and provides services to the reportable segments. Balances in relation to Citizens and the international private banking business are included in Central items in the relevant periods.

Results and dividends

The loss attributable to the ordinary shareholders of the company for the year ended 31 December 2015 amounted to £1,979 million compared with a loss of £3,470 million for the year ended 31 December 2014, as set out in the consolidated income statement on page 263.

The company did not pay a dividend on ordinary shares in 2014 or 2015.

In the context of prior macro-prudential policy discussions, the Board decided to partially neutralise any impact on Core Tier 1 capital of coupon and dividend payments in respect of 2014 and 2015 Group hybrid capital instruments through equity issuances of c.£300 million. Consequently, approximately £300 million was raised during 2014 and 2015 through the issue of new ordinary shares and the Board has decided a further £300 million of new equity will be issued during the course of 2016 to again partially neutralise the CET1 impact of coupon and dividend payments.

The Dividend Access Share (DAS) retirement agreement was approved at the General Meeting of shareholders held on 25 June 2014. The first dividend payment on the DAS of £320 million was made in the third quarter of 2014. The balance of £1.18 billion is subject to an uplift at 5% per annum from 1 January 2016 until 1 January 2021. The uplift rate on any unpaid balance is 10% per annum thereafter. RBS intends to pay a final dividend on the Dividend Access Share (DAS) during the first half of 2016 subject to final Board and PRA approval, further normalising the capital structure of the bank and removing an obstacle toward the resumption of capital distributions.

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Report of the directors

Business review

Activities

RBS is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of RBS, including the products and services provided by each of its segments, are contained in the Business review on page 100. Details of the strategy for delivering the company’s objectives can be found in the Strategic report.

Risk factors

RBS’s future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Full details of these and other risk factors are set out on pages 384 to 408.

The reported results of RBS are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of RBS’s critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 279 to 282.

RBS’s approach to risk management, including its financial risk management objectives and policies and information on RBS’s exposure to price, credit, liquidity and cash flow risk, is discussed in the Business review: Capital and risk management.

Financial performance

A review of RBS's performance during the year ended 31 December 2015, including details of each segment, and RBS's financial position as at that date is contained in the Business review on pages 103 to 141.

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2007, RFS Holdings B.V., which was jointly owned by RBS, the Dutch State (successor to Fortis) and Santander completed the acquisition of ABN AMRO Holding N.V.

Following the announcements in April 2011 by the Boards of RBSG, RBS plc, RBS Holdings and RBS N.V., a substantial part of the business activities of RBS N.V. had been successfully transferred to RBS plc by the end of 2012, with further transfers in 2013 and 2014. There have been no transfers in 2015, the focus continues to be on further de-risking the RBS N.V. balance sheet.

Business divestments

To comply with the European Commission State Aid requirements RBS agreed a series of restructuring measures. These include the divestment of Direct Line Insurance Group plc (completed in 2014) the sale of 80.01% of RBS's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK ("UK branch-based businesses").

In September 2013, RBS reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985. The Group's target remains full divestment by the end of 2017.

Following an IPO in 2014 when RBS disposed of 30% of its shareholding in Citizens Financial Group Inc., RBS disposed of further tranches of shares in March 2015 (28%), August 2015 (21%) and October 2015 (21%). Consequently, RBS has completed its divestment of Citizens.

Employees

As at 31 December 2015, RBS employed 93,659 people (full-time equivalent basis, including temporary workers) throughout the world. Details of related costs are included in Note 3 on the consolidated accounts.

Living our values

Our values, introduced in 2012, guide our actions every day, in every part of our business. They are at the heart of the way we work. They are embedded within our behavioural frameworks - this means the way we recruit, promote, reward and manage our people are all aligned.

Building a healthy culture and risk culture that lives up to our values is one of our core priorities. We have governance to monitor and guide and track progress on our cultural goals. We gather qualitative and quantitative feedback to assess our progress and respond accordingly. We do this in tandem with feedback from regulators and industry bodies.

Engaging our people

We recognise that building an engaged, healthy and inclusive workforce is crucial if we are to achieve our ambition. We continue to ask people across the Bank to share their thoughts on what it's like to work at RBS via our annual employee survey (OurView). The results enable our people leaders to monitor levels of engagement and work with their teams to make improvements.

Report of the directors

It also enables us to monitor employee perception and the progress we are making versus our goals. Our most recent survey, in which more than 62,000 colleagues took part, showed significant improvement in employee engagement and leadership.

In 2015 we launched determined to make a difference, an internal campaign that provides a rallying call for our employees. It was drawn from our extensive research with staff and is based on their reflections about the difference we make for our customers, colleagues, communities and shareholders.

Rewarding our people

Our approach to performance management allows us to provide clarity for our people about how their individual contribution links to our ambition. It recognises behaviour that supports our values and holds individuals to account for behaviour and performance that does not.

In the UK we are a living wage employer meaning that we adhere to Living Wage Benchmarks (both national and London) for all employees. All third party contractors who regularly work in our buildings will also be in scope by 2017 at the latest.

In 2015, we announced the removal of incentive schemes for our customer facing employees in Personal & Business Banking. Instead, we gave every eligible employee an increase to their guaranteed pay. This change ensures that our people are paid clearly, fairly and simply for the job they do for our customers every day. It also ensures our customers can be certain that if they take a product from us, it has no financial impact on what our people are paid.

Developing our people

Developing great leaders with the capability to deliver our ambition is a key priority. In 2015, we launched ‘Determined to lead’, a programme that focuses on great people management, a consistent tone from leaders throughout the Bank and the tools to engage our people. In 2015 we trained over 13,000 leaders.

We are committed to professionalising all our people. We offer a wide range of learning which can be mandatory, role specific or related to personal development.

We have mandatory learning that has to be completed by everyone and is focused on keeping our people, our customers and the Bank safe. Elements of our learning have been aligned to the Chartered Banker: Professional Standards Board foundation standards. We committed that our people in the UK (excluding Williams & Glyn and Ulster Bank) would complete this learning in 2015.

Youth employment

We have hired over 250 graduates and over 300 Apprentices in 2015. We have been accredited by "Investors in Young People" for how we attract, recruit and develop our talent.

Health and wellbeing of our people

We offer a wide range of health benefits and services to help maintain physical and mental health, and support our people if they become unwell.

In 2015, our wellbeing programme focused on three main areas; Mental Health, Physical Health and Resilience. Activities include the continued promotion of Lifematters (RBS's Employee Assistance Programme), participation in the Global Corporate Challenge, the launch of Resilience programmes and continued support for Time to Change, the UK's biggest programme to challenge mental health stigma.

Employee consultation

We recognise employee representatives such as trade unions and work councils in a number of businesses and countries. There has been ongoing engagement and discussion with those bodies given the changes the bank announced in February 2015. Management have continued to meet regularly with our European Employee Council to discuss developments and update on the progress of our strategic plans.

Inclusion

Building a more inclusive bank is essential for our customers and colleagues. Our inclusion policy standard applies to all our people globally.

During 2015 we continued our roll out of unconscious bias learning for all employees. We've introduced a gender goal to have at least 30% of women in the bank's top three leadership levels by 2020. Further, we aim to have 50/50 balance at all levels by 2030. This is supported by the launch of a female development proposition. An increased focus on disability has led to the development of a comprehensive plan to support our colleagues and customers with additional needs and will help RBS achieve its ambition of becoming a 'disability smart' organisation. From an LGBT perspective, we continue to deliver improvements to our people policies and customer operating procedures, including the introduction of guidance to support employees going through gender transition, introducing the 'Mx' honorific, and improving our customer gender change process. We are finalising plans to improve our ethnic representation within senior roles and are continuing to support our 15,000 strong employee-led networks.

RBS has been recognised for its work on Equality, Diversity and Inclusion by our Platinum ranking from Opportunity Now (gender) - our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; and improving upon our ranking in the Stonewall Workplace Equality Index (LGBT).

Sustainability

Our purpose is to serve customers well. We will rebuild our reputation and earn our customers' trust by putting customers first, making RBS a great place to work, supporting our communities and being mindful of environmental impacts. The Sustainable Banking Committee's role is to support the Board in overseeing, supporting and challenging actions being taken by management to run the bank as a sustainable business.

Report of the directors

For more information on our approach and progress please read the RBS Sustainability Report, available on rbs.com/sustainable.

Greenhouse gas emissions

Disclosures relating to greenhouse gas emissions are included in the Strategic report on page 40.

Going concern

RBS's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Business review. The risk factors which could materially affect RBS's future results are set out on pages 384 to 408. RBS's regulatory capital resources and significant developments in 2015 and anticipated future developments are detailed on pages 154 to 168. The liquidity and funding section on pages 169 to 179 describes RBS's funding and liquidity profile, including changes in key metrics, the build up of liquidity reserves and the outlook for 2016.

Having reviewed RBS's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that RBS and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of RBS and of the company have been prepared on a going concern

BBA disclosure code

RBS's 2015 financial statements have been prepared in compliance with the principles set out in the Code for Financial Reporting Disclosure published by the British Bankers' Association in 2010.The Code sets out five disclosure principles together with supporting guidance. The principles are that RBS and other major UK banks will provide high quality, meaningful and decision-useful disclosures; review and enhance their financial instrument disclosures for key areas of interest to market participants; assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; seek to enhance the comparability of financial statement disclosures across the UK banking sector; and clearly differentiate in their annual reports between information that is audited and information that is unaudited.

Enhanced Disclosure Task Force (EDTF)

The EDTF established by the Financial Stability Board, published its report 'Enhancing the Risk Disclosures of Banks' in October 2012. All EDTF recommendations are reflected in the RBS's 2015 Annual Report on Form 20-F.

Corporate governance

The company is committed to high standards of corporate governance. Details are given in the Corporate governance report on pages 42 to 89. The Corporate governance report and compliance report (pages 90 and 92) form part of this Report of the directors.

Share capital

Details of the ordinary and preference share capital at 31 December 2015 and movements during the year are shown in Note 24 on the consolidated accounts.

During 2015, the company allotted and issued a total of 90.1 million new ordinary shares of £1 each for the purposes of ensuring 2015 coupon payments on discretionary hybrid capital securities were partly neutralised from a Core Tier 1 capital perspective.

The shares were allotted to UBS AG at the subscription prices determined by reference to the average market prices during the sale periods set out below.

Number of shares sold	Subscription price	Sale period	Gross proceeds	Share price on allotment
21.3m	352.070p	26/2/15-15/4/15	£75 million	355.7p
21.3m	352.811p	30/4/15-11/6/15	£75 million	361.5p
47.5m	315.942p	30/7/15-17/12/15	£150 million	294.7p

In the three years to 31 December 2015, the percentage increase in issued share capital due to non-pre-emptive issuance (excluding employee share schemes) for cash was 2.2.%.

In addition, the company issued 69 million shares in connection with employee share schemes during 2015.

In October 2015, HMT converted its entire holding of 51 billion B shares into 5.1 billion new ordinary shares of £1 each.

Authority to repurchase shares

At the Annual General Meeting in 2015, shareholders authorised the company to make market purchases of up to 643,628,671 ordinary shares. The directors have not exercised this authority to date. Shareholders will be asked to renew this authority at the Annual General Meeting in 2016.

Additional information

Where not provided elsewhere in the Report of the directors, the following additional information is required to be disclosed by Part 6 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The rights and obligations attached to the company's ordinary shares and preference shares are set out in the company's Articles of Association, copies of which can be obtained from Companies House in the UK or can be found at rbs.com>about us.

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares or cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held.

Report of the directors

The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.008% of the total voting rights of the company, the remainder being represented by the ordinary shares.

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws).

Pursuant to the Listing Rules of the FCA, certain employees of the company require the approval of the company to deal in the company's shares.

The rules governing the powers of directors, including in relation to issuing or buying back shares and their appointment are set out in the company's Articles of Association. It will be proposed at the 2016 Annual General Meeting that the directors be granted authorities to allot shares under the Companies Act 2006. The company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

A number of the company's share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

The rights and obligations of holders of non-cumulative preference shares are set out in Note 24 on the consolidated accounts.

Except in relation to the Dividend Access Share, the company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank of Scotland plc and Ulster Bank Dublin Trust Company as Trustees. Voting rights are exercised by the Trustees on receipt of participants' instructions. If a participant does not submit an instruction to the Trustee no vote is registered.

The Royal Bank of Scotland plc 1992 Employee Share Trust, The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of RBS's employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.

Awards granted under the company's employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company's employee benefit trusts.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company's employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

Directors

The names and brief biographical details of the current directors are shown on pages 43 to 46.

Sandy Crombie, Alison Davis, Morten Friis, Robert Gillespie, Penny Hughes, Ross McEwan, Brendan Nelson, Baroness Noakes and Ewen Stevenson all served throughout the year and to the date of signing of the financial statements.

Howard Davies was appointed to the Board on 14 July 2015 and assumed the role of Chairman on 1 September 2015. Mike Rogers was appointed to the Board on 26 January 2016.

Philip Hampton stepped down from the Board on 31 August 2015.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting and, in accordance with the UK Listing Rules, the election or re-election of independent directors requires approval by all shareholders and also by independent shareholders.

Directors' interests

The interests of the directors in the shares of the company at 31 December 2015 are shown on page 83. None of the directors held an interest in the loan capital of the company or in the shares or loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2015 to 25 February 2016.

Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the company to its directors, members of the RBS Executive Committee, PRA/FCA Approved Persons and certain directors and/or officers of RBS subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of RBS pension schemes.

Report of the directors

Post balance sheet events

Other than the matter disclosed on page 358, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Controlling shareholder

In accordance with the UK Listing Rules, the company has entered into an agreement with HM Treasury (the ‘Controlling Shareholder’) which is intended to ensure that the Controlling Shareholder complies with the independence provisions set out in the UK Listing Rules. The company has complied with the independence provisions in the relationship agreement and as far as the company is aware the independence and procurement provisions in the relationship agreement have been complied with in the period by the controlling shareholder.

Shareholdings

The table below shows shareholders that have notified RBS that they hold more than 3% of the total voting rights of the company at 31 December 2015.

Solicitor For The Affairs of Her Majesty’s Treasury as Nominee for Her Majesty’s Treasury	Number of shares (millions)	% of share class held	% of total voting rights held
Ordinary shares	8,434	72.6	72.6

As at 25 February 2016, there were no changes to the shareholdings shown in the table above.

Listing Rule 9.8.4

In accordance with the UK Financial Conduct Authority’s Listing Rules the information to be included in the Annual Report and Accounts under LR 9.8.4, is set out in this Directors’ report with the exception of details of contracts of significance under LR 9.8.4. (10) and (11) given in Additional Information on page 381.

Political donations

At the Annual General Meeting in 2015, shareholders gave authority under Part 14 of the Companies Act, for a period of one year, for the company (and its subsidiaries) to make political donations and incur political expenditure up to a maximum aggregate sum of £100,000. This authorisation was taken as a precaution only, as the company has a longstanding policy of not making political donations or incurring political expenditure within the ordinary meaning of those words. During 2015, RBS made no political donations, nor incurred any political expenditure in the UK or EU and it is not proposed that RBS's longstanding policy of not making contributions to any political party be changed. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2016.

Directors' disclosure to auditors

Each of the directors at the date of approval of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

Auditors

Deloitte LLP are currently the auditors. On 3 November 2014, the Company announced its intention to appoint Ernst & Young LLP (EY) as auditor for the year ending 31 December 2016. It is expected that EY will be appointed to fill the casual vacancy arising from Deloitte LLP's resignation following the signing of the 2015 accounts and the Group's Form 20-F. A resolution to appoint EY as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor

Company Secretary

25 February 2016

The Royal Bank of Scotland Group plc

is registered in Scotland No. SC45551

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Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 262.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the company. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' report (incorporating the Business review) include a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, the directors are of the opinion that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

By order of the Board

Howard Davies	Ross McEwan	Ewen Stevenson
Chairman	Chief Executive	Chief Financial Officer

25 February 2016

Board of directors

Chairman	**Executive directors**	**Non-executive directors**
Howard Davies	Ross McEwan Ewen Stevenson	Sandy Crombie Alison Davis Morten Friis Robert Gillespie Penny Hughes Brendan Nelson Baroness Noakes Mike Rogers

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Presentation of information

Pensions accounting policy

As set out in 'Accounting policies' on page 270, RBS has revised its accounting policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. The change has been applied retrospectively and comparatives restated.

Segmental reorganisation

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this and reflect the progress made the previously reported operating segments have been realigned as follows:

Personal & Business Banking (PBB) comprises two reportable segments. UK Personal & Business Banking (UK PBB) and Ulster Bank RoI. UK PBB serves individuals and mass affluent customers in the UK together with small businesses (generally up to £2 million turnover). UK PBB includes Ulster Bank customers in Northern Ireland. Ulster Bank RoI serves individuals and businesses in the Republic of Ireland (RoI).

Commercial & Private Banking (CPB) comprises three reportable segments; Commercial Banking, Private Banking and RBS International (RBSI). Commercial Banking serves commercial and corporate customers in the UK and Western Europe. Private Banking serves UK connected high net worth individuals and RBSI serves retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man and Gibraltar.

Corporate & Institutional Banking (CIB) serves UK and Western European corporate customers, and global financial institutions, supported by trading and distribution platforms in the UK, US and Singapore.

Capital Resolution includes CIB Capital Resolution and the remainder of RBS Capital Resolution (RCR).

Williams & Glyn (W&G) comprises the RBS England and Wales branch-based businesses, along with certain small and medium enterprises (SME) and corporate activities across the UK. During the period presented W&G has not operated as a separate legal entity. The perimeter of the segment currently reported does not include certain portfolios that are ultimately intended to be divested as part of W&G, for example, certain NatWest branches in Scotland.

Central items & other includes corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS capital resources and RBS-wide regulatory projects and provides services to the reportable segments. Balances in relation to Citizens and the international private banking business are included in Central items in the relevant periods.

Reporting changes

In line with RBS's strategy to be a simpler bank the following reporting changes have been implemented in relation to the presentation of RBS results:

Other items

The following items were previously reported separately after operating profit, they are now being reported within operating profit.

- Own credit adjustments;
- Gain/(loss) on redemption of own debt;
- Write-down of goodwill;
- Strategic disposals; and
- RFS Holdings minority interest (RFS MI).

Own credit adjustments are included within segmental results in CIB, Capital Resolution and Central items (Treasury) in line with where the related liabilities are recorded. The non-statutory results will continue to show these items and restructuring costs and litigation and conduct costs as separate line items within the relevant caption of the income statement where significant.

Allocation of central balance sheet items

RBS allocates all central costs relating to Services and Functions to the business using appropriate drivers, these are reported as indirect costs in the segmental income statements. However, previously central balance sheet items have not been allocated. The assets (and risk-weighted assets) held centrally, mainly relating to Treasury, are now allocated to the business using appropriate drivers.

Revised treasury allocations

Treasury allocations which are included within segmental net interest income and segmental net interest margins, have been revised to reflect the following.

· In preparation for the separation of Williams & Glyn, that element of treasury allocations previously charged to UK PBB is now retained centrally.

· The impact of changes to the notional equity allocation is detailed below.

Revised segmental return on equity

RBS's CET 1 target is 13% but for the purposes of computing segmental return on equity (ROE), to better reflect the differential drivers of capital usage, segmental operating profit after tax and adjusted for preference dividends is divided by notional equity allocated at different rates of 11% (Commercial Banking and Ulster Bank RoI), 12% (RBSI) and 15% for all other segments, of the monthly average of segmental risk-weighted assets after capital deductions (RWAes). This notional equity was previously 13% for all segments. In addition, due to changes in UK tax rules enacted in the Finance (No 2) Act 2015, RBS has increased its longer-term effective 31 December tax rate. The notional tax rate used in the segmental ROE has been revised from 25% to 28% (Ulster Bank RoI - 15%; RBSI - 10%). RBS's forward planning tax rate is 26%.

Comparatives have been restated accordingly for the changes outlined above.

Citizens

Citizens was classified as a discontinued operation and as a disposal group on 31 December 2014 and its assets and liabilities from that date to 3 August 2015 have been aggregated and presented as separate lines in accordance with IFRS 5. On 3 August 2015, RBS's interest in Citizens fell to 20.9% and consequently it is treated as an associate held for sale thereafter. On 30 October 2015, RBS sold all of its remaining shareholding in Citizens. Citizens is no longer treated as a reportable segment.

Presentation of information

Competition

Personal & Business Banking (including UK PBB and Ulster Bank RoI)

In the personal and small business banking business, the bank competes with a range of providers including UK banks and building societies, major retailers and life assurance companies, as well as the UK subsidiaries of major international banks. In the mortgage market, the bank competes with UK banks, building societies and specialist lenders. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms either through organic growth or in some cases by acquiring businesses made available through restructuring of incumbents. Entrants with new business models such as peer-to-peer lending platforms, while currently small, continue to grow rapidly and are emerging as significant competitors. Such competitors often target specific elements of the value chain or customer segments. RBS distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market.

In the UK credit card market large retailers and specialist card issuers are active in addition to the UK banks. In addition to physical distribution channels, providers compete through direct marketing activity and digital channels.

In an environment in which central banks have maintained very low interest rates for an unusually long period or introduced negative rates , competitive dynamics have changed in some of the principal markets in which we operate. Ability to attract and manage funding remains a critical competitive advantage. Other key competitive factors in this market segment include cost management, growing digital sales focus, branch network re-shaping, and product simplification. Cost management remains a key focus in the market, as banks seek to simplify their organisational and IT architectures while at the same time investing to ensure that they can meet customers’ evolving channel preferences. Customers have increasingly focused on the use of internet and mobile as sales and service channels for certain types of products. Therefore, competitive position and performance in the sector increasingly depends on the possession of user-friendly, diverse and efficient online solutions.

Although conveniently located branches are still important, RBS faces competitive pressure to adjust its branch formats to meet changing customer expectations and to manage its branch footprint as over-the-counter transaction volumes decline. In terms of product offering, the industry trend is to limit the number of products and present the product structure and costs in a clear and transparent manner.

Commercial & Private Banking (including Commercial Banking, Private Banking and RBS International)

Competition for corporate and institutional customers in the UK is from UK banks, from specialised global and regional investment banks and from large foreign universal banks that offer combined investment and commercial banking capabilities as well as from new entrants and nonbank challengers. In asset finance and invoice finance, the bank competes with banks and specialist finance providers, both captive and non-captive. In the small business banking market, the bank competes with other UK banks, specialist finance providers and building societies. In all of these areas, entrants with new technology-based business model are also showing rapid growth. RBS International competes with other UK and international banks to offer offshore banking services as well as domestic banking services in the Channel Islands, Gibraltar and the Isle of Man. Coutts and Adam & Company compete as private banks with UK clearing and private banks, asset managers and with international private banks. Competition in wealth management remains strong as banks maintain their focus on competing for affluent and high net worth customers.

Corporate & Institutional Banking

Following the restructuring of the business in February 2015, CIB focuses on the needs of large corporates operating in the UK and Western Europe as well as global financial institution customers. CIB provides financing and risk management for these customers, and trades with financial institutions and counterparties for distribution and market making. There are sales and trading operations in London, the US and Singapore and offices in a select number of countries. CIB therefore competes with large domestic banks, major international banks and a number of investment banks that offer such products in these regions.

The bank’s product proposition is built around our core strengths: supporting customers across currencies, rates and financing. Key competitive factors in this market include the ability to develop automation across flow products as well as delivering value-adding bespoke solutions for our customers.

With an evolving regulatory landscape and continued pressure on margins, competition in this market remains strong. Many market participants are also revising their strategy in order to ensure they deliver sustainable returns.

Business review

Summary consolidated income statement for the year ended 31 December 2015

	2015	2014	2013
	£m	£m	£m
Interest receivable	11,925	13,079	14,488
Interest payable	(3,158)	(3,821)	(5,471)
Net interest income	8,767	9,258	9,017
Fees and commissions receivable	3,742	4,414	4,678
Fees and commissions payable	(809)	(875)	(923)
Income from trading activities	1,060	1,285	2,571
(Loss)/gain on redemption of own debt	(263)	20	175
Other operating income	426	1,048	1,219
Non-interest income	4,156	5,892	7,720
Total income	12,923	15,150	16,737
Staff costs	(5,726)	(5,757)	(6,086)
Premises and equipment	(1,827)	(2,081)	(2,038)
Other administrative expenses	(6,288)	(4,568)	(6,692)
Depreciation and amortisation	(1,180)	(930)	(1,247)
Write down of goodwill and other intangible assets	(1,332)	(523)	(1,403)
Operating expenses	(16,353)	(13,859)	(17,466)
(Loss)/profit before impairment losses	(3,430)	1,291	(729)
Impairment releases/(losses)	727	1,352	(8,120)
Operating (loss)/profit before tax	(2,703)	2,643	(8,849)
Tax charge	(23)	(1,909)	(186)
(Loss)/profit from continuing operations	(2,726)	734	(9,035)
Profit/(loss) from discontinued operations, net of tax	1,541	(3,445)	558
Loss for the year	(1,185)	(2,711)	(8,477)
Attributable to:			
Non-controlling interests	409	60	120
Preference shareholders	297	330	349
Paid-in equity holders	88	49	49
Dividend access share	—	320	—
Ordinary shareholders	(1,979)	(3,470)	(8,995)
	(1,185)	(2,711)	(8,477)

Key metrics and ratios

Net interest margin	2.12%	2.14%	1.90%
Cost:income ratio	127%	91%	104%
(Loss)/earnings per ordinary share from continuing operations (pence)			
- basic	(27.7p)	0.5p	(85.0p)
Return on tangible equity (1)	(4.7%)	(8.2%)	(18.7%)

Note:

(1) Tangible equity is equity attributable to ordinary shareholders less intangible assets.

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Business review

Analysis of results
Net interest income

	2015	2014	2013
	£m	£m	£m
Interest receivable (1,2)	11,925	13,079	14,488
Interest payable (1,2)	(3,158)	(3,821)	(5,471)
Net interest income	8,767	9,258	9,017
Yields, spreads and margins of the banking business	%	%	%
Gross yield on interest-earning assets of the banking business (3)	2.89	3.02	3.05
Cost of interest-bearing liabilities of the banking business	(1.14)	(1.26)	(1.51)
Interest spread of the banking business (4)	1.75	1.76	1.54
Benefit from interest-free funds	0.37	0.38	0.36
Net interest margin of the banking business (5)	2.12	2.14	1.90
Gross yield (3)			
- Group	2.89	3.02	3.05
- UK	3.35	3.57	3.54
- Overseas	1.32	1.55	1.84
Interest spread (4)			
- Group	1.75	1.76	1.54
- UK	2.24	2.34	1.99
- Overseas	—	0.15	0.46
Net interest margin (5)			
- Group	2.12	2.14	1.90
- UK	2.49	2.53	2.21
- Overseas	0.87	1.08	1.14
The Royal Bank of Scotland plc base rate (average)	0.50	0.50	0.50
London inter-bank three month offered rates (average)			
- Sterling	0.57	0.54	0.52
- Eurodollar	0.32	0.23	0.24
- Euro	(0.02)	0.21	0.27

Notes:

(1) Interest receivable includes £400 million (2014 - £453 million; 2013 - £538 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.

(2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(3) Gross yield is the interest earned on average interest-earning assets of the banking book.

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

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

(6) The analysis into UK and overseas has been compiled on the basis of location of office.

2015 compared with 2014

Net interest income declined by £491 million, or 5% to £8,767 million compared with £9,258 million, driven principally by a 46% reduction in Capital Resolution, down from £673 million to £365 million, in line with the planned shrinkage of the balance sheet.

Net interest margin (NIM) declined by 2 basis points to 2.12% reflecting new business volumes in core UK businesses, primarily mortgages remaining under competitive margin pressures combined with an increased portion of the book shifting toward lower margin secured assets. This was partly offset by deposit repricing and the planned run down of low margin assets in Capital Resolution.

UK PBB net interest income fell by £69 million, 2% to £4,152 million, as competitive front book margin pressures impacted. In addition, customers continued to roll off standard variable rate products (17% of overall mortgage book in 2015) and onto lower margin fixed rate products. As a result NIM fell by 14 basis points to 3.18% compared with 3.32% in 2014.

Ulster Bank RoI net interest income fell by £102 million, 22% to £365 million compared with £467 million primarily due to the weakening of the euro relative to sterling and reduced income on free funds. Ulster Bank RoI NIM continues to be impacted by the low yielding tracker mortgage book.

2014 compared with 2013

Net interest income increased by 3%, to £9,258 million. This mainly reflected improvements in deposit margins in CPB which includes Commercial Banking, Private Banking and RBSI and PBB which includes UK PBB and Ulster Bank RoI.

Net interest margin was 2.14%, up from 1.90% in 2013, with improved liability margins partially offset by pressure on mortgage and corporate lending margins and by the continuing shift in mix towards lower margin secured lending.

Business review

Non-interest income

The following table reconciles the non-statutory non-interest income (a non-GAAP financial measure) to the statutory results.

	2015	2014	2013
	£m	£m	£m
Fees and commissions receivable - statutory basis	3,742	4,414	4,678
Fees and commissions payable - statutory basis	(809)	(875)	(923)
Income from trading activities			
- non-statutory basis	806	1,325	2,536
- own credit adjustments	254	(40)	35
Statutory basis	1,060	1,285	2,571
Own credit adjustments (1)			
- non-statutory basis	309	(146)	(120)
- income from trading activities	(254)	40	(35)
- other operating income	(55)	106	155
Statutory basis	—	—	—
(Loss)/gain on redemption of own debt - statutory basis	(263)	20	175
Strategic disposals (1)			
- non-statutory basis	(157)	191	161
- other operating income	157	(191)	(161)
Statutory basis	—	—	—
Other operating income			
- non-statutory basis	528	963	1,213
- own credit adjustments	55	(106)	(155)
- strategic disposals	(157)	191	161
Statutory basis	426	1,048	1,219
Total non-interest income - non statutory basis	4,156	5,892	7,720
Total non-interest income - statutory basis	4,156	5,892	7,720

Note:

(1) Items reallocated to other income lines, not reconciling items.

2015 compared with 2014

Non-interest income totalled £4,156 million, a decline of £1,736 million, or 29%, compared with £5,892 million in 2014, primarily driven by a reduction of £945 million in Capital Resolution as the business accelerated the planned shrinkage of the balance sheet, including disposal losses from the sale of several portfolios in the year. A movement of £530 million from volatile items under IFRS was recorded, which represented a gain of £29 million in 2015 compared with a charge of £501 million in 2014.

Net fees and commissions fell by £606 million, or 17%, to £2,933 million, compared with £3,539 million, principally from the reduced scale of activity in CIB, run down of Capital Resolution and lower card interchange fees in UK PBB, down £59 million.

Income from trading activities declined by £225 million, or 18%, to £1,060 million compared with £1,285 million, due to the reduced scale and resources in CIB and the continued planned reduction of the Capital Resolution business and the impact of disposal losses partially offset by a gain on own credit adjustments of £254 million compared with a charge of £40 million in 2014.

A loss of £263 million was recognised on redemption of own debt, from a liability management exercise to repurchase certain US dollar, sterling and euro senior debt securities, compared with a gain of £20 million in 2014.

Total disposal losses in Capital Resolution were £367 million, including £38 million of strategic disposal losses. Total strategic disposal losses were £157 million, compared with a gain of £191 million in 2014, principally relating to the international private banking business.

Other operating income reduced by £622 million, or 59%, to £426 million compared with £1,048 million, principally due to the reduced scale of CIB together with the run down of Capital Resolution and the impact of disposal losses. A loss of £67 million on the disposal of available-for-sale securities in Treasury was recorded compared with a gain of £149 million in 2014. Own credit adjustments represented a gain of £55 million compared with a charge of £106 million in 2014.

Business review

2014 compared with 2013

Non-interest income declined by £1,828 million or 24% to £5,892 million including lower gains from the redemption of own debt of £20 million compared with £175 million in 2013.

Net fees and commissions fell by 6% principally reflecting declines in CIB and Commercial Banking.

Income from trading activities declined by £1,286 million, or 50%, in line with CIB's smaller balance sheet and reduced risk profile and the planned reduction of the Capital Resolution business. Own credit adjustments represented a charge of £40 million compared with a gain of £35 million in 2013.

The decrease in other operating income reflected a loss from RFS MI of £18 million (2013 - gain of £111 million). A reduction in charge from own credit adjustments was offset by an increase in income from strategic disposals.

Business review

Operating expenses

The following table reconciles non-statutory operating expenses (a non-GAAP financial measure) to the statutory basis

	2015	2014	2013
	£m	£m	£m
Staff costs			
- non-statutory basis	4,896	5,376	5,809
- restructuring costs	830	381	277
Statutory basis	5,726	5,757	6,086
Premises and equipment			
- non-statutory basis	1,483	1,812	1,923
- restructuring costs	344	269	115
Statutory basis	1,827	2,081	2,038
Other administrative expenses			
- non-statutory basis	2,124	2,120	2,606
- litigation and conduct costs	3,568	2,194	3,844
- restructuring costs	596	254	242
Statutory basis	6,288	4,568	6,692
Restructuring costs (1)			
- non-statutory basis	2,931	1,154	640
- staff costs	(830)	(381)	(277)
- premises and equipment	(344)	(269)	(115)
- other administrative expenses	(596)	(254)	(242)
- depreciation and amortisation	(402)	(3)	(6)
- write-down of other intangible assets	(759)	(247)	—
Statutory basis	—	—	—
Litigation and conduct costs (1)			
- non-statutory basis	3,568	2,194	3,844
- other administrative expenses	(3,568)	(2,194)	(3,844)
Statutory basis	—	—	—
Administratative expenses - non-statutory	15,002	12,656	14,822
Administratative expenses - statutory	13,841	12,406	14,816
Depreciation and amortisation			
- non-statutory basis	778	927	1,241
- restructuring costs	402	3	6
Statutory basis	1,180	930	1,247
Write-down of goodwill (1)			

- non-statutory basis	498	130	1,059
- write-down of goodwill and other intangible assets	(498)	(130)	(1,059)
Statutory basis	—	—	—
Write-down of other intangible assets (1)			
- non-statutory basis	75	146	344
- write-down of goodwill and other intangible assets	(75)	(146)	(344)
Statutory basis	—	—	—
Write-down of goodwill and other intangible assets			
- non-statutory basis	—	—	—
- write-down of goodwill	498	130	1,059
- write-down of other intangible assets	75	146	344
- restructuring costs	759	247	—
Statutory basis	1,332	523	1,403
Operating expenses - non-statutory basis	16,353	13,859	17,466
Operating expenses - statutory basis	16,353	13,859	17,466

Note:

(1) Items reallocated to other expense lines, not reconciling items.

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Business review

2015 compared with 2014

Total operating expenses of £16,353 million included significantly higher litigation and conduct costs of £3,568 million (2014 - £2,194 million), restructuring costs of £2,931 million (2014 - £1,154 million) and a goodwill impairment of £498 million attributed to Private Banking (2014 - £130 million in Capital Resolution).

Operating expenses excluding litigation and conduct costs of £3,568 million (2014 - £2,194 million), restructuring costs of £2,931 million (2014 - £1,154 million) and a write-down of goodwill of £498 million (2014 - £130 million) fell by £1,025 million, 10% to £9,356 million compared with £10,381 million. Excluding expenses associated with Williams & Glyn (2015 - £261 million; 2014 - £232 million) and the benefit of lower intangible asset write offs (2015 - £75 million; 2014 - £146 million), operating expenses reduced by £983 million, exceeding the revised 2015 cost saving target of over £900 million.

Staff costs were 1% lower totalling £5,726 million compared with £5,757 million, with the reductions as a result of lower headcount in CIB and Capital Resolution offset by increases in restructuring costs to £830 million as the transformation of the bank accelerated, particularly in CIB.

Restructuring costs totalled £2,931 million compared with £1,154 million in 2014, as the transformation of the bank accelerated, particularly re-engineering the CIB business. This is in line with prior guidance for total restructuring costs of c.£5 billion from 2015 to 2019. CIB restructuring costs totalled £524 million, including software and property write downs. Capital Resolution restructuring costs were much higher totalling £1,307 million as the business continues its planned rundown. Williams & Glyn separation costs totalled £630 million. Private Banking also recorded a £91 million asset write down related to software.

Litigation and conduct costs increased by £1,374 million, or 63% to £3,568 million, compared with £2,194 million in 2014. This includes: additional provisions for mortgage backed securities litigation in the US of £2,100 million; provisions for foreign exchange investigations in the US of £334 million; customer redress provisions primarily relating to PPI of £600 million; packaged accounts provisions of £157 million; and other conduct provisions of £377 million.

2014 compared with 2013

Operating expenses decreased by £3,607 million or 21% to £13,859 million, including a write down of goodwill of £130 million in 2014 compared with £1,059 million in 2013.

Operating expenses excluding restructuring costs of £1,154 million (2013 - £640 million), litigation and conduct costs of £2,194 million (2013 - £3,844 million) and write down of goodwill of £130 million (2013 - £1,059 million), declined by £1,542 million, or 13%, to £10,381 million, mainly reflecting cost savings of £1.1 billion.

Staff expenses declined by 5% and by 1% on a per capita basis against average full time employees. Average full time employees, rounded to the nearest hundred, for continuing operations was 95,600 (2013 - 102,000).

Restructuring costs increased by £514 million to £1,154 million, including £378 million in relation to Williams & Glyn and a write off of intangible assets of £247 million.

Litigation and conducts costs totalled £2,194 million compared with £3,844 million in 2013. This included additional provisions for Payment Protection Insurance redress (£650 million) in PBB, potential costs following investigations into the foreign exchange market (£720 million) in CIB, Interest Rate Hedging Product redress (£185 million) in Commercial Banking and CIB, the IT incident fine (£59 million) booked in Centre and other costs (£580 million) primarily relating to packaged accounts and investment products.

Business review

Impairment losses

	2015	2014	2013
	£m	£m	£m
New impairment (releases)/losses	(552)	(1,250)	8,246
Less: recoveries of amounts previously written-off	(175)	(102)	(126)
(Releases)/losses to income statement	(727)	(1,352)	8,120
Comprising:			
Loan impairment (releases)/losses	(853)	(1,364)	8,105
Securities	126	12	15
(Releases)/losses to income statement	(727)	(1,352)	8,120

2015 compared with 2014

Net impairment releases of £727 million were 46% lower compared with net impairment releases of £1,352 million in 2014. Although releases were at lower levels than in 2014, credit quality remained stable, reflecting supportive economic conditions in UK and Ireland with continued elevated recoveries in certain businesses.

Capital Resolution recorded net releases of £725 million, compared with £1,307 million in 2014, with disposal activity continuing. Ulster Bank RoI recorded net impairment releases of £141 million, down from £306 million in 2014, as economic conditions in Ireland continue to improve. UK PBB recorded a release of £7 million compared with a loss of £154 million, due to lower debt flows and increased releases and recoveries. Net impairment releases were also reported in CIB, although at more modest levels.

Securities losses rose to £126 million from £12 million in 2014, principally related to a small number of single name exposures, mainly an exposure in the RBS N.V. liquidity portfolio.

Risk elements in lending (REIL) declined from £28.2 billion to £12.2 billion, with REIL as a percentage of gross loans falling from 6.8% to 3.9%. The reduction was driven by the disposal of Citizens and the continued rundown of Capital Resolution.

2014 compared with 2013

Net loan impairment releases of £1,352 million were recorded in 2014 compared with a net impairment loss of £8,120 million in 2013 which included £4,490 million provisions related to the creation of RCR.

Releases were recorded principally in Capital Resolution (£1,307 million), which benefited from favourable economic and market conditions, and in Ulster Bank RoI (£306 million) supported by rising Irish property values and proactive debt management. Excluding these releases, the underlying charge was low at just over £261 million, primarily in UK PBB (£154 million).

Loan impairment provision coverage of REIL remained stable at 64% and the provision now stands at £18.0 billion, a £7.2 billion reduction in the year. Provision coverage of gross loans is 4.4% compared with 6.0% at the end of 2013.

Tax

	2015	2014	2013
	£m	£m	£m
Tax charge	(23)	(1,909)	(186)
UK corporation tax rate	20.25%	21.50%	23.25%

2015 compared with 2014

The tax charge for the year ended 31 December 2015 reflects the impact of non-deductible goodwill and bank levy charges, conduct charges for which no tax relief has been recognised, the impact of UK tax rate changes on the carrying value of deferred tax balances and the release of tax provisions that reflect the reduction of exposures in countries where RBS is ceasing operations.

2014 compared with 2013

The tax charge for the year ended 31 December 2014 reflects a reduction in the carrying value of the deferred tax asset in respect of UK tax losses (£850 million) and US temporary differences (£775 million) reflecting the impact of the decision to restructure CIB, partially offset by an increase in the carrying value of the deferred tax asset in respect of Irish tax losses, the benefit of previously unrecognised Irish tax losses being offset against profits arising in Ireland during the year and the impact of certain conduct charges that do not qualify for tax relief.

Business review

Segment performance

UK Personal & Business Banking

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	4,152	4,221	3,924
Net fees and commissions	1,020	1,162	1,186
Other non-interest income	28	61	(8)
Non-interest income	1,048	1,223	1,178
Total income	5,200	5,444	5,102
Direct expenses			
- staff costs	(801)	(824)	(844)
- other costs	(272)	(346)	(505)
Indirect expenses	(1,965)	(1,958)	(1,922)
Restructuring costs			
- direct	(38)	(10)	(130)
- indirect	(129)	(101)	(114)
Litigation and conduct costs	(972)	(918)	(881)
Operating expenses	(4,177)	(4,157)	(4,396)
Operating profit before impairment releases/(losses)	1,023	1,287	706
Impairment releases/(losses)	7	(154)	(670)
Operating profit	1,030	1,133	36
Analysis of income by product			
Personal advances	747	842	748
Personal deposits	747	664	485
Mortgages	2,305	2,399	2,388
Cards	621	700	805
Business Banking	726	663	626
Other	54	176	50
Total income	5,200	5,444	5,102
Analysis of impairments by sector			
Personal advances	69	128	156
Mortgages	4	(29)	39
Business Banking	(79)	46	143
Cards	10	75	107
Other	(11)	(66)	225
Total impairment (releases)/losses	(7)	154	670
Loan impairment (release)/charge as a % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Personal advances	1.2%	2.0%	2.1%
Business Banking	(1.5%)	0.8%	2.4%
Cards	0.2%	1.6%	1.9%

Other	(0.8%)	(4.4%)	11.8%
Total	—	0.1%	0.6%
Performance ratios			
Return on equity (1)	11.7%	11.9%	(0.7%)
Net interest margin	3.18%	3.32%	3.13%
Cost:income ratio	80%	76%	86%

Note:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 15% (previously 13%) of the monthly average of segmental RWAes, assuming 28% tax rate; previously 25%.

Business review

Capital and balance sheet	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)			
- personal advances	6.0	6.5	7.3
- mortgages	104.8	95.5	91.7
- business	5.3	5.9	6.0
- cards	4.1	4.7	5.5
- other	1.4	1.5	1.9
Total loans and advance to customers (gross)	121.6	114.1	112.4
Loan impairment provisions	(1.8)	(2.5)	(3.2)
Net loans and advances to customers	119.8	111.6	109.2
Total assets	143.9	137.8	133.8
Funded assets	143.9	137.8	133.8
Risk elements in lending	2.7	3.6	5.0
Provision coverage (1)	69%	69%	63%
Customer deposits			
- personal current accounts	37.2	34.4	33.5
- personal savings	78.9	76.3	75.6
- business/commercial	19.6	19.5	17.6
- other	2.1	2.4	3.2
Total customer deposits	137.8	132.6	129.9
Assets under management (excluding deposits)	4.3	4.9	5.8
Loan:deposit ratio (excluding repos)	87%	84%	84%
Risk-weighted assets (2)			
- credit risk (non-counterparty)	25.4	29.0	37.0
- operational risk	7.9	7.6	7.9
Total risk-weighted assets	33.3	36.6	44.9

Notes:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(2) RWAs in 2013 are on a Basel 2.5 basis.

Key points

UK Personal & Business Banking (UK PBB) made signficant positive changes to the customer proposition in 2015, whilst becoming simpler and fair. We have seen a number of key customer metrics improve. Results now include Ulster Bank Northern Ireland and exclude Williams & Glyn, which is reported as a separate segment.

Delivering enhanced digital capabilities:

- In February RBS became the first UK bank to launch TouchID, enabling customers to log-in to its mobile app using only their fingerprint.
- Enabled real time registration of our mobile banking app, allowing customers to log-in immediately as they open their new current account.
- Continued to be at the forefront of technological collaboration; one of the first UK banks to launch Apple Pay whilst developing an Apple Watch app.
- Customers using the mobile app increased 27% to 3.7 million in 2015 as we continue to invest and enhance the platform to reflect the growing customer preference for this channel.
- Launched online diary where customers can book an appointment with an advisor from the comfort of their own home.

Launched market differentiating propositions:

- UK PBB continued to invest in building deeper engagement with our customers through the launch of our new banking proposition – “Reward” whereby customers receive 3% cashback on their household bills.
- Launched the fee free Foundation account to better support the 1.5 million unbanked individuals in the UK.
- We launched testing of small value overdrafts to c.1 million customers, specifically to help customers avoid unexpected fees.
- Launched an online mortgage application tracker to improve customer experience.
- Launched an innovative new home insurance product offering customers a fixed premium for three years, which we believe is a positive departure from industry practice.
- Launched Royal National Institute of Blind People (RNIB) approved cards, becoming the first UK bank product to achieve RNIB accreditation.

Business review

Helping UK homebuyers:

- In 2015 the business made a concerted investment in its mortgage business, increasing mortgage advisors by 21% from 803 to 974 (excluding Ulster Bank NI). This contributed to a strong year for mortgage lending with net balances increasing by £9.3 billion to £104.8 billion.

- One of the first UK banks to offer the UK Government-led Help to Buy: ISA as we continue to help first time buyers. NatWest and Ulster Bank customers are offered a variable rate of 2% AER and can save up to £1,200 in the first month.

Operational investment continued apace:

- New onboarding system for Business Banking was completed in November 2015. It has reduced the average account opening time by 50% from 15 days to 7 days and we are onboarding c. 500 new customers every day.

- We continue to invest and improve our branch network to meet the demands and enrich the experience of our customers. During 2015 322 branches received an upgrade via our Branch Transformation programme.

- We replaced 922 ATMs during the year.

- Time to open a new current account reduced by 50%, allowing frontline staff more time to have great customer conversations.

Investing in our people:

- We continue on our journey to enhance the capability of our people. During the year, we have made significant further investment in training our leaders, in rolling out skills based pay in our telephony centres and in introducing the new Personal Banker role in branches, enabling more of our staff to fulfil customer needs.

- We also announced the ending of incentives for our frontline staff from January 2016, which has been positively received and will ensure our staff are focused on what is best for the customer.

2015 compared with 2014

UK PBB recorded an operating profit of £1,030 million in 2015, a reduction of 9% or £103 million from 2014. This was primarily driven by lower non-interest income combined with increased restructuring costs and litigation and conduct costs. This was partially offset by a small net impairment release compared to a prior year charge. Operating profit excluding restructuring costs of £167 million (2014 - £111 million) and litigation and conduct costs of £972 million (2014 - £918 million) was £2,169 million compared to £2,162 million and return on equity of 11.7% were broadly flat compared to prior year.

Total income was £5,200 million, a reduction of 4% from £5,444 million. Net interest income declined 2% to £4,152 million primarily as a result of continued margin pressure in the mortgage market as customers move to lower margin fixed rate products together with higher internal funding costs. The decline was partly offset by improved deposit margins. Reflecting strong mortgage balance growth, net interest margin (NIM) declined 14 basis points from 2014 to 3.18% as the overall portfolio mix continues to be increasingly weighted toward secured lending, together with the decline in unsecured balances. The decline was slightly offset by improved deposit margins.

Non-interest income was £1,048 million, a reduction of 14% compared with the prior year as interchange fees on credit and debit cards declined £59 million, combined with reduced advice income. Operating expenses were £4,177 million, remaining broadly stable against 2014. Litigation and conduct costs increased 6% due to customer redress provisions, primarily relating to PPI, to £972 million, whilst higher restructuring costs were up £56 million, to £167 million. This was principally offset by a reduction in staff and other costs. Operating expenses excluding restructuring costs of £167 million (2014 - £111 million) and litigation and conduct costs of £972 million (2014 - £918 million) totalled £3,038 million (2014 - £3,128 million), 3% lower than 2014.

Net impairment releases totalled £7 million, compared with a net charge of £154 million in 2014, driven by decreased charges from bad debt flows and benefit of provision releases and recoveries.

2015 was a strong year for the mortgage business with net balances growing by £9.3 billion or 10% to £104.8 billion. Gross new lending rose 29% to £23 billion with market share of new mortgages of 10.5% versus a stock share of 8.2%. Mortgage growth was the principal driver of an £8.2 billion increase in net loans and advances to customers. Unsecured balances continued to decline gradually, albeit at a much slower rate.

Customer deposit balances increased £5.2 billion to £137.8 billion due to growth in personal savings, current accounts and business banking. RWAs fell £3.3 billion to £33.3 billion due to the improved quality of portfolio.

2014 compared with 2013

UK PBB recorded an operating profit of £1,133 million, up £1,097 million, while operating profit excluding restructuring costs of £111 million (2013 - £244 million) and litigation and conduct costs of £918 million (2013 - £881 million) totalled £2,162 million compared with £1,161 million in the prior year. This reflected higher income, together with substantially lower impairments, down £516 million to £154 million.

Net interest income increased by £297 million or 8% with strong improvements in deposit margins and volume growth. This was partly offset by lower asset margins linked to the continued change in the mix of the loan book towards secured lending and lower mortgage margins.

Non-interest income increased by £45 million or 4%, largely reflecting the transfer of the commercial cards business to UK PBB from Commercial Banking within CPB in August 2014.

Operating expenses decreased by £239 million or 5%, reflecting a reduction in other costs supported by a 5% reduction in headcount and lower Financial Services Compensation Scheme (FSCS) accruals. Litigation and conduct costs included additional provisions for Payment Protection Insurance redress (£650 million) and other conduct provisions in respect of legacy investment products and packaged account sales.

The net impairment charge was down by 77% to £154 million driven by a further decrease in new default charges together with releases of provisions and recoveries on previously written off debt. Mortgage balances increased by £3.8 billion or 4%, to £96 billion driven by strong performance supported by increased advisor capacity. RWAs declined 18% to £36.6 billion with improved credit quality and lower unsecured balances.

Business review

Ulster Bank RoI

Income statement	2015 €m	2014 €m	2013 €m	2015 £m	2014 £m	2013 £m
Net interest income	503	579	563	365	467	478
Net fees and commissions	116	116	104	85	93	88
Other non-interest income	139	54	115	100	44	98
Gain on redemption of own debt	—	—	284	—	—	242
Non-interest income	255	170	503	185	137	428
Total income	758	749	1,066	550	604	906
Direct expenses (1)						
- staff costs	(220)	(203)	(189)	(160)	(164)	(160)
- other costs	(116)	(104)	(63)	(85)	(83)	(54)
Indirect expenses	(251)	(224)	(211)	(182)	(180)	(179)
Restructuring costs						
- direct	(17)	10	(18)	(12)	8	(15)
- indirect	(4)	(26)	(8)	(3)	(21)	(7)
Litigation and conduct costs	18	24	(82)	13	19	(69)
Operating expenses	(590)	(523)	(571)	(429)	(421)	(484)
Operating profit before impairment releases/(losses)	168	226	495	121	183	422
Impairment releases/(losses)	194	380	(1,796)	141	306	(1,525)
Operating profit/(loss)	362	606	(1,301)	262	489	(1,103)
Average exchange rate - €/£				1.377	1.241	1.178
Analysis of income by business						
Corporate	202	230	291	147	185	247
Retail	443	361	361	321	291	307
Other	113	158	414	82	128	352
Total income	758	749	1,066	550	604	906
Analysis of impairments by sector						
Mortgages	(100)	(212)	259	(73)	(171)	220
Commercial real estate						
- investment	7	(10)	637	5	(7)	541
- development	—	(3)	116	(1)	(3)	98
Other corporate	(90)	(169)	768	(64)	(137)	653
Other lending	(11)	14	16	(8)	12	13
Total impairment (releases)/losses	(194)	(380)	1,796	(141)	(306)	1,525
Loan impairment (release)/charge as a % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Mortgages	(0.5%)	(1.1%)	1.3%	(0.5%)	(1.1%)	1.3%
Commercial real estate						
- investment	0.8%	(0.8%)	14.5%	0.7%	(0.7%)	14.6%

- development	—	(1.0%)	16.6%	(0.5%)	(1.0%)	16.3%
Other corporate	(1.9%)	(3.8%)	12.6%	(1.8%)	(4.0%)	13.3%
Other lending	(2.2%)	2.0%	2.0%	(2.0%)	2.4%	1.9%
Total	(0.8%)	(1.4%)	5.5%	(0.8%)	(1.5%)	5.7%
Performance ratios						
Return on equity (2)	10.6%	18.6%	(24.5%)	10.6%	18.6%	(24.5%)
Net interest margin	1.57%	1.92%	1.50%	1.57%	1.92%	1.50%
Cost:income ratio	78%	70%	53%	78%	70%	53%

Notes:

(1) Staff expenses include costs relating to employees of Ulster Bank Ireland Limited only. Recharges for services provided by or to Ulster Bank Limited are reflected through a management fee within other costs.

(2) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 11% (previously 13%) of the monthly average of segmental RWAes, assuming 15% tax rate.

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Capital and balance sheet	2015 €bn	2014 €bn	2013 €bn	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)						
Mortgages	18.8	19.6	20.1	13.8	15.3	16.8
Commercial real estate						
- investment	0.9	1.3	4.4	0.7	1.0	3.7
- development	0.3	0.3	0.7	0.2	0.3	0.6
Other corporate	4.8	4.5	6.1	3.5	3.4	4.9
Other lending	0.5	0.7	0.8	0.4	0.5	0.7
Total loans and advances to customers (gross)	25.3	26.4	32.1	18.6	20.5	26.7
Loan impairment provisions						
- mortgages	(1.4)	(1.8)	(2.0)	(1.1)	(1.4)	(1.7)
- commercial real estate						
- investment	(0.2)	(0.2)	(1.2)	(0.1)	(0.1)	(1.0)
- development	(0.1)	(0.1)	(0.3)	(0.1)	(0.1)	(0.2)
- other corporate	(0.8)	(0.9)	(2.0)	(0.6)	(0.7)	(1.8)
- other lending	(0.1)	(0.1)	(0.2)	—	(0.1)	(0.1)
Total loan impairment provisions	(2.6)	(3.1)	(5.7)	(1.9)	(2.4)	(4.8)
Net loans and advances to customers	22.7	23.3	26.4	16.7	18.1	21.9
Total assets	29.0	28.9	33.0	21.3	22.5	27.5
Funded assets	28.8	28.7	32.8	21.2	22.4	27.3
Risk elements in lending						
- mortgages	3.5	4.2	3.8	2.6	3.3	3.1
- Commercial real estate						
- investment	0.2	0.3	2.5	0.2	0.2	2.1
- development	0.1	0.2	0.4	0.1	0.1	0.3
- other corporate	0.8	0.8	2.3	0.5	0.7	2.0
- other lending	0.1	0.1	0.2	0.1	0.1	0.1
Total risk elements in lending	4.7	5.6	9.2	3.5	4.4	7.6
Provision coverage (1)	55%	55%	62%	55%	55%	62%
Customer deposits	17.8	18.9	18.2	13.1	14.7	15.2
Loan:deposit ratio (excluding repos)	127%	124%	144%	127%	124%	144%
Risk-weighted assets (2)						
- credit risk						
- non-counterparty	24.6	26.1	32.1	18.1	20.3	26.7
- counterparty	0.1	0.1	—	0.1	0.1	—
- operational risk	1.7	1.8	2.0	1.2	1.4	1.7
Total risk-weighted assets	26.4	28.0	34.1	19.4	21.8	28.4
Spot exchange rate - €/£				1.362	1.285	1.201

Notes:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(2) RWAs in 2013 are on a Basel 2.5 basis.

Key points

Following the strategic review of Ulster Bank in 2014, it was confirmed that the Northern Ireland and Republic of Ireland businesses were to be separated. The change of management controls and governance was completed in October 2015 with the Northern Irish business included in UK Personal & Business Banking (UK PBB) and the reportable segment of Ulster Bank RoI now comprising the core Republic of Ireland business only.

Ulster Bank RoI has continued to strengthen its customer offering and service capability in 2015 as it made it simpler for customers to do business. The year has also seen stronger new lending volumes, buoyed by the improving economic conditions:

- Further investment in the mortgage business through the launch of the "mortgage you can live with" campaign which offers a range of new product options to both new and existing customers combined with a re-entry to the mortgage broker market and the introduction of a team of mobile mortgage managers. Gross new mortgage lending increased 53% to £0.5 billion in 2015.

Business review

- Delivered new propositions for commercial customer lending across several sectors, including food and drink, agriculture, asset finance and international business. Gross new lending to commercial customers increased by 65% to £1.1 billion from 2014.

- Made it easier for our customers to bank with us. The bank's current account proposition was re-launched in October and a partnership with 'An Post' provides customers with 1,140 new points of presence.

2015 compared with 2014

A significant weakening of the euro relative to sterling during 2015 had a material impact on Ulster Bank RoI's financial comparison with 2014 and the income trend in particular.

Ulster Bank RoI recorded an operating profit of £262 million compared with an operating profit of £489 million in 2014, the decline primarily due to considerably lower net impairment releases in 2015. Operating profit excluding restructuring costs of £15 million (2014 - £13 million) and litigation and conduct recoveries of £13 million (2014 - £19 million) was £264 million, a decrease of £219 million from 2014. Return on equity was 10.6%, down from 18.6% in 2014.

Total income was £550 million, a decrease of 9% from the prior year reflecting the weakening of the euro during 2015. In Euro terms total income increased 1% due to a continued improvement in deposit pricing in line with market trends, combined with benefits, including a gain on the sale of a buy-to-let portfolio of £12 million and the closure of a foreign exchange exposure of £24 million. These benefits were largely offset by a lower return on free funds.

Net interest margin (NIM) was 1.57%, a decrease of 35 basis points from 2014, primarily driven by reduced income on free funds and an increased drag from liquidity management requirements. NIM continues to reflect a sizeable drag from the low yielding tracker mortgage book.

Operating expenses increased by 2% from £421 million to £429 million, reflecting an increase in pension servicing costs, totalling £22 million and by further investment in the business and operational infrastructure, this was partially offset by cost savings delivered through a continued reduction in both employee numbers and the property footprint as well as the weakening of euro (an impact of £41 million).

Net impairment releases reduced by £165 million to £141 million, and although at lower levels, continued to reflect the improving economic conditions and the benefits of proactive debt management.

Gross new mortgage lending increased 53% to £0.5 billion whilst gross lending to commercial customers increased 65% to £1.1 billion. Strong new lending volumes across the business in 2015 were offset by high levels of customer repayments and the sale of a £0.3 billion buy-to-let mortgage portfolio. Net loans and advances to customers decreased £1.4 billion to £16.7 billion, £1 billion of which related to exchange rate movements. The low yielding tracker mortgage portfolio balances reduced balances from £10.6 billion in 2014 to £9.2 billion, but continues to make up a significant part of the overall mortgage book.

RWAs reduced 11% from £21.8 billion to £19.4 billion due to improved credit metrics and the impact of a weakening euro an impact of £1.2 billion, while RWA intensity reduced by 2 percentage points to 104%. RWAs on the tracker mortgage portfolio reduced from £9.3 billion in 2014 to £7.8 billion.

2014 compared with 2013

Ulster Bank RoI recorded an operating profit of £489 million in 2014 compared with a loss of £1,103 million in 2013. The turnaround was driven by £306 million net impairment releases compared with impairment losses of £1,525 million in 2013. Operating profit excluding restructuring costs of £13 million (2013 - £22 million), litigation and conduct recoveries of £19 million (2013 – charge of £69 million) and in 2013 a gain of redemption of own debt of £242 million was £483 million compared with a loss in 2013 of £1,254 million.

Total income decreased by £302 million to £604 million largely as a result a £242 million gain on redemption of own debt in 2013 following a successful liability management exercise.

Net interest income decreased by £11 million to £467 million, driven by a weakening of the euro against sterling an impact of £24 million. In Euro terms net interest income increased by £13 million due to a significant reduction in the cost of deposits and a benefit from the recognition of income on certain previously nonperforming assets, partly offset by the adverse impact on the tracker mortgage book of lower European Central Bank refinancing interest rates. Net interest margin increased 42 basis points to 1.92%. Other non-interest income reduced by £54 million primarily due to significant hedging gains on the mortgage portfolio in 2013.

The continued focus on costs resulted in a reduction in staff numbers and the bank’s property footprint. Litigation and conduct costs decreased by £88 million reflecting the outcome of reviews relating to provisions on PPI and Interest Rate Hedging Products. These benefits were partly offset by higher regulatory charges and levies including a new bank levy introduced in the Republic of Ireland, of £12 million, and the impact of a realignment of costs following the creation of RCR, £35 million.

The transfer of assets to RCR coupled with improved credit quality across key portfolios resulted in a 42% reduction in risk elements in lending. Provision coverage reduced from 62% to 55% during 2014 reflecting the further de-risking of the balance sheet coupled with the impact of an increase in asset values. RWAs decreased by 23% reflecting an improvement in credit metrics and a reduced loan book.

The loan:deposit ratio decreased from 144% to 124% during 2014 mainly due to a 17% reduction in net loan balances to £18.1 billion reflecting the transfer of assets to RCR and continued customer repayments partly offset by growth in new lending. Customer deposits declined by 3% largely driven by exchange rate movements, an impact of £1 billion.

Business review

Commercial Banking

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	1,997	1,976	1,909
Net fees and commissions	984	983	1,046
Other non-interest income	273	346	325
Non-interest income	1,257	1,329	1,371
Total income	3,254	3,305	3,280
Direct expenses			
- staff costs	(483)	(495)	(500)
- other costs	(97)	(100)	(135)
- operating lease costs	(141)	(141)	(129)
Indirect expenses	(1,080)	(1,008)	(1,068)
Restructuring costs			
- direct	(52)	(41)	(17)
- indirect	(17)	(67)	(46)
Litigation and conduct costs	(51)	(112)	(247)
Operating expenses	(1,921)	(1,964)	(2,142)
Operating profit before impairment losses	1,333	1,341	1,138
Impairment losses	(69)	(85)	(601)
Operating profit	1,264	1,256	537
Analysis of income by business			
Commercial lending	1,634	1,618	1,725
Deposits	477	375	229
Asset and invoice finance	710	740	671
Other	433	572	655
Total income	3,254	3,305	3,280
Analysis of impairments by sector			
Commercial real estate	18	3	394
Asset and invoice finance	9	11	32
Private sector services (education, health, etc)	9	—	120
Banks & financial institutions	—	2	10
Wholesale and retail trade repairs	3	17	9
Hotels and restaurants	(2)	7	27
Manufacturing	1	9	(2)
Construction	6	11	1
Other	25	25	10
Total impairment losses	69	85	601
Loan impairment charge as a % of gross customer loans and advances by sector			
Commercial real estate	0.1%	—	2.1%
Asset and invoice finance	0.1%	0.1%	0.3%
Private sector services (education, health, etc)	0.1%	—	1.4%

Banks & financial institutions	—	—	0.2%
Wholesale and retail trade repairs	—	0.3%	0.1%
Hotels and restaurants	(0.1%)	0.2%	0.7%
Manufacturing	—	0.2%	(0.1%)
Construction	0.3%	0.6%	—
Other	0.1%	0.1%	—
Total	0.1%	0.1%	0.7%

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Business review

	2015	2014	2013
Performance ratios	%	%	%
Return on equity (1)	9.8%	10.2%	3.6%
Net interest margin	1.88%	1.91%	1.84%
Cost:income ratio	59%	59%	65%
Capital and balance sheet	£bn	£bn	£bn
Loans and advances to customers (gross)			
- Commercial real estate	16.7	16.6	18.9
- Asset and invoice finance	14.4	14.2	11.7
- Private sector services (education, health, etc)	6.7	6.8	8.4
- Banks & financial institutions	7.1	5.5	5.6
- Wholesale and retail trade repairs	7.5	6.8	6.8
- Hotels and restaurants	3.3	3.3	3.7
- Manufacturing	5.3	3.9	3.8
- Construction	2.1	2.0	2.3
- Other	28.9	26.7	23.7
Total loan and advances to customers (gross)	92.0	85.8	84.9
Loan impairment provisions	(0.7)	(0.9)	(1.4)
Net loans and advances to customers	91.3	84.9	83.5
Total assets	133.5	127.9	127.3
Funded assets	133.5	127.9	127.3
Risk elements in lending	1.9	2.4	4.2
Provision coverage (2)	39%	39%	33%
Customer deposits (excluding repos)	88.9	84.9	89.0
Loan:deposit ratio (excluding repos)	103%	100%	94%
Risk-weighted assets (3)			
- Credit risk (non-counterparty)	65.3	55.8	60.6
- Operational risk	7.0	7.4	7.1
Total risk-weighted assets	72.3	63.2	67.7

Notes:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 11% (previously 13%) of the monthly average of segmental RWAes, assuming 28% tax rate; previously 25%.

(2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(3) RWAs in 2013 are on a Basel 2.5 basis.

Key points

Commercial Banking made progress towards improving customer experience by becoming easier and simpler to do business with through operational investment and process simplifications. Continued enhancements within the business contributed to commercial lending growth in 2015.

In the course of the year Commercial Banking:

- Opened four Entrepreneur Hubs across the UK, increasing our involvement to seven, enabling entrepreneurs and small businesses to access free office space, mentoring and financial support, with a further five hubs to be opened in 2016.
- Rolled out a new on-boarding and account opening system across England and Wales which has delivered a reduction in customer paper work and a reduction in account opening times of approximately 30%.
- Launched a lending pilot to upgrade and simplify end-to-end processes with a focus on streamlining our product, pricing and governance operations.
- Issued 12,500 statements of appetite letters to customers, offering up to £8 billion of new borrowing facilities as part of our continued support of UK business.
- Supported AB Inbev's acquisition of SABMiller, the fifth largest corporate takeover ever and largest in the UK.
- Awarded Residential Funder of the Year, providing finance for c.20k homes to be built in 2015.
- Our Commercial Relationship Bankers are undertaking intensive training and development, accredited by the Chartered Bankers Institute, with over 5,000 participants.
- Grew net new lending by £3.6 billion excluding the impact of the transferred businesses from CIB and strategic run-off decisions.
- Proactive capital management with £2.2 billion of lower performing assets run-off in 2015.

2015 compared with 2014

Comparisons with prior periods are affected by a number of internal business transfers. In line with changes to the business model, the UK and Western European corporate loan portfolios transferred to Commercial Banking on 1 May 2015 and 1 October 2015 respectively. The prior period financials were adjusted for the UK Transaction Services business transfer and do not affect comparisons. The results exclude RBS International which is reported as a separate segment for the first time.

Business review

Commercial Banking recorded an operating profit of £1,264 million, broadly in line with the prior year. Operating profit excluding restructuring costs of £69 million (2014 - £108 million) and litigation and conduct costs of £51 million (2014 - £112 million) was £1,384 million, a decrease of £92 million from 2014 due to a marginal fall in income reflecting margin pressure. Return on equity was broadly stable year on year.

Total income was £3,254 million, compared with £3,305 million in 2014. Net interest income was £1,997 million, a 1% increase from 2014, driven largely by higher asset and deposit volumes. Net interest margin decreased three basis points to 1.88% with improved deposit margins partly offsetting competitive pressures on new business asset margins. Non-interest income fell by 5% to £1,257 million driven by a loss of £34 million from the sale of non-strategic asset portfolios and the transfer of the commercial cards business to UK PBB in 2014.

Operating expenses totalled £1,921 million, a reduction of 2% from 2014, principally driven by tight control on discretionary costs and lower litigation and conduct costs, down 54% to £51 million, combined with restructuring costs falling 36% to £69 million. Operating expenses excluding restructuring costs of £69 million (2014 - £108 million) and litigation and conduct costs of £51 million (2014 - £112 million) were £1,801 million, an increase of £57 million, primarily as a result of a higher UK bank levy charge.

Net impairment losses decreased £16 million to £69 million due to lower individual charges, offsetting lower net provision releases.

Commercial Banking recorded volume growth across segments, resulting in net loans and advances to customers increasing by £6.4 billion to £91.3 billion. This included £5.0 billion from the transferred businesses, offset by strategic run-off and sale of selected assets totalling £2.2 billion. Total net new lending was £1.4 billion.

Customer deposits totalled £88.9 billion, an increase of £4.0 billion reflecting high levels of liquidity in the market.

RWAs increased £9.1 billion to £72.3 billion in 2015, of which £8.4 billion relates to £5 billion of assets transferred in. The higher capital intensity reflects increased level of undrawn commitments in the transferred businesses.

The Commercial Banking run-off portfolio includes funded assets of £12.5 billion and RWAs of £8.5 billion.

2014 compared with 2013

Commercial Banking recorded an operating profit of £1,256 million compared with £537 million in the prior year. This was driven by lower net impairment losses, down £516 million, lower operating expenses, down £178 million and higher income, up £25 million. Operating profit excluding restructuring costs of £108 million (2013 - £63 million) and litigation and conduct costs of £112 million (2013 - £247 million) increased by £629 million to £1,476 million.

Net interest income increased by £67 million or 4%, largely reflecting re-pricing activity on deposits partly offset by the impact of reduced asset margins, a result of the net transfer in of lower margin legacy loans (after the cessation of Non-Core). Non-interest income was down £42 million or 3% as lower CIB revenue share income, restructuring fees and the transfer out of commercial cards income to UK PBB in August 2014 were only partially offset by higher fair value gains and operating lease income, along with lower close out costs of interest rate products associated with impaired loans.

Operating expenses were down £178 million or 8%, as a result of lower litigation and conduct costs, primarily relating to interest rate swap redress, and lower underlying direct costs reflecting the continued focus on cost saving. These reductions were partially offset by higher restructuring costs, as the business aligned itself to better support customers, and growth in operating lease depreciation. Operating expenses excluding restructuring costs of £108 million (2013 - £63 million) and litigation and conduct costs of £112 million (2013 - £247 million) declined by £88 million.

Net impairment losses declined £516 million to £85 million, with fewer individual cases across the portfolio, reduced collectively assessed provisions and higher latent provision releases, reflecting improved credit conditions.

The loan:deposit ratio increased to 100%, representing a 2% increase in net loans and advances to customers, as reductions in the commercial real estate and restructuring portfolio were offset by growth across other businesses and reduced customer deposits, down 5%, reflecting the rebalancing of the bank’s liquidity position.

RWAs were £4.5 billion lower at £63.2 billion, primarily reflecting net transfers to RCR, effective 1 January 2014, and improving credit quality on the back of UK economic recovery, offset by loan growth.

Business review

Private Banking

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	436	454	414
Net fees and commissions	186	214	216
Other non-interest income	22	21	24
Non-interest income	208	235	240
Total income	644	689	654
Direct expenses			
- staff costs	(176)	(178)	(176)
- other costs	(35)	(37)	(33)
Indirect expenses	(307)	(289)	(340)
Restructuring costs			
- direct	(7)	(1)	(15)
- indirect	(66)	—	(2)
Litigation and conduct costs	(12)	(90)	(107)
Write down of goodwill	(498)	—	—
Operating expenses	(1,101)	(595)	(673)
Operating (loss)/profit before impairment (losses)/releases	(457)	94	(19)
Impairment (losses)/releases	(13)	5	(7)
Operating (loss)/profit	(470)	99	(26)
Analysis of income by business			
Investments	86	104	112
Banking	558	585	542
Total income	644	689	654
Performance ratios			
Return on equity (1)	(27.7%)	4.1%	(2.8%)
Net interest margin	2.75%	2.89%	2.56%
Cost:income ratio	171%	86%	103%

Note:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 15% (previously 13%) of the monthly average of segmental RWAes, assuming 28% tax rate; previously 25%.

Capital and balance sheet	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)			
- Personal	2.7	2.6	2.8
- Mortgages	6.5	6.1	5.8

- Other	2.0	2.3	2.5
Total loans and advances to customers (gross)	11.2	11.0	11.1
Loan impairment provisions	—	—	(0.1)
Net loans and advances to customers	11.2	11.0	11.0
Total assets	17.0	17.7	17.4
Funded assets	17.0	17.7	17.2
Assets under management	13.9	13.8	14.2
Risk elements in lending	0.1	0.1	0.2
Provision coverage (1)	28%	25%	39%
Customer deposits (excluding repos)	23.1	22.3	22.6
Loan:deposit ratio (excluding repos)	48%	49%	49%
Risk-weighted assets (2)			
- Credit risk (non-counterparty)	7.6	7.6	6.8
- Market risk	—	0.1	—
- Operational risk	1.1	1.0	1.9
Total risk-weighted assets	8.7	8.7	8.7

Notes:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(2) RWAs in 2013 are on a Basel 2.5 basis.

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Business review

Key points

Private Banking is being repositioned to focus on its UK connected customers and implement growth initiatives to create long term sustainable returns. The business has moved forward with simplifying its operating model and continued to develop new customer propositions for wealthy individuals and families. Private Banking results exclude the international private banking business given its plan for disposal.

Private Banking continued to invest in the customer proposition whilst moving toward a more focused business model:

- Strategic repositioning to focus on UK customers with the sale of the European, the Middle East and Africa tranche of the international private banking business completed in Q4 2015. The smaller Far East tranche is scheduled to complete in the first half of 2016.
- A series of customer initiatives to ensure client connectivity has resulted in a 29% increased use of digital channels, increased volumes of payments and transfers with a rise in the client satisfaction score.
- Growth in customer referrals from Personal & Business Banking and Commercial Banking has driven increased client introductions and on-boarding.
- Operational enhancements delivered in the credit application process combined with improved customer experience through improved fraud detection functionality.
- Global Private Banking Awards 2015: Coutts named best Private Bank in the UK.

2015 compared with 2014

A goodwill impairment charge of £498 million attributed to the business drove an operating loss of £470 million, compared with an operating profit of £99 million in 2014. Operating profit excluding restructuring costs of £73 million (2014 - £1 million), litigation and conduct costs of £12 million (2014 - £90 million) and write down of goodwill of £498 million (2014 - nil) was £113 million in 2015, a fall of £77 million reflecting lower income and higher net impairment losses.

Total income was £644 million, a reduction of £45 million from 2014. Net interest income was £436 million, down 4% primarily due to lower net interest margin. Non-interest income totalled £208 million, a decrease of 11% driven by lower investment and transactional income as the business adjusted pricing to reflect a more competitive market.

Operating expenses totalled £1,101 million, an increase of £506 million, driven by a £498 million goodwill impairment charge, and considerably higher restructuring costs of £73 million which includes a share of asset write down related to software of £91 million, and lower litigation and conduct costs of £12 million. Operating expenses excluding restructuring costs of £73 million (2014 - £1 million), litigation and conduct costs of £12 million (2014 - £90 million) and write down of goodwill of £498 million (2014 - nil) were £518 million, up 3%, with reductions in the direct cost base offset by a higher UK bank levy charge.

Net impairment losses totalled £13 million, compared with a release of £5 million, due to higher individual and latent charges.

Despite challenging market conditions, assets under management and net loans and advances to customers were broadly stable compared with the prior year.

2014 compared with 2013

Private Banking recorded an operating profit of £99 million compared with a loss of £26 million in the prior year. This was driven by reduced operating expenses, down £78 million, income higher by £35 million with impairment releases of £5 million compared to a net £7 million loss in 2013. Operating profit excluding restructuring costs of £1 million (2013 - £17 million) and litigation and conduct costs of £90 million (2013 - £107 million) increased by £92 million to £190 million.

Net interest income growth of £40 million or 10% was driven by increased deposit margins with non interest income down £5 million resulting in an annual increase in total income of £35 million or 5%.

Operating expenses declined by £78 million or 12% with restructuring and litigation and conduct costs driving the reduction. Operating expenses excluding restructuring costs of £1 million (2013 - £17 million) and litigation and conduct costs of £90 million (2013 - £107 million) declined £45 million or 8% reflecting lower technology costs and benefits from the exit of a number of London properties.

Net impairment releases of £5 million, compared with a net impairment loss of £7 million in the prior year reflected improved credit conditions and higher UK property prices.

The loan:deposit ratio was stable with assets, customer deposits and assets under management all flat.

Business review

RBS International

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	303	323	299
Net fees and commissions	40	43	39
Other non-interest income	24	25	27
Non-interest income	64	68	66
Total income	367	391	365
Direct expenses			
- staff costs	(42)	(44)	(43)
- other costs	(16)	(15)	(19)
Indirect expenses	(98)	(94)	(77)
Restructuring costs			
- direct	—	(2)	(1)
- indirect	(4)	(5)	(4)
Litigation and conduct costs	—	—	(9)
Operating expenses	(160)	(160)	(153)
Operating profit before impairment releases/(losses)	207	231	212
Impairment releases/(losses)	—	7	(47)
Operating profit	207	238	165
Performance ratios			
Return on equity (1)	18.5%	24.2%	17.8%
Net interest margin	1.48%	1.65%	1.59%
Cost:income ratio	44%	41%	42%

Note:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 12% (previously 13%) of the monthly average of segmental RWAes, assuming 10% tax rate.

Capital and balance sheet	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)			
- Corporate	4.5	4.5	3.6
- Mortgages	2.5	2.6	2.7
- Other	0.4	0.2	0.2
Total loans and advances to customers (gross)	7.4	7.3	6.5
Loan impairment provisions	(0.1)	(0.1)	(0.1)
Net loans and advances to customers	7.3	7.2	6.4
Total assets	23.1	23.4	21.5
Funded assets	23.1	23.4	21.5

Risk elements in lending	0.1	0.2	0.2
Provision coverage (1)	34%	27%	63%
Customer deposits	21.3	20.8	20.9
Loan:deposit ratio (excluding repos)	35%	35%	31%
Risk-weighted assets (2)			
- Credit risk - non-counterparty	7.6	6.8	7.0
- Operational risk	0.7	0.7	—
Total risk-weighted assets	8.3	7.5	7.0

Notes:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(2) RWAs in 2013 are on a Basel 2.5 basis.

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Business review

Key points

RBS International (RBSI) operates under the CPB franchise, serving retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man and Gibraltar. RBSI is reported as a separate segment for the first time. RBSI leverages a strong multi-currency banking platform combined with a comprehensive product suite. RBSI completed a strategy review at the end of 2015 with plans to invest in and grow the business now being implemented, with particular focus on the funds and mortgage businesses.

During 2015 RBSI has enhanced its customer offering:

- Invested in the multi-currency online banking platform, a unique system to RBSI, to ensure a transformative service to further simplify customer experience.
- Continued its support for Gibraltar's largest private sector turnover company through a syndicated working capital facility.

2015 compared with 2014

RBSI reported an operating profit of £207 million, £31 million lower than 2014, largely due to lower income from deposits which in turn drove return on equity down to 18.5%, from 24.2%.

Total income decreased 6% to £367 million, mainly due to reductions in net interest income, falling £20 million to £303 million, principally reflecting lower deposit margins and lower return on free funds partly offset by higher asset volumes. Non-interest income declined £4 million to £64 million as a result of a lower CIB revenue share and lower net lending fees.

There were no impairments in 2015 compared with modest impairment releases of £7 million in the prior year.

Operating expenses remained stable at £160 million due to control in direct expenditure offset by a slightly higher UK bank levy charge.

Net loans and advances to customers increased by £0.1 billion to £7.3 billion. Customer deposit balances grew £0.5 billion to £21.3 billion. The business is a liability heavy business with a loan:deposit ratio of 35%.

RWAs increased by £0.8 billion to £8.3 billion as a result of a change in business mix and foreign exchange movements.

2014 compared with 2013

RBS International recorded an operating profit of £238 million compared with £165 million in the prior year. This was driven by a net impairment release, instead of a prior year loss and increased income. Operating profit excluding restructuring costs of £7 million (2013 - £5 million) and litigation and conduct costs nil (2013 - £9 million) increased by £66 million to £245 million.

Net interest income increased by £24 million or 8%, largely reflecting an increase in new lending volumes, which was partly offset by the impact of reduced deposit volumes and margins.

Non-interest income was up £2 million as higher lending and guarantee fees were offset by lower CIB revenue share income, impacted by reducing foreign exchange margins.

Operating expenses rose £7 million or 5%, primarily as a result of UK bank levy charges. Litigation and conduct costs were down £9 million, primarily relating to interest rate swap redress, but partially offset by £2 million higher restructuring costs.

Net impairment losses reduced £54 million with net impairment releases of £7 million in 2014. 2013 included a charge for one large individual case.

Net loans and advances to customers increased 13% or £0.8 billion as growth returned to some key asset classes. Deposits were stable at £20.8 billion.

RWAs were £0.5 billion higher at £7.5 billion, primarily reflecting the growth in the asset book.

Business review

Corporate & Institutional Banking

Income statement	2015 £m	2014 £m	2013 £m
Net interest income from banking activities	87	(11)	68
Net fees and commissions	218	408	475
Income from trading activities	1,153	1,386	1,788
Other operating income	(51)	157	152
Own credit adjustments	120	(9)	23
Non-interest income	1,440	1,942	2,438
Total income	1,527	1,931	2,506
Direct expenses			
- staff costs	(348)	(446)	(536)
- other costs	(122)	(190)	(397)
Indirect expenses	(997)	(1,080)	(1,287)
Restructuring costs			
- direct	(44)	(13)	(20)
- indirect	(480)	(89)	(58)
Litigation and conduct costs	(378)	(832)	(613)
Operating expenses	(2,369)	(2,650)	(2,911)
Operating loss before impairment losses	(842)	(719)	(405)
Impairment releases	5	9	37
Operating loss	(837)	(710)	(368)
Analysis of income by product			
Rates	688	823	964
Currencies	390	551	679
Financing	296	551	875
Banking/Other	(65)	(208)	(279)
Total excluding own credit adjustments	1,309	1,717	2,239
Own credit adjustments	120	(9)	23
Businesses transferred to Commercial Banking	98	223	244
Total income	1,527	1,931	2,506
Performance ratios			
Return on equity (1)	(11.1%)	(7.9%)	(5.0%)
Net interest margin	0.53%	(0.07%)	0.43%
Cost:income ratio	155%	137%	116%

Note:

(1) Return on equity is based on segmental operating profit after tax adjusted for preference dividends divided by average notional equity based on 15% (previously 13%) of the monthly average of segmental RWAes, assuming 28% tax rate (previously 25%).

Business review

Capital and balance sheet	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross, excluding reverse repos)	16.1	26.5	24.7
Loans and advances to banks (excluding reverse repos) (1)	5.7	2.5	2.1
Reverse repos	38.6	45.9	51.8
Securities	23.7	43.7	46.1
Cash and eligible bills	14.3	10.4	8.6
Other	4.9	8.7	10.9
Total assets	215.3	276.2	246.0
Funded assets	103.3	137.7	144.2
Customer deposits (excluding repos)	5.7	11.8	12.1
Bank deposits (excluding repos)	6.7	10.8	10.5
Repos	35.2	52.8	54.4
Debt securities in issue	3.3	4.9	4.0
Loan:deposit ratio (excluding repos)	284%	226%	203%
Risk-weighted assets (2)			
- credit risk			
- non-counterparty	5.0	10.3	12.9
- counterparty	11.3	12.5	6.1
- market risk	13.8	15.4	15.1
- operational risk	3.0	3.7	7.3
Total risk-weighted assets	33.1	41.9	41.4

Notes:

(1) Excludes disposal groups.

(2) RWAs in 2013 are on a Basel 2.5 basis.

Key points

Corporate & Institutional Banking (CIB) announced its new business strategy in February 2015, separating the segment between go-forward and CIB Capital Resolution (now Capital Resolution).

The current CIB business is undergoing a multi-year transformation implementing a simpler and sustainable operating model as the business re-shapes and downsizes. The business has been shaped around three product lines: Rates, Currencies and Financing with core focus on UK and Western European corporates and global financial institutions.

The steady-state target for the business is c.£1.4 billion of income with c.£30 billion of RWAs. Operating expenses are targeted at c.£0.7-0.8 billion to deliver 8-10% return on equity. Achieving target steady state requires a multi-year transformation programme, which was launched in 2015. Alongside this, CIB continues to focus on customers:

- Agreements signed by RBS with three separate investment partners: AIG Asset Management (Europe) Ltd, Hermes Investment Management and M&G Investments to provide small to mid-market UK businesses with greater access to capital investment.
- Managed the largest liability management exercise in Europe in 2015.
- RBS Automated Treasury solutions recognised at the 2015 BBA/IFS Financial Innovation awards for delivering innovative, flexible and customer-centric products.
- Raising approximately £50 billion for customers in debt capital markets in 2015.

Comparisons with prior periods are affected by a number of internal business transfers. In line with changes to the business model, the UK and Western European corporate loan portfolios transferred to Commercial Banking on 1 May 2015 and 1 October 2015 respectively; the Short Term Money markets business was transferred to Treasury on 1 August 2015. The prior period financials were adjusted for the UK Transaction Services business transfer to Commercial Banking and do not affect prior period comparisons.

2015 compared with 2014

CIB reported an operating loss of £837 million in 2015, compared with an operating loss of £710 million in 2014. This included restructuring costs of £524 million and litigation and conduct costs of £378 million. The reduction was driven by lower income partially offset by the continued reduction in expenses, down £281 million, or 11%, to £2,369 million as the business continues to take costs out and move towards a more sustainable cost base.

Operating loss excluding a gain on own credit adjustments of £120 million (2014 - £9 million charge), restructuring costs of £524 million (2014 - £102 million) and litigation and conduct costs of £378 million (2014 - £832 million) was £55 million, compared with a profit of £233 million in 2014.

Business review

Total income declined by £404 million, or 21%, to £1,527 million in 2015. This includes £120 million relating to own credit adjustments and £98 million relating to the transfer of portfolio businesses to Commercial Banking. CIB income excluding own credit adjustments (2015 - £120 million; 2014 - £9 million charge), was £1,407 million, in line with previous guidance.

- Rates income declined, reflecting the reduced scale and risk appetite of the business.
- Currencies incurred losses when the Swiss Central Bank unexpectedly removed the Swiss Franc's peg to the Euro.
- Financing was impacted by the strategically reduced corporate footprint especially in the US and by lower levels of EMEA investment grade issuance.

Operating expenses fell by £281 million, or 11%, to £2,369 million in 2015. This includes £35 million relating to the transfer of portfolio businesses to Commercial Banking. Expenses remaining in CIB were £2,334 million as the business reshaped, including a considerable reduction in headcount. Litigation and conduct costs fell by £454 million, or 55%, to £378 million, primarily relating to foreign exchange settlements in the US. This reduction was offset by an increase in restructuring costs of £422 million to £524 million, primarily relating to property and intangible asset write downs. Operating expenses excluding restructuring costs of £524 million (2014 - £102 million) and litigation and conduct costs of £378 million (£832 million) fell by £249 million or 15% to £1,467 million.

Total assets fell by £60.9 billion to £215.3 billion. as the business continues to work through re-shaping, and included £17 billion (2014 - £20 billion) relating to the transfer to Treasury of the Short Term Markets business and £5 billion from the transfer of the UK and Western European corporate loan portfolios to Commercial Banking. Funded assets fell by £34.4 billion to £103.3 billion.

RWAs reduced by £8.8 billion to £33.1 billion compared with £41.9 billion, nearing the end-state target of c.£30 billion. The reduction was primarily driven by the transfer of the UK and Western European portfolio businesses to Commercial Banking.

2014 compared with 2013

CIB recorded an operating loss of £710 million compared with an operating loss of £368 million in 2013. This included litigation and conduct costs of £832 million compared with £613 million a year before. Operating profit excluding a charge from own credit adjustments of £9 million (2013 - £23 million gain), litigation and conduct costs of £832 million (2013 - £613 million) and restructuring costs of £102 million (2013 - £78 million) was £233 million compared with £300 million in 2013. This movement was primarily driven by lower income, partially offset by a reduction in expenses.

Total income declined by £575 million, 23%, to £1,931 million reflecting reduced deployment of resources and difficult trading conditions, characterised by subdued levels of customer activity and limited market volatility:

- Rates suffered from weak trading conditions in the fourth quarter of 2014, largely driven by subdued activity and balance sheet de-risking.
- Currencies income declined in a highly competitive market as both market volatility and customer activity remained subdued for much of the year. Some volatility returned in the fourth quarter of 2014, boosting income in the Options business in particular.
- Financing income reduced, reflecting the year on year weakening in EMEA corporate investment grade primary issuance and subdued secondary credit markets.

Operating expenses fell by £261 million driven primarily by lower business and support costs, partially offset by an increase in litigation and conduct costs. Operating expenses excluding litigation and conduct costs of £832 million (2013 - £613 million) and restructuring costs of £102 million (2013 - £78 million) decreased by £504 million, or 23%, reflecting the continued focus on cost savings across both business and support areas.

Net impairment releases totalled £9 million compared with £37 million in 2013.

Risk-weighted assets were £41.9 billion as at 31 December 2014, flat compared with 31 December 2013 despite the introduction of CRDIV on 1 January 2014. This reflected the businesses commitment to carefully manage risk-weighted assets.

Business review

Capital Resolution

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	365	673	510
Net fees and commissions	266	483	497
Income from trading activities	(410)	401	1,275
Other operating income	181	271	122
Own credit adjustments	175	(36)	35
Strategic disposals	(38)	—	—
Non-interest income	174	1,119	1,929
Total income	539	1,792	2,439
Direct expenses			
- staff costs	(296)	(444)	(436)
- other costs	(202)	(293)	(287)
Indirect expenses	(1,041)	(1,283)	(1,405)
Restructuring costs			
- direct	(380)	(80)	(57)
- indirect	(927)	(105)	(59)
Litigation and conduct costs	(2,105)	(162)	(1,828)
Write-down of goodwill	—	(130)	(1,059)
Operating expenses	(4,951)	(2,497)	(5,131)
Operating loss before impairment releases/(losses)	(4,412)	(705)	(2,692)
Impairment releases/(losses)	725	1,307	(723)
Operating (loss)/profit	(3,687)	602	(3,415)

Analysis of income by portfolio			
APAC portfolio (1)	74	94	65
Americas portfolio	60	98	105
EMEA portfolio (2)	76	146	151
Legacy loan portfolio	129	416	—
Shipping	80	95	74
Markets	180	866	1,485
GTS	346	563	629
Other	(214)	(481)	(105)
Income excluding disposals and own credit adjustments	731	1,797	2,404
Disposal (losses)/gains	(367)	31	—
Own credit adjustments	175	(36)	35
Total income	539	1,792	2,439

Notes:

(1) Asia-Pacific portfolio.

(2) European, the Middle East and Africa portfolio.

Business review

Capital and balance sheet	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)	25.9	64.0	40.6
Loan impairment provisions	(2.3)	(11.1)	(0.9)
Net loans and advances to customers	23.6	52.9	39.7
Net loans and advances to banks	7.1	14.5	18.2
Total assets	201.5	327.3	311.4
Funded assets	53.4	115.6	130.6
Risk elements in lending	3.4	15.6	1.6
Provision coverage (1)	67%	71%	56%
Customer deposits (excluding repos)	26.0	36.4	40.1
Bank deposits (excluding repos)	14.7	19.8	15.3
Repos	—	8.3	20.4
Debt securities in issue	4.3	9.3	17.5
Risk-weighted assets (2)			
- credit risk			
- non-counterparty	27.3	62.6	56.6
- counterparty	12.0	16.9	11.2
- market risk	5.7	8.5	11.5
- operational risk	4.0	7.1	7.8
Total risk-weighted assets	49.0	95.1	87.1

Analysis of RWAs by portfolio			
APAC portfolio (3)	0.5	4.0	3.3
Americas portfolio	1.0	7.8	8.8
EMEA portfolio (4)	1.2	5.9	10.7
Legacy loan portfolio	3.7	10.5	—
Shipping	4.5	5.8	5.8
Markets	20.7	33.3	28.1
GTS	3.6	9.8	12.5
Saudi Hollandi Bank	6.9	5.9	4.6
Other	2.9	5.0	5.5
Total credit and market risk RWAs	45.0	88.0	79.3
Operational risk	4.0	7.1	7.8
Total RWAs	49.0	95.1	87.1

Notes:

(1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(2) RWAs in 2013 are on a Basel 2.5 basis.

(3) Asia-Pacific portfolio.

(4) European, the Middle East and Africa portfolio.

Business review

Key points

Capital Resolution consists of two established businesses: CIB Capital Resolution, and RBS Capital Resolution (RCR), with total funded assets of £116 billion and RWAs of £95 billion at the start of 2015.

CIB Capital Resolution was created from non-strategic portfolios from CIB, to enable the build of a strong go-forward CIB business. Funded assets on 1 January 2015 were £101 billion, consisting of three regional portfolios (Americas, EMEA and APAC), Shipping, Markets assets, Other legacy assets including Saudi Hollandi Bank (SHB) and Global Transaction Services. There is a three stage process in place to guide the business down; starting with taking the capital out, then running down the cost base and finally managing tail risk in the longer-term.

RCR was created on 1 January 2014 and had funded assets of £14.9 billion at the start of 2015 - Refer to pages 129 to 132 for background and more details. RCR formally closed following approval from the PRA on 22 February 2016.

2015 was a year of strong progress across Capital Resolution:

CIB Capital Resolution included within Capital Resolution accelerated the execution of its strategy;

- Reduced RWAs by £32.6 billion to £40.5 billion, achieving the £25 billion target;
- North American loan portfolios sales drove £6.8 billion of RWA reduction, removing substantially all of our North American exit portfolio;
- APAC loan portfolio reduction of £3.5 billion RWA to £0.5bn RWA was driven by disposal activity;
- Similarly, EMEA loan portfolio reduced RWAs by £4.7 billion to £1.2 billion; and
- A partnership was formed with BNP Paribas to offer existing international customers an alternative to Global Transaction Services (GTS). Uncommitted GTS trade lending and new business has been terminated.

RCR included within Capital Resolution has achieved its asset reduction objective:

- Reduced funded assets by 88% since its formation to £4.6 billion with £10.3 billion reduction in 2015. This exceeded the targeted reduction of 85%, a year ahead of schedule; and
-

The net effect of the operating profit of £465 million and RWA equivalent reduction of £17.8 billion was CET1 accretion of £2.2 billion in 2015 and £8.3 billion since the perimeter was agreed.

2015 compared with 2014

Capital Resolution RWAs reduced from £95.1 billion to £49.0 billion which primarily reflected disposals and repayments activity. This was driven by significant reductions across CIB Capital Resolution and RCR which are included within Capital Resolution.

Capital Resolution made an operating loss of £3,687 million, including income related disposal losses of £367 million, restructuring costs of £1,307 million together with litigation and conduct costs of £2,105 million. Operating expenses increased by £2,454 million to £4,951 million, principally reflecting increases in litigation and conduct costs relating to additional provisions for mortgage-backed securities litigation in the United States. Operating expenses excluding restructuring costs of £1,307 million (2014 - £185 million) and litigation and conduct costs of £2,105 million (2014 - £162 million) were reduced by £481 million, or 24% to £1,539 million, principally reflecting a fall in headcount of approximately 1,100. Net impairment releases of £725 million were recorded, primarily in RCR included within Capital Resolution, driven by the disposal strategy and favourable market and economic conditions.

Capital Resolution total assets fell by £125.8 billion to £201.5 billion, funded assets fell £62.2 billion to £53.4 billion. Included within Capital Resolution CIB Capital Resolution total assets fell by £106.4 billion to £191.9 billion and funded assets fell £51.9 billion to £48.8 billion in 2015, primarily due to the loan portfolio disposals. RCR, total assets fell £19.4 billion to £9.6 billion, funded assets fell £10.3 billion to £4.6 billion, driven by extensive disposal activity across all asset groups with 533 deals completed in 2015 at an average price of 109% of book value.

Business review

RBS Capital Resolution (RCR)

Following the businesses reorganisation in Q4 2015, RCR is included in the Capital Resolution reportable segment, and the balances below are included in the Capital Resolution disclosures on pages 126 to 128.

RCR was managed and analysed in four asset management groups - Ulster Bank (RCR Ireland), Real Estate Finance, Corporate and Markets. Real Estate Finance excludes commercial real estate lending in Ulster Bank.

The following disclosures illustrate the progress made since the creation of RCR in relation to the targeted 85% run down of funded assets, achieving a reduction of 88% to £4.6 billion. As RCR has now achieved its targeted rundown and has been closed these are the final standalone RCR disclosures.

Income statement	2015 £m	2014 £m
Net interest expense	(109)	(24)
Funding cost of rental assets	(7)	(23)
Net interest income	(116)	(47)
Net fees and commissions	18	58
Income from trading activities (1)	(144)	(217)
Other operating income (1)	141	251
Own credit adjustments	—	(22)
Non-interest income	15	70
Total income	(101)	23
Direct expenses		
- staff costs	(98)	(167)
- other costs	(20)	(85)
Indirect expenses	(58)	(104)
Restructuring costs	(3)	(7)
Operating expenses	(179)	(363)
Operating loss before impairment releases	(280)	(340)
Impairment releases (1)	742	1,306
Operating profit	462	966
Total income		
Ulster Bank	(75)	(20)
Real Estate Finance	108	222
Corporate	(97)	(39)
Markets	(37)	(140)
Total income	(101)	23

Impairment (releases)/losses		
Ulster Bank	(588)	(1,106)
Real Estate Finance	(242)	(183)
Corporate	13	(21)
Markets	75	4
Total impairment releases	(742)	(1,306)
Loan impairment charge as a % of gross customer loans and advances (2)		
Ulster Bank	(36.8%)	(10.1%)
Real Estate Finance	(17.4%)	(4.5%)
Corporate	0.7%	(0.3%)
Markets	(0.8%)	(1.7%)
Total	(15.2%)	(6.0%)

Notes:

(1) Asset disposals contributed £757 million (2014 - £904 million) to RCR’s operating profit: impairment provision releases of £770 million (2014 - £874 million); £63 million loss (2014 - £87 million gain) in income from trading activities and £50 million gain (2014 - £57 million loss) in other operating income.

(2) Includes disposal groups.

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Business review

Capital and balance sheet	2015 £bn	2014 £bn
Loans and advances to customers (gross) (1)	5.4	21.9
Loan impairment provisions	(2.1)	(10.9)
Net loans and advances to customers	3.3	11.0
Debt securities	0.3	1.0
Total assets	9.6	29.0
Funded assets	4.6	14.9
Risk elements in lending (1)	3.1	15.4
Provision coverage (2)	68%	71%
Risk-weighted assets		
- Credit risk		
- non-counterparty	4.1	13.6
- counterparty	1.7	4.0
- Market risk	3.1	4.4
- Operational risk	(0.4)	—
Total risk-weighted assets	8.5	22.0
Total RWA equivalent (3)	9.5	27.3
Gross loans and advances to customers (1)		
Ulster Bank	1.6	11.0
Real Estate Finance	1.4	4.1
Corporate	1.8	6.2
Markets	0.6	0.6
	5.4	21.9
Funded assets - Ulster Bank		
Commercial real estate - investment	0.2	1.2
Commercial real estate - development	—	0.7
Other corporate	0.1	0.7
	0.3	2.6
Funded assets - Real Estate Finance (4)		
UK	0.9	2.5
Germany	0.1	0.4
Spain	0.3	0.5
Other	0.1	0.8
	1.4	4.2
Funded assets - Corporate		
Structured finance	0.4	1.7
Shipping	0.5	1.8
Other	1.0	2.3
	1.9	5.8

Funded assets - Markets		
Securitised products	1.0	1.8
Emerging markets	—	0.5
	1.0	2.3

Notes:

(1) Includes disposal groups.

(2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(3) RWA equivalent (RWAe) is an internal metric that measures the equity capital employed in segments. RWAe converts both performing and non-performing exposures into a consistent capital measure, being the sum of the regulatory RWAs and the regulatory capital deductions, the latter converted to RWAe by applying a multiplier. RBS applies a CET1 ratio of 10% for RCR; this results in an end point CRR RWAe conversion multiplier of 10.

(4) Includes investment properties.

Business review

Funded assets

	1 January 2014 £bn	Repayments £bn	Disposals (1) £bn	Impairments £bn	Other £bn	31 December 2015 £bn
Ulster Bank	4.8	(0.2)	(5.6)	1.7	(0.4)	0.3
Real Estate Finance	9.5	(3.1)	(5.1)	0.3	(0.2)	1.4
Corporate	9.8	(3.6)	(4.5)	(0.1)	0.3	1.9
Markets	4.8	(1.5)	(2.4)	—	0.1	1.0
Total	28.9	(8.4)	(17.6)	1.9	(0.2)	4.6

Risk-weighted assets

	1 January 2014 £bn	Repayments £bn	Disposals (1) £bn	Risk parameters (2) £bn	Impairments £bn	Other (3) £bn	31 December 2015 £bn
Ulster Bank	3.3	(0.5)	(1.1)	(1.2)	—	(0.1)	0.4
Real Estate Finance	13.5	(2.9)	(2.8)	(6.5)	—	(0.1)	1.2
Corporate	16.4	(3.1)	(5.7)	(5.4)	(0.4)	0.6	2.4
Markets	13.5	(4.5)	(3.6)	(0.7)	(0.2)	—	4.5
Total	46.7	(11.0)	(13.2)	(13.8)	(0.6)	0.4	8.5

Capital deductions

	1 January 2014 £m	Repayments £m	Disposals (1) £m	Risk parameters (2) £m	Impairments £m	Other (3) £m	31 December 2015 £m
Ulster Bank	559	(31)	(525)	(147)	182	(32)	6
Real Estate Finance	505	(458)	(904)	783	173	(29)	70
Corporate	477	(268)	(188)	137	(156)	8	10
Markets	291	(37)	(86)	(147)	2	(6)	17
Total	1,832	(794)	(1,703)	626	201	(59)	103

RWA equivalent (4)

	1 January 2014 £bn	Repayment £bn	Disposals (1) £bn	Risk parameters (2) £bn	Impairments £bn	Other (3) £bn	31 December 2015 £bn
Ulster Bank	8.9	(0.8)	(6.3)	(2.7)	1.8	(0.4)	0.5
Real Estate Finance	18.6	(7.4)	(11.9)	1.3	1.7	(0.4)	1.9
Corporate	21.1	(5.8)	(7.6)	(4.0)	(1.9)	0.7	2.5
Markets	16.4	(4.8)	(4.5)	(2.2)	(0.2)	(0.1)	4.6
Total	65.0	(18.8)	(30.3)	(7.6)	1.4	(0.2)	9.5

Notes:

(1) Includes all effects relating to disposals, including associated removal of deductions from regulatory capital.

(2) Principally reflects credit migration and other technical adjustments.

(3) Includes fair value adjustments and foreign exchange movements.

(4) RWA equivalent (RWAe) is an internal metric that measures the equity capital employed in segments. RWAe converts both performing and non-performing exposures into a consistent capital measure, being the sum of the regulatory RWAs and the regulatory capital deductions, the latter converted to RWAe by applying a multiplier. RBS applies a CET1 ratio of 10% for RCR; this results in an end-point CRR RWAe conversion multiplier of 10.

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Business review

Gross loans and advances, REIL and impairments

				Credit metrics				
	Gross loans	REIL	Provisions	REIL as a % of gross loans	Provisions as a % of REIL	Provisions as a % of gross loans	Impairment (releases)/ losses (2)	Amounts written-off
2015 (1)	£bn	£bn	£bn	%	%	%	£m	£m
By sector								
Commercial real estate								
- investment	1.8	1.2	0.6	67	50	33	(564)	2,004
- development	0.8	0.8	0.7	100	88	88	(327)	3,933
Asset finance	0.6	0.3	0.1	50	33	17	68	316
Other corporate	2.2	0.8	0.7	36	88	32	84	1,358
	5.4	3.1	2.1	57	68	39	(739)	7,611
Of which								
UK	3.8	1.9	1.0	50	53	26	(106)	2,980
Europe	1.4	1.1	1.0	79	91	71	(682)	4,510
US	0.1	—	—	—	—	—	67	1
RoW	0.1	0.1	0.1	100	100	100	(18)	120
Customers	5.4	3.1	2.1	57	68	39	(739)	7,611
Banks	0.3	—	—	—	—	—	(3)	33
Total	5.7	3.1	2.1	55	67	37	(742)	7,644

2014 (1)								
By sector								
Commercial real estate								
- investment	6.2	4.9	2.8	79	57	45	(553)	1,911
- development	6.4	6.2	5.3	97	85	83	(611)	560
Asset finance	2.3	0.9	0.4	39	44	17	37	80
Other corporate	7.0	3.4	2.4	49	71	34	(169)	1,032
	21.9	15.4	10.9	70	71	50	(1,296)	3,583
Of which								
UK	10.0	6.2	4.1	62	66	41	(402)	2,266
Europe	10.9	8.9	6.6	82	74	61	(875)	1,267
US	0.3	0.1	—	33	—	—	(19)	26

RoW	0.7	0.2	0.2	29	100	29	—	24
Customers	21.9	15.4	10.9	70	71	50	(1,296)	3,583
Banks	0.5	—	—	—	—	—	(10)	8
Total	22.4	15.4	10.9	69	71	49	(1,306)	3,591

Notes:

(1) Includes disposal groups.

(2) Impairment (releases)/losses include those relating to AFS securities; sector analyses above include allocation of latent impairment charges.

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Business review

Williams & Glyn (1)

Income statement	2015 £m	2014 £m	2013 £m
Net interest income	658	664	657
Net fees and commissions	160	170	178
Other non-interest income	15	18	21
Non-interest income	175	188	199
Total income	833	852	856
Direct expenses			
- staff costs	(209)	(196)	(175)
- other costs	(52)	(36)	(34)
Indirect expenses	(98)	(98)	(98)
Restructuring costs			
- direct	(28)	—	—
Operating expenses	(387)	(330)	(307)
Operating profit before impairment losses	446	522	549
Impairment losses	(15)	(55)	(80)
Operating profit	431	467	469
Analysis of income by product			
Retail	472	502	523
Commercial	361	350	333
Total income	833	852	856
Analysis of impairments by sector			
Retail	16	48	46
Commercial	(1)	7	34
Total impairment losses	15	55	80
Loan impairment charge as a % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Retail	0.1%	0.4%	0.4%
Commercial	(0.0%)	0.1%	0.4%
Total	0.1%	0.3%	0.4%
Performance ratios			
Net interest margin	2.87%	2.93%	2.86%
Cost:income ratio	46%	39%	36%

Note:

(1) Does not reflect the cost base, funding, liquidity and capital profile of a standalone bank. Operating expenses include charges based on an attribution of support provided by RBS to Williams & Glyn.

Business review

Capital and balance sheet (1)	2015 £bn	2014 £bn	2013 £bn
Loans and advances to customers (gross)			
- Retail	11.6	11.3	11.4
- Commercial	8.7	8.6	8.7
Total loans and advance to customers (gross)	20.3	19.9	20.1
Loan impairment provisions	(0.3)	(0.4)	(0.4)
Net loans and advances to customers	20.0	19.5	19.7
Total assets	24.1	23.6	23.5
Funded assets	24.1	23.6	23.5
Risk elements in lending	0.5	0.6	0.6
Provision coverage (2)	60%	61%	69%
Customer deposits			
- Retail	11.4	10.3	9.7
- Commercial	12.7	11.7	11.8
Total customer deposits	24.1	22.0	21.5
Loan:deposit ratio (excluding repos)	83%	88%	92%
Risk-weighted assets (3)			
- credit risk (non-counterparty)	8.5	8.6	10.3
- operational risk	1.4	1.5	1.4
Total risk-weighted assets	9.9	10.1	11.7

Notes:

(1) Does not reflect the cost base, funding, liquidity and capital profile of a standalone bank.

(2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

(3) RWAs in 2013 are on a Basel 2.5 basis.

Key points

As part of its commitments to the European Commission (EC), RBS has agreed to divest part of its UK retail and commercial banking franchise. This comprises RBS branches in England and Wales and NatWest branches in Scotland, RBS Business Banking Direct and NatWest Direct Business Banking and certain mid-corporate customers across the UK. Together, this business is referred to as ‘Williams & Glyn’ (W&G).

W&G has c.1.6 million retail banking customers with an estimated market share of 2% in Personal Current Accounts (PCA) in the UK. The bank has c.240,000 commercial customers served, through either the retail bank or a national network of relationship managers.

W&G is in the process of being established as a fully licensed, independent, full-service retail and commercial bank, with its own operating infrastructure and platform. RBS continues to work towards the separation of W&G and to meeting its EC commitments to fully divest the business by the end of 2017.

Basis of presentation

This view of W&G, as it stands as a reportable segment within the RBS Group, reflects the contribution made by W&G's ongoing business to RBS, as distinct to the financial effects of any disposal transaction itself. These figures do not reflect the cost base, funding, liquidity and capital profile of W&G as a standalone bank and does not include certain customer portfolios which are currently reported through other reportable segments within RBS.

2015 compared with 2014

Operating profit was £431 million, compared with a profit of £467 million in 2014. The reduction was principally driven by lower non-interest income and restructuring costs attributed to Commercial Banking, partly offset by a lower net impairment charge. Operating profit excluding restructuring costs of £28 million (2014 - nil) was down £8 million from £467 million to £459 million.

Total income was £833 million, compared with £852 million in 2014. Net interest income reduced £6 million to £658 million due to mortgage margin pressure from the impact of market competition on new business pricing. Net interest margin declined 6 basis points to 2.87%, due to the aforementioned margin pressure on new mortgage volumes and a reduction in the number of customers on the standard variable rate. Non-interest income fell by 7%, primarily due to lower fee income from credit and debit cards as well as lower overdraft usage and tariffs.

Business review

Operating expenses totalled £387 million, an increase of £57 million as the business continued to stand up the central functions and operations areas resulting in an increase in staff costs of 7% or £13 million, this further included a restructuring charge of £28 million in Commercial Banking.

Net impairment losses were £15 million, lower than the £55 million loss incurred in 2014 due to portfolio provision releases and reduced levels of defaults in portfolios reflecting a benign UK economy.

Loans and advances grew by £0.4 billion, or 2%, to £20.3 billion. Excluding the transfer of £0.3 billion of Commercial lending back to CPB, lending grew £0.7 billion, or 4%, driven by good growth in both mortgage lending and commercial loans. Customer deposits rose £2.1 billion, or 10%, to £24.1 billion with growth in both transactional accounts and savings accounts.

RWAs fell £0.2 billion to £9.9 billion due to the better credit quality of the overall portfolio.

2014 compared with 2013

Operating profit was £467 million, compared with a profit of £469 million in 2013. The reduction is primarily attributable to an increase in staff costs and lower non-interest income partially off-set by an increase in net interest income and a reduction in net impairment charges.

Total income was £852 million, compared with £856 million in 2013. Net interest income increased £7 million to £664 million primarily due to improved margins on new lending volumes and product mix within Commercial Banking. Net interest margin was 2.93%, 7 basis points higher than 2013. Non-interest income fell by 6% due to lower credit card and interchange fees within the Retail division.

Operating expenses totalled £330 million, an increase of £23 million, or 7% primarily due to a 12%, or £21 million, increase in staff costs as a result of headcount growth as the business stands up functions and operations ahead of divestment.

Net impairment losses were £55 million, a reduction of £25 million compared with the prior year as a result of increased recoveries and reduced levels of default.

Loans and advances decreased £0.2 billion from £20.1 billion to £19.9 billion. Customer deposits increased £0.5 billion to £22 billion.

RWAs fell £1.6 billion to £10.1 billion due to a regulatory change in the calculation of RWAs related to Commercial lending and a reduction in Retail mortgages RWAs linked to improved loss given default rates.

Central items and other

	2015	2014	2013
	£m	£m	£m
Central items not allocated	(903)	(931)	300

Funding and operating costs have been allocated to operating segments based on direct service usage, the requirement for market funding and other appropriate drivers where services span more than one segment.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a segment.

2015 compared with 2014

Central items not allocated represented a charge of £903 million compared with a charge of £931 million in 2014. This includes restructuring costs relating to Williams & Glyn of £630 million, a write-off of intangible assets of £59 million, a loss of £263 million on the repurchase of certain US dollar, Sterling and Euro senior debt securities and a loss of £67 million on the disposal of available-for-sale securities. These were partially offset by Treasury funding costs, including volatile items under IFRS, a gain of £169 million. Also included are £56 million of income, £109 million of direct operating expenses and £122 million of indirect operating expenses in relation to the international private banking business.

2014 compared with 2013

Central items not allocated represented a charge of £931 million compared with a gain of £300 million in 2013. The charge includes lower gains on the disposal of available-for-sale securities in Treasury, which were down £575 million to £149 million in 2014, along with a £309 million higher restructuring charge relating to the Williams & Glyn segment. 2014 includes a £247 million write-down of previously capitalised software development. In addition, unallocated Treasury funding costs, including volatile items under IFRS, were £437 million in the year versus £282 million in 2013.

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Business review

Non-Core

2013 was the final reporting period for the Non-Core division. Approximately £12 billion of assets which were managed by Non-Core were returned to the relevant originating segments, with the remaining assets transferring to RCR within Capital Resolution from 1 January 2014.

Income statement	2013 £m
Net interest income	(134)
Funding cost of rental assets	(35)
Net interest income	(169)
Net fees and commissions	53
Loss from trading activities	(150)
Other operating income	
- other (1)	(159)
Strategic disposal	6
Non-interest income	(250)
Total income	(419)
Direct expenses	
- staff costs	(188)
- other costs	(182)
Indirect expenses	(213)
Restructuring cost	
- direct	(16)
- indirect	(6)
Operating expenses	(605)
Loss before impairment losses	(1,024)
Impairment losses	(4,420)
Operating loss	(5,444)

Capital and balance sheet	£bn
Loans and advances to customers (gross) (2)	34.4
Loan impairment provisions	(13.6)
Net loans and advances to customers	20.8
Risk elements in lending (2)	18.7
Provision coverage (3)	73%
Risk-weighted assets	
- credit risk	

- non-counterparty	17.8
- counterparty	4.7
- market risk	3.3
- operational risk	1.4
Total risk-weighted assets	27.2

Notes:

(1) Includes losses on disposals of £221 million for 2013.

(2) Excludes disposal groups.

(3) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

Consolidated balance sheet as at 31 December 2015

	2015 £m	2014* £m
Assets		
Cash and balances at central banks	79,404	74,872
Net loans and advances to banks	18,361	23,027
Reverse repurchase agreements and stock borrowing	12,285	20,708
Loans and advances to banks	30,646	43,735
Net loans and advances to customers	306,334	334,251
Reverse repurchase agreements and stock borrowing	27,558	43,987
Loans and advances to customers	333,892	378,238
Debt securities subject to repurchase agreements	20,224	23,048
Other debt securities	61,873	63,601
Debt securities	82,097	86,649
Equity shares	1,361	5,635
Settlement balances	4,116	4,667
Derivatives	262,514	353,590
Intangible assets	6,537	7,781
Property, plant and equipment	4,482	6,167
Deferred tax	2,631	1,911
Prepayments, accrued income and other assets	4,242	5,763
Assets of disposal groups	3,486	82,011
Total assets	815,408	1,051,019
Liabilities		
Bank deposits	28,030	35,806
Repurchase agreements and stock lending	10,266	24,859
Deposits by banks	38,296	60,665
Customers deposits	343,186	354,288
Repurchase agreements and stock lending	27,112	37,351
Customer accounts	370,298	391,639
Debt securities in issue	31,150	50,280
Settlement balances	3,390	4,503
Short positions	20,809	23,029
Derivatives	254,705	349,805
Provisions, accruals and other liabilities	15,115	13,346
Retirement benefit liabilities	3,789	4,318
Deferred tax	882	500
Subordinated liabilities	19,847	22,905
Liabilities of disposal groups	2,980	71,320
Total liabilities	761,261	992,310
Non-controlling interests	716	2,946
Owners’ equity	53,431	55,763
Total equity	54,147	58,709

Total liabilities and equity	815,408	1,051,019

*Restated – refer to page 270 for further details.

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Business review

Commentary on consolidated balance sheet

2015 compared with 2014

Total assets of £815.4 billion as at 31 December 2015 were down £235.6 billion, 22%, compared with 31 December 2014. This was primarily driven by the disposal of Citizens, and decreases in loans and advances to customers and derivative assets, reflecting the reshaping of CIB and Capital Resolution run-down.

Loans and advances to banks decreased by £13.1 billion, 30%, to £30.6 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £8.4 billion, 41%, to £12.3 billion, bank placings declined £4.7 billion, 20%, to £18.3 billion, mainly reflecting Capital Resolution run-down.

Loans and advances to customers declined £44.3 billion, 12%, to £333.9 billion. Within this, reverse repos were down £16.4 billion, 37%, to £27.6 billion. Customer lending decreased by £27.9 billion, 8%, to £306.3 billion, or £38.3 billion to £313.5 billion before impairments. This reflected reductions in CIB together with run-down and disposals in Capital Resolution, partially offset by increases in UK PBB reflecting growth in mortgages and in Commercial Banking which recorded strong new business volumes.

Debt securities were down £4.6 billion, 5%, to £82.1 billion, driven mainly by reductions within CIB, partially offset by increases in Treasury in the liquidity portfolio.

Equity shares decreased by £4.3 billion, 76%, to £1.4 billion primarily due to the continuing risk reduction and run-down in Capital Resolution.

Movements in the value of derivative assets, down £91.1 billion, 26%, to £262.5 billion, and liabilities, down £95.1 billion, 27% to £254.7 billion, were driven by a reduction in interest rate swap notionals as well as yield curve moves.

Property, plant and equipment decreased by £1.7 billion, 27%, to £4.5 billion mainly reflecting disposals and write downs.

Intangible assets decreased by £1.2 billion, 16%, to £6.5 billion due to the write down of £0.5 billion goodwill in Private Banking and the write down of other intangible assets of £0.8 billion, mainly in relation to the reorganisation of CIB.

The decrease in assets and liabilities of disposal groups, down £78.5 billion to £3.5 billion, and £68.3 billion to £3.0 billion respectively, primarily reflects the disposal of Citizens partially offset by the transfer of the international private banking business to disposal groups.

Deposits by banks decreased by £22.4 billion, 37%, to £38.3 billion, with decreases in inter-bank deposits, down £7.8 billion, 22%, to £28.0 billion and decreases in repurchase agreements and stock lending ('repos'), down £14.6 billion, 59%, to £10.3 billion, reflecting the reshaping of CIB and Capital Resolution run-down.

Customer accounts decreased £21.3 billion, 5%, to £370.3 billion. Within this, repos decreased £10.2 billion, 27%, to £27.1 billion. Excluding repos, customer deposits were down £11.1 billion, 3%, to £343.2 billion, primarily reflecting the reduction of corporate deposits in CIB and run-down in Capital Resolution offset by growth in UK PBB and in Commercial Banking.

Debt securities in issue decreased £19.1 billion, 38%, to £31.2 billion reflecting a decrease in CIB and Treasury given the lower funding requirements of a reduced balance sheet.

Subordinated liabilities decreased by £3.1 billion, 13% to £19.8 billion, primarily as a result of the net decrease in dated loan capital with redemptions of £3.0 billion.

Non-controlling interests decreased by £2.2 billion to £0.7 billion reflecting the disposal of Citizens.

Owners' equity decreased by £2.3 billion, 4%, to £53.4 billion, primarily driven by the £2.0 billion attributable loss for the year.

Business review

Cash flow

	2015	2014	2013
	£m	£m	£m
Net cash flows from operating activities	918	(20,387)	(30,631)
Net cash flows from investing activities	(4,866)	6,609	21,183
Net cash flows from financing activities	(940)	(404)	(2,728)
Effects of exchange rate changes on cash and cash equivalents	576	909	512
Net decrease in cash and cash equivalents	(4,312)	(13,273)	(11,664)

2015

The major factors contributing to the net cash inflow from operating activities of £918 million were the increase of £8,589 million in operating assets and liabilities, other provisions charged net of releases of £4,566 million, write down of goodwill and other intangible assets £1,332 million and depreciation and amortisation of £1,180 million. These were partially offset by loans and advances written-off net of recoveries of £8,789 million, other provisions utilised of £2,202 million, elimination of foreign exchange differences of £1,501 million, profit on sale of subsidiaries and associates of £1,135 million, cash contribution to defined benefit pension schemes of £1,060 million, decrease in income accruals of £1,075 million and the operating loss before tax of £937 million.

Net cash outflows from investing activities of £4,866 million related to the net outflows from purchase of securities of £5,906 million and the purchase of property, plant and equipment of £783 million, offset by inflows of £391 million from disposals, primarily Citizens and net cash inflows from the sale of property, plant and equipment of £1,432 million.

Net cash outflows from financing activities of £940 million relate primarily to the repayment of subordinated liabilities of £3,047 million, redemption of preference shares of £1,214 million and interest paid on subordinated liabilities of £975 million partly offset by the proceeds of non-controlling interests issued of £2,537 million and the issue of Additional Tier 1 capital notes of £2,012 million.

2014

The major factors contributing to the net cash outflow from operating activities of £20,387 million were the decrease of £18,260 million in operating assets and liabilities, loans and advances written-off net of recoveries of £5,073 million, other provisions utilised of £3,528 million and the loss before tax of £564 million from continuing and discontinued operations. These were partially offset by the loss on reclassification to disposal groups of £3,994 million and other provisions charged net of releases of £2,711 million.

Net cash inflows from investing activities of £6,609 million related to the net inflows from sales and maturity of securities of £7,744 million and the sale of property, plant and equipment of £1,162 million, offset by net investments in business interests and intangible assets of £1,481 million and net cash outflows from the purchase of property, plant and equipment of £816 million.

Net cash outflows from financing activities of £404 million relate primarily to the repayment of subordinated liabilities of £3,480 million and interest paid on subordinated liabilities of £854 million partly offset by the issue of subordinated liabilities of £2,159 million and proceeds of non-controlling interests issued of £2,147 million.

2013

The major factors contributing to the net cash outflow from operating activities of £30,631 million were the decrease of £28,745 million in operating assets and liabilities, the net loss before tax of £8,066 million from continuing and discontinued operations, loans and advances written-off net of recoveries of £4,090 million and other provisions utilised of £2,066 million. These were partially offset by provisions for impairment losses of £8,432 million and other provisions charged net of releases of £4,422 million.

Net cash inflows from investing activities of £21,183 million related to the net inflows from sales of securities of £19,211 million, the sale of property, plant and equipment of £1,448 million and net divestments of business interests and intangible assets of £1,150 million offset by net cash outflows from the purchase of property, plant and equipment of £626 million.

Net cash outflows from financing activities of £2,728 million relate primarily to the repayment of subordinated liabilities of £3,500 million and interest paid on subordinated liabilities of £958 million partly offset by the issue of subordinated liabilities of £1,796 million.

Business review

Analysis of balance sheet pre and post disposal groups

In accordance with IFRS 5, assets and liabilities of disposal groups are presented as a single line on the face of the balance sheet. As allowed by IFRS, disposal groups are included within risk measures in the Capital and risk management section.

	2015			2014*		
	Balance sheet £m	Disposal groups (1) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (2) £m	Gross of disposal groups £m
Assets						
Cash and balances at central banks	79,404	535	79,939	74,872	622	75,494
Net loans and advances to banks	18,361	642	19,003	23,027	1,745	24,772
Reverse repurchase agreements and stock borrowing	12,285	67	12,352	20,708	—	20,708
Loans and advances to banks	30,646	709	31,355	43,735	1,745	45,480
Net loans and advances to customers	306,334	1,639	307,973	334,251	60,550	394,801
Reverse repurchase agreement and stock borrowing	27,558	—	27,558	43,987	—	43,987
Loans and advances to customers	333,892	1,639	335,531	378,238	60,550	438,788
Debt securities	82,097	419	82,516	86,649	15,293	101,942
Equity shares	1,361	24	1,385	5,635	572	6,207
Settlement balances	4,116	—	4,116	4,667	—	4,667
Derivatives	262,514	30	262,544	353,590	402	353,992
Intangible assets	6,537	—	6,537	7,781	583	8,364
Property, plant and equipment	4,482	19	4,501	6,167	549	6,716
Deferred tax	2,631	—	2,631	1,911	—	1,911
Prepayments, accrued income and other assets	4,242	111	4,353	5,763	1,695	7,458
Assets of disposal groups	3,486	(3,486)	—	82,011	(82,011)	—
Total assets	815,408	—	815,408	1,051,019	—	1,051,019
Liabilities						
Bank deposits	28,030	32	28,062	35,806	5,128	40,934
Repurchase agreements and stock lending	10,266	—	10,266	24,859	1,666	26,525
Deposits by banks	38,296	32	38,328	60,665	6,794	67,459
Customer deposits	343,186	2,805	345,991	354,288	60,583	414,871
Repurchase agreements and stock lending	27,112	—	27,112	37,351	706	38,057
Customer accounts	370,298	2,805	373,103	391,639	61,289	452,928
Debt securities in issue	31,150	—	31,150	50,280	1,625	51,905
Settlement balances	3,390	7	3,397	4,503	—	4,503
Short positions	20,809	—	20,809	23,029	—	23,029
Derivatives	254,705	28	254,733	349,805	144	349,949
Provisions, accruals and other liabilities	15,115	97	15,212	13,346	683	14,029

Retirement benefit liabilities	3,789	3	3,792	4,318	197	4,515
Deferred tax	882	8	890	500	362	862
Subordinated liabilities	19,847	—	19,847	22,905	226	23,131
Liabilities of disposal groups	2,980	(2,980)	—	71,320	(71,320)	—
Total liabilities	761,261	—	761,261	992,310	—	992,310

*Restated – refer to page 270 for further details.

For the notes to this table refer to the following page.

Business review

	2015			2014		
	Balance sheet £m	Disposal groups (1) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (2) £m	Gross of disposal groups £m
Selected financial data						
Gross loans and advances to customers	313,452	1,659	315,111	351,711	61,090	412,801
Customer loan impairment provisions	(7,118)	(20)	(7,138)	(17,460)	(540)	(18,000)
Net loans and advances to customers (3)	306,334	1,639	307,973	334,251	60,550	394,801
Gross loans and advances to banks	18,362	642	19,004	23,067	1,745	24,812
Bank loan impairment provisions	(1)	—	(1)	(40)	—	(40)
Net loans and advances to banks (3)	18,361	642	19,003	23,027	1,745	24,772
Total loan impairment provisions	7,119	20	7,139	17,500	540	18,040
Customer REIL	12,136	20	12,156	26,842	1,335	28,177
Bank REIL	1	—	1	42	—	42
REIL	12,137	20	12,157	26,884	1,335	28,219
Gross unrealised gains on debt securities	876	4	880	1,316	261	1,577
Gross unrealised losses on debt securities	(140)	—	(140)	(145)	(137)	(282)

Notes:

(1) Primarily international private banking.

(2) Primarily Citizens.

(3) Excludes reverse repos.

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Business 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 142 to 260) is within the scope of the Independent Registered Public Accountants report. Unless otherwise indicated, disclosures in this section include disposal groups businesses in relevant exposures. Refer to pages 140 and 141 for the Analyses of the balance sheet pre and post-disposal groups.

Following the deconsolidation of Citizens during 2015, to aid comparison, the 2014 Citizens balances have been presented as a separate line in the disclosures in the Capital and risk management section, with the exception of capital management and most liquidity and funding disclosures which remain in line with the relevant regulatory reporting basis. The 2014 comparatives in the Credit risk section exclude Citizens unless otherwise stated.

Business model and associated risks

RBS aims to become a bank that its customers and all other stakeholders can trust. It is doing so by focusing on Personal & Business Banking (PBB), Commercial & Private Banking (CPB) and Corporate & Institutional Banking (CIB) customers in its main markets of the UK and the Republic of Ireland. By delivering only services that meet their needs, it aims to achieve an appropriate return. Accordingly, RBS is simplifying its services as well as the processes it uses to deliver them, providing customers with better value services. It aims to become the number one bank in the UK for customer service, trust and advocacy by 2020.

RBS predominantly serves UK and Republic of Ireland customers through retail and commercial banking activities. PBB serves individual and mass affluent customers together with small businesses, providing a variety of traditional retail banking products, including current and savings accounts, residential mortgages and credit cards in the UK through UK PBB and in the Republic of Ireland through Ulster Bank RoI. CPB serves commercial and corporate customers in the UK and Western Europe and high-net-worth individuals, providing loan products and investment services. RBS International serves customers in Jersey, Guernsey, Isle of Man and Gibraltar. CIB serves UK and Western European corporates and global financial institutions through three core business lines: Rates, Currencies and Financing. CIB is moving towards a simpler business model and is re-shaping and downsizing.

The main sources of earnings are interest income from lending and fee income from transactional and other services. Given increased competition and the low interest rate environment in the UK, RBS's net interest margin has been under pressure. RBS is reducing costs through rationalisation, integration and simplification. A major programme is in train to transform and enhance the ways in which RBS operates.

RBS has made significant progress on the accelerated disposal of selected assets, with the complete divestment of Citizens, the sale of the majority of international private banking businesses, the run-down or sale of RCR assets one year ahead of schedule and a significant proportion of CIB Capital Resolution. Completion of this process will significantly reduce or otherwise improve the profile of credit and market risk faced by the bank. RBS is also committed to full divestment of Williams & Glyn, which provides retail and commercial banking services in the UK, by the end of 2017.

RBS's business model faces regulatory risk and is responding to new and impending regulation. In particular, RBS’s business model is adapting to UK Financial Services (Banking Reform) Act requirements that retail banking operations be ‘ring fenced’ - separate and protected from more volatile undertakings - by 2019.

These divestment, rationalisation and transformation projects expose RBS to a high degree of execution risk over the next few years as it transitions to its target business model. If not effectively managed, this represents a potential management burden and distraction, and associated business upheaval may affect RBS’s ability to attract the talent and skills required.

An improved ability to serve customers and other stakeholders through increased focus on key strengths in Western European markets is intended to deliver financial robustness and stronger risk management. However, it does raise geographic and product concentration risks within RBS’s target business model. These risks must be managed effectively in increasingly competitive and fast changing target markets, while navigating industry-wide risks such as those related to increasing cyber crime.

RBS continues to resolve issues related to historical misconduct and unsustainable strategic decision-making. To prevent recurrence of similar issues in the future, RBS aims to underpin its business model with a strong risk culture across its businesses, one that promotes appropriate risk awareness and judgements about risk-taking.

*unaudited

Business review Capital and risk management
Risk overview* continued

RBS is also exposed to a range of other risks including pension, business, conduct, reputational and strategic risks. These, and the business model related risks outlined above, are considered in the relevant sections below, and illustrated by the concentration of risk-weighted assets by segment below.

RWAs by segment

Risk governance

Governance structure

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

*unaudited

Business review Capital and risk management
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 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 Risk Management and Conduct & Regulatory Affairs, (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'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 is managing its material risks effectively.
- Monitoring, evaluating and reporting on the remediation of material risks across RBS.
- 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 Group Audit Committee and executive management with respect to RBS's material risks and their associated controls.
- Reporting any matters which warrant escalation to the RBS Board, the Board Risk Committee, Group Audit Committee and the Executive Committee as appropriate.
- Providing independent assurance to the FCA, PRA, CBI and other key jurisdictional regulators on both specific risks and control themes.

*unaudited

Business review Capital and risk management
Risk overview* continued

Risk management structure

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

Notes:

(1) RBS Risk Management

The RBS Chief Risk Officer (CRO) leads RBS Risk Management. The CRO reports directly to the Chief Executive and has an indirect reporting line to the Chairman of the Board Risk Committee and a right of access to the committee's chairman.

RBS 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 business segments, 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-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 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, 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'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-wide risk appetite and standards of their respective areas.

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Business review Capital and risk management
Risk overview* continued

Risk assurance

Risk assurance is a second line of defence function in which most of RBS'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 the bank's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

The 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. Since the team's creation in late 2014, testing has primarily covered key controls within CIB and CPB.

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.

MRM is responsible for setting policy, providing governance and insight for all of RBS's statistical, economic, financial or mathematical models and performing independent model validation where necessary. It works with individual businesses to set appropriate model standards, and monitor adherence to these, to ensure that models are developed and implemented appropriately and that their operational environment is fit for purpose.

Going forward, 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 251. For more specific information relating to credit risk models.

Models used within Risk

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

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.

A new model is typically introduced when an existing model is deemed no longer fit for purpose or when exposure to a new product requires a new approach to ensure that risks are appropriately quantified. Amendments are usually made when a weakness is identified during use of a model or following analysis either by the model developers or by MRM.

MRM's independent review comprises some or all of the following steps, as appropriate:

- Testing and challenging the logical and conceptual soundness of the methodology;

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Testing the assumptions underlying the model, where feasible, against actual behaviour. In its validation report, MRM will opine on the reasonableness and stability of the assumptions and specify which assumptions, if any, should be routinely monitored in production;

- Testing whether all key appropriate risks have been sufficiently captured;
- Checking the accuracy of calculations;
- Comparing outputs with results from alternative methods;
- Testing parameter selection and calibration;
- Ensuring model outputs are sufficiently conservative in areas where there is significant model uncertainty;
- Confirming the applicability of tests for accuracy and stability; recalculating and ensuring that results are robust; and
- Ensuring appropriate sensitivity analysis has been performed and documented.

Based on the review and findings from MRM, the bank's 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.

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Business review Capital and risk management
Risk overview* continued

MRM reassesses the appropriateness of approved risk models on a periodic basis according to the approved Periodic Review Policy. Each periodic review begins with an initial assessment. A decision is then made by an internal model governance committee with appropriate delegated authority. Based on the initial assessment, the committee will decide to re-ratify a model based on the initial assessment or to carry out additional work prior to making a decision. In the initial assessment, MRM assesses changes since the last approval along the following dimensions, as appropriate: change in size/composition of the portfolio, market changes, model performance, model changes, status of any outstanding issues, scheduled activities including work carried over from previous reviews.

MRM also monitors the performance of RBS's portfolio of models. By engaging with the business and model users, MRM assesses whether models still capture underlying business rationale appropriately.

Risk culture and appetite

Risk culture

A strong risk culture, as part of a healthy organisational culture, is essential to the realisation of RBS's ambition to build a truly customer-centric bank.

It 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's risk culture should be embedded across the organisation and made integral to performance reviews.

In 2015 RBS made significant steps in measuring and benchmarking its risk culture across all areas of the bank. This has resulted in agreement on its target risk culture and initiatives needed to achieve it. While changing organisational culture will take time, RBS's risk culture objectives form a key part of individual performance objectives at all levels of the bank.

RBS'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.

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 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'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's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. The Group Performance and Remuneration Committee also consider risk performance and conduct when determining overall bonus pools. The Committee's decisions on pay aim to reinforce the need for good behaviours by all employees.

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

Risk-based key performance indicators

RBS-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 71.

Training

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

RBS offers a wide range of risk learning 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.

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Business review Capital and risk management
Risk overview* continued

Risk appetite

Risk appetite is the way in which RBS 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.

The Board reviews and approves the risk appetite framework annually, establishing the level and types of risks RBS is able and willing to take in order to meet its:

- Strategic objectives - The strategic plan is built on the core foundations of serving customers well, building a sustainable risk profile and creating long-term value for its shareholders; and
- Wider obligations to stakeholders - If RBS is safe and sound and puts serving customers at the heart of its thinking, it will also perform well for its owners, employees, regulators and communities.

Risk appetite is set for material risks and is cascaded and embedded across RBS. It clearly informs, guides and empowers the businesses to execute their strategies within risk appetite.

Strategic risk appetite

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

The 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:

- Maintain capital adequacy. To ensure there is sufficient capital resources to meet regulatory requirements and to cover the potential for unexpected losses.
- Deliver stable earnings growth. To ensure that strategic growth is based around a longer-term risk-versus reward consideration, RBS sets risk appetite to remain profitable under severe stress.
- Designed to ensure stable and efficient access to funding and liquidity. To ensure that there is sufficient funding to meet its obligations, taking account of the constraint that some forms of funding may not be available when they are

most needed.

- Maintain stakeholder confidence. To ensure that RBS is respected, valued and trusted by stakeholders (customers, employees, debt and equity investors, regulators and the wider community) to attain its strategic objectives, and establish and maintain an appropriate business culture and operational controls.

The strategic risk objectives are the bridge between the RBS-wide business strategy and the frameworks, limits and tolerances that are used to set risk appetite and manage risk in the business franchises on a day-to-day basis.

Risk appetite measures

Risk appetite starts with the strategic goals set by the Board and is cascaded through key limits and risk tolerances that influence decision-making at all levels.

Risk appetite 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 to the business. Where possible risk appetite is expressed quantitatively and in a manner that can be cascaded meaningfully and unambiguously to the business. 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'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, in a manner that is easily communicated.

Risk appetite is set at RBS-wide level then cascaded and embedded across all businesses and support functions.

Each franchise, RBS-wide material risk owner, function and material legal entity is required to develop, own and manage a risk appetite statement that:

- Evidences alignment with strategic objectives and financial plans.
- Articulates the level of acceptable risk for all risks deemed material.
- Articulates the escalation path to be followed in the instance of a breach in risk appetite.

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Business review Capital and risk management
Risk overview* continued

The communication of risk appetite helps embed appropriate risk taking into the bank's culture.

Risk control frameworks and limits

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

The RBS Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in RBS's risk control and governance. Its integrated approach is designed to ensure that appropriate controls, aligned to risk appetite, are set for each of the 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 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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Business review Capital and risk management
Risk overview* continued

Risk coverage

The main risk types faced by RBS are presented below. For further information, refer to pages 154 to 260.

Risk type	How the risk arises	2015 overview (1)
Capital adequacy risk	Capital adequacy risk arises from inefficient management of capital resources.	· Capital strength continued to improve throughout 2015, driven by the successful execution of exit strategy including the disposal of Citizens and continued de-risking of the balance sheet, primarily in Capital Resolution. RBS's CET1 ratio improved from 11.2% to 15.5% at 31 December 2015 despite absorbing the 0.7% impact of the pension accounting policy change and 0.8% impact from additional US RMBS and PPI provisions of £2 billion during Q4 2015. · Capital structure extended and leverage ratio improved through issuance of £2 billion AT1 capital notes in August 2015. · RWAs have reduced by £113 billion from £356 billion to £243 billion, ahead of our year-end target of £300 billion, driven by the disposal of Citizens (£63 billion) and the continued progress of Capital Resolution down £46 billion. There were further small reductions across most core business. · Leverage ratio improved from 4.2% to 5.6% reflecting the improvements in capital strength, including AT1 issuance, as well as reduction in funded assets by £145 billion from £697 billion to £553 billion. · RBS would have a GSIB capital surcharge requirement of 1.0% of RWAs, based on the FSB's most recent determination of RBS's systemic importance, a reduction from 1.5% previously.

Liquidity and funding risk	Liquidity and funding risk arise through the maturity transformation role that RBS performs and arises from day-to-day operations.	· The liquidity portfolio increased by £5 billion in the year to £156 billion, primarily reflecting the strategic run-down of Capital Resolution loans faster than the associated liabilities and proceeds from the Citizens share sales; this was offset to some extent by UK PBB and Commercial Banking loan growth. · Short-term whoesale funding (STWF) including derivative collateral decreased by £16 billion to £38 billion mainly due to the maturity of term debt issued during the financial crisis. STWF excluding derivative collateral covering short-term wholesale funding (STWF), by more than nine times. · LCR was 136% at 31 December 2015, with the improvement from 112% at year end 2014 primarily reflecting the strategic run-down of Capital Resolution assets at a faster rate than their associated liabilities. The ratio was strengthened by the placing of surplus Capital Resolution liabilities in short-term liquid assets. · NSFR, based on RBS's interpretation of the Basel framework, had increased to 121% at 31 December 2015 from 112% at 31 December 2014. The increase in the metric is also partly due to the reduced need for stable funding as a result of Capital Resolution rundown. · The customer loan:deposit ratio reduced to 89% compared with 95% at the end of 2014. This reflects the strategic run down of Capital Resolution loans and higher retail and commercial deposits, this was partly offset by loan growth within UK PBB and Commercial Banking. · Based on its assessment of the PRA's proposals, RBS may issue between £3-£5 billion per annum during 2016-2019 to meet MREL requirements.
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.	· RBS reduced its business risk profile by implementing its strategic plan to shift the business mix towards the UK and the retail and commercial banking segments, with riskier activities in CIB and Capital Resolution curtailed via disposals and run-down.

- RBS continued with its simplification agenda and cost reduction programme.

Note:

(1) Refer to page 430 for abbreviations and acronyms.

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Business review Capital and risk management
Risk overview* continued

Risk type	How the risk arises	2015 overview
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 importance of reputational risk was reinforced with the implementation of a Reputational Risk Policy across business franchises and functions to improve the identification, assessment and management of customers and issues that present a reputational risk. · The most material threats to RBS's reputation continued to originate from historical and more recent conduct issues. As a result, RBS has been the subject of investigations and reviews by a number of its regulators, some of which have resulted in fines and public censure.
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 RBS does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from RBS's regulatory, business or operating environments and RBS's response to them.	· Conduct and litigation costs were £3.6 billion in 2015 compared with £2.2 billion in 2014 and included additional provisions of £2.1 billion for historical investment banking activity in the US and £0.6 billion for PPI. RBS continued to remediate historical conduct issues, while also focusing its customer-facing businesses and support functions around the needs of its customers. · A new Conduct Risk Appetite Framework was established. · RBS implemented programmes to prepare for ring-fencing and the UK's new individual accountability regime, as well as other future regulatory requirements; there was significant investment in anti-money laundering controls, governance and training.
Operational risk	Operational risk arises from a failure to manage operations, transactions and assets appropriately. It	· The functional operating model for operational risk was embedded, with the aim of

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.

ensuring this is managed consistently across RBS. This supplemented work by the customer businesses to improve understanding of the operational risk profile and the actions required to mitigate risks outside of appetite.

· Following the major IT incident of 2012, there was further significant investment in upgrading RBS's core banking technology infrastructure and in improving a broad range of processes and tools.

· The threat to the security of RBS's information from cyber attacks continued to be closely monitored. During 2015 RBS participated in industry-wide cyber attack simulations in order to help test and develop defence planning. Actions taken to mitigate the risk included a large-scale programme to improve user access controls, a reduction in the number of external websites, and enhanced protection against malware.

· Operational Risk continued to oversee the execution of major projects, including the transformation plan, the restructuring of CIB and the divestment of Williams & Glyn. This ensured the associated risks were assessed and understood with mitigating activity in place wherever possible.

*unaudited

Business review Capital and risk management
Risk overview* continued

Risk type	How the risk arises	2015 overview
Pension risk	RBS is exposed to pension risk through its defined benefit schemes and the variations in their value.	· Following developments in pension accounting and reporting during 2015, RBS revised its policy for determining whether or not it has an unconditional right to a refund of any surpluses in its employee pension funds and also revised prior periods. The incremental impact of this, combined with the accelerated payment expected to be made in 2016, is anticipated to improve RBS's risk profile, capital planning, and resilience through the period to 2019. The accelerated payment is also expected to provide the Main Scheme Trustee with more flexibility over investment strategy. · Subject to PRA approval, the adverse CET1 capital impact resulting from the accounting policy change and the accelerated payment is expected to be partially offset by a reduction in CET1 capital requirements. Any such core capital offsets are likely to occur at the earliest from 1 January 2017, but they will depend on the PRA's assessment of RBS's CET1 capital position at that time.
Credit risk	Credit risk arises from lending and AFS debt securities. Counterparty credit risk results from derivatives and securities financing transaction activities.	· Overall credit risk exposure decreased in 2015 in line with RBS's strategy to decrease exposure in non-strategic regions. The growth in UK PBB gross mortgage lending reflected our strategy to refocus the business on the UK market, as well as improving economic conditions and increasing house prices in a continuing low interest environment. · Risk appetite limits for the sector and product and asset class frameworks were reduced taking account of the revised risk appetite associated with the restructured CIB business. · Asset quality improved due to continued focus on reducing risk concentrations and the reduction in exit portfolios driven by the RCR disposal strategy as well as improving economic and market conditions in the UK and Ireland. · Deteriorating market conditions in the Oil & Gas and Mining & Metals sectors have led to heightened credit monitoring in these sectors. However, there was no material deterioration in asset quality during 2015

		with the majority of the portfolios remaining investment grade.
		· Overall credit metrics strengthened in 2015 principally reflecting Capital Resolution disposals but also the impact of supportive economic conditions:
		° Impairment provisions of £7.1 billion (2014 - £18.0 billion) covered REIL of £12.2 billion (2014 - £28.2 billion) by 59% (2014 - 64%).
		° CRE lending fell to £27.6 billion from £43.3 billion at the end of 2014, of which £3.6 billion (2014 - £13.3 billion) was REIL with provision coverage of 58% (2014 - 68%).
Market risk	The majority of RBS's traded market risk exposure arises in CIB and Capital Resolution 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 retail and commercial banking activities in all franchises from assets and liabilities that are not classified as held for trading.	· Average trading internal VaR decreased to £18.9 million (2014 - £27.8 million), reflecting strategic exits including from US asset-backed products trading in the first half of 2015. · RWAs decreased by £2.8 billion to £21.2 billion, primarily in Capital Resolution. · Non-trading interest rate VaR was significantly lower following the divestment of Citizens.

*unaudited

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Business review Capital and risk management
Capital management*

Definition

Capital management lies at the core of RBS's strength and sustainability goals. RBS 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 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 bank'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.

Overview and key developments

- Capital strength continued to improve during 2015, driven by the successful execution of exit strategy including the disposal of Citizens and continued de-risking of the balance sheet, primarily in Capital Resolution. CET1 ratio improved from 11.2% to 15.5% at end 2015 despite absorbing the 0.7% impact of the pension accounting policy change (0.4% on a pro forma basis at end 2014) and 0.8% impact from additional US RMBS and PPI provisions of £2 billion during Q4 2015.

- Capital structure extended and improved leverage ratio through the over-subscribed issuance of US$3.15 billion (£2 billion) AT1 capital notes in August 2015.

- RWAs have reduced by £113 billion from £356 billion to £243 billion, ahead of year end target of £300 billion, driven by the disposal of Citizens (£63 billion) and the continued progress of Capital Resolution (down £46 billion).There were further small reductions across most core businesses.

- The de-risking throughout 2015 has allowed RBS to free up capital into the core franchises, helping to align to our strategy of becoming a more focused bank better able to serve our customers in our key markets.

- Leverage ratio improved from 4.2% to 5.6% reflecting the improvements in capital strength, including AT 1 issuance as well as reduction in leverage exposure, as funded assets fell by £145 billion to £553 billion. The pension accounting policy change lowered the leverage ratio by approximately 0.2% at 31 December 2015 and on a pro forma basis at end 2014.

- RBS's current Pillar 2A requirement was 5.0% of RWAs at 31 December 2015, with 56% met by CET1 capital (2.8%). The Prudential Regulation Authority (PRA) Pillar 2A assessment is a point in time measure of the amount of capital that is required to be held to meet the overall financial adequacy rules. This assessment may change over time, including as a result of an at least annual supervisory review and evaluation of RBS's internal capital adequacy assessment process.

- Based on PRA's proposals on MREL being twice current minimum Pillar 1 and Pillar 2A requirements, RBS's current MREL rates equivalent would be approximately 13%.

- Based on CRR requirements being phased in by 2019, RBS would have a GSIB surcharge requirement of 1.0% (previously 1.5%) of RWAs, based on the FSB's most recent determination of RBS's systemic importance.

Risk appetite and strategy

Risk appetite

The RBS risk appetite framework establishes appetite targets on quantitative and qualitative measures which are set by the Board, aligned with its key strategic risk objectives.

RBS has a capital management framework including policies and procedures that are designed to measure actual and projected capital performance against risk appetite, ensures that it continues to comply with regulatory requirements and is positioned to meet anticipated future changes to its capital requirements.

RBS's capital risk appetite, which informs its capital targets, is reviewed and set annually by the Board. Capital risk appetite sets target ratios for CET1 and leverage under stress scenarios and reverse stress tests. These then inform capital targets for CET1 and leverage. RBS also looks at other factors that may impact capital targets such as double leverage, distributable reserves, capital headroom to Maximum Distributable Amount (MDA) and intra group limits and exposures. Risk appetites are also set at legal entity level and may encompass additional specific risk measures such as intra group exposures and limits and double leverage.

Strategy

RBS maintains a sufficient level of capital that allows it to operate over its strategic horizon with an agreed risk appetite in pursuit of its business strategy, taking into account regulatory requirements, support for customers and to provide confidence to stakeholders.

RBS is able to accumulate additional capital through the reduction in RWAs (either through disposals or natural attrition) accumulation of profits over time, by raising new equity via, for example, a rights issue or debt exchange and by raising AT1 and Tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. RBS is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals.

The level of CET1 at the consolidated level and within specific legal entities is the cornerstone of capital strategy. Complementing CET1, RBS issues externally and will allocate internally AT1 capital, Tier 2 capital and looking forward, MREL instruments in accordance with internal needs, regulatory requirements and strategic plans. The amount of additional capital is determined as part of the annual budgeting cycle, by market conditions and through ongoing dialogue with regulators. It is under constant review and evaluation to ensure that it provides efficient and optimally valued benefits to the bank at all times.

The capital raising strategy is driven by two factors: the optimal blend to satisfy regulatory requirements, and the most cost effective means of financing. RBS has a range of instruments available to it both internally and externally. RBS also has legacy capital instruments that may still have some transitional benefits under the changing regulatory framework. RBS constantly looks at the value and efficiency provided by those instruments and will take such market related actions to the extent that circumstances and conditions merit such action. RBS's policy is to manage its externally issued portfolio of debt securities for value.

*unaudited

Business review Capital and risk management
Capital management* continued

Framework and governance

The framework for capital management within RBS first looks at the sources and drivers of risk based capital requirements. Through the internal budget and planning cycle, and increasingly through stress testing, each franchise balances the blend of products that is offered to customers, having regard to the impact of each on capital and leverage against the backdrop of the overall business strategy

A number of tools and processes taken together contribute to an integrated view of capital management. The diagram below is used to present this view:

Governance

The Board sets the strategic direction and ensures RBS manages risk effectively by approving and monitoring RBS's strategic risk appetite, considering RBS-wide stress scenarios and agreed mitigants, as well as identifying longer-term strategic threats to the business operations. The Board also approves the ICAAP.

Capital planning	Stress Testing (and use of)	Recovery and resolution planning
RBS uses the budgeting cycle to forecast future capital requirements at CET1, Tier 1, Tier 2 and total capital levels including MREL at both RBS level and major operating entity level. Forecasts are measured against minimum regulatory requirements and specific regulatory guidance such as the Individual Capital Guidance. Strategic considerations in the medium-term capital plan will be driven by key impacts such as a more restrictive approach to the capital base, higher capital ratio targets and enhanced risk coverage.	This is an integral part of capital planning. Stress testing results are produced through the same capital planning and stress testing models used for the budgeting and monthly review. In addition to informing the ICAAP, stress testing in RBS is a key risk management tool used to support strategic financial planning, risk appetite, risk identification and risk mitigation.	RBS prepares an annual recovery plan, which include a framework of indicators identifying the points at which appropriate actions may be taken in the event of unexpected weaknesses in its capital or liquidity resulting from either idiosyncratic or systemic stress, as well as a menu of options for addressing such weaknesses. RBS's 2015 Recovery Plan was prepared in line with the PRA's requirement that banks prepare, maintain and review recovery plans.

Stress testing results are presented to senior management (and BRC/Board) periodically, and used to assess capital impacts of business decisions

Internal Capital Adequacy Assessment Process (ICAAP)

The ICAAP assesses RBS's material risks determining how much capital is required to cover these risks. The ICAAP consists of two types of internal capital assessment:

· a Point-in-time capital assessment as at the financial year end, and

· a Forward-looking stress capital assessment.

The final ICAAP is approved by the Board prior to submission to the PRA.

	Board Risk Committee (BRC)	Capital Risk Assessment (CRA)
Assessing, monitoring and maintaining adequate capital. It is RBS's policy to build and sustain a strong capital base and to use it efficiently throughout its activities to support strategic objectives and optimise shareholder returns while maintaining a prudent relationship between its capital base and the underlying risks of the business, including the risk of excessive leverage.	With sight of various risk types the Board Risk Committee (BRC) is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures of RBS and future risk strategy, including determination of risk appetite and tolerance.	CRAs are annual 'top down' processes to help identify, understand and assess material risks. Consideration is given to whether and how much capital should be set aside against each risk type forming a key input to the ICAAP. For effective risk management CRAs are marked against financial or non-financial thresholds.

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Business review Capital and risk management
Capital management* continued

Capital planning

Capital and leverage is actively managed and regulatory ratios are a key factor in the Group's planning processes and stress analyses. Capital planning is an activity undertaken within Treasury to determine the appropriate amount of capital needed over the budget horizon under both base and stress projections using both risk and leverage based assessment tools and given a specific risk appetite.

Capital plans are derived for RBS overall and its major operating, regulated entities. Capital plans are prepared in compliance with specific regulatory rules (for example CRD IV) and in accordance with system wide and local, specific regulatory guidance. Capital plans for UK regulated entities are drawn up centrally whereas capital plans for non-UK regulated entities are drawn up locally and subject to central review and challenge to ensure consistency of approach and adherence to capital management policies.

The starting point for any capital plan will be with the annual budget cycle which forecasts the bank's balance sheet trajectory over a 5 year forward looking horizon. The budget cycle will incorporate assumptions about the future shape and direction of the balance sheet of RBS and its operating entities. It will include assumptions around the future path of RWAs, profitability and tax. Idiosyncratic factors such as conduct and litigation costs and disposals are also considered. Finally known or expected system or firm specific regulatory guidance (for example phasing in of CRD IV assumptions or leverage requirements) are also considered.

The capital plans are tested for capital adequacy and measured against the bank's risk appetite framework using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the bank. In addition the bank maintains a recovery plan which sets out a range of potential mitigating actions that could be taken in response to an extreme stress. Known and expected assumptions around the future direction of regulation is also taken into account. Furthermore specific idiosyncratic risks such as conduct risk are factored into capital plans.

From these inputs a forecast will be derived on how much capital is required to support these assumptions using both risk and leverage based approaches. This will estimate the required amount of CET1 through to non-capital minimum requirement eligible liabilities (MREL) in each period over the forecast.

Once the capital plan is approved it is then subject to ongoing review and assessment to reflect changes to the underlying components such as forecasts or new regulatory guidance or assumptions. Shorter term forecasts are more frequently undertaken to understand and respond to variations of actual performance against the plan.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected capital and leverage ratios, including those in stressed scenarios, is undertaken, including submissions to the ALCo, ERF, EXCo, Board Risk Committee and the Board.

The regulatory framework within which RBS operates continues to be developed at a global level through the FSB and Basel Committee, at a European level mainly through the issuance of CRD IV technical standards and guidelines and within the UK by the PRA and through directions from the FPC.

RBS continues to monitor regulatory developments very closely, analysing the potential capital impacts to ensure RBS continues to maintain a strong capital position that exceeds the minimum regulatory requirements and risk appetite and is consistent with market expectations.

Capital requirements: Pillar 1 and 2

Capital demand is normally the aggregation of Pillar 1, Pillar 2A, the greater of the CRD IV or Pillar 2B buffers, and any management buffer (for example over and above MDA). Pillar 2 is becoming an increasingly important component of our capital requirements.

Pillar 2A is determined through the ICAAP process mentioned herein and reflects RBS specific risks. Factors driving Pillar 2 requirements include operational risk, interest rate risk in the banking book, credit concentration risk and pension risk amongst others.

The Pillar 2B requirement and recently introduced PRA buffer reflects the impact of stress through the analysis undertaken in annual ICAAP. The amount of stress capital may well also be informed by performance under the new regulatory stress testing process. The amount of stress based capital requirement is the higher of Pillar 2B or the CRD IV risk buffers plus any management buffer.

A management buffer may be overlaid on top of that to reflect additional risks that the Board believe are prudent to cover (such as headroom over and above any MDA threshold).

Capital supply

Capital supply consists of the amount of CET1, AT1, Tier 2 and, going forward, non-capital MREL securities in existence at any one time.

The capital planning process determines the most efficient mix between these different types of security in keeping with the bank's strategic plans and risk appetite. Considerations include:

- Internal risk appetite (including stress testing);
- Regulatory policies and guidance; and
- Market conditions and expectations.

The bank will issue capital securities from time to time and may engage in selective buy backs, liability management exercises and other market actions in line with its stated risk appetite and other metrics. RBS's policy is to manage its externally issued portfolio of debt securities for value.

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Business review Capital and risk management
Capital management* continued

Stress testing

The diagram below summarises a number of areas where stress testing is used within RBS. These include four overall categories, including strategic, financial and capital planning, risk appetite, risk identification and risk mitigation.

Stress testing usage within RBS
1 Strategic financial & capital planning
- Assess impact of plausible downside scenarios on financial position.
- Assessment of strategic plans against market concerns and headwinds.

2 Risk appetite
- Better understanding of underlying risks to inform the setting of risk appetite (e.g. sector reviews, earnings volatility, reverse stress test).
- Assess the impact of current business strategies on risk appetite.
- Identify drivers of risk appetite triggers.

3 Risk identification
- Manage business through improved understanding of the underlying risk. Examples:
  - Tail risk assessment: identification of risky portfolios that breach a series of pre-determined triggers.
  - Business vulnerabilities analysis: assessment of business model weaknesses through cross-functional discussions.
- Identify high-risk portfolios to be investigated further.

4 Risk mitigation
- Inform mitigating actions within RBS and segmental strategic plans.
- Determine a schedule of potential management actions to be executed in the event of stress.

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Business review Capital and risk management
Capital management* continued

Stress testing process and techniques

The stress testing process has four key stages.

- Stress scenario definition:
  - RBS-specific vulnerabilities are identified and linked to the development of relevant stresses;
  - Scenario is defined, severity calibrated and parameters established; and
  - Governance is put in place for stress theme approval and scenario validation.
- Stress test execution and governance:
  - Impact of stress scenario is translated via relevant risk drivers such as RWAs, impairments;
  - Profit and loss impacts of stress scenario are also assessed; and
  - Review of stress output by the business as well as risk, treasury and finance teams.
- Consolidation and capital planning:
  - Segmental results are consolidated to provide a combined view of stress impact;
  - Stressed profit and loss and RWA assessment contribute towards arriving at a stressed capital plan;
  - Additional capital impacts under stress are considered such as pension deficit, foreign exchange reserves; and
  - Final stressed capital, leverage and liquidity ratios are produced for each year of the scenario.
- Management actions and governance:
  - Internal subject matter experts determine a 'menu' of possible management actions under stress conditions such as capital raising, de-risking and sale of assets, and cost reduction; and
  - Stress testing is reviewed by senior risk management and executives; and governance is provided by ERF, BRC and Board.

Risk-type specific stress testing is also conducted. For example, within the market risk management framework, a comprehensive programme of stress tests covers a variety of historical and hypothetical scenarios.

Portfolio-specific stress tests assess the reaction of key portfolios to systemic shocks and identify potential vulnerabilities, including risks that have not yet matured or are not yet visible. They assess the potential for outsized losses and the impact of rebalancing portfolios.

Regulatory stress test exercises

RBS also takes part in external stress tests as part of wider stress testing frameworks implemented by regulatory authorities to test industry-wide vulnerabilities under crystallising global systemic risks. In 2015, RBS participated in a regulatory stress test designed by the Bank of England (BoE).

The BoE stress test exercise tested the impact of a synchronised global downturn triggered by a sharp slowdown in China and deep recession in the eurozone, amidst amplifying disinflationary pressures. In particular, the scenario examined the resilience of UK banks to corporate vulnerabilities such as deep recession in trading partners' economies. Under the scenario, the UK suffers a severe recession with economic uncertainty damaging confidence and causing business investment contraction, a housing market shock and a significant rise in unemployment accompanied by a period of deflation.

Under the Bank of England's hypothetical adverse scenario, the results show that RBS's capital position remains above the threshold CET1 ratio of 4.5% and meets the leverage ratio of 3.0% with a low point of 6.1% CET1 ratio and 3.0% leverage ratio after 'strategic' management actions. The PRA Board judged that RBS did not meet its individual capital guidance after management actions in this scenario. Since December 2014, RBS has taken actions to improve its capital position. During the course of 2015, RBS issued £2 billion of AT1. In light of the steps that RBS has already taken to strengthen its capital position, coupled with its plans for future AT1 issuance, the PRA Board did not require RBS to submit a revised capital plan.

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Business review Capital and risk management
Capital management* continued

Internal capital adequacy assessment process (ICAAP)

The ICAAP assesses RBS's material risks and determines how much capital is required to cover these risks.

The ICAAP consists of two types of internal capital assessment:

- Point-in-time capital assessment as at the financial year end:

  - Pillar 1 - CET1 4.5% of credit, market and operational RWAs at the financial year end.
  - Pillar 2A - additional capital requirements for risks not captured or not adequately captured in Pillar 1. A Capital Risk Assessment is performed to ensure that all material risks are identified, appropriately managed and adequately capitalised where appropriate.

- Forward-looking stress capital assessment:

  - Pillar 2B - Capital planning buffer is set to ensure RBS maintains adequate capital resources in stress to allow it to continue to meet the minimum capital requirements. The current capital planning buffer will be replaced by the PRA buffer from 1 January 2016.

The final ICAAP is approved by the Board prior to submission to the PRA. Component parts of the ICAAP are set out in the diagram below.

Internal capital adequacy assessment process

*unaudited

Business review Capital and risk management
Capital management* continued

Economic capital

An economic capital framework and associated models are used by RBS as a supplement to other risk and capital management tools, such as stress testing and regulatory capital. Economic capital enables the bank to assess the adequacy of capital allocated to its material risks at different confidence levels/severities and to incorporate the assessment of additional risks that are not fully addressed by other measures, for example, concentration risk, which is not addressed by regulatory capital requirements. Models are developed and maintained for the bank's material risk categories and are used in the ICAAP, to assess risk profiles within the risk appetite framework and as part of risk management frameworks e.g. operational risk and credit risk management.

The characteristics of the models relating to these risks are consistent across risks, business lines and throughout the economic cycle, but are also flexible to allow outcomes to be employed for a number of purposes e.g. severity level/confidence interval, time horizon and correlations. Models have been developed internally but are subject to rigorous governance including external benchmarking, independent validation and extensive internal review and challenge. Models are regularly reviewed and continue to be updated for new data sources and improvements in risk modelling methodology.

The ability to change severity levels supports the management of earnings volatility and capital risk. Economic models are used in the ICAAP, assessing risk profiles within the risk appetite framework and functional risk management such as Operational Risk and Credit Risk management.

Recovery planning

In line with regulatory requirements, RBS regularly updates its recovery plans, which include a framework of indicators identifying the points at which appropriate actions may be taken in the event of unexpected weaknesses in its capital or liquidity resulting from either idiosyncratic or systemic stress, as well as a menu of options for addressing such weaknesses. Recovery plans are subject to an ongoing improvement assessment in line with regulatory feedback and internal standards and expectations.

RBS continues to develop its resolution capability and planning in line with best practice and regulatory guidance.

Recovery Plans are required to be updated annually; it is anticipated that RBS's 2016 Recovery Plan will be prepared in line with revised rules taking into account the European Union Bank Recovery and Resolution Directive of 2014 and the European Banking Authority's regulatory technical standards on recovery planning. These rules would require a bank to notify the PRA, without delay, if it decides to take action under the recovery plan or refrains from taking action.

Regulatory developments and RBS's current and future capital position

Regulatory proposals and rules issued or set by the following regulators are the most relevant for RBS:

- Basel - recommendations for all major international institutions - usually through Basel Committee of Banking Supervision (BCBS);
- EU - issue consistent rules for all EU banks and investment firms, commonly through the European Banking Authority (EBA); and
- PRA - additional local rules for UK banks and investment firms.

Capital

Following the implementation of the Basel III proposals through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRR/CRD IV, which came into effect on 1 January 2014, the regulatory drive towards improved capital standards for banks continues and is centred on three broad themes:

- Robust definitions of capital for CET1 and leverage purposes that are not dependent on one or more economic cycles;
- Improved strength of banks, with strategic plans and business models capable of undergoing one or more significant stress events; and
- Valid and viable recovery plans in place for banks to return to normality after a period of stress or, easy application of the resolution frameworks.

Many of these aspects still require analysis and debate and therefore any implementation is likely to take many years.

CRR/CRD IV introduced the following minimum requirements to be met by 2019:

- Pillar 1 requirement of: CET1 of 4.5% of RWAs; Tier 1 of 6%; and total capital of 8%;
- CRD IV Combined buffers: capital conservation buffer of 2.5% of RWAs; countercyclical capital buffer of up to 2.5%; GSIB surcharge of 1.0% based on the most recent determination from the FSB; and
- Minimum Tier 1 leverage ratio of 3%.

The PRA policy statement PS7/13 outlined changes to the minimum level of CET1 capital for large UK banks as follows:

- The PRA required UK banks to meet the CRD IV end point Pillar 1 requirement from 1 January 2015;
- All Pillar 2A risks must be met with at least 56% CET1 capital. This matches the proportion of CET1 capital required for Pillar 1. The remaining (44%) allocation of Pillar 2A is restricted to 19% Tier 1 and 25% Tier 2; and

- All regulatory deductions from capital align CET1 with the end-point CRR definition, effectively making fully loaded Basel III the regulatory definition.

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Business review Capital and risk management

Capital management* continued

The PRA issued Policy Statement 17/15 in July 2015 setting out the Pillar 2 capital requirements for UK banks. The changes are intended to support a more risk sensitive and consistent approach to setting Pillar 2A (P2A) capital and to provide greater transparency of the PRA capital setting process by allowing firms to manage present and future regulatory capital demands. Implementation is from 1 January 2016 in line with the CRD IV capital conservation and systemic buffers and the European Banking Authority's Supervisory Review and Evaluation Process guidelines. The changes are as follows:

- The variable element of P2A is now expressed as a percentage of RWAs plus fixed add-ons instead of the current method where P2A is a formula comprising both a variable and a fixed element;
- The PRA buffer replaces the current Capital Planning Buffer (CPB). Use of the buffer will not be a breach in capital requirements and will not result in capital distribution restrictions however, failure to meet Pillar 2B (P2B) buffer may result in enhanced supervisory action;
- The P2B buffer is now calculated as a percentage of RWAs rather than absolute terms and is to be met with CET1;
  - Firms already subject to a CPB are required to meet P2B with CET1 in full immediately;
- Where the PRA considers that firms have weak risk management or governance, PRA may require firms to hold additional PRA buffer on a scalar ranging from 10-40% of a firm's CET1 Pillar 1 plus P2A capital requirements; and
- Firms have the discretion to publicly disclose their aggregate P2A charge from 1 January 2016. Component parts of P2A and the PRA buffer remain confidential.

Leverage

Leverage ratio requirements are also subject to the following key aspects (consistent with proposals outlined in PS27/15 - 'Implementing a UK leverage ratio framework'):

- Minimum Tier 1 leverage ratio of 3%. To be met 75% by CET1 and a maximum 25% AT1;
- A supplementary leverage buffer applying to GSIBs equal to 35% of the corresponding risk-weighted systemic risk buffer rates to be met with CET1; and
- A countercyclical leverage ratio buffer equal to 35% of the risk-weighted countercyclical capital buffer rate to be met from CET1. The countercyclical buffer is currently set at 0%.

Stress testing

In October 2015, the BoE published its approach to stress testing of the UK banking system out to 2018. The publication outlines the following key features of the BoE approach:

- A cyclical scenario to assess the risks to the banking system based on the financial cycle.
- The severity of the scenario to be counter-cyclical in nature.
- Every second year, the BoE will complement the annual testing with an additional exploratory scenario to probe the resilience of the system to risks not easily linked to the financial cycle.
- The BoE intends to include an integrated framework for decision-making around the setting of capital buffers, as well as a clear and transparent process for determining whether banks need to strengthen their capital positions.
- A hurdle rate framework is to be enhanced, and will align to the overall capital framework. Within the hurdle rate, a bank will be expected to meet all of its minimum risk-based CET1 capital requirements (Pillar 1) in the scenario, as well as Pillar 2A CET1 requirements. Additionally, GSIB buffers will be included in the hurdle rate.

As a major UK bank, RBS will be included in the annual cyclical scenarios and may also be required to participate in the biennial exploratory scenario stress tests to the extent that the risks being probed are relevant to RBS.

MREL and TLAC

The banking resolution and recovery directive introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that may be bailed in using the bail-in tool), known as the minimum requirements for eligible liabilities (MREL). The aim is that the minimum amount should be proportionate and adapted for each category of bank on the basis of their risk or the composition of their sources of funding.

The EBA noted that the technical standards would be compatible with the proposed term sheet published by the FSB on TLAC requirements for GSIBs, but there remains a degree of uncertainty as to the extent to which MREL and TLAC requirements may differ.

Following the FSB finalising its TLAC proposals in November 2015, the PRA published its proposed requirements for MREL which will be the way in which the UK implements the TLAC standard. MREL will apply to GSIBs from 2019 and to other relevant UK firms from 2020. The purpose of MREL is to ensure that, in the event of failure, a bank has sufficient loss-absorbing and recapitalisation capacity to allow for an orderly resolution that minimises any adverse impact on financial stability whilst preventing public funds being exposed to loss. The requirements will be firm-specific but the PRA's consultation paper proposes that MREL will be required:

- At a consolidated and individual bank level, including for the holding entity of a banking group.

- At an amount at least equal to two times the current minimum Pillar 1 and Pillar 2A capital requirements, or, if higher, any applicable leverage ratio requirement, or the minimum capital requirements under Basel plus any applicable CRD IV capital buffers: once for loss absorbency, once for recapitalisation

The US Federal Reserve has proposed rules which will require US bank holding companies and intermediate holding companies of foreign banks to hold specified amounts of both long term debt and TLAC from January 2019. RBS is considering the impact of these rules.

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Business review Capital and risk management

Capital management* continued

Systemically Important Banks

As at November 2015, RBS was moved down to the lowest bucket for required loss absorbency in the FSB's updated list of GSIBs.

Regulatory proposals relating to Domestically Systemically Important Banks (DSIBs) and Other Systemically Important Institutions (OSII) continue to be progressed and could impact the level of CET1 that is required to be held by RBS and specific legal entities including NatWest and the Royal Bank. The EBA published in December 2014 a quantitative methodology as to how European regulators could quantify which firms would qualify as DSIBs. The PRA published CP39/15 on this in October 2015, and published its list of the sixteen firms designated as OSII; RBS is included within this list.

Systemic risk buffer (SRB)

In January 2015, HM Treasury issued an explanatory memorandum on the SRB for banks, building societies and investment firms. The regulation implements Articles 133 and 134 of Directive 2013/36/EU and addresses the outstanding capital buffer element of the ring-fencing policy recommended by the Independent Commission on Banking (ICB) and agreed by the UK Government.

The purpose of the SRB is to prevent and mitigate long term non-cyclical systemic or macro prudential risks not covered by existing regulation where there is potential for serious negative consequences for the financial system and real economy

The SRB will apply to large banks with core (ring fenced entity) deposits of more than £25 billion and large building societies with deposits of more than £25 billion. Implementation will occur from 1 January 2019 and capital buffers will range from 0-3% of a firm's RWAs.

On 29 January 2016, the FPC proposed that those banks and building societies with total assets above £175 billion will be set progressively higher SRB rates as total assets increase through defined buckets. HM Government required the FPC to produce a framework for the SRB at rates between 0% and 3% of RWAs. Under the FPC's proposals, ring-fenced bank sub-groups and large building societies in scope with total assets below £175 billion will be subject to a 0% SRB. Based on current information, under these proposals the FPC expects the largest ring-fenced bank in 2019 to have a 2.5% SRB. In line with the FPC's previous announcement on the leverage ratio framework, those institutions subject to the SRB will also be set a 3% minimum leverage ratio requirement, together with an additional leverage ratio buffer calculated at 35% of the applicable SRB rate. For example, an institution with an SRB rate of 1%

would have an additional leverage ratio buffer of 0.35%. The proposed calibration is expected to add around an aggregate 0.5 percentage points of risk-weighted assets to equity requirements of the system in aggregate.

The PRA will be responsible for applying the framework and will have ultimate discretion over which firms must hold the buffer and its specific size.

Ring-fencing

- The UK Financial Services (Banking Reform) Act passed into UK law in December 2013 implementing recommendations of the ICB. The PRA is in the process of finalising its rules with respect to ring-fencing.
- The PRA is consulting on the need for firms to hold capital resources equivalent to at least 25% of annual fixed overheads in respect of critical services to facilitate operational continuity in resolution.

Basel proposals

The more relevant proposals issued by the BCBS are as follows:

- Capital floors (BCBS 306);
- Revised Pillar 3 disclosure (BCBS 309);
- Total loss absorption capacity (BCBS 342);
- Standardised approach for credit risk (BCBS 347); and
- Minimum capital for market risk (BCBS 352).

RBS is continuing its assessments of these proposals.

*unaudited

Business review Capital and risk management

Capital management* continued

Measurement

Capital and leverage: key ratios

Capital, RWAs and risk asset ratios, on the basis of end-point CRR and transitional rules, calculated in accordance with PRA definitions, are set out below.

	2015		2014 (1)	
	End-point CRR basis (2)	PRA transitional basis	End-point CRR basis (2)	PRA transitional basis
Capital	£bn	£bn	£bn	£bn
CET1	37.6	37.6	39.9	39.6
Tier 1	39.6	46.3	39.9	47.1
Total	47.6	60.0	48.6	60.7
RWAs				
Credit risk				
- non-counterparty	166.4	166.4	264.7	264.7
- counterparty	23.4	23.4	30.4	30.4
Market risk	21.2	21.2	24.0	24.0
Operational risk	31.6	31.6	36.8	36.8
	242.6	242.6	355.9	355.9
Risk asset ratios	%	%	%	%
CET1	15.5	15.5	11.2	11.1
Tier 1	16.3	19.1	11.2	13.2
Total	19.6	24.7	13.7	17.1
Leverage ratio (3)	2015		2014	
Tier 1 capital	£39.6bn	£46.3bn	£39.9bn	£47.1bn
Leverage exposure	£702.5bn	£702.5bn	£939.5bn	£939.5bn
Leverage ratio	5.6%	6.6%	4.2%	5.0%

Notes:

(1) Capital and leverage ratios have not been restated following the pension accounting policy change. Components within CET1 capital have however been represented to reflect revisions to accounting tangible equity, with corresponding adjustments to other deductions above.

(2) Capital Requirements Regulation (CRR) as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full for with the exception of unrealised gains on available-for-sale (AFS) securities which has been included from 2015 under the PRA transitional basis.

(3) Based on end-point CRR Tier 1 capital and leverage exposure under the CRR Delegated Act.

General:

In accordance with the PRA's Policy Statement PS7/2013 issued in December 2013 on the implementation of CRD IV, all regulatory adjustments and deduction to CET1 have been applied in full (end-point CRR) with the exception of unrealised gains on AFS securities which will be included from 2015 (PRA transitional basis).

From 1 January 2015, RBS must meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 and/or Tier 2 capital. The Pillar 2A capital requirement is the additional capital that RBS must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Measures in relation to end-point CRR basis, including RWAs, are based on the current interpretation, expectations, and understanding, of the CRR requirements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities (end-point CRR basis). The actual end-point CRR impact may differ when the final technical standards are interpreted and adopted.

Capital base:

(1) Own funds are based on shareholders' equity.

(2) 2014 includes the nominal value of B shares (£0.5 billion) on the assumption that RBS will be privatised in the future and that they will count as permanent equity in some form by the end of 2017.

(3) The adjustment arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full. The prudential valuation adjustment relating to assets under advanced internal ratings approach has been included in impairment provisions in the determination of the deduction from expected losses.

(4) Where the deductions from AT1 capital exceed AT1 capital, the excess is deducted from CET1 capital. The excess of AT1 deductions over AT1 capital in year one of transition is due to the application of the current rules to the transitional amounts.

(5) Insignificant investments in equities of other financial entities (net): long cash equity positions are considered to have matched maturity with synthetic short positions if the long position is held for hedging purposes and sufficient liquidity exists in the relevant market. All the trades are managed and monitored together within the equities business.

(6) Based on our current interpretations of the Commission Delegated Regulation issued in December 2013 on credit risk adjustments, RBS's standardised latent provision has been reclassified to specific provision and is not included in Tier 2 capital.

Risk-weighted assets (RWAs):

(1) Current securitisation positions are shown as risk-weighted at 1,250%.

(2) RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on banks and central counterparties.

(3) RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.

(4) Non-financial counterparties and sovereigns that meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.

(5) The CRR final text includes a reduction in the risk-weight relating to small and medium-sized enterprises.

*unaudited

Business review Capital and risk management

Capital management* continued

Capital and leverage: Capital resources

	2015		2014	
	End-point CRR basis	PRA transitional basis	End-point CRR basis	PRA transitional basis
	£m	£m	£m	£m
Shareholders’ equity (excluding non-controlling interests)				
Shareholders' equity	53,431	53,431	55,763	55,763
Preference shares - equity	(3,305)	(3,305)	(4,313)	(4,313)
Other equity instruments	(2,646)	(2,646)	(784)	(784)
	47,480	47,480	50,666	50,666
Regulatory adjustments and deductions				
Own credit	(104)	(104)	500	500
Defined benefit pension fund adjustment	(161)	(161)	(238)	(238)
Cash flow hedging reserve	(458)	(458)	(1,029)	(1,029)
Deferred tax assets	(1,110)	(1,110)	(1,222)	(1,222)
Prudential valuation adjustments	(381)	(381)	(384)	(384)
Goodwill and other intangible assets	(6,537)	(6,537)	(7,781)	(7,781)
Expected losses less impairments	(1,035)	(1,035)	(1,491)	(1,491)
Other regulatory adjustments	(86)	(64)	898	628
	(9,872)	(9,850)	(10,747)	(11,017)
CET1 capital	37,608	37,630	39,919	39,649
Additional Tier 1 (AT1) capital				
Eligible AT1	1,997	1,997	—	—
Qualifying instruments and related share premium subject to phase out	—	5,092	—	5,820
Qualifying instruments issued by subsidiaries and held by third parties	—	1,627	—	1,648
AT1 capital	1,997	8,716	—	7,468
Tier 1 capital	39,605	46,346	39,919	47,117
Qualifying Tier 2 capital				
Qualifying instruments and related share premium	5,745	6,265	5,542	6,136
Qualifying instruments issued by subsidiaries and held by third parties	2,257	7,354	3,175	7,490
Tier 2 capital	8,002	13,619	8,717	13,626
Total regulatory capital	47,607	59,965	48,636	60,743

Note:

(1) Capital Requirements Regulation (CRR) as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full for the end-point CRR basis with the exception of unrealised gains on available-for-sale (AFS) securities which has been included from 2015 for the PRA transitional basis.

The table below analyses the movement in end-point CRR CET1, AT1 and Tier 2 capital for the year.

	CET1	AT1	Tier 2	Total
	£m	£m	£m	£m
At 1 January 2015	39,919	—	8,717	48,636
Loss for the year net of movements in fair value of own credit	(2,583)	—	—	(2,583)
Share capital and reserve movements in respect of employee share schemes	206	—	—	206
Ordinary shares issued	300	—	—	300
Foreign exchange reserve (1)	(1,809)	—	—	(1,809)
AFS reserves	8	—	—	8
Decrease in goodwill and intangibles deduction	1,244	—	—	1,244
Deferred tax assets	112	—	—	112
Prudential valuation adjustments	3	—	—	3
Excess of expected loss over impairment provisions	456	—	—	456
New issue of capital instruments	—	2,007	—	2,007
Dated subordinated debt issues/(maturities)	—	—	(82)	(82)
Net dated subordinated debt/grandfathered instruments	—	—	(713)	(713)
Foreign exchange movements	—	—	90	90
Other movements	(248)	(10)	(10)	(268)
At 31 December 2015	37,608	1,997	8,002	47,607

Note:

(1) This reflects the recycling of the reserve to profit and loss account following the deconsolidation of Citizens.

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Business review Capital and risk management

Capital management* continued

Capital and leverage: Leverage ratio and related disclosures

Leverage exposure

The leverage exposure is based on the CRR Delegated Act.

Leverage	End-point CRR basis 2015 £bn	2014 £bn
Derivatives	262.5	354.0
Loans and advances	327.0	419.6
Reverse repos	39.9	64.7
Other assets	186.0	212.7
Total assets	815.4	1051.0
Derivatives		
- netting	(258.6)	(330.9)
- potential future exposures	75.6	98.8
Securities financing transactions gross up	5.1	25.0
Undrawn commitments	63.5	96.4
Regulatory deductions and other adjustments	1.5	(0.8)
Leverage exposure	702.5	939.5

Additional analysis of derivative notionals and undrawn commitments, two of the major components contributing to the leverage exposure are set out below.

Leverage ratio and related disclosures: Derivative notionals

The table below analyses the derivative notionals by maturity for contracts other than credit derivatives, and credit derivatives by qualifying and non-qualifying.

2015				2014			
Derivatives other than credit derivatives (1)	Credit derivatives (2)			Derivatives other than credit derivatives (1)	Credit derivatives (2)		
<1 year	Qualifying	Non-qualifying	Total	<1 year	Qualifying	Non-qualifying	Total

		1-5 years	>5 years					1-5 years	>5 years			
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Interest rate	8,701	7,328	3,754			19,783	11,069	10,423	5,839			27,331
Exchange rate	2,838	573	291			3,702	3,649	720	306			4,675
Equity	8	8	1			17	42	33	2			77
Commodities	1	—	—			1	1	—	—			1
Credit				56	11	67				99	26	125
Total	11,548	7,909	4,046	56	11	23,570	14,761	11,176	6,147	99	26	32,209

Notes:

(1) Derivative potential future exposures (PFE) are calculated based on the notional value of the contracts and is dependent on the type of contract. For contracts other than credit derivatives the PFE is based on the type and maturity of the contract after the effect of netting arrangements.

(2) The PFE on credit derivatives is based on add-on factors determined by the asset quality of the referenced instrument. Qualifying credit derivatives attract a PFE add-on of 5% and have reference securities issued by public sector entities, multilateral development banks or other investment grade issuers. Non-qualifying credit derivatives attract a PFE add-on of 10%.

Leverage ratio and related disclosures: Weighted undrawn commitments

The below table provides a breakdown of weighted undrawn commitments.

	2015	2014
	£bn	£bn
Unconditionally cancellable credit cards	2.4	2.2
Other Unconditionally cancellable items	7.2	4.6
Unconditionally cancellable items (1)	9.6	6.8
Undrawn commitments <1 year which may not be cancelled	0.6	2.3
Other off-balance sheet items with 20% CCF	1.4	2.1
Items with a 20% CCF	2.0	4.4
Revolving credit risk facilities	25.3	38.1
Term loans	4.3	2.8
Mortgages	5.9	4.9
Other undrawn commitments > 1 year which may not be cancelled & off-balance sheet items with 50% CCF	5.3	10.1
Items with a 50% CCF	40.8	55.9
Items with a 100% CCF	11.1	17.8
Citizens	n/a	11.5
Total	63.5	96.4

Note:

(1) Based on a 10% credit conversion factor (CCF).

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Business review Capital and risk management

Capital management* continued

Loss absorbing capital

RBS's capital components and estimated loss absorbing capital (LAC) at 31 December 2015 based on current regulatory interpretations are set out below. Under current TLAC guidance, RBS will be required to hold a minimum LAC of 16% of RWAs by the beginning of 2019 and 18% of RWAs by the beginning of 2020. For additional details regarding regulatory developments in relation to MREL/TLAC requirements, refer to Capital management on page 161. The roll-off profile and average spread relating to senior debt is set out on page 167.

The following table illustrates the components of estimated LAC in the holding company and operating companies.

2015	Par value (1) £bn	Balance sheet value £bn	Regulatory value (2) £bn	LAC value (3) £bn
CET1 capital (4)	37.6	37.6	37.6	37.6
Tier 1 capital: end point CRR compliant AT1				
of which: RBSG plc (holdco)	2.0	2.0	2.0	2.0
of which: RBSG operating subsidiaries (opcos)	—	—	—	—
	2.0	2.0	2.0	2.0
Tier 1 capital: non-end point CRR compliant				
of which: holdco	6.0	6.0	5.9	4.6
of which: opcos	2.5	2.5	2.5	0.3
	8.5	8.5	8.4	4.9
Tier 2 capital: end point CRR compliant				
of which: holdco	5.8	5.9	5.7	4.4
of which: opcos	5.1	5.5	3.8	5.5
	10.9	11.4	9.5	9.9
Tier 2 capital: non-end point CRR compliant				
of which: holdco	0.3	0.3	0.2	0.1
of which: opcos	3.3	3.6	3.0	2.9
	3.6	3.9	3.2	3.0
Senior unsecured debt securities issued by:				
RBSG holdco	4.9	5.0	—	2.9
RBSG opcos	17.7	18.1	—	—
	22.6	23.1	—	2.9
Total	85.2	86.5	60.7	60.3
RWAs				242.6
Leverage exposure				702.5

LAC as a ratio of RWAs	24.9%
LAC as a ratio of leverage exposure	8.6%

Notes:

(1) Par value reflects the nominal value of securities issued.

(2) Regulatory capital instruments issued from operating companies are included in the transitional LAC calculation, to the extent they meet the TLAC/MREL criteria.

(3) 'LAC value' reflects RBS's interpretation of the 9 November 2015 FSB Term Sheet on TLAC and the Bank of England's consultation on their approach to setting MREL, published on 11 December 2015. MREL policy and requirements remain subject to further consultation, as such RBS estimated position remains subject to potential change. Liabilities excluded from LAC include instruments with less than one year remaining to maturity, structured debt, operating company senior debt, and other instruments that do not meet the TLAC/MREL criteria.

(4) Corresponding shareholders' equity was £53.4 billion. Refer to capital resources table on page 164 for further details.

(5) Regulatory amounts reported for Additional Tier 1, Tier 1 and Tier 2 instruments are before grandfathering restrictions imposed by CRR.

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Business review Capital and risk management

Capital management* continued

Senior debt roll-off profile

Based on current guidance, RBS anticipates issuing senior bonds from its holding company to ensure LAC classification under MREL/TLAC proposals. The following table illustrates the roll-off profile and weighted average spreads of RBS's major wholesale funding programmes.

RBSG plc	As at and for year ended 31 December 2015	Roll-off profile H1 2016	H2 2016	2017	2018	2019 & 2020	2021 & later
- amount (£m)	4,436	85	1,303	1,079	73	1,888	8
- weighted average rate spread (bps)	162	77	110	139	172	211	266
RBS plc							
- amount (£m)	23,360	5,856	2,051	2,403	2,341	5,935	4,774
- weighted average rate spread (bps)	182	202	171	167	141	212	156
RBS N.V.							
- amount (£m)	296						