Company Registered Number: 25766

ULSTER BANK IRELAND DESIGNATED ACTIVITY COMPANY

ANNUAL REPORT AND ACCOUNTS

31 December 2018

Contents

Board of directors and secretary

Chairman
Des O'Shea

Executive directors
Jane Howard (appointed 3 September 2018)
Chief Executive Officer

Paul Stanley
Chief Financial Officer

Non-executive director
Helen Grimshaw (appointed 21 November 2018)

Independent non-executive directors
Dermot Browne (appointed 3 September 2018)

William Holmes (appointed 1 July 2018)

Martin Murphy

Rosemary Quinlan

Gervaise Slowey (appointed 11 April 2018)

Company Secretary
Andrew Nicholson (appointed 4 June 2018)

Other Board changes in 2018
The following executive director resigned on 10 May 2018
Gerard Mallon

The following company secretary resigned on 4 June 2018
Caoimhe Norris

Auditors
Ernst & Young
Chartered Accountants and Statutory Auditor
Ernst & Young Building
Harcourt Centre
Harcourt Street
Dublin 2
D02 YA40

Registered office and Head office
Ulster Bank Group Centre
George's Quay
Dublin 2
D02 VR98

Ulster Bank Ireland Designated Activity Company
Registered in Republic of Ireland No. 25766

Presentation of information

Ulster Bank Ireland Designated Activity Company ('UBIDAC' or the 'Bank') is a wholly-owned subsidiary of NatWest Holdings Limited ('NatWest Holdings'). The ultimate holding company is The Royal Bank of Scotland Group plc ('RBSG' or the 'ultimate holding company'). The 'Group' or 'UBIDAC Group' comprises UBIDAC and its subsidiary and associated undertakings. 'RBS Group' comprises the ultimate holding company and its subsidiary and associated undertakings.

The Bank publishes its financial statements in euros ('€' or 'Euro'). The abbreviation '€m' represents millions of euros and the abbreviation '€k' represents thousands of euros. The abbreviation '£' represents 'pounds sterling'.

The directors of UBIDAC present their report, together with audited financial statements of the Group for the financial year ended 31 December 2018. The financial statements are prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (EU).

Principal activities

The Bank, operating under the Ulster Bank and Lombard brands, provides a comprehensive range of financial services through its Personal Banking and Commercial Banking divisions. Personal Banking provides loan and deposit products through the Group's network of branches and direct channels, including the internet, mobile and telephony. Commercial Banking provides services to business and corporate customers, including small and medium enterprises. The Bank is regulated by the Central Bank of Ireland (CBI)/Single Supervisory Mechanism.

Business review

The Group's strategic ambition is to become the number one bank for customer service, trust and advocacy in its chosen markets. In working towards this ambition the Group is focused on meeting customer needs and building lasting relationships with customers through digital and technological innovation that creates value for customers and operational efficiency for the Bank. The Group is building a customer focused culture underpinned by 'Our Values' of 'serving customers', 'working together', 'doing the right thing' and 'thinking long term'. A culture where colleagues consistently live 'Our Values' and where effective management of risk is a natural part of how colleagues think and work is key to delivering the Group's strategic plan and building a sustainable bank.

Significant progress has been made during the financial year in remediating legacy conduct and other issues including the tracker mortgage examination. At 31 December 2018 in excess of 85% of impacted tracker mortgage examination customers had received redress and compensation. Payments are expected to be made to all remaining impacted customers by April 2019.

Remaining legacy conduct issues are now managed under a single accountable executive to ensure that these are brought to an effective and timely conclusion for our customers. This facilitates enhanced focus on a forward looking agenda.

The Group has also made good progress in delivering on the European Central Bank (ECB) requirement for banks to reduce their non-performing loan ratios. The disposal of a portfolio of non-performing loans with a gross value of €1 billion was executed during the financial year. This contributed to a reduction in the Group's non-performing loan ratio from 16.7% at 31 December 2017 to 11.3% at 31 December 2018. A further portfolio of non-performing loans has been identified for sale during 2019. Realising these assets over shorter timeframes reduces the value that the Group can expect to recover and therefore additional impairments were recognised.

The Group's capital and funding positions remain strong evidenced by all three major credit rating agencies, Moody's, Standard & Poor's and Fitch, upgrading the Bank's ratings during the year. In January 2018 the directors approved and paid a dividend of €1.5 billion to NatWest Holdings. During the year the Group raised €1 billion funding from the sale of mortgage backed bonds to international investors, the first such funding raised by the Group since the financial crisis.

Personal Banking's 'Help for the movers' campaign contributed to new mortgage lending of €1.1 billion in the financial year, an increase of 13% from 2017. Lending continued to be driven by a strong uptake of both the Group's variable and fixed rate propositions, including a market-leading 2.3% two year fixed rate mortgage launched in June. The 'First Five' mortgage initiative highlighted the range of benefits on offer to first time buyers in addition to the competitive rates.

The Group continued to focus on strengthening its digital proposition through enhancing its online and mobile capabilities. During 2018, the Group launched the 'DigiDocs' and 'Manage Your Mortgage' features. These secure online platforms provide additional channels for customers to conveniently interact with the bank. 'DigiDocs' allows eligible customers applying online for current accounts or personal loans to submit ID verification documents without having to visit a branch. The 'Manage Your Mortgage' portal provides self-serve capabilities to mortgage customers, enabling them to, amongst other things, access real-time balance information, manage their direct debit details and request a Certificate of Interest.

During 2018, 69% of the Group's active current account customer base were 'digitally active'. A number of new features were introduced to the app, including the ability for customers with Ulster Bank MasterCard credit cards to temporarily freeze their card if it is misplaced or for their convenience. These customers can also view real-time balance updates as well as access a budgeting feature to create a personal credit card budget.

The Bank also initiated a further programme of investment to enhance the branch network. Nine branches were significantly upgraded including the installation of self-service automation terminals, digital marketing screens and mobile banking tablet technology. Self-service automation terminals were added to a further 32 branches meaning customers now have the option to self-serve in 61% of the branch network.

The continued development and optimisation of the Group's digital and technology offerings were complemented by a more comprehensive geographical presence to meet customers' needs across the country. The Bank expanded its mortgage broker panel, with the intermediary channel generating 28% of new mortgage business in 2018. Complementing our mobile mortgage managers and the fleet of five mobile banks or "banks on wheels", a team of Community Bankers visited towns weekly, providing support to both individuals and community groups. Community Bankers also partnered with the local branch network to deliver "digital days" covering the use of technology to make banking safer, easier and more convenient.

During 2018 the Group leveraged RBS Group's partnership with UK National Trading Standards and launched 'Friends against Scams' training for colleagues, customers and the wider community. The purpose is to raise awareness of how consumers can best protect themselves from becoming victim of a scam. To date over 1,800 of the Group's colleagues have completed the training and customer training events have been held both in-branch and at external locations. Furthermore, the Bank, along with fellow member banks, has continued to support the Banking & Payments Federation Ireland's industry initiative, 'FraudSMART', which provides fraud awareness advice online and via social media channels.

Commercial Banking continued to support existing and new customers with new lending of €1.4 billion in 2018, matching that achieved in 2017. New lending activity was particularly strong in the Large Corporate business where the Group is supporting growth across multiple sectors including healthcare, agriculture, hospitality and commercial real estate within the Group's risk appetite.

The Lombard asset finance business generated in excess of €190 million of new lending in 2018, an increase of 40% over 2017. The business introduced the Adobe E-sign platform in 2018, enabling customers to use a digital signature for their Lombard contracts, saving time and reducing use of paper. Lombard Motor Finance announced a partnership with Cars Ireland, an online car sales search engine. This partnership saw the integration of the Bank's consumer car finance offerings on a third party channel for the first time, allowing customers to get real-time quotes.

The Group continued to invest in its Business Achievers network, a free peer-to-peer digital platform with over 20,000 registered business owners throughout Ireland. Users have the opportunity to share insights, generate collaboration and attract investment.

As a result of a number of instances of adverse weather conditions throughout 2018, €15 million was made available through the Bank's Weather Agri Fund to both existing and new customers to help support farmers and alleviate cash flow pressures.

The Group recognises the impact that uncertainty over Brexit is having on businesses, particularly SMEs. As a result, in continued partnership with the Strategic Banking Corporation of Ireland, a €50 million SME Brexit Loan Scheme was launched in 2018. The scheme made term funding available to eligible customers to enable them to prepare for the potential impacts of Brexit.

The Board continues to monitor the impact of the UK decision to leave the EU on the Group and its customers. The directors are conscious of the potential for future impacts on the Group, its customers and operations. A Bank-wide Brexit response programme has been mobilised to assess those impacts and to develop contingencies under a number of Brexit scenarios to ensure that the Group can continue to serve its customers well. The uncertainty surrounding Brexit is discussed further in the Outlook section of this report.

The Group maintained its focus on innovation evidenced by the introduction of technology enhancements in its Personal and Commercial businesses. The Bank expanded its partnership with Dogpatch Labs, a leading co-working space for technology startups. In addition to co-hosting a fourth annual Hackathon, that brought together members of the external technology community to design and pitch banking innovation solutions, an "intrapreneurship" programme was launched. The 12 week incubator programme, delivered by Dogpatch Labs, focuses on harnessing the creativity of the Group's colleagues and helps them develop ideas into customer-focused propositions.

The Board has put in place a culture plan which defines culture as *"the way we do things – the manifestation of consistently living our values to act in the best interests of our customers, colleagues and stakeholders."* Led by the Chief Executive Officer, the Board and Executive Committee are focusing on culture transformation to support the delivery of the Group's strategic plan and to continue to build a sustainable bank for the long term. The Group is a founder member of the Irish Banking Culture Board, an independent body which has been established to rebuild trust and embed a customer-focused culture across the banking sector.

The Group's expected culture and behaviours are embedded into Our Standards which guide colleague behaviours. These are aligned to the Group's core values of 'serving customers', 'working together', 'doing the right thing' and 'thinking long term'. Our Standards are used for recruitment, selection and development of colleagues and performance management.

Over the past year the Group's corporate governance and risk management frameworks have been strengthened. These enhancements complement the risk culture programme launched in 2016 which seeks to make risk management a natural part of how colleagues think, behave and work.

The new risk, compliance and internal control frameworks together with enhanced corporate governance processes form essential building blocks in improving culture.

The Group continued with its strong corporate social responsibility ("CSR") agenda and holds the Business Working Responsibly Mark, the highest level of CSR accreditation in Ireland. The Group raised €120k for its charity partners through its 'Do Good Feel Good' initiatives in June, including partnering with Special Olympics Ireland to raise funds for the organisation as well as supporting it through volunteering at its 2018 Games held in Dublin. The Skills and Opportunities Fund made available grants of up to €35k to social enterprise initiatives in communities across the Republic of Ireland. MoneySense, the Bank's financial education programme for primary and secondary level students, has enjoyed continued success with multiple workshops held across the country, presented by volunteer colleagues from the Bank.

Financial performance

The Group's financial performance is presented in the consolidated income statement on page 18.

The Group reported a total profit after tax for the financial year of €85 million (2017 - €162 million loss). The improvement reflects a €116 million increase in total income and a reduction in operating expenses as the impact of charges in respect of legacy issues decrease.

Net interest income

Net interest income increased by 6% to €500 million reflecting reduced funding costs, an improving asset mix and a €14 million one-off income benefit on the Targeted Long Term Refinancing Operation 2 ("TLTRO 2") drawdowns as a result of meeting the 2.5% ECB net lending growth target.

Non-interest income

Non-interest income increased from €138 million in 2017 to €225 million, primarily due to an increase in the mark-to-market income on interest rate swaps and a €9 million loss recognised in 2017 on redemption of subordinated debt.

Operating expenses

Operating expenses decreased by 15% to €603 million in 2018. Although the impact of charges in respect of legacy issues was again significant in 2018, it continued to reduce. The Group maintained a focus on reducing the underlying cost base, evidenced by reduced staff costs and a reduction in the charge from restructuring of the Group's property footprint.

Impairment loss

The impairment loss of €23 million under IFRS 9 (2017 - €68 million under IAS 39) primarily reflects the impact of the Group's ongoing strategy to reduce non-performing loans towards normalised levels through external debt sales with a focus on mortgages that are not sustainable and where additional forbearance will not bring them back to a performing position. As permitted by IFRS9 prior year figures have not been restated and consequently are not directly comparable.

Return on assets

At the financial year end the total assets of the Group were €29,538 million (2017 - €30,248 million). Return on total assets for 2018 was 0.3% (2017 - -0.5%).

Capital ratios

The Group's capital position remained strong during 2018, as evidenced by the CET1 ratio of 27.5% at 31 December 2018 (2017 – 30.5%). Total risk weighted assets (RWAs) reduced from €19.8 billion in 2017 to €16.2 billion at the balance sheet date.

Share capital presented as equity

Details of share capital presented as equity can be found in Note 20 to the accounts.

Outlook

The directors note that economic data trends for the Republic of Ireland continue to be positive. The latest Central Statistics Office ('CSO') reports show annual economic (real GDP) growth of 2.5% in the first three quarters of 2018. The rate of unemployment fell for the twenty-fifth consecutive quarter to 6.0% in Q3 2018 and the number of people in employment increased by 2.0% for the year to Q3 2018. The Economic and Social Research Institute has predicted continued strong economic growth in 2019 but recognises the potential challenges posed by international developments.

The Group remains vulnerable to changes and uncertainty in the external economic and political environment, which despite the current strong economy remain heightened. Scenarios identified as having a potentially material negative impact on the Bank include: the impact of Brexit; global financial market volatility linked to advanced economy interest rate increases or decreases; a continued period of low interest rates; vulnerabilities in emerging market economies resulting in contagion in the local market; potential legislative changes; changes to EU tax law; the impact of US tax policy on foreign direct investment and major geopolitical instability.

With the introduction of IFRS 9, impairments are expected to be more volatile and the directors remain mindful of potential downside risks, particularly from single name and sector driven events.

Uncertainties surrounding the UK's withdrawal from the European Union

Following the UK's EU Referendum in June 2016, and pursuant to the exit process triggered under Article 50 of the Treaty on the European Union in March 2017, the UK is scheduled to leave the EU on 29 March 2019. The terms of a Brexit withdrawal agreement negotiated by the UK Government were decisively voted against by the UK Parliament on 15 January 2019. The UK Government and Parliament is currently actively engaged in seeking to determine the terms of this departure, including any transition period, and the resulting economic, trading and legal relationships with both the EU and other counterparties currently remain unclear and subject to significant uncertainty.

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

The direct and indirect effects of the UK's exit from the EU and the European Economic Area ('EEA') are expected to affect aspects of the Group's business and operating environment and may be material and/or cause a near-term impact on impairment. The longer term effects of Brexit on the Group's operating environment are difficult to predict, and are subject to wider global macro-economic trends and events, but may significantly impact the Group and its customers and counterparties who are themselves dependent on trading with, or personnel from, the United Kingdom and may result in or be exacerbated by periodic financial volatility and slower economic growth, in Northern Ireland and the wider UK, the Republic of Ireland, the rest of Europe and potentially the global economy.

The Irish economy's solid momentum and favourable medium-term growth potential provide important buffers against possible future economic shocks, including Brexit. However, available evidence indicates that Brexit is likely to have a lasting negative impact on the Irish economy. Economic output and trade is likely to be lower than would be the case in a no-Brexit scenario, with associated knock-on adverse impacts on many areas of the economy, including labour and housing markets which present a threat to impairment losses. The extent of the impact of Brexit remains highly uncertain and will be linked to the nature and form of the UK's future relationship with the EU and the extent to which effective transition arrangements to the new relationship are put in place.

Significant uncertainty exists as to the respective legal and regulatory arrangements under which the Group will operate when the UK is no longer a member of the EU. The legal and political uncertainty and any actions taken as a result of this uncertainty, as well as new or amended rules, could have a significant impact on the Group's operations, including attendant restructuring costs, level of impairments, capital requirements, regulatory environment and tax implications and as a result may adversely affect the Group's profitability, competitive position, viability, business model and product offering.

The RBS Group is implementing plans designed to continue its (and the Group's) ability to clear euro payments in the event that there is an immediate loss of access to the European Single Market on 29 March 2019 (or any alternative date) with no alternative arrangement for continuation of such activities under current rules (also known as 'Hard Brexit').

To ensure continued ability to clear euro denominated payments, the RBS Group is finalising a third-country licence for the Frankfurt branch of National Westminster Bank Plc (NatWest Bank) with the German regulator.

In addition, the RBS Group is working to satisfy the conditions of the Deutsche Bundesbank (DBB), for, among other things, access to SEPA, Euro 1 and Target 2 clearing and settlement mechanisms. Satisfying these DBB and accessing SEPA, Euro1 and Target 2 conditions will allow the RBS Group to continue to clear cross border payments in euros, which is a fundamental requirement for the daily operations and customers of all Group franchises, including Ulster Bank. This capacity is also critical to manage the Group's euro-denominated central bank cash balances. A draft license has recently been issued for NatWest Bank which the RBS Group intends to finalise imminently. Once in place, the Frankfurt branch approvals would each become effective when the UK leaves the EU and the current passporting arrangements cease to apply. The RBS Group fully expects to have received the requisite third country licenses and access to SEPA, Euro 1 and Target 2 ahead of the UK's departure from the EU. However, given the quantum of affected payments and lack of short term contingency arrangements, in the event that such euro clearing capabilities were not in place in time for a Hard Brexit or as required in the future, this would have an immediate material effect on the Group and its customers.

The directors, noting the continued and forecast economic growth and cognisant of the macroeconomic and political risks, consider that the actions the Group is taking on its legacy issues and the continued focus on strength and sustainability, customer experience, simplifying the Bank, supporting growth and colleague engagement will assist in the delivery of the Group's ambition to be number one for customer service, trust and advocacy in its chosen markets.

Accounting policies

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of estimation uncertainty are included in Notes 6, 8, 11, 12 and 19 to the accounts.

Risk management

The major risks associated with the Group's business are credit, market, liquidity and funding, reputational, operational, capital adequacy and business risk underpinned by conduct and compliance risk. The Group has a risk management framework for managing these risks which are under continual review as the Group's business activities change in response to consumer market, credit, product, regulatory and other developments.

The Group is also exposed to risks from its defined benefit pension schemes. The Group's policies for managing each of these risks and its exposure thereto are detailed in Note 23 to the accounts.

Board of directors

The Board is the main decision-making forum for the Bank. It has overall responsibility for management of the business and affairs of the Group, the Group strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance.

The Board considers strategic issues and ensures the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations. The Board's terms of reference includes key aspects of the Bank's affairs reserved for the Board's decision and are reviewed at least annually.

There are a number of areas where the Board has delegated specific authority to management, including the Chief Executive Officer and Chief Financial Officer. These include responsibility for the operational management of the Group's businesses as well as reviewing high level strategic issues and considering risk appetite, risk policies and risk management strategies in advance of these being considered by the Board and/or its Committees.

Specific delegated authorities are also in place in relation to business commitments across the Group.

The roles of Chairman and Chief Executive Officer are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive, non-executive and independent non-executive directors. The Chief Executive Officer has responsibility for all Group businesses and acts in accordance with authority delegated by the Board. The independent non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and leadership team.

Board and Executive Committees with delegation from the Board include:

The Audit Committee - comprises at least three members who are all non-executive directors, with a majority of independent non-executive directors, and assists the Board in discharging its responsibilities for the disclosure of the financial affairs of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's systems and standards of internal controls, and monitors the Group's processes for internal audit and external audit.

The Board Risk Committee - comprises at least three members who are all non-executive directors, with a majority of independent non-executive directors. It provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's performance on risk appetite and oversees the operation of the Group Policy Framework.

The Nominations and Governance Committee - comprises at least three members who are all non-executive directors, with a majority of independent non-executive directors and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors and senior management.

It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees. It also monitors the governance arrangements for UBIDAC, ensuring that these are consistent with best practice and policy.

The Performance and Remuneration Committee - comprises at least three members who are all non-executive directors, with a majority of independent non-executive directors and advises the Board on remuneration matters.

The Related Party Lending Committee - comprises at least three members, two of whom are independent non-executive directors. The committee is responsible for approving lending to related parties, which is regulated under the CBI Code of Practice on Related Party Lending 2013.

The Sustainable Banking Committee - was established in January 2019 and comprises at least three members who are all non-executive directors, with a majority of independent non-executive directors. The purpose of the committee is to support the Board in overseeing, supporting and challenging actions being taken by management to run the Bank as a sustainable customer centric business, capable of generating long term value for its stakeholders.

The Board may from time to time seek to establish ad hoc committees to address key areas of focus. Two such committees were in place during 2018 – a Customer Remediation Committee, to focus on policy and remediation, and a Board Oversight Committee, established to oversee enhancements to the governance and risk management practices in the Group. The Board Oversight Committee was disbanded on 31 December 2018. Both committees comprised a mix of executive, non-executive and independent non-executive directors.

The Executive Committee comprises the Group's senior executives and supports the Chief Executive Officer in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations.

The Executive Risk Committee comprises the Group's senior executives, the directors and function heads of Risk and Compliance, and supports the Chief Executive Officer in managing the Group's risk strategy, policy and risk management matters across the Group. The committee has delegated authority from the Executive Committee and reports to the Board Risk Committee.

Directors and secretaries

The directors and secretaries who served at any time during the financial year and up to the date of signing are listed on page 1.

In accordance with the Constitution, the directors are not required to retire by rotation.

Interests in shares or debentures

At 1 January and 31 December 2018, the directors and secretary did not have any interests in the shares or debentures of The Royal Bank of Scotland Group plc representing more than 1% of the nominal value of its issued share capital.

Colleagues

Colleague engagement

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

Our community programmes focus on delivering genuine benefits that make a difference to people's lives throughout Ireland. The Group invests in programmes promoting financial education. Our colleagues across the Group continue to widely support, financially and through volunteering, many community and other worthy causes.

Such activity is encouraged by the Group through its use of payroll giving and staff charity funds which support worthy causes at local, national and international level. Whilst our community programme ("Do Good, Feel Good") and activities run throughout the year, every June we have a particular focus and colleagues come together to raise funds for local and national charities. This programme offers colleagues a day to give their time as volunteers and fundraisers to a charity or cause that matters to them.

The Group promotes flexible working for all colleagues. We help to facilitate flexible working and colleagues are able to avail of a range of flexible working options including regular or occasional working from home, working variable hours or working part time.

The Group is represented on the European Employee Council which facilitates dialogue amongst employee representatives in the European Economic Area.

Employment of people with disabilities

The Group's policy is that people with disabilities are always considered for employment and subsequent training, career development and promotion based on merit. If colleagues develop a disability, it is the Group's policy, wherever possible, to retain them in their existing jobs or to re-deploy them in suitable alternative duties, making appropriate adjustments.

Diversity and inclusion

The Group has a Diversity and Inclusion Policy and values and promotes diversity in all areas of recruitment and employment. Building a working environment where all our colleagues can develop to their full potential is important to us irrespective of their age, belief, disability, ethnic or national origin, gender, gender identity, marital or civil partnership status, political opinion, race, religion or sexual orientation.

We work to avoid limiting potential through bias, prejudice or discrimination. The Group recognises the beneficial contribution of a diverse mix of uniquely talented individuals for the delivery of great service to our diverse customer base. Key principles of our Diversity and Inclusion Policy include that we attract, motivate and retain the best talent. We base the employment relationship on the principles of fairness, respect and inclusion. We comply with local laws on equality and Our Code, which sets out the Group's expected behaviours and standards of conduct, to build and develop an inclusive workforce in order to understand and respond to our diverse customer base.

Safety, health and wellbeing

The Group recognises that people are key to the success of its business. The Group's vision is for its colleagues and communities to recognise that the Group's pride and performance in safety, health and wellbeing adds value to them and to the Group's business. Benchmarking, industry leading expertise, innovative events and resources are combined to ensure a comprehensive 'Wellbeing Plan' continues to be developed and delivered. Feedback on effectiveness of this plan is facilitated through the 'Our View' survey results, cross divisional colleague focus groups, the Financial Services Union and HR Business Partners.

The Group holds the 'KeepWell Mark', the Irish Business and Employers Confederation's workplace wellness national accreditation programme. We believe that investing in the 'KeepWell Mark' demonstrates our commitment to focus on and improve the wellbeing of our colleagues.

The 'Wellbeing Plan' for 2018 included a focus on mental health. Delivery of mental health awareness training was facilitated by Aware, a mental health charity, and events on World Mental Health Day included a range of topical webinar and audio sessions. There was a continued focus on physical wellbeing also with Bupa health assessment stations installed in various locations and online questionnaires available for colleagues to complete. The Bupa Boost Challenge took place throughout July where colleagues were encouraged to set a number of health-focused goals throughout the month, earning "wellness points" as these were achieved.

Charitable contributions

During the financial year the Group made charitable and community investment donations in the Republic of Ireland totalling €262,308 (2017 - €316,976).

Political donations

During the financial year the Group did not make any political donations (2017 - nil).

Branches outside the Republic of Ireland

The Bank and Group has a branch (as defined by Council Directive 89/666/EEC) in Northern Ireland. The banking activities of the branch ceased on 31 December 2018.

Corporate Governance Code for Credit Institutions

The Corporate Governance Requirements for Credit Institutions 2015 ("the Code") imposes minimum core standards upon all credit institutions licensed or authorised by the CBI with additional requirements upon credit institutions which are designated as High Impact. The Bank has been designated as a High Impact credit institution and is therefore subject to the additional requirements for High Impact designation credit institutions included within Appendix 1 of the Code.

Corporate Governance Statement under Section 1373(2) of the Companies Act 2014

The Group operates internal control processes over financial reporting to support the preparation of the consolidated financial statements and manage risk in relation to financial statements preparation. The main components of this framework are as follows:

- a comprehensive set of accounting policies are in place to facilitate preparation of the annual financial statements in accordance with International Financial Reporting Standards as adopted by the EU;
- a control process is in place involving the appropriate level of management review of significant account line items and disclosures to ensure that the financial information required for the financial statements is presented fairly and disclosed appropriately;
- the financial statements are subject to detailed review and approval by senior management and executive personnel within Finance and Risk with other specialists consulted as appropriate;
- a Disclosure Committee operates as a sub-committee of the Bank's Executive Committee to oversee, evaluate and review accounting issues and developments and recommendations on key accounting judgements including impairment provisions and valuations prior to presentation to the Bank's Audit Committee and Board;
- detailed papers are prepared for review and approval by the Bank's Audit Committee and Board setting out significant judgemental and technical accounting issues and any significant presentation and disclosure considerations;
- user access to financial reporting systems is restricted to those individuals that require it to fulfil their assigned roles and responsibilities; and
- Internal Audit, as the Bank's third Line of Defence, and in accordance with the Institute of Internal Auditors International Professional Practices Framework, provides independent assurance to the Board and executive management on the quality and effectiveness of governance, risk management and internal controls to monitor, manage and mitigate key risks to achieving the Bank's objectives.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the business review on pages 2 to 4.

The financial position of the Group, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 11, 23 and 34 to the accounts include the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to market, credit and liquidity risks.

The Group's liquidity position remained strong during 2018, evidenced by the Liquidity Coverage Ratio of 191% at 31 December 2018 (2017 - 186%). The Group avails of a number of sources of liquidity including retail and commercial deposits, the European Central Bank's TLTRO 2 and debt securities in issue. In April 2018 the Group issued a €1 billion residential mortgage securitisation. Furthermore, the Group's assets as at 31 December 2018 contain €3.5 billion of short term liquidity instruments and an additional €0.6 billion of reverse repos.

The Group's capital position remained strong during 2018, as evidenced by the CET1 ratio of 27.5% at 31 December 2018 (2017 – 30.5%).

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the Bank will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and the Bank have been prepared on a going concern basis.

Accounting records

The measures taken by the directors to secure compliance with the requirements of Sections 281 to 285 of the Companies Act 2014 with regard to the keeping of accounting records are the employment of appropriately qualified accounting personnel and the maintenance of computerised accounting systems. The Company's accounting records are maintained at the Company's registered office at Ulster Bank Group Centre, George's Quay, Dublin 2, D02 VR98.

Investments in Group undertakings

Details of the Bank's investments in Group undertakings are shown in Notes 14 and 29. All of the Group undertakings are included in the Group's consolidated financial statements and all have an accounting reference date of 31 December except two which have an accounting reference date of 30 June.

Country-by-country reporting

The Bank has opted to publish the information required under Section 77 of Statutory Instrument No. 158 of 2014 on its website: www.ulsterbank.ie.

European Union (Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups) Regulations 2017

The Bank complies with the disclosure of the non-financial elements of the above regulations by publishing the required disclosures in its Strategic Report. This document is made available on the Bank's website (www.ulsterbank.ie) within six months of the Bank's financial year end date. No part of the Bank's website or its contents are deemed to be incorporated by reference unless specifically stated otherwise.

Directors' compliance statement

In accordance with the provisions of Section 225 of the Companies Act 2014, the directors acknowledge that they are responsible for securing the Bank's compliance with the relevant obligations, as defined by the Act. The directors confirm that:

- a compliance statement has been drawn up setting out the Group's policies in relation to complying with the relevant obligations;
- appropriate measures are in place that are designed to ensure material compliance with the relevant obligations; and
- the directors have carried out a review of these measures during the financial year.

Dividends

The Board approved and paid an interim dividend €1.5 billion during the financial year (2017 - nil). The Directors do not recommend the payment of a final dividend (2017 - nil).

Post balance sheet events

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

Auditors

The auditor, Ernst & Young, Chartered Accountants and Statutory Audit Firm, were appointed on 31 December 2016 and will continue in office in accordance with the Companies Act 2014.

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 Bank's auditors are unaware; and

(b) the director has taken all steps he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 330(1) of the Companies Act 2014.

On behalf of the Board:

Des O'Shea	Jane Howard
Chairman	Chief Executive Officer

13 February 2019

Statement of directors' responsibilities

The directors are responsible for preparing the directors' report and the financial statements in accordance with the Companies Act 2014 and applicable regulations.

Irish company law requires the directors to prepare the financial statements for each financial year. Under company law, the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union ("relevant financial reporting framework"). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the assets, liabilities and financial position of the Group and Bank as at the financial year end date and of the profit or loss of the Group and Bank for the financial year and otherwise comply with the Companies Act 2014.

In preparing these financial statements the directors are required to:

- select suitable accounting policies for the Bank and the Group financial statements and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the financial statements have been prepared in accordance with applicable accounting standards, identify those standards, and note the effect and the reasons for any material departure from those standards; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Bank will continue in business.

The directors are responsible for ensuring that the Group and Bank keep or cause to be kept adequate accounting records which correctly explain and record the transactions of the Group and Bank, enable at any time the assets, liabilities, financial position and profit or loss of the Group and Bank to be determined with reasonable accuracy, enable them to ensure that the financial statements and directors' report comply with the Companies Act 2014 and enable the financial statements to be audited. They are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website.

By order of the Board:

Des O'Shea
Chairman

Jane Howard
Chief Executive Officer

Paul Stanley
Chief Financial Officer

13 February 2019

Board of directors

Chairman
Des O'Shea

Executive directors
Jane Howard
Paul Stanley

Non-executive directors
Dermot Browne
Helen Grimshaw
William Holmes
Martin Murphy
Gervaise Slowey
Rosemary Quinlan

Independent auditor's report to the members of Ulster Bank Ireland Designated Activity Company

Opinion

We have audited the financial statements of Ulster Bank Ireland Designated Activity Company ('the Company') and its subsidiaries (all together, 'the Group') for the year ended 31 December 2018, which comprise the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group and Parent Company Statements of Changes in Equity, the Group and Parent Company Cash Flow Statements and notes to the financial statements, including the summary of significant accounting policies set out in Note 1. The financial reporting framework that has been applied in their preparation is Irish Law and International Financial Reporting Standards ('IFRS') as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2014.
In our opinion:

- the Group financial statements give a true and fair view of the assets, liabilities and financial position of the group as at 31 December 2018 and of its profit for the year then ended;
- the Company financial statements give a true and fair view of the assets, liabilities and financial position of the company as at 31 December 2018;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2014; and
- the Group financial statements and Company financial statements have been properly prepared in accordance with the requirements of the Companies Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (Ireland) (ISAs (Ireland)) and applicable law. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group and Company in accordance with ethical requirements that are relevant to our audit of financial statements in Ireland, including the Ethical Standard as applied to public interest entities issued by the Irish Auditing and Accounting Supervisory Authority (IAASA), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters	• Impairment provision on loans to customers under IFRS 9 • Remediation and associated programme costs provisions • Recoverability of deferred tax assets • IT systems and controls
Materiality	• Group materiality of €48m which represents 1% of Equity

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk
Impairment provision on loans to customers under IFRS 9 On 1 January 2018, the Group adopted IFRS 9 Financial Instruments, which replaced IAS 39 Financial Instruments: Recognition and Measurement. At year end the Group reported total gross loans to customers subject to expected credit losses ('ECL') of €24,806m and €879m of ECL. Key judgements and estimates in respect of the timing and measurement of ECL include: • Allocation of assets to stage 1, 2, or 3 using criteria in accordance with the accounting standard; • Modelling assumptions and key parameters used to build the models that calculate the ECL; • Completeness and accuracy of data used to calculate the ECL; • Inputs and assumptions used to estimate the impact of multiple economic scenarios; • Completeness and valuation of post model adjustments; • Accuracy and completeness of the financial statement disclosures. Refer to the Accounting policies and Notes 12 and 23 of the Consolidated Financial Statements.	As IFRS 9 was adopted at the beginning of the year, we performed audit procedures on the opening balances to gain assurance on the transition from IAS 39. This included evaluating the accounting interpretations for compliance with IFRS 9 and testing the adjustments and disclosures made on transition. We tested the design and operating effectiveness of key controls across the processes relevant to the ECL. This included the allocation of assets into stages, model governance, data accuracy and completeness, credit stewardship, multiple economic scenarios, post model adjustments and production of journal entries and disclosures. We attended the key risk committees where the inputs, assumptions and adjustments to the ECL were discussed and approved. We performed an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the Group's portfolio, risk profile, credit risk management practices and the macroeconomic environment. We considered trends in the economy and industries to which the Group is exposed. We challenged the criteria used to allocate an asset to stage 1, 2 or 3 in accordance with IFRS 9. We tested assets in stage 1, 2 and 3 to verify that they were allocated to the appropriate stage. With the support of our modelling specialists, we tested the assumptions, inputs and formulas used in a sample of ECL models. This included assessing the appropriateness of model design and formulas used, considering alternative modelling techniques and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of models. To verify data quality, we tested the data used in the ECL calculation by reconciling to source systems. With the support of our economic specialists, we assessed the base case and alternative economic scenarios, including challenging probability weights. We assessed whether forecasted macroeconomic variables were appropriate, such as GDP, unemployment, interest rates and House Price Index. With the support of our modelling specialists we challenged the correlation and impact of the macroeconomic factors to the ECL including how non-linearity was captured. We assessed the completeness and appropriateness of post model adjustments and recalculated a sample. Based on current economic conditions and market circumstances, we considered the need for sector or systemic adjustments. We assessed the appropriateness of the scenarios used in response to Brexit related economic uncertainty. We assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards including disclosure of transition from IAS 39. Our planned audit procedures were completed without material exception.

Risk	Our response to the risk
Remediation and associated programme cost provisions The continued heightened regulatory scrutiny gives rise to a high level of judgement in determining appropriate provisions and disclosures. At the year end the Group reported €287m (2017: €370m) of Provisions for liabilities and other charges of which €225m (2017: €326m) related to remediation and associated programme cost provisions. Management judgement is needed to assess whether an obligation exists and a provision should be recorded at 31 December 2018 in accordance with the accounting criteria set under IAS 37. This includes determining if: • It is likely that an economic outflow such as a payment will occur; and • The amount of the payment (or other economic outflow) can be estimated reliably The measurement of the provision is based on the best estimate of the expenditure to settle the present obligation. The most significant areas of judgement are: • Completeness of provisions recognised; judgement in the determination of whether an outflow in respect of identified material matters are probable or can be estimated reliably. • Measurement of provisions recognised; Integrity and completeness of data, and the appropriateness of assumptions and judgements used in the estimation of material provisions. • Adequacy of disclosures of contingent liabilities. Refer to the Accounting policies and Notes 19 and 24 of the Consolidated Financial Statements.	We tested the key controls over the identification, estimation and monitoring of provisions considering the potential for management override of controls. The controls tested include those implemented to assess the completeness and accuracy of data used to estimate provisions, and to check the accuracy and completeness of disclosures made in accordance with accounting standards. In obtaining sufficient audit evidence we: • Understood, assessed, and challenged the provisioning methodology. Tested the data and assumptions used in the calculation of the provisions recorded. Where appropriate, we involved our conduct risk specialists to review methodology. • Considered the policy decisions and the documentation supporting the Group's position including legal advice where available. • Considered regulatory correspondence as appropriate. • Reviewed the provision including programme costs to determine if the provision met the requirements of IAS 37. In addition, for matters where a provision was not recognised, we considered whether the outcome was probable and reliably estimable in accordance with the accounting criteria. • Attended meetings with key management and reviewed the minutes of meetings of those charged with governance to conclude on the appropriateness of the conclusions reached. • Tested the disclosure provided on provisions to determine whether it complied with accounting standards. Given the inherent estimation uncertainty and the judgemental nature of these provisions, we evaluated the appropriateness of the disclosure made in the financial statements. Our planned audit procedures were completed without material exception.

Risk	Our response to the risk
Recoverability of deferred tax assets The Group has deferred tax assets of €271m (2017: €285m). The recognition and carrying value of deferred tax assets are based on estimates of future profitability which require significant management judgement. Key judgements and estimates include: • Revenue and cost forecasts • Macro economic assumptions including Brexit • Key assumptions used in the recoverability assessments (discount rates, growth rates, macroeconomic assumptions, etc.) Refer to the Accounting policies and Note 8 of the Consolidated Financial Statements.	In the performance of our audit procedures, focus was placed on assessing the key judgement inputs and assumptions underlying the profit projections such as macro-economic assumptions, business growth rates, cost reduction and restructuring initiatives. In obtaining sufficient audit evidence we: • Tested the design and operating effectiveness of key controls around the preparation and review of budgets and forecasts supporting deferred tax assessment and profitability projections, including appropriate governance procedures and management challenge. • With the support of our EY Economists, we tested whether key macroeconomic assumptions used in the Group's forecasting process were reasonable and considered the impact of Brexit on the forecast. • We assessed the reasonableness of revenue forecasts by challenging the underlying business strategies, comparing to expected market trends and considering anticipated balance sheet growth. • We evaluated how the discount rates and long-term growth rates used by management compared to peer practice, external market data and EY reasonable ranges from corroborative calculations performed by our valuation specialists. • We tested how previous management forecasts and cost reduction programmes compared to actual results to evaluate the accuracy of the forecasting process. • We evaluated how management considered alternative assumptions and performed our own sensitivity and scenario analyses on certain key assumptions. Our planned audit procedures were completed without material exception.

Risk	Our response to the risk
IT systems and controls The IT environment is complex and pervasive to the operations of the Group due to the large volume of transactions processed in numerous locations daily and the reliance on automated and IT dependent manual controls. Our audit approach relies upon IT applications and the related control environment including: • User access management across application, database and operating systems; • Changes to the IT environment, including transformation that changes the IT landscape; • IT operational controls; • IT application or IT dependent controls; and • Evaluation of IT control environment at third party service providers.	We tested the design and operating effectiveness of IT controls over the relevant applications, operating systems and databases that are relevant to financial reporting. Our testing included evaluating IT general controls over the appropriateness of access rights and password settings, authorisation of changes to the IT environment, and monitoring of job scheduling, back-ups and incidents. We tested automated controls within business processes and the reliability of relevant reports used as part of a manual control. This included challenging the integrity of interfaces, the completeness and accuracy of data feeds, automated calculations and specific input controls. Where we identified systems outsourced to third party service providers we evaluated IT general controls through the relevant Service Organisation Controls Reports produced by third parties and tested any required complementary controls performed by the Group. Where control deficiencies were identified, we tested remediation activities performed by management and any compensating controls in place. We performed alternative substantive procedures where necessary to mitigate any residual risk. Our planned audit procedures were completed without material exception.

In the prior year we included a key audit matter in relation to valuation of derivative financial instruments with higher risk characteristics. We have removed this key audit matter following the collapse of the Celtic structures which previously held the complex derivative financial instruments. These derivatives which drove our increased risk assessment have all been fully redeemed and no longer appear on the balance sheet.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

Materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be €48m (2017: €64m), which equates to 1% of Equity (2017: 1%). We believe that Equity provides us with the most appropriate basis for materiality having considered the expectation of the users of the financial statements, the ultimate parent entity and the overall business environment.

Performance materiality

Performance materiality is the threshold for application of materiality at the individual account or balance level. Performance materiality is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the overall control environment, our judgement was that performance materiality should be set at 75% (2017: 50%) of our planning materiality, namely €36m (2017: €32m). We have set performance materiality at this percentage having considered our prior year experience of the risk of misstatements, both corrected and uncorrected.

Reporting threshold

The reporting threshold is set as the amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of €2.4m (2017: €3.2m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. Our reporting threshold amount is designated at an amount below which misstatements would not be accumulated because we expect that the accumulation of such amounts clearly would not have a material effect on the financial statements.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

An overview of the scope of our audit report

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of Group wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity.

There have been no significant changes in scoping from that applied in our prior year audit as all subsidiaries are included in full scope population and all audit work performed for the purposes of these financial statements was undertaken by the Group audit team.

Other information

The directors are responsible for the other information. Other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2014

Based solely on the work undertaken in the course of the audit, we report that:

- in our opinion, the information given in the directors' report is consistent with the financial statements; and
- in our opinion, the directors' report has been prepared in accordance with the Companies Act 2014.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit.

In our opinion the accounting records of the Company were sufficient to permit the financial statements to be readily and properly audited and the Company statement of financial position is in agreement with the accounting records.

Matters on which we are required to report by exception

Based on the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report.

The Companies Act 2014 requires us to report to you if, in our opinion, the disclosures of directors' remuneration and transactions required by sections 305 to 312 of the Act are not made. We have nothing to report in this regard.

Respective responsibilities

Responsibilities of directors for the financial statements

As explained more fully in the directors' responsibilities statement set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and have a direct impact on the preparation of the financial statements and understood how the Group is complying with those frameworks by reviewing policy framework, holding discussions with the Group's general counsel, internal audit, amongst others.

- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Chief Executive Officer, Chief Financial Officer, Head of Internal Audit and Group Audit Committee Chairman. We also reviewed the Group's fraud-related policies and mandates of different governance forums assessing fraud.

- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reviewing the correspondence exchanged with the Regulator.

A further description of our responsibilities for the audit of the financial statements is located on the IAASA's website at: http://www.iaasa.ie/getmedia/b2389013-1cf6-458b-9b8f-a98202dc9c3a/Description_of_auditors_responsibilities_for_audit.pdf.

This description forms part of our auditor's report.

Other matters which we are required to address

We were appointed by the board of Ulster Bank Ireland Designated Activity Company on 20 April 2016 to audit the financial statements for the year ending 31 December 2016 and subsequent financial periods. The current period of total uninterrupted engagement including previous renewals and reappointments of the firm is 3 years.

The non-audit services prohibited by IAASA's Ethical Standard were not provided to the Group and we remain independent of the Group in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

The purpose of our audit work and to whom we owe our responsibilities

Our report is made solely to the Company's members, as a body, in accordance with section 391 of the Companies Act 2014. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Martina Keane
for and on behalf of
Ernst & Young Chartered Accountants and Statutory Audit Firm

Office: Dublin

Date: 13 February 2019

Consolidated income statement for the financial year ended 31 December 2018

	Note	2018 €m	2017 €m
Interest receivable		558	545
Interest payable		(58)	(74)
Net interest income	2	500	471
Fees and commission receivable		113	114
Fees and commission payable		(8)	(9)
Other operating income		120	33
Non-interest income	3	225	138
Total income		725	609
Staff costs		(191)	(220)
Premises and equipment		(44)	(50)
Other administrative expenses		(360)	(427)
Depreciation and amortisation		(8)	(12)
Operating expenses	4	(603)	(709)
Profit/(loss) before impairment losses		122	(100)
Impairment losses	12	(23)	(68)
Operating profit/(loss) before tax		99	(168)
Tax (charge)/credit	8	(14)	6
Profit/(loss) for the financial year		85	(162)
Attributable to:			
Ordinary shareholders		85	(162)

Consolidated statement of comprehensive income for the financial year ended 31 December 2018

	2018 €m	2017 €m
Profit/(loss) for the financial year	85	(162)
Items that do not qualify for reclassification		
Gains on remeasurement of retirement benefit schemes	9	93
Fair value through other comprehensive income (FVOCI) financial assets	(1)	-
Tax	(1)	(12)
	7	81
Items that do qualify for reclassification		
Fair value through other comprehensive income (FVOCI) financial assets	2	(3)
Other comprehensive income after tax	9	78
Total comprehensive income/(loss) for the financial year	94	(84)
Attributable to:		
Ordinary shareholders	94	(84)

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

Balance sheet as at 31 December 2018

		Group		Bank	
		2018	2017	2018	2017
	Note	€m	€m	€m	€m
Assets					
Cash and balances at central banks	11	287	322	287	322
Derivatives	10	210	582	210	554
Loans to banks - amortised cost	11	3,065	2,757	2,817	2,757
Loans to customers - amortised cost	11	21,016	21,711	21,016	21,711
Amounts due from holding companies and fellow subsidiaries	11	1,458	2,375	3,993	8,070
Other financial assets	13	2,949	2,043	2,949	2,043
Investments in group undertakings	14	-	-	7	5
Other assets	15	553	458	551	456
Total assets		29,538	30,248	31,830	35,918
Liabilities					
Bank deposits - amortised cost	11	1,983	2,000	1,983	2,000
Customer deposits - amortised cost	11	20,085	19,079	20,085	19,079
Other financial liabilities	17	1,045	697	176	697
Amounts due to holding companies and fellow subsidiaries	11	869	1,066	4,061	6,770
Derivatives	10	131	439	131	204
Subordinated liabilities	18	86	86	86	86
Other liabilities	19	436	478	436	476
Total liabilities		24,635	23,845	26,958	29,312
Owners' equity		4,903	6,403	4,872	6,606
Total liabilities and equity		29,538	30,248	31,830	35,918

The accompanying notes form an integral part of these financial statements. As detailed in Note 9 the Bank's loss after tax for the year ended 31 December 2018 was €141 million (2017 - €151 million).

The financial statements were approved by the Board of Directors on 13 February 2019 and signed on its behalf by:

Des O'Shea	Jane Howard	Paul Stanley	Andrew Nicholson
Chairman	Chief Executive Officer	Chief Financial Officer	Company Secretary

Statement of changes in equity for the financial year ended 31 December 2018

	Group		Bank	
	2018	2017	2018	2017
	€m	€m	€m	€m
Called up share capital - at 1 January and 31 December (Note 20)	3,592	3,592	3,592	3,592
Share premium - at 1 January and 31 December	1,142	1,142	1,142	1,142
Arising on business transfer during the financial year (Note 20)	2	-	2	-
At 31 December	1,144	1,142	1,144	1,142
FVOCI reserve - at 1 January	-	3	-	3
Gain/(loss) in the financial year	1	(3)	1	(3)
At 31 December	1	-	1	-
Foreign exchange reserve - at 1 January	-	(2)	-	-
Transfer to retained earnings	-	2	-	-
At 31 December	-	-	-	-
Retained earnings - at 1 January	1,669	1,752	1,872	1,942
Implementation of IFRS 9 on 1 January 2018[1]	(96)	-	(104)	-
Gains on remeasurement of retirement benefit schemes	9	93	9	93
Tax	(1)	(12)	(1)	(12)
Transfer from foreign exchange reserve	-	(2)	-	-
Profit/(loss) attributable to ordinary shareholders	85	(162)	(141)	(151)
Dividends paid	(1,500)	-	(1,500)	-
At 31 December	166	1,669	135	1,872
Owners' equity at 31 December	4,903	6,403	4,872	6,606
Non-controlling interests - at 1 January	-	1	-	-
Decrease in existing non-controlling interests holdings	-	(1)	-	-
At 31 December	-	-	-	-
Total equity at 31 December	4,903	6,403	4,872	6,606
Total comprehensive income/(loss) recognised in the statement of changes in equity is attributable as follows:				
Ordinary shareholders	94	(84)	(132)	(73)

Note:

(1) Refer to Note 30 for further information on the impact of IFRS 9. The financial year ended 31 December 2018 was prepared under IFRS 9 and the financial year ended 31 December 2017 under IAS 39.

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

Cash flow statement for the financial year ended 31 December 2018

	Note	Group 2018 €m	Group 2017 €m	Bank 2018 €m	Bank 2017 €m
Cash flows from operating activities					
Operating profit/(loss) before tax		99	(168)	(127)	(157)
Depreciation, amortisation and impairment of property, plant and equipment		8	12	8	12
Interest on subordinated liabilities		5	5	5	5
Dividends received		(3)	(1)	(5)	(31)
Defined benefit pension schemes		(104)	(202)	(104)	(202)
Impairment losses on loans to banks and customers		23	68	19	68
Loans written-off		(421)	(128)	(421)	(128)
Impairment of investments in Group undertakings		-	-	1	2
Elimination of foreign exchange differences		(6)	(16)	(6)	(16)
Other provisions charged net of releases		87	200	87	200
Other non-cash items		(15)	29	(17)	37
Net cash outflow from trading activities		(327)	(201)	(560)	(210)
Decrease in loans to banks and customers		721	337	973	337
Decrease/(increase) in amounts due from holding companies and fellow subsidiaries		481	(61)	3,385	2,459
Decrease in other financial assets		149	118	149	118
(Increase)/decrease in other assets		(9)	7	(9)	9
Decrease/(increase) in derivative assets and liabilities		64	(4)	271	285
Increase in banks and customers deposits		468	1,434	468	1,434
(Decrease)/increase in amounts due to holding companies and fellow subsidiaries		(197)	249	(2,709)	(3,641)
Decrease in other liabilities		(126)	(84)	(124)	(87)
Changes in operating assets and liabilities		1,551	1,996	2,404	914
Income taxes received/(paid)		-	(3)	1	(2)
Net cash flows from operating activities[1]		1,224	1,792	1,845	702
Cash flows from investing activities					
Sale and maturity of debt securities		1,311	1,355	1,311	1,355
Purchase of debt securities		(2,224)	(1,124)	(2,224)	(1,124)
Sale of equity shares		-	(1)	-	(1)
Sale of property, plant and equipment		5	3	4	3
Purchase of property, plant and equipment		(9)	(12)	(9)	(12)
Acquisition of subsidiary undertakings		(4)	-	(4)	-
Disposal of subsidiary undertakings		4	-	4	-
Dividends received		3	1	5	31
Net cash flows (used in)/from investing activities		(914)	222	(913)	252
Cash flows from financing activities					
Issue/(redemption) of debt securities in issue		869	(1,377)	-	-
Redemption of subordinated liabilities		-	(100)	-	(100)
Interest on subordinated liabilities		(5)	(5)	(5)	(5)
Redemption of non-controlling interest		-	(1)	-	-
Dividends paid		(1,500)	-	(1,500)	-
Net cash flows used in financing activities		(636)	(1,483)	(1,505)	(105)
Effect of exchange rate changes on cash and cash equivalents		6	(26)	6	(26)
Net (decrease)/increase in cash and cash equivalents		(320)	505	(567)	823
Cash and cash equivalents 1 January	26	5,471	4,966	5,471	4,648
Cash and cash equivalents 31 December	26	5,151	5,471	4,904	5,471

Note:
(1) Includes interest received of: Group €560 million (2017 - €556 million); Bank €567 million (2017 - €573 million) and interest paid of: Group €115 million (2017 - €107 million); Bank €355 million (2017 - €253 million).

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

1. Accounting policies

a) Presentation of accounts

The accounts, set out on pages 18 to 106 including these accounting policies on pages 22 to 28 and the Risk management section on pages 58 to 96, are prepared on a going concern basis (see the Report of the directors, page 8) and in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted by the EU (together IFRS).

The Bank is incorporated as a designated activity company and registered in the Republic of Ireland (Registration number - 25766). The Bank's registered and head office is Ulster Bank Group Centre, George's Quay, Dublin 2, D02 VR98. The Group and Bank's accounts are presented in accordance with the Companies Act 2014 and the European Communities (Credit Institutions: Financial Statements) Regulations, 2015. With the exception of certain financial instruments as described in accounting policies (m) and (v) the accounts are presented on a historical cost basis.

Adoption of IFRS 9

Refer to Note 30 for details of the adoption of IFRS 9.

Other amendments to IFRS

IFRS 15 'Revenue from Contracts with Customers' has been adopted with effect from 1 January 2018. The accounting policy is updated to reflect the terminology in the new standard but it has had no effect on financial information reported in the current or comparative periods. Interest income and expense continues to be recognised using the effective interest rate method for financial instruments measured at historical cost. There has been no restatement of profit or loss for comparative periods.

Other amendments to IFRS effective for 2018, have not had a material effect on the Group's financial statements.

b) Basis of consolidation

The consolidated accounts incorporate the financial statements of the Bank and entities (including certain structured entities) that are controlled by the Group. The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity. Power generally arises from holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at their fair value. A subsidiary is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances.

Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions.

All inter-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated financial statements are prepared under uniform accounting policies.

c) Revenue recognition

Interest income or expense on financial instruments that are measured at amortised cost and fair value through other comprehensive income is determined using the effective interest rate method. The effective interest rate allocates the interest income or interest expense over the expected life of the asset or liability at the rate that exactly discounts all estimated future cash flows to equal the instrument's initial gross carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows. Negative effective interest accruing to financial assets is presented in interest payable. When a financial asset becomes credit-impaired (Stage 3), interest income is recognised by applying the effective interest rate to the net amortised cost of the financial asset. If the financial asset is no longer credit-impaired, the calculation reverts to the gross basis.

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

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

d) Assets held for sale

A non-current asset is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset is acquired as part of a business combination it is initially measured at fair value less costs to sell. Non-current assets classified as held for sale are shown under the heading of Other assets on the balance sheet.

e) Employee benefits

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

1. **Accounting policies** continued

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

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

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

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

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

f) Intangible assets

Intangible assets relate to the development of computer software and are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in depreciation and amortisation. These estimated useful economic lives are between 3 and 12 years.

Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate.

Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred, as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

g) Property, plant and equipment

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

Depreciation is charged to profit or loss on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated. The estimated useful lives of the Group's property, plant and equipment are:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

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

h) Impairment of intangible assets and property, plant and equipment

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

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets or property, plant and equipment can be recognised when an increase in service potential arises provided the increased carrying value is not greater than it would have been, had no impairment loss been recognised.

1. **Accounting policies** continued

i) Foreign currencies

The Group's consolidated financial statements are presented in Euro, which is the functional currency of the Group.

Transactions in foreign currencies are recorded in the functional currency at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in non-interest income.

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

Assets and liabilities of foreign operations are translated into euro at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into euro at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions.

j) Leases

As lessor

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

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

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within property, plant and equipment and depreciated over their useful lives (accounting policy (g)). Operating lease rentals receivable are included in other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

k) Provisions

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

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

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

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

l) Taxation

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

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

1. **Accounting policies** continued

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

m) Financial instruments

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

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

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

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

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

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

Assets designated at fair value through other comprehensive income – An equity instrument may be designated irrevocably at fair value through other comprehensive income. Other assets have to meet both the following criteria:

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

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

Fair value - the fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

n) Impairments

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

1. Accounting policies continued

Expected credit losses are a probability-weighted estimate of credit losses. The probability is determined by the risk of default which is applied to the cash flow estimates. In the absence of a change in credit rating, allowances are recognised when there is reduction in the net present value of expected cash flows. On a significant increase in credit risk, allowances are recognised without a change in the expected cash flows, although typically expected cash flows do also change; and expected credit losses are rebased from 12 month to lifetime expectations.

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

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

The costs of loss allowances on assets held at amortised cost are presented as impairments in the income statement. Allowances in respect of financial guarantees and loan commitments are presented in administrative expenses.

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

o) Financial guarantee contracts

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

p) Loan commitments

Provision is made for expected credit loss on loan commitments, other than those classified as held-for-trading

q) Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition.

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

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement.

The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt.

The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

r) Securitisation of residential mortgages

In accordance with the requirements of IFRS 10, the Group consolidates securitisation entities in which it does not hold voting rights but where it does retain the majority of the residual ownership risks and rewards in respect of interests in mortgages initially originated by the Bank or First Active Limited where the beneficial interest in the mortgage has been transferred to the relevant securitisation entity. The transaction involves the issuance of debt securities by the securitisation entity to fund the purchase price of the mortgage pool and provision of a subordinated loan by UBIDAC to the securitisation entity to fund reserves. Excess returns generated by the mortgage pool are paid to the Bank via a coupon on the most junior tranche of debt securities, which is retained by the Bank.

The Bank retains the risks and rewards of ownership of the mortgages through ownership of the junior debt securities and provisions of the subordinated loan. Therefore the mortgages are not derecognised from the balance sheet of the Bank. When the Bank has an asset to which it is contractually entitled under the terms of the transaction or a contractual liability these are recognised in full in the balance sheet of the Bank. Income and costs are recognised in profit or loss on an accruals basis.

1. **Accounting policies** continued

Senior and junior debt securities and assets in respect of the subordinated debt are recognised in the Bank balance sheet as Amounts due from holding companies and fellow subsidiaries. Liabilities due to the securitisation entities in respect of the cash flows from the underlying mortgages are recognised as Amounts due to holding companies and fellow subsidiaries in the Bank balance sheet.

As the securitisation entities are included in the Group's financial position under IFRS 10 all transactions and balances between the Bank and securitisation entities are fully eliminated on consolidation in the Group financial statements.

s) Sale and repurchase transactions

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

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

t) Netting

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

u) Capital instruments

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

v) Derivatives and hedging

In accordance with IAS 39 'Hedge relationships', derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 11 to the accounts.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the host is a financial asset or the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in non-interest income.

The Group enters into hedge relationships in respect of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges).

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

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

w) Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

1. **Accounting policies** continued

x) Investments in Group undertakings

The Bank's investments in its subsidiaries are stated at cost less any impairment losses.

y) Critical accounting policies and key sources of estimation uncertainty

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

The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

Critical accounting policy	Note
Pensions	6
Deferred tax	8
Fair value: financial instruments	11
Loan impairment provisions	12
Provisions for liabilities and charges	19

z) Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2018 that would affect the Group from 1 January 2019 or later. On adoption, none of these standards are expected to have a material effect on the Group's results.

Effective 1 January 2019

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

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

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

The opening balance sheet at 1 January 2019 will be adjusted to create a right of use asset of approximately €37 million. A lease liability will also be recognised of €57 million. Retained earnings will decrease by €20 million before tax.

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

Effective after 2019

IFRS 17 'Insurance contracts' was issued in May 2017 to replace IFRS 4 and to establish a comprehensive standard for inceptors of insurance policies. The effective date is 1 January 2021, subject to IASB's approval of a deferral until 1 January 2022.

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

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

2. Net interest income

	Group	
	2018	2017
	€m	€m
Interest receivable on assets:		
Loans to customers - amortised cost	540	545
Interest receivable on liabilities:		
Bank deposits - amortised cost	18	-
Total Interest receivable	558	545
Interest payable on liabilities:		
Bank deposits - amortised cost	(9)	(16)
Customer deposits: demand - amortised cost	(14)	(10)
Customer deposits: savings - amortised cost	(1)	(1)
Customer deposits: other time - amortised cost	(5)	(14)
Other financial liabilities	-	(1)
Subordinated liabilities	(5)	(5)
Interest payable on assets:		
Loans to banks - amortised cost	(11)	(17)
Other financial assets	(13)	(10)
Total interest payable	(58)	(74)
Net interest income [1]	500	471

Note:

(1) Included within net interest income is €25 million (2017 - €29 million) of interest on impaired loans.

3. Non-interest income

	Group	
	2018	2017
	€m	€m
Net fees and commissions (Note 5)	105	105
Other operating income:		
Profit on disposal or settlement of loans	9	10
Loss on redemption of subordinated debt	-	(9)
Economic hedged and designated hedged ineffectiveness		
- Foreign exchange	11	15
- Interest rates	88	7
- Changes in fair value of own debt and derivative liabilities attributable to own credit	-	(4)
- Equities and other	-	4
Other income	12	10
	120	33
Non-interest income	225	138

4. Operating expenses

	Group	
	2018	2017
	€m	€m
Wages, salaries and other staff costs	152	150
Social security costs	17	17
Pension costs		
- defined benefit schemes (Note 6)	24	32
- defined contribution schemes	2	3
Restructure costs	(4)	18
Staff costs	191	220
Premises and equipment	44	50
Other administrative expenses	360	427
Administrative expenses	404	477
Property, plant and equipment depreciation and impairment (Note 16)	8	12
	603	709

Included within administrative expenses is €74 million (2017 - €192 million) in respect of conduct and remediation provisions. Further details are provided in Note 19.

The average number of persons employed by the Group during the year, excluding temporary staff, was 2,368 (2017 - 2,491). The average number of temporary employees during 2018 was 247 (2017 - 209). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group	
	2018	2017
	Number	Number
Personal Banking	908	1,011
Commercial Banking	363	334
Other	1,072	992
	2,343	2,337

Amounts paid to the auditors for the statutory audit and other services are set out below:

	Group	
	2018	2017
	€'000	€'000
Fees payable for the audit of the Bank's individual and Group accounts	1,595	1,670
Fees payable to the auditor for other assurance services	65	45
Total audit and audit related assurance service fees	1,660	1,715

Other than the amounts disclosed above, no remuneration was payable in respect of tax advisory services and other non-audit services. The figures in the auditor's remuneration table relate to fees payable to the statutory auditor, exclusive of VAT.

5. Segmental analysis

The Group operates in the financial services industry in the Republic of Ireland. The directors manage the Group primarily by class of business and present the segmental analysis on that basis. Funding charges between divisions are determined by Treasury, having regard to commercial demands.

Reportable operating segments

The reportable operating segments are as follows:

Personal Banking: Personal Banking, including Business Direct customers, provides loan and deposit products through a network of branches and direct channels.

Commercial Banking: Commercial Banking provides services to business and corporate customers, including small and medium enterprises.

Other: Other represents central functions comprising Group and corporate functions such as Treasury, Finance, Risk, Compliance, Legal, Customer Debt Solutions, Communications and Human Resources which support the Personal Banking and Commercial Banking divisions.

5. Segmental analysis continued

Class of Business	Group							
	2018				2017			
2018	Personal Banking €m	Commercial Banking €m	Other €m	Total €m	Personal Banking €m	Commercial Banking €m	Other €m	Total €m
Net interest income	381	126	(7)	500	350	128	(7)	471
Net fees and commissions	62	40	3	105	72	35	(2)	105
Other operating income	51	29	40	120	51	40	(58)	33
Total income	494	195	36	725	473	203	(67)	609
Operating profit/(loss) before tax	361	153	(415)	99	245	179	(592)	(168)
Total assets	16,418	5,260	7,860	29,538	17,450	4,999	7,799	30,248
Total liabilities	(11,198)	(9,567)	(3,870)	(24,635)	(10,701)	(9,511)	(3,633)	(23,845)
Net assets/(liabilities)	5,220	(4,307)	3,990	4,903	6,749	(4,512)	4,166	6,403

Class of business	2018				2017			
	Personal Banking €m	Commercial Banking €m	Other €m	Total €m	Personal Banking €m	Commercial Banking €m	Other €m	Total €m
Fees and commission receivable								
- Payment services	27	11	3	41	29	5	-	34
- Credit and debit card fees	20	5	-	25	25	4	-	29
- Lending (Credit facilities)	10	23	-	33	9	26	-	35
- Brokerage	7	-	-	7	11	-	-	11
- Trade finance	-	2	-	2	-	-	-	-
- Investment management	5	-	-	5	5	-	-	5
Total	69	41	3	113	79	35	-	114
Fees and commission payable	(7)	(1)	-	(8)	(7)	-	(2)	(9)
Net fees and commissions	62	40	3	105	72	35	(2)	105

6. Pensions

Defined contribution schemes

The Group makes contributions to a small number of RBS Group pension schemes, the costs of which are accounted for as defined contributions.

Defined benefit schemes

The Group operates the following defined benefit pension schemes, the assets of which are independent of the Group's finances:

Name of schemes

Ulster Bank Pension Scheme (Republic of Ireland) ("main scheme")
First Active Pension Scheme ("FA scheme")
Lombard Ireland Limited Non-Contributory Pension and Death Benefit Plan ("Lombard scheme")

The Group's main scheme operates under Irish trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, scheme rules and Irish legislation (principally the Pensions Act 1990).

Under Irish legislation a defined benefit pension scheme is required to build up and maintain enough funds to pay members their pension entitlements should the scheme be wound up. Pension fund trustees are required to obtain regular actuarial valuations and reports, put in place a recovery plan addressing any funding shortfall and submit that plan to the Irish Pensions Authority for approval.

The corporate trustee of the main scheme is Ulster Bank Pension Trustees (RI) Limited ("UBPTRIL"), a wholly owned subsidiary of the Bank. UBPTRIL is the legal owner of the scheme assets which are held separately from the assets of the Group. The board of UBPTRIL comprises two trustee directors nominated by the unions and seven appointed by the Group. The board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Group, but who still have benefits in the scheme. Similar governance principles apply to the other two schemes. The schemes were closed to new entrants beyond 2010, when new defined contribution schemes were launched.

6. Pensions continued

Employees make contributions at varying levels depending on which scheme they are a member of and when they joined the scheme. In addition, employees may make voluntary contributions to secure additional benefits on a money-purchase basis.

Pension risk is the risk to the Group arising from its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees, for those of a related company or otherwise. For further details on pension risk, refer to Note 23.

Investment strategy

The assets of the schemes are invested in a diversified portfolio of quoted equities, government and corporate fixed-interest and index-linked bonds, and other assets including real estate and hedge funds.

The schemes employ derivative instruments to achieve a desired asset class exposure and to reduce the scheme's interest rate, inflation and currency risk. This means that the net funding position is considerably less sensitive to changes in market conditions than the value of the assets or liabilities in isolation.

	2018			2017		
Major classes of plan assets as a weighted percentage of total plan assets of the schemes	Quoted %	Unquoted %	Total %	Quoted %	Unquoted %	Total %
Equities	19	2	21	27	2	29
Government fixed interest bonds	9	-	9	8	-	8
Corporate and other bonds	29	2	31	32	-	32
Hedge funds	-	3	3	-	2	2
Real Estate	-	3	3	-	3	3
Derivatives	-	5	5	-	5	5
Cash and other assets	-	28	28	-	21	21
	57	43	100	67	33	100

	Group and Bank		
Changes in value of net pension asset/(liability)	Fair value of plan assets €m	Present value of defined benefit obligations €m	Net pension asset/(liability) €m
At 1 January 2017	1,354	(1,598)	(244)
Income statement	30	(62)	(32)
Statement of comprehensive income	48	45	93
Contributions by employer	234	-	234
Contributions by plan participants	2	(2)	-
Benefits paid	(45)	45	-
At 1 January 2018	1,623	(1,572)	51
Income statement:	36	(60)	(24)
Net interest cost	36	(35)	1
Current service cost	-	(23)	(23)
Expenses	-	(2)	(2)
Statement of comprehensive income:	(47)	56	9
Return on plan assets above recognised interest income	(47)	-	(47)
Experience gains and losses	-	11	11
Effect of changes in actuarial financial assumptions	-	44	44
Effect of changes in actuarial demographic assumptions	-	1	1
Contributions by employer	128	-	128
Contributions by plan participants	2	(2)	-
Benefits paid	(49)	49	-
At 31 December 2018	1,693	(1,529)	164

6. Pensions continued

Amounts recognised on the balance sheet	All schemes 2018 €m	2017 €m
Fund assets at fair value	1,693	1,623
Present value of fund liabilities	(1,529)	(1,572)
Retirement benefit asset	164	51

Net pension asset comprises	Group and Bank 2018 €m	2017 €m
Net assets of schemes in surplus (included in Other assets - Note 15)	165	62
Net liabilities of schemes in deficit (included in Other liabilities - Note 19)	(1)	(11)
	164	51

Amounts recognised in the income statement	Group and Bank 2018 €m	2017 €m
Operating expenses	24	32

Funding and contributions by the Group

In the Republic of Ireland, the Trustees of defined benefit pension schemes are required to perform funding valuations every three years. The Trustees and the Company, with the support of the scheme actuary, agree the assumptions used to value the liabilities and a Schedule of Contributions required to eliminate any funding deficit. The funding assumptions incorporate a margin for prudence over and above the expected cost of providing the benefits promised to members, taking into account the sponsor's covenant and the investment strategy of the scheme. The last funding valuation of the main scheme was at 31 December 2015 and the next funding valuation is due at 31 December 2018. A special contribution of €100 million was made to the main scheme in December 2018 as part of an agreement to facilitate a further reduction in investment risk. The funding plan for the FA scheme remains in place for €6.8 million p.a. until 2020 (increasing in line with inflation each year). For both schemes contingent asset arrangements have been put in place to cover the Risk Reserve requirements arising under the Minimum Funding Standard framework.

A funding plan was put in place for the Lombard scheme during 2016 which requires contributions of €1.65 million p.a. until 2025.

The Group expects to contribute €25 million to its defined benefit pension schemes in 2019.

Critical accounting policy: Pensions

The assets of defined benefit schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at an interest rate based on the yields of high-quality corporate bonds of appropriate duration, with high-quality almost universally understood to mean AA-rated.

The choice of discount rate is a source of estimation uncertainty, due to a lack of appropriate Euro-denominated AA-rated bonds of equivalent duration to the pension schemes' liabilities.

The approach used is to fit a yield curve to an appropriate dataset of AA bonds, and derive the discount rate from that curve.

To increase the number of reference bonds available at the end of the reporting period, equivalent AA yields were extrapolated for longer dated A and AAA rated bonds by applying a credit spread adjustment to their actual yields. These were then included in the dataset used to create the yield curve.

Assumptions

Placing a value on the Group's defined benefit pension schemes' liabilities requires the Group's management to make a number of assumptions, with the support of independent actuaries who provide advice and guidance. In determining the value of scheme liabilities, financial and demographic assumptions are made as to price inflation, pension increases, earnings growth and employee life expectancy. A range of assumptions could be adopted in valuing the schemes' liabilities. The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events and the assumptions made are unlikely to be exactly borne out in practice, meaning the final cost may be higher or lower than expected.

6. Pensions continued

A year-end valuation of the Group's pension schemes was prepared to 31 December 2018 by independent actuaries, using the following assumptions:

	Principal IAS 19 actuarial assumptions		Principal assumptions of 2015 triennial valuation
	2018	2017	2015
	%	%	%
Discount rate	2.30	2.20	Fixed interest Euro swap yield curve plus 2.05% per annum from 2016 through 2023 reducing uniformly thereafter to 0.80% per annum by 2046
Inflation assumption (CPI)	1.55	1.75	CPI Euro swap yield curve
Rate of increase in salaries	1.35	1.50	CPI curve with an allowance for the 0% per annum floor and 2% per annum cap
Rate of increase in deferred pensions	1.65	1.70	CPI curve with an appropriate cap and floor
Rate of increase in pensions in payment	0.00 - 1.65	0.00 - 1.85	0.00% per annum
Proportion of pension converted to a cash lump sum at retirement	12.00	12.00	12.00
Longevity:	years	years	years
Current pensioners, aged 70 years			
Males	17.9	17.8	17.8
Females	19.3	19.2	19.1
Future pensioners, currently aged 63 years			
Males	24.4	24.3	24.3
Females	26.1	26.0	25.9

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

Discount rate

The IAS 19 valuation uses a single discount rate by reference to the yield on a basket of 'high quality' sterling corporate bonds. For the triennial valuation discounting is by reference to a yield curve.

The weighted average duration of the Group's defined benefit obligation at 31 December 2018 is 21 years (2017 - 22 years).

Significant judgement is required when setting the criteria for bonds to be included in IAS 19's basket of bonds that is used to determine the discount rate used in the valuations. The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

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

	Group and Bank			
	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2018	2017	2018	2017
	€m	€m	€m	€m
0.25% increase in the discount rate	(4)	(4)	(79)	(86)
0.25% increase in inflation	1	1	27	30
Longevity increase of 1 year	2	2	43	44
0.25% additional rate of increase in pensions in payment	1	-	18	19
0.25% additional rate of increase in deferred pensions	-	-	18	21
0.25% additional rate of increase in salaries	2	2	17	19

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions:

Membership category	2018 %	2017 %
Active members	29.4	28.6
Deferred members	40.1	40.4
Pensioners and dependents	30.5	31.0
	100.0	100.0

6. Pensions continued

The experience history of Group schemes is shown below.

History of defined benefit schemes	2018 €m	2017 €m	2016 €m	2015 €m	2014 €m
Present value of defined benefit obligations	(1,529)	(1,572)	(1,598)	(1,456)	(1,650)
Fair value of plan assets	1,693	1,623	1,354	1,069	1,062
Net surplus/(deficit)	164	51	(244)	(387)	(588)
Experience gains on plan liabilities	11	18	48	15	12
Experience (losses)/gains on plan assets	(47)	48	79	(26)	129
Actual return on pension scheme assets	(11)	78	111	(2)	162

7. Emoluments of directors

	2018 €	2017 €
Emoluments for the provision of directors' services	1,571,975	1,583,885
Contributions and allowances in respect of pension schemes	73,270	69,384
Emoluments relating to long-term incentive schemes	350,975	151,101
Total emoluments received	1,996,220	1,804,370

Retirement benefits were accruing to two directors under defined contribution schemes as at 31 December 2018 (2017 - one). No retirement benefits were accruing to directors under defined benefit schemes as at 31 December 2018 or as at 31 December 2017.

No share options were exercised during the year that resulted in gains to directors (2017 - none).

Performance related bonuses are awarded to executive directors on the basis of measuring annual performance against certain specified financial targets, which include both corporate performance objectives and key strategic objectives.

During the financial year there were no emoluments in respect of compensation payments for loss of office (2017 - nil).

During the year the highest paid director received emoluments of €637,269 (2017 - €917,661).

The executive directors may also participate in the RBS executive share option and Sharesave schemes.

There were no amounts paid or payable to third parties during the financial year or the preceding financial year in respect of making available the services of any person as a director of the Bank or any of its subsidiaries or otherwise in connection with the management of the Group's affairs.

8. Tax

	2018 €m	2017 €m
Corporation tax at 12.5% (2017 - 12.5%)		
(Charge)/credit for the financial year	(1)	2
Deferred tax		
(Charge)/credit for the financial year	(13)	4
Tax (charge)/credit for the financial year	(14)	6

The actual tax (charge)/credit differs from the expected tax (charge)/credit computed by applying the standard rate of Irish Corporation tax of 12.5% (2017 - 12.5%) as follows:

	2018 €m	2017 €m
Expected tax (charge)/credit	(12)	21
Tax arising at rates other than the standard rate of tax	(28)	(17)
Temporary differences	1	(2)
Non-deductible items	(3)	(3)
Non-taxable income	57	33
Deferred tax not recognised on current year losses	(29)	(26)
Actual tax (charge)/credit for the financial year	(14)	6

8. Tax continued

Deferred tax

Net deferred tax asset comprised:

	Group and Bank			
	Pension €m	Accelerated capital allowances €m	Tax losses €m	Total €m
At 1 January 2017	2	(1)	292	293
Credit to income statement	4	-	-	4
Charge to other comprehensive income	(12)	-	-	(12)
At 1 January 2018	(6)	(1)	292	285
Charge to income statement	(13)	-	-	(13)
Charge to other comprehensive income	(1)	-	-	(1)
At 31 December 2018	(20)	(1)	292	271

Critical accounting policy: Deferred tax

The net deferred tax assets of €271 million as at 31 December 2018 (2017 - €285 million) principally comprise deferred tax assets on tax losses and deferred tax liabilities on temporary differences. These deferred tax assets are recognised to the extent that it is probable that there will be future taxable profits to recover them.

Tax losses

The tax losses of €292 million (2017 - €292 million) arose principally from significant impairment losses incurred during a time of weak economic conditions in the Republic of Ireland.

Judgement - The Group has considered the carrying value of deferred tax assets on these losses and continues to be of the view that based on management's estimates of future performance and profitability, sufficient taxable profits will be generated in future years to recover the recognised deferred tax assets.

Estimate **-** Management's estimates are partly based on forecast performance beyond the horizon for management's detailed plans. Management has carefully assessed the time period over which it expects to be able to recover the deferred tax assets taking into account existing and expected economic conditions.

As the Group operates in a small, open economy subject to short term volatility and extended non-performing loan realisation periods management expects in assessing its deferred tax assets on tax losses that they will be consumed by future taxable profits by the end of 2027. Set out below is the impact of some of the material sensitivities considered:

	Sensitivity	
Assumptions	Change in assumption	Consequential change in deferred tax assets
		€m
Outlook period	+/- 1 year	54
Profit outlook	+/- 5%	15

Unrecognised deferred tax

Deferred tax assets of €945 million (2017 - €919 million) have not been recognised in respect of tax losses carried forward of €7,557 million (2017 - €7,351 million). Under Republic of Ireland tax rules, tax losses can be carried forward indefinitely.

9. Loss dealt with in the financial statements of the Bank

In accordance with the exemption contained within Section 304 of the Companies Act 2014 the primary financial statements of the Bank do not include an income statement or statement of comprehensive income. The Bank's loss after tax for the year ended 31 December 2018 was €141 million (2017 - €151 million).

10. Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The following table shows the notional amount and fair value of the Group and the Bank's derivatives.

	Group					
	2018			2017		
	Notional amounts €m	Assets €m	Liabilities €m	Notional amounts €m	Assets €m	Liabilities €m
Over-the counter derivatives						
Exchange rate contracts	1,800	53	54	1,946	55	58
Interest rate contracts	19,809	127	77	29,873	436	381
Equity contracts	162	30	-	620	91	-
	21,771	210	131	32,439	582	439
Amounts above include:						
Due from/to fellow subsidiaries	20,877	170	76	30,705	514	394

	Bank					
	2018			2017		
	Notional amounts €m	Assets €m	Liabilities €m	Notional amounts €m	Assets €m	Liabilities €m
Over-the-counter derivatives						
Exchange rate contracts	1,800	53	54	1,946	55	58
Interest rate contracts	19,809	127	77	25,402	408	146
Equity contracts	162	30	-	620	91	-
	21,771	210	131	27,968	554	204
Amounts above include:						
Due from/to fellow subsidiaries	20,877	170	76	26,234	486	159

Included in the tables are derivatives held for hedge accounting purposes as follows:

	Group and Bank					
	2018			2017		
	Notional amounts €m	Assets €m	Liabilities €m	Notional amounts €m	Assets €m	Liabilities €m
Fair value hedging						
Interest rate contracts	163	-	3	386	1	4

Hedge ineffectiveness recognised in other operating income comprised:

	2018 €m	2017 €m
Fair value hedging		
Gains on the hedged items attributable to the hedged risk	-	1
Losses on the hedging instruments	-	(1)
Fair value hedging ineffectiveness	-	-

11. Financial instruments – classification

The following tables analyse the Group's financial assets and financial liabilities in accordance with the categories of financial instruments in IFRS 9/IAS 39. Assets and liabilities outside the scope of IFRS 9/IAS 39 are shown within other assets/liabilities.

	Group						
2018	MFVPL €m	HFT €m	FVOCI €m	DFVPL €m	Amortised cost €m	Other assets/ liabilities €m	Total €m
Assets							
Cash and balances at central banks	-	-	-	-	287	-	287
Derivatives	210	-	-	-	-	-	210
Loans to banks - amortised cost[1]	-	-	-	-	3,065	-	3,065
Loans to customers - amortised cost[2]	-	-	-	-	21,016	-	21,016
Amounts due from holding companies and fellow subsidiaries[3]	-	-	-	-	1,458	-	1,458
Other financial assets	-	-	2,949	-	-	-	2,949
Other assets	-	-	-	-	-	553	553
	210	-	2,949	-	25,826	553	29,538
Liabilities							
Bank deposits - amortised cost	-	-	-	-	1,983	-	1,983
Customer deposits - amortised cost	-	-	-	-	20,085	-	20,085
Other financial liabilities[4]	-	5	-	171	869	-	1,045
Amounts due to holding companies and fellow subsidiaries	-	-	-	-	869	-	869
Derivatives	-	131	-	-	-	-	131
Subordinated liabilities	-	-	-	-	86	-	86
Other liabilities	-	-	-	-	-	436	436
	-	136	-	171	23,892	436	24,635

	Group						
2017	HFT €m	DFVPL €m	Available -for- sale €m	Loans and receivables €m	Amortised cost €m	Non financial assets/ liabilities €m	Total €m
Assets							
Cash and balances at central banks	-	-	-	322	-	-	322
Derivatives	582	-	-	-	-	-	582
Loans to banks - amortised cost[1]	-	-	-	2,757	-	-	2,757
Loans to customers - amortised cost[2]	-	-	-	21,711	-	-	21,711
Amounts due from holding companies and fellow subsidiaries[3]	-	-	-	2,375	-	-	2,375
Other financial assets	-	-	2,043	-	-	-	2,043
Other assets	-	-	-	-	-	458	458
	582	-	2,043	27,165	-	458	30,248
Liabilities							
Bank deposits - amortised cost	-	-	-	-	2,000	-	2,000
Customer deposits - amortised cost	-	-	-	-	19,079	-	19,079
Other financial liabilities[4]	8	689	-	-	-	-	697
Amounts due to holding companies and fellow subsidiaries	-	-	-	-	1,066	-	1,066
Derivatives	439	-	-	-	-	-	439
Subordinated liabilities	-	-	-	-	86	-	86
Other liabilities	-	-	-	-	-	478	478
	447	689	-	-	22,231	478	23,845

Notes:

(1) Includes items in the course of collection from other banks of €36 million (2017 - €38 million).

(2) The Group has advances secured on residential property subject to non-recourse funding. Under IFRS 9/IAS 39, these mortgages qualify for full recognition on the balance sheet at 31 December 2018 and are included in loans to customers. As at 31 December 2018 €5,236 million (2017 - €6,814 million) is included in loans to customers.

(3) Includes reverse repurchase agreements of €611 million (2017 - €861 million).

(4) The Group holds €5 million (2017 - €8 million) of cash and securities received as collateral in respect of derivative assets. There are no other financial instruments that are subject to IAS 32 (on balance sheet) netting arrangements or subject to enforceable master netting instruments or similar agreements that are not set off in accordance with IAS 32. The carrying amount of other customer accounts designated at fair value through profit or loss is €28 million higher (2017 - €83 million) than the principal amount. No amounts have been recognised (2017 - nil) in profit or loss for changes in credit risk associated with these liabilities.

11. Financial instruments – classification continued

Amounts due from/to holding companies and fellow subsidiaries comprise:

	Group	
	2018	2017
	€m	€m
Amounts due from holding companies and fellow subsidiaries		
Loans to banks - amortised cost	1,433	2,136
Loans to customers - amortised cost	25	239
	1,458	2,375
Amounts due to holding companies and fellow subsidiaries		
Bank deposits - amortised cost	275	487
Customer deposits - amortised cost	64	49
Subordinated liabilities	530	530
	869	1,066

The following tables analyse the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IFRS 9/IAS 39. Assets and liabilities outside the scope of IFRS 9/IAS 39 are shown within other assets/liabilities.

	Bank						
	MFVPL	HFT	FVOCI	DFVPL	Amortised cost	Other assets/ liabilities	Total
2018	€m	€m	€m	€m	€m	€m	€m
Assets							
Cash and balances at central banks	-	-	-	-	287	-	287
Derivatives	210	-	-	-	-	-	210
Loans to banks - amortised cost[1]	-	-	-	-	2,817	-	2,817
Loans to customers - amortised cost[2]	-	-	-	-	21,016	-	21,016
Amounts due from holding companies and fellow subsidiaries[3]	707	-	-	-	3,286	-	3,993
Other financial assets[4]	-	-	2,949	-	-	-	2,949
Investments in group undertakings	-	-	-	-	-	7	7
Other assets	-	-	-	-	-	551	551
	917	-	2,949	-	27,406	558	31,830
Liabilities							
Bank deposits - amortised cost	-	-	-	-	1,983	-	1,983
Customer deposits - amortised cost	-	-	-	-	20,085	-	20,085
Other financial liabilities[5]	-	5	-	171	-	-	176
Amounts due to holding companies and fellow subsidiaries	-	-	-	707	3,354	-	4,061
Derivatives	-	131	-	-	-	-	131
Subordinated liabilities	-	-	-	-	86	-	86
Other liabilities	-	-	-	-	-	436	436
	-	136	-	878	25,508	436	26,958

For notes relating to this table refer to page 40.

11. Financial instruments – classification continued

	Bank						
2017	HFT €m	DFVPL €m	Available-for-sale €m	Loans and receivables €m	Amortised cost €m	Non financial assets/ liabilities €m	Total €m
Assets							
Cash and balances at central banks	-	-	-	322	-	-	322
Derivatives	554	-	-	-	-	-	554
Loans to banks - amortised cost[1]	-	-	-	2,757	-	-	2,757
Loans to customers - amortised cost[2]	-	-	-	21,711	-	-	21,711
Amounts due from holding companies and fellow subsidiaries[3]	-	-	-	8,070	-	-	8,070
Other financial assets[4]	-	-	2,043	-	-	-	2,043
Investments in Group undertakings	-	-	-	-	-	5	5
Other assets	-	-	-	-	-	456	456
	554	-	2,043	32,860	-	461	35,918
Liabilities							
Bank deposits - amortised cost	-	-	-	-	2,000	-	2,000
Customer deposits - amortised cost	-	-	-	-	19,079	-	19,079
Other financial liabilities[5]	8	689	-	-	-	-	697
Amounts due to holding companies and fellow subsidiaries	-	-	-	-	6,770	-	6,770
Derivatives	204	-	-	-	-	-	204
Subordinated liabilities	-	-	-	-	86	-	86
Other liabilities	-	-	-	-	-	476	476
	212	689	-	-	27,935	476	29,312

Notes:

(1) Includes items in the course of collection from other banks of €36 million (2017 - €38 million).

(2) The Bank has advances secured on residential property subject to non-recourse funding. Under IFRS 9/IAS 39, these mortgages qualify for full recognition on the balance sheet at 31 December 2018 and are included in loans to customers. As at 31 December 2018 €5,236 million (2017 - €6,814 million) is included in loans to customers.

(3) Includes reverse repurchase agreements of €611 million (2017 - €861 million).

(4) Of the debt securities balance above, the Bank had pledged nil (2017 - €236 million) of the debt securities to RBS plc as collateral against intraday SEPA payments which RBS plc processes on behalf of the Bank. A further €20 million (2017 - €20 million) of debt securities were pledged as collateral to UBPS and €16.5 million (2017 - €17 million) of debt securities were pledged as collateral to the trustees of FA Scheme under contingent asset arrangements put in place to cover the Risk Reserve requirements arising under the Minimum Funding Standard framework. The debt securities classified as loans and receivables in the Bank have been issued by limited recourse entities that are controlled by the Bank. The securities are collateralised on the cash flows of residential mortgages held by the Bank, are long term in nature and generate variable interest, typically at mark-ups over Euro Interbank Offer Rates. The carrying value of the instruments is not considered to be impaired as at 31 December 2018 and 31 December 2017 and represents the full extent of the credit risk on the instruments.

(5) The Bank holds €5 million (2017 - €8 million) of cash and securities received as collateral in respect of derivative assets. There are no other financial instruments that are subject to IAS 32 (on balance sheet) netting arrangements or subject to enforceable master netting instruments or similar agreements that are not set off in accordance with IAS 32. The carrying amount of other customer accounts designated as at fair value through profit or loss is €28 million higher (2017 - €83 million) than the principal amount.

Amounts due from/to holding companies and fellow subsidiaries comprise:

	Bank	
	2018 €m	2017 €m
Amounts due from holding companies and fellow subsidiaries		
Loans to banks - amortised cost	1,428	2,136
Loans to customers - amortised cost	76	653
Other financial assets		
- Debt securities	2,489	5,281
	3,993	8,070
Amounts due to holding companies and fellow subsidiaries		
Bank deposits - amortised cost	274	486
Customer deposits - amortised cost	3,257	5,754
Subordinated liabilities	530	530
	4,061	6,770

11. Financial instruments - valuation

Critical accounting policy: Fair value - financial instruments

In accordance with accounting policies (m) and (v) financial instruments classified at fair value through profit or loss and financial assets classified as fair value through other comprehensive income are recognised in the financial statements at fair value. All derivatives are measured at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability.

In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given below.

Valuation of financial instruments carried at fair value

Fair Value Hierarchy

Financial instruments carried at fair value have been classified under the IFRS fair value hierarchy as follows.

Level 1 – instruments valued using unadjusted quoted prices in active and liquid markets, for identical financial instruments. Examples include government bonds, listed equity shares and certain exchange-traded derivatives.

Level 2 - instruments valued using valuation techniques that have observable inputs. Examples include most government agency securities, investment-grade corporate bonds, certain mortgage products, including collateralised loan obligations (CLO), most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most over-the-counter (OTC) derivatives.

Level 3 - instruments valued using a valuation technique where at least one input, which could have a significant effect on the instrument's valuation, is not based on observable market data. Examples include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets and derivatives with unobservable model inputs.

The following tables show the financial instruments carried at fair value by valuation method:

	Group							
	2018				2017			
	Level 1 €m	Level 2 €m	Level 3 €m	Total €m	Level 1 €m	Level 2 €m	Level 3 €m	Total €m
Assets								
Other financial assets (Note 13)								
- Debt securities	2,002	943	-	2,945	1,558	480	-	2,038
- Equity shares	-	-	4	4	-	-	5	5
Derivatives	-	177	33	210	-	303	279	582
Total	2,002	1,120	37	3,159	1,558	783	284	2,625
Liabilities								
Other financial liabilities (Note 17)								
- Bank deposits	-	5	-	5	-	8	-	8
- Customer deposits	-	171	-	171	-	689	-	689
Derivatives	-	123	8	131	-	169	270	439
Total	-	299	8	307	-	866	270	1,136

11. Financial instruments: carried at fair value - valuation hierarchy continued

	Bank							
	2018				2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	€m	€m	€m	€m	€m	€m	€m	€m
Assets								
Amounts due from holding companies and fellow subsidiaries	-	-	707	707	-	-	-	-
Other financial assets (Note 13)								
- Debt securities	2,002	943	-	2,945	1,558	480	-	2,038
- Equity shares	-	-	4	4	-	-	5	5
Derivatives	-	177	33	210	-	303	251	554
Total	2,002	1,120	744	3,866	1,558	783	256	2,597
Liabilities								
Amounts due to holding companies and fellow subsidiaries	-	-	707	707	-	-	-	-
Other financial liabilities (Note 17)								
- Bank deposits	-	5	-	5	-	8	-	8
- Customer deposits	-	171	-	171	-	689	-	689
Derivatives	-	123	8	131	-	169	35	204
Total	-	299	715	1,014	-	866	35	901

Level 3 portfolio movement tables

	Group					
	Other financial assets		Derivative assets		Derivative liabilities	
	2018	2017	2018	2017	2018	2017
	€m	€m	€m	€m	€m	€m
At 1 January	5	6	279	429	(270)	(575)
Disposals	-	(1)	-	-	-	-
Charge to other comprehensive income	(1)	-	-	-	-	-
(Charge)/credit to income statement	-	-	(246)	(150)	262	305
At 31 December	4	5	33	279	(8)	(270)

	Bank									
	Other financial assets		Derivative assets		Derivative liabilities		Amounts due from holding companies and fellow subsidiaries		Amounts due to holding companies and fellow subsidiaries	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
At 1 January	5	6	251	390	(35)	(40)	-	-	-	-
Additions	-	-	-	-	-	-	707	-	(707)	-
Disposals	-	(1)	-	-	-	-	-	-	-	-
Charge to other comprehensive income	(1)	-	-	-	-	-	-	-	-	-
(Charge)/credit to income statement	-	-	(218)	(139)	27	5	-	-	-	-
At 31 December	4	5	33	251	(8)	(35)	707	-	(707)	-

11. Financial instruments: carried at fair value - valuation hierarchy continued

The Bank places reliance on the Ring Fenced Bank independent price verification (IPV) process and the Bank eliminates its market risk on its portfolios by entering into back to back positions with NWB plc.

Valuation Techniques

The fair value of instruments are derived differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products are valued directly from a price input typically on a position by position basis. Examples include equities and most debt securities.

Products that are priced using models range in complexity from comparatively vanilla such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model.

Inputs to valuation models

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

Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.

Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from 3rd party benchmarking services. For counterparty credit spreads, adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).

Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), European Interbank Offered Rate (EURIBOR), Overnight Index Swaps (OIS) rate and other quoted interest rates in the swap, bond and futures markets.

Foreign currency exchange rates - there generally are observable prices both for spot and forward contracts and futures in the world's major currencies.

Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.

Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.

Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together.

Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing pre-payable instruments that are not quoted in active markets, Group considers the value of the prepayment option.

Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Valuation Control

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions.

IPV is a key element of the control environment. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.
Where measurement differences are identified through the IPV process these are grouped by fair value level and quality of data. If the size of the difference exceeds defined thresholds adjustment to independent levels are made.

IPV takes place at least each month, for all fair value positions. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds.

Valuation committees are made up of valuation specialists and senior business representatives from various functions and oversees pricing, reserving and valuations issues. These committees meet monthly to review and ratify any methodology changes. The Ring Fenced Bank Executive Valuation Committee meets monthly to address key material and subjective valuation issues, to review items escalated by valuation committees and to discuss other relevant matters including prudential valuation. UBIDAC Treasury Model Committee is responsible for approving model documentation, validation reports and performance monitoring for all models used by UBIDAC Treasury and monitoring compliance with the Model Risk policy standards.

Initial classification of a financial instrument is carried out following the principles in IFRS 13. These initial classifications are subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

11. Financial instruments: carried at fair value - valuation hierarchy continued

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV processes using a formalised input quality hierarchy. These adjustments reflect the assessment of factors that market participants would consider in setting a price.

Valuation - Areas of judgement

The majority of Group financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is market activity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid, little judgement is required. However, when the information regarding the liquidity in a particular market is not clear, a judgement may need to be made. This can be more difficult as assessing the liquidity of a market is not always straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an OTC derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related matter is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects. Material movements between levels are reviewed quarterly.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A valuation is derived from the use of the independent market inputs calculated using Group's model.

The decision to classify a modelled instrument as Level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability and quality of input parameters and other factors. All these must be assessed to classify the asset.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments for example vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information are considered during the classification process. An assessment is made regarding the quality of the independent information. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be Level 3. This hurdle rate is that used in the IPV process to determine the IPV quality rating. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as Level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations the highest quality source is used to determine the classification of the asset.

Valuation

Valuation of financial instruments in the banking books are made to the mid-price.

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. During 2018 in preparation for ring-fencing under UK legislation the RBS Group transferred some of the customer interest rate and foreign exchange derivatives business of its ring-fenced bank entities, including the Group, to NatWest Markets Plc. The remaining derivatives activity retained by the Group and permitted under ring-fencing legislation was redesignated from a prudential perspective from trading book to banking book with no financial impact.

11. Financial instruments: carried at fair value - valuation hierarchy continued

Credit valuation adjustments

Credit valuation adjustments (CVA) represent an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA at 31 December 2018 was €1 million (2017 - €1 million).

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Debt valuation adjustments

The fair value of the Group's derivative financial liabilities is adjusted to reflect the Group's own credit risk through debt valuation adjustments (DVA). Expected gains are applied to estimated potential future negative exposures, the modelling of which is consistent with the approach used in the calculation of CVA. Expected gains are determined from market implied probabilities of default and recovery levels. Funding valuation adjustment (FVA) is considered the primary adjustment applied to derivative liabilities. The extent to which DVA and FVA overlap is eliminated from DVA.

Fair value of financial instruments not carried at fair value

The following tables show the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost. The fair value of cash and balances at central banks and €2,509 million of loans to banks carried at amortised cost (2017 - €2,438 million) have been determined using procedures consistent with the requirements of level 2 valuation methodologies, as set out on page 41. All other balances have been fair valued using procedures that fall within level 3 of the fair value methodologies.

	Group			
	2018 Carrying value €m	2018 Fair value €m	2017 Carrying value €m	2017 Fair value €m
Financial assets				
Cash and balances at central banks	287	287	322	322
Loans to banks - amortised cost	3,065	3,065	2,757	2,757
Loans to customers - amortised cost	21,016	19,485	21,711	19,790
Amounts due from holding companies and fellow subsidiaries				
- Loans to banks	1,433	1,433	2,136	2,136
- Loans to customers	25	25	239	239
Financial liabilities				
Bank deposits - amortised cost	1,983	1,991	2,000	2,000
Customer deposits - amortised cost	20,085	20,088	19,079	19,082
Other financial liabilities	869	865	-	-
Amounts due to holding companies and fellow subsidiaries				
- Bank deposits	275	275	487	487
- Customer deposits	64	64	49	49
- Subordinated liabilities	530	513	530	505
Subordinated liabilities	86	73	86	68

11. Financial instruments: not carried at fair value continued

	Bank			
	2018	2018	2017	2017
	Carrying value	Fair value	Carrying value	Fair value
	€m	€m	€m	€m
Financial assets				
Cash and balances at central banks	287	287	322	322
Loans to banks - amortised cost	2,817	2,817	2,757	2,757
Loans to customers - amortised cost	21,016	19,485	21,711	19,789
Amounts due from holding companies and fellow subsidiaries				
- Loans to banks	1,428	1,428	2,136	2,136
- Loans to customers	28	28	653	572
- Debt securities	1,830	1,830	5,281	4,135
Financial liabilities				
Bank deposits - amortised cost	1,983	1,991	2,000	2,000
Customer deposits - amortised cost	20,085	20,088	19,079	19,082
Amounts due to holding companies and fellow subsidiaries				
- Bank deposits	274	274	486	486
- Customers deposits	2,550	2,550	5,754	4,525
- Subordinated liabilities	530	513	530	505
Subordinated liabilities	86	73	86	68

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For loans to banks and certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, fair value approximates to carrying value.

Loans to banks and customers

In estimating the fair value of loans to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. The principal method used to estimate fair value in the Group is to discount expected cash flows at the current offer rate for the same or similar products.

For certain portfolios where there are very few or no recent transactions bespoke approaches are utilised.

Debt securities

The majority of debt securities are valued using quoted prices in active markets, or using quoted prices for similar assets in active markets. Fair values of the rest are determined using discounted cash flow valuation techniques.

Bank and customer deposits

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

Debt securities in issue and Subordinated liabilities

Fair values are determined using quoted prices for similar liabilities where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

11. Financial instruments – maturity analysis

Remaining maturity

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

	Group					
	2018			2017		
	Less than 12 months €m	More than 12 months €m	Total €m	Less than 12 months €m	More than 12 months €m	Total €m
Assets						
Cash and balances at central banks	287	-	287	322	-	322
Derivatives	45	165	210	141	441	582
Loans to banks - amortised cost	3,065	-	3,065	2,757	-	2,757
Loans to customers - amortised cost	1,745	19,271	21,016	2,510	19,201	21,711
Amounts due from holding companies and fellow subsidiaries	1,414	44	1,458	2,374	1	2,375
Other financial assets	1,153	1,796	2,949	1,312	731	2,043
Liabilities						
Bank deposits - amortised cost	-	1,983	1,983	1,500	500	2,000
Customer deposits - amortised cost	19,899	186	20,085	18,180	899	19,079
Other financial liabilities	176	869	1,045	534	163	697
Amounts due to holding companies and fellow subsidiaries	269	600	869	533	533	1,066
Derivatives	10	121	131	29	410	439
Subordinated liabilities	-	86	86	-	86	86

	Bank					
	2018			2017		
	Less than 12 months €m	More than 12 months €m	Total €m	Less than 12 months €m	More than 12 months €m	Total €m
Assets						
Cash and balances at central banks	287	-	287	322	-	322
Derivatives	45	165	210	141	413	554
Loans to banks - amortised cost	2,817	-	2,817	2,757	-	2,757
Loans to customers - amortised cost	1,745	19,271	21,016	2,506	19,205	21,711
Amounts due from holding companies and fellow subsidiaries	3,949	44	3,993	8,069	1	8,070
Other financial assets	1,153	1,796	2,949	1,312	731	2,043
Liabilities						
Bank deposits - amortised cost	-	1,983	1,983	1,500	500	2,000
Customer deposits - amortised cost	19,899	186	20,085	18,180	899	19,079
Other financial liabilities	176	-	176	534	163	697
Amounts due to holding companies and fellow subsidiaries	3,461	600	4,061	6,237	533	6,770
Derivatives	10	121	131	29	175	204
Subordinated liabilities	-	86	86	-	86	86

11. Financial instruments – maturity analysis continued

On balance sheet liabilities

The following table shows, by contractual maturity, the undiscounted cash flows payable from the balance sheet date, including future payments of interest. The balances in the table below do not agree directly to the Group or Bank balance sheets, as the table include all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

	Group						
	0–3 months	3–12 months	1–3 years	3–5 years	5–10 years	10–20 years	>20 years
2018	€m	€m	€m	€m	€m	€m	€m
Liabilities by contractual maturity							
Bank deposits - amortised cost	-	-	1,969	-	-	-	-
Customer deposits - amortised cost	18,083	1,819	177	11	-	-	-
Other financial liabilities	53	123	-	-	-	-	869
Amounts due to holding companies and fellow subsidiaries	268	1	-	530	70	-	-
Derivatives held for hedge accounting	-	1	2	-	-	-	-
Subordinated liabilities	-	6	10	10	25	93	2
	18,404	1,950	2,158	551	95	93	871
Guarantees and commitments notional amount							
Guarantees[1]	208	-	-	-	-	-	-
Commitments[2]	3,655	-	-	-	-	-	-
	3,863	-	-	-	-	-	-
2017							
Liabilities by contractual maturity							
Bank deposits - amortised cost	-	1,500	500	-	-	-	-
Customer deposits - amortised cost	16,245	1,863	901	76	-	-	-
Other financial liabilities	169	365	163	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	529	3	2	530	2	-	-
Derivatives held for hedge accounting	-	1	2	-	-	-	-
Subordinated liabilities	-	6	10	10	25	98	2
	16,943	3,738	1,578	616	27	98	2
Guarantees and commitments notional amount							
Guarantees[1]	154	-	-	-	-	-	-
Commitments[2]	3,516	-	-	-	-	-	-
	3,670	-	-	-	-	-	-

For notes relating to this table refer to page 49.

11. Financial instruments – maturity analysis continued

	Bank						
	0–3 months	3–12 months	1–3 years	3–5 years	5–10 years	10–20 years	>20 years
2018	€m	€m	€m	€m	€m	€m	€m
Liabilities by contractual maturity							
Bank deposits - amortised cost	-	-	1,969	-	-	-	-
Customer deposits - amortised cost	18,083	1,819	177	11	-	-	-
Other financial liabilities	53	123	-	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	3,460	1	-	530	70	-	-
Derivatives held for hedge accounting	-	1	2	-	-	-	-
Subordinated liabilities	-	6	10	10	25	93	2
	21,596	1,950	2,158	551	95	93	2
Guarantees and commitments notional amount							
Guarantees[1]	208	-	-	-	-	-	-
Commitments[2]	3,655	-	-	-	-	-	-
	3,863	-	-	-	-	-	-
2017							
Liabilities by contractual maturity							
Bank deposits - amortised cost	-	1,500	500	-	-	-	-
Customer deposits - amortised cost	16,245	1,863	901	76	-	-	-
Other financial liabilities	169	365	163	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	6,233	3	2	530	2	-	-
Derivatives held for hedge accounting		1	2				
Subordinated liabilities	-	6	10	10	25	98	2
	22,647	3,738	1,578	616	27	98	2
Guarantees and commitments notional amount							
Guarantees[1]	154	-	-	-	-	-	-
Commitments[2]	3,516	-	-	-	-	-	-
	3,670	-	-	-	-	-	-

Notes:
(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.
(2) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above show the timing of cash outflows to settle financial liabilities. Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end.

12. Loan impairment provisions

Loan exposure and impairment metrics

The table below summarises loans and related credit impairment measures on IFRS 9 basis at 31 December 2018 and 1 January 2018 and on IAS39 basis at 31 December 2017.

	Group		
	31 December 2018 €m	1 January 2018 €m	31 December 2017 €m
Loans - amortised cost			
Stage 1	19,904	19,811	
Stage 2	2,323	2,295	
Stage 3	2,579	3,523	
Total	24,806	25,629	23,214
ECL provisions			
Stage 1	39	31	
Stage 2	127	122	
Stage 3	713	1,173	
Total	879	1,326	1,264
ECL provision coverage [1]			
Stage 1 (%)	0.20	0.16	
Stage 2 (%)	5.47	5.32	
Stage 3 (%)	27.65	33.30	
Total	3.54	5.17	5.4
ECL charge	(23)		(68)
Impairment losses			
ECL loss rate (%)	(0.09)		(0.3)
Amounts written off	421		141
Risk profile of loans to customers - non performing loans [2]			
Credit-impaired	2,579		3,244
Not credit-impaired	218		1,086
Total	2,797		4,330

Notes:

(1) ECL provision coverage is the ECL provision divided by loans.
(2) Non-performing as per the European Banking Authority definition. The 2018 balance is reflective of the revision in the treatment of forborne balances, as per the EBA's Final Report - Guidelines on Management of Non-performing and Forborne Exposures, issued in October 2018. The 2017 comparatives have not been restated.

Amounts due from holding companies and fellow subsidiaries are all considered as Stage 1. Expected credit loss (ECL) provisions on these balances are not considered material.

Collateral and credit enhancement

For information on collateral and credit enhancement held as security, refer to risk management - credit risk on page 81.

Critical accounting estimates

The Group's 2017 loan impairment provisions were established in accordance with IAS 39 in respect of incurred losses. They comprised individual and collective components as more fully explained in the 2017 Annual Report and Accounts. In 2018 the loan impairment provisions have been established in accordance with IFRS 9. Accounting policy (n) sets out how the expected loss approach is applied. At 31 December 2018, customer loan impairment provisions amounted to €879 million (2017 - €1,264 million). A loan is impaired when there is objective evidence that the cash flows will not occur in the manner expected when the loan was advanced.

Such evidence includes changes in the credit rating of a borrower, the failure to make payments in accordance with the loan agreement; significant reduction in the value of any security; breach of limits or covenants; and observable data about relevant macroeconomic measures.

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

IFRS 9 ECL model design principles

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

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

12. Loan impairment provisions continued

Critical accounting estimates continued

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

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

Approach for multiple economic scenarios (MES)

The base scenario plays a greater part in the calculation of ECL than the approach to MES. Further details are given in Note 23 to the accounts.

13. Other financial assets

	Group and Bank				
	Debt securities			Equity shares	
	Central and local government	Other	Total	Unlisted	Total
2018	€m	€m	€m	€m	€m
Fair value through other comprehensive income	2,002	943	2,945	4	2,949
2017					
Available-for-sale	2,038	-	2,038	5	2,043

Details of investment	Carrying value as at 31 December 2018 €m	Dividend income 2018 €m
Ulster Bank Diageo Venture Fund III	3	-
Ulster Bank Private Equity Bond Fund	1	3

The Group made an irrevocable election at initial recognition to measure the below at fair value through other comprehensive income.

A net unrealised gain of €1 million (2017 - €3 million loss) was recorded during the financial year.

14. Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the financial year:

	Bank	
	2018 €m	2017 €m
At 1 January	5	16
Acquisitions	4	-
Disposal	(1)	-
Dissolution	-	(9)
Impairment	(1)	(2)
At 31 December	7	5

During the financial year, the Bank acquired Ulster Bank Holdings (ROI) Limited and Ulster Bank Dublin Trust Company Unlimited Company from another part of the NatWest Holdings Limited Group.

During the financial year, the Bank disposed of its investment in Easycash (Ireland) Limited to a third party. Profit on disposal of €3 million was recognised on the sale. There was no profit on disposal in 2017.

All of the Group undertakings, as detailed in Note 29, are consolidated in the Group's financial statements. All have an accounting reference date of 31 December except Norgay Property Limited and Walter Property Limited which have an accounting reference date of 30 June.

15. Other assets

	Group		Bank	
	2018	2017	2018	2017
	€m	€m	€m	€m
Prepayments	9	5	7	5
Accrued income	7	7	7	7
Retirement benefit assets (Note 6)	165	62	165	62
Deferred tax (Note 8)	271	285	271	285
Property, plant and equipment (Note 16)	68	72	68	71
Intangible assets	1	1	1	1
Assets held for sale	1	3	1	3
Other assets	31	23	31	22
	553	458	551	456

16. Property, plant and equipment

	Group				
2018	Freehold land and buildings €m	Leases of 50 years or more unexpired €m	Leases of 50 years or less unexpired €m	Computer and other equipment €m	Total €m
Cost or valuation:					
At 1 January	63	14	63	55	195
Additions	3	-	3	3	9
Transfer to assets held for sale	-	-	(2)	-	(2)
Disposals and write-off of fully depreciated assets	(1)	(6)	(5)	(11)	(23)
At 31 December	65	8	59	47	179
Accumulated impairment, depreciation and amortisation:					
At 1 January	25	10	44	44	123
Transfer to assets held for sale	-	-	(1)	-	(1)
Disposals and write-off of fully depreciated assets	-	(6)	(5)	(8)	(19)
Depreciation charge for the financial year	2	-	4	2	8
At 31 December	27	4	42	38	111
Net book value at 31 December	38	4	17	9	68
2017					
Cost or valuation:					
At 1 January	64	15	63	64	206
Additions	3	1	5	3	12
Transfer to assets held for sale	(4)	(2)	-	(1)	(7)
Disposals and write-off of fully depreciated assets	-	-	(5)	(11)	(16)
At 31 December	63	14	63	55	195
Accumulated impairment, depreciation and amortisation:					
At 1 January	26	11	40	51	128
Transfer to assets held for sale	(2)	(1)	-	(1)	(4)
Disposals and write-off of fully depreciated assets	-	-	(4)	(9)	(13)
Depreciation charge for the financial year	1	-	8	3	12
At 31 December	25	10	44	44	123
Net book value at 31 December	38	4	19	11	72

16. Property, plant and equipment continued

	Bank				
2018	Freehold land and buildings €m	Leases of 50 years or more unexpired €m	Leases of 50 years or less unexpired €m	Computer and other equipment €m	Total €m
Cost or valuation:					
At 1 January	63	8	63	51	185
Additions	3	-	3	3	9
Transfer to assets held for sale	-	-	(2)	-	(2)
Disposals and write-off of fully depreciated assets	(1)	-	(5)	(7)	(13)
At 31 December	65	8	59	47	179
Accumulated impairment, depreciation and amortisation:					
At 1 January	25	4	44	41	114
Transfer to assets held for sale	-	-	(1)	-	(1)
Disposals and write-off of fully depreciated assets	-	-	(5)	(5)	(10)
Depreciation charge for the financial year	2	-	4	2	8
At 31 December	27	4	42	38	111
Net book value at 31 December	38	4	17	9	68
2017					
Cost or valuation:					
At 1 January	64	9	63	60	196
Additions	3	1	5	3	12
Transfer to assets held for sale	(4)	(2)	-	(1)	(7)
Disposals and write-off of fully depreciated assets	-	-	(5)	(11)	(16)
At 31 December	63	8	63	51	185
Accumulated impairment, depreciation and amortisation:					
At 1 January	26	5	40	48	119
Transfer to assets held for sale	(2)	(1)	-	(1)	(4)
Disposals and write-off of fully depreciated assets	-	-	(4)	(9)	(13)
Depreciation charge for the financial year	1	-	8	3	12
At 31 December	25	4	44	41	114
Net book value at 31 December	38	4	19	10	71

The Group and Bank recognised a €1 million profit on disposal of freehold land and buildings during the financial year (2017 - nil).

17. Other financial liabilities

	Group		Bank	
	2018 €m	2017 €m	2018 €m	2017 €m
Bank deposits - HFT	5	8	5	8
Customer deposits - DFVPL	171	689	171	689
Debt securities in issue - amortised cost	869	-	-	-
Total	1,045	697	176	697

18. Subordinated liabilities

	Group and Bank	
	2018	2017
Undated loan capital:	€m	€m
€31 million 11.375% perpetual tier two capital	55	55
£11 million 11.75% perpetual tier two capital	30	30
£1.1 million perpetual floating rate tier two capital (6 month sterling LIBOR plus 2.55%)	1	1
	86	86

Claims in respect of the Bank's loan capital are subordinate to the claims of other creditors. None of the loan capital is secured.

19. Other liabilities

	Group		Bank	
	2018	2017	2018	2017
	€m	€m	€m	€m
Accruals	61	64	61	63
Deferred income	6	7	6	7
Provisions for liabilities and charges	287	370	287	370
Retirement benefit liabilities (Note 6)	1	11	1	11
Other liabilities	81	26	81	25
	436	478	436	476

The following amounts are included within provisions for liabilities and charges:

	Group and Bank						
	Tracker mortgage examination	Other customer remediation	Litigation	Global restructuring group	Property	Other	Total
	€m	€m	€m	€m	€m	€m	€m
At 1 January 2017	190	-	15	11	10	10	236
Charge to income statement	87	100	4	-	15	7	213
Utilised in the year	(54)	(3)	(1)	(5)	(3)	-	(66)
Release to income statement	-	-	(2)	-	(4)	(7)	(13)
At 1 January 2018	223	97	16	6	18	10	370
Implementation of IFRS 9 on 1 January 2018	-	-	-	-	-	7	7
Transfer from accruals	-	-	-	-	-	6	6
Arising on acquisition	-	2	-	-	-	-	2
Reclassification	5	(5)	-	-	-	-	-
Charge to income statement	-	74	6	9	10	3	102
Utilised in the year	(133)	(42)	-	(2)	(6)	(2)	(185)
Release to income statement	(9)	-	(1)	-	(3)	(2)	(15)
At 31 December 2018	86	126	21	13	19	22	287

Critical accounting policy: Provisions for liabilities

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

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

Tracker mortgage examination

In December 2015, the CBI announced that it had written to a number of lenders requiring them to put in place a robust plan and framework to review the treatment of customers who have been sold mortgages with a tracker interest rate or with a tracker interest rate entitlement. The CBI stated that the intended purpose of the review was to identify any cases where customers' contractual rights under the terms of their mortgage agreements were not fully honoured, or where lenders did not fully comply with various regulatory requirements and standards regarding disclosure and transparency for customers.

During the financial year the Group continued to progress its in-depth review and customer remediation.

19. Other liabilities continued

At 31 December 2018 the Group has recognised a provision of €86 million (2017 - €223 million). The Group expects that the majority of this provision will be utilised within 12 months.

Due to the scale and complexity of the review a number of assumptions are inherent in the calculation of the provision which represents management's best estimate of expected remediation and project costs.

Other customer remediation

As part of an internal review of the wider personal and commercial loan portfolios, extending from the tracker mortgage examination programme, the Group identified further legacy business issues. A programme is ongoing to identify and remediate impacted customers. Any issues relating to the tracker mortgage examination are included in the tracker mortgage examination provision as outlined above.

At 31 December 2018 the Group has recognised a provision of €126 million (2017 - €97 million) based on management's best estimate of expected remediation and project costs relating to the above internal review. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided.

Customer remediation across these issues has progressed in 2018. The Group expects the majority of this provision to be utilised within the next 12 months.

Global restructuring group (GRG)

The Group holds a provision of €13 million (2017 - €6 million) in respect of the FCA review of the treatment of SME customers, relating to the automatic refund of complex fees for SME customers that were in GRG between 2008 and 2013, additional redress costs arising from a new complaints process and the associated operational costs. Background information in relation to the FCA review of SME customers is given in Note 24. The Group expects the majority of this provision to be utilised within the next 12 months.

Property

The property provisions principally comprise provisions for onerous lease contracts. The timing for such payments is uncertain. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

20. Share capital presented as equity

	Group and Bank			
	Allotted, called up and fully paid		Authorised	
	2018 €m	2017 €m	2018 €m	2017 €m
Equity shares:				
Ordinary B shares of €1.27	1,825	1,825	2,223	2,223
Ordinary B shares of €1	1,745	1,745	2,400	2,400
Ordinary A shares of £1	22	22	33	34
Total share capital	3,592	3,592	4,656	4,657

	Allotted, called up and fully paid		Authorised	
Number of shares	2018 Millions	2017 Millions	2018 Millions	2017 Millions
Equity shares:				
Ordinary B shares of €1.27	1,437	1,437	1,750	1,750
Ordinary B shares of €1	1,745	1,745	2,400	2,400
Ordinary A shares of £1	15	15	25	25
Total share capital	3,197	3,197	4,175	4,175

All share classes rank pari passu in all respects.

On 31 March 2018 the Bank issued one ordinary B share of €1 at a premium of €2 million as consideration to acquire the invoice finance business of Ulster Bank Commercial Services Limited from its then immediate holding company by means of a merger by acquisition. The results and net assets of the invoice finance business acquired are not material to the Bank or Group financial statements.

The Bank paid an interim dividend of €0.47 per ordinary share during the year (2017 - nil).

21. Leases

Minimum amount receivable under non-cancellable leases.

	Group and Bank					
	Finance lease contracts and hire purchase agreements					
	2018			2017		
Year in which receipt will occur:	Gross amounts €m	Present value adjustments €m	Present value €m	Gross amounts €m	Present value adjustments €m	Present value €m
Within 1 year	141	(10)	131	104	(6)	98
After 1 year but within 5 years	196	(18)	178	137	(12)	125
After 5 years	2	-	2	3	-	3
Total	339	(28)	311	244	(18)	226

	Group and Bank	
	2018 €m	2017 €m
Amounts recognised in income statement		
Operating leases - minimum rentals payable	12	14

Acting as a lessor the Group provides asset finance to its customers. It purchases plant, equipment and intellectual property; renting them to customer under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

22. Collateral and securitisations

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it receives or transfers cash or securities as collateral in accordance with normal practice. Generally, the agreements require additional collateral to be provided if the value of the securities fall below a predetermined level.

Under standard terms for repurchase transactions in the Republic of Ireland, the recipient of the collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

There were no securities transferred under repurchase transactions included within debt securities on the balance sheet at 31 December 2018 and 31 December 2017.

There were securities amounting to €611 million received as collateral under reverse repurchase agreements at 31 December 2018 (2017 - €861 million).

Securitisations and other asset transfers

The Group undertakes securitisations to fund specific portfolios of assets. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity (SPE) which then issues liabilities to third party investors. SPEs are vehicles established for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

It is primarily the extent of risks and rewards assumed that determines whether these entities are consolidated in the Group's financial statements.

22. Collateral and securitisations continued

Assets pledged as collateral

The Group pledges other collateral with its counterparties in respect of:

	Group		Bank	
	2018	2017	2018	2017
Group assets charged as security for liabilities	€m	€m	€m	€m
Loans to customers	5,236	6,814	5,236	6,814

	Group		Bank	
	2018	2017	2018	2017
Liabilities secured by charges on assets	€m	€m	€m	€m
Other financial liabilities				
- debt securities in issue[1]	3,370	5,281	-	-
Amounts due to holding companies and fellow subsidiaries	-	333	-	333
Bank deposits	5	8	5	8
	3,375	5,622	5	341

Note:
(1) At 31 December 2018, €2,501 million (2017 - €5,281 million) of the debt securities in issue from the Group were held as assets by the Bank and consolidated in the Group accounts.

The following table sets out the asset categories together with carrying amounts for those assets that have been pledged as collateral and continue to be recognised on the balance sheet.

	Group and Bank	
	2018	2017
	€m	€m
Residential mortgages		
- securitisations	3,146	4,589
- central bank secured borrowing	2,090	2,225
	5,236	6,814

The mortgage backed securities at 31 December 2017, issued by Celtic Residential Irish Mortgage Securitisation No. 14 Designated Activity Company and Celtic Residential Irish Mortgage Securitisation No. 15 Designated Activity Company were redeemed at par during the financial year. The 2018 securitisation assets relate to two new SPEs formed during the financial year, Ardmore Securities No. 1 Designated Activity Company and Dunmore Securities No. 1 Designated Activity Company. These limited recourse entities were controlled by the Group and included in the consolidated financial statements on that basis.

At the balance sheet date the Bank had none (2017 - €236 million) of the debt securities pledged to RBS plc as collateral against intraday SEPA payments which RBS plc processed on behalf of the Bank.

At 31 December 2018, €20 million (2017 - €20 million) of UBIDAC bonds were pledged as collateral to Ulster Bank Pension Scheme and €17 million (2017 - €17 million) of UBIDAC bonds were pledged as collateral to the trustees of the First Active Pension Scheme under contingent asset arrangements put in place to cover the Risk Reserve requirements arising under the Minimum Funding Standard framework.

23. Risk management

Risk Management Framework

A strong culture, including a risk culture, in the Group helps the achievement of strategic goals with the right behaviours, supported by a sustainable Risk Management Framework (RMF).

The RMF has been significantly enhanced during 2018 and is one of five Board approved Frameworks that form the pillars of the Group's approach to risk management and controls, the other four being the Internal Control Framework (ICF), the Policy Management Framework (PMF), the Compliance Risk Framework (CRF) and the Risk Appetite Framework (RAF) (together the "Frameworks"). The five re-designed Frameworks were approved by the Board in Q3 2018 and have now been implemented across the organisation. The continued embedding of these in 2019 and beyond will be a key enabler in strengthening the risk culture of the Group and building a safe and secure bank for customers.

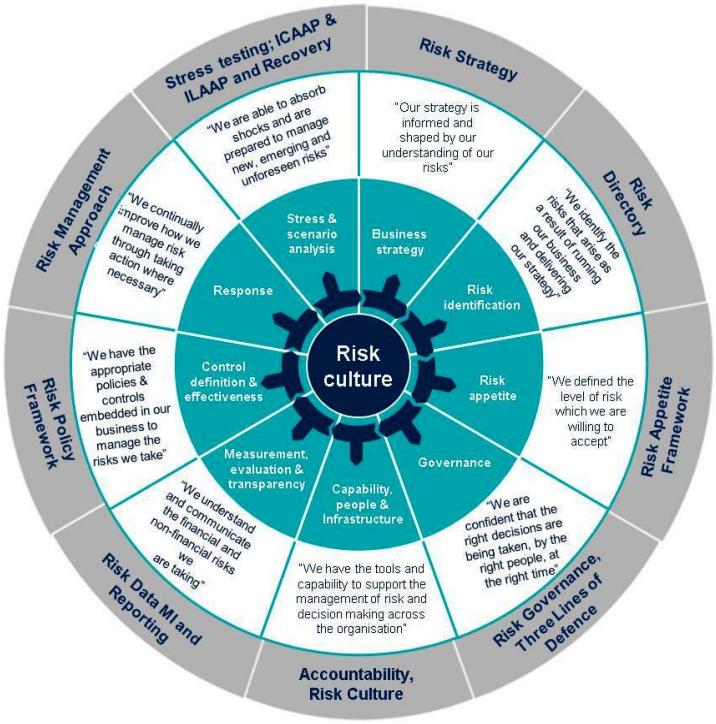
The Frameworks that the Group has implemented set out a structured approach to governance, risk management and compliance, the purpose of which is to support and inform the strategic objectives of the Group. The RMF facilitates an understanding of the risks the Group faces both strategically and in its day to day business activities and explains how these are identified, measured, managed and reported to enable decision-making through all levels of the Group, in line with the Group's vision and goals.

The scope of these Frameworks extends across all business areas, including internal control functions, and across all relevant financial and non-financial risks, to enable the Board and Executive Management to make fully informed decisions on risk taking. Effective use of the Frameworks contributes to, and is a strong indicator of, a robust risk culture.

The Frameworks set out the risk strategy of the Group, how the Group sets risk appetite, the policies, processes, limits and controls. This ensures adequate, timely and continuous identification, measurement, monitoring, management and reporting of risks at the business level and overall.

Risk Management Framework components

The RMF works as a continuum, where all components are intrinsically linked to the other components and the processes and practices which underpin the RMF are consistent and iterative. For simplicity, each component of the RMF is outlined in the following diagram.



Decisions relating to risk management are controlled through the governance structure of the Group. This includes the structure of Board and Executive committees, their roles and responsibilities for risk and compliance management, and governance. During 2018, this structure was simplified to reduce the number of Committees below Executive Committees to ensure clarity of roles and responsibilities for oversight of all material risk types.

The Group uses the Three Lines of Defence model to discharge accountabilities and responsibilities for managing risk across the Group, in line with industry practice.

The Group's business strategy is informed and shaped by an understanding of the risk landscape in which the Group operates. It is built around being an Irish retail and commercial bank with low risk appetite, in support of which the Group articulates a risk strategy to ensure that the business strategy can be delivered in a safe and controlled manner.

The top-down risk identification process is informed by elements of the RMF including horizon scanning and stress and scenario analysis. Risks identified at a Group-wide level are considered for inclusion in the Risk Directory.

23. Risk management – Risk Management Framework continued

The Risk Directory sets out the 'taxonomy' which describes in common language the risk types the Group could face in running its day to day business activities. The Risk Directory is refreshed on an annual basis where the material risks for the Group (financial and non financial) are identified and assessed. The Group does this through a process called the Material Risk Assessment and assesses materiality through financial, customer and reputational lenses. The Group determines through Risk Appetite Statements and Limits, the level of risk the Group is willing to accept in order to achieve its strategic objectives. The Risk Appetite Framework sets out how the Group does this.

The Group frequently (at least quarterly) reviews and reports the risk profile against agreed risk appetite metrics. This ensures that management focus is brought to bear on all material risks and emerging risk issues. Reporting to the Board is by means of Risk and Compliance Reports which outline the risk profile against Board approved appetite for each of the material risks. Key Risk Measurements ("KRMs") are reported to Executive committees with breaches escalated to the Board in line with policy.

To ensure that colleagues understand what is expected of them and ensure risks are managed within appetite the Policy Management Framework sets out the minimum standards of risk management and internal control to be adopted across all business units and processes.

For each risk type the Group determines how the risk is managed by reference to the overarching risk management approach. The way the Group identifies, assesses, measures, manages and reports actual risks in the business varies according to the specific nature of the risk, although the principles remain the same for all risk types. In addition, the Group adopts a top-down and pan-Group approach to the identification and management of scenarios that are of greatest strategic concern or that could threaten the existence of the Group through the Top and Emerging Risks process.

These scenarios are used to inform strategic objectives and corporate planning, as well as stress scenarios, capital planning and recovery planning.

Effective internal control requires that risk decisions are informed by robust Risk Management Information (MI) and Reporting. Setting standards for the relevant data and for the structure of risk reports ensures that decision-makers can understand the risk profile of the Group across all risk types and make decisions which are consistent with the Group's risk appetite and strategy. Risk reporting practices have been enhanced during 2018 and the suite of MI and reporting provided to Board and Executive Risk Committees has been streamlined to focus on the material risks faced by the Group and improving the accuracy and consistency of risk reporting.

Stress testing is a key risk management tool through which the Group undertakes both solvency and liquidity stress tests to measure balance sheet resilience. Specific stress testing is also undertaken to create a forward-looking view of interest rate risk and counterparty credit risk.

By understanding the risk profile of the Group, the Group is then able to determine how much capital the Group is required to maintain in order to meet regulatory expectations. This is done through the Internal Capital Adequacy Assessment Process (ICAAP) which is mandated by the Capital Requirements Directive, and for which an annual return must be submitted to the Central Bank of Ireland and European Central Bank.

The capital and liquidity requirements of the Group, as reflected in ICAAP and Internal Liquidity Adequacy Assessment Process (ILAAP) submissions, are key components of the recovery plans. These set out the information and processes through which the Group monitors any deterioration in its capital and liquidity position as well as the Group's recovery options in the event of any deterioration.

Successful implementation of the RMF and its component parts depends on colleagues understanding their accountabilities and discharging their risk management responsibilities in line with the RMF's requirements and their role in the three lines of defence. The Group's Remuneration Policy sets out expectations of colleagues and how they are rewarded for managing risk well, in line with the behaviours the Group expects through 'Our Standards'. The EBA Guidelines on Internal Governance require banks to promote sound and effective risk management through their remuneration policies and practices.

Risk culture

A sound risk culture is essential to the realisation of the Group's ambition to be number one for customer service, trust and advocacy in its chosen markets. The Group's objective is to embed a risk culture that supports appropriate risk awareness, behaviours and judgements about risk-taking.

Colleagues at all levels are responsible for the management of risk. The Group requires colleagues to exhibit behaviours that support a sound culture, including risk culture where risk is part of the way its colleagues work and think. The behaviours supporting culture are based strongly on tone from the Board and Executive Committee and those behaviours that support are Tone from the Top, Effective Communication & Challenge, Accountability and Motivation. These behaviours are aligned to the values of 'serving customers', 'working together', 'doing the right thing' and 'thinking long term'.

Aligned to these values is Our Code. Our Code provides guidance on expected behaviours and sets out the standards of conduct that support the values. It explains how the values can affect and support decisions that are taken and describes the principles that must be followed.

23. Risk management – Risk Management Framework continued

The components of the RMF flow through the Group's governance in an annual cycle which ensures that agreed risk appetite is taken into account in setting business strategy, and that the strategy of the Group informs the understanding of the types of risk the Group is likely to face.

Management oversight of risk: Three lines of defence

Effective risk management requires the entire Group to apply a common approach to ownership, management and supervision of risks, proactively escalating and resolving the issues the Group finds. In line with industry practice, the EBA Guidelines on Internal Governance, the Group adopts the Three Lines of Defence (3LoD) model to ensure roles and responsibilities for risk management are clear across the Group and that all lines of defence work collaboratively to create an effective control environment.

Mandatory wording for inclusion in all role profiles provides clarity on the standard accountabilities for risk management across all lines of defence, and the annual Risk Management Plan sets out how the three lines of defence are required to work together to ensure risk is managed effectively and in line with the overall Risk Strategy.

The RMF includes the following key principles for the operation of the 3LoD model.

Standard accountabilities for all roles across the three lines of defence:

- To provide management with information on risk, including escalating concerns where appropriate.
- For the management and oversight of risk relating to day-to-day activities.
- To display those risk practices and behaviours that are consistent with a risk culture where "risk is simply part of the way we work and think".
- To work collaboratively across the 3LoD to achieve the overall strategy of the Group whilst maintaining the independence of each line.

First line of defence (1LOD) – management and supervision

The 1LOD encompasses most roles in the Group. This includes those that directly serve customers or which directly support those that do. They originate most risks in the Group and have responsibility for the ownership, management and the supervision of them. Responsibilities include:

- Developing business and function strategies that are aligned to, and informed by, financial objectives, customer outcomes and risk appetite.
- Proposing their risk appetite, aligned to Group-wide risk appetite where cascaded.
- Identifying, owning, monitoring and managing risks in business delivery within risk appetite.
- Exercising informed judgement in considering risk in decision making.
- Designing, implementing and maintaining effective processes, procedures and controls to identify, measure, report and mitigate risks within risk appetite.
- Demonstrating adequacy and effectiveness of controls and remediating where residual risk is outside of appetite.
- Ensuring compliance with the letter and spirit of all legal and regulatory requirements and maintenance of records to evidence compliance.

Second line of defence (2LOD) – oversight and control

The 2LOD primarily comprises roles in the Risk and Compliance functions. It also includes aspects of activities in Corporate Governance, Finance, Legal, and Human Resources. The 2LOD:

- Set the standards for the effective management of risk across the Group and undertake independent oversight and challenge to ensure risk is being managed within risk appetite.
- Provide expert guidance and direction to the 1LOD in the application of effective risk and control frameworks and consideration of risk in decision making.
- Operate a management assurance programme that covers, thematic reviews, control testing, re-performance of first line testing and quality assurance.

Responsibilities include:

- Defining, managing and maintaining risk management frameworks and policies, to inform the effective management of risk in the 1LOD.
- Facilitating, aggregating and proposing Group-wide strategic and material risk appetite statements to be approved by the Board and Executive.
- Approving the Group's risk appetite at both aggregate and individual business level, where delegated.
- Providing independent oversight and challenge of the implementation of risk management frameworks, policies and controls within the 1LOD to manage risks within appetite and within the letter and spirit of all legal and regulatory requirements. This includes:
- Challenging a proposed decision and providing direction where risks have the potential to exceed risk appetite, breach policy or where risk appetite and controls are inadequately expressed or embedded.
- Imposing controls to support the management of risk within risk appetite.

2LOD activities undertaken outside the Risk and Compliance Functions

Due to specific subject matter expertise there are some activities undertaken elsewhere (Corporate Governance, Finance, Legal, HR) that are responsible for defining and overseeing Group-wide control frameworks and policies.

Third line of defence (3LOD) – Internal Audit

The 3LOD is Internal Audit. They provide the Board and senior management with independent assurance on the appropriateness of the design and operational effectiveness of governance, risk management, compliance and internal controls to monitor, manage and mitigate the Group's material risks.

23. Risk management – Risk Management Framework continued

Risk appetite

The Group's strategy is informed and shaped by an understanding of the risk landscape, including a range of significant risks and uncertainties in the external economic, political and regulatory environment. Identifying these risks and understanding how they affect the Group informs risk appetite and risk management practice.

Risk appetite, which is supported by a robust set of principles, policies and practices, defines levels of tolerance for a variety of risks. It is a key element of the risk management framework and culture, providing a structured approach to risk-taking within agreed boundaries. Risk appetite is defined by the type and level of risk the Group is willing to accept in pursuing its strategic objectives and business plans.

The Group's Risk Appetite Framework and Risk Appetite Statements are reviewed and approved at a minimum on an annual basis by the Board. Risk Appetite Statements are set in line with the Group's strategic objectives, and set over a short, medium and long-term horizon as required under the CBI Corporate Governance Requirements for Credit Institutions 2015.

The Group continues to work with each business to enhance the management information linked to their Risk Appetite Statements. This is required to help ensure appropriate customer outcomes are delivered and that management information is compliant with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

Risk appetite and strategic planning

The risk appetite mandatory procedures require that the annual process of reviewing risk appetite must be completed by the Risk Appetite Statement (RAS) owner alongside the business and financial planning process to ensure risk appetite remains appropriate given the levels of risk expected across the planning horizon.

- If the business plan takes the Group's risk profile outside of approved risk appetite, then the RAS owner must consider if a change in strategy or a change in risk appetite is appropriate (subject to Board approval); this is also considered against the Group's risk capacity.
- If the business plan takes the Group's risk profile to significantly within approved risk appetite, then the RAS owner must decide whether more risk should be taken or if a change in risk appetite is appropriate.

Model risk

Model risk is the risk that a model is specified incorrectly (not achieving the objective for which it is designed), implemented incorrectly (an error in translating the model specification into the version actually used), or being used incorrectly (correctly specified but applied inappropriately).

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

Model risk management

Model Risk Management monitors adherence to model risk standards, ensuring that models are developed and implemented appropriately and that their operational environment is fit for purpose.

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

Model Risk Management reviews may test and challenge the logic and conceptual soundness of the methodology, or the assumptions underlying a model. Reviews may also test whether or not all appropriate risks have been sufficiently captured as well as checking the accuracy and robustness of calculations.

Based on the review and findings from Model Risk Management, the Risk Models Approval Forum and Group Treasury Models Committee consider whether a model can be approved for use. Models used for regulatory reporting may additionally require regulatory approval before implementation.

Model Risk Management reassesses the appropriateness of approved risk models on a periodic basis. Each periodic review begins with an initial assessment. Based on the initial assessment, an internal model governance committee will decide to re-ratify a model or to carry out additional work. In the initial assessment, Model Risk Management assesses factors such as a change in the size or composition of the portfolio, market changes, the performance of – or any amendments to – the model and the status of any outstanding issues or scheduled activities carried over from previous reviews.

Model Risk Management also monitors the performance of the Group's portfolio of models to ensure they appropriately capture underlying business rationale.

23. Risk management continued

Compliance and conduct risk

Definition

Compliance risk is the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities. Conduct Risk is the risk that the conduct of the Group and its colleagues towards customers leads to damage arising from breaches of regulatory requirements, failure to adequately protect customers or meet their expectations.

Sources of compliance and conduct risk

Compliance risk, which covers all policy and prudential requirements, arises i) if the Compliance function fails to fulfil its obligations as per regulatory requirements; ii) if governance, controls or policy assessments are insufficient to ensure compliance with legislative and regulatory requirements; iii) if regulatory interaction is inadequate or ineffective; iv) if people are inadequately assessed, trained and managed to ensure compliance with legislative and regulatory requirements; or v) if the Group fails to comply with relevant prudential regulation thereby incurring material losses or regulatory censure.

Conduct risk exists across all areas of the Group and at all stages of the Group's relationships with its customers, from the development of its business strategies to post-sales processes. The activities through which conduct risk may arise are varied and include, but are not limited to, product design, marketing and sales, complaint handling, colleague training, and handling of confidential insider information. Conduct risk also arises if the Group does not take effective action to prevent fraud, bribery and money laundering.

Key developments in 2018

- A new independent Compliance function has been established and a Director of Compliance appointed to ensure that the function is effectively structured to oversee the compliance and conduct risks of the Group as it evolves to meet the changing needs of customers.
- A compliance risk strategy has been defined as follows: *"To assist delivery of the Group strategy and vision in a safe and controlled manner, putting customers first, by embedding compliance risk management into day to day decision making"* and a series of actions to execute this strategy were delivered.
- A new Compliance Risk Framework has been developed to enhance the ability of the Group to meet regulatory obligations and deliver good customer outcomes.

Compliance and conduct risk management function

The Compliance and Conduct function, which is part of the second line of defence, is an independent, stand alone function with a Director of Compliance who has responsibility for ensuring the Group operates with integrity and in compliance with applicable laws, regulation and internal policies. It is responsible for providing oversight, challenge and advisory services to the Group.

The function seeks to ensure that there is a consistent approach to maintaining regulatory compliance and the management of conduct risk within the Group's stated risk appetite.

The overall objective of the function is to deliver customer protection and good customer outcomes across all areas of the Group's day to day business in order to achieve the Group's ambition to be number one for customer service, trust and advocacy in its chosen markets.

Governance

The Board is responsible for defining appropriate standards of conduct and compliance and driving adherence to them, ensuring that the Framework for managing these risks is in place and operating effectively as well as overseeing remediation activity. The Board has overall responsibility for setting strategy with respect to the management of compliance and conduct risk and setting a risk appetite within which the Group will deliver that strategy. The Board and its senior committees receive updates on conduct and compliance risk exposures and action plans through regular reporting through the Executive Committee and its sub-committees, particularly the Executive Risk Committee and the Consumer Protection Risk Committee.

Controls

The Compliance Risk Framework is designed to meet local regulatory requirements while remaining consistent with the RBS Compliance Risk framework. The Framework is designed to ensure that the Group meets legislative and regulatory obligations, and provides the necessary clarity to colleagues on their conduct and compliance obligations.

The Regulatory Affairs function oversees interactions with regulators, including regulatory approvals for individuals in pre-approved controlled function roles.

The Compliance function is responsible for the development of an Annual Compliance Plan which includes assurance and monitoring. The plan is subject to annual review and approval by the Board. The plan outlines the activity required to manage Compliance and Conduct within pre-defined risk appetite levels.

Risk appetite

The Compliance Risk Framework facilitates a consistent approach across the Group for assessing compliance and conduct risk. The Group has no appetite for not fulfilling its required obligations as per regulatory requirements.

Risk monitoring and measurement

Management reports are prepared on the most material matters for the appropriate committees, including Board Risk Committee, Audit Committee and Board. Regular compliance reports are presented to the Board Risk Committee and Board. Compliance breaches are escalated through the Group Notifiable Event Process.

The UBIDAC Audit Committee is provided with a whistleblowing report on a bi-annual basis. It details cases by internal reporting categories based on the definition of whistleblowing, which is contained within the Group's Speak Up policy.

23. Risk management – Compliance and conduct risk continued

The Group continues to work with each business to enhance the management information linked to their risk appetite statements. This is required to help ensure appropriate customer outcomes are delivered and that management information is compliant with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

Financial crime risk

Definition

Financial crime risk is the risk that the Group or associated third parties, enable money-laundering transactions or facilitate the financing of terrorist groups or the evasion of sanctions. It also incorporates the risk that the services of the Group or associated third parties are used to facilitate bribery and corruption.

Sources

Financial crime risk arises from all aspects of the Group's business, including both retail and commercial banking, dealings with third parties and activities in each of the markets the Group operates in.

Key developments

In line with RBS Group during 2018, policies and procedures were updated within the Group to address the new regulatory requirements under the EU Fourth Money Laundering Directive which came into effect in Ireland on 26 November 2018.

Risk governance

The Financial Crime team within the Group operates within the Compliance function. The Financial Crime Accountable Executive chairs the Group Financial Crime Risk Executive Forum. The Forum is responsible for Group-wide oversight and monitoring of financial crime risk management and regulatory compliance, including escalation as appropriate to the Group's Executive Risk Committee and Board Risk Committee. The Forum reviews and monitors key financial crime risks, provides guidance, challenge, recommendations and decisions on financial crime issues affecting Group.

Risk identification & measurement

Financial crime risks are identified through qualitative and quantitative means across four key areas: anti-money laundering (AML), anti-bribery and corruption (ABC), anti-tax evasion (ATE) and sanctions. Industry-standard approaches – including transactions monitoring and client screening – are used to identify any potential or actual breaches.

Management information is regularly reported to the Group Executive Risk Committee, the Group Board Risk Committee and the Group Board.

Risk mitigation

The Group has systems, policies, processes and controls in place to manage financial crime risk. The Group's financial crime risk assessment approach is regularly reviewed to ensure it is optimised to keep pace with the continually-evolving environment.

The Group Financial Crime team provides centralised expertise to detect and disrupt threats to the Group and its customers. Intelligence is shared with law enforcement, regulators and government bodies in order to strengthen overall defences against those who would misuse the financial system for criminal motives.

Awareness training is mandatory for all colleagues across the Group.

Capital adequacy risk

Definition

Capital consists of financial resources and instruments issued that are available to the Group and that have a degree of permanency and are capable of absorbing losses. A number of strict conditions set by regulators must be satisfied to be eligible to count as capital.

Capital adequacy risk is the risk of being unable to conduct business in base or stress conditions due to insufficient qualifying capital as well as the failure to assess, monitor, plan and manage capital adequacy requirements.

Capital management is the process by which the Group manages its capital risk and is a key focus of its risk management activities.

Constituents of capital

The determination of what instruments and financial resources are eligible to be counted as capital is laid down in applicable regulation.

Capital is categorised by applicable regulation under two tiers (1 and 2) according to the ability to absorb losses, degree of permanency and the ranking of absorbing losses. There are three broad categories of capital across these two tiers:

- Common Equity Tier 1 (CET1) capital CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings. CET1 capital absorbs losses before other types of capital and any loss absorbing instruments.
- Additional Tier 1 (AT1) capital. AT1 capital is the second form of loss absorbing capital and must be capable of absorbing losses on a going concern basis. These instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached. Coupons on AT1 issuances are discretionary and may be cancelled at the discretion of the issuer at any time. AT1 capital must have a minimum maturity of five years.
- Tier 2 capital. Tier 2 capital is the Group's supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years.

23. Risk management – Capital adequacy risk continued

In addition to capital, other specific loss absorbing instruments may be used to cover certain gone concern capital requirements which, in the EU, is referred to as minimum requirement for own funds and eligible liabilities (MREL).

The Group does not currently hold any AT1 or MREL instruments. These are kept under consideration for capital planning purposes.

Capital adequacy ratios

The Group has to hold a minimum amount and quality of capital to satisfy regulatory capital adequacy requirements.

Risk-weighted assets

Capital adequacy ratios compare the amount of capital held to risk-weighted assets (RWAs). RWAs are a measure of the Group's assets and off-balance sheet positions that capture both the size and risks inherent in those positions.

For regulatory purposes, RWAs are grouped into four categories:

Risk	Description
Credit	Risk of loss from a borrower failing to repay amounts due by the due date.
Counterparty credit	Risk of loss from a counterparty not meeting its contractual obligations. Also included is the risk of loss from changes in the fair value of derivative instruments.
Market	Risk of loss arising from fluctuations in market prices.
Operational	Risk of loss from inadequate or failed internal processes, people and systems or from external events.

Minimum percentage

Regulation defines a minimum percentage of capital compared to RWAs. There are two broad categories of capital requirements:

Category	Description
Minimum capital adequacy ratio	Represents the minimum amount of capital that all banks must hold at all times.
Capital buffers	Capital required to be held by banks that may be used in periods of stress.

The Group may be required to hold capital over and above the minimum requirements under Pillar 2. Pillar 2 looks at capital that may need to be held by the Group against risks that are not fully captured or not captured under minimum requirements and risks across a forward-looking planning horizon.

Leverage ratios

The Group has to hold a minimum amount and quality of capital to satisfy the leverage ratio regulatory requirements. Unlike capital adequacy ratios, leverage ratio requirements do not consider the riskiness of the Group's positions.

The leverage exposure is broadly aligned to the accounting value of the Group's on and off-balance sheet exposures but subject to certain adjustments for trading positions, repurchase agreements and off-balance sheet exposures.

In common with capital adequacy ratios, the leverage ratio requirement for the Group consists of a minimum requirement and a leverage ratio buffer.

Capital management

Capital management is the process by which the Group ensures that it has sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within the Board approved Group risk appetite, maintaining its credit rating and supporting its strategic goals.

In the management of capital resources, the Group is governed by the Group policies which are to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business.

In carrying out these policies the Group has regard to and has complied with the capital supervisory requirements of the ECB and CBI throughout the financial year.

Capital management is critical in supporting the Group's business and is enacted through a Group-wide end to end approach. The key elements of the Group capital management approach are set out below.

Risk appetite

Capital adequacy risk appetite is set by the Board, reflecting the Group's strategic objectives, current and future prudential regulatory requirements and market expectations. It is expressed as a set of target ratios for CET1, total capital and leverage under both normal and stress financial conditions. Performance against risk appetite is regularly monitored.

Capital planning

Capital planning is integrated into the Group's wider annual budgeting process and is one of the tools that the Group uses to monitor and manage the risk of excessive leverage.

Stress testing

Stress testing is a key risk management tool used by the Group and is a fundamental component of the Group's approach to capital management. Stress testing is used to quantify, evaluate and understand the potential impact on the financial strength of the Group, including its capital position, given specified changes to risk factors.

23. Risk management – Capital adequacy risk continued

Stress testing includes:

- *Scenario testing*: to examine the impact of a hypothetical future state of the world to define changes in risk factors and capital leverage affecting the Group; and
- *Sensitivity testing*: to examine the impact on expected capital and leverage of an incremental change to one or more risk factors.

Specific areas that involve capital management include:

- Strategic financial and capital planning: through assessing the impact of sensitivities and scenarios on the capital plan and capital ratios;
- Risk appetite: through gaining a better understanding of the drivers of and the underlying risks associated with risk appetite;
- Risk identification: through a better understanding of the risks that could potentially impact the Group's financial strength and capital position; and
- Risk mitigation: through identifying actions that can be taken to mitigate risks or could be taken in the event of adverse changes to the business or economic environment. Risk mitigation is substantially supplemented through the Group's recovery plan.

Internal assessment of capital adequacy

The ICAAP is an annual internal assessment conducted by the Group to assess its material risks and evaluate how much capital is required to cover these risks. The ICAAP is approved by the Board and submitted to regulators. The ICAAP consists of a point in time capital assessment of the Group's exposures and risks at the financial year end and a forward looking stress capital assessment.

The ICAAP is used by the Group to form a view of capital adequacy separately to the regulatory minimum requirements. The ICAAP is used by the CBI and ECB to make an assessment of bank-specific capital requirements through the Supervisory Review and Evaluation Process (SREP).

Governance

Capital management is subject to substantial review and governance across the Group including capital management policies that are approved by Asset and Liability Management Committee and/or Board Risk Committee. The Board approves the Group's capital plans.

Risk management - recovery planning

The Group maintains an internal Contingency and Recovery Framework (UCRF) that sets out credible recovery options that could be implemented in the event of a stress to restore its business to a stable and sustainable condition. Elements of this UCRF are subsequently incorporated into the RBS Group Recovery Plan.

The UCRF sets out a range of triggers that activate the implementation of the framework and sets out the operational plan for its implementation. The UCRF is a key component of the overall risk management of the Group and is updated and approved by the Board quarterly.

Liquidity and funding risk

Definition

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

Sources of liquidity and funding

Liquidity and funding risk arises through the maturity transformation role that banks perform, lending long-term but obtaining funding predominantly through short-term liabilities such as customer deposits. It is dependent on Group specific factors such as maturity profile, composition of sources and uses of funding, the quality and size of the liquidity portfolio as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

The Group's primary funding sources are as follows:

Type	Description
Customer deposits	Retail and Corporate deposits.
Wholesale markets	Short-term (less than 1 year) unsecured money markets and secured repo market funding.
Term debt	Issuance of long-term (more than 1 year) unsecured and secured debt securities.

The Group may access various funding facilities offered by central banks from time to time. The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the broader liquidity management and funding strategy. Usage and repayment of available central bank facilities will fit within the overall liquidity risk appetite and concentration limits.

Policy, risk appetite and governance

The key elements of the Group's liquidity and funding management are as follows:

Type	Description
Risk appetite	Meeting regulatory and set internal risk limits for liquidity and funding.
Policies	Managing liquidity and funding across the Group.
Governance	Management oversight and three lines of defence.

Internal liquidity and funding policies are designed to ensure that the Group:

- *Has a clearly stated liquidity and funding risk tolerance*: the appetite for liquidity risk is set by the Board as a percentage of Regulatory Liquidity Coverage. The Board also sets the appetite for funding risk to ensure that stable sources of funding are used to fund the Group's assets. The Group monitors its liquidity and funding positions against these risk tolerances on a daily basis. In setting risk limits the Board considers the nature of the Group's activities, overall risk appetite, market best practice and regulatory compliance.

23. Risk management - Liquidity and funding risk continued

- *Has in place strategies, policies and practices to ensure that the Group maintains sufficient liquidity*: the risk management framework determines the sources of liquidity risks and the steps that can be taken when these risks exceed certain actively monitored limits. These actions include when and how to use the liquid asset portfolio, and what other adjustments to the balance sheet should be undertaken to manage these risks within the Group's risk appetite.
- *Incorporates liquidity costs, benefits and risks in product pricing and performance management*: the Group uses internal funds transfer pricing to ensure that these costs are reflected in the measurement of business performance and to correctly incentivise businesses to source the most appropriate mix of funding.

The liquidity and funding risk tolerance forms part of the Group's risk appetite statement, which is overseen by the Board Risk Committee and then approved by the Board. The risk appetite statement defines key metrics, risk trigger levels and capacity for liquidity and funding management within the Group.

The Asset and Liability Management Committee (ALCO), oversees the implementation of liquidity and funding management across the Group in accordance with set risk appetite.

Regulatory oversight

The key regulatory metrics are:

Ratio	Exposure type	Description
Liquidity coverage ratio	Liquidity profile	Coverage of 30 day net cash outflows in stress.
Net stable funding ratio	Structural funding profile	Required and available stable funding sources less than and greater than 1 year timeline.

Liquidity risk regulation for the Group is driven by the quantitative and qualitative requirements of the CBI with financial supervision now joint with the ECB under the Single Supervisory Mechanism (SSM).

Activity	Description
ILAAP	An annual process undertaken in compliance with regulatory guidance to formalise the Group's approach to understanding its liquidity risk profile and the processes and systems it needs to have in place to assess, quantify and monitor these risks.
SREP	One of the pillars of the SSM's SREP process is to review liquidity and funding of the Group. This involves a comprehensive review of the Group ILAAP, liquidity policies and risk management framework.

Measurement, monitoring and contingency planning

A suite of tools are used to monitor, limit and stress test the liquidity and funding risks within the balance sheet. The limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

Liquidity risks are reviewed daily, with performance reported to ALCO at least monthly. Any breach of internal metric limits will set in motion a series of actions and escalations outlined under the UCRF. This framework sets out credible recovery options that could be implemented in the event of severe stress to restore the business to a stable and sustainable position, focussing on addressing the Group's capital and liquidity position.

Stress testing

The Group carries out a regular assessment of net stressed liquidity outflows. The Group considers a range of severe but plausible stress scenarios on cash flows, liquidity resources, profitability, solvency, asset encumbrance and survival horizon.

Type	Description
Idiosyncratic scenario	The market perceives the Group to be suffering from a severe stress event which results in an immediate assumption of increased credit risk or concerns over solvency.
Market-wide scenario	A market stress event affecting all participants in a market through contagion, counterparty failure and other market risks. The Group is impacted under this scenario but no more severely than any other participant with equivalent exposure.
Combined scenario	This scenario models the combined impact of an idiosyncratic and market stress occurring at once. The combined scenario reflects the contingency that a severe name-specific event occurs at the Group in conjunction with a broader market stress, causing wider damage to the market and financial sector and severely impacting funding markets and assets.

The Group uses the most severe of the three outcomes above to set the internal stress testing view. The results of this enable the Group to set its internal liquidity risk appetite to complement the regulatory Liquidity Coverage Ratio requirement.

As part of the ILAAP, the Group maintains a further internal assessment relevant scenario, in addition to the other internal liquidity stress tests.

23. Risk management – Liquidity and funding risk continued

Liquidity portfolio

The Group's balance sheet composition is a function of the broad array of product offerings and diverse markets served. The structural composition of the balance sheet is enhanced as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments, while ensuring adequate coverage of all cash requirements under extreme stress conditions. The Group holds an adequate stock of unencumbered high-quality liquid assets that can be converted easily into cash to meet liquidity needs in a stress scenario.

Contractual maturity

The table shows the residual maturity of financial instruments, based on contractual date of maturity. MFVPL and HFT assets and liabilities have been excluded from the maturity analysis due to their short-term nature and are shown in total in the table below. Loans are shown gross of impairment provisions.

Group	Other than MFVPL and HFT												
2018	Less than 1 month €m	1–3 months €m	3–6 months €m	6 months-1 year €m	Subtotal €m	1–3 years €m	3–5 years €m	More than 5 years €m	Total excluding MFVPL and HFT €m	MFVPL and HFT €m	Customer ECL provisions €m	Amount due from/to holding company and fellow subsidiaries €m	Total €m
Cash and balances at central banks	287	-	-	-	287	-	-	-	287	-	-	-	287
Derivatives	-	-	-	-	-	-	-	-	-	210	-	-	210
Loans to banks	3,065	-	-	-	3,065	-	-	-	3,065	-	-	-	3,065
Loans to customers	774	539	430	881	2,624	3,694	3,379	12,198	21,895	-	(879)		21,016
Personal	238	193	283	557	1,271	2,088	1,923	11,176	16,458	-	-	-	16,458
Corporate	484	338	146	322	1,290	1,562	1,446	1,013	5,311	-	-	-	5,311
Financial institutions (excluding banks)	52	8	1	2	63	44	10	9	126	-	-	-	126
Other financial assets	146	301	356	350	1,153	1,603	189	4	2,949	-	-	-	2,949
Total financial assets	4,272	840	786	1,231	7,129	5,297	3,568	12,202	28,196	210	(879)	1,458	28,985
2017													
Total financial assets	3,844	646	843	1,713	7,046	4,444	3,375	13,232	28,097	582	(1,264)	2,375	29,790
Bank deposits	-	-	-	-	-	1,983	-	-	1,983	-	-	-	1,983
Customer deposits	16,871	1,210	1,165	653	19,899	175	11	-	20,085	-	-	-	20,085
Personal	8,373	206	344	441	9,364	14	-	-	9,378	-	-	-	9,378
Corporate	6,781	663	300	16	7,760	13	-	-	7,773	-	-	-	7,773
Financial institutions (excluding banks)	1,717	341	521	196	2,775	148	11	-	2,934	-	-	-	2,934
Derivatives	-	-	-	-	-	-	-	-	-	131	-	-	131
Other financial liabilities	15	33	50	73	171	-	-	869	1,040	5	-	-	1,045
Securitisations	-	-	-	-	-	-	-	869	869	-	-	-	869
Bank deposits	-	-	-	-	-	-	-	-	-	5	-	-	5
Customer deposits	15	33	50	73	171	-	-	-	171	-	-	-	171
Subordinated liabilities	-	-	-	-	-	-	-	86	86	-	-	-	86
Total financial liabilities	16,886	1,243	1,215	726	20,070	2,158	11	955	23,194	136	-	869	24,199
2017													
Total financial liabilities	15,533	1,126	1,010	2,537	20,206	1,488	74	86	21,854	447	-	1,066	23,367

23. Risk management – Liquidity and funding risk continued
Contractual maturity continued

Bank	Other than MFVPL and HFT												
2018	Less than 1 month €m	1–3 months €m	3–6 months €m	6 months-1 year €m	Subtotal €m	1–3 years €m	3–5 years €m	More than 5 years €m	Total excluding MFVPL and HFT €m	MFVPL and HFT €m	Customer ECL provisions €m	Amount due from/to holding company and fellow subsidiaries €m	Total €m
Cash and balances at central banks	287	-	-	-	287	-	-	-	287	-	-	-	287
Derivatives	-	-	-	-	-	-	-	-	-	210	-	-	210
Loans to banks	2,817	-	-	-	2,817	-	-	-	2,817	-	-	-	2,817
Loans to customers	774	539	430	881	2,624	3,694	3,379	12,198	21,895	-	(879)	-	21,016
Personal	238	193	283	557	1,271	2,088	1,923	11,176	16,458	-	-	-	16,458
Corporate	484	338	146	322	1,290	1,562	1,446	1,013	5,311	-	-	-	5,311
Financial institutions (excluding banks)	52	8	1	2	63	44	10	9	126	-	-	-	126
Other financial assets	146	301	356	350	1,153	1,603	189	4	2,949	-	-	-	2,949
Total financial assets	4,024	840	786	1,231	6,881	5,297	3,568	12,202	27,948	210	(879)	3,993	31,272
2017													
Total financial assets	3,844	642	843	1,713	7,042	4,448	3,375	13,232	28,097	554	(1,264)	8,070	35,457
Bank deposits	-	-	-	-	-	1,983	-	-	1,983	-	-	-	1,983
Customer deposits	16,871	1,210	1,165	653	19,899	175	11	-	20,085	-	-	-	20,085
Personal	8,373	206	344	441	9,364	14	-	-	9,378	-	-	-	9,378
Corporate	6,781	663	300	16	7,760	13	-	-	7,773	-	-	-	7,773
Financial institutions (excluding banks)	1,717	341	521	196	2,775	148	11	-	2,934	-	-	-	2,934
Derivatives	-	-	-	-	-	-	-	-	-	131	-	-	131
Other financial liabilities	15	33	50	73	171	-	-	-	171	5	-	-	176
Customer deposits	15	33	50	73	171	-	-	-	171	-	-	-	171
Bank deposits	-	-	-	-	-	-	-	-	-	5	-	-	5
Subordinated liabilities	-	-	-	-	-	-	-	86	86	-	-	-	86
Total financial liabilities	16,886	1,243	1,215	726	20,070	2,158	11	86	22,325	136	-	4,061	26,522
2017													
Total financial liabilities	15,533	1,126	1,010	2,537	20,206	1,488	74	86	21,854	212	-	6,770	28,836

The contractual maturity of balance sheet assets and liabilities reflects the maturity transformation role banks perform. In practice, the behavioural profiles of many liabilities generally exhibit greater stability and longer maturity than the contractual maturity. This is particularly true of many types of retail and corporate deposits which, despite being repayable on demand or at short notice, have demonstrated very stable characteristics even in periods of stress. In analysis, to assess and manage asset and liability maturity gaps the Group determines the expected customer behaviour through qualitative and quantitative techniques, incorporating observed customer behaviours over long periods of time. Procedures for determining expected behaviour are subject to regulatory and internal requirements and are stressed according to these requirements.

The policy and key inputs for managing maturity and behavioural analysis are subject to governance through ALCO.

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

If the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met.

23. Risk management continued

Credit risk

Definition

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

Sources of credit risk

The principal sources of credit risk for the Group are as follows:

Lending - the Group offers a number of lending products that involve an obligation to provide credit facilities to customers. To mitigate the risk of loss, security may be obtained in the form of physical collateral (such as commercial real estate assets and residential property) or financial collateral (such as cash and bonds). Exposures arising from leasing activities are also included.

Derivatives and securities financing - the Group enters into derivatives contracts and securities financing transactions. These result in counterparty credit risk, which is the risk of financial loss arising from the failure of a counterparty to meet obligations. To mitigate the risk of loss, collateral and netting are used along with the additional legal rights provided under the terms of over-the-counter contracts.

Debt securities - the Group holds some debt securities for liquidity management purposes and is exposed to credit risk as a result.

Off-balance sheet products - the Group provides trade finance and guarantees for customers, as well as committed but undrawn lending facilities, and is exposed to credit risk as a result.

Other activities - the Group is exposed to settlement risk through its activities in foreign exchange, trade finance and payments.

Credit risk management function

Governance

As is standard practice in the industry, credit risk management activities are organised along two separate lines, wholesale and retail, reflecting the distinction between business types and consequent drivers of credit risk. Wholesale focuses on activities with institutional, corporate and SME customers. Retail covers personal customers, small businesses as well as personal lending activities in private banking. Nonetheless, many activities remain common to both business lines.

The activities of the Group's credit risk management function, which is led by the Chief Credit Officer, include:

- approving credit for customers; in both Retail and Wholesale;
- ensuring that credit risk is within the risk appetite set by the Board;
- managing concentration risk and credit risk control processes;
- developing and ensuring compliance with credit risk policies and mandatory procedures; and
- conducting assessments of provision adequacy.

Risk appetite

Risk appetite across all risk types is set by the Group's Board using qualitative statements of risk appetite and specific quantitative targets under stress, including earnings volatility and capital adequacy. The credit risk processes take into account concentrations and sector/product limits at Bank-wide level and have been designed to reflect factors that influence the ability to meet those targets. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite processes and risk appetite targets. The processes are supported by a suite of policies/mandatory procedures and transaction acceptance standards that set out the risk parameters within which businesses must operate.

23. Risk management - Credit risk continued

Risk models

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

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

Impact of credit model changes

The Group reviews and updates models on an ongoing basis in order to reflect the impact of more recent data, changes to products and portfolios, and new regulatory requirements.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, in commentary, differentiations are made between instances where movements in risk measures reflect the impact of model changes and those where such movements reflect changes in the size of underlying credit portfolios or their credit quality.

A credit model sensitivity analysis is presented on page 79.

Risk mitigation

Risk mitigation techniques are used in the management of credit portfolios across the Group, typically to mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, customer credit balances are netted against obligations. Mitigation tools applied can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties.

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

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

For further information, refer to the sub-sections on wholesale credit risk mitigation and retail credit risk mitigation.

Counterparty credit risk

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

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

23. Risk management - Credit risk continued

Collateral may consist of either cash or securities. Additional collateral may be called should the net value of the obligations to the Group rise or should the value of the collateral itself fall. The majority of agreements are subject to daily collateral calls with collateral valued using internal valuation methodologies.

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

Risk assessment and monitoring

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

Wholesale risk assessment

Before credit facilities are made available to customers, a credit assessment is undertaken with approval obtained through either auto-decisioning or by a manual sanctioning process. This process is applied across the Group for the setting, use and monitoring of the application of credit authorities.

Credit authority is delegated relative to the individual's level of experience, knowledge and qualifications and must be supported by a clear business need. Only a small number of senior executives hold the highest authority provided under the process. Both business and credit approvers are accountable for the quality of each decision taken but the credit risk approver holds ultimate sanctioning authority. Credit approval levels are determined by considering the aggregate borrowing of the customer and their credit quality, for example, a larger facility from a weaker customer would require a more experienced sanctioner to approve the proposal.

Auto-decisioning is used for larger volume/lower value applications. The quality of the auto-decisions is kept under review to determine if adjustments need to be made to thresholds.

The wholesale credit approval process is governed by a policy and a related mandatory procedure. These detail:

- the rules of delegation of authority;
- specific types of sanctioning and the approval rules associated with them; and
- monitoring requirements.

It is the Group's policy that an oversight programme is in place where a selection of sanctioner approvals are reviewed by line managers to ensure that a consistent standard of decision making exists. All authorities are also reviewed by the heads of the credit sanctioning teams on an annual basis to ensure that the authority has been appropriately used and examines whether the level should be reviewed, based on the individual performance, for the following year.

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

- the amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- compliance with relevant credit policies, mandatory procedures and transaction acceptance standards;
- the customer's ability to meet obligations, based on an analysis of financial information;
- a review of payment and covenant compliance history;
- the customer's risk profile, including sector, sensitivity to economic and market developments and management capability;
- legal capacity of the customer to engage in the transaction;
- credit risk mitigation including requirements for valuation and revaluation. The customer's credit grade and the loss given default estimate for the facilities, including any expected changes;
- the requirement for the provision of financial information, covenants and/or monitoring formulae to monitor the customer's financial performance;
- refinancing risk - the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;
- consideration of other risks such as environmental, social and ethical, regulatory and reputational risks; and
- the portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed business risk appetite.

Where the customer is part of a group, the credit assessment considers aggregated credit risk limits for the customer group as well as the nature of the relationship with the broader group (e.g. parental support) and its impact on credit risk. Credit relationships are reviewed and credit grades (PD and LGD) re-approved annually.

The review process addresses borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; compliance with terms and conditions; and refinancing risk.

Wholesale credit risk mitigation

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

- Commercial real estate.
- Other physical assets - including stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of ways, depending on the type of asset and may rely on balance sheet valuations in certain cases.
- Receivables - these are amounts owed to the Group's counterparties by their own customers. The Group values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.

23. Risk management - Credit risk continued

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

Commercial real estate valuations
The Group has a panel of chartered surveying firms that cover the spectrum of geography and property sectors in which the Group takes collateral. The Group has a programme that identifies suitable valuers for particular assets, all of whom must be registered valuers and members or fellows of the Institute of Chartered Surveyors (MRICS, FRICS) or Society of Chartered Surveyors Ireland (MSCSI, FSCSI). They are contracted through a single service agreement to ensure consistency of quality and advice. Valuations are commissioned when an asset is taken as security; a material increase in a facility is requested; or an event of default is anticipated or has occurred. Valuations are conducted in accordance with current regulatory requirements.

Wholesale problem debt management

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

Risk of Credit Loss
This process focuses on wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the Group. There are two classifications which apply to non-defaulted customers - Heightened Monitoring and Risk of Credit Loss. The process also applies to those customers that have met the Group's default criteria.

Heightened Monitoring customers are performing customers who possess certain characteristics, which have led to material credit deterioration. Collectively, characteristics reflect circumstances that may affect the customer's ability to meet repayment obligations. Characteristics include trading issues, covenant breaches, material PD downgrades and past due facilities. Sector-specific characteristics also exist. Heightened Monitoring customers require pre-emptive actions (outside the customer's normal trading patterns) to return or maintain their facilities within the Group's current risk appetite prior to maturity.

Risk of Credit Loss customers are performing customers who have met the criteria for Heightened Monitoring and also pose a risk of credit loss to the Group in the next twelve months, should mitigating action not be taken or not be successful.

Concentration risk management

Four formal processes are used to manage wholesale credit concentration risk. These are Product/Asset Class, Sector, Single Name and Country concentration risks. These risks and the limits set associated with them are assessed for appropriateness on a regular basis.

Product/asset class concentration - the Group manages certain lines of business where the nature of credit risk assumed could result in a concentration or a heightened risk in some other form. This will include specific credit risk types such as asset finance, settlement risk, sponsor owned corporates and products such as long-dated derivatives. Typically specific limits and thresholds are deployed to manage the credit risk inherent in these areas, which are subject to regular review.

Sector concentration - sector concentration risk arises from the potential for excessive exposure to exist to any one or combination of correlated industry sectors that could behave similarly under stressed conditions. Risk appetite and portfolio strategies are set at sector or sub-sector level in order to mitigate this potential risk where historic experience or trends in external factors or portfolio performance give cause for concern. Concentration thresholds are set and approved by the Board and monitored via the Wholesale Credit Risk Appetite Statement.

Single-name concentration
Single name concentration addresses the risk of outsized exposure to a borrower or borrower group. The process includes elevated approval authority, additional reporting and monitoring and the requirement for plans to address excessive exposures. Appetite thresholds are set and approved by the Board and monitored via the Wholesale Credit Risk Appetite Statement.

Country concentration - is the risk of losses occurring as a result of either a country event or unfavourable country operating conditions. As country events may simultaneously affect all or many individual exposures to a country, country event risk is a concentration risk. It arises from possible economic or political events in each country to which the Group has exposure and from unfavourable conditions affecting daily operations in a country. The Group's risk exposure is predominantly in the Republic of Ireland, in line with its strategic focus on core customer markets and lack of international lending activity.

The Group actively manages its concentrations and aligns its appetite for future business to the scale of its activities. Sectors and Product/asset classes that the Group has a material concentration in are reviewed at a minimum annually to ensure that the business strategy, sector limit and transaction acceptance standards remain appropriate. Single Name Concentration is reviewed annually for appropriateness including:

- simplifying the process to ensure it remains fit for purpose; and
- sizing limits appropriately for the Group's core customer base and future strategy.

23. Risk management - Credit risk continued

Retail credit risk management

Retail credit risk management within the Group is conducted in line with the common policies and procedures that apply across the RBS Group.

Risk appetite

The Group uses a credit risk appetite framework to control credit risk for its retail business. The framework sets limits that measure and control the quality of both existing and new business. The actual performance of each portfolio is tracked relative to these limits and action taken where necessary. These limits apply to a range of credit risk-related measures including expected loss of the portfolio, the expected loss in a given stress scenario, projected credit default rates and the LTV of retail mortgage portfolios. Appetite thresholds are set and approved by the Board and monitored via the Retail Credit Risk Appetite Statement.

Retail credit risk assessment

Retail lending generally entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, the Group analyses credit information, including the historical debt servicing behaviour of customers with respect to both the Group and their other lenders. The Group then sets its lending rules accordingly, developing different rules for different products. The process is somewhat automated, with customers receiving a credit score that reflects a comparison of their credit profile with the rule set. For relatively high-value, complex personal loans, including all residential mortgage lending, specialist credit managers make the final lending decision, having considered the application in totality. Underwriting standards are monitored on an ongoing basis to ensure they remain appropriate.

Retail risk mitigation

The Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages and home equity lending. The Group values residential property during the loan underwriting process by appraising properties individually. Collateral is valued based on management's expectation regarding ability to collect. The Group updates residential property values quarterly using the Central Statistics Office residential property price index.

Retail problem debt management

The approach adopted in the management of retail mortgage customers in financial difficulty has been developed considering the Code of Conduct on Mortgage Arrears ("CCMA") requirements and the steps outlined in the Mortgage Arrears Resolution Process ("MARP") ensuring that:

- Each customer's individual circumstances are taken account of while treating them in a consistent manner.
- The reason for financial difficulty is established and a long term sustainable solution for the mortgage is sought.

Only customers who co-operate fully with the Group can be considered and assessed for forbearance.

The range of forbearance solutions made available to customers in financial difficulty are designed to provide the customer with a long term sustainable solution.

It is the Group's preference to keep people in their home where this can be achieved with a long term sustainable solution.

Where that outcome is not affordable to the customer, the Group will seek to provide options for co-operating customers with unsustainable mortgages to exit their home in a way that minimises the impact to them.

Identification of long term solution

Customers who contact the Group because of financial difficulties, or who are already in payment arrears and who co-operate fully with the Group will be considered for a long term sustainable solution.

These long term sustainable solutions include:

- Capitalisation of arrears - the customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.
- Term extensions - the maturity date of the loan is extended.
- Modified Mortgage - A Modified Mortgage will be considered where a customer can afford a mortgage but their income is not sufficient to fully support their current mortgage. The existing mortgage is split into two parts: Part One being the sustainable element, which is repaid on the basis of principal and interest, and Part Two being the unsustainable element which is written off in full subject to a period of performance.
- Payment Concession – the customer is offered a discounted interest rate that involves the forgiveness of some interest.
- Assisted Surrender – An Assisted Surrender solution will be considered where the loan is deemed to be unsustainable and the customer is agreeable to surrendering the property. This solution may include an element of debt write-off.

For unsecured portfolios, payment plans can be arranged for customers in difficulty. Arrangements to facilitate the repayment of excesses or loan arrears are generally agreed dependent on affordability.

Recoveries

- If a customer refuses to cooperate with the Group in the resolution of financial difficulties or refuses to accept a sustainable solution offered, recoveries activity, including litigation, may be taken by the Group.
- The recoveries activity seeks to minimise the Group's loss by maximising cash recovery while treating customers fairly.

The incidence of the main types of retail forbearance on the balance sheet as at 31 December, presented using the gross carrying value is analysed below. Definitions are based on those used within the CBI forbearance guidelines.

23. Risk management - Credit risk continued

	2018 €m	2017 €m
Term extensions – capital repayment and interest only	237	361
Interest only conversions	108	238
Payment concessions/holidays	1,873	2,781
Capitalisation of arrears	734	1,007
Other	1	-
Total	2,953	4,387

In the retail portfolio, loans are considered forborne until they meet the exit criteria set out by the European Banking Authority. These include being classified as performing for two years since the last forbearance event, making regular repayments and the debtor being less than 30 days past due.

Impairment, provisioning and write-offs

In the overall assessment of credit risk, impairment, provisioning and write-offs are used as key indicators of credit quality.

The new IFRS 9 impairment provisions accounting standard was implemented with effect from 1 January 2018. Set out below is further detail regarding the impact of the transition from IAS 39 to IFRS 9 impairment provisioning, how the Group's key credit risk management activities link to IFRS 9 impairment provisioning and the key policy and modelling decisions that the Group has made in implementing IFRS 9 (refer to accounting policy (n) and Note 12).

Transition from IAS 39 to IFRS 9

The Group implemented IFRS 9 with effect from 1 January 2018 with no restatement of comparatives other than the day one impact on implementation reflected in opening equity (Note 30).

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

New elements include:

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

The key elements of IFRS 9 impairment provisions

IFRS 9 introduced additional complexity into the determination of credit impairment provisioning requirements. However, the building blocks that deliver an ECL calculation already existed in the Group. Existing Basel models were used as a starting point in the construction of IFRS 9 models. A bespoke suite of models for the mortgage portfolio was built intending to capture most recent portfolio dynamics.

Five key areas may materially influence the measurement of credit impairment under IFRS 9 – two of these relate to model build and three to their application:

- Model build:
  - The determination of economic indicators that have most influence on credit loss for each portfolio and the severity of impact (this leverages existing stress testing mechanisms).
  - The build of term structures to extend the determination of the risk of loss beyond twelve months that will influence the impact of lifetime loss for assets in Stage 2.
- Model application:
  - The assessment of the significant increase in credit risk and the formation of an approach capable of consistent application.
  - The determination of asset lifetimes that reflect behavioural characteristics whilst also representing management actions and processes (using historical data and experience).
  - The determination of a base case (or central) economic scenario which has the most material impact (of all forward-looking scenarios) on the measurement of loss (the Group uses consensus forecasts where possible to remove management bias).

Policy elections and simplifications relating to IFRS 9

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

23. Risk management - Credit risk continued

Policy elections and simplifications relating to IFRS 9 continued

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

- Models – in the case of some low default portfolios, Basel parameter estimates have been applied for IFRS 9.
- Discounting of future losses – the ECL calculation is based on expected future cash-flows. These are discounted using the effective interest rate – for practical purposes, this is typically applied at a portfolio level rather than being established and operated at an individual asset level; and

Multiple Economic Scenarios (MES) – it is the selection of the central (or base) scenario that is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities.

Different approaches to model MES around the central scenario have all been found of low significance for the overall ECL impact. Thus, internal committees consider and challenge the probability weighted ECL outcome and make further adjustments if considered appropriate.

IFRS 9 credit risk modelling

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

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

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

IFRS 9 ECL model design principles

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

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

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

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

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

PD estimates

Wholesale models

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

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

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

Retail models

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

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

LGD estimates

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

23. Risk management - Credit risk continued

LGD estimates continued

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

For retail, forward-looking information has only been incorporated for the secured portfolios, where changes in property prices can be readily accommodated.

For retail mortgages a bespoke IFRS 9 model is utilised. Analysis indicates minimal impact for retail unsecured portfolios.

EAD estimates

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

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

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

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

Significant increase in credit risk

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

The framework comprises the following elements:

- IFRS 9 lifetime PD assessment (the primary driver) – on modelled portfolios the assessment is based on the relative deterioration in forward-looking lifetime PD and is assessed monthly. To assess whether credit deterioration has occurred, the residual lifetime PD at balance sheet date (which PD is established at Date of Initial Recognition) is compared to the current PD. If the current lifetime PD exceeds the residual origination PD by more than a threshold amount deterioration is assumed to have occurred and the exposure transferred to Stage 2 for a lifetime loss assessment. For wholesale, a doubling of PD would indicate a significant increase in credit risk subject to a minimum PD uplift of 0.1%. For Personal portfolios, the criteria varies by risk band, with lower risk exposures needing to deteriorate more than higher risk exposures, as outlined in following table:

Personal risk bands	Risk bandings (based on residual lifetime PD calculated at DOIR)	PD deterioration threshold criteria
Risk band A	<0.762%	$PD^{@DOIR}$ + 1%
Risk band B	<4.306%	$PD^{@DOIR}$ + 3%
Risk band C	>=4.306%	1.7 x $PD^{@DOIR}$

In the mortgage portfolio the above risk bandings are applied to exposures originated post 1 January 2012. For mortgage exposures originated prior to 2012 the threshold applied is 2.8 x $PD^{@DOIR}$.

- Qualitative high-risk backstops – the PD assessment is complemented with the use of qualitative high-risk backstops to further inform whether significant deterioration in lifetime risk of default has occurred. The qualitative high-risk backstop assessment includes the use of the mandatory 30+ days past due backstop, as prescribed by IFRS 9 guidance, and other features such as forbearance support, Wholesale exposures managed within the Risk of Credit Loss framework and adverse credit bureau results in Personal.
- Persistence (Personal and Business Banking only) - the persistence rule ensures that accounts which have met the criteria for PD driven deterioration are still considered to be significantly deteriorated for three months thereafter. This additional rule enhances the timeliness of capture in Stage 2. It is a Personal methodology feature and is applied to PD driven deterioration only.

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

- Criteria effectiveness – the criteria should be effective in identifying significant credit deterioration and prospective default population.
- Stage 2 stability – the criteria should not introduce unnecessary volatility in the Stage 2 population.

Portfolio analysis – the criteria should produce results which are intuitive when reported as part of the wider credit portfolio.

23. Risk management - Credit risk continued

Asset lifetimes

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

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

Primary economic loss drivers and base case scenarios used in IFRS 9 modelling

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

The typical primary economic loss drivers for retail portfolios include GDP, unemployment rate, house price index (HPI), and ECB base rate. In addition to some of these loss drivers, for wholesale portfolios World GDP is a primary loss driver.

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

	31 December 2018					1 January 2018				
Republic of Ireland	Up 2 %	Up 1 %	Base %	Down 1 %	Down 2 %	Up 2 %	Up 1 %	Base %	Down 1 %	Down 2 %
GDP - change	4.3	3.6	3.0	3.1	2.8	3.7	3.2	2.9	2.6	2.3
Unemployment	4.2	4.6	5.2	6.0	6.7	5.0	5.4	5.7	5.8	6.1
HPI – change	9.2	6.8	4.0	3.2	0.8	6.8	5.6	4.5	3.9	3.2
ECB base rate	1.3	0.8	0.3	0.0	0.0	0.6	0.4	0.2	0.1	0.0

Approach for multiple economic scenarios (MES)

Retail

The approach to MES is based on using a set of discrete scenarios. In addition to the central base case a further four bespoke scenarios are taken into account – a base case upside and downside – and an additional upside and downside. The overall MES ECL is calculated as a probability weighted average across all five scenarios.

Probability weightings of scenarios

The Group's approach to IFRS 9 MES in Retail involves selecting a suitable set of discrete scenarios to characterise the distribution of risks in the economic outlook and assigning appropriate probability weights to those scenarios. This has the following basic steps:

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

Wholesale

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

In terms of practical application, the impact from MES is factored in to account level PDs through a scalar, and these MES adjusted PDs are used to assess whether a significant increase in credit risk has occurred.

23. Risk management - Credit risk continued

Management review and expert judgement

The impacts arising from the systematic MES process are formally reviewed each quarter. These reviews occur under the auspices of the Provisions Committee and utilise many inputs, including a variety of macroeconomic forecasts, relevant stress testing models and the expert judgement of committee members.

Provisioning overlays – modelled portfolios

The ECL provisioning requirement is primarily driven by statistical models with these requirements supported by post model adjustments (PMAs). PMA are held to ensure the completeness of balance sheet provision requirements in circumstances which are considered appropriate. PMA are subject to oversight and governance at UBIDAC Provisions Committee. As at 31 December 2018 PMAs represented approximately 11% of total ECL provisions, predominately driven by adjustments held for deleveraging activity associated with non-performing loans and for future economic uncertainity.

Measurement uncertainty and ECL sensitivity analysis

The recognition and measurement of expected credit losses (ECL) is highly complex and involves the use of significant judgement and estimation.

This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9. The ECL provision is sensitive to the model inputs and economic assumptions underlying the estimate. Set out below are the impact of some of the material sensitivities considered for the 2018 year end reporting.

The focus of the simulations is on ECL provisioning requirements on performing exposures in stage 1 and 2. We have applied the following common scenarios across the key retail and wholesale portfolios:

- Economic uncertainty – we simulated the impact arising from our Downside 2 scenario, which is one of the 5 discrete scenarios used in our methodology for retail MES. In the simulation we have assumed that the economic macro variables associated with the Downside 2 scenario replace our existing base case economic assumptions, with them given a 100% probability weighting.

Our Downside 2 scenario reflects a significant economic downturn as reflected in the macro variables in the following table:

	Base case economic parameters					Downside 2 economic parameters				
	2019 Q4 %	2020 Q4 %	2021 Q4 %	2022 Q4 %	2023 Q4 %	2019 Q4 %	2020 Q4 %	2021 Q4 %	2022 Q4 %	2023 Q4 %
GDP (year-on-year)	4.19	2.85	2.76	2.78	2.50	0.73	3.51	4.35	4.54	4.00
ECB base rate	-	-	0.25	0.50	0.75	-	-	-	-	-
House Price Index (year-on-year)	5.83	2.70	3.00	3.40	3.50	(6.68)	(5.36)	2.23	7.15	8.75
Unemployment rate	5.24	5.14	5.12	5.16	5.26	7.58	7.71	6.51	5.86	5.71

This scenario has been applied to all modelled portfolios in the analysis below. For some portfolios this creates a significant impact on ECL, for others less so but on balance the impact is deemed reasonable. In this simulation, it is assumed the existing modelled relationship between key economic variables and loss drivers holds good.

- Portfolio risk – evaluation of the impact of a movement in one of the key metrics, probability of default (PD), simulating a relative 25% upward shift in PDs.

We complemented these common scenarios with two specific portfolio simulations:

- Wholesale portfolios – simulating the impact of PDs moving upwards to the through-the-cycle (TTC) average from their current point-in-time (PIT) estimate. This simulation looks solely at PD movements, potential movements in LGD rates have not been considered. With the current benign economic conditions wholesale IFRS 9 PIT PDs are significantly lower than TTC PD. This scenario shows the increase to ECL by immediately switching to TTC PDs providing an indication of long run average expectations. IFRS 9 PDs have been used so there remains some differences to Basel TTC PDs where conservative assumptions are required, such as caps or floors, not permitted under the IFRS 9 best estimate approach.
- Mortgages – House Price Inflation (HPI) is a key economic driver and the Group have simulated a univariate scenario of a 5% decrease in HPI across the main mortgage portfolios. A univariate analysis using only HPI does not allow for the interdependence across the other key primary loss drivers to be reflected in any ECL estimate. The simulated impact is based on 100% probability weighting to demonstrate the sensitivity of HPI on the central base case. The Downside 2 scenario above has house prices falling by a more material amount, and also includes the impact of PD increases which are not captured under the HPI univariate simulation.

The Group's core criterion to identify a significant increase in credit risk is founded on PD deterioration, as discussed above. Under the simulations, PDs increase and result in exposures moving from Stage 1 to Stage 2 contributing to the ECL uplift.

Brexit presents a risk for Ireland. However, given Ireland's current positive position in the economic cycle, management believes the potential Brexit impact is captured within the range of historical economic data used to generate IFRS 9 scenarios.

23. Risk management - Credit risk continued

	Stage 1 and 2 Exposures			Common scenarios - ECL uplift						Specific scenarios		
				Downside 2			25% PD increase			HPI fall / TTC PD		
	Exposure	of which In Stage 2	ECL provision	ECL Uplift		Exposure In Stage 2	ECL Uplift		Exposure In Stage 2	ECL Uplift		of which In Stage 2
	€bn	%	€m	€m	%	%	€m	%	%	€m	%	%
Retail	14.2	11.91%	112	68	60.49%	24.46%	27	24.42%	17.30%			
of which: mortgages	13.6	11.45%	96							7	7.19%	11.70%
Wholesale	10.9	5.89%	54	5	9.42%	7.30%	14	26.22%	7.24%	8	14.73%	8.43%

Note:

Group core criteria to identify a significant increase in credit risk is founded on PD deterioration. Under the simulations, PDs increase and result in exposures moving from stage 1 to stage 2 contributing to the ECL uplift. The HPI simulation looks at LGD only, PDs are not impacted.

Credit risk - Banking activities

Introduction

This section covers the credit risk profile of Group's banking activities.

Refer to Note 1 for revisions to accounting policies. Critical judgements relating to impairment loss determination and key IFRS 9 terms and their differences to IAS 39 accounting and the regulatory framework, are discussed in this note.

Financial instruments within the scope of IFRS 9 ECL

Refer to Note 11 for balance sheet analysis of financial assets that are classified as amortised cost (AC) or fair value through other comprehensive income (FVOCI), the starting point for IFRS 9 ECL assessment.

Those assets outside the framework were as follows:

- Settlement balances, items in the course of collection, cash balances and other non-credit risk assets were assessed as having no ECL unless there was evidence that they were credit impaired.
- Commercial cards which operate similar to charge cards, with balances repaid monthly via mandated direct debit with the underlying risk of loss captured within the customer's linked current account – €16 million.

Contingent liabilities and commitments

In addition to contingent liabilities and commitments disclosed in Note 24 – reputationally committed limits are also included in the scope of the IFRS 9 ECL framework. These are offset by €1.4 billion out of scope balances primarily related to facilities that, if drawn would not be classified as AC or FVOCI, or undrawn limits relating to financial assets exclusions.

Portfolio summary - sector analysis

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

31 December 2018	Retail €m	Wholesale €m	Total €m
Loans by geography			
- Republic of Ireland	16,384	7,735	24,119
- United Kingdom	-	289	289
- Other Europe	-	90	90
- Rest of the World	-	308	308
Loans by asset quality			
- AQ 1-4	6,065	4,392	10,457
- AQ 5-8	7,396	3,814	11,210
- AQ 9	518	42	560
- AQ 10	2,405	174	2,579
Loans by stage			
- Stage 1	12,351	7,553	19,904
- Stage 2	1,628	695	2,323
- Stage 3	2,405	174	2,579
Loans - past due analysis			
- Not past due	14,465	8,221	22,686
- Past due 1-29 days	300	46	346
- Past due 30-89 days	249	12	261
- Past due 90-180 days	292	12	304
- Past due > 180 days	1,078	131	1,209

23. Risk management – Credit risk continued

Portfolio summary - sector analysis continued

31 December 2018	Retail €m	Wholesale €m	Total €m
Stage 2			
- Not past due	1,352	674	2,026
- Past due 1-29 days	159	13	172
- Past due 30-89 days	117	8	125
- Past due 90-180 days	-	-	-
- Past due >180 days	-	-	-
ECL provision (total)	700	179	879
ECL provisions by geography			
- Republic of Ireland	700	166	866
- United Kingdom	-	11	11
- Other Europe	-	0.2	0.2
- Rest of the World	-	2	2
ECL provisions by stage			
- Stage 1	14	25	39
- Stage 2	94	33	127
- Stage 3	592	121	713
ECL Provision coverage (total) - ECL/loans			
- Stage 1 (%)	0.11	0.33	0.20
- Stage 2 (%)	5.77	4.75	5.47
- Stage 3 (%)	24.62	69.61	27.65
ECL charge			
- Third party	(24)	1	(23)
ECL charge			
- Republic of Ireland	(24)	1	(23)
ECL loss rate (%)	(0.15)	-	(0.09)
Amounts written off	388	33	421
Other financial assets by asset quality			
- AQ 1-4	-	2,580	2,580
- AQ 5-8	-	361	361
- AQ 9	-	-	-
- AQ10	-	-	-
Off balance sheet			
Loan commitments	787	2,509	3,296
Financial guarantees	-	492	492
Off balance sheet by asset quality			
- AQ 1-4	308	1,696	2,004
- AQ 5-8	468	1,263	1,731
- AQ 9	6	17	23
- AQ 10	5	25	30
Weighted average life - ECL measurement (years)	9	4	8
Weighted average life 12 months PDs			
- IFRS 9 (%)	1.10	2.50	1.39
- Basel (%)	1.78	0.94	1.47

At 31 December 2018, AQ10 includes €620 million of exposures which are not currently considered defaulted for capital calculation purposes but are included in Stage 3.

The table below analyses gross loans (excluding reverse repos) and related credit metrics by reportable segment.

31 December 2017	Retail €m	Wholesale €m	Total €m
Gross loans to banks	-	2,757	2,757
Gross loans to customers	18,210	4,765	22,975
Risk elements in lending (REIL)	3,501	185	3,686
Provisions	1,111	153	1,264
REIL as a % of gross loans to customers	19.2	3.9	16
Provisions as a % of REIL	31.7	82.7	34.3
Provisions as a % gross loans to customers	6.1	3.2	5.5
Impairment losses/(releases)	84	(16)	68

In the table above REIL refers to Risk Elements in Lending as accounted for under IAS 39. REIL comprised impaired loans and accruing loans past due 90 days or more. Accruing loans past due 90 days or more were loans past due 90 days where no impairment loss was expected.

23. Risk management – Credit risk continued

Collateral and credit enhancement - Total

The table below summarises financial assets of modelled portfolios within the scope of the ECL framework as well as credit mitigation and credit enhancements.

					Credit enhancements						
	Gross exposure	ECL	Maximum exposure to credit risk	Maximum exposure to credit risk: of which stage 3	Financial	Property	Other	Total credit enhancements	Total credit enhancements: of which stage 3	Exposure post credit mitigation & enhancement	Exposure post credit mitigation & enhancement: of which stage 3
31 December 2018	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Financial assets											
Cash and balances at central banks	-	-	-	-	-	-	-	-	-	-	-
Loans - amortised cost											
Retail	16,383	697	15,686	1,812	-	15,305	-	15,305	1,795	381	17
Wholesale	8,422	177	8,245	53	35	2,152	453	2,640	41	5,605	12
Other financial assets	2,942	1	2,941	-	-	-	-	-	-	2,941	-
Total	27,747	875	26,872	1,865	35	17,457	453	17,945	1,836	8,927	29
Contingent liabilities and commitments											
Retail	404	2	402	5	-	-	-	-	-	402	5
Wholesale	3,001	6	2,995	23	48	326	83	457	2	2,538	21
Total	3,405	8	3,397	28	48	326	83	457	2	2,940	26
Total exposures	31,152	883	30,269	1,893	83	17,783	536	18,402	1,838	11,867	55

The Group holds collateral in respect of individual loans. This collateral includes mortgages over property (both personal and commercial). Property valuations are capped at the loan value.

23. Risk management – Credit risk continued

Retail portfolio

Disclosures in the Personal portfolio section include drawn exposure (gross of provisions). Loan-to-value (LTV) ratios are split by stage under IFRS 9 at 31 December 2018 and by performing and non-performing status under IAS 39 at 31 December 2017. Weighted average LTVs are separated into owner-occupied and buy-to-let categories.

Retail lending	2018 €m	2017 €m
Mortgages	16,039	17,297
Owner occupied	14,636	15,160
Buy-to-let	1,403	2,137
Interest only - variable	210	293
Interest only - fixed	13	9
Mixed [1]	76	89
ECL provision [2]	672	1,024
Other lending	368	392
Drawn exposure	368	392
ECL provision [2]	28	50
Total retail lending	16,407	17,689
Mortgage LTV ratios		
- Total portfolio	62%	69%
- Stage 1/performing	58%	65%
- Stage 2/performing	67%	
- Stage 3/non-performing	77%	87%
- Buy-to-let	64%	75%
- Stage 1	58%	-
- Stage 2	72%	-
- Stage 3	78%	-
Gross new mortgage lending	1,134	1,003
Owner occupied exposure	1,122	986
Weighted average LTV [3]	73%	75%
Buy-to-let	12	17
Weighted average LTV [3]	57%	57%
Interest only variable rate	-	7
Interest only fixed rate	-	1
Mixed [1]	1	-
Mortgage forbearance		
Forbearance flow	235	226
Forbearance stock	2,954	4,386
Current	1,441	2,004
1-3 months in arrears	292	525
>3 months in arrears	1,221	1,857

Notes:

(1) Includes accounts which have an interest only sub-account and a capital and interest sub-account to provide a more comprehensive view of interest only exposures.

(2) 31 December 2018 data was prepared under IFRS 9. 31 December 2017 data was prepared under IAS 39.

(3) Weighted by current exposure gross of provisions.

23. Risk management – Credit risk continued

Retail portfolios

Mortgage LTV distribution by stage

The table below shows gross mortgage lending and related ECL by LTV band.

	2018													2017			
	Drawn exposure - Total book				Of which:	ECL provisions				ECL provisions coverage [1]				Drawn exposure - Total book			Of which:
	Stage 1 €m	Stage 2 €m	Stage 3 €m	Total €m	Gross new lending €m	Stage 1 €m	Stage 2 €m	Stage 3 €m	Total €m	Stage 1 %	Stage 2 %	Stage 3 %	Total %	Performing €m	Non-performing €m	Total €m	Gross new lending €m
≤50%	4,264	417	517	5,198	122	1	6	45	52	0.02%	1.39%	8.61%	0.99%	4,217	375	4,592	-
>50% and ≤70%	3,984	407	513	4,904	262	2	11	53	66	0.05%	2.66%	10.26%	1.33%	4,056	430	4,486	-
>70% and ≤80%	1,747	212	270	2,229	397	2	12	58	72	0.09%	5.55%	21.51%	3.20%	2,093	263	2,356	-
>80% and ≤90%	1,182	205	304	1,691	342	2	17	92	111	0.17%	8.34%	30.16%	6.54%	1,600	308	1,908	-
>90% and ≤100%	636	172	292	1,100	4	2	19	109	130	0.35%	11.07%	37.67%	11.92%	1,206	348	1,554	-
>100% and ≤110%	220	89	232	541	5	2	11	95	108	0.87%	12.85%	41.10%	20.07%	917	357	1,274	-
>110% and ≤130%	57	39	199	295	2	-	6	94	100	0.85%	16.61%	47.01%	34.04%	426	466	892	-
>130% and ≤150%	5	6	42	53	-	-	1	23	24	0.30%	19.09%	54.68%	45.21%	23	142	165	-
>150%	11	3	14	28	-	-	1	8	9	2.11%	27.24%	58.94%	33.48%	26	44	70	-
Total	12,106	1,550	2,383	16,039	1,134	11	84	577	672	0.09%	5.44%	24.21%	4.19%	14,563	2,733	17,297	1,003

Note:
(1) ECL provisions coverage is ECL provision divided by drawn exposure.

23. Risk management – Credit risk continued

Flow statements

The ECL flow statements analyse the key elements that drive the movement of ECL and related income statement over the reporting period. The flow statements capture the changes in ECL as well as the changes in related financial assets used in determining ECL. Exposures in this section may therefore differ from those reported in other tables in the credit risk section, principally in relation to exposures in Stage 1 and Stage 2. These differences do not have a material ECL impact.

As expected - there was a significant uplift in ECL on move to a poorer quality stage (net re-measurement). For example, assets transferring from Stage 2 to Stage 3 move from having a probability of default (PD) of less than one to default (that is, a PD equal to one). Closing exposures in this section are consistent with the exposures used in ECL determination. The Other category within the tables reflects items that did not affect the ECL provision balance but which did have an impact on the impairment charge, for example, fortuitous recoveries on previously written-off debt. It is included to show movement in the profit and loss charge but is not part of the flow statement. Assets derecognised represented the effective write down of assets in the period (where ECL was held) as a result of debt sale activity.

	Stage 1		Stage 2		Stage 3		Total	
Total	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m
At 1 January 2018	21,552	31	2,497	122	3,833	1,173	27,882	1,326
Acquisition of Invoice finance business	210	-	39	1	16	6	265	7
Transfers from Stage 1 to Stage 2	(684)	(3)	684	3	-	-	-	-
Transfers from Stage 2 to Stage 1	626	18	(626)	(18)	-	-	-	-
Transfers to Stage 3	(52)	-	(166)	(12)	218	12	-	-
Transfers from Stage 3	8	1	293	49	(301)	(50)	-	-
Net re-measurement of ECL on stage transfer	-	(15)	-	4	-	28	-	17
Changes in risk parameters (model inputs)	-	6	-	1	-	(40)	-	(33)
Other changes in net exposure	1,181	2	(366)	(7)	(743)	17	72	12
Other	-	-	-	-	-	27	-	27
Income statement (releases)/charges	-	(7)	-	(2)	-	32	-	23
Amounts written-off	-	-	(15)	(15)	(406)	(406)	(421)	(421)
Unwinding of discount	-	-	-	-	-	(25)	-	(25)
At 31 December 2018	22,841	40	2,340	128	2,617	715	27,798	883
Net carrying amount	22,801		2,212		1,902		26,915	

The following tables analyse the ECL flow for significant classes of assets in the Group.

Residential mortgages								
At 1 January 2018	11,999	9	1,726	81	3,568	993	17,293	1,083
Transfers from Stage 1 to Stage 2	(389)	(1)	389	1	-	-	-	-
Transfers from Stage 2 to Stage 1	468	8	(468)	(8)	-	-	-	-
Transfers to Stage 3	(35)	-	(141)	(10)	176	10	-	-
Transfers from Stage 3	5	-	277	41	(282)	(41)	-	-
Net re-measurement of ECL on stage transfer	-	(6)	-	(5)	-	12	-	1
Changes in risk parameters (model inputs)	-	1	-	2	-	(26)	-	(23)
Other changes in net exposure	(7)	-	(211)	(3)	(710)	16	(928)	13
Other	-	-	-	-	-	32	-	32
Income statement (releases)/charges	-	(5)	-	(6)	-	34	-	23
Amounts written-off	-	-	(15)	(15)	(364)	(364)	(379)	(379)
Unwinding of discount	-	-	-	-	-	(22)	-	(22)
At 31 December 2018	12,041	11	1,557	84	2,388	578	15,986	673
Net carrying amount	12,030	-	1,473	-	1,810	-	15,313	-

23. Risk management – Credit risk continued

Flow statements continued

	Stage 1		Stage 2		Stage 3		Total	
	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m
Commercial								
At 1 January 2018	9,017	16	622	28	217	150	9,856	194
Acquisition of Invoice finance business	210	-	39	1	16	5	265	6
Transfers from Stage 1 to Stage 2	(242)	(1)	242	1	-	-	-	-
Transfers from Stage 2 to Stage 1	113	7	(113)	(7)	-	-	-	-
Transfers to Stage 3	(12)	-	(18)	(2)	30	2	-	-
Transfers from Stage 3	2	-	14	8	(16)	(8)	-	-
Net re-measurement of ECL on stage transfer	-	(6)	-	7	-	9	-	10
Changes in risk parameters (model inputs)	-	6	-	(1)	-	(11)	-	(6)
Other changes in net exposure	1,201	3	(143)	(4)	(36)	(4)	1,022	(5)
Other	-	-	-	-	-	(4)	-	(4)
Income statement (releases)/charges	-	3	-	2	-	(10)	-	(5)
Amounts written-off	-	-	-	-	(31)	(31)	(31)	(31)
Unwinding of discount	-	-	-	-	-	(1)	-	(1)
At 31 December 2018	10,289	25	643	31	180	111	11,112	167
Net carrying amount	10,264	-	612	-	69	-	10,945	-

Related financial asset movements are one month in arrears relative to the balance sheet reporting dates, as these are the balances used to calculate the modelled ECL (i.e. reported financial assets at 1 January 2018 in flow statements below reflect 30 November 2017 positions, and 31 December 2018 reported figures reflect 30 November 2018 positions).

Asset quality

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

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

Internal asset quality band	Probability of default range	Indicative S&P rating
AQ1	0% - 0.034%	AAA to AA
AQ2	0.034% - 0.048%	AA to AA-
AQ3	0.048% - 0.095%	A+ to A
AQ4	0.095% - 0.381%	BBB+ to BBB-
AQ5	0.381% - 1.076%	BB+ to BB
AQ6	1.076% - 2.153%	BB- to B+
AQ7	2.153% - 6.089%	B+ to B
AQ8	6.089% - 17.222%	B- to CCC+
AQ9	17.222% - 100%	CCC to C
AQ10	100%	D

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

23. Risk management - Credit risk continued

Credit risk concentrations

Credit risk assets by industry

Industry analysis plays an important part in assessing the potential for concentration risk in the loan portfolio. Particular attention is given to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future.

The following tables analyse financial assets by sector.

	Group				
2018	Gross loans to banks and customers €m	Other financial assets[2] €m	Derivatives €m	Total €m	Netting and offset[1] €m
Central and local government	27	2,000	-	2,027	-
Manufacturing	477	-	1	478	7
Construction	89	-	-	89	-
Finance	3,195	939	175	4,309	26
Service industries and business activities	2,786	-	34	2,820	81
Agriculture, forestry and fishing	520	-	-	520	6
Property	1,086	-	-	1,086	-
Individuals					
Home mortgages	16,039	-	-	16,039	-
Other	727	-	-	727	-
Interest accruals	14	10	-	24	-
	24,960	2,949	210	28,119	120

	Group				
2017	Gross loans to banks and customers €m	Other financial assets[2] €m	Derivatives €m	Total €m	Netting and offset[1] €m
Central and local government	28	1,170	-	1,198	-
Manufacturing	469	-	4	473	10
Construction	153	-	-	153	-
Finance	2,876	861	524	4,261	21
Service industries and business activities	2,511	-	53	2,564	49
Agriculture, forestry and fishing	553	-	-	553	7
Property	1,117	-	1	1,118	1
Individuals					
Home mortgages	17,317	-	-	17,317	-
Other	694	-	-	694	-
Interest accruals	14	12	-	26	-
	25,732	2,043	582	28,357	88

Notes:

(1)This column shows the amount by which the Group's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Group a right to set-off the financial asset against a financial liability due to the same counterparty. Cash and securities are received as collateral in respect of derivative transactions.

(2) Other financial assets includes debt securities and equity shares.

23. Risk management – Credit risk continued

Credit risk concentrations continued

Credit risk assets by industry continued

	Bank				
2018	Gross loans to banks and customers €m	Other financial assets[2] €m	Derivatives €m	Total €m	Netting and offset[1] €m
Central and local government	27	2,000	-	2,027	-
Manufacturing	477	-	1	478	7
Construction	89	-	-	89	-
Finance	2,947	939	175	4,061	26
Service industries and business activities	2,786	-	34	2,820	81
Agriculture, forestry and fishing	520	-	-	520	6
Property	1,086	-	-	1,086	-
Individuals					
Home mortgages	16,039	-	-	16,039	-
Other	727	-	-	727	-
Interest accruals	14	10	-	24	-
	24,712	2,949	210	27,871	120

	Bank				
2017	Gross loans to banks and customers €m	Other financial assets[2] €m	Derivatives €m	Total €m	Netting and offset[1] €m
Central and local government	28	1,170	-	1,198	-
Manufacturing	469	-	4	473	10
Construction	153	-	-	153	-
Finance	2,879	861	496	4,236	21
Service industries and business activities	2,508	-	53	2,561	49
Agriculture, forestry and fishing	553	-	-	553	7
Property	1,117	-	1	1,118	1
Individuals					
Home mortgages	17,317	-	-	17,317	-
Other	694	-	-	694	-
Interest accruals	14	12	-	26	-
	25,732	2,043	554	28,329	88

Notes:

(1) This column shows the amount by which the Group's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Group a right to set-off the financial asset against a financial liability due to the same counterparty. Cash and securities are received as collateral in respect of derivative transactions.

(2) Other financial assets includes debt securities and equity shares.

23. Risk management continued

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

Attribute	IFRS 9	IAS 39	Regulatory (CRR)
Default / credit impairment	To determine the risk of a default occurring, management applies a default definition that is consistent with the Basel/Regulatory definition of default. Assets that are defaulted are shown as credit impaired. The Group uses 90 days past due as a consistent measure for default across all product classes. The population of credit impaired assets is broadly consistent with IAS 39, though measurement differs because of the application of MES.	Default aligned to loss events, all financial assets where an impairment event has taken place - 100% probability of default and an internal asset quality grade of AQ10 - are classed as non-performing. Impaired financial assets are those for which there is objective evidence that the amount or timing of future cash flows have been adversely impacted since initial recognition.	A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place: - The Group considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; - the customer is past due more than 90 days. For retail exposures, the definition of default is applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.
Probability of default (PD)	PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.	Regulatory PDs adjusted to point in time metrics are used in the latent provision calculation.	The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. For wholesale, PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels. For retail, the prevailing economic conditions at the reporting date (point in time) are used in the incumbent modelling approach.
Significant increase in credit risk (SICR)	A framework incorporating both quantitative and qualitative measures aligned to the Group's current risk management framework has been established. Credit deterioration will be a management decision, subject to approval by governing bodies such as the Group Provisions Committee. The staging assessment requires a definition of when a SICR has occurred; this moves the loss calculation for financial assets from a twelve month horizon to a lifetime horizon. Management has established an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined	Not applicable.	Not applicable.

23. Risk management continued

Key IFRS 9 terms and differences to the previous accounting and current regulatory framework continued

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

23. Risk management continued

Market risk

The Group's exposure to traded market risk is no longer material.

Non-traded market risk is discussed below.

Definition

Non-traded market risk is the risk to the value of assets or liabilities or the risk to income that arises from changes in market prices such as interest rates, foreign exchange rates and equity prices, or from changes in managed rates.

Sources of risk

The majority of non-traded market risk exposure arises from retail and commercial banking activities and from the High Quality Liquid Asset portfolio and investment of equity capital.

Non-traded market risk largely comprises interest rate risk, credit spread risk, accounting volatility risk and foreign exchange risk.

Interest rate risk

Non-traded interest rate risk ("NTIRR") arises from the provision to customers of a range of banking products with differing interest rate characteristics. When aggregated, these products form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market interest rates. Mismatches can give rise to volatility in net interest income as interest rates vary.

Credit spread risk

Credit spread risk arises from the potential adverse economic impact of a move in the spread between bond yields and swap rates, where the bond portfolios are accounted at fair value in the non-trading book.

Accounting volatility risk

Accounting volatility risk arises when a non-trading book exposure is accounted at amortised cost but economically hedged by a derivative that is accounted at fair value. Although this is not an economic risk, the difference in accounting between the exposure and the hedge creates volatility in the income statement.

Foreign exchange risk

Non-traded foreign exchange risk exposures arise from three main sources:

- Structural foreign exchange risk - arising from the capital deployed in branches and related currency funding where it differs from Euro.
- Transactional foreign currency exposure - arising from mismatches in the currency balance sheet.
- Foreign currency profit streams and costs - in respect of branches in the UK and the costs of services acquired from other RBS Group companies charged in Sterling.

Risk governance

Responsibility for identifying, measuring, monitoring and controlling the market risk lies with Treasury, with independent oversight provided by the Market Risk function.

Market risk positions are reported monthly to ALCO and the Executive Risk Committee and quarterly to the Board Risk Committee. In addition, Market Risk maintains daily and monthly monitoring.

Risk appetite

The Group's qualitative market risk appetite is set out in the non-traded market risk appetite statement.

Its quantitative market risk appetite is expressed in terms of exposure limits for the non-trading activities that are consistent with business plans. These limits comprise both Board risk measures (which are approved by the NatWest Holdings Board on the recommendation of the Board Risk Committee) and key risk measures (which are approved by the ALCO).

These limits are cascaded further down the organisation as required, as approved by the Technical Executive Risk forum in the case of Board risk measures and by ALCO in the case of the key risk measures and are considered for approval at ALCO and Board. For each desk, a document known as a dealing authority compiles details of all applicable limits and dealing restrictions.

The limit framework comprises VaR, stressed value-at-risk (SVaR) and sensitivity and stress limits, and earnings-at-risk (EaR) and Economic Value of Equity (EVE) limits. The limits are reviewed to reflect changes in risk appetite, business plans, portfolio composition and the market and economic environments.

To ensure approved limits are not breached and that the Group remains within its risk appetite, triggers at the Group and lower levels have been set such that if exposures exceed a specified level, action plans are developed by the front office, Market Risk and Finance.

Risk identification and assessment

Identification and assessment of traded and non-traded market risk is achieved through gathering, analysing, monitoring and reporting market risk information by business line or at a consolidated level. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification and assessment of all material market risks.

This is complemented by the New Product Risk Assessment process, which requires market risk teams to assess and quantify the market risk associated with all proposed new products.

23. Risk management - Market risk continued

Risk monitoring

Non-traded Market Risk exposures for the Short Term desk are monitored against limits and analysed daily by market risk reporting and control functions and monthly in the case of structural interest rate risk. The Market Risk function also prepares daily risk reports that detail exposures against a more granular set of limits and triggers. Limit reporting is supplemented with stress testing information as well as ad hoc reporting.

Risk measurement

The Group uses a comprehensive set of methodologies and techniques to measure non-traded market risk.

The main risk measurement methods are VaR, SVaR, sensitivity, EaR and EVE. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR.

The key inputs into these measurement methods are market data and risk factor sensitivities. Sensitivities refer to the changes in deal or portfolio value that result from small changes in market parameters that are subject to the market risk limit framework. Revaluation ladders are used in place of sensitivities to capture the impact on the income statement of large moves in risk factors or the joint impact of two risk factors.

These methods have been designed to capture correlation effects and allow the Group to form an aggregated view of its market risk across risk types, markets and business lines while also taking into account the characteristics of each risk type.

Risk assessment, monitoring and mitigation

Interest rate risk

NTIRR factors are grouped into the following categories:

- Gap risk - which arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
- Basis risk - which captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.
- Option risk – which primarily arises from optional elements embedded in assets, liabilities and/or off-balance sheet items, where the Group or its customer can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk.

To manage exposures within appetite, Group aggregates its interest rate positions and hedges these internally with NatWest Bank using derivatives (primarily interest rate swaps). Credit spread volatility is a consequence of holding high quality liquid assets and is not hedged or mitigated while managed within conservative risk appetite parameters.

NTIRR is measured from both an economic value-based and earnings-based perspective. Value-based approaches measure the change in value of the balance sheet assets and liabilities over a longer timeframe, including all cash flows. Earnings-based approaches measure the potential short-term (generally one year) impact on the income statement of changes in interest rates.

The Group uses both approaches to quantify its interest rate risk: VaR as its value-based approach and sensitivity of net interest income (NII) as its earnings-based approach.

These two approaches provide different yet complementary views of the impact of interest rate risk on the balance sheet at a point in time. The scenarios employed in the NII sensitivity approach incorporate business assumptions and simulated modifications in customer behaviour as interest rates change. In contrast, the VaR approach assumes static underlying positions and therefore does not provide a dynamic measurement of interest rate risk. In addition, while NII sensitivity calculations are measured to a 12-month horizon and thus provide a shorter-term view of the risks on the balance sheet, the VaR approach can identity risks not captured in the sensitivity analysis, in particular the impact of duration and repricing risk on earnings beyond 12 months.

Value-at-Risk

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

The non-traded interest rate risk VaR metrics for Group are included in the Banking book VaR table below. The VaR captures the risk resulting from mismatches in the repricing dates of assets and liabilities. It includes any mismatch between structural hedges and stable non and low interest-bearing liabilities such as equity and money transmission accounts as regards their interest rate repricing behavioural profile.

23. Risk management – Market risk continued

Calculation of regulatory capital

The Group capitalises non-traded market risk as part of the ICAAP. The approach combines both earnings based and economic value based methodologies, in accordance with regulatory guidelines. The calculation captures the principal sources of non-traded market risk – interest rate risk, credit spread risk, structural foreign exchange risk and accounting volatility risk. Models and methodologies are reviewed by the NatWest Holdings Model Risk Management and based on their review and findings the Treasury Models Committee considers whether a model / methodology can be approved for use. The results are approved by Group ALCO.

Pillar 1 capital must be held for non-trading book foreign exchange exposures, as outlined under CRR Articles 455 and 92(3)c. Structural foreign exchange exposures are excluded from the calculations as outlined under CRR Article 352(2); such exposures are considered under Pillar 2A.

Total VaR

The total VaR for the Group's dealing is presented in the table below:

	31 December 2018 €m	Maximum €m	Minimum €m	Average €m
Value-at-Risk	1.2	1.6	0.7	1.1

	31 December 2017 €m	Maximum €m	Minimum €m	Average €m
Value-at-Risk	0.9	1.3	0.6	0.9

Interest Rate VaR

The Interest Rate VaR limit is a sub limit of the Total VaR limit and is monitored daily.

Interest Rate VaR is presented in the table below:

	31 December 2018 €m	Maximum €m	Minimum €m	Average €m
Value-at-Risk	0.2	2.6	0.2	0.5

	31 December 2017 €m	Maximum €m	Minimum €m	Average €m
Value-at-Risk	0.7	0.9	0.6	0.7

Business risk

Definition

Business risk is the risk that the Group makes inappropriate business or strategic choices or that the Group is not able to execute its chosen strategy in line with its budget. The risk is that the Group does not deliver its strategic plan's budgeted performance which could lead to a deterioration in stakeholder trust and confidence or to a breach of regulatory thresholds.

Sources of risk

Business risk arises as a result of the Group's exposure to the macro-environment, to the competitive environment, and to technological changes. Current macro issues that give rise to business risk include Brexit, cyber threats, corporate structure reform and political and economic uncertainty. In addition, internal factors such as volatility in sales volumes, and input costs, and other operational risks such as the Group's ability to assess the business operating environment, or to execute its chosen strategy, contribute to business risk.

Governance

The Board has ultimate responsibility for business risk and for approving strategic plans, initiatives and changes to strategic direction. The Group's strategic planning process is managed by the Specialised Finance department. The Risk and Finance functions are key contributors to strategic planning. As part of the process, each banking division develops a strategic plan within a process set by the Group's Executive Committee. The strategic plans are consolidated at the Group-wide level, and reviewed and assessed against risk appetite by the Chief Executive, the Chief Financial Officer and the Director of Risk before review, challenge and ultimately approval by the Board.

23. Risk management – Business risk continued

Controls and assurance

Business risk is directly managed and controlled through the Group's strategic planning, budgeting and new product development processes, in which the following elements are incorporated:

- Evaluation of the macroeconomic environment
- Industry analysis
- Competitor analysis, across geography, product, and customer
- Customer behaviour analysis (understanding customer segments, trends and behaviours)
- Impact of technological developments
- Assessment of regulatory developments and changes
- Evaluation of the political environment

Furthermore, business risk is controlled as a result of having a requirement for the Group and each business to incorporate the following elements in strategic plans:

- Organisational capabilities
- Organisational resources
- Organisational commitment
- Requirements of stakeholders, including customers, regulators, colleagues, and investors

Risk appetite

The Group has limited appetite to make inappropriate business or strategic choices or to deliver a financial performance that is materially worse than its chosen strategic business plan.

Risk identification and assessment

Estimated revenue, costs and capital, including the potential range of outcomes, are key considerations in the design of any new product or in any new investment decision.

Risk mitigation

The Group operates a monthly rolling forecasting process to identify projected changes in, or risks to, key financial metrics, and ensures appropriate actions are taken.

Key strategies are reviewed and approved by the Board. These reviews are intended to maximise the capture of market and customer insight while providing independent scrutiny and challenge. Strategic plans contain analysis of current and expected operating conditions, current and targeted competitive and market positioning, key strategic initiatives, financial and customer targets and milestones, and upside and downside risks.

A full sensitivity analysis of the consolidated strategic plan is undertaken at the end of the strategic and financial planning process to assess the robustness of the plan and compliance with strategic risk objectives under a variety of stressed conditions. Following consideration of an opportunity the Group may decide not to pursue the opportunity as a result of a perceived strategic risk.

The Group also undertakes strategic reviews to decide on how to react to specific developments.

Reputational risk

Definition

Reputational risk is the risk to the Group's public image from a failure to meet stakeholders' expectations in relation to performance, conduct or business profile. Stakeholders include customers, investors, colleagues, suppliers, government, regulators, special interest and consumer groups, media and the general public. It can arise as a consequence of actions taken (or not taken) by the Group.

Sources of risk

Reputational risk can arise from the conduct of colleagues; activities of customers and the sectors and countries in which they operate; provision of products and transactions; as well as operations and infrastructure.

Governance

The Group has a Reputational Risk Policy which sets out controls to manage the risk. A Reputational Risk Forum (RRF), under delegated authority from the Group's Executive Risk Committee, acts as a central forum to review customer transactions, themes or issues which have material reputational implications, escalated to it by first line of defence business areas. The forum also reviews reputational risk arising from environmental, social and ethical risk positions, for example, in the defence and gambling sectors. Cases which have material reputational risk implications for the wider RBS Group are escalated to the RBS Group Reputational Risk Committee (GRRC).

Risk appetite

The Group manages and articulates its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement. The Group relies on due consideration of its reputation in its decision making. As a minimum this should include using the Yes Check. The Group has no appetite for a lack of escalation of material reputational risks. Escalation and subsequent debate must be timely and holistic and involve all relevant stakeholders. The Group recognises that unforeseen outcomes occur from time to time and seeks to address any customer detriment as quickly as possible.

Risk mitigation

Reputational risk is mitigated through clear escalation responsibilities of all colleagues through their business line, should they identify potential reputational risk impact, with the most material cases being submitted to the RRF. Referrals are recorded in a Reputational Risk Register.

Early identification and effective escalation are essential to the successful mitigation of reputational risk. Lessons learned from discussions at RRF meetings will improve the way cases and issues are debated and decisions made.

23. Risk management continued

Operational risk

Definition

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

Operational risk may directly affect customers, lead to financial loss or damage to the Group's reputation (for example, a major IT systems failure or fraudulent activity).

Sources of risk

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

Operational risk can arise from a failure of other parts of the RBS Group to provide services provided to the Group in accordance with Service Level Agreements. There can also be a link between operational risk failures and conduct risk issues.

Risk governance

A strong Operational Risk management function is vital to support the Group's ambition to serve its customers better. Improved management of operational risk against a defined appetite directly supports the strategic risk objective of improving stakeholder confidence and is vital for stability and reputational integrity.

The Operational Risk function, part of the second line of defence, undertakes a leadership role and is tasked with delivering an operational risk management approach across the Group.

The Operational Risk function is responsible for the design, development, delivery and continuous improvement of operational risk management through application of the Operational Risk Handbook. The Operational Risk policy is incorporated into the Policy Management Framework and the Operational Risk Handbook provides direction for the consistent identification, assessment, management, monitoring and reporting of operational risk. Through a network of oversight teams, the function seeks to ensure the integrity of the framework, and manages overall operational risk profile against risk appetite.

During 2018, the Operational Risk Committee (ORC) was established and is responsible for reviewing operational risk exposure; identifying and assessing both current and emerging material operational risks; reviewing and monitoring the operational risk profile; and reviewing and approving material operational risk policy changes.

Risk assessment, controls and assurance

The Control Environment Certification (CEC) process is a half-yearly self-assessment by the business. It gives an assessment on the adequacy and effectiveness of the internal control environment in a consistent and comparable manner, highlighting areas where targeted effort is needed to meet the standards required in order to create a safer and more secure bank for customers. It covers material risks and the key controls that underpin them, including financial, operational and compliance controls, as well as the supporting risk management frameworks.

The CEC outcomes, including forward-looking assessments for the next two half-yearly cycles and the progress made to improve the control environment, are reported to the Board, the Audit Committee and the Board Risk Committee. They are also shared with external auditors.

The CEC process helps to ensure compliance with the Policy Management Framework.

Assurance and monitoring activities are essential to measure the extent to which the Group manages its delivery of specific customer outcomes. Risk assessments are used to identify material risks and implement key controls across all business areas. The risk assessment process is designed to confirm that risks are effectively managed and prioritised, as well as ensuring that controls are tested.

Scenario analysis is used to assess the impact of extreme but plausible operational risks. It provides a forward-looking basis for evaluating and managing operational risk exposures.

The scenarios assess the risks that could significantly affect the Group's financial performance, customers or reputation and are an important component in operational risk management and the economic capital model.

Risk appetite

The operational risk appetite framework supports effective management of key operational risks. It expresses the level and types of operational risk the Group is willing to accept in order to achieve its strategic objectives and business plans.

The Group's operational risk appetite is expressed through a set of qualitative risk appetite statements and quantitative measures which are defined at a material risk driver level. Appetite covers the Group's most material operational risks, defined by a materiality assessment, which considers past, current and future risk exposures. Appetite exposures for all material risks are regularly reported to the Executive Risk Committee and Board Risk Committee.

23. Risk management – Operational risk continued

Risk appetite continued

The aggregation of operational risk appetite drives measurement of how effective the Group is in managing its material risks across the core components of the operational risk management framework. It provides for an aggregate view of risk appetite, risk and control profile, loss event data management and control environment.

Above these sit the Group-level operational risk appetite statement which encompasses the full range of operational risks. This drives the strategic risk measurement of stakeholder confidence and is reviewed annually by the Executive Risk Committee, Board Risk Committee and Board. The statement is supported by five board risk measures: (i) recoverability of Tier 1 systems; (ii) security control failure impacts on customers; (iii) mandatory programmes at risk of non delivery; (iv) the relationship between operational risk losses and the Group's capital held (including individual losses experienced across material risks); and (v) the requirement for the material Group-wide operational risks to be managed within risk appetite.

Risk identification and assessment

Across all business areas risk and control assessments are used to identify and assess material risks and key controls. To support identification of risk concentrations, all risks and controls are mapped to the risk directory. Risk assessments are refreshed at least annually or triggered when a material change occurs to ensure they remain relevant and capture any emerging risks.

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

Risk mitigation

Risks are mitigated through the application of key preventative and detective controls. This is an integral step in the risk assessment methodology, which determines residual risk exposure. Control owners are accountable for the design, execution, performance and maintenance of key controls.

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

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

Risk monitoring

Monitoring and reporting are part of the Group's operational risk management processes, which aim to ensure that risks are identified, considered by senior executives, and managed effectively. The most material operational risks and their position relative to risk appetite are regularly reviewed by the Executive Risk Committee, along with any emerging risks and the actions taken to mitigate them. These are also reported to the Board Risk Committee.

Risk measurement

The Group uses the standardised approach to calculate its operational risk capital requirement. This is based upon multiplying three years' average historical gross income by coefficients set by the regulator based on type of income.

As part of the wider ICAAP an operational risk economic capital model is used. The model uses loss data and scenario analysis inputs from the Operational Risk Handbook, plus external loss data and certain other factors to provide a risk-sensitive view of the Group's operational risk capital requirement.

Event and loss data management

The operational risk event and loss data management process ensures the Group captures and records operational risk loss events that meet defined criteria. Loss data is used for regulatory and industry reporting and is included in the economic capital modelling when calculating regulatory capital for operational risk.

The most serious events are escalated in a simple, standardised process to all senior management, by way of a 'Notifiable Event Process'.

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2018 may relate to events that occurred, or were identified in, prior years.

Pension risk

Definition

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

Sources of risk

The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility for the Group's pension schemes is separate from Group management. The Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

23. Risk management – Pension risk continued

Sources of risk continued

The Ulster Bank Pension Scheme (the main scheme) is the largest of the schemes and the main source of pension risk. It operates under trust deeds by which the corporate trustee is a wholly owned subsidiary of the Group. The trustee board comprises seven directors selected by the Group and two directors nominated by members.

Developments in 2018

- The existing Memorandum of Understanding between the Bank and the trustee of the main scheme was revised in December 2018.
- The Bank made a €100 million contribution to the main scheme in December 2018.
- The contribution to the main scheme facilitated a reduction in the risk profile of the fund and increased interest rate and inflation hedging.

Risk appetite

Investment policy and related investment limits are agreed by the trustees with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustees also consult with the Group to obtain its view on the appropriate level of risk within the pension funds. The Group independently monitors risk within its pension funds as part of the ICAAP including metrics focused on capital volatility incorporated in the overall risk appetite framework.

Risk mitigation

The trustees are solely responsible for the investment of the schemes' assets which are held separately from the assets of the Group. The Group and the trustees must agree on the investment principles and the funding plans. An Investment Review Committee is in place for the scheme, comprising Bank and trustee representatives, which has specific responsibility for scheme investment matters.

The schemes are invested in diversified portfolios of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property, derivatives and hedge funds.

24. Memorandum items

Contingent liabilities and commitments

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

	Group and Bank	
	2018	2017
	€m	€m
Contingent liabilities:		
Guarantees and assets pledged as collateral security	208	154
Other contingent liabilities	280	263
	488	417
Commitments:		
Documentary credits and other short-term trade related transactions	2	2
Commitments to lend	3,632	3,494
Other commitments	21	20
	3,655	3,516

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

Contingent liabilities

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Group expects most guarantees it provides to expire unused.

Regulatory enquiries and investigations - in the normal course of business the Bank and its subsidiaries co-operate with regulatory authorities in their enquiries or investigations into alleged or possible breaches of regulations.

24. Memorandum items continued

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material losses will arise from these transactions.

Commitments

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

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and revolving underwriting facilities, documentary credits and other short-term trade related transactions.

The Bank has given guarantees on the liabilities of the following subsidiary undertakings in accordance with the provision of Section 357 of the Companies Act 2014 and these entities will avail of the exemptions under Section 357 regarding the provisions of Sections 347 and 348.

First Active Insurances Services Limited
First Active Investments No.4 Limited
The RBS Group Ireland Retirement Savings Trustee Limited

Contractual obligations for future expenditure not provided for in the accounts

The following table shows contractual obligations for future expenditure not provided for in the financial statements at the financial year end:

	Group and Bank	
	2018	2017
	€m	€m
Operating leases		
Minimum rentals payable under non-cancellable leases		
- within 1 year	10	12
- after 1 year but within 5 years	25	31
- after 5 years	26	28
	61	71
Contracts to purchase goods or services	5	4
Total	66	75

Litigation, investigations and reviews

The Group is involved in litigation arising in the ordinary course of business. No material adverse effect on the net assets of the Group is expected to arise from the ultimate resolution of these claims. Material investigations and reviews involving the Group are described below. These matters could, individually or in aggregate, have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

FCA review of RBS Group's treatment of SMEs

In 2014, the FCA appointed an independent Skilled Person under section 166 of the Financial Services and Markets Act 2000 to review RBS Group's treatment of SME customers whose relationship was managed by RBS Group's Global Restructuring Group (GRG) in the period 1 January 2008 to 31 December 2013.

The Skilled Person delivered its final report to the FCA during September 2016 and the FCA published an update in November 2016. In response, RBS Group announced redress steps for SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013.

These steps were (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an independent third party. The complaints process closed on 22 October 2018 for new complaints in the UK. The complaints process closed on 31 December 2018 for new complaints in the Republic of Ireland, with the exception of a small cohort of potential complainants for whom there is an extended deadline.

The Group has made provisions totalling €20 million to date in respect of the above redress steps of which €7 million had been utilised by 31 December 2018.

The FCA published a summary of the Skilled Person's report in November 2017. The UK House of Commons Treasury Select Committee, seeking to rely on Parliamentary powers, published the full version of the Skilled Person's report on 20 February 2018. On 31 July 2018, the FCA confirmed that it had concluded its investigation and that it does not intend to take disciplinary or prohibitory action against any person in relation to these matters. It has subsequently indicated that it will shortly publish a final summary of its investigative work.

24. Memorandum items continued

Review and investigation of treatment of tracker mortgage customers

In December 2015, the CBI announced that it had written to a number of lenders requiring them to put in place a robust plan and framework to review the treatment of customers who have been sold mortgages with a tracker interest rate or with a tracker interest rate entitlement. The CBI stated that the intended purpose of the review was to identify any cases where customers' contractual rights under the terms of their mortgage agreements were not fully honoured, or where lenders did not fully comply with various regulatory requirements and standards regarding disclosure and transparency for customers. The CBI has required the Group to participate in this review and the Group is co-operating with the CBI in this regard. The Group submitted its phase 2 report to the CBI on 31 March 2017, identifying impacted customers. The redress and compensation phase (phase 3) commenced in Q4 2017 and is ongoing.

The Group has made provisions totalling €297 million to date for this matter of which €211 million had been utilised by 31 December 2018.

Separately, on 15 April 2016, the CBI notified UBIDAC that it was also commencing an investigation under its Administrative Sanctions Procedure into suspected breaches of the Consumer Protection Code 2006 during the period 4 August 2006 to 30 June 2008 in relation to certain customers who switched from tracker mortgages to fixed rate mortgages. This investigation is ongoing and the Group continues to co-operate with the CBI.

As part of an internal review of the wider retail and commercial loan portfolios extending from the tracker mortgage examination programme, the Bank identified further legacy business issues. A programme is ongoing to identify and remediate impacted customers. The Group has made provisions totalling €167 million to date based on expected remediation and project costs in relation to this matter. Of the €167 million cumulative provision, €41 million had been utilised by 31 December 2018.

25. Analysis of changes in financing during the financial year

	Group					
	Share capital and share premium		Subordinated liabilities[1]		Debt securities in issue[2]	
	2018 €m	2017 €m	2018 €m	2017 €m	2018 €m	2017 €m
At 1 January	4,734	4,734	616	719	-	1,377
Redemption of subordinated liabilities	-	-	-	(100)	-	-
Issue/(redemption) of debt securities in issue	-	-	-	-	869	(1,377)
Net cash (outflow)/inflow from financing	-	-	-	(100)	869	(1,377)
Currency translation and other adjustments	2	-	-	(3)	-	-
At 31 December	4,736	4,734	616	616	869	-

	Bank			
	Share capital and share premium		Subordinated liabilities[1]	
	2018 €m	2017 €m	2018 €m	2017 €m
At 1 January	4,734	4,734	616	719
Redemption of subordinated liabilities	-	-	-	(100)
Net cash outflow from financing	-	-	-	(100)
Currency translation and other adjustments	2	-	-	(3)
At 31 December	4,736	4,734	616	616

Notes:
(1) Subordinated liabilities of €530 million are included in Amount due to holding companies and fellow subsidiaries (Note 11).
(2) Included in Other financial liabilities (Note 17).

26. Analysis of cash and cash equivalents

	Group		Bank	
	2018 €m	2017 €m	2018 €m	2017 €m
At 1 January				
Cash	798	814	797	497
Cash equivalents	4,673	4,152	4,674	4,151
	5,471	4,966	5,471	4,648
Net cash inflow	(326)	531	(573)	849
Effect of exchange rate changes on cash and cash equivalents	6	(26)	6	(26)
At 31 December	5,151	5,471	4,904	5,471
Comprising:				
Cash and balances at central banks	287	322	287	322
Debt securities[1]	447	295	447	295
Loans to banks - amortised cost[2]	4,417	4,854	4,170	4,854

Notes:
(1) Included in Other financial assets (Note 13).
(2) Included in Amount due from holding companies and fellow subsidiaries (Note 11).

27. Transactions with directors

Transactions, arrangements and agreements entered into by authorised institutions in respect of loans to persons who were directors of the Bank (or persons connected with them) at any time during the financial period were as follows:

Directors

	Principal and interest				
Name of director	As at 1 January (or date of appointment if later) €	As at 31 December €	Maximum outstanding amount during the financial year €	Interest due but not yet paid €	Provision €
2018					
D O'Shea [1]	446,372	406,455	446,396	-	-
2017					
D O'Shea [1]	485,991	446,372	486,114	-	-

Note:
(1) Mortgage loans held at commercial interest rates. During the period €39,917 (2017- €39,619) was repaid.

Connected parties

Pursuant to the provisions of the Companies Act 2014 the amounts required to be disclosed are as follows:

- the aggregate amounts outstanding as at 31 December 2018 were €1,765,779 (2017 - €1,753,017),
- the aggregate maximum amounts outstanding during the period were €1,825,177 (2017 - €1,920,711),
- the number of relevant persons for or with whom relevant transactions as at 31 December 2018 were made by the institution was 4 (2017 - 4), and
- the maximum number of relevant persons for or with whom relevant transactions, arrangements and agreements that subsisted at any time during the period were made by the institution was 4 (2017 - 4).

There were no guarantees, security or arrangements involving a guarantee or security entered into by authorised institutions in the Group in respect of guarantees to persons who were directors of the Bank (or persons connected with them) at any time during the financial period (2017 - nil).

At 31 December 2018, the total amount outstanding under any arrangement by the Bank with any director or person connected to a director was less than 10% of the Bank's total assets.

There were no amounts outstanding at 31 December 2018 (2017 - nil) in respect of loans made to directors by subsidiary undertakings which were not authorised institutions.

28. Directors' and secretary's interest in shares

At 31 December 2018, the directors and secretary did not have any interest in the shares or debentures of the ultimate holding company representing more than 1% of the nominal value of its issued share capital.

29. Related parties

The Bank's immediate parent company is NatWest Holdings Limited.

The Bank's ultimate holding company, and the parent of the largest group into which the Bank is consolidated, is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. Copies of the consolidated accounts for The Royal Bank of Scotland Group plc can be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh, EH12 1HQ, or at www.rbs.com.

UK Government

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

The following table details active related undertakings incorporated in the Republic of Ireland which are 100% owned by the Bank and fully consolidated for accounting purposes.

Entity name	Activity[1]
First Active Investments No. 4 Limited	INV
First Active Insurances Services Limited	BF
First Active Limited	BF
The RBS Group Ireland Retirement Savings Trustee Limited	TR
Ulster Bank Holdings (ROI) Limited	OTH
Ulster Bank Pension Trustees (R.I.) Limited	TR
Ulster Bank Dublin Trust Company Unlimited Company	SC

The following table details related undertakings incorporated in the Republic of Ireland that are in liquidation but fully consolidated, including entities where Bank ownership was less than 100%.

Entity name	Activity [1]	Group Interest %
Hume Street Nominees Limited	OTH	100
Norgay Property Limited	INV	100
Walter Property Limited	INV	100
Ulster Bank Group Treasury Limited	INV	100
UB SIG (ROI) Limited	INV	100
Ulster Bank Wealth Unlimited Company	BF	100
Qulpic Limited	INV	67
West Register (Republic of Ireland) Property Limited	INV	100
Zrko Limited	INV	67

The following table details related undertakings incorporated in the Republic of Ireland that are active. These are securitisation companies in which the Bank does not hold any of the voting rights but the activities of which are conducted on behalf of the Bank and it retains the majority of the residual ownership risks and benefits related to their activities. Therefore in accordance with the requirements of IFRS 10 the results of these securitisation companies are included in the Group's consolidated financial statements.

Entity name	Activity [1]	Group Interest %
Ardmore Securities No.1 Designated Activity Company	BF	-
Dunmore Securities No.1 Designated Activity Company	BF	-
Celtic Residential Irish Mortgage Securitisation No.14 Designated Activity Company	BF	-
Celtic Residential Irish Mortgage Securitisation No.15 Designated Activity Company	BF	-

Note:
(1) Activity - Banking and Financial institution (BF), Other/non-financial (OTH), Service Company (SC), Investment (shares or property) holding company (INV), Trustee (TR).

29. Related parties continued

During the financial year the Group had the following transactions with related parties:

(a) Directors and key management

At 31 December 2018, amounts advanced by the Bank were €406,455 (2017 - €453,029) in respect of loans to 1 person (2017- 2 persons) who served as a director during the financial period.

The aggregate transactions between the Bank and its directors, key management, their close families and companies which they control were:

	Number of directors	Number of key management	Connected parties	Transaction €
Transactions during the financial year				
Loans made during the financial year:				
- at a commercial rate	-	-	-	-
Balances outstanding at the end of the year				
Loans:				
- at a commercial rate	1	2	7	3,127,858
- at a preferential rate	-	1	-	925
Customer accounts:				
- Savings	6	6	19	1,919,815

(b) Related party transactions

Included in the Group and Bank's balance sheet are the following balances with related parties at the financial year end:

	Group		Bank	
	2018	2017	2018	2017
Assets	€m	€m	€m	€m
Loans:				
Parent companies	1,433	2,136	1,433	2,135
Key management	1	1	1	1
Other related parties, including fellow subsidiaries	27	240	2,566	6,137
	1,461	2,377	4,000	8,273
Equity shares:				
Other	4	5	4	5
Derivatives:				
Parent companies	170	514	170	486
Total assets	1,635	2,896	4,174	8,764
Liabilities				
Deposits:				
Parent companies	275	488	275	486
Key management	2	2	2	2
Other related parties, including fellow subsidiaries	65	50	3,257	5,755
	342	540	3,534	6,243
Subordinated loans:				
Parent companies	530	530	530	530
Derivatives:				
Parent companies	76	394	76	159
Total liabilities	948	1,464	4,140	6,932

29. Related parties continued

(c) Compensation of key management

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

	Group	
	2018	2017
	€	€
Short term benefits	4,009,814	3,861,418
Long term benefits	288,274	300,129
Share-based benefits	530,206	283,435
Post-employment benefits	181,301	141,688
	5,009,595	4,586,670

30. The adoption of IFRS 9

The Group's accounting policies have significantly changed on the adoption of IFRS 9 'Financial Instruments' with effect from 1 January 2018. Prior year is re-presented but there has been no restatement of prior years. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018.

IFRS 9 changed the classification categories from IAS 39: held for trading assets were classified to mandatory fair value through profit or loss; loans and receivables were classified to amortised costs assets; and available for sale assets were classified as fair value through other comprehensive income unless they are deemed to be in a fair value business model or have failed the contractual cash flow requirements under IFRS 9. There were no changes in the classification and measurement of financial liabilities.

The net increase to loan impairment provisions was €64 million under the expected credit loss requirements of IFRS 9 including €7 million under provisions for contingent liabilities and commitments.

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

	Group						
				Impact of IFRS 9			
	31 December 2017 (IAS 39)	New presentation	31 December 2017 re-presented	Classification & measurement	Expected credit losses	1 January 2018 (IFRS 9)	
	€m	€m	€m	€m	€m	€m	
Assets							Assets
Cash and balances at central banks	322	-	322	-	-	322	Cash and balances at central banks
Derivatives	582	-	582	-	-	582	Derivatives
Loans and advances to banks	4,893	(2,136)	2,757	-	-	2,757	Loans to banks - amortised cost
Loans and advances to customers	21,950	(239)	21,711	(32)	(57)	21,622	Loans to customers - amortised cost
Amounts due from holding companies and fellow subsidiaries	-	2,375	2,375	-	-	2,375	Amounts due from holding companies and fellow subsidiaries
Debt securities	2,038	(2,038)	-	-	-	-	
Equity shares	5	(5)	-	-	-	-	
Other financial assets	-	2,043	2,043	-	-	2,043	Other financial assets
Other assets	458	-	458	-	-	458	Other assets
Total assets	30,248	-	30,248	(32)	(57)	30,159	
Liabilities							Liabilities
Deposits by banks	2,495	(495)	2,000	-	-	2,000	Bank deposits - amortised cost
Customer accounts	19,817	(738)	19,079	-	-	19,079	Customer deposits - amortised cost
Other financial liabilities	-	697	697	-	-	697	Other financial liabilities
Amounts due to holding companies and fellow subsidiaries	-	1,066	1,066	-	-	1,066	Amounts due to holding companies and fellow subsidiaries
Derivatives	439	-	439	-	-	439	Derivatives
Subordinated liabilities	616	(530)	86	-	-	86	Subordinated liabilities
Other liabilities	478	-	478	-	7	485	Other liabilities
Total liabilities	23,845	-	23,845	-	7	23,852	Total liabilities
Total equity	6,403	-	6,403	(32)	(64)	6,307	Total equity
Total liabilities and equity	30,248	-	30,248	(32)	(57)	30,159	Total liabilities and equity

30. The adoption of IFRS 9 continued

	Bank						
				Impact of IFRS 9			
	31 December 2017 (IAS 39) €m	New presentation €m	31 December 2017 re-presented €m	Classification & measurement €m	Expected credit losses €m	1 January 2018 (IFRS 9) €m	
Assets							Assets
Cash and balances at central banks	322	-	322	-	-	322	Cash and balances at central banks
Derivatives	554	-	554	-	-	554	Derivatives
Loans and advances to banks	4,893	(2,136)	2,757	-	-	2,757	Loans to banks - amortised cost
Loans and advances to customers	22,364	(653)	21,711	(32)	(57)	21,622	Loans to customers - amortised cost
Amounts due from holding companies and fellow subsidiaries[1]	-	8,070	8,070	(1,232)	(8)	6,830	Amounts due from holding companies and fellow subsidiaries
Debt securities	7,319	(7,319)	-	-	-	-	
Equity shares	5	(5)	-	-	-	-	
Other financial assets	-	2,043	2,043	-	-	2,043	Other financial assets
Investments in group undertakings	5	-	5	-	-	5	Investments in group undertakings
Other assets	456	-	456	-	-	456	Other assets
Total assets	35,918	-	35,918	(1,264)	(65)	34,589	Total assets
Liabilities							Liabilities
Deposits by banks	2,494	(494)	2,000	-	-	2,000	Bank deposits - amortised cost
Customer accounts	25,522	(6,443)	19,079	-	-	19,079	Customer deposits - amortised cost
Other financial liabilities	-	697	697	-	-	697	Other financial liabilities
Amounts due to holding companies and fellow subsidiaries[1]	-	6,770	6,770	(1,232)	-	5,538	Amounts due to holding companies and fellow subsidiaries
Derivatives	204	-	204	-	-	204	Derivatives
Subordinated liabilities	616	(530)	86	-	-	86	Subordinated liabilities
Other liabilities	476	-	476	-	7	483	Other liabilities
Total liabilities	29,312	-	29,312	(1,232)	7	28,087	Total liabilities
Total equity	6,606	-	6,606	(32)	(72)	6,502	Total equity
Total liabilities and equity	35,918	-	35,918	(1,264)	(65)	34,589	Total liabilities and equity

Note:
(1) The classification and measurement impact on amounts due from/to holding companies and fellow subsidiaries relates to fair value adjustments following business model and solely payment of principal and interest reviews.

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

	Group €m	Bank €m
At 31 December 2017 - under IAS 39	6,403	6,606
Classification & measurement		
- Additional write down of amortised cost assets	(32)	(32)
Expected credit losses		
- Amortised cost assets	(57)	(65)
- Contingent liabilities and commitments	(7)	(7)
At 1 January 2018 - under IFRS on transition to IFRS 9	6,307	6,502

31. Ultimate holding company

The Bank's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland and its immediate holding company is NatWest Holdings Limited which is incorporated in Great Britain and registered in England.

As at 31 December 2018, The Royal Bank of Scotland Group plc heads the largest group in which the Bank is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh, EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 62.3% of the issued ordinary share capital of the holding company and is therefore the Bank's ultimate controlling party.

32. Post balance sheet events

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

33. Date of approval

The financial statements were approved by the Board of Directors on 13 February 2019.

34. Capital resources - unaudited

Capital regulation

The EU adopted legislative package, known as CRD IV consists of the Capital Requirements Regulation ("CRR") which is directly applicable across firms in the EU, and the new Capital Requirements Directive ("CRD"), which has been implemented by member states of the European Economic Area through national law. CRD IV is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework.

The Bank Recovery and Resolution Directive ("BRRD") marks another step by European authorities in improving the stability of the financial system. The new framework is intended to enable resolution authorities to resolve failing banks with a lower risk of triggering contagion to the broader financial system, while sharing the costs of resolution with bank shareholders and creditors. To achieve this objective, the BRRD includes explicit provisions for the 'bail-in' of senior creditors where necessary.

Capital management

The objectives of the Bank's capital management and risk appetite framework are to at all times comply with the regulatory and internal capital requirements and to ensure that the Bank has sufficient capital to cover the current and future risks inherent in its business and to support its future development.

The Bank achieves this through the ICAAP process. The ICAAP is an internal assessment of capital that the Bank undertakes to ensure it is appropriately capitalised for its risk profile. The purpose of the ICAAP is to formalise the Bank's approach to understanding its risk profile and the processes and systems it needs to have in place to assess, quantify and monitor these risks.

The primary objective of the ICAAP is to ensure the Bank has adequate and appropriate capital to cover all material risks to which it is or may be exposed, at present or in the future. The Bank has in place a risk management framework to ensure that the identification and evaluation of those risks is comprehensive.

In support of the ICAAP, the Bank embeds risk management processes (Material Risk Assessment, Risk Appetite, Stress Testing and Capital Planning), which are integrated into the wider risk management processes in the Bank including ILAAP and recovery planning, ensuring effective management of the risk profile of the Bank.

34. Capital resources - unaudited continued

The Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD IV - which was enacted in Irish law by S.I. No. 158 of 2014 and S.I. No. 159 of 2014) requirements are being implemented on a phased basis from 1 January 2014, with full implementation from 1 January 2019. For 2018, the capital resources disclosures are on a full implementation basis.
The disclosures for 2017 reflect the transition arrangements of the legislation together with the CBI guidance (Implementation of Competent Authority Discretions and Options in CRD IV and CRR) on the application of transitional rules in Ireland. The 2017 disclosures have been restated in line with CRR Article 478.2.

	Unaudited[1] 2018 €m	Unaudited[1] 2017 €m
Shareholders' equity (excluding non-controlling interests)	4,903	6,403
Regulatory adjustments and deductions[2]		
Own Credit	(2)	(1)
Defined benefit pension fund adjustment	(144)	(44)
Deferred tax assets	(292)	(188)
Excess of expected losses over impairment provisions	(1)	(120)
Goodwill and other intangible assets	(1)	(1)
Qualifying deductions exceeding AT1 capital	-	(15)
	(440)	(369)
Core tier 1 capital	4,463	6,034
Deductions		
Excess of expected losses over impairment provisions	-	(15)
Qualifying deductions exceeding AT1 capital	-	15
Total tier 1 capital	4,463	6,034
Qualifying tier 2 capital		
Paid up capital instruments and subordinated loans	467	573
Tier 2 deductions		
Residual amount for shortfall of provisions to expected loss	-	(15)
	-	(15)
Total tier 2 capital	467	558
Total regulatory capital	4,930	6,592
Key capital ratios	%	%
Tier 1	27.5	30.5
Total capital	30.4	33.3
Risk weighted assets by risk	€m	€m
Credit risk	14,951	18,116
Counterparty risk	136	362
Market risk	53	76
Operational risk	1,070	1,240
Total risk weighted assets	16,210	19,794

Notes:

(1) The capital metrics included in the above table have not been audited for the financial years ended 31 December 2018 and 31 December 2017.

(2) During 2018 all Tier 1 regulatory adjustments moved to a full implementation basis from previously following the transitional rules per the CBI publication from 2014 'Implementation of Competent Authority Discretions and Options in CRD IV and CRR'.

(3) The core tier 1 capital includes the total comprehensive income/(loss) for the financial year.

34. Capital resources - unaudited continued

In the management of capital resources, the Bank is governed by the UBIDAC and RBS policies which are to maintain a strong capital base, generate capital accretion and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business.

In carrying out these policies the Bank has regard to and has complied with the capital supervisory requirements of the ECB and CBI throughout the financial year.