Company Registered Number: 2304

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ANNUAL REPORT AND ACCOUNTS

31 December 2020

Contents

	Page
Board of directors and secretary	1
Report of the directors	2
Statement of directors' responsibilities	6
Independent auditor's report to the members of the Royal Bank of Scotland International Limited	7
Income statement for the year ended 31 December 2020	10
Statement of comprehensive income for the year ended 31 December 2020	11
Balance sheet as at 31 December 2020	12
Statement of changes in equity for the year ended 31 December 2020	13
Cash flow statement for the year ended 31 December 2020	14
Accounting policies	15
Notes to the accounts	21

Board of directors and secretary

Chairman
John Philip Ward Brewster

Executive directors
Andrew Martin McLaughlin
Chief Executive Officer

Lynn Ann Cleary
Chief Financial Officer

Non-executive directors
Louis Philip Chetwynd Taylor (resigned 31 October 2020)

Stuart Porteous

Bruce Mark Cannon

Gregory John Branch

Christine Hilary Ashton (appointed 14 September 2020)

Company Secretary
Rachael Emma Pocklington (resigned 1 September 2020)

Andrew Nicholson (appointed 1 September 2020)

Auditor
Ernst & Young LLP
Castle Street
St Helier
Jersey
JE1 1EY

Registered office and Head office
Royal Bank House
71 Bath Street
St Helier
Jersey
JE4 8PJ

The Royal Bank of Scotland International Limited
Registered in Jersey, Channel Islands No. 2304

Report of the directors

Presentation of information

The directors of The Royal Bank of Scotland International Limited (the "Company"/"RBS International"/"RBSI"/the "Bank") present their annual report, together with the audited financial statements of the Company for the year ended 31 December 2020. The financial statements are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB). The Bank publishes its financial statements in the functional currency, pounds sterling ('£' or 'sterling') and all values are rounded to the nearest million pound, except when otherwise indicated. The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, respectively.

ACTIVITIES AND BUSINESS REVIEW

Principal activities

The Bank is one of the largest banks operating in the Channel Islands, Isle of Man and Gibraltar with wholesale branches in Luxembourg and the UK. It provides a comprehensive range of financial services through its International Retail & Commercial Banking and Institutional Banking customer segments. International Retail & Commercial Banking provides loan and deposit products and services to personal, private, business and commercial customers. Institutional Banking provides services to European fund asset Managers, fund administrators and corporate service providers.

The directors do not anticipate any material change in the type or activities of the Company.

The Bank is a wholly-owned subsidiary of The Royal Bank of Scotland International (Holdings) Limited ('RBSIH'). The ultimate holding company is NatWest Group plc ('NWG') (renamed from The Royal Bank of Scotland Group plc on 22 June 2020) which provides support and access to all central resources. The Bank will leverage this relationship to NWG and other subsidiaries to continue to improve on the quality and efficiency of the services and products provided.

Copies of the annual report of NWG can be obtained from Corporate Governance and Regulatory Affairs, NatWest Gogarburn, Edinburgh EH12 1HQ, the Registrar of Companies or through the NWG website, www.natwestgroup.com.

Business review

The Bank's purpose, which is aligned with NatWest Group, is to champion potential, helping people, families and businesses to thrive. The Bank has identified three focus areas where it can make a meaningful contribution to its clients, colleagues and communities; climate, enterprise and learning.

With 2020 being dominated by the Coronavirus Disease 2019 (COVID-19) crisis, the Bank has demonstrated our purpose-led approach with its ongoing support of clients and the launch of key sustainability initiatives. We continue to focus on improving client satisfaction through fully understanding their needs across the financial lifecycle.

The Bank worked closely with local governments to implement emergency policies to support local communities and businesses in light of COVID-19. It led the offshore banking sector in the creation of the loan Disruption Guarantee Scheme (DGS), providing £858 million of loan facilities to financially support customers through forbearance, the DGS and payment holidays in 2020.The Bank's priority during the coronavirus pandemic has been to look after the safety and wellbeing of its clients and colleagues. The Bank has created a safe working environment for its colleagues through rigorous health and safety procedures in its buildings and providing the right support for colleagues to work at home. With the majority of colleagues now working from home the Bank has provided them with the technology they require to work effectively to continue to service its clients in addition to wellbeing support to help them in adapting to home working.

We build long-term partnerships, working collaboratively to understand our customers' needs and create tailored solutions to help them grow and prosper. Our relationship teams provide insight and expertise in the sectors and locations where we operate. Leading a digital transformation across the communities we operate in and becoming a bank that is easy to deal with is the best way to fulfil our purpose to champion potential.

International Retail & Commercial Banking

There have been 26 releases of new features across Bank's personal digital channels; driven by customer feedback, supporting a 17% increase in users. Overall 68% Local Banking customers are now registered with digital banking which is an 8% increase on 2019.

The Bank has improved its service propositions for our Coutts Crown Dependencies clients with the introduction of payment functionality and new deposit products.

Performance Key metrics and ratios	2020	2019
Total Income	£461m	£563m
Operating profit before tax	£82m	£335m
Loans and advances to customers	£13.3bn	£14.1bn
Customer deposits	£31.3bn	£30.0bn
Loan to Deposit ratio	42%	47%
Liquidity portfolio	£18.9bn	£15.7bn
Risk Weighted Assets	£7.3bn	£6.6bn
CET1 capital ratio	18.6%	19.2%
T1 capital ratio	22.7%	23.7%
Leverage ratio(1)	4.4%	4.3%
Liquidity Coverage Ratio (LCR)	137%	137%
Assets held in a fiduciary capacity	£3.1bn	£2.8bn

Note:
(1) Leverage ratio is Tier 1 capital as a percentage of on and off balance sheet exposures in line with Jersey Financial Services Commission (JFSC) guidance. The primary driver of the ratio is short term deposit balances, which RBSI typically holds in high quality liquid assets. Excluding unencumbered central bank balances would result in a ratio of 6.75%.

The Bank has accelerated its digital transformation strategy in light of COVID-19 and is now meeting the increasing customer demand for digital solutions. This change in customer behaviour has also led the Bank to consolidate the branch network in local markets reducing the branch network to 8 in early January 2021.

Institutional Banking

Through increased investment in the multi-currency banking platform, eQ, the Company has improved the digital experience for institutional customers. With 11 releases of new features in 2020, there have been multiple improvements and all users have moved to the new version of eQ, making sure everyone has the same great functionality and experience. In September 2020 the Bank has released its multi-currency platform for Corporate and Institutional banking clients on mobile.

Financial performance in a challenging environment

The Bank's operating profit before tax was £82m compared with an operating profit before tax of £335m in 2019, reflecting lower income and significantly higher impairment charges primarily due to the current COVID-19 crisis and resulting uncertain economic conditions.

The Bank's financial performance is presented in the Income Statement on page 10. These results demonstrate the resilience of our underlying business and the strength of our balance sheet in the face of significant continued uncertainty.

Income

Income decreased by 18% to £461m reflecting the impact of central bank responses to COVID-19 as lower interest rates cause deposit margins to fall significantly.

Operating expenses

Operating expenses increased by 20% to £272m. Included in operating expense is £34m of restructuring costs related to property exits and redundancy costs.

Impairments

Impairment losses of £107m primarily reflect a more uncertain economic environment and refreshed staging and maturity date analysis. £28m of this amount is specific impairments (Stage 3 Expected Credit Loss).

Loans and advances to customers

Loans and advances to customers have decreased by £0.9bn during the year to £13.3bn. Funds Banking clients repaid loans to position themselves for potential future opportunities and to meet cleared funds requirements. The Bank has worked closely with local governments to implement emergency policies to support local communities and businesses in light of COVID-19.

Customer deposits

Customer deposits at £31.3bn have increased £1.1bn and represent the Bank's primary funding source. Year end balances comprised £10bn (2019: £9.7bn) International Retail & Commercial Banking deposits and £21.3bn (2019: £20.4bn) Institutional Banking deposits.

Capital and Liquidity Management

The Bank's capital and liquidity positions remained robust during 2020.

As at 31 December 2020 the CET1 ratio was 18.6% (2019: 19.2%) and the Liquidity Coverage Ratio was 137% (2019: 137%).

The decrease in CET1 reflects an increase in RWAs and an increase in capital deduction for a defined benefit pension scheme surplus.
RWAs have increased £0.7bn to £7.3bn driven by increased lending commitments and movements in customer maturities and credit risk.

The Bank's loan to deposit ratio stands at 42% at 31 December 2020 (2019: 47%). To support diversification of funding sources the Bank has issued Euro Commercial Paper of £0.5bn and broadened its notice deposit product offering. In addition, as part of its management of the structural hedging programme the Bank introduced interest rate swaps during the year.

The Bank's securities holdings of £5.4bn are highly liquid and comprised primarily of UK Gilts, German Bund and US Treasuries.

Assets held in a fiduciary capacity

The Bank holds assets under management which are not included in its financial statements.

Credit ratings

The Bank, has the following Credit Ratings at 31 December 2020:

S&P	A- / A-2 (Negative)
Moody's	Baa1 / P-2 (Positive)
Fitch	A / F1 (Negative)

ACCOUNTING POLICIES

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underline the preparation of its financial statements. Details of the Company's accounting policies and key sources of estimation uncertainty are included within the Accounting policies on pages 15 to 20.

RISK MANAGEMENT

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

The financial position of the Bank, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. Notes 8 and 17 to the financial statements include the Bank's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

THE BOARD

The Board considers strategic issues and ensures the Bank manages risk effectively through approving and monitoring the Bank's risk appetite, considering stress scenarios and agreed mitigants and identifying longer term strategic threats to the Bank's business operations. The Board's terms of reference include 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 (CEO) and Chief Financial Officer (CFO). These include responsibility for the operational management of the Bank'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.

The roles of Chairman and CEO 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 CEO has responsibility for all Bank 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.

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

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

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

The Board has delegated day to day management of the business to the CEO. The CEO is supported by various management level committees including the Executive Committee which assists the CEO in managing strategic, financial, capital and operational issues related to the running of the business.

DIRECTORS AND SECRETARY

The present directors and secretary, who have served during the year, are listed on page 1.

COLLEAGUES

Colleague engagement

The Bank prioritised the wellbeing of our colleagues in this challenging year. It enabled the majority of colleagues to work from home. It ensured that all colleagues continued to be paid as normal until September if they needed to take some time to look after their families, were unable to work from home or were ill. It also enhanced our free mental health support through a new partnership with Silvercloud, providing substantial, sector-leading support to any colleague who needs it and provided all leaders access to extended mental health awareness support.

The Bank 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 Bank in support of improving employee engagement and satisfaction. This progress is tracked through a survey during the financial year, utilising questions common across the financial services industry to compare ourselves against our peers. 75% of colleagues completed the staff opinion survey. Scores improved in 7 of the 15 categories though there was an overall decline in wellbeing.

Diversity and inclusion

The Bank 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 Bank 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 Bank'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

As a strong component of making the Bank a purpose-led organisation, an established wellbeing strategy is key. The Bank's Wellbeing strategy is delivered against four pillars; Physical, Mental, Social and Financial.

Championing the potential of our colleagues

Ongoing professional development for our colleagues and continuous learning culture is important to the Bank.

The Bank offers a wide range of learning opportunities including technical knowledge and skills. We need to prepare colleagues for the future, and we continue to focus broader development on our Critical People Capabilities.

We're committed to developing colleagues in the five key critical capability areas we have identified, that will help build the right knowledge, skills and behaviours, to help our colleagues stay relevant and employable, and support our ambition and purpose. In addition, we are encouraging agility and shifting mindsets so that a focus on the future, continuous learning, knowledge sharing and reflective practice becomes the norm.

Rewarding our colleagues

Our approach to performance management provides clarity for our colleagues about how their contribution links to our ambition. It recognises contributions that support our values and holds individuals to account for behaviour and performance that does not.

ENTERPRISE

In July the Bank introduced the Woman in Business accreditation, with 46 colleagues completing the qualification. In tandem we nominated 9 customers for the NatWest Everywoman Awards, championing their potential and helping to remove the barriers to business.

In the second half of 2020 we selected six local, social enterprises to support with mentoring, sharing our knowledge and resources with our communities. We also held virtual Business Builder events which were open to anyone in the community, a first for RBS International, we had 93 attendees, of which a third signed up for further support.

CLIMATE

The Bank continues to help drive the transition to a low carbon economy. In the fourth quarter of 2020 we signed an investor backed loan facility (IBLF) for an energy transition fund focusing on clean energy production, energy efficiency enhancements and clean energy utilisation. We also signed an IBLF for a European fund; who invests in the development, construction and management of subsidy-free and sustainable renewable energy assets

Throughout 2020 we have sought to increase customer and colleague knowledge on climate by running education sessions on sustainability-linked loans, holding a Climate Awareness month and by enrolling over 100 colleagues on climate education courses; in partnership with the University of Edinburgh and Cambridge Institute of Sustainability Leadership.

OUTLOOK

The Bank faces increased political and economic risks and uncertainty. In the current environment, and recognising ongoing market uncertainty, we continue to expect challenges on income.

Scenarios identified as having a potentially material negative impact on the Bank include; persistent or more intense weakness in global economic growth, particularly COVID-19 pandemic related uncertainties; shifts in the international tax policy environment; an extended period of low inflation and low (or negative) interest rates; market volatility or fluctuations in the value of the pound sterling, new or extended economic sanctions, volatility in commodity prices or concerns regarding sovereign debt; and political and geopolitical instability.

This may be compounded by the ageing demographics of the populations in the markets that the Bank serves, or rapid change to the economic environment due to the adoption of technology and artificial intelligence. Any of the above developments could adversely impact the Bank directly (for example, as a result of credit losses) or indirectly (for example, by impacting global economic growth and financial markets and the Bank's clients and their banking needs).

The directors, noting the continued and forecast challenging economic outlook and cognisant of the macroeconomic and political risks, consider that the Bank's continued focus on accelerating digital transformation, simplifying its business model, maintaining strength and sustainability and supporting growth will assist in the delivery of the NatWest Group's purpose to champion potential, helping people, families and businesses to thrive.

Economic and political landscape

The Bank continues to deal with a range of significant risks and uncertainties in the external economic, political and regulatory environment.

Scenarios identified as having a potentially negative impact on the Bank include

- Further decreases in interest rates and/or continued sustained low or negative interest rates could put pressure on the Bank's interest margins and adversely affect the Bank's profitability.
- Changes in currency rates, particularly in the sterling-US dollar and euro-sterling rates, can adversely affect the value of assets, liabilities, income, RWAs and expenses.
- Shifts in the international tax policy environment and imposition of levies and taxes can affect the distributable profits of the Bank, as the Bank is subject to the tax laws and practice in the jurisdictions in which it has operations.
- Political and geopolitical instability could result in subdued confidence and impact on credit ratings.
- Changes to IRB regulation from the Prudential Regulatory Authority (PRA).
- the uncertainty around the consequences of Brexit on cross-border activities.

GOING CONCERN

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

Having reviewed the Bank's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Bank will continue in operational existence for the foreseeable future. Foreseeable future is defined as 12 months from the date of signing of this Report and Accounts. Accordingly, the financial statements of the Bank have been prepared on a going concern basis.

DIVIDENDS

In light of the economic uncertainty, the directors have not declared any ordinary dividend (2019: £762m) to The Royal Bank of Scotland International (Holdings) Limited. A preference dividend of £20m (2019: £10m) was paid to NatWest Group Plc.

POST BALANCE SHEET EVENTS

Post balance sheet events are described in note 22 to the financial statements.

AUDITOR

The auditor, Ernst & Young LLP, has expressed its willingness to continue as auditor and will continue in office.

By order of the Board:

Andrew Martin McLaughlin
Chief Executive Officer

Date: 16 February 2021

Lynn Ann Cleary
Chief Financial Officer

Date: 16 February 2021

Statement of directors' responsibilities

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

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Annual Report and Accounts complies with the Companies (Jersey) Law 1991, the Banking Business (Jersey) Law 1991, the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005, the Financial Services (Trust Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007 and the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007, the Financial Services (Jersey) Law 1998 and their Codes of Practice. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

By order of the Board:

Andrew Martin McLaughlin
Chief Executive Officer

Date: 16 February 2021

Lynn Ann Cleary
Chief Financial Officer

Date: 16 February 2021

Independent auditor's report to the members of The Royal Bank of Scotland International Limited

Opinion

We have audited the financial statements of The Royal Bank of Scotland International Limited (the "Company") for the year ended 31 December 2020 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 22, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as issued by the IASB.

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as issued by IASB;
- have been properly prepared in accordance with the requirements of the Companies (Jersey) Law 1991;
- have been prepared in accordance with the requirements of the Banking Business (Jersey) Law 1991;
- have been prepared in accordance with the Financial Services (Trust Company and Investment Business (Accounts Audits and Reports)) (Jersey) Order 2007;
- have been prepared in accordance with the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007; and
- have been prepared in accordance with the requirements of the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements, including the UK FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

Other information

The other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the Annual Report.

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

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 course of 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 themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.
We have nothing to report in this regard.

Matters on which we are required to report by exception

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

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

Responsibilities of directors

As explained more fully in the Statement of directors' responsibilities set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Company and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are those that relate to the financial reporting framework, namely:
    - the Companies (Jersey) Law 1991;
    - the Banking Business (Jersey) Law 1991; and
    - the Financial Services (Jersey) Law 1998
- We understood how the Company is complying with those frameworks by making enquiries of management, internal audit and those responsible for legal and compliance matters, and corroborated this by reviewing supporting documentation. We also read correspondence between the Company and the Jersey Financial Services Commission; read minutes of the Board; and gained an understanding of the Company's governance framework;
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur, by considering the controls established to address risks identified to prevent or detect fraud. We identified the risk of management override associated to impairment provisions and the risk associated with the revenue recognition of manual and partly manual revenue streams to be a fraud risks. When performing our fraud procedures we identified others areas that we considered, such as cybersecurity, the impact of remote working and the appropriateness of sources used when performing confirmation testing on accounts such as cash, loans and securities;
- Based on this understanding we designed our audit procedures to identify noncompliance with such laws and regulations. Our procedures involved reading Board minutes, complaints register, compliance reports, and inquiries of internal legal counsel, those charged with governance, executive management, compliance and internal audit, and the performance of journal entry testing meeting our defined risk criteria and our understanding of the business; and
- The Company operates in the banking industry which is a highly regulated environment. As such the Audit Partner considered the experience and expertise of engagement team to ensure that the team had the appropriate competence and capabilities, which included use of specialists where appropriate.

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

Independent auditor's report to the members of The Royal Bank of Scotland International Limited

Use of our report

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

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

16 February 2021

Notes:

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

Income statement for the year ended 31 December 2020

	Note	2020 £m	2019 £m
Interest receivable		439	563
Interest payable		(66)	(92)
Net interest income	1	373	471
Fees and commissions receivable		86	91
Fees and commissions payable		(1)	(1)
Other operating income		3	2
Non-interest income	2	88	92
Total income		461	563
Staff costs		(126)	(117)
Premises and equipment		(32)	(16)
Other administrative expenses		(95)	(82)
Depreciation, impairment and amortisation		(19)	(11)
Operating expenses	3	(272)	(226)
Operating profit before impairment gains		189	337
Impairment losses	8	(107)	(2)
Operating profit before tax		82	335
Tax charge	5	(24)	(42)
Profit for the year		58	293

The accompanying notes on pages 21 to 70 and the accounting policies on pages 15 to 20 form an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 December 2020

	Note	2020 £m	2019 £m
Profit for the year		58	293
Items that do not qualify for reclassification			
Remeasurement of retirement benefit schemes	4	23	-
Tax	5	(2)	-
		21	-
Items that do qualify for reclassification			
FVOCI financial assets		6	-
Cash flow hedges		1	-
Tax	5	(1)	-
		6	-
Other comprehensive gains for the year after tax		27	-
Total comprehensive income for the year		85	293

The accompanying notes on pages 21 to 70 and the accounting policies on pages 15 to 20 form an integral part of these financial statements.

Balance sheet as at 31 December 2020

	Note	2020 £m	2019 £m
Assets			
Cash and balances at central banks	7	13,531	10,617
Derivatives	6	41	36
Loans to banks - amortised cost	7	1,204	1,337
Loans to customers - amortised cost	7	13,262	14,115
Amounts due from holding companies and fellow subsidiaries	7	646	1,056
Other financial assets	9	5,363	5,069
Intangible assets	11	8	7
Other assets	12	278	247
Total assets		34,333	32,484
Liabilities			
Bank deposits	7	5	14
Customer deposits	7	31,280	30,137
Derivatives	6	126	56
Other financial liabilities	13	542	-
Amounts due to holding companies and fellow subsidiaries	7	322	279
Other liabilities	14	155	160
Total liabilities		32,430	30,646
Owners' equity		1,903	1,838
Total liabilities and equity		34,333	32,484
Memorandum items			
Contingent liabilities and commitments	18	9,642	6,610

The accompanying notes on pages 21 to 70 and the accounting policies on pages 15 to 20 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 16 February 2021 and signed on its behalf by:

Andrew Martin McLaughlin
Chief Executive Officer

Lynn Ann Cleary
Chief Financial Officer

Statement of changes in equity for the year ended 31 December 2020

	Note	2020 £m	2019 £m
Called up share capital - at 1 January and 31 December	15	97	97
Paid-in equity - at 1 January		300	-
Additional Tier 1 capital notes issued		-	300
At 31 December	15	300	300
Share premium - at 1 January and 31 December		5	5
FVOCI reserve - at 1 January		-	-
Unrealised gains		6	-
Tax		(1)	-
At 31 December		5	-
Cash flow hedging reserve - at 1 January		-	-
Amount recognised in equity [1]		1	-
At 31 December		1	-
Retained earnings - at 1 January		1,436	1,919
Implementation of IFRS 16 on 1 January 2019		-	(4)
Remeasurement of retirement benefit schemes	4	23	-
Deferred taxation on actuarial movements recognised on defined benefit schemes	5	(2)	-
Ordinary dividends paid		-	(762)
Equity preference dividends paid		(20)	(10)
Profit attributable to ordinary shareholders and other equity owners		58	293
At 31 December		1,495	1,436
Owners' equity at 31 December		1,903	1,838

Note:
(1) In 2020, the amount credited to the cash flow hedging reserve comprised £1m (2019: nil) in relation to interest rate hedges.

The accompanying notes on pages 21 to 70 and the accounting policies on pages 15 to 20 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2020

	Note	2020 £m	2019 £m
Cash flows from Operating activities			
Operating profit before tax		82	335
Impairment losses on loans to customers		107	2
Defined benefit pension schemes		(3)	(83)
Depreciation, amortisation and impairment of other assets		19	11
Elimination of foreign exchange differences		(205)	277
Interest receivable on other financial assets		(45)	(46)
Charges and releases on provisions		25	4
Other non - cash items		1	(46)
Net cash flows from trading activities		(19)	454
(Increase)/decrease in net loans to banks		-	-
Decrease/(Increase) in net loans to customers		746	(1,484)
Decrease in amounts due from holding companies and fellow subsidiaries		23	49
(Increase)/Decrease in other assets		(2)	4
(Decrease)/Increase in banks deposits		(9)	12
Increase in customer deposits		1,143	4,139
Increase in derivative assets		(5)	(10)
Increase in derivative liabilities		70	19
Increase/(decrease) in amounts due to holding companies and fellow subsidiaries		43	(2,003)
Increase/(decrease) in other financial liabilities		542	(2)
(Decrease)/increase in other liabilities		(10)	(3)
Changes in operating assets and liabilities		2,541	721
Income taxes paid		(59)	(38)
Net cash flows from operating activities (1)		2,463	1,183
Cash flows from investing activities			
Sale and maturity of other financial assets		1,811	983
Purchase of other financial assets		(2,099)	(2,317)
Interest received on other financial assets		45	46
Sale of property, plant and equipment		5	2
Purchase of property, plant and equipment		(14)	(27)
Net movement in intangible assets		(2)	-
Net cash flows used in investing activities		(254)	(1,313)
Cash flows from financing activities			
Issue of Additional Tier 1 capital notes		-	300
Dividends paid		(20)	(772)
Net cash flows used in financing activities		(20)	(472)
Effects of foreign exchange on cash & cash equivalents		205	(277)
Net decrease/(increase) in cash and cash equivalents		2,394	(925)
Cash and cash equivalents at 1 January	20	12,887	13,812
Cash and cash equivalents at 31 December	20	15,281	12,887

Note:

(1) Includes interest received of £386m (2019 - £511m) and interest paid of £17m (2019 - £42m).
Cash flows from operating activities also include interest and repayment of lease liabilities of £6m (2019 - £4m).

The accompanying notes on pages 21 to 70 and the accounting policies on pages 15 to 20 form an integral part of these financial statements.

Accounting policies

1. Presentation of accounts

The accounts, set out on pages 10 to 70 including these accounting policies on pages 15 to 20 and Risk management sections on pages 42 to 68, are prepared on a going concern basis (see the Report of the directors, page 5) and in accordance with International Financial Reporting Standards as issued by the IASB. The significant accounting policies and related judgments are set out below.

The Company is incorporated and registered in Jersey, Channel Islands (Registration number - 2304). The Bank's registered and head office is Royal Bank House, 71 Bath Street, St Helier, Jersey, JE4 8PJ.

The accounts are presented in the functional currency, pounds sterling.

With the exception of certain financial instruments as described in Accounting policies 11 and 17, the accounts are presented on a historical cost basis.

Accounting policy changes effective 1 January 2020

Amendments to IFRS 3 Business Combinations (IFRS 3) - Changes to the definition of a business

The IASB amended IFRS 3 to provide additional guidance on the definition of a business. The amendment aims to help entities when determining whether a transaction should be accounted for as a business combination or as an asset acquisition. The amendments are in line with current accounting policy and therefore did not affect the accounts.

Definition of material - Amendments to IAS 1 - Presentation of Financial Statements (IAS 1) and IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8)

The IASB clarified the definition of 'material' and aligned the definition of material used in the Conceptual Framework and in other IFRS standards. The amendments clarify that materiality will depend on the nature or magnitude of information. Under the amended definition of materiality, an entity will need to assess whether the information, either individually or in combination with other information, is material in the context of the accounts. A misstatement of information is material if it could reasonably be expected to influence decisions made by the primary users. Bank's definition and application of materiality is in line with the definition in the amendments.

Interest Rate Benchmark Reform (IBOR reform) Phase 1 amendments to IFRS 9 and IAS 39

The IASB issued 'Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)' as a first reaction to the potential effects the IBOR reform could have on financial reporting. The amendments focused on hedge accounting and allow hedge relationships affected by the IBOR reform to be accounted for as continuing hedges. Amendments are effective for annual reporting periods beginning on or after 1 January 2020.

Interest Rate Benchmark Reform (IBOR reform) Phase 2 amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16

Phase 2 of the IASB's IBOR project addresses the wider accounting issues arising from the IBOR reform. This was published in August 2020 and is endorsed in January 2021 in the UK and EU. The amendments are effective for annual reporting periods beginning on or after 1 January 2021 with early application permitted. The Bank early adopted these amendments for the annual period ending on 31 December 2020. The Bank's IBOR transition program remains on track and key milestones have been met. Conversion from LIBOR to alternative risk-free Rates (RFRs) is expected to increase as RFR based products become more widely available and key market-driven conversion events occur.

2. Revenue recognition

Interest income or expense relates to financial instruments measured at amortised cost and debt instruments classified as fair value through OCI using the effective interest rate method, the effective part of any related accounting hedging instruments, and finance lease income recognised at a constant periodic rate of return before tax on the net investment. Negative effective interest accruing to financial assets is presented in interest payable. 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 the service is rendered. The pricing base is usually known and always determinable.

3. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accrual 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 NatWest Group or by NatWest Group plc shares. The Company operates a number of share-based compensation schemes under which it awards NatWest Group plc shares and share options to its employees. Such awards are generally subject to vesting conditions.

Variable compensation that is settled in cash or debt instruments is charged to profit or loss on a straight-line basis over the vesting period, taking account of forfeiture and clawback criteria.

Contributions to defined contribution pension schemes are recognised in profit or loss as employee service costs accrue.

For defined benefit pension schemes, the net of the recognisable scheme assets and obligations is reported in the balance sheet. The defined benefit obligation is measured on an actuarial basis. The charge to profit or loss for pension costs (mainly the service cost and the net interest on the net defined benefit asset or liability) is recognised in operating expenses.

Actuarial gains and losses (i.e. gains and/or 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. The difference between scheme assets and scheme liabilities, the net defined benefit asset or liability, is recognised in the balance sheet subject to the asset ceiling test which requires the net defined benefit surplus to be limited to the present value of any economic benefits available to the company in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (mainly the service cost and the net interest on the net defined benefit asset or liability) is recognised in operating expenses.

4. Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.
Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on

operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives are as follows:

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

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

5. Intangible assets and goodwill

Intangible assets acquired by the Company are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated useful 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:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

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

Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities.

Goodwill is measured at initial cost less any subsequent impairment losses. The gain or loss on the disposal of a subsidiary includes the carrying value of any related goodwill.

6. Impairment of non-financial assets

At each balance sheet date, the Company assesses whether there is any indication that its intangible assets, right of use assets or property, plant and equipment are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

The recoverable amount of an asset that does not generate cash flows that are independent from those of other assets or groups of assets, is determined as part of 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. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Company's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell or 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.

An impairment loss is recognised if the recoverable amount of an intangible or tangible asset is less than its carrying value. The carrying value of the asset is reduced by the amount of the loss and a charge recognised in profit or loss. A reversal of an impairment loss on intangible assets (excluding goodwill) 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. Impairment losses on goodwill are not reversed.

7. Foreign currencies

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 income from trading activities except for differences arising on cash flow hedges (see Accounting policy 17).

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

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into Sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into Sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on translation of foreign operations are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

8. Leases

As lessor

Finance lease contracts are those which transfer substantially all the risks and rewards of ownership of an asset to a customer. All other contracts with customers to lease assets are classified as operating leases.

Loans to customers include finance lease receivables measured at the net investment in the lease, comprising the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Interest receivable includes finance lease income recognised at a constant periodic rate of return before tax on the net investment. 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 other operating 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.

As lessee
On entering into a new lease contract, the Company recognises a right of use asset and a lease liability to pay future rentals. The liability is measured at the present value of future lease payments discounted at the applicable incremental borrowing rate. The right of use asset is depreciated over the shorter of the term of the lease and the useful economic life, subject to review for impairment.

Short term and low value leased assets are expensed on a systematic basis.

9. Provisions and contingent liabilities

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

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

The Company recognises any onerous cost of the present obligation under a contract as a provision. An onerous cost is the unavoidable cost of meeting the Company's contractual obligations that exceed the expected economic benefits. When the Company vacates a leasehold property, the right of use asset would be tested for impairment and a provision may be recognised for the ancillary occupancy costs, such as rates.

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

10. Tax

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

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.

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 their recovery is probable.

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.

Accounting for taxes is judgmental and carries a degree of uncertainty because tax law is subject to interpretation, which might be questioned by the relevant tax authority. The Company recognises the most likely current and deferred tax liability or asset, assessed for uncertainty using consistent judgments and estimates. Current and deferred tax assets are only recognised where their recovery is deemed probable and current and deferred tax liabilities are recognised at the amount that represents the best estimate of the probable outcome having regard to their acceptance by the tax authorities.

11. Financial instruments

Financial instruments are classified either by product, by business model or by reference to the IFRS default classification.

Classification by product relies on specific designation criteria which are applicable to certain classes of financial assets or circumstances where accounting mismatches would otherwise arise. Classification by business model reflects how the Company manages its financial assets to generate cash flows. A business model assessment determines if cash flows result from holding financial assets to collect the contractual cash flows; from selling those financial assets; or both.

The product classifications apply to financial assets that are either designated at fair value through profit or loss (DFV), or to equity investments designated as at fair value through other comprehensive income (FVOCI).

Financial assets may also be irrevocably designated at fair value through profit or loss upon initial recognition if such designation eliminates, or significantly reduces, accounting mismatch. In all other instances, fair value through profit or loss (MFVTPL) is the default classification and measurement category for financial assets.

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.

Business model assessment of assets is made at portfolio level, being the level at which they are managed to achieve a predefined business objective. 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.

Most financial assets are within 'held to collect' business models and have the contractual cash flows that comprise solely payments of principal and interest and therefore measured at amortised cost. Certain financial assets are managed under a business model of both to 'held to collect and sell' and have contractual cash flows comprising solely of payments of principal and interest, are measured at fair value through other comprehensive income ('FVOCI').

A debt instrument is normally measured at FVOCI if both of the following conditions are met:

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

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

The contractual terms of a facility, any leverage features, prepayment and extension terms, and triggers that might reset the effective rate of interest, are considered in determining whether cash flows comprise solely payments of principal and interest.

All financial instruments are measured at fair value on initial recognition.

All liabilities not subsequently measured at fair value are measured at amortised cost.

12. Impairment: expected credit losses (ECL)

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 and presented as impairments in the income statement. Loss allowances are forward looking, based on 12 month expected credit losses where there has not been a significant increase in credit risk (SICR) rating (refer Note 17 for details), otherwise allowances are based on lifetime expected losses.

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 change also; and expected credit losses are adjusted from 12 month to lifetime expectations.

Judgement is exercised as follows:

- Models – in certain low default portfolios, Basel parameter estimates are also applied for IFRS 9.
- Non-modelled portfolios, RBSI Retail remains Basel standardised for Risk Weighted Assets, therefore modelled Probability of Default (PDs) and Loss Given Default (LGDs) are not available for calculating stage 1 and stage 2 ECLs. Instead this is undertaken by sourcing the equivalent product PD & LGD from within NatWest UK, which was identified as the closest comparable portfolio to RBSI Retail. The PD and LGD benchmarks are then used, along with the known exposure, to calculate an account level ECL.
- Multiple economic scenarios (MES) – the central, or base, scenario is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities.
- Significant increase in credit risk - 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.

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.

Impaired loans are written off and therefore derecognised from the balance sheet when the Company 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 the 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.

The typical time frames from initial impairment to write off for Bank's collectively-assessed portfolios are:

- Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
- Overdrafts and other unsecured loans: write off occurs within six years
- Commercial loans: write offs are determined in the light of individual circumstances; the period does not typically exceed five years.
- Business loans are generally written off within five years.

13. Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. Conversely, an asset is not derecognised by a contract under which the Company retains substantially all the risks and rewards of ownership. If substantially all the risks and rewards have been neither retained nor transferred, the Company does not derecognise an asset over which it has retained control but limits its recognition to the extent of its continuing involvement.

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

14. Sale and repurchase transactions

Securities subject to sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Company 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 Company 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. Where Collateral supporting the transaction is received in the form of cash, deposit is recorded. Sale and repurchase transactions that are not accounted for at fair value through profit or loss are measured at amortised cost. The difference between the consideration paid or received and the repurchase or resale price is treated as interest and recognised in interest income or interest expense over the life of the transaction.

15. Netting

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

16. Capital instruments

The Bank 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 Bank after the deduction of liabilities.

17. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Bank's approach to determining the fair value of financial instruments is set out in the Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 7 on the accounts.

A derivative embedded in a financial liability contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value 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 profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income. The Company enters into two types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges) and hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges).

Hedge relationships are formally designated and documented at inception in line with the requirements of IAS 39 Financial instruments – Recognition and measurement. The documentation identifies the hedged item, the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if NatWest 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.

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

18. 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.

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its accounts. IFRS require the directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard 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 Company'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 Company would affect its reported results.

During 2020, estimation uncertainty has been affected by the COVID-19 pandemic. Consideration of this source of estimation uncertainty has been set out in the notes below:

Critical accounting policy	Note
Amortisation of fees	1
Pensions	4
Fair value - financial instruments	7
Loan impairment provisions	8
Provisions for liabilities and charges	14

Future Accounting developments

International Financial Reporting Standards

COVID-19 amendments on lease modifications – Amendments to IFRS 16 – Leases (IFRS 16)

The IASB published 'amendments to IFRS 16 covering COVID-19-Related Rent Concessions'. These provide lessees with an exemption from assessing whether a COVID-19 related rent concession is a lease modification. The amendment is effective for annual reporting periods beginning on or after 1 June 2020. The effect of the amendment on the Company's accounts is immaterial and will be adopted from 1 January 2021.

Other new standards and amendments that are effective for annual periods beginning after 1 January 2022, with earlier application permitted, are set out below.

Effective 1 January 2022

- Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37).
- Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16).
- Reference to Conceptual Framework (Amendments to IFRS 3).
- Classification of Liabilities as Current or Non-current (Amendments to IAS 1).
- Fees in the "10 per cent" test for Derecognition of Financial Liabilities (Amendments to IFRS 9).

Effective 1 January 2023

- IFRS 17 Insurance Contracts (Amendments to IFRS 17 Insurance Contracts).

The Bank is assessing the effect of adopting these standards and amendments on its financial statements but do not expect the effect to be material.

1. Net interest income

	2020 £m	2019 £m
Interest receivable on assets:		
Loans to banks - amortised cost [1]	25	89
Loans to customers - amortised cost	330	379
Amounts due from holding company and fellow subsidiaries	5	22
Other financial assets- Debt Securities	45	46
Interest receivable on liabilities:		
Customer deposits	34	27
Interest receivable [2]	439	563
Interest payable on liabilities:		
Balances with banks	(2)	(2)
Customer deposits: demand	(4)	(10)
Customer deposits: savings	(1)	(22)
Customer deposits: other time	(30)	(24)
Lease liabilities	(1)	(1)
Amounts due to holding company and fellow subsidiaries	(6)	(15)
Interest payable on assets:		
Loans to banks - amortised cost	(22)	(18)
Interest payable [2]	(66)	(92)
Net interest income	373	471

Notes:
(1) Includes interest received on cash balances at Central Bank.
(2) Negative interest on loans to banks is classed as interest payable and on customer deposits is classed as interest receivable.

Interest income on financial instruments measured at amortised cost and debt instruments classified as FVOCI is measured using the effective interest rate which allocates the interest income or interest expense over the expected life of the asset or liability at the rate that exactly discounts all estimated future cash flows to equal the instrument's initial carrying amount. 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. Finance lease income included in interest receivable was £4.7m (2019: £5.04m).

Critical accounting policies: Amortisation of fees

The Bank amortises the loan arrangement fees over the contractual life of the loan for the fees above £50k. If the arrangement fee is less than £50k, the behavioural life of each portfolio is used to amortise the fees as this is considered more an appropriate measure. The average behavioural life of 33 months was used to amortise the fees below £50k in 2020 (2019: 33 months).

The average behaviour life is calculated based on the contractual life of the loans and judgement is applied to determine the appropriate length of time over which fees should be deferred and hence booked into the Income statement. The Board does not believe there is a significant risk of a material adjustment as a result of possible changes in the length of the behaviour life. This is broadly split into 4 areas being: Financial and Corporate services, Funds, Real Estate & Corporate and Commercial.

The average behavioural lives of these four areas are:

Financial and Corporate services years	24 months (2019: 24 months)
Funds	20 months (2019: 20 months)
Real Estate	33 months (2019: 33 months)
Corporate and Commercial	54 months (2019: 54 months)

Interest receivable on loans to customers includes amortisation of arrangement fees of £43m (2019: £42m).

2. Non-interest income

	2020 £m	2019 £m
Fees and commissions receivable		
- Payment Services	18	25
- Credit & Debit Card Fees	2	2
- Lending - (Credit Facilities)	30	30
- Trade Finance	3	4
- Investment Management	4	4
- Other services	4	4
- Other commissions [1]	25	22
Fees and commissions payable	(1)	(1)
Other operating income	3	2
Total non interest income	88	92

Note:
(1) Other commissions includes dealing profits.

3. Operating expenses

	2020 £m	2019 £m
Wages, salaries and other staff costs	78	78
Temporary and contractor costs	20	21
Social security costs	6	6
Restructure costs	14	4
Pension costs:		
- defined benefit schemes (see note 4)	5	6
- defined contribution schemes (see note 4)	3	2
Staff costs	126	117
Premises and equipment [1]	31	15
Provision for property costs (see note 14)	1	1
Depreciation, impairment and amortisation:		
- Property, plant and equipment (see note 10)	18	10
- Intangible assets (see note 11)	1	1
Other administrative expenses	95	82
Administrative expenses	146	109
Total operating expenses	272	226

Note:
(1) Includes £12m provision for property exits in 2021.

Auditor's remuneration	2020 £'000	2019 £'000
Fee payable for:		
- the audit of RBSI annual accounts	1,011	754
- audit-related assurance services	84	129
- Other services	6	-
	1,101	883

Staff

The average number of persons employed by the Company during the year, excluding temporary staff was 1,364 (2019: 1,371). The average number of temporary employees during 2020 was 212 (2019: 185).

4. Pensions

Defined contribution schemes

The Company made contributions of £3m to its own defined contribution schemes in 2020 (2019: £2.3m).

Eligible employees of the Bank can participate in membership of NatWest Group operated pension schemes. Employees are members of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. Detailed disclosure of the NatWest Group pension schemes is available in the NatWest Group Annual Report and Accounts 2020.

Defined benefit schemes

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

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

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

The Board of RBSIEPTL comprises two trustee directors nominated by members selected from eligible active staff and pensioner members who apply; three directors appointed by the Company; and one independent Trustee. The Board is responsible for operating the scheme in line with its formal rules and pensions law.

It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Company, but who still have benefits in the scheme.

The Company's UK scheme is a fully segregated section of The Royal Bank of Scotland Group Pension Fund. The section only provides benefits to employees of the Company. For further information on the Fund, please refer to the NatWest Group Annual Report and Accounts 2020.

In 2019 the assets and liabilities which includes two pension schemes of Isle of Man Bank Limited were transferred to the Company. The Isle of Man Bank Pension Fund ("IOMPF") and The Isle of Man Bank Widows' and Orphans' Fund ("IOMWO"), the assets of which are independent of the Company's finances.

The schemes operate under Isle of Man trust law and are managed and administered on behalf of their members in accordance with the terms of the trust deed, the scheme rules and Isle of Man legislation.

The trustees of the schemes collectively own the scheme assets which are held separately from the assets of the Company. The Trustee body comprises three trustees nominated by the Company:- one representative of the pensioners; one representative of the recognised union in the Isle of Man and one independent trustee.

4. Pensions (continued)

The trustees are responsible for operating the schemes in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Company but who still have benefits in the schemes.

The Bank with the support of the trustees of IOMPF and IOMWO funds proposed a merger of the funds into the IPT.

Required consent of Active Members and Pensioners has been received and merger has been approved. The merger will be achieved by transferring the assets and liabilities of the funds in to the RBSIPT. The effective date of the merger is expected to be 1st March 2021. The merger provides clear benefits to both the Bank and to members. For transferring members there will be benefits from changes to factors and pension increases. It also simplifies governance and reduces the operational risk and cost of running three separate pension schemes. The completion of the merger will result an increase in the past service costs due to the uplift in the members' benefits at the point of merger. The Bank has not provided for the additional past service costs that will be created in 2021 on the completion of the merger.

Investment strategy

The assets of all the 4 schemes are invested in a diversified portfolio of quoted equities, government and corporate fixed-interest and index-linked bonds. The Scheme's equity holdings are held in passive pooled funds managed by State Street. The Trustee's investment benchmark is for the majority to be invested in global developed markets, with a small proportion invested in emerging markets. The Bank and Trustees have agreed to reduce the level of risk in the investment strategy, which is expected to result in lower, but more stable, investment returns in the future.

Major classes of plan assets as a weighted percentage of total plan assets of the schemes	2020 Quoted %	2020 Unquoted %	2020 Total %	2019 Quoted %	2019 Unquoted %	2019 Total %
Equities	22%	-	22%	25%	-	25%
Index-linked bonds	52%	-	52%	34%	-	34%
Government fixed interest bonds	5%	-	5%	16%	-	16%
Corporate and other bonds	17%	-	17%	18%	-	18%
Hedge funds	-	-	-	-	-	-
Property	-	2%	2%	-	3%	3%
Derivatives	-	-	-	-	1%	1%
Cash and other assets	-	2%	2%	-	3%	3%
	96%	4%	100%	93%	7%	100%

Changes in value of net pension asset/(liability)	All schemes: Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset Ceiling [1] £m	Net pension asset £m
At 1 January 2019	665	(579)	(27)	59
Inter group transfer	121	(93)	(23)	5
Income statement	22	(27)	(1)	(6)
Statement of comprehensive income	105	(114)	9	-
Contributions by employer	89	-	-	89
Benefits paid	(33)	33	-	-
At 1 January 2020	969	(780)	(42)	147
Inter group transfer	-	-	-	-
Income statement: [2]				
Interest income	19	-	-	19
Interest expense	-	(15)	(1)	(16)
Current service cost	-	(7)	-	(7)
Expenses	-	(2)	-	(2)
	19	(24)	(1)	(6)
Statement of comprehensive income:				
Actuarial gains due to experience gains	141	5	-	146
Actuarial losses due to changes in financial assumptions	-	(125)	-	(125)
Actuarial losses due to changes in demographic assumptions	-	(2)	-	(2)
Asset ceiling adjustment	-	-	4	4
	141	(122)	4	23
Contributions by employer	9	-	-	9
Benefits paid	(62)	62	-	-
At 31 December 2020	1,076	(864)	(39)	173

Notes:

(1) The Bank recognises the net pension scheme surplus or deficit as a net asset or liability. In doing so, the funded status is adjusted to reflect any schemes with a surplus that the Bank may not be able to access, as well as any minimum funding requirement to pay in additional contributions.

(2) Amount charged to income statement of £6m includes £5m related to RBSI and £1m related to NWTDS.

4. Pensions (continued)

Amounts recognised on the balance sheet	2020 £m	2019 £m
Fund assets at fair value	1,076	969
Present value of fund liabilities	(864)	(780)
Funded status	212	189
Asset ceiling	(39)	(42)
	173	147

Net pension asset/(liability) comprises	2020 £m	2019 £m
Net assets of schemes in surplus - IPT	171	140
Net assets of schemes in surplus - UK Scheme	25	23
Net assets of schemes in surplus - IOMB	16	26
Asset ceiling -UK Scheme	(25)	(23)
Asset ceiling - IOMB	(14)	(19)
	173	147

Funding and contributions by the Company

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 Company expected to contribute £8m to its defined benefit pension schemes in 2021.

The weighted average duration of the Company's defined benefit obligation is 24 years (2019: 23years).

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 UK-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 Company's defined benefit pension schemes' liabilities requires the Company'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 Company will depend upon actual future events and the assumptions made are unlikely to be exactly borne out in in practice, meaning the final cost may be higher or lower than expected.

A year-end valuation of the Company's pension schemes was prepared to 31 December 2020 by independent actuaries, using the following assumptions for the material pension schemes:

Principal actuarial assumptions at 31 December	2020	2019
Discount rate	1.40%	2.05%
Rate of increase in salaries	1.75%	1.75%
Rate of increase in pensions in payment	2.36%	2.75%
Rate of increase in deferred pensions	3.00%	2.95%
Inflation assumption	2.85%	2.90%

Post–retirement mortality assumptions	2020	2019
Longevity at age 60 for current pensioners aged 60 (years)		
Males	28.3	28.5
Females	29.9	29.7
Longevity at age 60 for future pensioners currently aged 40 (years)		
Males	29.8	30.0
Females	31.4	31.2

4. Pensions (continued)

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

Discount rate

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

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

	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2020	2019	2020	2019
	£m	£m	£m	£m
0.25% increase in the discount rate	(2)	(2)	(52)	(42)
0.25% increase in inflation	1	1	40	33
0.25% additional rate of increase in pensions in payment	-	1	25	20
0.25% additional rate of increase in deferred pensions	-	-	15	13
0.25% additional rate of increase in salaries	-	-	3	3
Longevity increase of one year	1	1	32	18

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

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

The experience history of the Company's schemes is shown below.

	2020	2019	2018	2017	2016
History of defined benefit schemes	£m	£m	£m	£m	£m
Fair value of plan assets	1,076	969	665	653	653
Present value of plan obligations	(864)	(780)	(579)	(614)	(655)
Fund status	212	189	86	39	(2)
Asset ceiling	(39)	(42)	(27)	-	-
Net surplus	173	147	59	39	(2)
Experience gains/(losses) on plan liabilities	5	(2)	32	7	-
Experience gains/(losses) on plan assets	141	105	(47)	38	109
Actual return on pension scheme assets	160	127	(30)	56	128

5. Tax

	2020	2019
	£m	£m
Current tax:		
Charge for the year	20	49
Over provision in respect of prior years	-	(8)
	20	41
Deferred tax:		
Charge for the year	3	1
Prior year adjustment	1	-
Tax charge for the year	24	42

The actual tax charge differs from the expected tax charge computed by applying the standard rate of income tax as follows: Jersey, Guernsey, Isle of Man and Gibraltar 10% (2019: 10%), London 27% (2019: 27%) and Luxembourg 24.94% (2019: 24.94%).

5. Tax (continued)

	2020 £m	2019 £m
Expected tax charge	8	34
Non-deductible items	7	2
Rate differences on current tax	8	14
Adjustments in respect of prior years	1	(8)
Actual tax charge	24	42

Deferred tax

	2020 £m	2019 £m
Deferred tax assets	3	7
Deferred tax liabilities	(19)	(16)
Net deferred tax liabilities	(16)	(9)

	Pension £m	Accelerated capital allowances £m	Other £m	Total £m
At 1 January 2019	(6)	(2)	-	(8)
(Charge)/credit to income statement	(8)	-	7	(1)
(Charge)/credit to other comprehensive income	(1)	-	1	-
At 1 January 2020	(15)	(2)	8	(9)
Charge to income statement	-	-	(4)	(4)
Charge to other comprehensive income	(2)	-	(1)	(3)
At 31 December 2020	(17)	(2)	3	(16)

6. Derivatives

The Bank transact derivatives as principal to manage balance sheet foreign exchange and interest rate risk.

	2020			2019		
	Notional amounts £m	Assets £m	Liabilities £m	Notional amounts £m	Assets £m	Liabilities £m
Exchange rate contracts						
Spots and forwards - NatWest entities	4,549	32	65	2,158	26	17
Spots and forwards - third party	1,030	8	17	862	9	14
Interest rate swaps						
NatWest entities	1,729	1	44	585	1	25
	7,308	41	126	3,605	36	56

The Bank applies hedge accounting to manage interest rate and foreign exchange risk.

Bank's interest rate hedging relate to the management of non-trading structural interest rate risk, caused by the mismatch between fixed interest rates and floating interest rates. The bank manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges.

Cash flow hedges of interest rate risk relate to exposures to the variability in future interest payments and receipts due to the movement of benchmark interest rates on forecast transactions and on recognised financial assets and financial liabilities. This variability in cash flows is hedged by interest rate swaps, fixing the hedged cash flows. For these cash flow hedge relationships, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to the relevant benchmark rate LIBOR, EURIBOR, SONIA, the Bank of England Official Bank Rate or the European Central Bank Refinance Rate. The variability in cash flows due to movements in the relevant benchmark rate is hedged; this risk component is identified using the risk management systems of NatWest. This risk component comprises the majority of cash flow variability risk.

Fair value hedges of interest rate risk involve interest rate swaps transforming the fixed interest rate risk in recognised financial assets and financial liabilities to floating. The hedged risk is the risk of changes in the hedged items fair value attributable to changes in the benchmark interest rate embedded in the hedged item. The significant embedded benchmarks are LIBOR, EURIBOR and SONIA. This risk component is identified using the risk management systems of the Bank. This risk component comprises the majority of the hedged items fair value risk.

6. Derivatives (continued)

Exchange rate risk also arises in the Bank where payments are denominated in different currencies than the functional currency. Residual risk positions are hedged with forward foreign exchange contracts. Exposure to the variability in future payments due to the movement of foreign exchange rates is hedged, fixing the exchange rate the payments will be settled in. The derivatives are documented as cash flow hedges.

For all cash flow hedging and fair value hedge relationships the Bank determines that there is an adequate level of offsetting between the hedged item and hedging instrument via assessing the initial and ongoing effectiveness by comparing movements in the fair value of the expected highly probable forecast interest cash flows / fair value of the hedged item attributable to the hedged risk with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap.

Hedge effectiveness is measured on a cumulative basis over a time period management determines to be appropriate. The Bank uses either the actual ratio between the hedged item and hedging instrument(s) or one that minimises hedge ineffectiveness to establish the hedge ratio for hedge accounting.

A number of the current cash flow and fair value hedges of interest rate risk that mature post 31 December 2021 will be directly affected by interest rate benchmark reform. As at 31 December 2020 the exact transition date of affected hedge accounting relationships is not known.

The Bank is managing the process to transition to alternative benchmark rates in the following ways:

- reviewed or is in the process of reviewing the fall-back language for IBOR linked instruments
- continues to liaise with regulators, standard setters, industry groups and customers on other relevant matters as the transition to risk free rates progresses
- is in the process of adjusting its products, processes and information systems to deal with the expected effects of the discontinuation of IBOR most notably the transition and calculation rules.

Included in the table on previous page are derivatives held for hedging purposes as follows:

	2020				2019			
	Notional amounts £m	Assets £m	Liabilities £m	Changes in fair value used for hedge ineffectiveness (1) £m	Notional amounts £m	Assets £m	Liabilities £m	Changes in fair value used for hedge ineffectiveness (1) £m
Fair Value hedging								
Interest rate contracts	1,388	-	40	23	559	-	22	2
Cash flow hedging								
Interest rate contracts	277	1	-	(1)	-	-	-	-

Note:
(1) The change in fair value used for hedge ineffectiveness includes instruments that were derecognised in the year.

The notional of hedging instruments affected by interest rate benchmark reform is as follows:

	2020 £m	2019 £m
Fair Value hedging		
- LIBOR	265	274
- EURIBOR	69	65
- USD LIBOR	9	-
	343	339
Cash flow hedging		
- USD LIBOR	22	-
- BOE	100	-
	122	-

6. Derivatives (continued)

The following table shows the period in which the hedging contract ends:

2020	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m	>20 years £m	Total £m
Fair value hedging						
Hedging assets -interest rate risk	285	60	388	441	214	1,388
Hedging liabilities -interest rate risk	-	-	-	-	-	-
Cash flow hedging						
Hedging assets -interest rate risk	5	172	100	-	-	277
Average fixed interest rate (%)	(0.07)	0.10	0.27	-	-	0.16

The table below analyses assets and liabilities subject to hedging derivatives.

2020	Carrying value (CV) of hedged assets and liabilities £m	Impact on hedged items included in CV £m	Change in[(1)] fair value used as a basis to determine ineffectiveness £m
Fair value hedging - interest rate			
Loans and advances to customers - amortised cost	1,478	36	(23)
Cash flow hedging - interest rate			
Loans and advances to customers - amortised cost	285	-	1
2019			
Fair value hedging - interest rate			
Loans and advances to customers - amortised cost	582	19	(2)

Note:
(1) The change in fair value used for hedge ineffectiveness instruments derecognised in the year.

The following risk exposures will be affected by interest rate benchmark reform (notional, fair value):

2020	Notional £m	Hedged adjustment £m
Fair Value hedging		
- LIBOR	265	22
- EURIBOR	69	1
- USD LIBOR	9	-
	343	23
Cash flow hedging		
- USD LIBOR	22	-
- BOE	100	-
	122	-

The following shows analysis of cash flow hedging reserve:

	2020 £m	2019 £m
Continuing		
Cash flow hedging - interest rate risk	1	-

	2020 £m	2019 £m
Interest rate risk		
Amount recognised in equity	1	-

6. Derivatives (continued)

Hedge ineffectiveness recognised in other operating income comprises:

	2020 £m	2019 £m
Fair Value hedging		
Losses on the hedged items attributable to the hedged risk	(23)	(2)
Gains on the hedging instruments	23	2
Fair value hedging ineffectiveness	-	-
Cash flow hedging		
- interest rate risk	-	-
Cash flow hedging ineffectiveness	-	-

The main sources of ineffectiveness for interest rate risk hedge accounting relationships are:

- The effect of the counterparty credit risk on the fair value of the interest rate swap, which is not reflected in the fair value of the hedged item attributable to the change in interest rate (fair value hedge).
- Differences in the repricing basis between the hedging instrument and hedged cash flows (cash flow hedge).
- Upfront present values on the hedging derivatives where hedge accounting relationships have been designated after the trade date (cash flow hedge and fair value hedge).

Additional information on cash flow hedging can be found in the Statement of Changes in Equity.

7. Financial instruments - classification

The following tables analyse financial assets and financial liabilities in accordance with the categories of financial instruments on an IFRS 9 basis. Assets and liabilities outside the scope of IFRS 9 are shown within other assets and other liabilities.

2020	MFVTPL £m	FVOCI £m	Amortised cost £m	Other assets/ liabilities £m	Total £m
Assets					
Cash and balances at central banks	-	-	13,531	-	13,531
Derivatives	41	-	-	-	41
Loans to banks - amortised costs	-	-	1,204	-	1,204
Loans to customers - amortised costs [(1)]	-	-	13,262	-	13,262
Amounts due from holding companies and fellow subsidiaries	-	-	646	-	646
Other financial assets	-	1,796	3,567	-	5,363
Intangible assets	-	-	-	8	8
Other assets	-	-	-	278	278
	41	1,796	32,210	286	34,333
Liabilities					
Banks deposits	2	-	3	-	5
Customer deposits	-	-	31,280	-	31,280
Derivatives	126	-	-	-	126
Other financial liabilities	-	-	542	-	542
Amounts due to holding companies and fellow subsidiaries	-	-	322	-	322
Other liabilities [(2)]	-	-	40	116	156
	128	-	32,187	116	32,431
Owners' equity					1,902
					34,333

7. Financial instruments – classification (continued)

2019	MFVTPL £m	FVOCI £m	Amortised cost £m	Other assets/ liabilities £m	Total £m
Assets					
Cash and balances at central banks	-	-	10,617	-	10,617
Derivatives	36	-	-	-	36
Loans to banks - amortised costs	-	-	1,337	-	1,337
Loans to customers - amortised costs (1)	-	-	14,115	-	14,115
Amounts due from holding companies and fellow subsidiaries	-	-	1,056	-	1,056
Other financial assets	-	1,760	3,309	-	5,069
Intangible assets	-	-	-	7	7
Other assets	-	-	-	247	247
	36	1,760	30,434	254	32,484
Liabilities					
Banks deposits	-	-	14	-	14
Customer deposits	-	-	30,137	-	30,137
Derivatives	56	-	-	-	56
Amounts due to holding companies and fellow subsidiaries	-	-	279	-	279
Other liabilities (2)	-	-	43	117	160
	56	-	30,430	160	30,646
Owners' Equity					1,838
					32,484

Notes:
(1) Includes finance lease receivables of £72m (2019 - £78m).
(2) Includes lease liabilities of £40m (2019: £43m), held at amortised cost. Lease liabilities amounting to £43m have been reclassified to amortised cost as against other liabilities in 2019.

Interest rate benchmark reform

In 2020 the Bank continued to implement its entity-wide LIBOR program with the view of being ready for the various transition events that are expected to occur prior to the cessation of the vast majority of the IBOR benchmark rates at the end of 2021 and the USD LIBOR in 2023. In the UK, the regulators most notably the Bank of England (BoE) and the Financial Conduct Authority have issued guidance on how market participants are expected to approach transition as well as the regulatory expectations in relation to the credit adjustment spread calculation methodologies, conversion strategies amongst, existence of products referencing IBOR benchmark rates amongst other items.

Our bank-wide program continued to address the key areas that will be affected by the IBOR reform most notably:

- Client stratification, engagement and education
- Contract fall-back remediation;
- Transition on an economically equivalent basis;
- Effect of modifications to existing terms beyond those that are attributable to the IBOR reform.
- Funding and liquidity management, planning and forecast;
- Risk management;
- Financial reporting and valuation;
- Changes to processes and systems covering front-end, risk and finance systems.

The Bank continued to develop new products across its different segments that reference the new alternative risk-free rates and worked with clients to assess their readiness and ability to adopt new products or transition existing products. A comprehensive review of the effect of IBOR reform on the funding, liquidity and risk management has also been conducted. This is expected to be fully implemented over the course of 2021. The Bank also focused and will continue to adapt its key systems, methodologies and processes to meet the requirements of the new risk-free rates. This is expected to be concluded in advance of the LIBOR cessation date at the end of 2021.

NatWest Group also remained engaged with regulators, standard setters and other market participants on key matters related with the IBOR reform and an open dialogue is expected throughout 2021. We expect that our program will meet all timelines set by the regulators.

7. Financial instruments – classification (continued)

The table below provides an overview of the Bank's IBOR related exposure by currency and nature of financial instruments. Non-Derivative financial instruments are presented on the basis of their carrying amounts excluding expected credit losses while derivative financial instruments are presented on the basis of their notional amount.

	Rate subject to IBOR reform						
	GBP LIBOR	USD IBOR	EURO IBOR	Other IBOR	Balances not subject to IBOR reform	Expected credit losses	Total
2020	£m	£m	£m	£m	£m	£m	£m
Loans to banks - amortised cost	-	-	-	-	1,205	(1)	1,204
Loans to customers - amortised cost	3,341	825	1,750	131	7,344	(129)	13,262
Other financial assets	-	-	-	-	5,363	-	5,363
Amounts due from holding companies and fellow subsidiaries	-	-	-	-	646	-	646
Bank deposits	-	-	-	-	5	-	5
Customer deposits - amortised cost	-	-	-	-	31,280	-	31,280
Other financial liabilities	-	-	-	-	542	-	542
Amounts due to holding companies and fellow subsidiaries	-	-	-	-	322	-	322
Loan commitments	1,690	706	-	-	7,386	-	9,782
Derivatives notional	377	31	69	-	6,831	-	7,308

AT1 issuances

The Bank has also issued certain capital instruments (AT1) under which reset clauses are linked to IBOR rates subject to reform. Where under the contractual terms of the instrument the coupon reset to a rate which has IBOR as a specified component of its pricing structure these are subject to IBOR reform and are shown in note 15.

Financial instruments- valuation

Critical accounting policy: Fair value - financial instruments

In accordance with accounting policies 11 and 17, financial instruments classified as mandatory 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 Bank maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Modelled approaches may be used to measure instruments classed as level 2 or 3. Estimation expertise is required in the selection, implementation and calibration of appropriate models. The resulting modelled valuations are considered for accuracy and reliability. Portfolio level adjustments consistent with IFRS 13 are raised to incorporate counterparty credit risk, funding and margining risks. Expert judgement is used in the initial measurement of modelled products by control teams.
Where the Bank 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 Bank'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.

7. Financial instruments- valuation (continued)

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.

Valuation techniques
The Bank derives fair value of its instruments 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 and include cash, equities and most debt securities.

Modelled products valued using a pricing model range in complexity from comparatively vanilla products 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. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Bank uses a number of modelling methodologies.

	2020				2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Derivatives	-	41	-	41	-	36	-	36
Other financial assets								
Securities	1,795	1	-	1,796	1,759	1	-	1,760
Total financial assets at fair value	1,795	42	-	1,837	1,759	37	-	1,796
Liabilities								
Banks deposits	-	2	-	2	-	-	-	-
Derivatives	-	126	-	126	-	56	-	56
Total financial liabilities at fair value	-	126	-	126	-	56	-	56

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 third party benchmarking services.

Interest rates - these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.

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

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

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 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 prepayable instruments that are not quoted in active markets, The Bank 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.

7. Financial instruments- valuation (continued)

Fair value of Financial Instruments not carried at fair value

The following table shows the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost. All assets and liabilities carried at amortised cost on the balance sheet fall within level 3 (except other financial assets that fall within level 2), of the valuation methodologies.

	2020 Carrying value £m	2020 Fair value £m	2019 Carrying value £m	2019 Fair value £m
Financial assets				
Cash and balances at central banks	13,531	13,531	10,617	10,617
Loans to banks - amortised costs	1,204	1,204	1,337	1,337
Loans to customers - amortised costs	13,262	13,204	14,115	14,212
Amounts due from holding companies and fellow subsidiaries	646	646	1,056	1,056
Other financial assets	3,567	3,662	3,309	3,345
Financial liabilities				
Bank deposits	3	3	14	14
Customer deposits	31,280	31,280	30,137	30,137
Other financial liabilities	542	542	-	-
Amounts due to holding companies and fellow subsidiaries	322	322	279	279

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgements covering prepayments, credit risk and discount rates. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

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 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, carrying value is a reasonable approximation of fair value.

Loans to banks and customers

In estimating the Fair value of net loans to customers and banks measured at amortised cost, the Bank's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans.

Two principal methods are used to estimate fair value:

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

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

Other financial assets

The majority of other financial assets consist of debt securities which 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.

Deposits by banks and customer accounts

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

Debt securities in issue

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.

7. Financial instruments- maturity analysis

Remaining maturity

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

	2020			2019		
	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	13,531	-	13,531	10,617	-	10,617
Derivatives	38	3	41	29	7	36
Loans to banks - amortised costs	1,204	-	1,204	1,337	-	1,337
Loans to customers - amortised costs	4,911	8,351	13,262	6,025	8,090	14,115
Amounts due from holding companies and fellow subsidiaries	646	-	646	1,056	-	1,056
Other financial assets	1,260	4,103	5,363	1,817	3,252	5,069
Liabilities						
Banks deposits	5	-	5	14	-	14
Customer deposits	31,277	3	31,280	30,131	6	30,137
Derivatives	81	45	126	27	29	56
Other financial liabilities	542	-	542	-	-	-
Lease liabilities	4	36	40	4	39	43
Amounts due to holding companies and fellow subsidiaries	322	-	322	279	-	279

Assets and liabilities by contractual cash flow maturity

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

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 Bank. 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 instrument is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the time band that contains the latest date on which it can be repaid, regardless of early repayment.

The liability is included in the time band that contains the earliest possible date on which the conditions could be fulfilled, without considering the probability of the conditions being met.

For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period, whatever the level of the index at the year end. The settlement date of debt securities in issue depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayments of assets and liabilities are linked, the repayment of assets in securitisations is shown on the earliest date that the asset can be prepaid, as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table, as are interest payments after 20 years.

The maturity of guarantees and commitments is based on the earliest possible date they would be drawn in order to evaluate the Bank's liquidity position.

MFVTPL assets of £41m (2019 - £36m) and HFT liabilities of £128m (2019 - £56m) have been excluded from the following tables.

7. Financial instruments- maturity analysis (continued)

2020	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Assets by contractual maturity						
Cash and balances at central banks	13,531	-	-	-	-	-
Loans to banks - amortised costs	1,204	-	-	-	-	-
Loans to customers - amortised costs	1,755	3,342	4,970	1,081	719	1,351
Amounts due from holding companies and fellow subsidiaries	546	100	-	-	-	-
Other financial assets	527	833	1,361	945	1,413	665
Liabilities by contractual maturity						
Bank deposits	3	-	-	-	-	-
Customer deposits	30,673	606	3	-	-	-
Other financial liabilities	35	507	-	-	-	-
Lease liabilities	1	4	9	8	11	13
Amounts due to holding companies and fellow subsidiaries	298	24	-	-	-	-
Guarantees and commitments notional amount						
Guarantees[1]	198	-	-	-	-	-
Commitments[2]	9,444	-	-	-	-	-

2019	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Assets by contractual maturity	-	-	-	-	-	-
Cash and balances at central banks	10,617	-	-	-	-	-
Derivatives	21	8	6	1	-	-
Loans to banks - amortised costs	1,337	-	-	-	-	-
Loans to customers - amortised costs	2,440	3,781	4,231	1,404	874	1,412
Amounts due from holding companies and fellow subsidiaries	933	123	-	-	-	-
Other financial assets	1,413	480	1,534	850	1,043	-
Liabilities by contractual maturity						
Bank deposits	14	-	-	-	-	-
Customer deposits	29,035	1,102	6	-	-	-
Derivatives	17	10	8	3	5	9
Other financial liabilities	-	-	-	-	-	-
Lease liabilities	1	4	10	9	12	15
Amounts due to holding companies and fellow subsidiaries	260	19	-	-	-	-
Guarantees and commitments notional amount						
Guarantees[1]	196	-	-	-	-	-
Commitments[2]	6,391	-	-	-	-	-

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.

7. Financial instruments- maturity analysis (continued)

The Bank's financial assets and liabilities include:

	2020 £m	2019 £m
Reverse repos		
Loans to banks - amortised costs	1,017	650
Repo		
Bank deposits	(1,017)	(650)
Loans to customers - amortized costs		
Central and local government	69	68
Service industries and business activities	11	6
Customer deposits		
Central and local government	(69)	(68)
Service industries and business activities	(11)	(6)

The above financial instruments are subject to IAS 32 (on balance sheet) netting arrangements or subject to enforceable master netting instruments and gives right to set off the financial asset against a financial liability due to same counterparty.

8. Loan impairment provisions

Loan exposure and impairment metrics

The table below summarises loans and related credit impairment measures within the scope of ECL framework.

	31 December 2020 £m	31 December 2019 £m
Loans - amortised cost		
Stage 1	12,143	14,815
Stage 2	2,215	545
Stage 3	211	121
Inter- group [1]	646	1,056
Total	15,215	16,537
Loans impairment provisions		
ECL provisions		
Stage 1	14	3
Stage 2	74	6
Stage 3	48	21
Total	136	30
ECL provision coverage [2,3]		
Stage 1 (%)	0.12	0.02
Stage 2 (%)	3.34	1.10
Stage 3 (%)	22.75	17.36
	0.93	0.19
Impairment losses/(releases)		
ECL charge	107	2
ECL loss rate - annualised (basis points) [4]	0.73	0.01
Amounts written off	3	5

Notes:
(1) Amounts due from holding companies and fellow subsidiaries (Inter-Group) are all considered as Stage 1.
(2) ECL provisions coverage is ECL provisions divided by loans - amortised cost.
(3) ECL provisions coverage and ECL loss rates are calculated on third party loans and related ECL provisions and charge respectively.
(4) ECL loss rate is calculated as annualised third party ECL charge divided by loans - amortised cost.
(5) The table shows gross loans only and excludes amounts that are outside the scope of the ECL framework. Other financial assets within the scope of the IFRS 9 ECL framework were cash and balances at central banks totalling £13.5bn (2019: £10.6 bn) and debt securities of £5.4bn (2019: £5.1bn).

8. Loan impairment provisions (continued)

Credit risk enhancement and mitigation
For information on Credit risk enhancement and mitigation held as security, refer to Risk management – credit risk.

Critical accounting estimates
The loan impairment provisions have been established in accordance with IFRS 9. Accounting policy 12 sets out how the expected loss approach is applied. At 31 December 2020, customer loan impairment provisions amounted to £136m (2019 £30m). 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.

The measurement of credit impairment under the IFRS expected loss model depends on management's assessment of any potential deterioration in the creditworthiness of the borrower, its modelling of expected performance and the application of economic forecasts. All three elements require judgments that are potentially significant to the estimate of impairment losses. For further information and sensitivity analysis, refer to Risk management note 17.

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

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

The general approach for the IFRS 9 LGD models is to leverage corresponding Basel LGD models with bespoke adjustments to ensure estimates are unbiased and where relevant forward-looking.

For Wholesale, while conversion ratios in the historical data show temporal variations, these cannot (unlike in the case of PD and some LGD models) be sufficiently explained by the Credit-Cycle Index ('CCI') measure and are presumed to be driven to a larger extent by exposure management practices. Therefore point-in-time best estimates measures for EAD are derived by estimating the regulatory model specification on a rolling five year window. For more details refer note 17.

Approach for multiple economic scenarios (MES)
The base scenario plays a greater part in the calculation of ECL than the approach to MES. This is discussed further in Note 17.

9. Other financial assets

	Debt securities					
	Central and local government				Equity	
	UK	US	Other	Total	shares	Total
2020	£m	£m	£m	£m	£m	£m
Fair value through other comprehensive income	1,155	501	139	1,795	1	1,796
Amortised cost	2,901	235	431	3,567	-	3,567
Total	4,056	736	570	5,362	1	5,363
2019						
Fair value through other comprehensive income	-	1,759	-	1,759	1	1,760
Amortised cost	2,945	241	123	3,309	-	3,309
	2,945	2,000	123	5,068	1	5,069

Other financial assets are made of debt securities in the following currencies:

Currency	S&P Risk Rating	Moody's Risk Rating	2020 £m	2019 £m
GBP	AA	Aa2	4,483	2,945
EUR	AAA	Aaa	116	123
USD	AA+	Aa1	763	2,000
			5,362	5,068

10. Property, plant and equipment

2020	Freehold premises £m	Short leasehold premises £m	Long leasehold premises £m	Computers and other equipment £m	Right of use property £m	Total £m
Cost or valuation						
At 1 January	28	4	2	96	70	200
Disposals	(2)	(2)	(2)	(16)	-	(22)
Additions [1]	-	-	-	14	2	16
At 31 December	26	2	-	94	72	194
Accumulated impairment, depreciation and amortisation:						
At 1 January	5	1	2	76	31	115
Disposals	-	(1)	(2)	(14)	-	(17)
Impairment losses	-	-	-	-	6	6
Charge for the year	1	-	-	6	5	12
At 31 December	6	-	-	68	42	116
Net book value at 31 December 2020	20	2	-	26	30	78

2019	Freehold premises £m	Short leasehold premises £m	Long leasehold premises £m	Computers and other equipment £m	Right of use property £m	Total £m
Cost or valuation						
At 1 January	22	3	3	90	-	118
Implementation of IFRS 16 on 1 January 2019 [2]	-	-	-	-	90	90
Transfers	5	-	-	3	-	8
Other adjustments [3]	-	-	-	-	(35)	(35)
Additions [1]	1	2	-	9	15	27
Disposals	-	(1)	(1)	(6)	-	(8)
At 31 December	28	4	2	96	70	200
Accumulated amortisation:						
At 1 January	4	-	2	75	-	81
Implementation of IFRS 16 on 1 January 2019 [2]	-	-	-	-	46	46
Transfers	1	-	-	3	-	4
Other adjustments [3]	-	-	-	-	(20)	(20)
Disposals	-	-	-	(6)	-	(6)
Depreciation charge for the year	-	1	-	4	5	10
At 31 December	5	1	2	76	31	115
Net book value at 31 December 2019	23	3	-	20	39	85

Notes:
(1) Additions to fixed assets include £4m (2019: £5m) of capital work in progress which represents costs incurred on fixed assets under development at the balance sheet date.
(2) Includes amount transferred from IOMB for plant and equipment of £19m and depreciation of £12m.
(3) Other adjustments relate to the surrender of the head lease for a property in Guernsey.
(4) Disposals of fixed assets in the year 2020 includes £22m of cost and £18m of accumulated depreciation that are related to closure of properties in Jersey and Isle of Man. This has resulted in £6m of impairment losses of the right to use assets.

11. Intangible assets

2020	Software development £m	Goodwill £m	Other intangibles[1] £m	Total £m
Cost:				
At 1 January	5	6	-	11
Additions	1	-	1	2
Disposals	(2)	-	-	(2)
At 31 December	4	6	1	11
Accumulated amortisation:				
At 1 January	4	-	-	4
Disposals	(2)	-	-	(2)
Charge for the year	1	-	-	1
At 31 December	3	-	-	3
Net book value at 31 December 2020	1	6	1	8

2019	Software development £m	Goodwill £m	Total £m
Cost:			
At 1 January and 31 December	5	6	11
Accumulated amortisation:			
At 1 January	3	-	3
Charge for the year	1	-	1
At 31 December	4	-	4
Net book value at 31 December 2019	1	6	7

The amortisation cost for the year was £763k (2019: £892k). The amortisation period for software development costs is 5 years. The amortisation is calculated using the straight-line method.

Note:
(1) The additions to other intangibles £1.2m (2019: nil) relates to costs of Cloud development.

12. Other assets

	2020 £m	2019 £m
Property plant and equipment (refer Note 10)	78	85
Prepayments	4	4
Accrued income	3	3
Other assets	1	1
Deferred Tax (refer Note 5)	3	7
Current taxation assets	16	-
Retirement benefit assets (refer Note 4)	173	147
	278	247

13. Other financial liabilities

	2020 £m	2019 £m
Debt securities in issue - amortised cost	542	-
	542	-

The above balance is related to 16 short term Euro debt securities issued in 2020 by the Bank and mature in 2021. These papers were issued at total premium of £2m.

14. Other liabilities

	2020	2019
	£m	£m
Accruals	10	13
Deferred income	51	51
Provisions for liabilities and charges	34	10
Current tax	-	23
Deferred tax (refer Note 5)	19	16
Other liabilities	1	4
Lease liabilities (refer Note 16)	40	43
	155	160

The following amounts are included within provisions:

	Property [1]	Restructuring [2]	Customer redress [3]	Other [4]	Total
	£m	£m	£m	£m	£m
At 1 January 2019	3	5	2	2	12
Transfer from IOMB	-	1	1	-	2
Charged to the income statement	1	5	-	-	6
Released during the year	-	(1)	-	(1)	(2)
Utilised in year	(3)	(5)	-	-	(8)
At 1 January 2020	1	5	3	1	10
Charged to the income statement	13	15	-	-	28
Released during the year	-	-	(3)	-	(3)
Other movements	-	-	-	5	5
Utilised in year	(1)	(5)	-	-	(6)
At 31 December 2020	13	15	-	6	34

(1) **Property provision**
The property provisions represent costs related to closure of properties.

(2) **Restructuring provision**
The restructuring provisions principally comprise redundancy costs. The Bank expects the majority of these provisions to be utilised within the next 12 months. Over the year, the bank has engaged with the trustees of the IOMB and IPT to arrange a merger of the IOMB schemes into the IPT. This merger is expected to complete during 2021. A provision of £2m (2019: nil) has been created to cover the costs of restructuring the pension schemes.

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

(4) **Other**
Other provisions is made up solely of ECL provisions on contingent liabilities and commitments, as calculated in accordance with IFRS 9.

Critical accounting policy: Provisions for liabilities

The key judgement is involved in determining whether an obligation exists. There is often a high degree of uncertainty and judgement is based on the specific facts and circumstances relating to individual events in determining whether there is a present obligation. Judgement is also involved in estimation of the probability, timing and amount of any outflows. Where the Bank 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. Any difference between the final outcome and the amounts provided will affect the reported results in the period when the matter is resolved.

15. Share capital and other equity

			Number of shares	
	2020	2019	2020	2019
Allotted, called up and fully paid	£m	£m	000s	000s
Equity shares:				
Ordinary shares of £1	97	97	96,540	96,540
	97	97	96,540	96,540

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

15. Share capital and other equity (continued)

Paid-in equity

Paid-in equity comprises equity instruments issued by the Bank to NatWest Group plc, other than those legally constituted as shares.

	31 December 2020 £m	31 December 2019 £m
Additional Tier 1 capital notes:		
£300m 6.604% notes repayable from September 2025	300	300
	300	300

The coupons on this instrument are non-cumulative and payable at the Company's discretion. In the event of winding up, any amounts outstanding on the loan will be subordinated. While taking the legal form of debt these notes are classified as equity under IFRS.

16. Leases

Lessee

The Bank is party to lease contracts as lessee to support its operations. The following table provides information in respect of those lease contracts as lessee.

	2020 £m	2019 £m
Amounts recognised in income statement		
Interest payable	1	1
Depreciation[1]	11	5
Rental expense on short leases	1	1
Losses from sale and lease back transactions	-	(2)

	2020 £m	2019 £m
Amounts recognised on Balance Sheet		
Right of use assets included in property, plant and equipment[2]	30	39
Additions to right of use assets	2	15
Lease Liabilities	(40)	(43)

Notes:
(1) Includes impairment of right of use assets of £6m (2019: nil).
(2) Includes right of use asset for plant and equipment of £72m (2019: £70m) and depreciation of £42m (2019: £31m)

Lessor

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

	2020 £m	2019 £m
Amounts included in income statement		
Finance leases		
Finance income on the net investment in leases	(5)	(5)

	2020 £m	2019 £m
Amount receivable under finance leases		
Within 1 year	18	11
1 to 2 years	11	18
2 to 3 years	19	11
3 to 4 years	6	19
4 to 5 years	6	6
After 5 years	35	41
Lease payments total	95	106
Unearned income	(23)	(28)
Present value of lease payments	72	78
Impairments	-	-
Net investment in finance leases	72	78

17. Risk management

Presentation of information
Risk management is generally conducted on an overall basis within NatWest Group and as such the common policies, procedures, frameworks and models apply across NatWest Group. The disclosures in this section discuss the NatWest Group risk management policies, procedures, frameworks and models as they apply to the Bank.

Update on COVID-19
The unprecedented challenge posed by the global pandemic – for families, businesses and governments around the world – also led to a number of significant risk management challenges. The Bank remained committed to supporting its customers while operating safely and soundly in line with its strategic objectives. Most notably, the credit risk profile was heightened as the Bank provided payment holidays during the crisis, and facilitated loans through the Disruption Guarantee Scheme (DGS) offered by the governments in Jersey, Guernsey, the Isle of Man and Gibraltar. This is detailed in the Credit risk section.

In addition, the Bank's operational risk profile became heightened for a time due to the need to adapt working methods and practices to large-scale working from home and the requirement to respond to the crisis – and provide customer support – at pace. The operational risk profile has now returned to normal levels.

As a result of its strong balance sheet and prudent approach to risk management, the Bank remains well placed to withstand the impacts of the pandemic as well as providing support to customers when they need it most.

Risk management framework
The Bank operates under NatWest Group's enterprise wide risk management framework, which is centred around the embedding of a strong risk culture. The framework ensures the governance, capabilities and methods are in place to facilitate risk management and decision-making across the organisation.

The framework ensures that the Bank's principal risks – which are detailed in this section – are appropriately controlled and managed. In addition, there is a process to identify and manage top risks, which are those which could have a significant negative impact on the Bank's ability to meet its strategic objectives. A complementary process operates to identify emerging risks. Both top and emerging risks are reported to the Board on a regular basis alongside reporting on the principal risks.

Risk appetite, supported by a robust set of principles, policies and practices, defines the levels of tolerance for a variety of risks and provides a structured approach to risk-taking within agreed boundaries.

All Bank colleagues share ownership of the way risk is managed, working together to make sure business activities and policies are consistent with risk appetite.

The methodology for setting, governing and embedding risk appetite is being further enhanced with the aim of revising current risk appetite processes and increasing alignment with strategic planning and external threat assessments.

Culture
Culture is at the centre of both the risk management framework and risk management practice. The target culture across the Bank is one in which risk is part of the way employees work and think. The target risk culture behaviours are aligned to the Bank's core values. They are embedded in Our Standards and therefore form an effective basis for risk culture since these are used for performance management, recruitment and development.

Training
A wide range of learning, both technical and behavioural, is offered across the risk disciplines. This training can be mandatory, role-specific or for personal development and enables colleagues to develop the capabilities and confidence to manage risk effectively.

Our Code
The Bank's conduct guidance Our Code provides direction on expected behaviour and sets out the standards of conduct that support the values. The code explains the effect of decisions that are taken and describes the principles that must be followed.

Three lines of defence
The Bank uses the industry-standard three lines of defence model to articulate accountabilities and responsibilities for managing risk. It supports the embedding of effective risk management throughout the organisation.

The first line of defence incorporates most roles in the Bank, including those in the customer-facing franchises, Technology and Services as well as support functions such as Human Resources, Legal and Finance. It is empowered to take risks within the constraints of the risk management framework and policies as well as the risk appetite statements and measures set by the Board. It is responsible for managing its direct risks. and it is also responsible for managing its consequential risks by identifying, assessing, mitigating, monitoring and reporting risks.

The second line of defence comprises the Risk function and is independent of the first line. It is empowered to design and maintain the risk management framework and its components. It undertakes proactive risk oversight and continuous monitoring activities to confirm that the Bank engages in permissible and sustainable risk-taking activities. It advises on, monitors, challenges, approves, escalates and reports on the risk-taking activities of the first line, ensuring that these are within the constraints of the risk management framework and policies as well as the risk appetite statements and measures set by the Board.

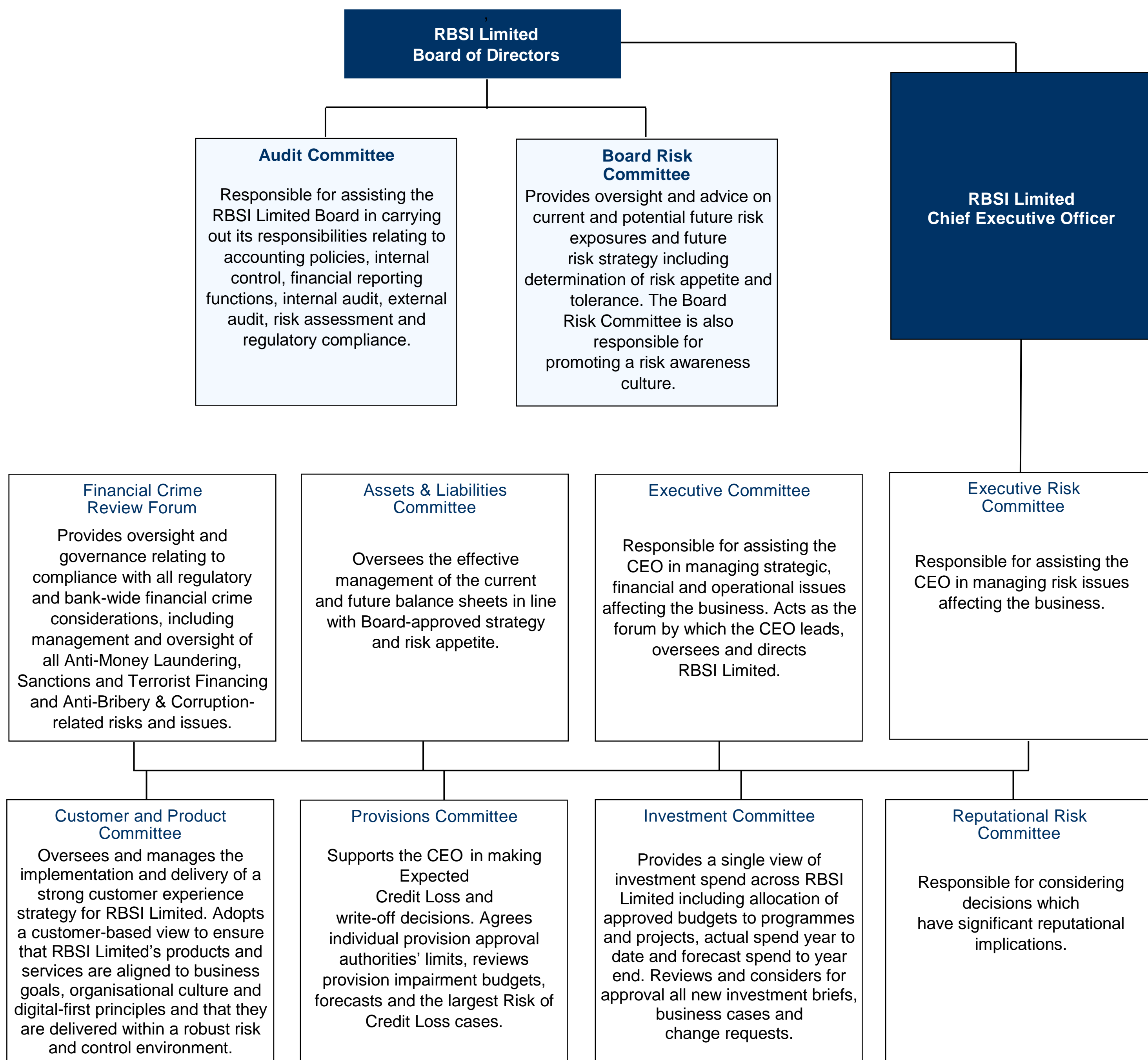
The third line of defence is the Internal Audit function and is independent of the first and second lines. It is responsible for providing independent and objective assurance to the Board, and executive management on the adequacy and effectiveness of key internal controls, governance and the risk management in place to monitor, manage and mitigate the key risks to the Bank. It executes its duties freely and objectively in accordance with the Institute of Internal Auditors' Code of Ethics & Standards.

17. Risk management (continued)

Governance

Committee structure

The diagram shows the Bank's risk committee structure in 2020 and the main purposes of each committee.

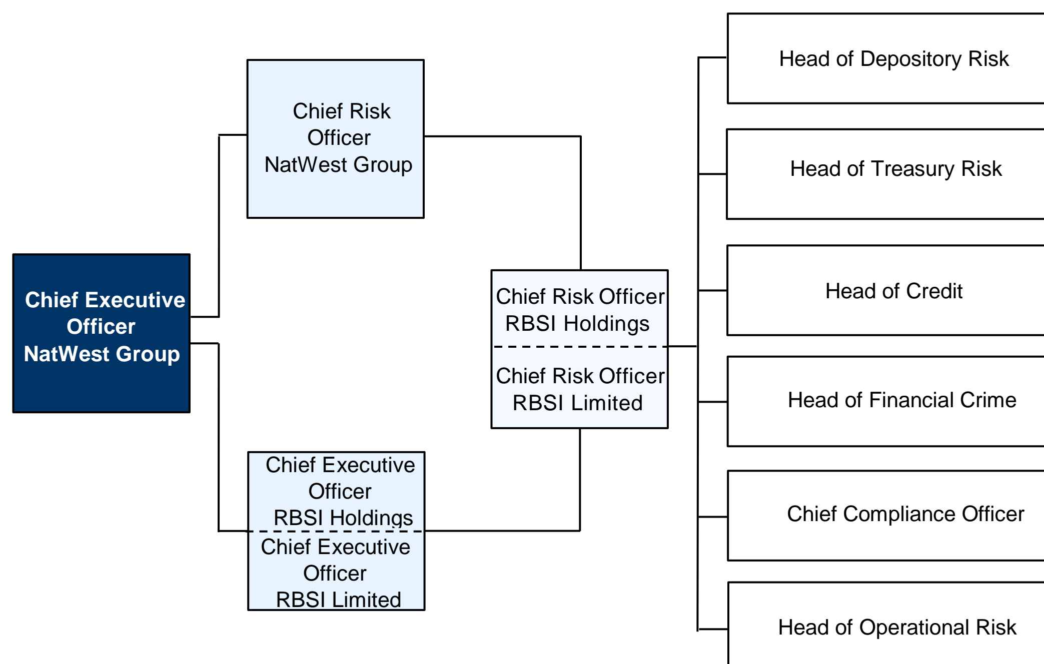


Notes:
(1) The Royal Bank of Scotland International Limited is one of the principal operating subsidiaries of RBSI Holdings.
(2) The chart does not show all management-level committees, only material committees which consider risk are shown.
(3) The NWH Group Risk function provides risk management services across NatWest Group, including – where agreed – to the RBSI Limited Chief Risk Officer. These services are managed, as appropriate, through service level agreements.

17. Risk management (continued)

Risk management structure

The diagram shows the Bank's risk management structure in 2020.



Notes:
(1) RBSI Limited is a wholly owned subsidiary of RBSI Holdings.
(2) The RBSI Limited Chief Risk Officer reports directly to i) the RBSI Limited Chief Executive Officer, who is also the RBSI Holdings Chief Executive Officer and ii) the NatWest Group Chief Risk Officer. There is an additional reporting line to the chair of the RBSI Limited Board Risk Committee, and a right of access to the committee.

Risk appetite

Risk appetite defines the level and types of risk that are acceptable, within risk capacity, in order to achieve strategic objectives and business plans. It links the goals and priorities to risk management in a way that guides and empowers staff to serve customers well and achieve financial targets.

The risk appetite framework, which is approved annually by the Board, bolsters effective risk management by promoting sound risk-taking through a structured approach, within agreed boundaries. It also ensures emerging risks and risk-taking activities that would be out of appetite are identified, assessed, escalated and addressed in a timely manner.

Risk appetite is maintained across the Bank through risk appetite statements. These provide clarity on the scale and type of activities that can be undertaken in a manner that is easily conveyed to staff.
The annual process of establishing risk appetite statements is completed alongside the business and financial planning process. This ensures plans and risk appetite are appropriately aligned. The Board sets risk appetite for the most material risks to help ensure the Bank is well placed to meet its priorities and long-term targets even in challenging economic environments. It is the basis on which the Bank remains safe and sound while implementing its strategic business objectives.

The Bank's risk profile is frequently reviewed and monitored and management focus is concentrated on all strategic risks, material risks and emerging risk issues. Risk profile relative to risk appetite is reported regularly to the Board and senior management.

Risk controls and their associated limits are an integral part of the risk appetite approach and a key part of embedding risk appetite in day-to-day risk management decisions. A clear tolerance for material risk types is set in alignment with business activities.

NatWest Group policies support the qualitative aspects of risk appetite. They ensure that appropriate controls are set and monitored.

Identification and measurement

Identification and measurement within the risk management process comprise:

- Regular assessment of the overall risk profile, incorporating market developments and trends, as well as external and internal factors.
- Monitoring of the risks associated with lending and credit exposures.
- Assessment of non-traded portfolios.
- Review of potential risks in new business activities and processes.
- Analysis of potential risks in any complex and unusual business transactions.

The financial and non-financial risks that the Bank faces are detailed in the Risk Directory. This provides a common risk language to ensure consistent terminology is used across NatWest Group. The Risk Directory is subject to annual review. This ensures that it continues to provide a comprehensive and meaningful list of the inherent risks within the Bank.

17. Risk management (continued)

Within the Bank, a 'Risk Universe' is produced to provide a legal entity view of the NatWest Group Risk Directory. This helps to acknowledge that there are some risks faced by the Bank that are not material at NatWest Group level and, conversely, there are risks that are more material to the NatWest Group than to the Bank directly.

Mitigation

Mitigation is an important aspect of ensuring that risk profile remains within risk appetite. Risk mitigation strategies are discussed and agreed within the Bank.

When evaluating possible strategies, costs and benefits, residual risks (risks that are retained) and secondary risks (those that are due to risk mitigation actions) are considered. Monitoring and review processes are in place to evaluate results. Early identification, and effective management, of changes in legislation and regulation are critical to the successful mitigation of compliance and conduct risk. The effects of all changes are managed to ensure the timely achievement of compliance. Those changes assessed as having a high or medium-high impact are managed more closely. Significant and emerging risks that could affect future results and performance are reviewed and monitored. Action is taken to mitigate potential risks as and when required. Further in-depth analysis, including the stress testing of exposures relative to the risk, is also carried out.

Testing and monitoring

Targeted credit risk, compliance & conduct risk and financial crime risk activities are subject to testing and monitoring to confirm to both internal and external stakeholders – including the Board, senior management, the customer-facing businesses, Internal Audit and the Bank's regulators – that policies and procedures are being correctly implemented and operating adequately and effectively. Selected key controls are also reviewed. Thematic reviews and deep dives are also carried out where appropriate.

The adequacy and effectiveness of selected key controls owned and operated by the second line of defence are also tested (with a particular focus on credit risk controls). Selected controls within the scope of Section 404 of the US Sarbanes-Oxley Act 2002, as well as selected controls supporting risk data aggregation and reporting, are also reviewed.

Anti-money laundering, sanctions, anti-bribery and corruption and tax evasion processes and controls are also tested and monitored. This helps provide an independent understanding of the financial crime control environment, whether or not controls are adequate and effective and whether financial crime risk is appropriately identified, managed and mitigated.

Stress testing – capital management

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

Stress testing includes:
- Scenario testing, which examines the impact of a hypothetical future state to define changes in risk factors.
- Sensitivity testing, which examines the impact of an incremental change to one or more risk factors.

The process for stress testing consists of four broad stages:

Stage	Activities
Define scenarios	• Identify specific Bank vulnerabilities and risks. • Define and calibrate scenarios to examine vulnerabilities and risks. • Formal governance process to agree scenarios.
Assess impact	• Translate scenarios into risk drivers. • Assess impact to current and projected P&L and balance sheet. • Impact assessment captures input from across the Bank.
Calculate results and assess implications	• Aggregate impacts into overall results. • Results form part of risk management process. • Scenario results are used to inform the Bank's business and capital plans.
Develop and agree management actions	• Scenario results are analysed by subject matter experts and appropriate management actions are then developed. • Scenario results and management actions are reviewed and agreed by senior management through executive committees, including the Executive Risk Committee, the Board Risk Committee and the Board.

Stress testing is used widely across NatWest Group. Specific areas that involve capital management include:
- *Strategic financial and capital planning* – by assessing the impact of sensitivities and scenarios on the capital plan and capital ratios.
- *Risk appetite* – by gaining a better understanding of the drivers of, and the underlying risks associated with, risk appetite.
- *Risk monitoring* – by monitoring the risks and horizon scanning events that could potentially affect NatWest Group's financial strength and capital position.
- *Risk mitigation* – by identifying actions to mitigate risks, or those that could be taken, in the event of adverse changes to the business or economic environment. Key risk mitigating actions are documented in the Bank's recovery plan.

Reverse stress testing is also carried out in order to identify circumstances that may lead to specific, defined outcomes such as business failure. Reverse stress testing allows potential vulnerabilities in the business model to be examined more fully.

Capital sufficiency – going concern forward-looking view

Going concern capital requirements are examined on a forward-looking basis – including as part of the annual budgeting process – by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states. These assessments include assumptions about regulatory and accounting factors (such as IFRS 9). They are linked to economic variables and impairments and seek to demonstrate that the Bank and its operating subsidiaries maintain sufficient capital. A range of future states are tested. In particular, capital requirements are assessed:
- Based on a forecast of future business performance, given expectations of economic and market conditions over the forecast period.
- Based on a forecast of future business performance under adverse economic and market conditions over the forecast period. Scenarios of different severity may be examined.

17. Risk management (continued)

The examination of capital requirements under normal economic and adverse market conditions enables the Bank to determine whether its projected business performance meets internal and regulatory capital requirements.

The examination of capital requirements under adverse economic and market conditions is assessed through stress testing. The results of stress tests are not only used widely across the Bank but also by the regulators to set specific capital buffers. The Bank takes part in stress tests run by regulatory authorities to test industry-wide vulnerabilities under crystallising global and domestic systemic risks.

Stress and peak-to-trough movements are used to help assess the amount of capital the Bank needs to hold in stress conditions in accordance with the capital risk appetite framework.

Internal assessment of capital adequacy

An internal assessment of material risks is carried out regularly to enable an evaluation of the amount, type and distribution of capital required to cover these risks. This is referred to as the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP consists of a point-in-time assessment of exposures and risks at the end of the financial year together with a forward-looking stress capital assessment. The ICAAP is approved by the Board and submitted to the Jersey Financial Services Commission (JFSC).

The ICAAP is used to form a view of capital adequacy separately to the minimum regulatory requirements. It is used by the JFSC to assess the Bank's specific capital requirements through the Pillar 2 framework.

Capital allocation

The Bank has mechanisms to allocate capital. These aim to optimise the use of capital resources taking into account applicable regulatory requirements, strategic and business objectives and risk appetite. The framework for allocating capital is approved by the Assets & Liabilities Committee.

Governance

Capital management is subject to substantial review and governance. The Board approves the capital plans, including those for key legal entities and businesses as well as the results of the stress tests relating to those capital plans.

Stress testing – liquidity

Liquidity risk monitoring and contingency planning

A suite of tools is used to monitor, limit and stress test the risks on the balance sheet. Limit frameworks are in place to control the level of liquidity risk, asset and liability mismatches and funding concentrations. Liquidity risks are reviewed at significant legal entity and business levels daily, with performance reported to the Assets & Liabilities Committee on a regular basis. Liquidity Condition Indicators are monitored daily. This ensures any build-up of stress is detected early and the response escalated appropriately using the Bank's recovery plan.

Internal assessment of liquidity

Under the liquidity risk management framework, the Bank maintains an Individual Liquidity Adequacy Assessment Process. This includes assessment of net stressed liquidity outflows under a range of extreme but plausible stress scenarios detailed in the table below.

Type	Description
Idiosyncratic scenario	The market perceives the Bank 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, potential counterparty failure and other market risks. The Bank is affected under this scenario but no more severely than any other participants with equivalent exposure.
Combined scenario	This scenario models the combined impact of an idiosyncratic and market stress occurring at once, severely affecting funding markets and the liquidity of some assets.

The Bank uses the most severe combination of these to set the internal stress testing scenario which underpins its internal liquidity risk appetite. This complements the regulatory liquidity coverage ratio requirement.

Stress testing – recovery and resolution planning

The recovery plan explains how the Bank would identify and respond to a financial stress event and restore its financial position so that it remains viable on an ongoing basis. The Bank has its own recovery plan which forms part of the overall NatWest Group plan.

The recovery plan ensures risks that could delay the implementation of a recovery strategy are highlighted and preparations are made to minimise the impact of these risks. Preparations include:

- Developing a series of recovery indicators to provide early warning of potential stress events.
- Clarifying roles, responsibilities and escalation routes to minimise uncertainty or delay.
- Developing a recovery playbook to provide a concise description of the actions required during recovery.
- Detailing a range of options to address different stress conditions.
- Appointing dedicated option owners to reduce the risk of delay and capacity concerns.
- Carrying out 'fire drills' to practice responding to recovery events.

The plan is intended to enable the Bank to maintain critical services and products it provides to its customers, maintain its core business lines and operate within risk appetite while restoring the Bank's financial condition. It is assessed for appropriateness on an ongoing basis and is updated annually. The plan is reviewed and approved by the Board prior to submission to the JFSC each year.

Resolution would be implemented if NatWest Group was assessed by the UK authorities to have failed and the appropriate regulator put it into resolution. The Bank (Recovery and Resolution) (Jersey) Law 2017 (the Law) has been registered by the Jersey Royal Court but is not yet in force. Once implemented, the Law will provide a new bank resolution regime for Jersey which is broadly consistent with the European Union Bank Recovery and Resolution Directive (2014/59) and the United Kingdom Banking Act 2009 (as amended). Specifically, it will establish the Jersey Resolution Authority which will be granted administrative powers to stabilise and/or resolve distressed banks.

17. Risk management (continued)

Stress testing – non-traded market risk

The Bank produces an internal scenario analysis as part of its financial planning cycles.

Non-traded exposures are capitalised through the ICAAP. This covers gap risk, basis risk, credit spread risk, pipeline risk, structural foreign exchange risk, prepayment risk, equity risk and accounting volatility risk. The ICAAP is completed with a combination of value and earnings measures. The total non-traded market risk capital requirement is determined by adding the different charges for each sub risk type. The ICAAP methodology captures at least ten years of historical volatility, produced with a 99% confidence level. Methodologies are reviewed by NatWest Group Model Risk and the results are approved by the NatWest Group Technical Asset & Liability Management Committee.

Credit risk

Definition

Credit risk is the risk that customers and counterparties fail to meet their contractual obligation to settle outstanding amounts.

Sources of risk

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

The Bank also has exposure to the Bank of England, the Central Bank of Luxembourg, US correspondent banks and to the UK, US and various eurozone governments through holding government bonds in its liquid asset portfolio. These exposures are also reviewed by the Board of Directors.

Governance

- The Credit Risk function provides oversight of frontline credit risk management activities. Governance activities include:
- Defining credit risk appetite for the management of concentration risk and credit policy to establish the key causes of risk in the process of providing credit and the controls that must be in place to mitigate them.
- Approving and monitoring credit limits.
- Oversight of the first line of defence to ensure that credit risk remains within the appetite set by the Board and that controls are being operated adequately and effectively.
- Assessing the adequacy of expected credit loss (ECL) provisions including approving any necessary in-model and post model adjustments through the Provisions Committee.

Risk appetite

Credit risk appetite aligns to the strategic risk appetite set by the Board and is set and monitored through risk appetite frameworks.

Personal

The Personal credit risk appetite framework sets limits that measure and control the quality and concentration of both existing and new business for each relevant business segment. The actual performance of each portfolio is tracked relative to these limits and management action is taken where necessary. In the Bank, the limits specifically measure exposure, new business growth and expected loss.

Wholesale

For Wholesale credit, the framework has been designed to reflect factors that influence the ability to operate within risk appetite. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the framework and risk appetite limits.

Four formal frameworks are used, classifying, measuring and monitoring credit risk exposure across single name, sector and country concentrations and product and asset classes with heightened risk characteristics.

The framework is supported by a suite of transactional acceptance standards that set out the risk parameters within which businesses should operate.

Credit policy standards are in place for both the Wholesale and Personal portfolios. They are expressed as a set of mandatory controls.

Identification and measurement

Credit stewardship

Risks are identified through relationship management and credit stewardship of customers and portfolios. Credit risk stewardship takes place throughout the customer relationship, beginning with the initial approval. It includes the application of credit assessment standards, credit risk mitigation and collateral, ensuring that credit documentation is complete and appropriate, carrying out regular portfolio or customer reviews and problem debt identification and management. Additional stewardship measures were put in place in response to COVID-19. Refer to the Impact of COVID-19 section for further details.

Asset quality

All credit grades map to an asset quality scale, used for financial reporting. Performing loans are defined as AQ1-AQ9 (where the probability of default (PD) is less than 100%) and defaulted non-performing loans as AQ10 or Stage 3 under IFRS 9 (where the PD is 100%). Loans are defined as defaulted when the payment status becomes 90 days past due, or earlier if there is clear evidence that the borrower is unlikely to repay, for example bankruptcy or insolvency.

Counterparty credit risk

The Bank mitigates counterparty credit risk through collateralisation and netting agreements, which allow amounts owed by the Bank to a counterparty to be netted against amounts the counterparty owes the Bank.

Mitigation

Mitigation techniques, as set out in the appropriate credit policies and transactional acceptance standards, are used in the management of credit portfolios across the Bank. These techniques 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 can include structuring a security interest in a physical or financial asset, the use of credit derivatives including credit default swaps, credit-linked debt instruments and securitisation structures, and the use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Property is used to mitigate credit risk across a number of portfolios, in particular residential mortgage lending and commercial real estate (CRE).

The valuation methodologies for collateral in the form of residential mortgage property and CRE are detailed below.

Residential mortgages – The Bank takes collateral in the form of residential property to mitigate the credit risk arising from mortgages. The Bank values residential property during the loan underwriting process by appraising properties individually.

Commercial real estate valuations – The Bank has a panel of chartered surveying firms that cover the spectrum of geography and property sectors in which the Bank takes collateral. Suitable valuers for particular assets are contracted through a single service agreement to ensure consistency of quality and advice. Valuations are generally commissioned when an asset is taken as security; a material increase in a facility is requested; or a default event is anticipated or has occurred.

17. Risk management (continued)

Credit risk continued

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 Personal and Wholesale portfolios.

Personal

Personal customers are served through a lending approach that entails offering a large number of small-value loans. To ensure that these lending decisions are made consistently, the Bank analyses internal credit information as well as external data supplied by credit reference agencies (including historical debt servicing behaviour of customers with respect to both the Bank and other lenders). The Bank then sets its lending rules accordingly, developing different rules for different products.

The process is then largely automated, with each customer receiving an individual credit score that reflects both internal and external behaviours and this score is compared with the lending rules set. For relatively high-value, complex personal loans, including residential mortgage lending, credit managers make the final lending decisions. These decisions are made within specified delegated authority limits that are issued dependent on the experience of the individual.

Underwriting standards and portfolio performance are monitored on an ongoing basis to ensure they remain adequate in the current market environment and are not weakened materially to sustain growth.

Wholesale

Wholesale customers are grouped by industry sectors and geography as well as by product/asset class and are managed on an individual basis. Customers are aggregated as a single risk when sufficiently interconnected.

A credit assessment is carried out before credit facilities are made available to customers. The assessment process is dependent on the complexity of the transaction. Credit approvals are subject to environmental, social and governance risk policies which restrict exposure to certain highly carbon intensive industries as well as those with potentially heightened reputational impacts.

Transactional acceptance standards provide detailed transactional lending and risk acceptance metrics and structuring guidance. As such, these standards provide a mechanism to manage risk appetite at the customer/transaction level and are supplementary to the established credit risk appetite.

PD and loss given default (LGD) are reviewed and if appropriate re-approved annually. The review process assesses borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; compliance with terms and conditions; and refinancing risk.

Problem debt management

Personal

Early problem identification

Pre-emptive triggers are in place to help identify customers that may be at risk of being in financial difficulty. These triggers are both internal, using the Bank's data, and external using information from credit reference agencies. Proactive contact is then made with the customer to establish if they require help with managing their finances. By adopting this approach, the aim is to prevent a customer's financial position deteriorating which may then require intervention from the Collections and Recoveries teams.

Personal customers experiencing financial difficulty are managed by the Collections team. If the Collections team is unable to provide appropriate support after discussing suitable options with the customer, management of that customer moves to the Recoveries team. If at any point in the collections and recoveries process the customer is determined as being potentially vulnerable, they will be identified as such and provided support by suitably experienced colleagues, to ensure they receive the appropriate support for their circumstances.

Collections

When a customer exceeds an agreed limit or misses a regular monthly payment the customer is contacted by the Bank and requested to remedy the position. If the situation is not regularised then, where appropriate, the Collections team will become more fully involved and the customer will be supported by skilled debt management staff who endeavour to provide customers with bespoke solutions. Solutions include short-term account restructuring, refinance loans and forbearance which can include interest suspension and 'breathing space'. In the event that an affordable/sustainable agreement with a customer cannot be reached, the debt will transition to the Recoveries team. For provisioning purposes, under IFRS 9, exposure to customers managed by the Collections team is categorised as Stage 2 and subject to a lifetime loss assessment, unless it is 90 days past due or has an interest non-accrual status, in which case it is categorised as Stage 3.

Recoveries

The Recoveries team will issue a notice of intention to default to the customer and, if appropriate, a formal demand, while also registering the account with credit reference agencies where appropriate. Following this, the customer's debt may then be placed with a third-party debt collection agency, or alternatively a solicitor, in order to agree an affordable repayment plan with the customer. An option that may also be considered is the sale of unsecured debt. Exposures subject to formal debt recovery are defaulted and categorised as Stage 3 impaired.

Wholesale

Early problem identification

Each sector has defined early warning indicators to identify customers experiencing financial difficulty, and to increase monitoring if needed. Early warning indicators may be internal, such as a customer's bank account activity, or external, such as a publicly-listed customer's share price. If early warning indicators 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 the Risk of Credit Loss framework.

Risk of Credit Loss framework

The Risk of Credit Loss framework is used where the credit profile of a Wholesale customer has deteriorated materially since origination. Experienced credit risk officers apply expert judgement to classify cases into categories that reflect progressively deteriorating credit risk. There are two classifications in the framework that apply to non-defaulted customers – Heightened Monitoring and Risk of Credit Loss. For the purposes of provisioning, all exposures subject to the framework are categorised as Stage 2 and subject to a lifetime loss assessment. The framework also applies to those customers that have met the Bank's default criteria (AQ10 exposures). Defaulted exposures are categorised as Stage 3 impaired for provisioning purposes.

Customers classified in the Heightened Monitoring category are those who are still performing but have certain characteristics – such as trading issues, covenant breaches, material PD downgrades and past due facilities – that may affect the ability to meet repayment obligations. Heightened Monitoring customers require pre-emptive actions to return or maintain their facilities within risk appetite prior to maturity.

Risk of Credit Loss customers are performing customers that have met the criteria for Heightened Monitoring and also pose a risk of credit loss to the Bank in the next 12 months should mitigating action not be taken or not be successful.

17. Risk management (continued)

Credit risk continued

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

Restructuring

Where customers are categorised as Risk of Credit Loss, relationships are mainly managed by the Restructuring team. The purpose of Restructuring is to protect the Bank's capital. Restructuring does this by working with customers in financial difficulty on their restructuring and repayment strategies. Restructuring will always aim to recover capital fairly and efficiently.

Specialists in Restructuring work with customers experiencing financial difficulties and showing signs of financial stress. Throughout Restructuring's involvement, the mainstream relationship manager will remain an integral part of the customer relationship, unless a repayment strategy is deemed appropriate. The objective is to find a mutually acceptable solution, including restructuring of existing facilities, repayment or refinancing.

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

Forbearance

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

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

A credit exposure may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms.
In the Personal portfolio, loans are reported as 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 loan/debt being less than 30 days past due.

Types of forbearance

Personal

In the Personal portfolio, forbearance may involve payment concessions and loan rescheduling (including extensions in contractual maturity) and capitalisation of arrears. Forbearance support is provided for both mortgages and unsecured lending.

Wholesale

In the Wholesale portfolio, forbearance may involve covenant waivers, reductions to margins, payment concessions and loan rescheduling (including extensions in contractual maturity), capitalisation of arrears, and debt forgiveness or debt-for-equity swaps.

Monitoring of forbearance

Personal

For Personal portfolios, forborne loans are separated and regularly monitored and reported while the forbearance strategy is implemented, until they exit forbearance.

Wholesale

In the Wholesale portfolio, customer PDs and facility LGDs are reassessed prior to finalising any forbearance arrangement. The ultimate outcome of a forbearance strategy is highly dependent on the co-operation of the borrower and a viable business or repayment outcome. Where forbearance is no longer appropriate, the Bank will consider other options such as the enforcement of security, insolvency proceedings or both, although these are options of last resort.

Provisioning requirements on forbearance are detailed in the Provisioning for forbearance section.

Impact of COVID-19

COVID-19 has necessitated various changes to the "business as usual" credit risk management approaches set out above. Specific adjustments made to credit risk management as a result of COVID-19 are set out below.

Risk appetite

Personal

The onset of COVID-19 resulted in a significant deterioration in the economic outlook and consequently the credit environment. In response, credit risk appetite was tightened including changes to credit score acceptance thresholds and certain credit policy criteria, for example, maximum loan-to-values on new mortgage business. The criteria were reviewed and adapted on an ongoing basis throughout the year.

Wholesale

At the outset of COVID-19, Wholesale Credit Risk undertook a vulnerability assessment of sectors and conducted more frequent monitoring of these portfolios, including sub-sector and single name analysis. Additional oversight forums for both new and existing customer requests linked to sector, customer viability and transaction value were also introduced. Monitoring of government support scheme lending, including tracking customer lending journeys to prioritise resources, ensured customers could be supported in a timely manner. Risk appetite limits were reduced to reflect current risks and remain under constant review.

Credit stewardship

Wholesale

The Bank's credit stewardship included carrying out regular portfolio or customer reviews and problem debt identification and management.

In line with existing credit policy parameters, relationship managers were able to defer annual reviews for a maximum of three months. These deferrals were used during 2020 to provide capacity to focus on supporting government lending scheme requests. Customer review meetings took place virtually unless a specific customer request was made, prior approval obtained and a risk assessment carried out.

Mitigation

During COVID-19, valuers were prohibited from conducting physical property inspections. As a result, mortgage application processing was suspended where a physical valuation was required. Following the easing of restrictions, the application backlog was cleared once valuers were able to safely return to physical property inspections.

Assessment and monitoring

Personal

Reflecting the deteriorated economic outlook, underwriting standards were tightened.

Customers requesting a COVID-19 related payment holiday were not subject to a credit assessment for those requests.

Portfolio performance monitoring was expanded to include insight on customers accessing payment holiday support and their performance at the end of the payment holiday.

17. Risk management (continued)

Credit risk continued

Wholesale
The Bank established guidance on credit grading in response to COVID-19 to ensure consistent and fair outcomes for customers, whilst appropriately reflecting the economic outlook.

- Within the Wholesale portfolio, customer credit grades were reassessed when a request for financing was made, a scheduled customer credit review undertaken or a material event specific to that customer occurred.
- A request for support using one of the government-backed COVID-19 support schemes was not, in itself, a reason for a customer's credit grade to be amended.
- Large or complex customers were graded using financial forecasts, incorporating both the effect of COVID-19 and the estimated length of time to return to within credit appetite metrics.
- All other customers who were not subject to any wider significant increase in credit risk (SICR) triggers and who were assessed as having the ability in the medium-term post-COVID-19 to be viable and meet credit appetite metrics, were graded using financial information for the previous 12 month period.
- The Bank identified those customers for whom additional borrowing would require remedial action to return to within risk appetite over the medium term, and customers who were exhibiting signs of financial stress before COVID-19. These customers were graded with reference to the impact COVID-19 had on their business.

Within the Wholesale portfolio, additional monitoring was implemented to identify and monitor specific sectors which had been particularly adversely affected by COVID-19 and the use of government support schemes.

Problem debt management

Personal
In accordance with regulatory guidance, Personal customers were able to obtain a payment holiday of up to three months, twice, if requested. Such payment holidays would not necessarily have been considered forbearance (refer to Forbearance below).

In addition, the Bank suspended new formal repossession recovery action for Personal customers.

Wholesale
In response to COVID-19, a new framework was introduced to categorise clients in a consistent manner across the Wholesale portfolio, based on the impact of COVID-19 on their financial position and outlook in relation to the sector risk appetite. This framework was extended to all Wholesale customers and supplemented the Risk of Credit Loss framework in assessing whether customers exhibited a SICR, and if support was considered to be granting forbearance.

Forbearance

Personal
In the absence of any other forbearance or SICR triggers, customers granted COVID-19 related payment holidays were not considered forborne and were not subject to Collections team engagement.

Wholesale
Customers seeking COVID-19 related support, including payment holidays, who were not subject to any wider SICR triggers and who were assessed as having the ability in the medium term post-COVID-19 to be viable and meet credit appetite metrics, were not considered to have been granted forbearance.

ECL modelling

The unprecedented nature of COVID-19 required various interventions in ECL modelling to ensure reasonable and supportable ECL estimates. These are detailed in the Governance and post model adjustments section.

Credit grading models

Credit grading models is the collective term used to describe all models, frameworks and methodologies used to calculate PD, exposure at default (EAD), LGD, maturity and the production of credit risk. Credit grading models are designed to provide:

- An assessment of customer and transaction characteristics.
- A meaningful differentiation of credit risk.
- Accurate internal default, loss and EAD estimates that are used in the capital calculation or wider risk management purposes.

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 approach that the Bank adopts in relation to the calculation of ECL within Personal includes the use of PD and LGD benchmarks. Refer to Personal non-modelled portfolio for further details.

The Bank's IFRS 9 provisioning models, which used existing Basel models as a starting point, incorporate term structures and forward-looking information. Regulatory conservatism within the Basel models has been removed as appropriate to comply with the IFRS 9 requirement for unbiased ECL estimates.

Five key areas may materially influence the measurement of credit impairment under IFRS 9 – two of these relate to model build and three relate to model 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 models which are reviewed annually).
- The build of term structures to extend the determination of the risk of loss beyond 12 months that will influence the impact of lifetime loss for assets in Stage 2.

Model application:

- The assessment of the SICR and the formation of a framework capable of consistent application.
- The determination of asset lifetimes that reflect behavioural characteristics while also representing management actions and processes (using historical data and experience).
- The choice of forward-looking economic scenarios and their respective probability weights.

IFRS 9 ECL model design principles

Modelling of ECL for IFRS 9 follows the conventional approach to divide the problem of estimating credit losses for a given account into its component parts of PD, LGD and EAD.

To meet IFRS 9 requirements, the PD, LGD and EAD parameters differ from their Pillar 1 internal ratings based counterparts in the following aspects:

- Unbiased – material regulatory conservatism has been removed from IFRS 9 parameters to produce unbiased estimates.
- Point-in-time – IFRS 9 parameters reflect actual economic conditions at the reporting date instead of long-run average or downturn conditions.
- Forward-looking – IFRS 9 PD estimates and, where appropriate, EAD and LGD estimates reflect forward-looking economic conditions.
- Tenor – IFRS 9 PD, LGD and EAD are provided as multi-period term structures up to exposure lifetimes instead of a fixed one-year horizon.

17. Risk management (continued)

Credit risk 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 PD over the remaining lifetime at the reporting date) 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.

PD estimates

Wholesale PD models use a point-in-time/through-the-cycle framework to convert one-year regulatory PDs into point-in-time estimates that accurately reflect economic conditions observed at the reporting date. The framework utilises credit cycle indices (CCIs) across a comprehensive set of region/industry segments. Further detail on CCIs is provided in the Economic loss drivers section.

One year point-in-time PDs are subsequently extended to forward-looking lifetime PDs using a conditional transition matrix approach and a set of econometric models.

LGD estimates

The general approach for the IFRS 9 LGD models is to leverage corresponding Basel LGD models with bespoke adjustments to ensure estimates are unbiased and where relevant, forward-looking.

Forward-looking economic information is incorporated into Wholesale LGD estimates using the existing CCI framework. For low default portfolios, including sovereigns and banks, loss data is too scarce to substantiate estimates that vary with economic conditions. Consequently, for these portfolios, LGD estimates are assumed to be constant throughout the projection horizon.

EAD estimates

Personal

EAD is calculated as the maximum of the balance exposure, or limit which has been factored up by a credit conversion factor sourced from the benchmarked modelled portfolio.

Wholesale

For Wholesale, EAD values are projected using product specific credit conversion factors (CCFs), closely following the product segmentation and approach of the respective Basel model. However, the CCFs are estimated over multi-year time horizons to produce unbiased model estimates.

No explicit forward-looking information is incorporated, on the basis that analysis has shown that temporal variations in CCFs are mainly attributable to changes in exposure management practices rather than economic conditions.

Governance and post model adjustments

The IFRS 9 PD, EAD and LGD models are subject to NatWest Group's model risk policy that stipulates periodic model monitoring, periodic re-validation and defines approval procedures and authorities according to model materiality. Various post model adjustments (PMAs) were applied where management judged they were necessary to ensure an adequate level of overall ECL provision. All PMAs were subject to formal approval through provisioning governance, and were categorised as follows:

- Deferred model calibrations – ECL adjustments where model monitoring indicated that losses were being over predicted but where it was judged that an implied ECL release was not supportable. As a consequence, any potential ECL release was deferred and retained on the balance sheet.
- Economic uncertainty – ECL adjustments primarily arising from uncertainties associated with multiple economic scenarios (also for 2019) and credit outcomes as a result of the effect of COVID-19 and the consequences of government interventions. In both cases, management judged that additional ECL was required until further credit performance data became available on the behavioural and loss consequences of COVID-19.
- Other adjustments – ECL adjustments where it was judged that the modelled ECL required to be amended.

ECL post model adjustments	2020 £m	2019 £m
Deferred model calibrations	—	—
Economic uncertainty	7.1	1.3
Other adjustments	3.1	4.3
Total	10.2	5.6

Significant increase in credit risk (SICR)

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 Bank has adopted a framework to identify deterioration based primarily on relative movements in lifetime PD supported by additional qualitative backstops. The principles applied are consistent across the Bank and align to credit risk management practices, where appropriate.

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 SICR subject to a minimum PD uplift of 0.1%. For Personal portfolios, the criteria vary by risk band, with lower risk exposures needing to deteriorate more than higher risk exposures.

- Qualitative high-risk backstops – the PD assessment is complemented with the use of qualitative high-risk backstops to further inform whether significant deterioration in lifetime risk of default has occurred. The qualitative high-risk backstop assessment includes the use of the mandatory 30+ days past due backstop, as prescribed by IFRS 9 guidance, and other features such as forbearance support, Wholesale exposures managed within the Risk of Credit Loss framework, and adverse credit bureau results for Personal customers. Where a Personal customer was granted a payment holiday (also referred to as a payment deferral) in response to COVID-19, they were not automatically transferred into Stage 2. Wholesale customers accessing the various COVID-19 support mechanisms were assessed as detailed in the Impact of COVID-19 section.

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.

17. Risk management (continued)

Credit risk continued

Provisioning for forbearance

Personal

The methodology used for provisioning in respect of Personal forborne loans will differ depending on whether the loans are performing or non-performing and which business is managing them due to local market conditions.

Granting forbearance will only change the arrears status of the loan in specific circumstances, which can include capitalisation of principal and interest in arrears, where the loan may be returned to the performing book if the customer has demonstrated an ability to meet regular payments and is likely to continue to do so.

The loan would continue to be reported as forborne until it meets the exit criteria set out by the European Banking Authority.

For ECL provisioning, all forborne but performing exposures are categorised as Stage 2 and are subject to a lifetime loss provisioning assessment.

For non-performing forborne loans, the Stage 3 loss assessment process is the same as for non-forborne loans.

In the absence of any other forbearance or SICR triggers, customers granted COVID-19 related payment holidays were not considered forborne. However, any support provided beyond completion of a second payment holiday is considered forbearance.

Wholesale

Provisions for forborne loans are assessed in accordance with normal provisioning policies. The customer's financial position and prospects – as well as the likely effect of the forbearance, including any concessions granted, and revised PD or LGD gradings – are considered in order to establish whether an impairment provision increase is required.

Wholesale loans granted forbearance are individually assessed in most cases. Performing loans subject to forbearance treatment are categorised as Stage 2 and subject to a lifetime loss assessment.

Forbearance may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows. This difference will lead to a customer being classified as non-performing.

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

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

Customers seeking COVID-19 related support, including payment holidays, who were not subject to any wider SICR triggers and who were assessed as having the ability in the medium term post-COVID-19 to be viable and meet credit appetite metrics, were not considered to have been granted forbearance. Refer to the Impact of COVID-19 section for further details.

Asset lifetimes

The choice of initial recognition and asset duration 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 that time provides the baseline used for subsequent determination of SICR as detailed above. For asset duration, the approach applied for term lending (in line with IFRS 9 requirements) is the contractual maturity date, reduced for behavioural trends where appropriate (such as, expected prepayment and amortisation).

Personal non-modelled portfolio

RBSI Personal remains Basel standardised for risk-weighted assets, therefore modelled PDs and LGDs are not available for calculating Stage 1 and Stage 2 ECLs. Instead, this is performed by sourcing the equivalent product PD and LGD from within NatWest UK, which was identified as the closest comparable portfolio to RBSI Personal. The PD and LGD benchmarks are then used, along with the known exposure, to calculate an account level ECL.

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

Economic loss drivers

Introduction

The portfolio segmentation and selection of economic loss drivers for IFRS 9 follow closely the approach used in stress testing. To enable robust modelling the forecasting models for each portfolio segment (defined by product or asset class and where relevant, industry sector and region) are based on a selected, small number of economic factors, (typically three to four) that best explain the temporal variations in portfolio loss rates. The process to select economic loss drivers involves empirical analysis and expert judgement.

The most material economic loss drivers for Personal portfolios include unemployment rate, house price index, and base rate for the UK, including the Crown Dependencies, Isle Of Man and Gibraltar.

In addition to some of these loss drivers, world GDP is a primary loss driver for Wholesale portfolios.

Economic scenarios

As at 31 December 2020, the range of anticipated future economic conditions was defined by a set of four internally developed scenarios and their respective probabilities. They comprised upside, base case, downside and extreme downside scenarios. The scenarios primarily reflect a range of outcomes for the path of COVID-19 and associated effects on labour and asset markets. The scenarios were consistent with the UK-EU Trade and Cooperation Agreement and are summarised as follows:

Upside – This scenario assumes a very strong recovery through 2021, facilitated by a very rapid rollout of the vaccine. Economic output regains its pre-COVID-19 peak by the end of the year. The rebound in consumer spending from an easing in lockdown restrictions is rapid, enabling a more successful reabsorption of furloughed labour compared to the base case. That limits the rise in unemployment. Consequently, the effect on asset prices is more limited compared to the base case.

Base case – The current lockdown restrictions are gradually loosened enabling a recovery over the course of 2021. The rollout of the vaccines proceeds as planned.

17. Risk management (continued)

Credit risk continued

Consumer spending rebounds as accumulated household savings are spent, providing support to the recovery in consumer-facing service sectors. Unemployment rises through to the second half of 2021, peaking at 7%, before gradually retreating. Housing activity slows in the second half of 2021 with a very limited decline in prices.

Downside – This scenario assumes the rollout of the COVID-19 vaccine is slower compared to base case, leading to a more sluggish recovery. Business confidence is slower to return while households remain more cautious. This scenario assumes that the labour market and asset market damage is greater than in the base case. Unemployment peaks at 9.4%, surpassing the financial crisis peak and causing more scarring.

Extreme downside – This scenario assumes a new variant of COVID-19 necessitates a new vaccine, which substantially slows the speed of rollout, prolonging the recovery. There is a renewed sharp downturn in the economy in 2021. Firms react by shedding labour in significant numbers, leading to a very difficult recovery with the unemployment rate surpassing the levels seen in the 1980s. There are very sharp declines in asset prices. The recovery is tepid throughout the five-year period, meaning only a gradual decline in joblessness.

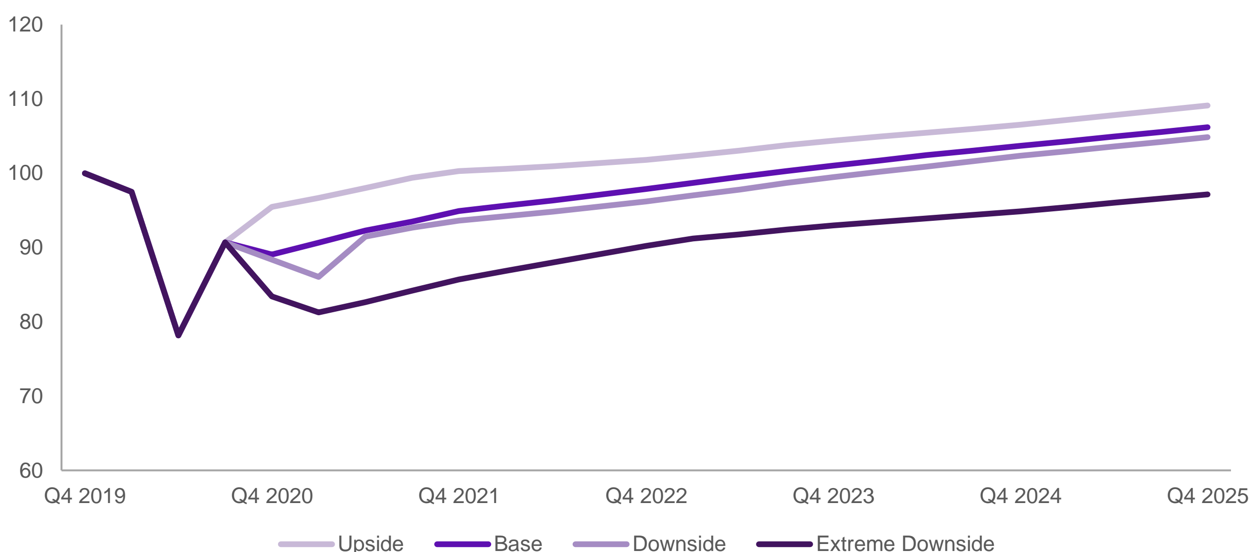
In contrast, as at 31 December 2019, the Bank used five discrete scenarios to characterise the distribution of risks in the economic outlook. For 2020, the four scenarios were deemed appropriate in capturing the uncertainty in economic forecasts and the non-linearity in outcomes under different scenarios. These four scenarios were developed to provide sufficient coverage across potential rises in unemployment, asset price falls and the degree of permanent damage to the economy, around which there are pronounced levels of uncertainty at this stage.

The tables and commentary below provide details of the key economic loss drivers under the four scenarios.

The main macroeconomic variables for each of the four scenarios used for ECL modelling are set out in the main macroeconomic variables table below. The compound annual growth rate (CAGR) for GDP is shown. It also shows the five-year average for unemployment and the Bank of England base rate. The House Price Inflation and commercial real estate figures show the total change in each asset over five years.

Main macroeconomic variables	2020				2019				
	Upside	Base case	Downside	Extreme downside	Upside 2	Upside 1	Base case	Downside 1	Downside 2
Five-year summary	%	%	%	%	%	%	%	%	%
UK									
GDP - CAGR	3.6	3.1	2.8	1.3	2.5	2.3	1.6	1.3	0.9
Unemployment - average	4.4	5.7	7.1	9.7	3.6	3.9	4.4	4.6	5.2
House Price Inflation - total change	12.5	7.6	4.4	(19.0)	22.4	17.6	8.3	4.0	(5.1)
Bank of England base rate - average	0.2	—	(0.1)	(0.5)	1.0	0.7	0.3	—	—
World GDP - CAGR	3.5	3.4	2.9	2.8	3.9	3.3	2.8	2.5	2.0
Probability weight	20.0	40.0	30.0	10.0	12.7	14.8	30.0	29.7	12.7

Note:
(1) The five year period starts at Q3 2020 for 2020 and Q3 2019 for 2019.



17. Risk management (continued)

Credit risk continued

Annual figures

UK GDP - annual growth

	Upside %	Base case %	Downside %	Extreme downside %
2020	(9.3)	(10.9)	(11.1)	(12.3)
2021	9.0	4.5	2.6	(4.6)
2022	2.6	4.2	4.6	6.1
2023	2.2	3.2	3.2	4.0
2024	2.3	2.8	3.1	2.3
2025	2.3	2.4	2.6	2.3

UK unemployment rate - annual average

	Upside %	Base case %	Downside %	Extreme downside %
2020	4.4	4.4	4.9	5.4
2021	5.6	6.3	8.5	12.3
2022	4.5	6.3	7.7	12.0
2023	3.8	5.5	6.7	9.0
2024	3.8	5.1	6.2	7.5
2025	3.9	5.1	6.2	7.3

UK House Price Inflation - four quarter growth

	Upside %	Base case %	Downside %	Extreme downside %
2020	2.7	1.5	(1.8)	(5.2)
2021	2.2	(3.0)	(7.4)	(26.9)
2022	1.7	3.6	6.5	5.1
2023	2.2	2.2	4.6	5.0
2024	2.8	2.8	2.8	5.6
2025	3.1	3.1	3.1	3.1

Worst points

The worst points refer to the worst four-quarter rate of change for GDP and House Price Inflation and the worst quarterly figures for unemployment between 2020 and 2025.

	31 December 2020				31 December 2019	
UK	Upside %	Base case %	Downside %	Extreme downside %	Downside 1 %	Downside 2 %
GDP (year-on-year)	(21.5)	(21.5)	(21.5)	(21.5)	(0.2)	(1.8)
Unemployment	5.9	7.0	9.4	13.9	4.9	5.5
House Price Inflation (year-on-year)	1.4	(3.6)	(11.2)	(29.8)	(3.5)	(8.4)

Peak (Q3 2020) to trough

	31 December 2020			
UK	Upside %	Base case %	Downside %	Extreme downside %
GDP	—	(1.8)	(5.1)	(10.4)
House Price Inflation	—	(3.6)	(11.2)	(32.0)

17. Risk management (continued)

Credit risk continued

Probability weightings of scenarios

The Bank's approach to IFRS 9 multiple economic scenarios (MES) involves selecting a suitable set of discrete scenarios to characterise the distribution of risks in the economic outlook and assigning appropriate probability weights. The scale of the economic impact of COVID-19 and the range of recovery paths necessitates a change of approach to assigning probability weights from that used in recent updates. Previously GDP paths for the Bank's scenarios were compared against a set of 1,000 model runs, following which a percentile in the distribution was established that most closely corresponded to the scenario. This approach does not produce meaningful outcomes in the current circumstances because GDP is highly volatile and highly uncertain.

Instead, the Bank has subjectively applied probability weights, reflecting internal expert views. The probability weight assignment was judged to present good coverage to the central scenarios and the potential for a far more robust recovery on the upside and exceptionally challenging outcomes on the downside. A 20% weighting was applied to the upside scenario, a 40% weighting applied to the base case scenario, a 30% weighting applied to the downside scenario and a 10% weighting applied to the extreme downside scenario. The Bank judged a downside-biased weighting as appropriate given the risk to the outlook posed by the numerous factors influencing the path of COVID-19, the rollout of the vaccine and the pace at which social distancing restrictions can be relaxed.

Use of the scenarios in Personal lending

The NatWest UK modelled Personal portfolio, from which PDs and LGDs are sourced to facilitate the calculation of ECL in RBSI Personal, follows a discrete scenario approach which means that for each account, PD and LGD values are calculated as probability weighted averages across the individual, discrete economic scenarios. The PD values for each discrete scenario are in turn calculated using product specific econometric models that aggregate forecasts of the relevant economic loss drivers into forecasts of the exogenous component of the respective PD models (refer to IFRS 9 ECL model design principles).

Use of the scenarios in Wholesale lending

The Wholesale lending methodology is based on the concept of CCIs. The CCIs represent, similar to the exogenous component in Personal, all relevant economic loss drivers for a region/industry segment aggregated into a single index value that describes the loss rate conditions in the respective segment relative to its long-run average. A CCI value of zero corresponds to loss rates at long-run average levels, a positive CCI value corresponds to loss rates below long-run average levels and a negative CCI value corresponds to loss rates above long-run average levels.
The four economic scenarios are translated into forward-looking projections of CCIs using a set of econometric models. Subsequently the CCI projections for the individual scenarios are averaged into a single central CCI projection according to the given scenario probabilities. The central CCI projection is then overlaid with an additional mean reversion assumption, i.e. that after one to two years into the forecast horizon the CCI gradually revert to their long-run average of zero.

Finally, ECL is calculated using a Monte Carlo approach by averaging PD and LGD values arising from many CCI paths simulated around the central CCI projection.

The rationale for the Wholesale approach is the long-standing observation that loss rates in Wholesale portfolios tend to follow regular cycles. This allows the Bank to enrich the range and depth of future economic conditions embedded in the final ECL beyond what would be obtained from using the discrete macro-economic scenarios alone.

UK economic uncertainty

Treatment of COVID-19 relief mechanisms

Use of COVID-19 relief mechanisms (for example, the Disruption Guarantee Scheme) will not automatically merit identification of SICR and trigger a Stage 2 classification in isolation.

For Wholesale customers, the Bank continues to provide support, where appropriate, to existing customers. Those who are deemed either (a) to require a prolonged timescale to return to within the Bank's risk appetite, (b) not to have been viable pre-COVID-19, or (c) not to be able to sustain their debt once COVID-19 is over, will trigger a SICR and, if concessions are sought, be categorised as forborne, in line with regulatory guidance.

As some of the government support mechanisms conclude, the Bank anticipates further credit deterioration in the portfolios. There are a number of key factors that could drive further downside to impairments, through deteriorating economic and credit metrics and increased stage migration as credit risk increases for more customers. A key factor would be a more adverse deterioration in GDP and unemployment in the economies in which the Bank operates, but also, among others:

- The timing and nature of governmental exit plans from lockdown and any future repeated lockdown requirements.
- The progress of COVID-19, with potential for changes in worker/consumer behaviour and sickness levels.
- The efficacy of the various government support initiatives in terms of their ability to defray customer defaults is yet to be proven, notably over an extended period.
- Any further damage to certain supply chains, most notably in the case of any re-tightening of lockdown rules but also delays caused by social distancing measures and possible export/import controls.
- The level of revenues lost by corporate clients and pace of recovery of those revenues may affect the Bank's clients' ability to service their borrowing, especially in those sectors most exposed to the impacts of COVID-19.
- Higher unemployment if companies fail to restart jobs after periods of staff furlough.

This could potentially lead to further ECL increases. However, the income statement impact of this will be mitigated to some extent by the forward-looking provisions taken as at 31 December 2020.

Model monitoring and enhancement

The abrupt and prolonged interruption of a wide range of economic activities due to COVID-19 and the subsequent government interventions to support businesses and individuals, has resulted in patterns in the data of key economic loss drivers and loss outcomes, that are markedly different from those that the Bank's models have been built on. To account for these structural changes, model adjustments have been applied and model changes have been implemented.

Government support

Most notably as a result of various government support measures, the increase in model-predicted defaults caused by the sharp contraction in GDP and consumer spending in Q2 2020 has to date, not materialised.

Accordingly, model-projected default rates in Wholesale and Personal have been adjusted by introducing lags of up to 12 months. These lags are based partly on objective empirical data (i.e. the absence of increases in realised default rates by the reporting date) and partly judgmental, based on the extension of government support measures into 2021 and their expected effectiveness.

17. Risk management (continued)

Credit risk continued

In Wholesale lending, most importantly business and commercial banking, model-projected default rates have also been scaled down based on the expectation that credit extended under various government support loan schemes will allow many businesses, not only to delay, but to sustainably mitigate their default risk profile.

Extreme GDP movements – Wholesale only

Due to the specific nature of COVID-19, GDP year-on-year movements in both directions are extremely sharp, many multiples of their respective extremes observed previously.

This creates a risk of overstretched, invalid extrapolations in statistical models. Therefore, all Wholesale econometric models were updated to make them robust against extreme GDP movements by capping projected CCI values at levels corresponding to three times the default rates observed at the peak of the global financial crisis and using quarterly averages rather than spot values for CCI projections.

Industry sector detail – Wholesale only

The economic impact of COVID-19 is highly differentiated by industry sector, with hospitality and other contact-based leisure, service, travel and passenger transport activities significantly more affected than the overall economy. On the other hand, the corporate and commercial econometric forecasting models used in Wholesale are sector agnostic. Sector performance was therefore monitored throughout the year and additional adjustments were applied when PDs were deemed inconsistent with expected loss outcomes at sector level. No such interventions were necessary at the year end.

Scenario sensitivity – Personal only

For the NatWest UK modelled Personal portfolio, from which PDs and LGDs are sourced to facilitate the calculation of ECL in RBSI Personal, the forward-looking components of the IFRS 9 PD models were modified, leveraging existing econometric models used in stress testing to ensure that PDs appropriately reflect the forecasts for unemployment and house prices in particular.

All in-model adjustments described have been applied by correcting the PD and LGD estimates within the core ECL calculation process and therefore consistently and systematically inform SICR identification and ECL measurement.

Additionally, post model ECL adjustments were made in Personal to ensure that the ECL was adjusted for known model over and under-predictions pre-existing COVID-19, pending the systematic re-calibration of the underlying models.

Measurement uncertainty and ECL sensitivity analysis

The recognition and measurement of ECL is complex and involves the use of significant judgement and estimation, particularly in times of economic volatility and uncertainty. 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.

The focus of the simulations is on ECL provisioning requirements on performing exposures in Stage 1 and Stage 2. The simulations are run on a stand-alone basis and are independent of each other; the potential ECL impacts reflect the simulated impact as at 31 December 2020. Scenario impacts on SICR should be considered when evaluating the ECL movements of Stage 1 and Stage 2. In all scenarios the total exposure was the same but exposure by stage varies in each scenario.

Stage 3 provisions are not subject to the same level of measurement uncertainty – default is an observed event as at the balance sheet date. Stage 3 provisions therefore have not been considered in this analysis.

The impact arising from the upside, downside and extreme downside scenarios has been simulated. These scenarios are three of the four discrete scenarios used in the methodology for Personal MES as described in the Economic loss drivers section. In the simulations, the Bank has assumed that the economic macro variables associated with these scenarios replace the existing base case economic assumptions, giving them a 100% probability weighting and thus serving as a single economic scenario.

These scenarios have been applied to all modelled portfolios in the analysis below, with the simulation impacting both PDs and LGDs. Modelled overlays present in the underlying ECL estimates are also sensitised in line with the modelled ECL movements, but those that were judgmental in nature, primarily those for economic uncertainty, were not (refer to the Governance and post model adjustments section). As expected, the scenarios create differing impacts on ECL by portfolio and the impacts are deemed reasonable. In this simulation, it is assumed that existing modelled relationships between key economic variables and loss drivers hold, but in practice other factors would also have an impact, for example, potential customer behaviour changes and policy changes by lenders that might impact on the wider availability of credit.

The Bank's core criterion to identify a SICR is founded on PD deterioration, as discussed above. Under the simulations, PDs change and result in exposures moving between Stage 1 and Stage 2 contributing to the ECL impact.

17. Risk management (continued)

Credit risk continued

The below table shows ECL sensitivity analysis:

2020	Actual	Upside	Downside	Extreme Downside
Stage 1 modelled exposure (£m)				
Wholesale	9,054	9,911	8,945	8,343
Stage 1 modelled ECL (£m)				
Wholesale	11	12	12	12
Stage 1 coverage (%)				
Wholesale	0.12%	0.12%	0.13%	0.14%
Stage 2 modelled exposure (£m)				
Wholesale	2,023	1,166	2,132	2,734
Stage 2 modelled ECL (£m)				
Wholesale	73	41	79	108
Stage 2 coverage (%)				
Wholesale	3.61%	3.52%	3.71%	3.95%
Stage 1 and Stage 2 modelled exposure (£m)				
Wholesale	11,077	11,077	11,077	11,077
Stage 1 and Stage 2 modelled ECL (£m)				
Wholesale	84	53	91	120
Stage 1 and Stage 2 coverage (%)				
Wholesale	0.76%	0.48%	0.82%	1.08%
Reconciliation to Stage 1 and Stage 2 ECL (£m)				
ECL on modelled exposures	84	53	91	120
ECL on non-modelled exposures	4	4	4	4
Total Stage 1 and Stage 2 ECL	88	57	95	124
Variance to actual total Stage 1 and Stage 2 ECL	-	(31)	7	36

Notes:
(1) Reflects ECL for all modelled exposure in scope for IFRS 9; in addition to loans this includes modelled exposure of bonds, and cash.
(2) All simulations are run on a stand-alone basis and are independent of each other, with the potential ECL impact reflecting the simulated impact as at 31 December 2020.
(3) Refer to the Economic loss drivers section for details of economic scenarios.
(4) 2019 comparatives are not included as the sensitivity scenario analysis relates to the 31 December 2020 balance sheet position.

Financial instruments within the scope of IFRS 9 ECL

Refer to Note 7 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 framework assessment.

Financial assets

	2020 £m	2019 £m
Balance sheet total gross AC/FVOCI	33,489	31,167
In scope of IFRS 9 ECL framework	33,384	31,166
% in scope	99.7%	99.99%
Loans - in scope	14,570	15,481
Stage 1	12,143	14,815
Stage 2	2,216	545
Stage 3	211	121
Other financial assets - in scope	18,814	15,685
Stage 1	18,814	15,685
Out of scope of IFRS 9 ECL framework	105	1

The assets outside the IFRS 9 ECL framework were as follows:

- Settlement balances, items in the course of collection, cash balances and other non-credit risk assets of £104m. These were assessed as having no ECL unless there was evidence that they were credit impaired.
- Equity shares of £1m as not within the IFRS 9 ECL framework by definition.
- Fair value adjustments on loans hedged by interest rate swaps, where the underlying loan was within the IFRS 9 ECL scope – £22m.

Contingent liabilities and commitments

Total contingent liabilities and commitments within IFRS 9 ECL scope of £9,642m comprised Stage 1 £8,601m, Stage 2 £1,037m and Stage 3 £4m.

17. Risk management (continued)

Credit risk continued

Flow statements

The flow statements that follow show the main ECL and related income statement movements. They also show the changes in ECL as well as the changes in related financial assets used in determining ECL. Due to differences in scope, exposures in this section may therefore differ from those reported in other tables, principally in relation to exposures in Stage 1 and Stage 2. These differences do not have a material ECL impact. Other points to note:

- Financial assets include treasury liquidity portfolios, comprising balances at central banks and debt securities, as well as loans. Both modelled and non-modelled portfolios are included.
- Stage transfers (for example, exposures moving from Stage 1 to Stage 2) are a key feature of the ECL movements, with the net re-measurement cost of transitioning to a worse stage being a primary driver of income statement charges. Similarly, there is an ECL benefit for accounts improving stage.
- Changes in risk parameters shows the reassessment of the ECL within a given stage, including any ECL overlays and residual income statement gains or losses at the point of write-off or accounting write-down.
- Other (P&L only items) includes any subsequent changes in the value of written-down assets (for example, fortuitous recoveries) along with other direct write-off items such as direct recovery costs. Other (P&L only items) affects the income statement but does not affect balance sheet ECL movements.
- Amounts written-off – represent the gross asset written-down against accounts with ECL, including the net asset write-down for debt sale activity.
- There were small ECL flows from Stage 3 to Stage 1. This does not, however, indicate that accounts returned from Stage 3 to Stage 1 directly. On a similar basis, there were flows from Stage 1 to Stage 3 including transfers due to unexpected default events. The small number of write-offs in Stage 1 and Stage 2 reflect the effect of portfolio debt sales and also staging at the start of the analysis period.
- The effect of any change in PMAs during the year is typically reported under changes in risk parameters, as are any impacts arising from changes to the underlying models. Refer to the section on Governance and post model adjustments for further details.
- All movements are captured monthly and aggregated. Interest suspended post default is included within Stage 3 ECL with the movement in the value of suspended interest during the year reported under currency translation and other adjustments.

ECL flow statement

The flow statement below shows the main ECL and related income statement movements. It also shows the changes in ECL as well as the changes in related financial assets used in determining ECL:

	Stage 1		Stage 2		Stage 3		Total	
	Loans	ECL	Loans	ECL	Loans	ECL	Loans	ECL
RBS International	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	33,448	3	648	6	135	21	34,231	30
Currency translation and other adjustments	456	-	(15)	-	2	4	443	4
Inter-group transfers	158	-	-	-	-	-	158	-
Transfers from Stage 1 to Stage 2	(3,697)	(11)	3,697	11	-	-	-	-
Transfers from Stage 2 to Stage 1	1,773	14	(1,773)	(14)	-	-	-	-
Transfers to Stage 3	(125)	-	(110)	(2)	235	2	-	-
Transfers from Stage 3	25	-	104	2	(129)	(2)	-	-
Net re-measurement of ECL on stage transfer	-	(9)	-	32	-	8	-	31
Changes in risk parameters (model inputs)	-	16	-	40	-	23	-	79
Other changes in net exposure	(2,728)	1	(505)	(1)	(27)	(4)	(3,260)	(4)
Other (P&L only items)	-	-	-	-	-	1	-	1
Income statement (releases)/charges		8		71		28		107
Amounts written-off	-	-	-	-	(3)	(3)	(3)	(3)
Unwinding of discount	-	-	-	-	-	(2)	-	(2)
At 31 December 2020	29,310	14	2,046	74	213	48	31,569	136
Net carrying amount	29,296		1,972		165		31,433	
At 1 January 2019	26,749	6	276	3	101	23	27,126	32
2019 movements	6,699	(3)	372	3	34	(2)	7,105	(2)
At 31 December 2019	33,448	3	648	6	135	21	34,231	30
Net carrying amount	33,445		642		114		34,201	

Note:
(1) 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 2020 in the flow statements reflect 30 November 2019 positions, and 31 December 2020 reported figures reflect 30 November 2020 positions).

17. Risk management (continued)

Credit risk continued

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

2020	Gross loans and advances to banks and customers £m	Other financial assets £m	Derivatives £m	Total exposure £m
Central and local government	212	5,363	-	5,575
Manufacturing	19	-	-	19
Construction	89	-	-	89
Finance	9,078	-	41	9,119
Service industries and business activities	44	-	-	44
Agriculture, forestry and fishing	11	-	-	11
Property	2,225	-	-	2,225
Individuals	338	-	-	338
Home mortgages	2,510	-	-	2,510
Other	716	1	-	717
	15,242	5,364	41	20,647

2019	Gross loans and advances to banks and customers £m	Other financial assets £m	Derivatives £m	Total exposure £m
Central and local government	380	5,068	-	5,448
Manufacturing	14	-	-	14
Construction	70	-	-	70
Finance	10,048	-	36	10,084
Service industries and business activities	44	-	-	44
Agriculture, forestry and fishing	11	-	-	11
Property	2,283	-	-	2,283
Individuals	344	-	-	344
Home mortgages	2,612	-	-	2,612
Other	731	1	-	732
	16,537	5,069	36	21,642

Gross assets of £1,097m (2019: £724m) and gross liabilities of £1,097m (2019: £724m), are subject to netting arrangements. The asset balances included above consist of only customer deposits and loans and advances to banks and customers which have been offset with the full amount of the liability balances of £80m (2019: £74m) in accordance with the offsetting rules of IAS 32.

This section covers the credit risk profile of trading activities.

	Reverse repos			Repos		
31-Dec-20	Total £m	of which offsettable £m	Outside netting arrangements £m	Total £m	of which offsettable £m	Outside netting arrangements £m
Gross	1,017	1,017	-	1,017	1,017	-
IFRS offset	(1,017)	(1,017)	-	(1,017)	(1,017)	-
Carrying value	-	-	-	-	-	-
Securities collateral	1,017	-	-	1,017	-	-

	Reverse repos			Repos		
31-Dec-19	Total £m	of which offsettable £m	Outside netting arrangements £m	Total £m	of which offsettable £m	Outside netting arrangements £m
Gross	650	650	-	650	650	-
IFRS offset	(650)	(650)	-	(650)	(650)	-
Carrying value	-	-	-	-	-	-
Securities collateral	650	-	-	650	-	-

17. Risk management (continued)

Credit risk continued

Credit risk enhancement and mitigation

The table below shows exposures of modelled portfolios within the scope of the ECL framework and related credit risk enhancement and mitigation (CREM).

	Gross	Netting		Maximum credit risk		CREM by type			CREM coverage		Exposure post CREM	
	exposure	and offset	ECL	Total	Stage 3	Financial [1]	Property	Other [2]	Total	Stage 3	Total	Stage 3
2020	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets												
Cash and balances at central banks	13,472	-	-	13,472	-	-	-	-	-	-	13,472	-
Loans - amortised cost	15,667	1,097	130	14,440	163	323	4,538	56	4,917	135	9,523	28
Personal	2,795	-	15	2,780	59	-	2,465	-	2,465	58	315	1
Wholesale	12,872	1,097	115	11,660	104	323	2,073	56	2,452	77	9,208	27
Debt securities	5,342	-	-	5,342	-	-	-	-	-	-	5,342	-
Total financial assets	34,481	1,097	130	33,254	163	323	4,538	56	4,917	135	28,337	28
Contingent liabilities and commitments												
Personal	525	-	-	525	-	-	-	-	-	-	525	-
Wholesale	9,116	-	6	9,110	4	98	441	175	714	2	8,396	2
Total off-balance sheet	9,641	-	6	9,635	4	98	441	175	714	2	8,921	2
Total exposure	44,122	1,097	136	42,889	167	421	4,979	231	5,631	137	37,258	30
2019	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets												
Cash and balances at central banks	10,617	-	-	10,617	-	-	-	-	-	-	10,617	-
Loans - amortised cost	16,205	724	29	15,452	100	536	4,833	47	5,416	81	10,036	19
Personal	2,914	-	14	2,900	53	-	2,573	-	2,573	52	327	1
Wholesale	13,291	724	15	12,552	47	536	2,260	47	2,843	29	9,709	18
Debt securities	5,068	-	-	5,068	-	-	-	-	-	-	5,068	-
Total financial assets	31,890	724	29	31,137	100	536	4,833	47	5,416	81	25,721	19
Contingent liabilities and commitments												
Personal	495	-	-	495	-	-	-	-	-	-	495	-
Wholesale	6,115	-	1	6,114	4	146	290	17	453	1	5,661	3
Total off-balance sheet	6,610	-	1	6,609	4	146	290	17	453	1	6,156	3
Total exposure	38,500	724	30	37,746	104	682	5,123	64	5,869	82	31,877	22

Notes:
(1) Includes cash and securities collateral.
(2) Includes guarantees.
(3) The Bank 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.

17. Risk management (continued)

Credit risk asset quality

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

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

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

The mapping to the S&P ratings is used by the Bank 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 Personal portfolios, smaller corporate exposures or specialist corporate segments given that S&P does not typically assign ratings to such entities.

17. Risk management (continued)

Credit risk asset quality continued

Portfolio summary - sector analysis

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

2020	Personal £m	Wholesale £m	Total £m
Loans by geography	2,795	11,774	14,569
- UK	2,795	8,314	11,109
- RoI	-	1	1
- Other Europe	-	2,178	2,178
- RoW	-	1,281	1,281
Loans by asset quality	2,795	11,774	14,569
- AQ1	-	5,219	5,219
- AQ2	-	1,330	1,330
- AQ3	-	1,316	1,316
- AQ4	-	2,249	2,249
- AQ5	-	551	551
- AQ6	-	520	520
- AQ7	2,725	329	3,054
- AQ8	-	115	115
- AQ9	-	4	4
- AQ10	70	141	211
Loans by stage	2,795	11,774	14,569
- Stage 1	2,676	9,467	12,143
- Stage 2	49	2,166	2,215
- Stage 3	70	141	211
Loans - past due analysis	2,796	11,773	14,569
- Not past due	2,695	11,649	14,344
- Past due 1-29 days	19	110	129
- Past due 30-89 days	16	6	22
- Past due 90-180 days	32	-	32
- Past due >180 days	34	8	42
Loans - Stage 2	49	2,166	2,215
- Not past due	18	2,131	2,149
- Past due 1-29 days	17	29	46
- Past due 30-89 days	14	6	20
ECL provisions by stage	15	121	136
- Stage 1	3	11	14
- Stage 2	1	73	74
- Stage 3	11	37	48
ECL provisions coverage (%)	0.54	1.03	0.93
- Stage 1 (%)	0.11	0.12	0.12
- Stage 2 (%)	2.04	3.37	3.34
- Stage 3 (%)	15.71	26.24	22.75
ECL charge	4	103	107
- UK	4	87	91
- Other Europe	-	16	16
ECL loss rate (%)	0.14	0.87	0.73
Amounts written-off	3	-	3
Other financial assets by asset quality	-	18,814	18,814
- AQ1 - AQ4	-	18,814	18,814
Off-balance sheet	525	9,116	9,641
- Loan commitments	525	8,901	9,426
- Financial guarantees [(1)]	-	215	215
Off-balance sheet by asset quality	525	9,116	9,641
- AQ1 - AQ4	-	8,511	8,511
- AQ5 - AQ8	525	600	1,125
- AQ9	-	1	1
- AQ10	-	4	4

17. Risk management (continued)

Credit risk asset quality continued

2019	Personal £m	Wholesale £m	Total £m
Loans by geography	2,914	12,567	15,481
- UK	2,914	8,789	11,703
- RoI	-	2	2
- Other Europe	-	2,437	2,437
- RoW	-	1,339	1,339
Loans by asset quality	2,914	12,567	15,481
- AQ1	-	5,548	5,548
- AQ2	-	1,566	1,566
- AQ3	-	1,401	1,401
- AQ4	-	2,311	2,311
- AQ5	-	814	814
- AQ6	-	533	533
- AQ7	2,849	311	3,160
- AQ8	-	22	22
- AQ9	-	5	5
- AQ10	65	56	121
Loans by stage	2,914	12,567	15,481
- Stage 1	2,799	12,016	14,815
- Stage 2	50	495	545
- Stage 3	65	56	121
Loans - past due analysis	2,914	12,567	15,481
- Not past due	2,826	12,549	15,375
- Past due 1-29 days	19	7	26
- Past due 30-89 days	8	1	9
- Past due 90-180 days	29	1	30
- Past due >180 days	32	9	41
Loans - Stage 2	50	495	545
- Not past due	26	494	520
- Past due 1-29 days	18	1	19
- Past due 30-89 days	6	-	6
ECL provisions by stage	14	16	30
- Stage 1	1	2	3
- Stage 2	1	5	6
- Stage 3	12	9	21
ECL provisions coverage (%)	0.48	0.13	0.19
- Stage 1 (%)	0.04	0.02	0.02
- Stage 2 (%)	2.00	1.01	1.10
- Stage 3 (%)	18.46	16.07	17.36
ECL charge	1	1	2
- UK	1	-	1
ECL loss rate (%)	0.03	0.01	0.01
Amounts written-off	5	-	5
Other financial assets by asset quality	-	15,685	15,685
- AQ1 - AQ4	-	15,685	15,685
Off-balance sheet	495	6,115	6,610
- Loan commitments	495	5,896	6,391
- Financial guarantees (1)	-	219	219
Off-balance sheet by asset quality	495	6,115	6,610
- AQ1 - AQ4	-	5,582	5,582
- AQ5 - AQ8	495	528	1,023
- AQ9	-	1	1
- AQ10	-	4	4

Notes:
(1) All Financial guarantees are considered as Stage 1.
(2) UK includes exposures in Jersey, Guernsey, Isle of Man and Gibraltar.

17. Risk management (continued)

Non-traded market risk

Definition

Non-traded market risk is the risk to the value of assets or liabilities outside the trading book, 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 key sources of non-traded market risk are interest rate 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.

The Bank has the benefit of a pool of stable, non and low interest-bearing liabilities, principally comprising equity and money transmission accounts. These balances are hedged, either by the use of interest rate swaps, generally booked as cash flow hedges of floating-rate assets, or by investing directly in longer-term fixed-rate assets (primarily fixed-rate mortgages or UK government Gilts), in order to provide a consistent and predictable revenue stream.

Foreign exchange risk

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

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

Value-at-risk (VaR)

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 Bank's standard VaR metrics – which assume a time horizon of one trading day and a confidence level of 99% – are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations from the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities. Behavioural assumptions are applied as appropriate.

The non-traded interest rate risk VaR metrics for the Bank's Personal and commercial banking activities are included in the banking book VaR table presented 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.

The Bank manages market risk through VaR limits as well as stress testing, position and sensitivity limits. The table below shows one-day internal banking book VaR at a 99% confidence level.

	31 December 2020	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.24	0.24	0.02	0.10

	31 December 2019	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.08	0.16	0.06	0.09

Liquidity risk

Liquidity risk is the risk of being unable to meet financial obligations as and when they fall due. Funding risk is the risk of not maintaining a diversified, stable and cost-effective funding base.

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that banks perform.

The risks are dependent on factors such as:
- Maturity profile;
- Composition of sources and uses of funding;
- The quality and size of the liquidity portfolio;
- Wholesale market conditions; and
- Depositor and investor behaviour.

The Bank manages its liquidity risk taking into account regulatory, legal and other constraints to ensure sufficient liquidity resources are available to cover liquidity stresses. In line with NatWest Group, the Bank maintains a prudent approach to the definition of liquidity resources comprised of cash and balances at central banks, treasury bills and other high quality government and US agency bonds.

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. To assess and manage asset and liability maturity gaps the Bank 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 the NatWest Group Asset and Liability Management Committee. 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 Bank. 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.

17. Risk management (continued)

Contractual maturity

This table shows the residual maturity of financial instruments, based on contractual date of maturity. Hedging derivatives are included in the relevant maturity bands.

	Banking activities								
	Less than 1 month	1-3 months	3-6 months	6 months - 1 year	Subtotal	1-3 years	3-5 years	More than 5 years	Total
2020	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	13,531	-	-	-	13,531	-	-	-	13,531
Derivatives	10	13	14	1	38	2	-	1	41
Loans to banks	1,204	-	-	-	1,204	-	-	-	1,204
Loans to customers[1]	738	956	632	2,585	4,911	4,784	957	2,610	13,262
Personal	306	2	3	9	320	67	84	2,361	2,832
Corporate	137	187	112	355	791	1,463	698	249	3,201
Financial institutions (excluding banks)	295	767	517	2,221	3,800	3,254	175	-	7,229
Other financial assets	256	230	205	569	1,260	1,228	841	2,034	5,363
Total financial assets	15,739	1,199	851	3,155	20,944	6,014	1,798	4,645	33,401
2019									
Total financial assets	13,302	2,438	1,371	2,714	19,825	5,452	2,060	3,837	31,174
Bank deposits	5	-	-	-	5	-	-	-	5
Customer deposits	25,540	5,134	362	241	31,277	3	-	-	31,280
Personal	6,458	262	224	225	7,169	1	-	-	7,170
Corporate	4,184	1,068	5	3	5,260	-	-	-	5,260
Financial institutions (excluding banks)	14,898	3,804	133	13	18,848	2	-	-	18,850
Derivatives	52	14	14	1	81	7	1	37	126
Other financial liabilities	35	-	97	410	542	-	-	-	542
Lease Liabilities	-	1	1	2	4	8	7	21	40
Total financial liabilities	25,632	5,149	474	654	31,909	18	8	58	31,993
2019									
Total financial liabilities[2]	24,641	4,426	708	397	30,172	14	3	18	30,207

Note:
(1) Loans to customers excludes £130m (2019: £29m) of Impairment provisions.

Capital risk

Regulatory capital consists of reserves and instruments issued that are available, 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 as capital.

Capital management ensures that there is sufficient capital and other loss-absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board-approved risk appetite, maintaining its credit rating and supporting its strategic goals.

The Bank is required to report its total capital ratio and Common Equity Tier 1 (CET1) capital ratio to its lead regulator, the JFSC, on a periodic basis. The ratios are calculated as total capital to total risk-weighted assets, expressed as a percentage and CET1 capital to total risk-weighted assets, expressed as a percentage. The JFSC has established the Codes of Practice for Deposit-taking Business and includes that a registered person's total capital ratio minimum is 10% and CET1 capital ratio minimum is 8.5%.

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:

- 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 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 is the Bank's supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. The Bank does not hold any Tier 2 capital.

17. Risk management (continued)

Pension risk

Definition

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

Sources of risk

The main source of pension risk for the Bank is through its largest scheme, the International Pensions Trust (IPT). Further detail on the Bank's pension obligations can be found in Note 4 on the accounts.

The Bank is exposed to the risk that the schemes' assets, together with future investment returns and additional future contributions, are estimated to be insufficient to meet liabilities as they fall due. In such circumstances, the Bank could be obliged (or might choose) to make additional contributions to the schemes, or be required to hold additional capital to mitigate such risk.

Key developments in 2020

- There have been no material changes to the Bank's exposure to pension risk during the year, and the positions of the schemes that the Bank sponsors have remained resilient despite the challenges caused by COVID-19.
- Further liability driven investment was carried out in early 2020 following the payment of an £80m contribution in December 2019.
- The next triennial actuarial valuation for the IPT will have an effective date of 31 March 2021. The expectation is that agreement will be reached with the Trustee such that no additional contributions are needed.
- The Bank with the support of the trustees of IOMPF and IOMWO funds proposed a merger of the funds into the RBSIPT. Following engagement with the trustees and the membership of the IOMPF and IOMWO funds, the Transfer Agreement was signed in December 2020. The effective date of the merger is expected to be 1 March 2021, subject to final conditions being satisfied. On completion, the merger will result in a single de-segregated scheme, with some changes to and alignment of benefits. The effect of the merger, including the changes to benefits, will be recognised when the final conditions are met.

Monitoring and measurement

The RBSI Pension Forum formulates the Bank view of pension risk and provides a governance framework for all the Bank's pension schemes.

The Bank calculates stochastic stresses on its material defined benefit pension schemes each year. These tests are used to satisfy the requests of regulatory bodies such as the Bank of England. The stress calculations also form the basis of the pension risk Pillar 2 charge in the Company ICAAP.

Mitigation

The trustee board of the IPT is solely responsible for the investment of scheme assets which are held separately from the assets of the Bank. The trustee board has taken measures to mitigate risk including adopting a diversified investment strategy and investing in liability driven investments, so that changes in the value of the liabilities will be partially matched by changes in the asset values, thus reducing volatility of the scheme's funding position.

In managing the assets of the IPT, the trustee board also takes account of, and gives consideration to, the ability of investment managers to effectively deal with environmental, social and governance issues.

Compliance & conduct risk

Definition

Compliance risk is the risk that the behaviour of the Bank towards customers fails to comply with laws, regulations, rules, standards and codes of conduct. Such a failure may lead to breaches of regulatory requirements, organisational standards or customer expectations and could result in legal or regulatory sanctions, material financial loss or reputational damage.

Conduct risk is the risk that the conduct of the Bank and its subsidiaries and its staff towards customers – or in the markets in which it operates – leads to unfair or inappropriate customer outcomes and results in reputational damage, financial loss or both.

Sources of risk

Compliance and conduct risks exist across all stages of the Bank's relationships with its customers and arise from a variety of activities including product design, marketing and sales, complaint handling, staff training, and handling of confidential insider information.

Key developments in 2020

- Through the development and enhancement of the Bank's upstream risk process, the Bank was better positioned to ensure that future regulatory change was captured and tracked and implemented in a timely manner. The Bank participated in a NatWest Group digital rules mapping programme that will further enhance this capability in 2021.
- Challenges presented by COVID-19 forced the Bank to move at pace to revise its processes and service delivery. This was managed through robust governance processes whereby purpose led decision making related to customer facing product and service delivery, without evidence of increased Compliance or Conduct Risk was seen. Notwithstanding, a number of projects with regulatory change drivers were paused requiring increased regulator engagement.

Governance

The Bank defines appropriate standards of compliance and conduct and ensures adherence to those standards through its risk management framework. Relevant compliance and conduct matters are escalated through the Board Risk Committee.

Risk appetite

Risk appetite for compliance and conduct risks is set at Board level. Risk appetite statements articulate the levels of risk that legal entities, businesses and functions work within when pursuing their strategic objectives and business plans.

A range of controls is operated to ensure the business delivers good customer outcomes and is conducted in accordance with legal and regulatory requirements. A suite of policies addressing compliance and conduct risks set appropriate standards across the Bank. Examples of these include the Complaints Management Policy, Client Assets & Money Policy, and Product Lifecycle Policy as well as policies relating to customers in vulnerable situations, cross-border activities and market abuse. Continuous monitoring and targeted assurance is carried out as appropriate.

Monitoring and measurement

Compliance and conduct risks are measured and managed through continuous assessment and reporting to the Bank's senior risk committees and at Board level. The compliance and conduct risk framework facilitates the consistent monitoring and measurement of compliance with laws and regulations and the delivery of consistently good customer outcomes. The first line of defence is responsible for effective risk identification, reporting and monitoring, with oversight, challenge and review by the second line. Compliance and conduct risk management is also integrated into the Bank's strategic planning cycle.

17. Risk management (continued)

Compliance & conduct risk continued

Mitigation

Activity to mitigate the most-material compliance and conduct risks is carried out across the Bank. Examples of mitigation include consideration of customer needs in business and product planning, targeted training, complaints management, as well as independent monitoring activity. Internal policies help support a strong customer focus across the Bank.

Financial crime risk

Definition

Financial crime risk is presented by criminal activity in the form of money laundering, terrorist financing, bribery and corruption, sanctions and tax evasion.

Sources of risk

Financial crime risk may be presented if the Bank's customers, employees or third parties undertake or facilitate financial crime, or if the Bank's products or services are used to facilitate such crime. Financial crime risk is an inherent risk across all lines of business.

Key developments in 2020

- A new system has been implemented to identify any adverse press related to customers or their key principals.
- All RBSI customers are now screened by the NWG preferred tool ensuring centralised expertise is available to detect and disrupt threats to the Bank and its customers.
- Following the move of the London book to RBSI, a review and uplift of the due diligence was completed for the customers.

Governance

The Financial Crime Review Forum is the principal financial crime risk management forum. The forum reviews and, where appropriate, escalates material financial crime risks and issues across the Bank. It is represented by all three lines of defence.

Risk appetite

There is no appetite to operate in an environment where systems and controls do not enable the identification, assessment, monitoring, management and mitigation of financial crime risk. The Bank's systems and controls must be comprehensive and proportionate to the nature, scale and complexity of its businesses. There is no tolerance to systematically or repeatedly breach relevant financial crime regulations and laws.

The Bank operates a framework of preventative and detective controls designed to mitigate the risk that it could facilitate financial crime. These controls are supported by a suite of policies, procedures and detailed instructions to ensure they operate effectively.

Monitoring and measurement

Financial crime risks are identified and reported through continuous risk management and regular monthly reporting to the Financial Crime Risk Forum and other risk governance committees. Quantitative and qualitative data is reviewed and assessed to measure whether financial crime risk is within risk appetite.

Mitigation

Through the financial crime framework, relevant policies, systems, processes and controls are used to mitigate financial crime risk. This includes the use of dedicated screening and monitoring controls to identify people, organisations, transactions and behaviours that may require further investigation or other actions. Centralised Group expertise is available to detect and disrupt threats to the Bank and its customers. Intelligence is shared with law enforcement, regulators and government bodies to strengthen jurisdictional defences against those who would misuse the financial system for criminal motives.

Climate-related risk

Definition

Climate-related risk is the threat of financial loss or adverse non-financial impacts associated with climate change and the political, economic and environmental responses to it.

Sources of risk

Physical risks may arise from climate and weather-related events such as heatwaves, droughts, floods, storms and sea level rises. They can potentially result in financial losses, impairing asset values and the creditworthiness of borrowers. The Bank could be exposed to physical risks directly by the effects on its property portfolio and, indirectly, by the impacts on the wider economy as well as on the property and business interests of its customers.

Transition risks may arise from the process of adjustment towards a low-carbon economy. Changes in policy, technology and sentiment could prompt reassessment of customers' financial risk and may lead to falls in the value of a large range of assets. The Bank could be exposed to transition risks directly through the costs of adaptation within economic sectors and markets as well as supply chain disruption leading to financial impacts on it and its customers. Potential indirect effects include the erosion of the Company's competitiveness, profitability, or reputation damage.

Within these broad categories specific climate risk factors have been identified, which give rise to climate-related risks over the short, medium and long-term.

Risk governance

The Board is responsible for monitoring and overseeing climate-related risk within the Bank's overall business strategy and risk appetite. Where climate-related risk is deemed to have a material impact on a particular risk discipline, then changes to policies and procedures will be made accordingly in 2021 and onwards. Availability of data and the robustness of risk measurement methodologies will influence the timing of any proposed changes.

Operational risk

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 organisation.

Operational risk appetite supports effective management of material operational risks. It expresses the level and types of operational risk the Bank is willing to accept to achieve its strategic objectives and business plans.

Risk appetite for operational risk is set at Board level. Risk appetite statements articulate the levels of risk that legal entities, businesses and functions work within when pursuing their strategic objectives and business plans.

Risk and control assessments are used across all business areas and support functions to identify and assess material operational and conduct risks and key controls.

All risks and controls are mapped to the NatWest Group's Risk Directory. Risk assessments are refreshed at least annually to ensure they remain relevant and capture any emerging risks as well as ensuring risks are reassessed.

17. Risk management (continued)

Operational risk (continued)

The process is designed to confirm that risks are effectively managed in line with risk appetite. Controls are tested on a regular basis to ensure they operate effectively to reduce identified risks.

Scenario analysis is used to assess how extreme but plausible operational risks will affect the Bank. It provides a forward-looking basis for evaluating and managing operational risk exposures.

Operational resilience is managed and monitored through the risk and control assessments methodology. This is underpinned by setting, monitoring and testing tolerances for key business services. Progress continues on the response to regulatory expectations on operational resilience.

Model risk

The Company uses a variety of models in the course of its business activities. To mitigate the risk that decisions are made based on model results that are incorrect, misinterpreted, used inappropriately or based on an outdated model, independent validation and regular reviews are carried out. Oversight is provided by Model Risk Officers and by a NatWest Group model risk governance committee in accordance with relevant policies and procedures, which includes representatives from the Company. For further information on model risk, refer NatWest Group Annual Report & Accounts.

Reputational risk

A reputational risk policy is in place to support the management of issues that could pose a threat to the Bank's public image. A number of measures – including some also used in the management of operational, conduct and financial risks – are used to assess risk levels against risk appetite. Where a material reputational risk is presented, this is escalated from the Bank's Reputational Risk Committee to the NatWest Group Reputational Risk Committee.

18. Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2020. Although the Bank is exposed to credit risk in the event of a customer's failure to meet its obligations, the amounts shown do not, and are not intended to, provide any indication of the Bank's expectation of future losses.

	2020 £m	2019 £m
Guarantees	198	196
Other contingent liabilities	17	23
Standby facilities, credit lines and other commitments	9,427	6,391
Contingent liabilities and commitments	9,642	6,610

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 Bank's maximum exposure to credit loss, in the event of its obligation crystallising and 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 Bank's normal credit approval processes.

Guarantees – The Bank gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Bank will meet a customer's specified obligations to third party if the customer fails to do so. The maximum amount that the Bank could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Bank expects most guarantees it provides to expire unused.

Other contingent liabilities – these include standby letters of credit, supporting customer debt issues, contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Standby facilities and credit lines - 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.

Litigation

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

19. Analysis of changes in financing during the year

	Share capital, share premium and paid-in equity	
	2020 £m	2019 £m
At 1 January	402	102
Issue of Additional Tier 1 capital notes	-	300
Net cash flows from financing	-	300
At 31 December	402	402

20. Analysis of cash and cash equivalents

	2020 £m	2019 £m
At 1 January		
- cash	10,617	10,437
- cash equivalents	2,270	3,375
	12,887	13,812
Net cash inflow/(outflow)	2,394	(925)
At 31 December	15,281	12,887
Comprising:		
Cash and balances at central banks	13,531	10,617
Amounts due from holding companies and fellow subsidiaries	546	933
Loans to banks - amortised cost	1,204	1,337
	15,281	12,887

The Company is required by law or regulation to maintain balances with the Central banks which are included in Cash and cash equivalents, and not available for use by the Company. These are set out below.

	2020 £m	2019 £m
Central Bank of Luxembourg	59	58
Bank of England	8	8
Total	67	66

21. Related parties

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

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

UK Government

The UK Government through HM Treasury is the ultimate controlling party of NatWest Group plc. The UK government's shareholding is managed by UK Government Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies are related parties of the Company.

The Company enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of: taxes – principally UK corporation tax (paid through London branch) and value added tax; national insurance contributions; and regulatory fees and levies together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

The Company may participate in a number of schemes operated by the Bank of England in the normal course of business.

Members of the Company that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.324% of their average eligible liabilities in excess of £600m.

(a) Transactions with key management

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

	2020 £'000	2019 £'000
Loans and advances to customers	1,591	1,304
Customer accounts	1,362	756
Interest received	15	19
Interest paid	2	2

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

21. Related parties (continued)

(b) Related party transactions

	2020 £'000	2019 £'000
Assets		
Loans and advances to banks:		
NatWest Group entities	646	1,056
Liabilities		
Deposits by banks:		
NatWest Group entities	322	279
Income		
Interest received:		
NatWest Group entities	5	22
Expenses		
Interest paid:		
NatWest Group entities	6	15

Operating expenses includes Inter-group cost recharges of £73m (2019: £63m) from NatWest Group.

No ordinary dividend was paid to RBSIH (2019: £762m) and preference dividends of £20m (2019: £10m) was paid to NatWest Group.

Furthermore, there were no transfer of loans to RBSI from Natwest Market Plc during the year (2019: £0.6bn).

(c) Compensation of key management

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

	2020 £'000	2019 £'000
Short-term benefits	3,019	2,466
Long-term benefit	20	804
Share-based	1,059	846
Post-Employment	151	673
	4,249	4,789

22. 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.