

ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 27, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**
For the fiscal year ended December 31, 2016

OR

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

OR

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

Commission file number: 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc

(Exact name of Registrant as specified in its charter)

United Kingdom

(Jurisdiction of incorporation)

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

(Address of principal executive offices)

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

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ

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

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

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

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

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

None

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

| | |
|---|----------------------|
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2020 | Irish Stock Exchange |
| | Irish Stock Exchange |
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2021 | Irish Stock Exchange |
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2025 | |

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2016, the close of the period covered by the annual report:

| (Title of each class) | (Number of outstanding shares) |
|--|--------------------------------|
| Ordinary shares of £1 each | 11,823,163,184 |
| 11% cumulative preference shares | 500,000 |
| 5½% cumulative preference shares | 400,000 |
| Non-cumulative dollar preference shares, Series F, H, L and S to U | 72,430,109 |
| Non-cumulative convertible dollar preference shares, Series 1 | 64,772 |
| Non-cumulative euro preference shares, Series 1 to 3 | 2,044,418 |
| Non-cumulative convertible sterling preference shares, Series 1 | 14,866 |
| Non-cumulative sterling preference shares, Series 1 | 54,442 |

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

Yes No

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

Yes No

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

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-Accelerated filer

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

U.S. GAAP

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

Other

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

Item 17 Item 18

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

Yes No

SEC Form 20-F cross reference guide

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Forward looking statements

Cautionary statement regarding forward-looking statements

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

In particular, this document includes forward-looking statements relating, but not limited to: future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; structural reform and the implementation of the UK ring-fencing regime; the implementation of RBS's transformation programme, including the further restructuring of the NatWest Markets business; the satisfaction of the Group's residual EU State Aid obligations; the continuation of RBS's balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAE), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to goodwill; restructuring and remediation costs and charges; future pension contributions; RBS's exposure to political risks, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including as interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promotor Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements

These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the Group's strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated. Accordingly, undue reliance should not be placed on these statements. Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Group's expectations with

regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Important factors that could affect the actual outcome of the forward-looking statements

We caution you that a large number of important factors could adversely affect our results or our ability to implement our strategy, cause us to fail to meet our targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors set as set out on pages 509 to 578 and other uncertainties discussed in this document. These include the significant risks for RBS presented by the outcomes of the legal, regulatory and governmental actions and investigations that RBS is or may be subject to (including active civil and criminal investigations) and any resulting material adverse effect on RBS of unfavourable outcomes and the timing thereof (including where resolved by settlement); economic, regulatory and political risks, including as may result from the uncertainty arising from the EU Referendum; RBS's ability to satisfy its residual EU State Aid obligations and the timing thereof; RBS's ability to successfully implement the significant and complex restructuring required to be undertaken in order to implement the UK ring-fencing regime and related costs; RBS's ability to successfully implement the various initiatives that are comprised in its transformation programme, particularly the proposed further restructuring of the NatWest Markets business, the balance sheet reduction programme and its significant cost-saving initiatives and whether RBS will be a viable, competitive, customer focused and profitable bank especially after its restructuring and the implementation of the UK ring-fencing regime; the exposure of RBS to cyber-attacks and its ability to defend against such attacks; RBS's ability to achieve its capital and leverage requirements or targets which will depend in part on RBS's success in reducing the size of its business and future profitability as well as developments which may impact its CET1 capital including additional litigation or conduct costs, additional pension contributions, further impairments or accounting changes; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; RBS's ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBS, RBS entities or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBS's strategic refocus on the UK; as well as increasing competition from new incumbents and disruptive technologies.

Forward looking statements

In addition, there are other risks and uncertainties that could adversely affect our results, ability to implement our strategy, cause us to fail to meet our targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to RBS's business and will increase as a result of RBS's significant restructuring initiatives being concurrently implemented; the potential negative impact on RBS's business of global economic and financial market conditions and other global risks; the impact of a prolonged period of low interest rates or unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBS operates as well as divergences in regulatory requirements in the jurisdictions in which RBS operates; the risks relating to RBS's IT systems or a failure to protect itself and its customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBS's capital position; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if its risk management framework is ineffective; RBS's ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, RBS's activities as a result of HM Treasury's investment in RBS; the value and effectiveness of any credit protection purchased by RBS; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which RBS operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBS's financial statements or adversely impact its capital position; the impact of the recovery and resolution framework and other prudential rules to which RBS is subject; the recoverability of deferred tax assets by the Group; and the success of RBS in managing the risks involved in the foregoing.

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

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

Presentation of information

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

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

Non-GAAP financial information

RBS prepares its financial statements in accordance with IFRS as issued by the IASB which constitutes a body of generally accepted accounting principles ('GAAP'). This document contains a number of non-GAAP (or non-IFRS) financial measures. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure.

The non-GAAP measures used in this document generally exclude certain items which management believe are not representative of the underlying performance of the business and which distort period-on-period comparison. These measures are used internally by management, in conjunction with IFRS financial measures, to measure performance and make decisions regarding the future direction of the business. Management believes these non-GAAP measures, when provided in combination with reported IFRS results, provide helpful supplementary information for investors. These adjusted measures, derived from the reported results are non-IFRS financial measures but are not a substitute to IFRS reported measures.

The main non-GAAP measures used in this document include:

- 'Adjusted' measures of financial performance, principally operating profit, operating expenses, total income and other performance measures before: own credit adjustments; gain or loss on redemption of own debt; strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill. RFS Holdings minority interest (RFS MI) was shown separately for 2014 only;

- Certain performance ratios based on the adjusted performance measures described above, including the adjusted cost:income ratio (calculated using adjusted operating income and costs), adjusted return on equity ratio (calculated using adjusted operating profit) and the 2016 cost saving progress and targets (calculated using operating expenses excluding litigation and conduct costs, restructuring costs, write down of goodwill, the impairment of other intangible assets, the operating costs of Williams & Glyn and the VAT recovery);
- Personal & Business Banking (PBB) franchise results, combining the reportable segments of UK Personal & Business Banking (UK PBB) and Ulster Bank RoI, Commercial & Private Banking (CPB) franchise results, combining the reportable segments of Commercial Banking, Private Banking and RBS International (RBSI) and 'core bank' results combining PBB, CPB and NatWest Markets results which are presented to provide investors with a summary of the Group's business performance (see page 172 for further business descriptions); and

Reconciliations of these non-GAAP measures to the closest equivalent GAAP measure are presented throughout this document and in the 2016 performance on page 6.

Key operating indicators

This document includes a number of operational metrics which management believes may be helpful to investors in understanding the Group's business, including the Groups position against its own targets. These metrics include performance, funding and credit metrics such as 'return on tangible equity' and related RWA equivalents incorporating the effect of capital deductions (RWAes), total assets excluding derivatives (funded assets) and net interest margin (NIM) adjusted for items designated at fair value through profit or loss (non-statutory NIM), cost:income ratio, loan:deposit ratio and REIL/impairment provision ratios. These are internal metrics used to measure business performance.

Capital and liquidity measures

Certain liquidity and capital measures and ratios are presented in this document as management believes they are helpful for investors' understanding of the liquidity and capital profile of the business and the Group's position against its own targets and applicable regulatory requirements. Some of these measures are used by management for risk management purposes and may not yet required to be disclosed by a government, governmental authority or self-regulatory organisation. As a result, the basis of calculation of these measures may not be the same as that used by the Group's peers. These capital and liquidity measures and ratios include: the liquidity coverage ratio, stressed outflow coverage and net stable funding ratio.

Transfers

The year on year comparison of the Commercial Banking results is affected by a number of internal business transfers which took place in 2015 and 2016. In line with changes to the business model, the UK and Western European corporate loan portfolios were transferred to Commercial Banking in Q2 2015 and

Q4 2015. Ulster Bank NI transferred Q1 2016 and a transfer of clients to Retail Q2 2016. The prior period financials were not restated.

Presentation of information

Recent developments

Board Appointment

RBS announced on 24 February 2017 that Mark Seligman has been appointed as a Non-executive Director with effect from 1 April 2017.

Payment Protection Insurance (PPI)

On 2 March 2017, the FCA published Policy Statement 17/3 containing its final rules and guidance on PPI complaint handling. The Policy Statement made clear the FCA's intention to implement a two year PPI complaints deadline with effect from 29 August 2017, bringing an end to new PPI complaints in August 2019. New rules for the handling of Plevin complaints will also come into force on 29 August 2017. The proposals in the Policy Statement are largely as previously anticipated and RBS does not currently consider that an additional provision will be required.

London Interbank Offered Rate (LIBOR)

As previously disclosed, certain members of the Group have been named as defendants in US class actions relating to alleged manipulation of various interest rate benchmarks, each of which is pending in the United States District Court for the Southern District of New York. On 10 March 2017, the court in the action relating primarily to over-the-counter derivatives allegedly linked to JPY LIBOR and Euroyen TIBOR dismissed the case on the ground that the plaintiffs lack standing. The dismissal by the court may be subject to appeal.

Claim by the US Federal Deposit Insurance Corporation

On 10 March 2017, the US Federal Deposit Insurance Corporation, on behalf of 39 failed US banks, issued a claim in the High Court of Justice of England and Wales against RBS, other LIBOR panel banks and the British Bankers' Association, alleging collusion with respect to the setting of USD LIBOR. The action alleges that the defendants breached English and European competition law as well as asserting common law claims of fraud under US law.

Regulator requests concerning certain historic Russian transactions

Recent media coverage has highlighted an alleged money laundering scheme involving Russian entities between 2010 and 2014. Allegedly certain European banks, including 17 UK based financial institutions, and certain US banks, were involved in processing certain transactions associated with this scheme.

In common with other banks, in March 2017 RBS received a request for information from the FCA in relation to this matter. RBS has also received similar requests from regulators in other jurisdictions. RBS has responded to the FCA and is in the course of responding to the requests from other regulators.

2016 performance

RBS reported an operating loss before tax of £4,082 million for 2016 and an attributable loss⁽¹⁾ of £6,955 million, which included litigation and conduct costs of £5,868 million, restructuring costs of £2,106 million, the final Dividend Access Share (DAS) dividend of £1,193 million and Capital Resolution disposal losses and impairments of £825 million. Restructuring costs included a £750 million provision in respect of the 17 February 2017 update on RBS's remaining State Aid obligation regarding Williams & Glyn.

Across our Personal & Business Banking (PBB), (which includes the reportable segments UK PBB and Ulster Bank RoI Commercial & Private Banking (CPB) which includes the reportable segments Commercial Banking, Private Banking and RBSI and NatWest Markets (NWM) franchises), (together the 'core bank'), RBS reported a £602 million, or 41%, increase in operating profit before tax to £2,058 million in 2016. Adjusted operating profit before tax increased by £163 million, or 4%, to £4,249 million for 2016 (refer to segmental income statement reconciliations on page 6)

In 2016 RBS delivered against all of its operating financial targets; PBB and CPB had combined income growth of 3%. PBB and CPB had combined adjusted income growth of 2%, (including transfers of £98 million in 2015) underpinned by 10% net lending growth, expenses have been reduced by around £1 billion for the third year in succession as the bank continues to focus on digital channels and on simplification of its processes, and Capital Resolution RWAs have reduced by a further £14.5 billion, or 30%, to £34.5 billion, with 80% of RWAs now relating to PBB, CPB and NatWest Markets compared with 72% at the end of 2015 (refer to segmental income statement reconciliations on page 6). RBS is committed to achieving its sub 50% cost:income ratio and 12% return on tangible equity targets by 2020.

Common Equity Tier 1 ratio of 13.4% reduced by 210 basis points during 2016, but remains ahead of our target despite recognising significant charges relating to remaining legacy issues.

Our 2016 performance at a glance

| | | |
|-------------------------------|-----------------------------------|---------------------------|
| (£4,082m) | 129% | £2,058m |
| Operating loss before tax (3) | Cost:income ratio - statutory (4) | PBB,CPB & NatWest Markets |

| | | |
|--|--|---|
| | | operating profit before tax |
| (£6,955m) | 66% | £4,249m |
| Loss attributable to ordinary shareholders | Cost:income ratio – adjusted (3) | PBB,CPB & NatWest Markets adjusted operating profit before tax(2,4) |
| £228.2bn | 2.18% | 123% |
| Risk-weighted assets | Net interest margin | Liquidity coverage ratio (5) |
| 13.4% | (17.9%) | £33.7bn |
| Common Equity Tier 1 ratio (6) | Return on tangible equity (7,8) | Gross new mortgage lending across England, Wales and Scotland (9) |
| 75% | £1.32bn | |
| Employee engagement score | Total tax paid to the UK Government (10) | |

Notes:

(1) Attributable to ordinary shareholders.

(2) Personal & Business Banking consists of the reportable segments UK PBB and Ulster Bank Rol, and Commercial & Private Banking consists of the reportable segments Commercial Banking, Private Banking and RBSI.

(3) Adjusted operating profit before tax means operating profit before tax excluding own credit adjustments (2016 - £180 million; 2015 - £309 million), loss on redemption of own debt (2016 - £126 million; 2015 - £263 million), strategic disposals (2016 - £164 million gain; 2015 - £157 million loss), restructuring costs (£2,106 million; 2015 – £2,931 million), litigation and conduct costs (2016 - £5,868 million; 2015 – £3,568 million) and write down of goodwill (2016 – nil; 2015 – £498 million).

(4) Adjusted cost:income ratio means cost:income ratio excluding own credit adjustments (2016 - £180 million; 2015 - £309 million), loss on redemption of own debt (2016 - £126 million; 2015 - £263 million), strategic disposals (2016 - £164 million gain; 2015 - £157 million loss), restructuring costs (2016 - £2,106 million; 2015 – £2,931 million), litigation and conduct costs (2016 - £5,868 million; 2015 – £3,568 million) and write down of goodwill (2016 – nil; 2015 – £498 million).

(5) On 1 October 2015 the LCR became the Prudential Regulation Authority's (PRA) primary regulatory liquidity standard; UK banks are required to meet a minimum standard of 80% initially, rising to 100% by 1 January 2018. The published LCR excludes Pillar 2 add-ons. RBS calculates the LCR using its own interpretation of the EU LCR Delegated Act, which may change over time and may not be fully comparable with that of other institutions.

(6) Based on end-point Capital Requirements Regulation (CRR) Tier 1 capital and leverage exposure under the CRR Delegated Act.

(7) Tangible equity is equity attributable to ordinary shareholders less tangible assets.

(8) RBS's CET 1 target is 13% but for the purposes of computing segmental return on equity (ROE), to better reflect the differential drivers of capital usage, segmental operating profit after tax and adjusted for preference dividends is divided by notional equity allocated at different rates of 11% (Commercial Banking and Ulster Bank RoI), 12% (RBS International) and 15% for all other segments, of the monthly average of segmental risk-weighted assets incorporating the effect capital deductions (RWAs). RBS Return on equity is calculated using profit for the period attributable to ordinary shareholders.(2) Excluding own credit adjustments, (loss)/gain on redemption of own debt, strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill.

(9) Gross new mortgage lending in UK PBB, Ulster Bank RoI and RBS International (RBSI).

(10) Comprises 174 million corporate tax, 660 million irrecoverable VAT, 208 million bank levies and 279 million employer payroll taxes.

Segmental income statement reconciliations

| | PBB | | CPB | | | | | | | | |
|-------------------------------------|---------|--------|------------|---------|-------|---------|------------|-------|---------|----------|--|
| | | Ulster | | | | | | | Central | | |
| | UK | Bank | Commercial | Private | | | Capital | | items | Total | |
| | PBB | Rol | Banking | Banking | RBSI | NWM | resolution | W&G | Other | RBS | |
| 2016 | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m | |
| Total income - statutory | 5,290 | 576 | 3,415 | 657 | 374 | 1,574 | (362) | 837 | 229 | 12,590 | |
| Own credit adjustments | — | (3) | — | — | — | (53) | (134) | — | 10 | (180) | |
| Loss on redemption of own debt | — | — | — | — | — | — | — | — | 126 | 126 | |
| Strategic disposals | — | — | — | — | — | — | 81 | — | (245) | (164) | |
| Total income - adjusted | 5,290 | 573 | 3,415 | 657 | 374 | 1,521 | (415) | 837 | 120 | 12,372 | |
| Operating expenses - statutory | (3,826) | (669) | (2,467) | (549) | (174) | (1,960) | (4,255) | (450) | (1,844) | (16,194) | |
| Restructuring costs - direct | 51 | 38 | 25 | 7 | 2 | 19 | 56 | 57 | 1,851 | 2,106 | |
| - indirect | 136 | 2 | 83 | 30 | 3 | 93 | 22 | — | (369) | — | |
| Litigation and conduct costs | 634 | 172 | 423 | 1 | — | 528 | 3,413 | — | 697 | 5,868 | |
| Operating expenses - adjusted | (3,005) | (457) | (1,936) | (511) | (169) | (1,320) | (764) | (393) | 335 | (8,220) | |
| Impairment (losses)/releases | (83) | 113 | (206) | 3 | (10) | — | (253) | (42) | — | (478) | |
| Operating profit/(loss) - statutory | 1,381 | 20 | 742 | 111 | 190 | (386) | (4,870) | 345 | (1,615) | (4,082) | |
| Operating profit/(loss) - adjusted | 2,202 | 229 | 1,273 | 149 | 195 | 201 | (1,432) | 402 | 455 | 3,674 | |
| Additional information | | | | | | | | | | | |

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| | | | | | | | | | | |
|-------------------------------------|---------|-------|---------|---------|-------|---------|---------|-------|---------|----------|
| Return on equity (1) | 16.2% | 0.7% | 4.1% | 5.6% | 13.8% | (6.6%) | nm | nm | nm | (17.9%) |
| Return on equity - adjusted (1,2) | 26.8% | 8.4% | 8.4% | 7.8% | 14.2% | 1.1% | nm | nm | nm | 1.6% |
| Cost income ratio | 72% | 116% | 72% | 84% | 47% | 125% | nm | 54% | nm | 129% |
| Cost income ratio - adjusted (2) | 57% | 80% | 57% | 78% | 45% | 87% | nm | 47% | nm | 66% |
| | | | | | | | | | | |
| 2015 | | | | | | | | | | |
| Total income - statutory | 5,200 | 550 | 3,254 | 644 | 367 | 1,527 | 539 | 833 | 9 | 12,923 |
| Own credit adjustments | — | — | — | — | — | (120) | (175) | — | (14) | (309) |
| Loss on redemption of own debt | — | — | — | — | — | — | — | — | 263 | 263 |
| Strategic disposals | — | — | — | — | — | — | 38 | — | 119 | 157 |
| | | | | | | | | | | |
| Total income - adjusted | 5,200 | 550 | 3,254 | 644 | 367 | 1,407 | 402 | 833 | 377 | 13,034 |
| Operating expenses - statutory | (4,177) | (429) | (1,921) | (1,101) | (160) | (2,369) | (4,951) | (387) | (858) | (16,353) |
| Restructuring costs - direct | 38 | 12 | 52 | 7 | — | 44 | 380 | 28 | 2,370 | 2,931 |
| - indirect | 129 | 3 | 17 | 66 | 4 | 480 | 927 | — | (1,626) | — |
| Litigation and conduct costs | 972 | (13) | 51 | 12 | — | 378 | 2,105 | — | 63 | 3,568 |
| Write down of goodwill | — | — | — | 498 | — | — | — | — | — | 498 |
| | | | | | | | | | | |
| Operating expenses - adjusted | (3,038) | (427) | (1,801) | (518) | (156) | (1,467) | (1,539) | (359) | (51) | (9,356) |
| Impairment releases/(losses) | 7 | 141 | (69) | (13) | — | 5 | 725 | (15) | (54) | 727 |
| Operating profit/(loss) - statutory | 1,030 | 262 | 1,264 | (470) | 207 | (837) | (3,687) | 431 | (903) | (2,703) |
| Operating profit/(loss) - adjusted | 2,169 | 264 | 1,384 | 113 | 211 | (55) | (412) | 459 | 272 | 4,405 |
| | | | | | | | | | | |
| Additional information | | | | | | | | | | |
| Return on equity (1) | 11.7% | 10.6% | 9.8% | (27.7%) | 18.5% | (11.1%) | nm | nm | nm | (4.7%) |
| Return on equity - adjusted (1,2) | 26.2% | 10.6% | 10.9% | 4.9% | 18.9% | (2.0%) | nm | nm | nm | 11.0% |
| Cost income ratio | 80% | 78% | 59% | 171% | 44% | 155% | nm | 46% | nm | 127% |
| Cost income ratio - | 58% | 78% | 55% | 80% | 43% | 104% | nm | 43% | nm | 72% |

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| | | | | | | | | | | | |
|-------------------------------------|---------|-------|---------|-------|-------|---------|---------|-------|---------|----------|--|
| adjusted (2) | | | | | | | | | | | |
| 2014 | | | | | | | | | | | |
| Total income - statutory | 5,444 | 604 | 3,305 | 689 | 391 | 1,931 | 1,792 | 852 | 142 | 15,150 | |
| Own credit adjustments | — | — | — | — | — | 9 | 36 | — | 101 | 146 | |
| Gain on redemption of own debt | — | — | — | — | — | — | — | — | (20) | (20) | |
| Strategic disposals | — | — | — | — | — | — | — | — | (191) | (191) | |
| Total income - adjusted | 5,444 | 604 | 3,305 | 689 | 391 | 1,940 | 1,828 | 852 | 32 | 15,085 | |
| Operating expenses - statutory | (4,157) | (421) | (1,964) | (595) | (160) | (2,650) | (2,497) | (330) | (1,085) | (13,859) | |
| Restructuring costs - direct | 10 | (8) | 41 | 1 | 2 | 13 | 80 | — | —1,015 | 1,154 | |
| - indirect | 101 | 21 | 67 | — | 5 | 89 | 105 | — | —(388) | — | |
| Litigation and conduct costs | 918 | (19) | 112 | 90 | — | 832 | 162 | — | —99 | 2,194 | |
| Write down of goodwill | — | — | — | — | — | — | 130 | — | — | 130 | |
| Operating expenses - adjusted | (3,128) | (427) | (1,744) | (504) | (153) | (1,716) | (2,020) | (330) | (359) | (10,381) | |
| Impairment (losses)/releases | (154) | 306 | (85) | 5 | 7 | 9 | 1,307 | (55) | 12 | 1,352 | |
| Operating profit/(loss) - statutory | 1,133 | 489 | 1,256 | 99 | 238 | (710) | 602 | 467 | (931) | 2,643 | |
| Operating profit/(loss) - adjusted | 2,162 | 483 | 1,476 | 190 | 245 | 233 | 1,115 | 467 | (315) | 6,056 | |
| Additional information | | | | | | | | | | | |
| Return on equity (1) | 11.9% | 18.6% | 10.2% | 4.1% | 24.2% | (7.9%) | nm | nm | nm | (8.2%) | |
| Return on equity - adjusted (1,2) | 23.7% | 18.4% | 12.2% | 9.1% | 24.9% | 1.3% | nm | nm | nm | (1.5%) | |
| Cost income ratio | 76% | 70% | 59% | 86% | 41% | 137% | nm | 39% | nm | 91% | |
| Cost income ratio - adjusted (2) | 57% | 71% | 53% | 73% | 39% | 88% | nm | 39% | nm | 69% | |

Notes:

(1) RBS's CET 1 target is 13% but for the purposes of computing segmental return on equity (ROE), to better reflect the differential drivers of capital usage, segmental operating profit after tax and adjusted for preference dividends is divided by notional equity allocated at different rates of 11% (Commercial Banking and Ulster Bank RoI), 12% (RBS International) and 15% for all other segments, of the monthly average of segmental risk-weighted assets incorporating the effect capital deductions (RWAes). RBS Return on equity is calculated using profit for the period attributable to ordinary shareholders.

(2) Excluding own credit adjustments, (loss)/gain on redemption of own debt and strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill.

Chairman's statement

Howard Davies

Chairman

2016 was another difficult year for RBS shareholders, even though there is good progress to report on our strategy to rebuild a strong bank focused primarily on retail and commercial customers in the UK and Ireland.

The core bank(1) performed strongly, and adjusted operating profits were up by around 4%(2), in a year of political and economic uncertainty. That progress reflects growth in our market share in the mortgage market and a resumption of growth in business lending, after many years of decline. It shows, too, that the strong focus on reducing costs is beginning to pay off.

Nonetheless the attributable loss(3), at around £7 billion, was more than three times as large as in 2015. It is hard to present that as a positive outcome for shareholders, though in fact it does reflect the impact of stronger efforts to resolve the bank's legacy problems. We settled a number of regulatory and legal actions and made a large provision for future costs, we retired the Dividend Access Share and made a large number of disposals of legacy assets. Restructuring costs were also large in the year. As a result, the bank is better placed than it was a year ago, though there are still some sizeable legacy problems to resolve. The Board and I are determined to press ahead with resolution of those issues and to continue with the strategy Ross McEwan first outlined in 2014. We are confident that we have the right management team in place to deliver effectively in both areas.

The Economic and Regulatory Environment

The UK economy grew by around 2% in 2016, a little less rapidly than in 2015, but still at a healthy rate in what is now a mature recovery. Unemployment remained low inflation stayed well below the Bank of England's target rate and house prices rose, on average, by around 5%, though the regional variations were wide. These might, overall, seem to be benign conditions for banks, but the low interest rate environment, and especially a relatively flat yield curve, are challenges to profitability. Some central banks are charging negative interest rates, and while the Bank of England has not followed them, the base rate was reduced from 0.5% to 0.25% in August, after the referendum on European Union (EU) membership. This lower interest rate environment puts further pressure on banks to control their costs.

The vote to leave the EU was widely expected to have a negative impact on the economy. So far, we have seen a significant fall in sterling, but consumer spending has remained robust, and growth has continued. Of course the UK has not yet left the EU, and we do not know the terms of our departure, so the long-term impact remains impossible to predict. The short-term effect on banks was felt primarily through the reduction in interest rates.

There has been much debate about the impact on the City, and on UK financial services in general, if, as now seems likely, we also leave the single market. As I write, the Article 50 negotiations have not yet begun, so it is idle to speculate. RBS as a primarily UK bank will be less affected than most, but we own Ulster Bank in Ireland and have modest presences in major EU corporate markets. We will take steps to protect those assets as the regulatory environment becomes clearer.

Our prime focus through this uncertain period has been, and will continue to be, to provide high quality banking services to our customers and to help them to understand the implications of change for their businesses and their families.

Chairman's statement

The regulatory environment continues to be challenging for banks. The Basel Committee is discussing a new set of proposals which could have the effect of increasing capital requirements materially, though no agreement has yet been reached. In the UK, the Bank of England stress tests are built on very rigorous assumptions about growth and asset prices. RBS failed its stress test in 2016, primarily on the basis of assumptions reflecting the uncertainty of future conduct costs, especially from legacy problems in the US. We agreed measures to strengthen our balance sheet as a result, which are already underway.

UK banks are also now heavily engaged in preparations for the implementation of ring-fencing, as required by the legislation implementing the recommendation of the Independent Commission on Banking. We are implementing our own plans and expect to meet the statutory deadline of 1 January 2019.

Strategy

Set against that backdrop our strategy remains consistent. The aim is to make RBS a simpler bank focused on doing fewer things, built around a low risk UK and Irish retail and commercial bank and markets business; a safer bank with a long-term target of a CET1 ratio of at least 13%; and a customer- focused bank that is easier to do business with. Our aspiration remains to be the best UK bank for customer service, trust and advocacy by 2020. We will retain a smaller markets business, which complements our strong domestic franchises. The Board are confident that this is the right path to follow and that the bank will deliver good returns for shareholders when its legacy problems have been resolved.

In early 2016 we renewed our long- term targets of 50% for the cost to income ratio and 12% for return on tangible equity. Given expected slower economic growth over the medium- term, we now think we will achieve those objectives in 2020, a year later than previously communicated. That change aligns the timing of our financial targets with our customer service ambitions. It is not yet possible to give a reliable forecast of when the bank will be able to restore a dividend.

Conduct, litigation and legacy issues

As I have said, during the year we made good progress in dealing with a number of legacy issues that have been clouding our performance and shareholder investment case.

We were able to remove one of the main barriers to paying a dividend by paying the final £1.2 billion to retire the Dividend Access Share.

In January 2016, the Board took the decision to make an accelerated £4.2 billion payment to our main pension scheme. Taking this action reduced the scheme deficit considerably and helped provide certainty on our capital management of the pension scheme for both members and regulators. The next valuation is scheduled for 2018.

We also resolved a number of litigation cases relating to foreign exchange and interest rate fixing allegations. These settlements were costly reminders of past behaviours that have no place in the industry or the bank we are building.

The treatment of some of our small business customers has been under scrutiny. Although the Financial Conduct Authority (FCA) review into the historical operation of our former Global Restructuring Group (GRG) continues, I am pleased that with the endorsement of the FCA we were able to announce a new complaints process, led by Sir William Blackburne, a retired High Court judge, alongside an automatic refund for some of the complex fees charged to customers who were in GRG between 2008 - 2013. While we have acknowledged we did not treat all these troubled business customers as well as we should have done, we do not accept that the bank artificially distressed otherwise viable SME businesses or deliberately caused them to fail. The FCA's skilled person and our independent investigators have also found no evidence that the bank either inappropriately targeted businesses to transfer them into GRG or drove them to insolvency.

Another legacy problem on the way to resolution is the shareholder litigation related to the 2008 rights issue. We announced in December that we made an offer to affected shareholders to resolve that litigation and four out of five groups involved have already accepted it.

Following the Government's injection of capital into the bank in 2008, RBS undertook to carry out five major divestments as part of the State Aid commitments agreed with the European Commission (EC). Four have been successfully implemented. The fifth entailed a divestment of assets to enhance competition in the UK's SME banking market. The bank identified a collection of branches and customer relationships, identified as a new bank to be known as Williams & Glyn.

Chairman's statement

Implementing that divestment has proved extremely difficult, partly for technological reasons. In addition, the lower interest rate environment threatened the viability of the new bank.

In the light of these changed circumstances, on 17 February this year, the EC and HM Treasury announced a consultation on a plan, intended to promote competition in different ways, which can be implemented more easily and rapidly. The plan is not yet firm, but we have prudently provided for its cost to the bank in our accounts. We are grateful to the EC for its willingness to consider alternative means to the same end. If carried through, they will relieve the bank of a major operational burden which has constrained our ability to upgrade and enhance our IT systems in the interests of our customers.

But there are other issues from the past which remain to be resolved, and where it has been frustratingly difficult to make progress. By a distance the most financially significant relates to the bank's participation in the US subprime mortgage market in the run up to the financial crisis, and especially in 2007. The Massachusetts Attorney General's Office has been investigating the circumstances of some of the transactions for some years, and we have been in parallel discussions with the Federal Housing Finance Agency. Shareholders will be aware that a number of other banks, both US and European, have settled their claims over the past year, but RBS remains under investigation and as we have said, faces potential criminal and civil action. At this point we cannot say when the issues will be resolved, as the timing is out of our hands.

Remuneration

While RBS continues to report losses it is vital that the bank remains disciplined in its approach to remuneration. On the other hand, we need to fairly reward our colleagues who work with customers from day to day and who bear no responsibility for the decisions which led to those losses, and it is important for the long-term value of shareholders' investment in the company that we attract and retain well-qualified and motivated people. We believe the decisions we have made this year, on the bonus pool (which has been further reduced) and on the proposed new long-term incentive scheme, strike that balance appropriately. They are more fully explained in the 2016 Remuneration report.

Supporting our communities

We refreshed our main customer facing brands during the year, with a new advertising campaign, emphasising their contribution to the communities in which they operate. In England our principal brand is NatWest, in Ireland it is Ulster Bank, and of course in Scotland it is The Royal Bank of Scotland, which has been providing banking services to the country since 1727. We also have a vital role to play in these communities that goes beyond traditional banking activity. Our support of small businesses continues to

strengthen through our partnership with Entrepreneurial Spark. In 2016 we opened a further six accelerator hubs. These accelerator hubs, which are based in our buildings, provide start-ups with free office space, mentoring and access to our networks. Over 7,000 entrepreneurs will be supported in this way over five years, helping to grow the economy and create thousands of jobs.

Our financial education programme, MoneySense, continues to deliver vital skills to young people that will help them be more financially aware in later life. This year we have helped over 300,000 young people in the UK.

In 2016 we also celebrated our 40th anniversary of supporting The Prince's Trust. To mark this milestone, we raised over £470,000 in just five days, with 566 colleagues cycling across the country in fundraising efforts.

This year, we have taken the first step towards combining our 2016 Sustainability and Strategic reports, bringing together in one place our financial and non financial performance to demonstrate how we are building a more sustainable bank to deliver long term value to all our stakeholders.

Stakeholder Engagement

We welcomed the opportunity to participate in the Department for Business, Energy and Industrial Strategy's (BEIS) Green Paper consultation on Corporate Governance Reform. The chapter on strengthening the employee, customer and wider stakeholder voice was of particular interest. This is a cause that we care about. As noted in our response to BEIS, we are looking at ways of improving and building upon our existing arrangements in order to promote the stakeholder voice at board level. We are supportive of the proposal to increase wide stakeholder engagement, including via a panel arrangement. As an organisation, we have maintained active engagement with stakeholders over several years through our Sustainable Banking Committee which, since 2011, has regularly met with external stakeholders and asks them to challenge the most senior decision makers in RBS. We see increased formal engagement as the natural evolution of that committee's work.

Chairman's statement

Board changes

Frank Dageard is the one new face around the boardroom table since last year. He joined the Board in May 2016 and brings a wealth of experience from a number of senior roles and directorships across a range of technology and financial services companies. This knowledge is vital as the bank adapts to increasing customer use of digital channels, and to the need for ever heightened awareness of the risk of cyber attacks.

Conclusion

I am uncomfortably aware that the reconstruction and rehabilitation of RBS has taken longer than expected, and is still not complete. We can now see clearly the shape of a profitable bank which serves its customers and communities well. There is still a road to travel before we reach that destination, and of course the competitive environment for banks continues to evolve. I assure you that the Board and management are single-mindedly focused on delivering value for our shareholders, and are grateful for your patience as we proceed.

Notes:

(1) The core bank consists of the reportable segments UK PBB, Ulster Bank RoI, Commercial Banking, Private Banking, RBSI and NatWest Markets.

(2) Adjusted operating profit before tax - UK PBB up by £33 million, 2%, to £2,202 million, Ulster Bank RoI down by £35 million, 13%, to £229 million, Commercial Banking down by £111 million, 8%, to £1,273 million, Private Banking up £36 million, 32%, to £149 million, RBSI down by £16 million, 8%, to £195 million and NatWest Markets up by £256 million to £201 million. See page 6 for segmental income statement reconciliations.

(3) Attributable to ordinary shareholders.

Chief Executive's review

Ross McEwan

Chief Executive

In 2016 RBS made an attributable loss(1) of £7.0 billion, mostly reflecting charges for outstanding litigation and conduct, and costs associated with restructuring of the bank. The financial impact of these issues is a difficult but necessary step in working through the bank's legacy issues. These costs are a stark reminder of what happens to a bank when things go wrong and you lose focus on the customer, as this bank did before the financial crisis. The more progress we have made on clearing these past issues, enables us to sharpen our focus on the core bank.

Our service level and product improvements are already delivering benefits for both customers and the core bank. In 2017 our focus will turn to going even further on reducing costs and faster on digital transformation in order to deliver a more simple, safe and customer-focused bank.

The bank we were

I joined RBS because I could see that underneath all the troubles it faced, there was a strong bank, with excellent brands and great colleagues, doing outstanding things for customers each day. This underlying strength is still evident today.

In 2014 I announced a three phase strategy. We are moving to the final phase of this, after delivering much during the first two phases, which were about building a platform of strength and stripping away unnecessary complexity. Our CET1 ratio has now materially improved to 13.4% from 8.6% at the start of 2014. We have thoroughly reshaped our investment banking business, now rebranded NatWest Markets. We have sold Citizens in the US, completing the largest bank IPO in US history in the process, and also sold our international private banking business. We have ended active operations in 26 countries, decommissioned 30% of our IT systems and applications, and almost halved the number of legal entities. We have also completed the run-down or sale of over three quarters of Capital Resolution legacy and non-core assets. We have reduced our cost base by over £3 billion, exceeding our target for the third consecutive year, with an operating cost reduction of £985 million(2).

The past is not completely behind us, with our dealings on Residential Mortgage Backed Securities (RMBS) and Williams & Glyn, our residual European Commission State Aid obligations, two significant issues that we still need to resolve. The recent proposal by HM Treasury on an alternative way to increase competition to allow us to meet our State Aid commitments would deliver an outcome more quickly, and with more certainty than undertaking a complex sale. We have been able to provide for both of these in our accounts, though there may still be substantial additional provisions on RMBS.

The bank we are today

We are now in a much better position to focus on our long term aspiration – to transform the bank into the number one for customer service, trust, and advocacy. While the signs of this transformation have at times been masked by our wider organisational changes, the core bank(3) has already evolved materially since 2014. Our decision to refocus on the UK has seen our balance sheet shrink by £229 billion since the start

of our plan. This is net of the continued growth in our Personal and Business Banking and Commercial and Private Banking franchises(4). We are seeing the benefits of our service-led strategy in the financial performance of the core bank, generating £4.2 billion in adjusted pre-tax operating profit(5) for the year, an average of £1 billion per quarter for the last eight quarters and 4% up on 2015.

Chief Executive's review

While Q4 was down from the levels seen earlier this year, our Net Promoter Scores for Commercial and NatWest Personal in 2016 were the highest they have ever been. With £30 billion of gross new mortgage lending in UK PBB, we helped 320,000 customers with their mortgage in 2016, growing our market share for the fourth consecutive year without leading on price or risk. We are the largest commercial bank in the UK, and are ranked joint number one by Net Promoter Score. Our ability to generate value here is shown by the scale of support we have provided to the economy in the past year, with almost £9 billion of new net commercial lending.

The bank we are becoming

We still have more work to do. In part, that means finishing the restructuring of RBS, resolving the remaining legacy issues, and preparing the bank for ring-fencing. In the main, however, it is about adapting to the changing nature of the UK and Irish banking sectors, and investing to meet our customers' evolving needs.

Digital innovation means customers are doing more of their transactions online. We interact with our customers over 20 times more through digital channels than physical ones. 35% of all new products were taken out digitally in UK PBB, and this is rising steadily. A fifth of our customers now solely use mobile and digital to interact with us. As customers change the way they bank with us, we must change the way we serve them. This means continuing to simplify for our customers, and accelerating our deployment of digital and mobile capabilities. The role of the branch is fast moving to an advice and service centre, away from transactions. While the branch will still be a core part of our offering to customers, inevitably some branches will have to close.

We're working to blur the line between traditional and digital banking channels. We are investing in a video sales and service proposition that will connect customers, no matter where they are, to the right specialist. This shift isn't only in personal banking. We are aiming to service 95% of our commercial customers' needs through mobile and online by 2020, up from nearly 80% today, by introducing a new digital banking service that will greatly improve experience. We're also responding to customer preferences for more innovative lending platforms and products.

We are investing heavily in technology in our NatWest Markets business. Hundreds of separate product databases will be replaced with a single, scalable platform, which will help reduce costs significantly and dramatically increase the speed at which we can deploy new capabilities for our customers. We are also introducing a single dealer platform, an electronic front door, through which we can provide FX and Rates solutions to our clients. These are the kind of changes that will lower costs while protecting revenue and delivering even better customer service at the same time.

We are committed to running the bank as a more sustainable and responsible business, serving today's customers in a way that also helps future generations, generating long term value for all of our stakeholders and society. In 2016, we improved on our position in a number of rankings, including achieving our highest ever score in the Dow Jones Sustainability Index. We continued with our commitment to manage our impacts on climate change and support our customers to move towards the transition to a low-carbon economy. We continue to support financial education and our goal is to help a further one million more young people understand all about money by the end of 2018.

Our commitment to sustainability is also evident in our annual results, where we have replaced our annual Sustainability Report with a more integrated approach. You will see a number of new elements in the Strategic Report that explain the key influences on our operating environment, and some of the impact we have had over the past year. This is an important step towards fully integrated reporting over the coming years.

Delivering our strategy

The decision last summer by UK voters to leave the EU will have wide-reaching consequences. In light of this, we reviewed our plan to ensure that it remained valid in a changed macro and political environment. Following that review, I want to re-iterate our commitment to the strategy we have been pursuing since I became CEO – we firmly believe that our aspiration to reach No.1 for customer service, trust and advocacy will maximise value for our shareholders.

This year we have met all our operating financial targets, though the results of some of our customer NPS and employee engagement surveys show we still have work to do. After the EU referendum result, we promised an update on our targets. We are targeting an unadjusted 12% or greater return on tangible equity, and a below 50% cost to income ratio by 2020, one year later than envisaged when we first set out our plan in 2014.

Chief Executive's review

Our service levels are improving and we believe we can meet our 2020 aspirational customer and colleague targets. Our focus on capital strength remains a cornerstone of our plan. In 2017, we will continue to reduce legacy RWAs, and we will target a CET1 ratio of at least 13%.

This has also been another tough year for our colleagues. I am grateful for their determination in serving our millions of customers every day, despite many negative headlines. Our colleagues are the face of the bank for our customers, and their engagement is critical to our success. One of our five key targets in 2017 is to improve employee engagement.

We no longer have global aspirations and we need to go further still on our operating costs. We expect to take out an additional £750 million of operating costs⁽⁶⁾ in 2017 through our focus on simplification and digital transformation. A simpler bank is a more profitable bank and a bank that delivers a better customer experience. Where we can make it easy for our customers, the more business they will do with us and the more sustainable our earnings will become.

Looking ahead

The progress of the last three years positions us well to achieve our vision for the future. We have the right strategy, and it is starting to deliver results. Now, we need to go further on cost reduction and faster on digital transformation.

We aren't alone in searching for efficiency gains and investing in digital capability, but the unique strength of this bank lies in the fact that we have a diverse business profile, with scale in all of our chosen markets. Investment in our market leading brands and better customer service will deliver steadier, higher quality earnings. Our focus on service rather than price has also shown that we can continue to grow in areas of strategic opportunity, such as mortgages, without compromising on risk. All of this will deliver a sustainable competitive advantage and a compelling investment case in the longer term.

This is a bank that has been on a remarkable journey. We still have further to go. But the next three years will not be the same as the past three. Legacy issues will take up a decreasing amount of our time and focus. Our customers, our cost base and the measures we plan to implement to return the bank to sustainable headline profits will be where we focus our efforts. Assuming we can conclude our issues on RMBS this year and resolve our residual State Aid obligations, we aim to have RBS back into profit in 2018 representing a significant step towards being able to start repaying UK taxpayers for their support.

Notes:

(1) Attributable to ordinary shareholders.

(2) Cost saving target and progress 2016 calculated using operating expenses excluding restructuring costs of £2,106 million (2015 – £2,931 million), litigation and conduct costs of £5,868 million (2015 – £3,568 million), write down of goodwill nil (2015 – £498 million), write down of other intangible assets of £117 million (2015 – £75 million), the operating costs of Williams & Glyn £393 million (2015 – £359 million) and the VAT recovery of £227 million.

(3) The core bank consists of the reportable segments UKPBB, Ulster Bank RoI, Commercial Banking, Private Banking, RBSI and NatWest Markets.

(4) Personal & Business Banking consists of the reportable segments UK PBB and Ulster Bank RoI, and Commercial & Private Banking consists of the reportable segments Commercial Banking, Private Banking and RBSI.

(5) Adjusted operating profit before tax - UK PBB up by £33 million, 2%, to £2,202 million, Ulster Bank RoI down by £35 million, 13%, to £229 million, Commercial Banking down by £111 million, 8%, to £1,273 million, Private Banking up £36 million, 32%, to £149 million, RBSI down by £16 million, 8%, to £195 million and NatWest Markets up by £256 million to £201 million. See page 6 for segmental income statement reconciliations.

(6) Cost saving target and progress 2017 calculated using operating expenses excluding restructuring costs, litigation and conduct costs, write down of goodwill and the 2016 VAT recovery.

2016 performance summary

RBS reported a loss attributable to ordinary shareholders of £6,955 million compared with £1,979 million in 2015. The loss attributable to ordinary shareholders for the year included; litigation and conduct costs of £5,868 million, restructuring costs of £2,106 million, payment of the final DAS dividend of £1,193 million, Capital Resolution disposal losses and impairments of £825 million and a £300 million deferred tax asset impairment.

The 2016 operating loss before tax of £4,082 million compared with an operating loss before tax of £2,703 million in 2015. Adjusted operating profit before tax, excluding own credit adjustments (2016 - £180 million; 2015 - £309 million), loss on redemption of own debt (2016 - £126 million; 2015-£263 million loss), strategic disposals (2016 - £164 million gain; 2015 - £157 million loss), restructuring costs (2016 - £2,106 million (2015 – £2,931 million), litigation and conduct costs £5,868 million (2015 – £3,568 million) and write down of goodwill nil (2015 – £498 million), of £3,674 million was £731 million, or 17%, lower than 2015.

The net interest margin (NIM) of 2.18% for 2016 was 6 basis points higher than 2015, as the benefit associated with the reduction in low yielding assets more than offset modest asset margin pressure and mix impacts across the core franchises.

Excluding expenses associated with Williams & Glyn(1,5), write-down of intangible assets and the VAT recovery in Q2, adjusted operating expenses have reduced by £985 million, or 11%, compared with 2015, exceeding our target of £800 million. RBS has reduced adjusted operating expenses(5) by over £3 billion in the last three years. Cost income ratio for 2016 was 129% compared with 127% in 2015 and the adjusted cost:income ratio was 66% compared with 72% in 2015.

Risk elements in lending (REIL) as a % of gross customer loans was 3.1%, 80 basis points lower than 31 December 2015 as RBS continues to de-risk its balance sheet.

PBB, CPB and NatWest Markets delivered increased profits and strong lending growth

RBS reported a £602 million, or 41%, increase in operating profit before tax to £2,058 million in 2016 and an adjusted operating profit before tax of £4,249 million across PBB, CPB and NatWest Markets, 4% higher than 2015 and an average of over £1 billion a quarter.

Income across PBB and CPB increased by 3% in 2016 compared with 2015. PBB and CPB had combined adjusted income growth of 2%, (including transfers of £98 million in 2015), as increased lending volumes more than offset reduced margins. NatWest Markets income of £1,574 million increased by 3% compared with 2015. Adjusted income of £1,521 million increased by 16% compared with 2015, including transfers (2), driven by Rates and Currencies.

PBB and CPB net loans and advances of £272.1 billion have increased by 10%(7) in 2016, compared with a target of 4%, reflecting strong growth across both residential mortgages and commercial lending.

The cost income ratio improved to 81% compared with 88% in 2015. Adjusted cost income ratio improved to 63% compared with 65% in 2015 as we continue to deliver efficiencies across PBB, CPB and NatWest Markets.

RBS continues to address its remaining legacy issues and drive forward its restructuring programme

Restructuring costs were £2,106 million for 2016, compared with £2,931 million in 2015, and included a £750 million provision in respect of the plan by the Commissioner responsible for EU competition policy to propose to the College of Commissioners to open proceedings to gather evidence on an alternative plan for RBS to meet its remaining State Aid obligations in respect of Williams & Glyn. If adopted, this alternative plan would replace the existing requirement to achieve separation and divestment by 31 December 2017. In addition, £706 million of the remaining restructuring costs related to Williams & Glyn, including £146 million of termination costs associated with the decision to discontinue the programme to create a cloned banking platform.

Litigation and conduct costs of £5,868 million included; a £3,107 million provision in relation to various investigations and litigation matters relating to RBS's issuance and underwriting of residential mortgage-backed securities (RMBS), an additional charge in respect of the settlement with the National Credit Union Administration Board to resolve two outstanding RMBS lawsuits, a provision in respect of the UK 2008 rights issue shareholder litigation, additional PPI provisions, a provision in respect of the FCA review of RBS's treatment of SMEs and a provision in Ulster BankRoI in respect of an industry wide examination of tracker mortgages.

A net strategic disposal gain of £164 million includes a £246 million gain on disposal of RBS's stake in Visa Europe partially offset by losses associated with the sale of our Russian subsidiary and exit of Kazakhstan.

PBB, CPB and NatWest Markets operating performance

Across our three customer facing franchises, PBB, CPB and NatWest Markets, operating profit before tax increased by £602 million, or 41%, to £2,058 million in 2016. Adjusted operating profit before tax, which excluded own credit adjustments (2016 - £56 million; 2015 - £120 million), restructuring costs (2016 - £489 million; 2015 – £852 million), litigation and conduct costs (2016 - £1,758 million; 2015 – £1,400 million) and write down of goodwill nil (2015 – £498 million), was £4,249 million, £163 million, or 4% higher than 2015.

2016 performance summary

UK PBB operating profit before tax was £1,381 million compared with £1,030 million in 2015. Adjusted operating profit before tax, which excludes restructuring costs of £187 million (2015 - £167 million) and litigation and conduct costs of £634 million (2015 - £972 million), of £2,202 million was £33 million, or 2%, higher than 2015 as increased income and reduced costs were partially offset by increased impairments. Total income increased by £90 million, or 2%, to £5,290 million compared with 2015 as the benefit of increased lending more than offset reduced margins, down 17 basis points to 3.01%, and lower fee income, reflecting reduced credit card interchange fees and increased cash back payments following the launch of the Reward account. Net loans and advances increased by 10% to £132.1 billion in 2016 principally driven by mortgage growth.

Ulster Bank RoI operating profit before tax was £20 million compared with £262 million in 2015. Adjusted operating profit before tax which excluded restructuring costs of £40 million (2015 - £15 million) and litigation and conduct costs of £172 million (2015 - £13 million credit), of £229 million was £35 million lower than 2015 principally reflecting a £28 million reduction in net impairment releases. REIL decreased by £1.3 billion in Q4 2016 largely driven by the sale of a portfolio of distressed loans.

Commercial Banking profit before tax was £742 million compared with £1,264 million in 2015. Adjusted operating profit before tax which excluded restructuring costs of £108 million (2015 - £69 million) and litigation and conduct costs of £423 million (2015 - £51 million), of £1,273 million was £111 million, or 8%, lower than 2015 primarily reflecting a £137 million increase in net impairment losses, largely driven by a single name charge in respect of the oil and gas portfolio. Excluding the business transfers, a benefit of £218 million (2015 - £79 million), total income increased by £21 million, or 1%, reflecting higher asset and deposit volumes partially offset by asset margin pressure. Net loans and advances increased by 10% in 2016 to £100.1 billion.

Private Banking(3) operating profit before tax was £111 million compared with an operating loss before tax of £470 million in 2015. Adjusted operating profit before tax which excluded restructuring costs of £37 million (2015 - £73 million) and litigation and conduct costs of £1 million (2015 - £12 million) and write down of goodwill (2015 - £498 million), of £149 million increased by £36 million, or 32%, compared with 2015 as increased asset volumes drove a £13 million, or 2%, uplift in income and cost efficiencies resulted in a £7 million, or 1%, reduction in adjusted operating expenses. In addition, net impairment losses reduced by £16 million.

RBS International operating profit before tax was £190 million compared with £207 million in 2015. Adjusted operating profit before tax which excluded restructuring costs of £5 million (2015 - £4 million), of

£195 million was £16 million, or 8%, lower than 2015 largely reflecting a £13 million, or 8%, increase in adjusted operating expenses which excluded restructuring costs of £5 million (2015 - £4 million), driven by a number of one-off charges, and a £10 million net impairment loss in 2016. Partially offsetting, total income increased by £7 million, or 2%, driven by increased asset volumes.

NatWest Markets total income was £1,574 million compared with £1,527 million in 2015. Adjusted income of £1,521 million which excluded the impact of transfers, £98 million in 2015 and own credit adjustments of £53 million (2015 - £120 million), was 16% higher than 2015, driven by Rates and Currencies, which benefited from sustained customer activity and favourable market conditions following the EU referendum and subsequent central bank actions. An adjusted operating profit of £201 million compared with a loss of £55 million in 2015.

Capital Resolution & Central items operating performance

Capital Resolution operating loss before tax was £4,870 million compared with £3,687 million in 2015. Adjusted operating loss before tax which excluded restructuring costs of £78 million (2015 - £1,307 million) and litigation and conduct costs of £3,413 million (2015 - £2,105 million), of £1,432 million compared with a loss of £412 million in 2015 and included disposal losses and impairments of £825 million, of which £683 million related to the shipping portfolio. RWAs reduced by £14.5 billion in 2016 to £34.5 billion.

Central items operating loss before tax was £1,615 million compared with £903 million in 2015. Adjusted operating profit which excluded own credit adjustments, £10 million credit (2015 - £14 million charge), loss on redemption of own debt £126 million (2015 - £263 million), strategic disposals resulting in a £245 million gain (2015 - £119 million loss), restructuring costs of £1,482 million (2015 - £744 million) and litigation and conduct costs of £697 million (2015 - £63 million), of £455 million compared with £272 million in 2015 and included a £349 million FX gain, principally associated with the weakening of sterling against the US dollar, a £227 million VAT recovery, a £97 million foreign exchange reserve recycling gain and other gains, partially offset by a £510 million loss in respect of IFRS volatility(4) due to reductions in long term interest rates (2015 – £15 million profit).

2016 performance summary

Delivery against our 2016 targets

| Strategy goal | 2016 target | 2016 |
|-------------------------------|--|--|
| Strength and sustainability | Maintain Bank CET1 ratio of 13% | CET1 ratio of 13.4% |
| | £2 billion AT1 issuance | £2 billion equivalent AT1 issued in Q3 2016 |
| | Capital Resolution RWAs around £30-35 billion | RWAs down £14.5 billion to £34.5 billion |
| Customer experience | Narrow the gap to No.1 in NPS in every primary UK brand | Year on year Commercial Banking have narrowed the gap. NatWest Personal, Ulster Business & Commercial in Northern Ireland and Ulster Business Direct in Republic of Ireland, have seen improvements in NPS |
| Simplifying the bank | Reduce operating expenses by £800 million | Operating expenses down £985 million (5) |
| Supporting sustainable growth | Net 4% growth in PBB and CPB customer loans | Net lending in PBB and CPB up 10% |
| Employee engagement | Raise employee engagement to within two points of the Global Finance Services (GFS) norm | Down 3 points to be 6 points adverse to GFS norm |

Notes:

(1) Williams & Glyn refers to the business formerly intended to be divested as a separate legal entity and comprises RBS England and Wales branch-based businesses, along with certain small and medium enterprises and corporate activities across the UK. During the period presented Williams & Glyn has not operated as a separate legal entity.

(2) NatWest Markets' results include the following financials for businesses subsequently transferred to Commercial Banking: total income of £98 million for the year ended 2015.

(3) Private Banking serves high net worth individuals through Coutts and Adam & Company.

(4)IFRS volatility arises from the changes to fair value of hedges of loans which do not qualify for hedge accounting under IFRS.

(5)Cost saving target and progress 2016 calculated using operating expenses excluding restructuring costs of £2,106 million (2015 – £2,931 million), litigation and conduct costs of £5,868 million (2015 – £3,568 million), write down of goodwill nil (2015 – £498 million), write down of other intangible assets of £117 million (2015 – £75 million), the operating costs of Williams & Glyn £393 million (2015 – £359 million) and the VAT recovery of £227 million.

(6)Personal & Business Banking consists of the reportable segments UK PBB and Ulster Bank RoI, and Commercial & Private Banking consists of the reportable segments Commercial Banking, Private Banking and RBSI.

(7)Net loans and advances - UK PBB up from £119.8 billion, 10%, to £132.1 billion, Ulster Bank RoI up from £16.7 billion, 13%, to £18.9 billion, Commercial Banking up from £91.3 billion, 10%, to £100.1 billion, Private Banking up from £11.2 billion, 9%, to £12.2 billion and RBSI up from £7.4 billion, 19% to £8.8 billion.

2016 performance summary

Building a stronger RBS

RBS is progressing with its plan to build a strong, simple, fair bank for customers and shareholders. During 2016, RBS narrowed the range of uncertainty around its capital position by addressing a number of legacy issues, and continued to strengthen its capital base.

CET1 ratio remains ahead of our 13.0% target at 13.4%, a 210 basis points reduction compared with Q4 2015 principally reflecting the loss attributable to ordinary shareholders of £6,955 million, equivalent to c.300 basis points, partially offset by a £14.4 billion reduction in RWAs, c.100 basis points. During Q4 2016, the CET1 ratio reduced by 160 basis points as the benefit of the reduction in RWAs was more than offset by the loss attributable to ordinary shareholders.

RWAs reduced by £14.4 billion, or 6%, during 2016 to £228.2 billion driven by £14.5 billion of disposals and run-off in Capital Resolution and a £3.9 billion reduction associated with the removal of Citizens operational risk RWAs, partially offset by an increase associated with the weakening of sterling and lending growth across our core franchises.

On 10 August 2016 RBS announced that it had successfully completed the pricing of \$2.65 billion 8.625% AT1 capital notes, with £4.0 billion equivalent issued since August 2015 (1.8% of Q4 2016 RWAs).

Leverage ratio reduced by 50 basis points during 2016 to 5.1% reflecting the loss attributable to ordinary shareholders for the year partially offset by the AT1 issuance and reduction in leverage exposure.

RBS issued £4.2 billion equivalent senior debt, which it expects to be eligible to meet its 'Minimum Requirement for Own Funds and Eligible Liabilities' (MREL), in line with our targeted £3-5 billion senior debt issuance for the year. €1.5 billion seven year 2.5% notes and \$1.5 billion ten year 4.8% notes were issued in Q1 2016 and \$2.65 billion seven year 3.875% notes were issued in Q3 2016.

In addition, RBS successfully completed the cash tender of £2.3 billion of certain US dollar, sterling and euro senior debt securities. The tender offers were part of the ongoing transition to a holding company capital and term funding model in line with regulatory requirements and included securities that RBS considers non-compliant for MREL purposes. In total, during 2016, £10 billion has matured across our funding pools and we have redeemed £8.2 billion through calls and repurchase.

As part of the 2016 Bank of England stress testing exercise RBS submitted a revised capital plan, incorporating further capital strengthening actions, which was accepted by the PRA Board.

RBS has successfully addressed a number of the remaining legacy issues and continues to de-risk its balance sheet.

During Q1 2016 RBS made the final dividend payment in respect of the DAS, £1,193 million, an action that was taken to normalise the ownership structure of the Bank.

In June 2016, the triennial funding valuation of the Main scheme of The Royal Bank of Scotland Group Pension Fund was agreed which showed that as at 31 December 2015 the value of liabilities exceeded the value of assets by £5.8 billion. In March 2016, to mitigate this anticipated deficit, RBS made a cash payment of £4.2 billion.

The next triennial valuation is due to occur at the end of 2018 with agreement on any additional contributions by the end of March 2020. As at 31 December 2016, the Main scheme had an unrecognised surplus reflected by a ratio of assets to liabilities of c.115% under IAS 19 valuation principles.

On 11 April 2016, RBS completed the successful transfer of the Coutts International businesses in Asia and the Middle East to Union Bancaire Privée, the final milestone in the sale of our International Private Bank. During 2016 we also completed the sale of our Russia and Kazakhstan subsidiaries.

Risk elements in lending (REIL) of £10.3 billion were £1.8 billion lower than 31 December 2015 and represented 3.1% of gross customer loans, compared with 3.9% as at 31 December 2015 and 3.8% at 30 September 2016.

In line with the progress to de-risk the balance sheet, exposures to the shipping and oil and gas sectors continued to reduce during 2016, with potential exposures declining by 29% to £5.2 billion and by 22% to £5.3 billion respectively. As at the end of 2016, our total exposure to the coal mining, oil and gas and power generation sectors represented 1.4% of our total lending.

2016 performance summary

Building the number one bank for customer service, trust and advocacy in the UK

Supporting households and business customers

RBS continued to deliver strong support for both household and business customers. Within UK PBB, gross new mortgage lending of £29.8 billion was 29% higher than 2015. Across 2016, our market share of new mortgages was 12%, supporting a growth in stock share to 8.8% at end 2016 from 8.2% at end 2015. As a result, total UK PBB net loans and advances increased by 10% compared with 2015. Commercial Banking net loans and advances have also grown by 10% over the course of 2016 reflecting increased borrowing across a number of sectors.

The Reward account continued to show positive momentum and now has 1,149,000 fee-paying customers compared with 202,000 at 31 December 2015. We have seen positive evidence of increased levels of engagement, with overall current account attrition levels falling by 7% in the year. This is particularly evident across our Private and Premium customer, with attrition 12% lower. We continue to embed the product across our population of valuable main bank customers.

RBS continues to support UK business growth through the launch of 6 new business accelerator hubs in 2016, bringing the total to 12. This included the opening of an Entrepreneurial Centre in our Edinburgh headquarters. In addition, NatWest launched a £1 billion lending fund to support small businesses.

Investing in our operational capabilities and enhancing digital channels

RBS continued to make better use of our digital channels to make it simpler to serve our customers and easier for them to do business with us. We now have 4.2 million customers regularly using our mobile app in the UK, 19% higher than the end of 2015, and around 60% of our personal customers used a digital channel within the last 90 days. In 2016, we more than doubled the number of customers who purchased a product through our mobile channel compared with 2015. NatWest customers can now apply for personal loans, credit cards and overdrafts via the mobile app, facilitating approximately 8% of total applications. Our new business banking 'Online Account Opening' service now allows start up business customers to submit an application online in just ten minutes and get a sort code and account number in under an hour.

Nearly 80% of our commercial customers' interaction with us is via digital channels, with 270,000 payments processed every day.

In addition to our digital channels, RBS continues to provide multiple physical channels for serving customers, including access to a network of c.11,500 Post Office branches in the UK, c.1,000 An Post branches in the Republic of Ireland, and 41 mobile banking vans, alongside our existing network of 1,425 branches and 4,646 ATMs across PBB.

RBS became the first UK Bank to be accredited by the Royal National Institute for Blind People for having an accessible mobile app for blind and partially sighted customers. In addition, we launched a new service for British Sign Language (BSL) customers, making it possible to instantly chat with an advisor through a BSL interpreter.

Coutts won the best private bank in the UK for the fifth year running, best private bank for philanthropy services and best initiative of the year in client facing technology at the Global Private Banking Awards, and was highly commended for innovation for its 'Coutts Concierge Online'.

Investing in our people

In 2016, RBS was one of only two banks to achieve formal recognition from the Chartered Banker Professional Standards Board for excellence in implementing, monitoring, reporting and commitment to the Foundation Standard for Professional Bankers.

Delivered leadership training to almost 16,000 leaders through a comprehensive 'Determined to Lead' programme.

We continue to work towards our goal of having at least 30% senior women in our top three leadership layers across each business by 2020 and to be fully gender balanced (50/50) by 2030. As at 31 December 2016, in aggregate terms 34% of our top three leadership layers were female.

RBS has attained silver status in the Business Disability Forum's Disability Standard, scoring 88% in its assessment of accessibility and inclusion in the workplace.

RBS has moved up to 13th place, from 32nd last year, in Stonewall's annual Top 100 employers for lesbian, gay, bi and trans (LGBT) staff, the highest position it has achieved in the index to date.

2016 performance summary

Looking forward

Capital reorganisation

It is our intention to implement a capital reorganisation in 2017 in order to increase the distributable reserves of the parent company, RBSG plc, providing greater flexibility for future distributions and preference share redemptions. We intend to seek shareholder approval to reduce the share premium account by around £25 billion and to cancel the capital redemption reserve, around £5 billion. This will, subject to approval by shareholders and regulators, and confirmation by the Court of Session in Edinburgh, increase RBSG plc distributable reserves by around £30 billion.

Ring-fenced structure

As previously announced, on 1 January 2017, RBS made a number of changes to its legal entity structure to support the move towards a ring-fenced structure, with further changes planned prior to 1 January 2019. Our new brand strategy is designed to align with our business strategy and future ring-fenced structure. NatWest will be our main customer facing brand in England, Wales and Western Europe, and in Scotland, Royal Bank of Scotland will be our core brand. In addition, our Corporate & Institutional Banking business has been rebranded as NatWest Markets in readiness for our future ring-fenced structure. The ring-fenced banking group is expected to comprise of 80% of RBS risk-weighted assets.(1)

IFRS9

RBS continues to develop its processes to enable IFRS 9 Financial Instruments to be implemented on 1 January 2018; an estimate of the initial impact will be included in 2017 H1 interim reporting.

Williams & Glyn

On 17 February 2017, RBS announced that it had been informed by HM Treasury (“HMT”) that the Commissioner responsible for EU competition policy plans to propose to the College of Commissioners to open proceedings to gather evidence on an alternative plan for RBS to meet its remaining State Aid obligations. If adopted, this alternative plan would replace the existing requirement to achieve separation and divestment by 31 December 2017 of Williams & Glyn. As previously disclosed, none of the proposals to acquire the business received by RBS can deliver a full separation and divestment before the 31 December 2017 deadline.

RBS has agreed that HMT will now seek formal amendment to RBS's State Aid commitments to pave the way for the Commissioner to propose to open proceedings, as described above. In addition to the Commission's proceedings, HMT will carry out a market testing exercise in parallel. The opening of the Commission's proceedings does not prejudice the outcome of the investigation.

The plan envisages that RBS will deliver the following revised package of remedies to promote competition in the market for banking services to small and medium enterprises ("SMEs") in the UK:

- A fund, administered by an independent body, that eligible challenger banks can access to increase their business banking capabilities;
- Funding for eligible challenger banks to help them incentivise SMEs to switch their accounts from RBS paid in the form of "dowries" to eligible challenger banks;
- RBS granting business customers of eligible challenger banks access to its branch network for cash and cheque handling, to support the measures above; and
- An independent fund to invest in fintech to support the business banking of the future.

The 2016 Annual Results include a £750 million restructuring provision as a consequence of this proposal.

2017 Outlook ⁽²⁾

Subject to providing fully for the remaining legacy issues, RMBS exposures in particular, RBS currently expects that 2017 will be its final year of substantive legacy clean up with significant one-off costs. Consequently, we anticipate that the bank will be profitable in 2018.

We are targeting net loans and advances growth of 3% across PBB and CPB, including taking into account the impact of balance sheet reductions associated with the RWA reduction target. We anticipate that this growth will be largely within PBB as we expect to see moderate growth in some segments in CPB, whilst at the same time selectively reducing exposures with weak returns and continuing to actively manage certain legacy loan exposures.

We expect that income in 2017 will continue to be supported by balance sheet growth across PBB and CPB. Within UK PBB, we anticipate that income will increase in 2017 compared with 2016, as we have already absorbed significant margin pressure from the changing mortgage mix and the impact of the sharp fall in interchange rates. Across CPB, we expect income to be broadly stable with continued competitive

pressure on margins, given the interest rate environment. NatWest Markets is expected to continue to benefit from increased market volatility and customer activity and we anticipate that 2017 income will be above previously indicated targets of £1.3 -£1.4 billion.

RBS plans to reduce adjusted operating expenses⁽³⁾ by a further £750 million in 2017, in addition to the £3.1 billion achieved across 2014 to 2016, and we expect that the adjusted cost:income ratio⁽³⁾ will improve across our combined PBB, CPB and NatWest Markets franchises in 2017 compared with 2016.

2016 performance summary

Net impairment charges should remain meaningfully below normalised levels in 2017. However, we expect the level of net impairment charges to be driven by a combination of increased gross charges and a materially reduced benefit from releases. Recent UK economic performance has been better than previous forecasts leading to improved expectations for the 2017 economic outlook. However, the medium term outlook remains less certain, and together with the increased volatility expected with the introduction of IFRS 9, quantification of future credit losses is more challenging beyond 2017 at this point. We continue to remain mindful of potential downside risks including from single name / sector driven events and lower releases of provisions.

We continue to expect that cumulative Capital Resolution disposal losses will total approximately £2.0 billion since the beginning of 2015, with £1,192 million of losses incurred to date (2016; £825 million, 2015; £367 million) with most of the balance expected to be incurred during 2017. Excluding RBS's stake in Alawwal Bank (previously Saudi Hollandi Bank, £7.9 billion at 31 December 2016), we expect Capital Resolution RWAs to be in the range £15-£20 billion by the end of 2017, at which point we plan to wind up Capital Resolution and transfer the assets back into the rest of the bank.

Excluding restructuring costs associated with the State Aid obligations relating to Williams & Glyn, we expect to incur restructuring costs of approximately £1 billion in 2017 and approximately a further £1 billion in aggregate during 2018 and 2019. Approximately 40% of this cost is expected to relate to the optimisation of our property portfolio.

Further to the update on 17 February 2017 in respect of the remaining State Aid obligations regarding the business known as Williams & Glyn, and subject to the alternative plan being finalised and adopted by the European Commission (EC) and further discussions with the EC and HMT, RBS will assess the timing and manner in which it would reincorporate the business into the RBS franchises. This reintegration would likely create some additional restructuring charges during 2017 and 2018.

We are targeting a CET1 ratio of at least 13% at the end of 2017. As part of the 2016 Bank of England stress testing exercise, RBS submitted a revised capital plan, incorporating further capital strengthening actions, which was accepted by the PRA Board.

RBS issuance plans for 2017 focus on issuing £3-£5 billion MREL-compliant Senior holding company (RBSG) securities. We do not currently anticipate the need for either AT1 or Tier 2 issuances. In addition, and reflecting our strategic progress, we also target a progressive return to other funding markets to support our lending growth.

RBS continues to deal with a range of significant risks and uncertainties in the external economic, political and regulatory environment and manage conduct-related investigations and litigation, including RMBS. Substantial additional charges and costs may be recognised in the coming quarters which would have an impact on RBS's level of capital and financial performance and condition.

2016 performance summary

Medium term outlook ⁽²⁾

We now target achieving our sub 50% cost:income ratio⁽³⁾ and 12% return on tangible equity targets in 2020, one year later than originally planned. Our confidence in achieving the targets is underpinned by our ability to protect income and drive cost reductions whilst managing credit and market risk and driving further capital efficiency.

We expect to be able to grow volumes faster than market growth rates over the coming years in chosen segments across PBB and CPB.

We plan to reduce adjusted operating expenses⁽³⁾ in the order of £2 billion in the next four years with around two thirds of this from the core bank.

We are targeting a gross RWA reduction of approximately £20 billion across PBB, CPB and NatWest Markets by the end of 2018, with some offsetting volume growth. We expect that the reduction will be largely achieved through improvements in the quality of our risk models, exiting low return, non strategic and risk intensive asset pools, improved risk metrics in certain portfolios and benefits from data clean-up. We estimate that the income loss associated with this reduction will be in the range £250 million – £300 million on an annualised, pre tax, basis.

We continue to monitor the ongoing discussions around the potential further tightening of regulatory capital rules and recognise that this could result in RWA inflation in the medium term.

In view of the significant risks and uncertainties in the external economic, political and regulatory environment including uncertainties around the resolution of RMBS, the timing of returning excess capital to shareholders through dividends or buybacks remains uncertain was accepted by the PRA Board.

Notes:

(1) Based on RBS future business profile business and excludes Capital Resolution.

(2) The targets, expectations and trends discussed in this section represent management's current expectations and are subject to change, including as a result of the factors described in this document and

in the “Risk Factors” on pages 509 to 578 of the Annual Report 2016 on Form 20-F. These statements constitute forward looking statements, please see Forward Looking Statements on pages 1 and 2 of the Annual Report 2016 on Form 20-F.

(3) Cost saving target and progress 2017 calculated using operating expenses excluding restructuring costs, litigation and conduct costs, write down of goodwill and the 2016 VAT recovery.

2017 targets

As we works towards our long-term goals, we have set the following targets for 2017.

| Strategy goal | Our long-term targets | Our 2017 goals |
|-------------------------------|---|---|
| Strength and sustainability | CET1 ratio of 13% RoTE (1,2) \geq 12% | Maintain bank CET1 ratio of 13% |
| Customer experience | Number 1 for service, trust and advocacy | Significantly increase NPS or maintain No.1 in chosen customer segments |
| Simplifying the bank | Headline cost:income ratio <50% | Reduce operating expenses by at least £750 million (3) |
| Supporting sustainable growth | Leading market positions in every franchise | Net 3% growth in total PBB and CPB loans to customers (4) |
| Employee engagement | Employee engagement in upper quartile of Global Financial Services (GFS) norm | Improve employee engagement |

Notes:

(1) Calculated using (loss)/profit for the period attributable to ordinary shareholders.

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

(3) Cost saving target and progress 2017 calculated using operating expenses excluding restructuring costs, litigation and conduct costs, write down of goodwill and the 2016 VAT recovery.

(4) Lending growth target is after including the impact of balance sheet reductions associated with the RWA reduction target across PBB, CPB and NatWest Markets as outlined in the outlook statement.

Business model and strategy

Our strategy

We are building a better bank for our customers, and one that will deliver sustainable returns for shareholders. Our purpose is to serve customers well, and to do so, we are becoming a safer, simpler, customer-focused UK and Ireland bank.

Our plan

Underpinning that ambition is our blueprint for success. This is our plan which drives our strategic decision making.

RBS is continuing to build a bank that is easy to do business with, and meets customers' continually evolving needs. Our plan focuses on delivering excellent customer service through all of our brands. Creating lasting relationships with our customers, who advocate for our bank, is the key to generating sustainable values.

Notes:

(1) Cost saving target and progress calculated using operating expenses excluding restructuring costs, litigation and conduct costs, write down of goodwill and the 2016 VAT recovery.

(2) Lending growth target is after including the impact of balance sheet reductions associated with the RWA reduction target across PBB, CPB and NatWest Markets as outlined in the outlook statement.

Business model and strategy

Our priorities

Strength and sustainability

We remain focused on building a strong and stable bank. We have continued to improve the fundamentals, by increasing our capital strength, building a robust liquidity position and balancing our loan to deposit ratio.

Customer experience

We are investing in our people, service, and product proposition to ensure we provide market leading technology and signature customer experiences, through a wide variety of channels.

Simplifying the bank

Streamlining of processes and removing unnecessary complexity lowers our operating costs, and makes our customer interactions more straightforward.

Supporting sustainable growth

A strong sustainable business grows with its customers. We continue to support our customers through offering products and services which meet their needs.

Employee engagement

Engaged colleagues lead to engaged customers. At RBS we are committed to investing in our colleagues and creating leaders who inspire and empower their teams.

Business model and strategy

Our structure

We have three customer franchises, and each is underpinned by a range of distinct brands, which are the route through which we engage with our customers.

Our franchises share operational and control functions, deriving economies of scale and diversification benefits. Our brands are personalised and each reflects a particular targeted customer segment.

Personal and Business Banking (PBB) With a branch network and mobile, telephone and online banking propositions, PBB services our retail banking, mass affluent and small business customers in both the UK and Republic of Ireland. PBB provides a simple range of products, including current accounts, loans and mortgages, to meet all core banking needs.

Commercial and Private Banking (CPB) CPB serves our commercial and our high net worth customers in the UK and Western Europe. Commercial Banking supports our corporate clients by providing comprehensive commercial banking and financing services with sector expertise. This includes specialist finance such as invoice finance, asset finance and leasing. Our Private Banking business offers high net worth clients private banking, wealth planning and investment management services. RBS International (RBSI) continues to focus on supporting retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man, Gibraltar and Luxembourg.

NatWest Markets

Focusing on our core markets in the UK and Western Europe, NatWest Markets provides financing and risk management to our UK and Western Europe corporate customers and global financial institutions.

Franchises

Our franchises bring together customers determined by the scale and complexity of their financial needs. This groups our business units that have the greatest economies of scale and synergies.

Teams define and deliver the customer proposition, and are accountable for end-to-end customer processes and products. The teams partner with functions and services to develop cost-effective propositions that meet customer needs.

Services

Services provide business-aligned technology, operations and property services across the bank. Operations are centralised to provide cost-efficient and consistently strong customer service, through simple processes and economies of scale. It is also accountable for technology risk, payments, data, change management and the bank's fraud and security functions.

Functions

These teams define functional strategy and the financial plan to support the franchises and other functions. Most functions are a mix of control, expertise and advisory. All common support activities across the organization are included.

Business model and strategy

Business model and strategy

Product and services

Our products and services are designed to ensure that we can create sustainable value for both our shareholders and our customers. We believe that keeping our product range simple and accessible is crucial to our success.

Business model and strategy

Our brands

Our brands are our main connection with customers. Each takes a clear and differentiated position that will help us strengthen our relationships with our customers, stand out in the market, and build the value of our brands.

Business model and strategy

Case Study - Flying High

Sarah-Jane Anthony saw her first falconry display aged seven and was hooked. Twenty years later, she decided to follow her dream and start her own business. Now she runs her own award-winning falconry centre in Essex.

“I’ve banked with NatWest all my life and when I needed a business account, Khaled, the local at West Women in Business specialist, was really supportive. Without his help and advice, I don’t think I’d be here today.”

Through our Chartered Banker accreditation programme in association with Everywoman, we’ve trained 400 Women in Business specialists across the bank. Their knowledge makes them ideally placed to help female business owners and budding entrepreneurs with their banking needs.

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Business model and strategy

Building a more sustainable bank

Our goal is to be No.1 for customer service, trust and advocacy. We are changing our culture and priorities for the better. We are committed to building a bank that works for all stakeholders.

By delivering the best possible service for customers to meet their needs, we aim to achieve a return for our shareholders. At the same time, we recognise our responsibility towards the society we serve and operate in. It is only by supporting our customers and communities to succeed that we will be able to become a more sustainable bank.

Our key resources and relationships

RBS provides financial services to individuals and businesses, primarily in the UK and Ireland. We rely on financial, human, intellectual, social, infrastructure and natural capital to do so. We leverage these forms of capital through our expertise, technology and customer focus across our different brands. This helps to improve customer service quality, personalised through our brands. We also seek to create sustainable value for our shareholders and other stakeholders, including customers, employees, and civil society.

Our business model

Our purpose is to serve our customers well; we earn income by providing lending and deposit services to our customers. We incur operating expenses in providing these services, and accept risk; including credit risk, liquidity risk and currency risk. The operating profit generated by the bank is targeted to compensate shareholders for the cost of these risks. Building a safe and customer-focused bank is central to our ability to create value.

The main source of our income is the interest income earned from loans and advances to our personal, business and commercial customers. We also earn fees from transactions and other services provided to our customers.

We pay interest to customers and other investors who have placed deposits with us and bought our debt securities. The difference between these is our net interest income. We also pay benefits to our customers, through loyalty products such as our Reward Account.

NatWest Markets puts its customers at the centre of the way it does business, making working with the bank easy and rewarding. The bank is organised around providing the right solution to meet its customers' needs. It anticipates emerging issues and provides depth of insight and innovative ideas.

Business model and strategy

How we create value for customers and society

| Financial | Social and Relationship | Infrastructure | Natural | Human and Intellectual |
|---|--|--|---|---|
| We make use of shareholder capital and other forms of financial capital, including £353.5 billion in customer deposits (1). | 18.9 million customers in the UK and Republic of Ireland. In 2016, we opened 40,860 Foundation Accounts(2), helping customers who may otherwise face difficulties when opening a bank account. | We continue to provide multiple physical channels for serving customers, including access to a network of c.12,500 Post Office and An Post branches(3) and 41 mobile banking vans alongside our existing network of 1,425 branches and 4,646 ATMs. | 754 GWh of energy consumed and 9,965 tonnes of paper used in 2016(4). | A capable and caring workforce of 79,099 (permanent headcount). In 2016 we recruited 254 graduates and 283 apprentices. |

How we create value for customers and society

Our activities generate outcomes across all parts of the economy

- Keeping money safe and accessible for our depositors, including preventing 498,000 cases of attempted fraud amounting to £303 million in the UK(5).
- Offering lending, advice and services to individuals. Supporting customers with financial life events, including £33.7 billion of gross new mortgage lending(6) to help our customers buy homes.
- Enabling individuals and businesses to make payments effectively and efficiently, including more than doubling the number of products sold through our mobile channel compared with 2015.
- Providing working capital and lending to help businesses meet their goals, including £30.5 billion(7) in lending to small and medium-sized enterprises across England, Scotland and Wales, and c.£1.0 billion in lending to infrastructure projects.
- Supporting local communities, including £2.5 million(8) of grants made by our Skills & Opportunities Fund to 125 organisations, who support people from disadvantaged communities start-up in business or get into employment.
- Supporting entrepreneurs to start up in business, including 1,736 businesses(9) helped through Entrepreneurial Spark powered by NatWest.
- Investing in our people and partners to develop a skilled workforce, including the delivery of leadership training to almost 16,000 leaders through a comprehensive 'Determined to Lead' programme.
- Payment of £1.32 billion(10) in tax to the UK Government, which supports central government and local authority spending.

Notes:

- (1) Customer deposits excluding repurchase agreements and stock lending.
- (2) Number of new Foundation Accounts opened across NatWest Plc, Royal Bank of Scotland plc and Ulster Bank Ireland DAC.
- (3) Comprises c.11, 500 Post Office branches in the UK and c.1000 An Post branches in the Republic of Ireland.
- (4) For further details refer to page 39.
- (5) Data relates to reported attempted fraud cases and prevented third party losses in the UK (not including policy declines for debit cards).
- (6) Gross new mortgage lending across UK PBB, Ulster Bank RoI and RBSI.
- (7) SME lending balances in over 9,960 postcode sectors across England, Scotland & Wales.
- (8) Data is compiled by Project North East (PNE) and is based on the total spend allocated by each Regional Board.
- (9) Data is compiled by Entrepreneurial Spark. The data includes all businesses which have been part of the programme since launch in 2012.
- (10) Comprises £174 million corporate tax, £660 million irrecoverable VAT, £208 million bank levies and £279 million employer payroll taxes.

Our Approach

Our Values

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

Our Approach

Case Study - Power to the people

We continue to play a key role in the transition to a low carbon economy by helping our customers to mitigate their emissions, save energy and reduce costs.

We have over 25 years experience in helping our customers to fund renewable energy and energy efficiency measures. According to InfraDeals, RBS has been the leading lender to the UK renewables sector by number of transactions over the past five years (2012-2016). During 2016 RBS took a lead role in financing the Beatrice Offshore Wind Farm, located 13.5km from the Caithness Coast.

This wind farm projected to power approximately 450,000 homes (around three times the number of homes in the Moray and Highland region). It was one of the first eight UK projects to be awarded an Investment Contract under the Contract for Difference feed in tariff. It will contribute £680m in the construction phase to the economy through supply chain opportunities and employment.

It is estimated to have an on-going £400-525 million impact on the economy over the windfarm's 25 year operational life. An integrated approach was delivered by RBS through close collaboration between teams highlighting the breadth, strength and market leadership of the RBS franchise and ensuring a successful outcome for our customer. An integrated approach was delivered by RBS through close collaboration between teams highlighting the breadth, strength and market leadership of the RBS franchise and ensuring a successful outcome for our customer.

Our Colleagues

Engaging our colleagues is critical to delivering on our strategy and ambition as a bank. Being better for our colleagues means we are better for our customers, and this makes us a better bank.

- Platinum ranking from Opportunity Now (gender)
- Gold ranking for Race for Opportunity (race)
- Time Top 50 Employers for Women
- Top Ten Global Employer in Stonewall's Global Equality Index (LBGT)
- Silver Status from the Business Disability Forum
- Top 10 Employer by Working Families

Creating a Healthy Culture

Building a healthy culture that embodies Our Values is one of our core priorities. Our Values guide the way we identify the right people to serve our customers well, and how we manage, engage and reward our

colleagues. Our Values are at the heart of both Our Standards, the bank-wide behavioural framework and Our Code, the bankwide Code of Conduct.

Our values are integral to the way we behave and do business and we continue to reinforce them in our systems, our policies and processes, our communications and our training and leadership role modelling.

We monitor our progress against our goals and gather feedback from our colleagues. Through metrics and key performance indicators we are able to assess our progress and respond accordingly. We measure our progress through internal reporting and report on progress quarterly. We participate in external benchmarking exercises and fully support the Banking Standards approach.

Our most recent survey, in which almost 63,000 colleagues took part, showed that we are changing the culture of RBS for the better. We remain above the Global Financial Services Norm for wellbeing, our inclusion scores continue to improve and there is a strong sense that managers act consistently with Our Values. However, the choices we've had to make as we move RBS forward have taken a toll on our colleagues. The scaling down of RBS and the impact of dealing with some difficult legacy issues have contributed to a decline in the improvements in engagement, pride and leadership that we saw in 2015.

We encourage colleagues to tell us what they think via the annual colleague survey and our regular comments boards. When colleagues wish to report concerns relating to wrong doing or misconduct they can raise concerns via Speak Up, the bank's whistleblowing service. In 2016 213 cases were raised compared to 142 in 2015.

Our Approach

Performance and Reward

Our approach to performance management provides clarity for our colleagues about how their contribution links to our ambition and all our colleagues have goals set across a balanced scorecard of measures. In 2016 we refreshed our behavioural framework to create one framework for all our colleagues (Our Standards).

We strive to pay the right wage to colleagues and continue to exceed the Living Wage Foundation Benchmarks. We have removed sales incentives for front line colleagues so they can concentrate on great customer service. For 2017, we have simplified how we pay our clerical colleagues, consolidating bonuses, making pay fairer and easier to understand. More information on our remuneration policies can be found on pages 101 to 149 of the Annual Report 2016 on Form 20-F.

Learning

We continue to embed 'Determined to lead' (DtI), our core leadership programme across the bank. DtI provides consistent tools to lead and engage our colleagues and is transforming the way we operate. In 2016 almost 16,000 leaders participated in the programme.

In October, we launched Service Excellence training, our new customer service programme. The first module introduces our Core Service Behaviours and provides an awareness of the tools and techniques that will help us to deliver the best possible service, every time. Since October over 34,000 colleagues have completed this module.

We work closely with the Chartered Banker Institute (CBI) and Chartered Banker Professional Standards Board (CB:PSB) to professionalise our colleagues. In 2016 we achieved an Excel rating in the CB:PSB Foundation Standard review, one of only two CB:PSB member firms to have secured 'Earned Autonomy'.

We also offer a wide range of learning opportunities which can be mandatory, role specific or related to personal development. Our mandatory learning is focused on keeping our customers, our colleagues and the bank safe.

Health and Wellbeing

Wellbeing is a fundamental part of creating a great place to work. We offer a wide range of wellbeing initiatives and benefits to help maintain physical and mental health and support our colleagues if they become unwell.

In 2016, we focused on physical, mental health and social wellbeing. More than 50,000 colleagues took part in the Global Corporate Challenge (GCC), helping us to win the GCC World Most Active Organisation Gold Award.

Our Approach

To support our colleagues through change we continue to promote our Employee Assistance Programme, where we have continued to see a high utilisation rate. We have supported Time to Change (the UK's biggest programme to challenge mental health stigma) since 2014 and launched a number of mindfulness support tools this year.

Inclusion

Building a more inclusive RBS is essential for our customers and colleagues.

Our inclusion policy applies to all our colleagues globally to make sure everyone feels included and valued, regardless of their background.

As at 31 December 2016, our permanent headcount was 79,099. 48% were male and 52% female.

We continue to work towards our goal of having at least 30% senior women in our top three leadership layers across each business by 2020 and to be fully gender balanced by 2030. We have a positive action approach in place, tailored by business, according to the specific challenges they face.

During 2016, we continued to roll out unconscious bias learning to all our colleagues to create a solid platform for the wider inclusion agenda. Almost 30,000 colleagues participated in unconscious bias training in 2016.

Our disability plan will support us becoming a disability smart organisation by 2018. It addresses areas for improvement including branch access, accessible services, improving colleague adjustment processes and inserting disability checkpoints into our key processes and practices.

We continue to focus on building an ethnically diverse RBS. Our plan focuses on positive action and includes reciprocal mentoring, targeted development workshops and leadership programmes and ensuring we have a Black, Asian and Minority Ethnic (BAME) focus on recruitment, talent identification and promotion.

Our LGBT agenda continues to deliver a better experience for our LGBT colleagues and customers. We have processes in place to support updating gender and title on customers' banking records and to support colleagues undergoing gender transition. And, we continue to support our 16,000-strong colleague networks.

Historically we have reported by grade, which has enabled us to track trend year on year, however as the structure of our business has changed, we have evolved our approach to reflect our organisational (CEO) levels. This method more accurately describes our gender balance at leadership/pipeline levels and is reflective of how work gets done across the bank.

| Grade | #Women | #Men | %Women |
|---------------------------------------|--------|------|--------|
| CEO – 1 | 3 | 10 | 23 |
| CEO – 2 | 33 | 73 | 31 |
| CEO – 3 | 232 | 443 | 34 |
| CEO – 4 | 1512 | 1891 | 44 |
| Target population (CEO – 3 and above) | 268 | 526 | 34 |

| | Male | Female |
|---------------------------|-----------|----------|
| Executive Employees | 113 (78%) | 32 (22%) |
| Directors of Subsidiaries | 481 (84%) | 90 (16%) |

There were 716 senior managers (in accordance with the definition contained within the relevant Companies Act legislation), which comprises our executive population and individuals who are directors of our subsidiaries. The RBS Board of directors has twelve members, consisting of nine male and three female directors.

Our Approach

Our Customers

RBS remains committed to achieving its target of being the number one bank for customer service, trust and advocacy by 2020.

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

Net Promoter Score (NPS)

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

The table below lists all of the businesses for which we have an NPS for 2016. Year-on-year, NatWest Personal and Commercial Banking have improved, along with Ulster Bank Business and Commercial in Northern Ireland and Ulster Bank Business Direct in the Republic of Ireland. In Great Britain, we have also narrowed the gap to number one in Commercial Banking. We do, however, acknowledge that there is still work to do, with four brands missing their year end targets.

In recent years, RBS has launched a number of initiatives to make it simpler, fairer and easier for customers to do business with the bank.

| | | Q4 2015 | Q3 2016 | Q4 2016 | Year end 2016 target |
|------------------|---------------------------------------|------------|------------|------------|-------------------------|
| Personal Banking | NatWest (England & Wales) (1) | 9 | 11 | 13 | 15 |
| | Royal Bank of Scotland (Scotland) (1) | -9 | -2 | -4 | -5 |
| | Ulster Bank (Northern Ireland) (2) | -9 | -16 | -16 | -3 |
| | Ulster Bank (Republic of Ireland) (2) | -14 | -8 | -7 | -10 |
| | NatWest (England & Wales) (3) | 9 | 4 | -2 | 13 |
| | Royal Bank of Scotland (Scotland) | -7 | -4 | -5 | 2 |

| | | | | | |
|------------------------|--|-----|-----|----|-----|
| Business Banking | (3) | | | | |
| Business Direct | Ulster Bank (Republic of Ireland) (5) | -21 | n/a | -2 | -15 |
| Business & Commercial | Ulster Bank (Northern Ireland) (4) | -19 | 0 | 0 | -4 |
| Commercial Banking (6) | | 9 | 21 | 20 | 17 |

Customer Trust

We also use independent experts to measure our customers' trust in the bank. Each quarter we ask customers to what extent they trust or distrust their bank to do the right thing. The score is a net measure of those customers that trust their bank (a lot or somewhat) minus those that distrust their bank (a lot or somewhat).

Customer trust in NatWest in England & Wales has exceeded its 2016 target, improving from 48% at Q4 2015 to 55% at Q4 2016. Trust in RBS in Scotland has fallen year on year (from 14% in Q4 2015 to 13% in Q4 2016) and has fallen behind its target for 2016. This is primarily due to ongoing reputational and legacy issues that the bank continues to work to resolve.

| | | Q4 2015 | Q3 2016 | Q4 2016 | Year end 2016 target |
|--------------------|--------------------------------------|---------|---------|---------|----------------------------|
| | NatWest (England & Wales) | 48% | 48% | 55% | 51% |
| Customer trust (7) | Royal Bank of Scotland (Scotland) | 14% | 13% | 13% | 26% |

Notes:

(1) Source: GfK FRS 6 month rolling data. Latest base sizes: NatWest (England & Wales) (3313) Royal Bank of Scotland (Scotland) (527). Based on the question: "How likely is it that you would recommend (brand) to a relative, friend or colleague in the next 12 months for current account banking?"

(2) Source: Coyne Research 12 month rolling data. Latest base sizes: Ulster Bank NI (375) Ulster Bank Rol (322) Question: "Please indicate to what extent you would be likely to recommend (brand) to your friends or family using a scale of 0 to 10 where 0 is not at all likely and 10 is extremely likely".

(3) Source: Charterhouse Research Business Banking Survey (GB), based on interviews with businesses with an annual turnover up to £2 million. Quarterly rolling data. Latest base sizes: NatWest England & Wales (1258), RBS Scotland (422). Weighted by region and turnover to be representative of businesses in England & Wales/Scotland, 4 quarter rolling data.

(4) Source: Charterhouse Research Business Banking Survey (NI), based on interviews with businesses with an annual turnover up to £1 billion. Latest base size: Ulster (399) Weighted by

turnover and industry sector to be representative of businesses in Northern Ireland, 4 quarter rolling data.

(5) Source: PWC ROI Business Banking Tracker 2016 (annual study only). Latest sample size: Ulster Bank (218) In 2017 we will be switching the source of advocacy measurement for Ulster Bank Business in ROI to Red C. Red C is a recognised research agency that will provide more frequent reporting of NPS, as well as additional diagnostic customer feedback to help us improve the customer experience.

(6) Source: Charterhouse Research Business Banking Survey (GB), based on interviews with businesses with annual turnover between £2 million and £1 billion. Latest base size: RBSG Great Britain (935). Weighted by region and turnover to be representative of businesses in Great Britain, 4 quarter rolling data.

(7) Source: Populus. Latest quarter's data. Measured as a net of those that trust RBS/NatWest to do the right thing, less those that do not. Latest base sizes: NatWest, England & Wales (871), RBS Scotland (226).

Our operating environment

Key influences in our operating environment

Our ability to serve customers and create value for the long term is heavily influenced by the environment in which we operate. We have assessed the importance of these influences both in terms of their relevance to our stakeholders (including customers, investors, UK government, employees and civil society) and their potential commercial impact on us. We have categorised them accordingly, shown in the diagram below. This provides additional context for our performance and future strategy. Each influence is briefly described on the following pages, with links provided to the relevant parts of the Strategic Report for more detail.

Our operating environment

Influences explained and where to find out more.

Our operating enviroment

Our operating environment

Our direct environmental footprint

RBS is committed to reducing the environmental impact of serving our customers. We outperformed our 2020 targets of 20% carbon, 5% water and 50% paper reduction during 2016 and we will increase our ambition in these areas during 2017. Our decrease in total carbon emissions is largely attributable to a 15% per full time equivalents reduction in energy consumption since 2014. We are containing growth in Data Centre energy consumption through legacy IT decommissions and energy reduction initiatives. The rationalisation of property space and investment in building management systems in 384 branches and 17 offices are examples of a number of projects delivering energy reductions. We buy renewable electricity in the UK, reflected in our market-based CO₂e emissions figure. Scope 3 business travel emissions are being driven down by a reduction in long haul flights, a focus on associated cost and improved virtual collaboration tools.

In 2016 we diverted 96% of waste from landfill in the UK, 70% globally. An increase in waste volume compared with 2015 is partly attributed to the destruction of outdated paper records which are recycled along with all paper waste. Removing paper hand towels from 800 branches and 22 offices has helped keep waste volume down. Sending food waste to anaerobic digestion and coffee waste for bio-fuel improves our recycling rate. Paper usage is linked to use of digital channels with approximately 55% of personal and business banking customers receiving online statements and a reduction in internal print of 20% in 2016.

We collaborate with colleagues and suppliers to improve performance in all areas. Our Innovation Gateway crowdsourcing community is a partnership with corporates and universities, now sourcing new solutions from 1,300 SMEs. We've tested 34 of these new products in our facilities since 2014 with notable success in reducing water usage. We engage colleagues via bank wide 'Determined to Make a Difference' campaigns. In 2016, 1,200 colleagues logged over 2500 activities to reduce our environmental impact, via our green reward app JUMP.

Carbon emissions disclosure

Notes:

*Scope 1: Emissions from fluorinated gas loss and fuel combustion in RBS premises/vehicles. **Scope 2: Emissions from electricity, district heating and district cooling used in RBS premises. ***Scope 3: Emissions associated with business travel (air, rail and road) by RBS employees. **** Scope 3 emissions have been restated and rebaselined to include Taxis in India.

***** market-based emissions have been calculated using the GHG Protocol guidelines. RBS has purchased renewable electricity that meets the Good Quality Criteria since March 2016. Paper and business travel targets have a baseline year of 2011.

Our operating environment

Our approach to human rights and modern slavery

RBS takes a proactive approach to upholding our commitment to respect human rights. This includes regular review of our policies and procedures. Our approach is centred on identifying and mitigating potential human rights risks across our business and our sphere of influence.

A main focus during 2016 has been to meet our new obligations under the Modern Slavery Act 2015 (MSA), which aims to protect victims, bring perpetrators to justice and provide more effective tools for law enforcement. We welcome the MSA and its aim to eradicate forced labour and human trafficking.

In accordance with the requirements of the MSA, our first annual statement will be published and available on our website in Spring 2017. Ahead of this we published an interim statement in December 2016 setting out our approach and seeking the input of external stakeholders.

We are taking a human rights approach to understand the impacts of our operations and supply chain. We are also working to ensure our employees, suppliers and customers are aware of the risks and are able to address any issues when they arise.

These steps include: reviewing and updating our policy commitments; raising awareness among employees; targeted training to relevant employees, such as supply chain managers and relationship managers; incorporating requirements under the MSA into our supplier sourcing process; and embedding MSA commitments within our Environment, Social and Ethical (ESE) Risk Policy and processes. Modern slavery, forced labour and harmful child labour are prohibited within our reputational and ESE risk framework, and our Sustainable Procurement Code.

RBS's international human rights' commitments are set out in our Human Rights Position Statement. Our approach is underpinned by our values and standards. For employees this is via the RBS Code of Conduct – 'Our Code' which was updated in 2016. Our Code includes a clear commitment to respect human rights, and the Yes Check, a tool to guide good decision-making. Employees are consulted on key aspects of their working environment, and they can utilise a confidential helpline to discuss any matters of concern. We are an accredited Living Wage employer, and the process of extending the Living Wage to our suppliers continued through 2016.

For suppliers, our Sustainable Procurement Code sets out the international human rights commitments we expect of the companies that we work with, including labour standards and non-discrimination.

Our ESE Risk Policy applies to our customers, and is kept under review. Alongside our sector specific risk appetite positions we have outlined ESE risk concerns for customers operating outside of these sectors. Our policy identifies human rights risks and due diligence is carried out on clients when human rights risks are identified. We expect our customers to share our commitment to respecting human rights within their operations.

Our commitment to the international progress of human rights includes being a signatory of the United Nations Global Compact since 2003, and we reaffirm our commitment to the ten principles of the Global Compact. We are committed to the implementation of the UN Guiding Principles on Business and Human Rights and participate with our peers in initiatives such as the Thun Group and United Nations Environment Programme Finance Initiative, to understand how these can best be applied. We have adopted the Equator Principles, since their inception in 2003, to manage social and environmental risks, including human rights, in project-related transactions.

Our operating environment

Independent assurance

The Royal Bank of Scotland Group plc appointed Ernst & Young LLP to provide limited independent assurance over selected sustainability content within the Strategic Report (“the Report”), as at and for the period ended 31 December 2016. The assurance engagement was planned and performed in accordance with the International Standard for Assurance Engagements (ISAE) 3000 Revised, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information.

These procedures were designed to conclude on:

The consistency of selected narrative claims on sustainability with underlying performance information, and;

The accuracy and completeness of the sustainability performance indicators listed below:

- Value (£) of attempted fraud prevented in UK;
- Number of cases raised via Speak Up, the bank’s whistleblowing service;
- Total gender balance in top 3 senior layers;
- Customer Trust score;
- % personal customers who are digitally active;
- Total scope 1 and 2 location based CO2e emissions and Scope 3 emissions from business travel;
- Number of Foundation accounts opened; and
- Lending to small and medium sized enterprises (SMEs) across England, Scotland and Wales.

An unqualified opinion was issued and is available on rbs.com, along with further details of the scope, respective responsibilities, work performed, limitations and conclusions.

Our operating environment

Key economic indicators

The UK economy grew by 2.1% in 2016, down from 2.2% in 2015 and close to its long-run average.

In a healthy job market, the number of people in work increased by 350,000 and unemployment fell below 5% for the first time since 2005. With inflation of 1.6%, wage growth of 2.8% provided a modest boost to consumers' spending power. Business profitability remained strong and business investment fell by around 2%. House price inflation moderated, but at 5% remained high.

Summary

The main development in 2016 was the fall in the value of sterling, which finished the year down 15%, 10% of that happening after the EU referendum. That quickly fed through to higher import costs, with producers' input prices rising by 16%, squeezing firms' margins. The Bank of England expects consumer price inflation to reach around 2.75% in 2017 and 2018, above the target set by Parliament. However, the Bank of England has not raised interest rates to moderate inflation. Rather, in August it cut Bank Rate to 0.25%. That reflected its concern that leaving the European Union would lead growth to slow and inflation to undershoot the target. In addition, the Bank of England tends to disregard inflation caused by a currency change unless it feeds through to wages.

The Republic of Ireland continued to grow at around 4%, with domestic demand contributing more, and exports less to growth than in recent years. Unemployment continued to fall, ending the year at 7.2%. House price inflation accelerated to 9% from 4.6% in 2015.

Eurozone area growth slowed slightly to 1.7% from 1.8%. Unemployment remained close to 10%. With inflation still close to zero, the European Central Bank reduced interest rates and expanded its quantitative easing programme.

Reflecting continued modest growth 1.6%, rising employment two million, and falling unemployment 4.7%, the US Federal Reserve raised the target range for its main interest rate by 0.25% to 0.5-0.75% in December.

While the year opened with considerable market volatility, which reflected concerns about the outlook for China, growth there was 6.7%, reflecting actions by the authorities to boost activity. That had beneficial

spillover effects among some of China's trading partners.

Despite continued growth and low unemployment in the UK, markets continue to expect interest rates to remain low. At the year's end, the first rise in Bank Rate was expected around mid-2019. While that partly reflects the Bank of England's response to the EU referendum result, more important are structural factors; slower global growth, higher levels of desired saving and lower levels of desired investment, which have been pushing down real interest rates for some time and which are likely to persist.

Our operating enviroment

Our operating environment

Risk overview

Effective risk management plays a central role in the successful development and execution of our strategy. Our Risk appetite is set in line with the overall strategy and approved by the board while the risk management framework identifies and manages current and emerging risks that could materially affect the delivery of the RBS strategy.

Progress in 2016

RBS has continued to make progress against its strategic objectives of reducing risk and strengthening both the balance sheet and the capital position. Against a backdrop of uncertainty in the wider political and economic environment, risk management played a key role in positioning RBS to prepare for, and respond to developments.

In particular, there has been a focus on enhancing our risk appetite framework and communicating and embedding it across the bank. For each of our material risks, significant emphasis has been placed on reviewing current measures along with associated limits and triggers and also the way our risk profile compared to risk appetite is reported across RBS. Risk culture has continued to be at the forefront of our work as RBS moves towards the achievement of its strategic objectives. To that end, the ambition is to make risk management simply part of the way colleagues across RBS work and think. In support of this, during 2016 the RBS-wide action plan focused on assessment, identifying and taking actions to build clarity, develop capability and motivate staff.

Similarly, activity has been underway to enhance our operational risk management framework to help ensure our businesses maintain a safe and secure environment for our customers. As part of this, during 2016 there was a focus on risk and control assessment, particularly relating to our most material products, processes and services. In addition, there continued to be an emphasis on understanding and managing the risks relating to RBS's transformation agenda.

In market risk, sustained effort has been necessary to anticipate and respond to major developments in the wider environment. Managing this has required close collaboration between our first and second lines of defence but, in turn, has demonstrated RBS's continued commitment to its wholesale banking proposition.

RWAs continued to decline (6%), ending the year at £228 billion (from £243 billion in 2015). The decline was driven by continued run down in Capital Resolution, where RWAs fell by £14.5 billion during the year, offset in part by an increase in RWAs in the core franchises.

The Common Equity Tier 1 (CET1) ratio decreased by 210 basis points to 13.4% in 2016, reflecting lower CET1 capital partially offset by a reduction in RWAs. Litigation and conduct charges of £5.9 billion in 2016 contributed to a significant reduction in the CET1 capital. Management actions to normalise the ownership structure and improve the long-term resilience of RBS also contributed to the reduction. These actions included the final Dividend Access Share payment of £1.2 billion and the impact of the accelerated pension payment of £4.2 billion. Tier 1 capital benefitted from the successful issuance of £2 billion of Additional Tier 1 (AT1) capital notes.

The leverage ratio fell by 50bps to 5.1% during 2016. This reflected the fall in the CET1 position, partly offset by the successful issuance of an additional £2 billion equivalent of AT1 instruments as planned at the beginning of the year. The Bank of England leverage ratio benefitted from an additional 50bps uplift following the FPC's guidance on 4 August that allowed banks, under certain conditions, to exclude central bank reserves from the leverage exposure measure. RBS also issued £4.2 billion of MREL-eligible senior debt as part of the issuance plan to meet its steady-state bail-in requirements by 2022.

In the Bank of England 2016 stress test, RBS did not meet its common equity Tier 1 (CET1) capital or Tier 1 leverage hurdle rates before additional Tier 1 (AT1) conversion under the hypothetical adverse scenario. After AT1 conversion, it did not meet its CET1 systemic reference point or Tier 1 leverage ratio hurdle rate. Based on RBS's own assessment of its resilience identified during the stress-testing process, RBS has already updated its capital plan to incorporate further capital strengthening actions and this revised plan has been accepted by the PRA Board. The PRA will continue to monitor RBS's progress against its revised capital plan.

Our operating environment

RBS maintained a robust liquidity and funding risk profile in 2016. Its loan-to-deposit-ratio was 91% at 31 December 2016, compared with 89% in 2015. The latest Internal Liquidity Adequacy Assessment Process (ILAAP) showed that RBS is in a strong position to withstand liquidity stress scenarios. It suggested that RBS's liquidity portfolio was large enough to cover more than 139% of the expected outflows in the worst of three severe scenarios.

Litigation and conduct costs of £5,868 million included a £3,107 million provision in relation to various investigations and litigation matters relating to RBS's issuance and underwriting of residential mortgage-backed securities (RMBS), an additional charge in respect of the settlement with the National Credit Union Administration Board to resolve two outstanding RMBS lawsuits, a provision in respect of the UK 2008 rights issue shareholder litigation, additional PPI provisions, a provision in respect of the FCA review of RBS's treatment of SMEs and a charge in Ulster Bank RoI in respect of an industry-wide examination of tracker mortgages.

Top and emerging risks

RBS employs a continuous process for identifying and managing its top and emerging risks. These are defined as scenarios that could have a significant negative impact on RBS's ability to operate or meet its strategic objectives. A number of scenarios attracted particular attention in 2016.

Macro-economic and political risks:

RBS remains vulnerable to changes and uncertainty in the external economic and political environment, which have intensified in the past year. To mitigate these risks, RBS has taken actions in 2016 with its capital, liquidity and leverage positions. A number of higher-risk portfolios have been exited or reduced. Stress testing and scenario planning is used extensively to inform strategic planning and risk mitigation relating to a range of macro-economic and political risks. Scenarios identified as having a potentially material negative impact on RBS include: the impact of the UK's exit from the EU; a second Scottish independence referendum; a UK recession including significant falls in house prices; global financial market volatility linked to advanced economy interest rate increases or decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in RBS's core markets; a eurozone crisis; and major geopolitical instability.

Risks related to the competitive environment:

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

An increase in obligations to support pension schemes:

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

Regulatory and legal risks

The impacts of past business conduct: Future litigation and conduct charges could be substantial. RBS is involved

in a number of investigations, including: ongoing class action litigation, securitisation and mortgage-backed securities related litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, investigations into the treatment of small and medium-sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products). Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material.

More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections of the 2016 Annual Report on Form 20-F. To prevent future conduct from resulting in similar impacts, RBS continues to embed a strong and comprehensive risk and compliance culture.

Our operating environment

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

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

Operational and execution risks increased losses arising from a failure to execute major projects successfully:

The successful execution of major projects, including the transformation plan, the restructuring of NatWest Markets, meeting the final European Commission State Aid requirements relating to Williams & Glyn compliance with structural reform requirements including the statutory ring-fencing requirements implemented as a result of the Independent Commission on Banking; delivering a robust control environment and the embedding of a strong and pervasive, customer centred organisational and risk culture, are essential to meet RBS's strategic objectives. These projects cover organisational structure, business strategy, information technology systems, operational processes and product offerings. RBS is working to implement change in line with its project plans while assessing the risks to implementation and is taking steps to mitigate those risks where possible.

Impact of cyber attacks:

Cyber attacks are increasing in frequency and severity across the industry. RBS has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a large scale programme to continue to improve controls, enhance protections and educate staff on the threat is underway.

Inability to recruit or retain suitable staff:

There is a risk that RBS lacks sufficient capability or capacity at a senior level to deliver – or to adapt to – change.

RBS monitors people risk closely and has plans in place to support retention of key roles, with wider programmes supporting engagement and training for all staff.

Failure of information technology systems:

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

Full risk factors are discussed on pages 509 to 578 of the 2016 Annual Report on Form 20-F

Case Study - Making sense of money

MoneySense is our flagship financial education programme for young people aged between 5 and 18. It aims to help young people towards a better financial future. Since we started providing financial education in schools over 22 years ago, we've helped an estimated 4.5 million young people understand all about money. By the end of 2018, we'll have helped a further one million young people.

Our programme is used to deliver lessons in primary and secondary schools in the UK and Ireland, thanks to the support of registered teachers and our dedicated volunteer network of over 2,800 employees.

We're proud of the work MoneySense does in our communities. By helping young people understand things like budgeting, saving and online security we're supporting them to become financially independent and confident money managers.

Business review

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

Personal & Business Banking

Personal & Business Banking (includes reportable segments UK PBB and Ulster Bank RoI); contribution to income of 47%

Les Matheson

CEO, Personal & Business Banking

Personal & Business Banking

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

Performance overview

PBB recorded an operating profit of £1,401 million in 2016 compared with £1,292 million in 2015 (UK PBB £1,381 million compared with £1,030 million in 2015; Ulster Bank RoI £20 million compared with £262 million in 2015).

Adjusted operating profit which excluded own credit adjustments, restructuring costs and litigation and conduct costs of £2,431 million was in line with 2015 (UK PBB operating profit excluding restructuring costs of £187 million (2015 - £167 million) and litigation and conduct costs of £634 million (2015 - £972 million) was £2,202 million (2015 - £2,169 million; Ulster Bank RoI operating profit excluding own credit adjustments of £3 million (2015 – nil), restructuring costs £40 million (2015 - £15 million) and litigation and conduct costs £172 million (2015 - £13 million credit) was £229 million (2015 - £264 million), as a reduction in net impairment releases was offset by higher income associated with volume growth.

Total income increased by £116 million, or 2%, to £5,866 million compared with 2015 (UK PBB increased by £90 million, or 2%, to £5,290 million compared with 2015 and Ulster Bank RoI increased by £26 million, or 5%, to £576 million compared with 2015) as the benefit of asset volume growth has more than offset margin compression. Net interest margin declined by 13 basis points to 2.80% (UK PBB declined 17 basis points to 3.01% and Ulster Bank RoI increased by 5 basis points to 1.62%) reflecting the impact of the overall portfolio mix being increasingly weighted towards secured lending and mortgage customers switching from standard variable rate (SVR) to lower rate products.

Net loans and advances of £151.0 billion were £14.5 billion, or 11%, higher than in 2015 (UK PBB net loans and advances of £132.1 billion were £12.3 billion, or 10%, higher; Ulster Bank RoI net loans and advances of £18.9 billion were £2.2 billion or 13% higher), principally reflecting mortgage growth.

Business review

Operating expenses were £4,495 million (UK PBB £3,826 million (2015 - £4,177 million); Ulster Bank RoI £669 million; (2015 - £429 million)). Adjusted operating expenses, which exclude restructuring and litigation and conduct costs, were £3,462 million (UK PBB adjusted operating expenses, which exclude restructuring costs of £187 million (2015 - £167 million) and litigation and conduct costs of £634 million (2015 - £972 million) were £3,005 million (2015 - £3,038 million; Ulster Bank RoI adjusted operating expenses, which exclude restructuring costs £40 million (2015 - £15 million) and litigation and conduct costs £172 million (2015 - £13 million credit) were £457 million (2015 - £427 million), in line with 2015.

Credit conditions remained benign, with a net impairment release of £30 million in 2016 compared with £148 million in 2015. (UK PBB net impairment losses were £83 million compared with £7 million releases in 2015; Ulster Bank ROI net impairment releases were £113 million compared with £141 million in 2015).

Case Study - Upwardly mobile

Whether it's logging in with your fingerprint, paying your contacts through your phone, cancelling a direct debit or amending standing orders, we've been working hard to make our apps even more convenient for customers, by making them easier to use and giving them increased functionality. In fact, over a third of all personal product sales are now completed digitally.

We're investing in our apps because increasing numbers of our customers want to be able to do their banking on the move. 4.2 million customers in the UK now use our apps.

Performance highlights

| | 2016 | | | 2015 | | |
|-----------------------------------|---------|--------------------|---------|---------|--------------------|---------|
| | UK PBB | Ulster Bank RoI | PBB | UK PBB | Ulster Bank RoI | PBB |
| Return on equity (%) | 16.2 | 0.7 | 11.6 | 11.7 | 10.6 | 11.4 |
| Net interest margin (%) | 3.01 | 1.62 | 2.80 | 3.18 | 1.57 | 2.93 |
| Cost:income ratio (%) | 72 | 116 | 77 | 80 | 78 | 80 |
| Operating profit (£m) | 1,381 | 20 | 1,401 | 1,030 | 262 | 1,292 |
| Operating expenses (£m) | (3,826) | (669) | (4,495) | (4,177) | (429) | (4,606) |
| Restructuring costs (£m) | (187) | (40) | (227) | (167) | (15) | (182) |
| Litigation and conduct costs (£m) | (634) | (172) | (806) | (972) | 13 | (959) |

| | | | | | | |
|--|---------|-------|---------|---------|-------|---------|
| Operating profit excluding own credit adjustments, restructuring and litigation and conduct costs (£m) | 2,202 | 229 | 2,431 | 2,169 | 264 | 2,433 |
| Operating expenses excluding restructuring and litigation and conduct costs (£m) | (3,005) | (457) | (3,462) | (3,038) | (427) | (3,465) |
| Net loans and advances to customers (£bn) | 132.1 | 18.9 | 151.0 | 119.8 | 16.7 | 136.5 |
| Customer deposits (£bn) | 145.8 | 16.1 | 161.9 | 137.8 | 13.1 | 150.9 |
| Loan:deposit ratio (%) | 91 | 117 | 93 | 87 | 127 | 90 |
| Risk-weighted assets (£bn) | 32.7 | 18.1 | 50.8 | 33.3 | 19.4 | 52.7 |

Building a better bank that serves customers well

PBB continue to make the bank simpler and fairer for customers by simplifying processes, professional standards training and removing sales based incentives for frontline staff.

Business review

We continued to make better use of our digital channels to make it simpler to serve our customers and easier for them to do business with us. We now have 4.2 million customers in the UK regularly using our mobile app, 19% higher than the end of 2015, and around 60% of our personal customers used a digital channel within the last 90 days. In 2016, we more than doubled the number of customers who purchased a product through our mobile channel compared with 2015. NatWest customers can now apply for personal loans, credit cards and overdrafts via the mobile app, facilitating approximately 8% of total applications. Advocacy amongst our active mobile customers increased significantly over 2016 with NatWest mobile NPS at an all time high of +52.

Our new business banking 'Online Account Opening' service now allows start up business customers to submit an application online in just ten minutes and get a sort code and account number in under an hour. RBS was awarded a Moneyfacts 5 star rating for Business Banking accounts.

In addition to our digital channels, PBB continues to provide multiple physical channels for serving customers, including access to a network of c.11,500 Post Office branches in the UK, c.1,000 An Post branches in the Republic of Ireland, and 41 mobile banking vans alongside our existing network of 1,425 branches and 4,646 ATMs.

PBB continues to help people manage their money better through; MoneySense, First Saver accounts, offering impartial advice, text alerts to customers and in-house Citizens Advice Bureau advisors to help distressed customers.

RBS enhanced its support for social enterprises in 2016. In May, RBS launched a new SE100 Social Business Club with communications agency Matter & Co. The partnership offers a package of business support plus a special programme of regional events. In addition, RBS also increased its support to social enterprises through its lending charity Social & Community Capital.

Following the launch of the Foundation account, an improved version of our Basic bank account, we opened a further 40,860 Foundation accounts in 2016, helping customers who would generally be declined a bank account.

Our customers, the bank and our entire industry faced a bigger threat from fraud, scams and cyber attacks in 2016. In response, we trained our staff to spot phishing e-mails and we ran security awareness seminars and events for around 12,800 customers, staff and industry partners.

Case Study - Committed to service

In 2015, Chief Executive, Ross McEwan, signed the Armed Forces Covenant, pledging that no customers or colleagues would be disadvantaged because of their involvement with the military.

Our Holt's Military Banking colleagues have specialist knowledge of the armed forces, which helps them to better understand, and serve, our armed forces customers. Many bank colleagues are also associated with the armed forces – whether they are reservists, veterans or family members – and need support too.

This year, the bank's support of these customers and colleagues was rewarded, when we were awarded the Gold Award by the Ministry of Defence Employer Recognition scheme.

Defence Secretary Michael Fallon said: "This commitment is making a real difference to everyone who serves and their families – whether giving Reservists more time to train or supporting veterans".

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Business review

Commercial & Private Banking (CPB)

Commercial & Private Banking (includes reportable segments Commercial Banking, Private Banking and RBSI) contribution to income of 35%

Alison Rose

CEO, Commercial & Private Banking

Commercial & Private Banking

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

Performance overview

Commercial & Private Banking (CPB) serves commercial and corporate customers, operating principally through the NatWest,

Royal Bank of Scotland and Lombard brands, and high net worth individuals, through Coutts and Adam & Company. RBS International (RBSI) continues to focus on supporting retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man, Gibraltar and Luxembourg. CPB aims to support the UK and Western European economies through its provision of credit and banking services to help businesses grow.

CPB recorded an operating profit of £1,043 million compared with £1,001 million in 2015 (Operating profit for Commercial Banking was £742 million (2015 - £1,264million); Private Banking, £111 million (2015 - £470 million loss) and RBSI, £190 million (2015 - £207 million). Adjusted operating profit which excludes restructuring costs, litigation and conduct costs and write down of goodwill was £1,617 million, £91 million lower than 2015 (Commercial Banking adjusted operating profit which excludes restructuring costs of £108 million (2015 - £69 million) and litigation and conduct costs of £423 million (2015 - £51 million) was £1,273 million compared with £1,384 million in 2015; Private Banking adjusted operating profit which excludes restructuring costs of £37 million (2015 - £73 million), litigation and conduct costs of £1 million (2015 - £12 million) and in 2015 write down of goodwill of £498 million, was £149 million compared with £113 million in 2015; RBSI adjusted operating profit which excludes restructuring costs of £5 million (2015 - £4 million) was £195 million compared with £211 million in 2015), largely reflecting an increase in net impairment losses.

Total income of £4,446 million was 1% higher than 2015. (Commercial Banking was £3,415 million, 5% higher than 2015 including the impact of business transfers(1) ; Private Banking was £657 million, 2% higher than 2015; and RBSI was £374 million, 2% higher than 2015.) Good growth was achieved in lending to UK businesses, with net loans and advances increasing by £11.3 billion, or 10%, to £121.1 billion, (Commercial Banking net loans and advances increased by £8.8 billion, or 10% to £100.1 billion; Private Banking net loans and advances increased by £1.0 billion, or 9%, to £12.2 billion; and RBSI net loans and advances increased by £1.5 billion, or 21%, to £8.8 billion), driven by increased borrowing across a number of sectors.

Business review

Operating expenses remained stable at £3,190 million (Commercial Banking £2,467 million (2015 - £1,921 million); Private Banking £549 million (2015 - £1,101 million); RBSI £174 million (2015 - £160 million)). Adjusted operating expenses, which exclude restructuring costs, litigation and conduct costs and write down of goodwill and including the impact of business transfers(1) , increased by 6% to £2,616 million (Commercial Banking adjusted operating expenses, which exclude restructuring costs of £108 million (2015 - £69 million) and litigation and conduct costs of £423 million (2015 - £51 million and including the impact of business transfers £109 million (2015 - £25 million) was £1,936 million compared with £1,801 million in 2015; Private Banking adjusted operating expenses, which exclude restructuring costs of £37 million (2015 - £73 million), litigation and conduct costs of £1 million (2015 - £12 million) and in 2015 write down of goodwill of £498 million, was £511 million compared with £518 million in 2015; RBSI adjusted operating expenses, which exclude restructuring costs of £5 million (2015 - £4 million) was £169 million compared with £156 million in 2015), reflecting an intangible asset write down and increased investment spend.

Impairment losses of £213 million increased £131 million compared with 2015 (Commercial Banking impairment losses of £206 million increased by £137 million compared with 2015; Private Banking impairment releases were £3 million compared with impairment losses of £13 million in 2015; and RBSI impairment losses were £10 million (2015 – nil), largely reflecting a single name charge taken in respect of the oil and gas portfolio.

Note:

(1) The business transfers included impact of: total income of £218 million (2015 - £79 million); operating expenses of £109 million (2015 - £25 million) and impairment losses of £50 million (2015 - £1 million releases; 2014 - nil).

Case Study - The shipping news

The Port of Dover is Europe's busiest ferry port. It's a vital international gateway for the movement of passengers and trade, handling up to £119 billion of UK trade each year.

The Dover Western Docks Revival is the port's biggest ever single investment. RBS acted as financial advisor in raising a £200 million package of funding and provided a £35 million revolving credit facility.

This funding will support improvements to the port, transform Dover's waterfront and create up to 600 new jobs.

Business review**Performance highlights**

| | 2016 | | | | 2015 | | | |
|--|--------------------|-----------------|-------|---------|--------------------|-----------------|-------|---------|
| | Commercial Banking | Private Banking | RBSI | CPB | Commercial Banking | Private Banking | RBSI | CPB |
| Return on equity (%) | 4.1 | 5.6 | 13.8 | 5.2 | 9.8 | (27.7) | 18.5 | 5.8 |
| Net interest margin (%) | 1.76 | 2.66 | 1.36 | 1.80 | 1.88 | 2.75 | 1.48 | 1.92 |
| Cost:income ratio (%) | 72 | 84 | 47 | 72 | 59 | 171 | 44 | 75 |
| Net loans and advances to customers (£bn) | 100.1 | 12.2 | 8.8 | 121.1 | 91.3 | 11.2 | 7.3 | 109.8 |
| Customer deposits (£bn) | 97.9 | 26.6 | 25.2 | 149.7 | 88.9 | 23.1 | 21.3 | 133.3 |
| Loan:deposit ratio (%) | 102 | 46 | 35 | 81 | 103 | 48 | 35 | 82 |
| Risk-weighted assets (£bn) | 78.5 | 8.6 | 9.5 | 96.6 | 72.3 | 8.7 | 8.3 | 89.3 |
| Operating profit (£m) | 742 | 111 | 190 | 1,043 | 1,264 | (470) | 207 | 1,001 |
| Operating expenses (£m) | (2,467) | (549) | (174) | (3,190) | (1,921) | (1,101) | (160) | (3,182) |
| Restructuring costs (£m) | (108) | (37) | (5) | (150) | (69) | (73) | (4) | (146) |
| Litigation and conduct costs (£m) | (423) | (1) | - | (424) | (51) | (12) | - | (63) |
| Write down of goodwill (£m) | - | - | - | - | - | (498) | - | (498) |
| Operating profit excluding restructuring, litigation and conduct costs | 1,273 | 149 | 195 | 1,617 | 1,384 | 113 | 211 | 1,708 |

and write
down of
goodwill (£m)

| | | | | | | | | |
|--|---------|-------|-------|---------|---------|-------|-------|---------|
| Operating expenses excluding restructuring, litigation and conduct costs and write down of goodwill (£m) | (1,936) | (511) | (169) | (2,616) | (1,801) | (518) | (156) | (2,475) |
|--|---------|-------|-------|---------|---------|-------|-------|---------|

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Business review

Building a better bank that serves customers well

Commercial Banking reported the largest (and only significant) year on year improvement in NPS amongst major UK banks.

Nearly 80% of our commercial customers' interaction with us is via digital channels, with around 270,000 payments processed every day.

Coutts won the best private bank in the UK for the fifth year running, best private bank for philanthropy services and best initiative of the year in client facing technology at the Global Private Banking Awards, and was highly commended for innovation for its 'Coutts Concierge Online'.

Our customers continue to benefit from the synergies between Commercial and Private Banking, with 1,100 referrals between Commercial and Private Banking in 2016.

RBS continues to support UK business growth through the launch of 6 new business accelerator hubs in 2016, bringing the total to 12. In addition, NatWest launched a £1 billion lending fund to support small businesses.

Case Study - Bright sparks

Several million homes will be more energy efficient thanks to advice from bank experts on the biggest UK smart metering finance deal to date.

Our Structured Finance team helped Calvin Capital fund its £1 billion 'Project Spark', which will support the installation of smart meters in seven million homes up and down the country.

The project is the largest of its kind in the UK, and represents a major step towards a government target to replace traditional meters in all homes by 2020.

Business review

NatWest Markets

NatWest Markets - Share of non-statutory operating profit, (13%)

Chris Marks

CEO, NatWest Markets

NatWest Markets

NatWest Markets provides financing and risk management solutions and is built around three product lines: Rates, Currencies and Financing. NatWest Markets puts its customers at the centre of the way it does business.

Performance overview

NatWest Markets reported an operating loss of £386 million compared with an operating loss of £837 million in 2015 and included litigation and conduct costs of £528 million. Adjusted operating profit which excludes own credit adjustments of £53 million (2015 - £120 million), restructuring costs of £112 million (2015 - £524 million) and litigation and conduct costs of £528 million (2015 - £378 million), was £201 million compared with a loss of £55 million in 2015. The increase was driven by lower operating expenses, excluding restructuring costs and litigation and conduct costs, and increased income.

Total income increased by £47 million to £1,574 million compared with 2015. Income excluding own credit adjustments of £53 million (2015 - £120 million) increased by £114 million, or 8%, to £1,521 million and included the impact of transfers of £98 million in 2015. The increase was driven by Rates and Currencies, reflecting sustained customer activity throughout the year and favourable market conditions following the EU referendum and subsequent central bank actions.

Operating expenses decreased from £2,369 million to £1,960 million in 2016, driven by lower restructuring costs and lower operating expenses, excluding restructuring costs and litigation and conduct costs. Adjusted operating expenses, which exclude restructuring costs of £112 million (2015 - £524 million) and litigation and conduct costs of £528 million (2015 - £378 million), reduced by £147 million, or 10%, reflecting c.£250 million of cost reductions partially offset by higher investment spend and also included the impact of business transfers of £31 million in 2015.

Case Study - Simple solutions

After buying mobile phone operator EE, telecoms group BT wanted to convert the bank loan it used for the acquisition into a longer-dated format.

We acted as a lead bond arranger as well as a cross- currency swap market hedge coordinator, and billing and delivery bank on the five-year bond. By focusing on excellent customer service and through our integrated one-team approach, we were able to find the best solution and to make the process as simple as possible.

This helped BT to return to the European bond market for the first time in nearly two years.

Business review

| Performance highlights | 2016 | 2015 |
|-------------------------------|-------------|-------------|
| Return on equity (%) | (6.6) | (11.1) |
| Net interest margin (%) | 0.84 | 0.53 |
| Cost:income ratio (%) | 125 | 155 |
| Total assets (£bn) | 240.0 | 215.3 |
| Funded assets (£bn) | 100.9 | 103.3 |
| Risk-weighted assets (£bn) | 35.2 | 33.1 |

Building a better bank that serves customers well

The NatWest Markets brand was introduced on 5 December 2016. The new brand is an important step towards our ambition to become No.1 for customers.

NatWest Markets started a Multi-year transformation in February 2015 and real progress is being made towards building a technology-led business with ongoing investment to improve efficiency and reduce costs while sustaining a well-controlled end-to-end model.

The business's progress against its transformation plan is already being recognised externally:

- No.1 for Gilts by Market Share EMEA FIs (Source: Greenwich Associates, European Fixed Income 2016 – Government Bonds)

- No.1 for GBP Options, GBP Inflation and GBP 2Y -10Y IRS (Source: Total Derivatives Dealer Rankings 2016)

- Best bank for FX post-trade services (FX Week Best Bank Awards 2016)

- No.1 for all European Issuers in the private placement market (Source: Dealogic Private Placement Review, Full Year 2016)

- Best for putting corporate client's interest before the bank's (Source: Global Capital Bond Awards 2016)

– NatWest Markets gained or held share in every Rates & FX product category for EMEA and the Americas
(Source: Coalition Client Analytics Top 500 FI Wallets: G10 Foreign Exchange, G10 Rates)

Business review

Capital Resolution

Mark Bailie

Chief Operating Officer

Capital Resolution

Capital Resolution was established to execute the sale or wind down of most of the global footprint, from 38 countries to 13, and trade finance and cash management outside the UK and Ireland. Additionally non-strategic markets, portfolio and banking assets identified are being sold or wound down.

Performance overview

Risk weighted assets (RWAs) decreased by £14.5 billion to £34.5 billion reflecting disposal activity partially offset by an increase due to the weakening of sterling.

Capital Resolution made an operating loss of £4,870 million, compared with an operating loss of £3,687 million in 2015, including litigation and conduct costs of £3,413 million.

Adjusted operating loss which excludes own credit adjustments of £134 million (2015 - £175 million), restructuring costs £78 million (2015 - £1,307 million) and litigation and conduct costs of £3,413 million

(2015 - £2,105 million, was £1,432 million compared with a loss of £412 million in 2015.

Total income included disposal losses of £572 million, £205 million higher than in 2015.

Operating expenses reduced by £696 million to £4,255 million reflecting a £775 million reduction in operating expenses excluding restructuring costs and litigation and conduct costs, and a £1,229 million reduction in restructuring costs, partially offset by a £1,308 million increase in litigation and conduct costs.

Adjusted operating expenses, which exclude restructuring costs £78 million (2015 - £1,307 million) and litigation and conduct costs of £3,413 million (2015 - £2,105 million) decreased by £775 million, or 50%, to £764 million, principally reflecting a 1,000 reduction in headcount.

A net impairment loss of £253 million compared with a net impairment release of £725 million in 2015 and principally comprised charges relating to a number of shipping assets (£424 million).

Governance at a Glance

Board of directors

| | |
|---|--|
| <u>Chairman</u> Howard Davies | <u>Executive directors</u> Ross McEwan Ewen Stevenson |
| <u>Non-executive directors</u> Sandy Crombie (Senior Independent Director) Frank Dangeard Alison Davis Morton Friis Robert Gillespie | Penny Hughes Brendan Nelson Baroness Noakes Mike Rogers |
| <u>Chief Governance Officer and Board Counsel</u> Aileen Taylor (Company Secretary) | |

Our Board

The Board has twelve directors comprising the Chairman, two executive directors and nine independent non-executive directors, one of whom is the Senior Independent Director. Biographies for each director can be found on pages 60 to 65. Mike Rogers was appointed to the Board on 26 January 2016 and Frank Dangeard was appointed to the Board on 16 May 2016.

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

An internal evaluation of the effectiveness of the Board and its committees was conducted in 2016, led by the Chief Governance Officer and Board Counsel.

Our Board committees

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

The full Governance report is on pages 59 to 149 of the 2016 Annual Report on Form 20-F.

Group Audit Committee

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

Board Risk Committee

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

Sustainable Banking Committee Provides support to the Board in overseeing actions being taken by management to run a sustainable long term business, with specific focus on culture, people, customer, brand and environmental social and ethical issues.

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

Group Nominations and Governance Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and the membership and chairmanship of Board committees. It considers succession planning taking into account the skills and expertise which will be needed on the Board in future. Its remit also includes governance oversight.

Governance at a Glance

Executive Committee

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

UK Corporate Governance Code

Throughout the year ended 31 December 2016, RBS has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated April 2016 except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. RBS considers that this is a matter which should rightly be reserved for the Board.

Case study

Free to dream

Through our partnership with Entrepreneurial Spark, we're helping entrepreneurs realise their dreams of owning and running their own business. We provide free facilities; free Wi-Fi, access to the bank's networks and suppliers, and free business advice. They don't need to bank with us and we take no equity; we simply believe it's right to support entrepreneurs and in turn help the economy grow.

Lawyer Sharon Amesu joined our Manchester hub in February 2016. "There was a real buzz and an immediate sense that I could be part of something quite special and significant" she says. "It's been instrumental in helping me grow my mentoring business and also a fantastically creative space to get to know, and network with, other aspirational and passionate people."

Across 12 accelerators throughout the UK, we have supported 1,736 companies with an aggregate turnover of more than £176 million. We've helped secure more than £151 million worth of investment for entrepreneurs in the Entrepreneurial Spark programme, and they in turn have created 3,152 jobs. More than 80% of the participating companies are still operating.

Our Board

| Governance | | Page | |
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| | Chairman | | |
| | <p>Howard Davies (age 66)</p> <p><i>Nationality:</i> British</p> <p><i>Date of appointment:</i> 14 July 2015 (Board), 1 September 2015 (Chairman)</p> <p><i>Experience:</i> Howard was Deputy Governor of the Bank of England from 1995 to 1997 and Chairman of the UK Financial Services Authority from 1997 to 2003. Howard was Director of the London School of Economics and Political Science from 2003 until May 2011. He is also Professor of Practice at the</p> | <p><i>External appointment(s):</i></p> <p>Independent director of Prudential plc and chair of the Risk Committee</p> <p>Member of the Regulatory and Compliance Advisory Board of Millennium Management LLC</p> <p>Chair of the International Advisory Council of the China Securities Regulatory Commission</p> <p>Member of the International Advisory Council of the China Banking Regulatory Commission</p> <p>Chairman of the London Library Trustees</p> <p><i>Committee membership(s):</i></p> | |

| | | |
|----------------------------|--|---|
| | <p>Paris Institute of Political Science (Sciences Po).</p> <p>Howard was chair of the UK Airports Commission between 2012 and 2015 and is also the author of several books on financial subjects.</p> | <p>Group Nominations and Governance Committee (Chairman)</p> |
| Executive directors | | |
| Executive | <p>Ross McEwan (age 59)</p> <p><i>Nationality:</i> New Zealand</p> <p><i>Date of appointment:</i> 1 October 2013</p> <p>Chief</p> <p><i>Experience:</i> Ross became Chief Executive of The Royal Bank of Scotland Group in October 2013.</p> <p>Between August 2012 and September 2013, he was Chief Executive Officer for UK Retail, joining from Commonwealth Bank of Australia where he was Group Executive for Retail Banking Services for five years. Prior to this he was Executive General Manager with responsibility for the branch network, contact centres and third party mortgage brokers.</p> <p>Ross has more than 25 years experience in the finance, insurance and investment industries. Prior to Commonwealth Bank of Australia, he was Managing Director of First NZ Capital Securities. He was also Chief</p> | <p><i>External appointment(s):</i></p> <p>None</p> <p><i>Committee membership(s):</i></p> <p>Executive Committee (Chairman)</p> |

| | | | | | | | |
|--|--|--|---|--|--|--|--|
| | | | Executive of National Mutual Life Association of Australasia Ltd/AXA New Zealand Ltd. Ross has an MBA from Harvard. | | | | |
| | | | | | | | |

Our Board

Executive directors Chief Financial Officer

Ewen Stevenson (age 50)

External appointment(s):

Nationality: British/New Zealand

None

Date of appointment: 19 May 2014

Committee membership(s):

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

Executive Committee

US Risk Committee

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

Independent non-executive directors

Sandy Crombie (age 68)

External appointment(s):

Nationality: British

President of the Cockburn Association

Date of appointment: 1 June 2009

(Senior Independent Director)

Committee membership(s):

Experience: Sandy spent his entire full-time career with Standard Life plc, retiring as Group Chief Executive. An actuary, he has served

Group Performance and Remuneration Committee (Chairman)

Group Audit Committee

his profession in a variety of roles and has also served as a director of the Association of British Insurers.

Group Nominations and Governance Committee

GRG Board Oversight Committee

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

Our Board

Independent non-executive directors

Frank Dangeard (age 59)

Nationality: French

Date of appointment: 16 May 2016

Experience: Previously, Frank served as a non-executive director of Crédit Agricole CIB, EDF, Home Credit, Orange, Sonaecom SGPS, and as Deputy Chairman and acting Chairman of Telenor ASA. During his executive career he held various roles at Thomson S.A., including Chairman and Chief Executive Officer, and was Deputy Chief Executive Officer of France Telecom. Prior to that he was Chairman of SG Warburg France and a Managing Director of SG Warburg.

External appointment(s):

Non-executive director of the RPX Corporation

Non-executive director of Symantec Corporation

Committee membership(s):

Board Risk Committee

Frank is a graduate of HEC and IEP in Paris and of the Harvard Law School in the US.

Alison Davis (age 55)

Nationality: British/USA

Date of appointment: 1 August 2011

Experience: Previously, Alison served as a director of City National Bank, First Data Corporation, Xoom, Diamond foods and chair of the board (and as Non-executive director) of LECG Corporation. She has

External appointment(s):

Non-executive director and member of the compensation and audit committees of Unisys Corporation

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

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

Committee membership(s):

| | |
|--|---|
| also worked at McKinsey & Company, AT Kearney, as Chief Financial Officer at Barclays Global Investors (now BlackRock) and as managing partner of Belvedere Capital, a private equity firm focused on buy-outs in the financial services sector. | Group Nominations and Governance Committee Group Performance and Remuneration Committee Sustainable Banking Committee |
|--|---|

Alison is a graduate of Cambridge University and Stafford Business School.

Our Board

Independent non-executive directors

Morten Friis (age 64)

Nationality: Norwegian

Date of appointment: 10 April 2014

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

External appointment(s):

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

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

Non-executive director of Jackson National Life Insurance Company

Committee membership(s):

Group Audit Committee

Board Risk Committee

US Risk Committee (Chairman)

Robert Gillespie (age 61)

Nationality: British

Date of appointment: 2 December 2013

Experience: Robert began his career with Price Waterhouse (now PricewaterhouseCoopers) where he qualified as a chartered accountant. He then moved into banking joining SG Warburg, specialising in corporate finance, and was appointed as Co-Head and Managing Director of its

External appointment(s):

Independent board director at Ashurst LLP

Chairman of Council at the University of Durham

Chairman of the Boat Race Company Limited

Director of Social Finance Limited

| | |
|---|---|
| US investment banking business in 1989. Following the acquisition in 1995 of Warburg by Swiss Bank Corporation (which subsequently merged with UBS), he then held the roles of Head of UK Corporate Finance, Head of European Corporate Finance and Co-Head of its global business and CEO of the EMEA region. He relinquished his management roles at the end of 2005, and was appointed Vice Chairman of UBS Investment Bank. Robert left UBS to join Evercore Partners, from where he was seconded to the UK Panel on Takeovers and Mergers, as Director General, from 2010 to 2013. | <i>Committee membership(s):</i> Group Nominations and Governance Committee Group Performance and Remuneration Committee Sustainable Banking Committee GRG Board Oversight Committee |
|---|---|

Our Board

Independent non-executive directors

Penny Hughes, CBE (age 57)

Nationality: British

Date of appointment: 1 January 2010

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

External appointment(s):

Non-executive Chairman of The Gym Group plc. Also chair of the nominations and member of the audit, risk and remuneration committees

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

Committee membership(s):

Sustainable Banking Committee (Chairman)

Board Risk Committee

GRG Board Oversight Committee

Brendan Nelson (age 67)

Nationality: British

Date of appointment: 1 April 2010

Experience: Brendan was global Chairman, financial services for KPMG. He previously held senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 to 2006 and as vice-Chairman

External appointment(s):

Non-executive director and Chairman of the audit committee of BP plc

Member of the Financial Reporting Review Panel

Committee membership(s):

Group Audit Committee (Chairman)

Group Nominations and Governance Committee

from 2006 until his retirement in Board Risk Committee
2010. He was Chairman of the
Audit Committee of the Institute GRG Board Oversight Committee
of Chartered Accountants of (Chairman)
Scotland from 2005 to 2008.
President of the Institute of
Chartered Accountants of
Scotland 2013/14.

Our Board

Independent non-executive directors

Baroness Noakes, DBE (age 67)

External appointment(s):

Nationality: British

Deputy Chairman, Ofcom

Date of appointment: 1 August 2011

Committee membership(s):

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

Board Risk Committee (Chairman)

Group Audit Committee

GRG Board Oversight Committee

US Risk Committee

Mike Rogers (age 52)

External appointment(s):

Nationality: British

None

Date of appointment: 26 January 2016

Committee membership(s):

Experience: Mike has extensive experience in retail banking and financial services. Mike joined Barclays in 1986 where he undertook

Group Performance and Remuneration Committee

Sustainable Banking Committee

Committee membership(s):

a variety of roles in the UK and overseas across business banking, wealth management and retail banking. Mike was Managing Director of Small Business, Premier Banking and UK Retail Banking and was latterly Chief Executive of Liverpool Victoria Group for 10 years.

Our Board

Chief Governance Officer and Board Counsel

Aileen Taylor (age 44)

Nationality: British

Date of appointment: 1 May 2010

(Company Secretary)

Aileen is a fellow of the Chartered Institute of Bankers in Scotland and a member of the European Corporate Governance Council. She is also a member of the FCA's Listing Authority Advisory Panel.

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

Executive Committee

The Board is supported by the Executive Committee comprising the executive directors and other senior executives. Details of the composition of the Executive Committee and biographies of its members can be found at [rbs.com>about us>board and governance>ceo and board>executive committee](https://www.rbs.com/about-us/board-and-governance/ceo-and-board/executive-committee).

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Corporate governance

Chairman's introduction

I am pleased to introduce the corporate governance report. The following report provides an overview of key roles and responsibilities of the Board, and sets out in greater detail how the Board spent its time in 2016. Board effectiveness and performance evaluation are also covered, as well as an overview of how we communicate with shareholders.

As mentioned in my Chairman's Statement on page 7, the Board has considered a number of key strategic, financial, regulatory and litigation matters during 2016.

Understandably, capital strategy and planning remains a priority for the Board. The Board has continued to provide detailed oversight of litigation and conduct matters, particularly the FCA review of the treatment of SME customers, shareholder litigation and RMBS litigation. The divestment of Williams & Glyn; the implications of the EU Referendum result; and the Transformation agenda were all key strategic challenges deliberated by the Board this year. The Board continues to monitor steps being taken to drive cultural change, including risk culture, and ensuring that the right culture and values are embedded throughout the organisation. The Board has considered the preparations for the implementation of ring-fencing and this will be an area of continued focus in 2017.

On 7 March 2016, the PRA and FCA's Senior Managers' Regime came into effect which, alongside the PRA and FCA's new Certification and Conduct Rules regimes, is aimed at strengthening personal accountability and conduct within banking. The Senior Managers' Regime required us to identify those senior executives and board members (referred to as Senior Managers) who would be allocated specific regulatory responsibilities under the Senior Managers' Regime. The Board has received training and ongoing support to ensure that those members who are Senior Managers are able to demonstrate their compliance with the relevant regulatory requirements.

I and my fellow directors are committed to observing high standards of corporate governance, integrity and professionalism. Our statement of compliance with the UK Corporate Governance Code (the Code) can be found on page 150.

I would like to take this opportunity to thank my fellow Directors for their continued commitment and dedication throughout 2016.

Howard Davies, Chairman of the Board

The Board

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

Biographies for each director and details of which Board committees they are members of can be found on pages 59 to 65. The Board considers that the Chairman was independent on appointment and that all non-executive directors are independent for the purposes of the Code.

Corporate governance

Board changes

Mike Rogers was appointed as a non-executive director on 26 January 2016. Mike was appointed as a member of the Sustainable Banking Committee with effect from 25 April 2016, and a member of the Group Performance and Remuneration Committee with effect from 1 January 2017. Frank Dangeard was appointed as a non-executive director on 16 May 2016 and as a member of the Board Risk Committee on 4 August 2016.

Roles and responsibilities

The Board

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

As mentioned above a number of board members have been designated as "Senior Managers" under the PRA and FCA's Senior Managers' Regime. The role profiles of relevant directors have been updated to reflect their regulatory responsibilities and they receive ongoing support to ensure they can demonstrate the reasonable steps they have taken to meet their responsibilities.

Chairman

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

The Chairman's key responsibilities are to:

- provide strong and effective leadership to the Board;
- ensure the Board is structured effectively, observes the highest standards of integrity and corporate governance, and sets the tone from the top in terms of culture and values;
- build an effective and complementary Board with an appropriate balance of skills and personalities, and as Chairman of the Group Nominations and Governance Committee consider succession planning for

Board appointments;

- manage the business of the Board and set the agenda, style and tone of Board discussions to promote effective decision-making and constructive debate;
- facilitate the effective contribution and encourage active engagement by all members of the Board;
- in conjunction with the Chief Executive and Chief Governance Officer and Board Counsel, ensure that members of the Board receive accurate, timely and clear information to enable the Board to lead RBS, take sound decisions and monitor effectively the performance of executive management;
- ensure that the performance of individual directors and of the Board as a whole and its committees is evaluated regularly; and
- ensure RBS maintains effective communication with shareholders and other stakeholders.

Corporate governance

Chief Executive

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

The Chief Executive's key responsibilities are to:

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

Senior Independent Director

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

Non-executive directors

Along with the Chairman and executive directors, the non-executive directors are responsible for ensuring the Board fulfils its responsibilities under its terms of reference. The non-executive directors combine broad

business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership across RBS's business activities.

The standard terms and conditions of appointment of non-executive directors are available on [rbs.com](https://www.rbs.com) or from RBS Corporate Governance and Regulatory Affairs.

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. Please see pages 57 and 58 of the Strategic Report for more details. The terms of reference are available on [rbs.com](https://www.rbs.com).

Corporate governance

The Board Committee established in 2015 in relation to the Financial Conduct Authority review of the treatment of SME customers continued to meet during 2016, to oversee and provide advice to the Board in relation to the review, the external independent review of Global Restructuring Group (GRG) instigated by the Group and other matters generally related to GRG. A new US Risk Committee was established to comply with US enhanced prudential standards and reports key matters discussed to the BRC. The first meeting took place in May 2016.

Chief Governance Officer and Board Counsel

Aileen Taylor is the Chief Governance Officer and Board Counsel and the Company Secretary. As of 1 January 2017, she also leads the bank's Regulatory Affairs function as part of an extended remit.

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

- working closely with the Chairman to ensure effective functioning of the Board and appropriate alignment and information flows between the Board and its committees, including the Executive Committee. This includes Board succession planning, induction, and professional development;
- providing support and advice to the Board on a broad range of strategic, governance, legal and regulatory issues;
- executive responsibility for Chairman/non-executive director search and appointment process;
- management of the bank's profile with key stakeholders, including oversight of relations with key influencers, such as regulators;
- defining and delivering the corporate governance and regulatory affairs strategy across RBS; and
- the provision of professional support to the Board and its committees and leading on implementation of recommendations from the annual Board evaluation.

Conflicts of interests

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

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

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

Corporate governance

Board meetings

In 2016, nine Board meetings were scheduled and individual attendance by directors at these meetings is shown in the table below.

In addition to the nine scheduled meetings, 11 additional meetings and committees of the Board were held, including meetings to consider and approve financial statements. The Chairman and the non-executive directors meet at least once per year without executive directors present.

| | Attended/ scheduled |
|--------------------|------------------------|
| Howard Davies | 9/9 |
| Ross McEwan | 9/9 |
| Ewen Stevenson | 9/9 |
| Sandy Crombie | 9/9 |
| Frank Dangeard (1) | 5/5 |
| Alison Davis | 9/9 |
| Morten Friis | 9/9 |
| Robert Gillespie | 9/9 |
| Penny Hughes | 9/9 |
| Brendan Nelson | 9/9 |
| Baroness Noakes | 9/9 |
| Mike Rogers (2) | 9/9 |

Notes:

(1) Appointed to the Board on 16 May 2016.

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

Principal areas of Board focus during 2016

In advance of each Board meeting, the directors are provided with comprehensive papers.

At each Board meeting the directors received reports from the Chairman, Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Conduct and Regulatory Affairs Officer, Franchise CEOs and the Board Committee Chairmen. An overview of the principal areas of Board focus during 2016 is set out below:

Customer

- customer service
- network distribution
- products and innovation
- branding
- culture
- customer trust and advocacy

Finance

- annual financial budget and plan
- capital strategy and planning
- Internal Capital Adequacy Assessment Process
- Individual Liquidity Adequacy Assessment
- pension funding
- recovery and resolution planning
- results and analysts' presentations

Corporate governance

Strategy

- annual Board strategy offsite
- EU referendum implications
- Ring-fencing, including legal entity restructuring
- transactions updates
- transformation programme
- Williams & Glyn disposal
- technology updates

Risk & Conduct

- stress testing
- risk appetite governance and framework
- annual review of strategic risk appetite
- Individual Accountability Regime implementation

Legal & Governance

- Annual Report and Accounts
- AGM arrangements
- board appointments
- board and committee evaluation
- annual PRA and FCA presentation to the Board
- external auditor evaluation
- internal audit evaluation

- legal report, including litigation updates

Human Resources

- employee survey results
- executive director remuneration proposals
- executive talent session

During 2016 the Board also visited the Ulster Bank business in the Republic of Ireland, spending time on the business, risks and challenges. The directors met with key customers, politicians and senior industry and business representatives.

Executive Committee

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

Board effectiveness

Skills and experience of the Board

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

Corporate governance

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

| | |
|--|---|
| <ul style="list-style-type: none"> • Retail Banking • Broad Financial Services • Markets/Investment Banking • Government & Regulatory • Mergers & Acquisitions • Corporate Restructuring • Stakeholder Management | <ul style="list-style-type: none"> • Chief Executive experience • Finance & Accountancy • Risk • Technology/Digital • Operations • Change Management • Consumer Facing |
|--|---|

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

Induction and professional development

Each new director receives a formal induction on joining the Board, which is co-ordinated by the Chief Governance Officer and Board Counsel. This includes visits to RBS's major businesses and functions and meetings with directors and senior management. Meetings with external auditors, counsel and stakeholders are also arranged as appropriate. An illustrative list of the meetings arranged during a new director's induction programme is set out below:

| | |
|-------------------------------|-----------------------|
| Chairman | Director, Finance |
| Chief Executive | Chief Accountant |
| Chief Financial Officer | Head of RBS Tax |
| Senior Independent Director | Chief Human Resources |
| Other non-executive directors | Officer |

| | |
|---|--|
| Chief Governance Officer and Board Counsel | Chief Administrative Officer |
| Chief Risk Officer | Head of Investor Relations |
| Chief Marketing Officer | Head of Public Affairs |
| Chief Operating Officer | Director of Strategy & Corporate Development |
| RBS Treasurer | Director of Transformation |
| Chief Audit Executive | Head of Restructuring |
| Chief Legal Officer and General Counsel | Chief Economist |
| Chairmen and CEOs of principal subsidiaries | External Auditors |
| Franchise Chief Executive Officers | External Counsel |
| | Regulators |
| | Institutional Investors |
| | Business visits (UK and overseas) |

The directors have access to a wide range of briefing and training sessions and other professional development opportunities. Internal training relevant to the business of RBS is also provided. Business visits are arranged as part of the Group Audit Committee and Board Risk Committee schedule (details of which can be found on pages 81 and 91) and all non-executive directors are invited to attend. Directors undertake the training they consider necessary to assist them in carrying out their duties and responsibilities as directors. Directors may also request individual in-depth briefings from time to time on areas of particular interest.

Corporate governance

During 2016, the directors received updates on a range of subjects to enhance their knowledge, including:

- investor and rating agencies views on RBS;
- disruptive technologies;
- Market Abuse Regulations (Inside Information and Persons Discharging Management Responsibility aspects);
- corporate investigations;
- Senior Managers' Regime;
- The Conduct Rules;
- PRA's final Supervisory Statement on corporate governance and board responsibilities;
- Ring-fencing;
- board diversity;
- The UK Government's proposals for corporate governance reform;
- Institute of Directors 2016 good governance report;
- FRC's report on corporate culture and the role of the board; and
- key regulatory & supervisory policy developments.

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

Information

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

Time commitment

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

Election and re-election of directors

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

Corporate governance

Performance evaluation

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

The 2015 evaluation was conducted externally by a specialist board evaluation consultancy and a number of initiatives were implemented aimed at improving the overall performance and effectiveness of the Board. These included the creation of a Nominations and Governance Committee, adding a governance oversight function and streamlining processes and membership; a range of actions to enhance agenda planning and the Board's overall operating rhythm; and actions to improve alignment between the Board and executives to ensure a consistent "tone from the top". These themes were taken forward during 2016 under an action plan, are being appropriately addressed and will be kept under regular review as a matter of good practice.

In 2016, the Board and committee evaluation process was conducted internally by the Chief Governance Officer and Board Counsel.

Performance evaluation process

The Chief Governance Officer and Board Counsel undertook a formal and rigorous evaluation by:

- preparing surveys that were completed by each director and holding interviews with each director;
- discussing the key themes and recommendations for action with the Chairman; and
- recommending the key themes and proposed actions to the Board.

Outcomes of the 2016 performance evaluation

The 2016 performance evaluation concluded that the Board was strong and operated effectively and within its terms of reference.

Key strengths identified included the following:

- The Chairman provides strong leadership to the Board and has settled into the role well.

- The Board works well together to create effective debate and challenge, and provides effective oversight and challenge to management.
- The Board's composition has been strengthened during 2016 by the appointments of Mr Rogers and Mr Dangeard.
- The quality of information received by the Board continues to improve.
- The Board's committees operated effectively within their terms of reference throughout the year, providing valuable support to the Board.

A summary of the key themes arising from the 2016 performance evaluation is set out below, together with an overview of the key actions proposed:

Key themes

Board composition and succession planning

The importance of keeping Board and committee composition under regular review was highlighted, in order to ensure diversity and an orderly succession as a number of non-executive directors approach the end of their tenure with RBS.

Corporate governance

Quality of information

Paper quality has improved over recent years. There is scope for further enhancement, by continuing to manage paper length and ensuring an appropriate level of detail is shared with the Board. Similar issues were raised during the committee evaluations.

Focus of agenda

The balance of the Board agenda tends towards legacy and internal issues, which reflects the current climate. However, it is also important to ensure continued focus on forward-looking and strategic discussions.

Non-executive director time commitment

Non-executive director time commitment remains significant. This is largely due to the number of extraordinary items which require to be considered by the Board in the current environment.

Customers and culture

The Sustainable Banking Committee has played a key role in customer and culture issues, however the directors would welcome greater Board focus on these priorities.

Proposed actions

Recommendations arising out of the 2016 evaluation have been carefully considered by the Board. An action plan has been agreed for 2017 and key actions include:

- Ensuring board & committee composition and succession plans are kept under regular review, to be led by the Group Nominations and Governance Committee.
- Refreshing Board and committee paper templates and guidance, to ensure consistency across the Board and committees in relation to paper length and content.
- Ensuring Board time is appropriately allocated in response to evaluation feedback, to facilitate the effective use of non-executive director time.

- Further developing the Board's role on culture, to include consideration of how Board time is spent on actions to drive cultural change.

In addition, a list of 2017 priorities for the Board was prepared following evaluation feedback and has been factored into the 2017 agenda planning process, as appropriate.

Individual director and Chairman effectiveness reviews

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

Corporate governance

Relations with investors

The Chairman is responsible for ensuring effective communication with shareholders. The company communicates with shareholders through the Annual Report on Form 20-F and by providing information in advance of the Annual General Meeting. Individual shareholders can raise matters relating to their shareholdings and the business of RBS at any time throughout the year by letter, telephone or email via rbs.com/ir.

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

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

- the Chief Executive and Chief Financial Officer meet regularly with UKFI, the organisation set up to manage the Government's investments in financial institutions, to discuss the strategy and financial performance of the business. The Chief Executive and Chief Financial Officer also undertake an extensive annual programme of meetings with the company's largest institutional shareholders;
- the Chairman independently meets with RBS's largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman, Senior Independent Director and chairmen of the Board committees met with the governance representatives of a number of institutional shareholders during the year;
- the Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels; and
- the Chairman of the Group Performance and Remuneration Committee consults extensively with major shareholders in respect of the Group's remuneration policy.

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

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

Report of the Group Nominations and Governance Committee

Letter from Howard Davies

Chairman of the Group Nominations and Governance Committee

Dear Shareholder,

As Chairman of the Board and Chairman of the Group Nominations and Governance Committee I am pleased to present our report on the committee's activity during 2016.

Role and responsibilities

The Group Nominations and Governance Committee was constituted in January 2016 and assumed the responsibilities of the previous Group Nominations Committee to review the structure, size and composition of the Board, and membership and chairmanship of Board Committees. In addition, the Committee monitors the Group's governance arrangements to ensure that best corporate governance standards and practices are upheld and considers developments relating to banking reform and analogous issues affecting the Group in the markets where it operates. The Committee makes recommendations to the Board in respect of any consequential amendments to the Group's operating model.

The Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board.

The terms of reference of the Group Nominations and Governance Committee are reviewed annually, approved by the Board and are available at rbs.com.

Principal activity during 2016

As highlighted in the Board's 2015 performance review, the Committee acknowledges the tenure of a number of the current Board directors and therefore made succession planning a priority in 2016.

| | | |
|-------------|--|------|
| | | 2016 |
| 0 - 3 years | | 40% |
| 3 - 6 years | | 30% |
| 6 + years | | 30% |
| | | 100% |

In addition to recruitment, the Committee assumed oversight of the process to reach agreement with the PRA in respect of a governance model that adheres to ring-fencing legislation. Ring-fencing also gives rise to a requirement to recruit additional non-executive directors to the boards of our material regulated subsidiaries, which the Committee has also been overseeing.

The Committee has spent time considering the Group's arrangements in respect of legal entity governance. This work is ongoing and is complementary to the Group's preparations for the implementation of ring-fencing legislation.

Membership and meetings

The Group Nominations and Governance Committee is comprised of the Chairman of the Board and four independent non-executive directors, which is consistent with the findings of last year's recommendation. The Committee holds at least four scheduled meetings per year and also meets on an ad hoc basis as

required. In 2016, there were four Group Nominations and Governance Committee meetings and individual attendance by directors at these meetings is shown in the table below.

| | Attended/ scheduled |
|--------------------------|------------------------|
| Howard Davies (Chairman) | 4/4 |
| Sandy Crombie | 4/4 |
| Alison Davis | 4/4 |
| Robert Gillespie | 4/4 |
| Brendan Nelson | 4/4 |

Report of the Group Nominations and Governance Committee

Consideration of new non-executive directors

As previously advised, JCA Group has been engaged to support the search for new non-executive directors. The search and nominations process has been streamlined, including by establishment of this Committee. The Committee has also considered (by reference to peer institutions) the significant time commitment required of the Group's non-executive directors and how this might be reduced to make the position accessible to a larger pool of candidates. JCA group does not provide search services to any other part of RBS. During 2016, the Committee considered a number of potential candidates and in May 2016, Frank Dangeard was appointed to the Board as a non-executive director.

The Committee has overseen the establishment of the Group's Technology Advisory Board, which was constituted on 1 December 2016 with a remit to *provide an external lens to RBS's innovation and technology agenda including consideration of driving a resilient, simple and efficient technology environment*.

In addition to appointments to the Board (and subsidiary appointments being required to specifically comply with ring-fencing legislation), the Committee has also overseen the process for the appointment of a new chairman for Ulster Bank Ireland DAC.

Tenure of non-executive directors

The tenure of non-executive directors is set out below.

Board and Committee membership

As previously mentioned, Frank Dangeard joined the Board as a non-executive director on 16 May 2016 and was subsequently appointed to the Board Risk Committee on 4 August 2016. Frank has substantial Board level experience across a number of sectors, including technology, telecom and financial services. His change management and transformation experience are a real asset to the Board.

The Committee recommended in February 2016 that the CIB Board Oversight Committee should be discontinued, due to its remit having been superseded.

Performance evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Group Nominations and Governance Committee, was conducted internally in 2016. The Committee has considered and discussed the outcomes of this evaluation and accepts the findings. Overall the review concluded that the Group Nominations and Governance Committee operated effectively. However, certain recommendations for action were recognised including the need to: regularly engage with the external search firm to provide clarity and guidance on RBS's recruitment requirements; and rebalance the agenda of the Committee to ensure greater focus on strategic issues, including director performance and board and senior management succession.

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

Boardroom diversity

The Board currently meets the target of 25 per cent female board representation as set out in Lord Davies' 2011 report on women on Boards. We acknowledge the updated targets published in the Hampton Alexander and Parker reports and will continue to consider the implications for RBS during 2017.

The gender diversity of the Board is set out below.

| | |
|--------|------|
| | 2016 |
| Female | 25% |
| Male | 75% |
| | 100% |

The Board operates a boardroom diversity policy and a copy of the Board's diversity statement is available on [rbs.com>about us](http://rbs.com/about-us).

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

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

Further details on RBS's approach to diversity can be found on pages 163 and 164.

Howard Davies

Chairman of the Group Nominations and Governance Committee

23 February 2017

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Report of the Group Audit Committee

Letter from Brendan Nelson,

Chairman of the Group Audit Committee

“The first priority of the Group Audit Committee is to ensure the integrity and quality of RBS’s financial statements”

Dear Shareholder,

Throughout 2016 RBS has continued to progress its plan to build a strong, simple, fair bank for customers and shareholders and the Group Audit Committee (GAC) has supported this through the review and consideration of RBS’s financial reports and disclosures. This report also sets out the key areas of focus for the GAC during 2016. I am pleased to confirm that the GAC operated effectively during 2016, as was confirmed by the annual evaluation process, details of which are also set out below.

Accounting and financial reporting

The first priority of the GAC is to ensure the integrity and quality of RBS's financial statements, including its quarterly, interim and full year results and its annual report and accounts. During 2016 the GAC spent considerable time reviewing and discussing RBS's financial results in detail, and challenging the material judgements proposed by management, before recommending them to the Board for approval.

In particular, during 2016 the GAC considered judgements relating to the recoverability of deferred tax assets, the carrying value of goodwill, provisions for litigation and conduct charges, loan impairment provisions and the fair value of financial instruments. Additionally, in the stand-alone parent company accounts, the GAC considered judgements relating to the carrying value of RBSG's investment in subsidiaries.

There were also a number of developments during 2016 which required the GAC's scrutiny from a disclosure perspective. The divestment of Williams & Glyn was an important issue during 2016 and the GAC was fully engaged on this issue in order to ensure that all developments and risks were transparently disclosed to the market. RBS also continues to work through a number of litigation and conduct issues which the GAC has carefully considered in order to ensure its disclosures remain accurate and up to date.

The implications of the EU referendum and subsequent developments in the macro economic environment were an important area of focus for RBS in the second half of 2016. The GAC received reports on the implications for the credit environment which it has considered in the context of RBS's disclosures and financial reports. This will remain an area of ongoing focus into 2017.

The Market Abuse Regulation took effect in July 2016. The GAC reviewed and discussed the implications for RBS's disclosures and the processes RBS has implemented to ensure compliance with these regulations.

The GAC also considered significant developments in relation to financial reporting to ensure that RBS is well prepared for legal and regulatory changes which impact its financial results and disclosures. In particular, the GAC has overseen the preparatory work relating to the introduction of IFRS 9 which will take effect on 1 January 2018.

In relation to the Annual Report and Accounts, the GAC carefully considered the viability report and the 'fair, balanced and understandable' statement, including the processes which support them. The directors are required to make these statements in line with the UK Corporate Governance Code.

Report of the Group Audit Committee

Systems of internal control

RBS continues to work on the improvement of its control environment, which is key to making RBS a safer and more secure bank. However, the level of change RBS is undergoing presents significant challenges and RBS's operational risk profile remains heightened. The GAC oversees the arrangements for RBS's systems of Internal Control relating to financial reporting. During 2016 the GAC received quarterly updates from Internal Audit detailing Internal Audit's control ratings for RBS's businesses and functions. The GAC also received bi-annual updates on the control environment certification process and the material operational risk events which are notified to RBS's senior management, executives and non-executive directors.

During 2016 RBS made good progress in developing its operational risk management framework with the roll-out of bank-wide risk appetite statements for its most material risks, this included financial reporting risk appetite which was considered by the GAC in August 2016. RBS has also developed end to end risk and control assessment for material processes during 2016, and the resulting actions to improve and enhance controls will be taken forward during 2017; this process will be overseen by the Board Risk Committee with the GAC focusing on those aspects impacting financial reporting. The drive to achieve satisfactory controls will benefit from the bank-wide programme to enhance risk culture, with its focus on encouraging a proactive approach to risk and a more open and challenging environment.

External audit

A priority for the GAC during 2016 was to oversee a change of the external auditors. Ernst & Young (EY) assumed the role of RBS's new auditors in March 2016, having been successful in the tender process run in 2014.

On behalf of the GAC, I would like to thank the outgoing external auditors, Deloitte LLP, for their hard work over many years and for their professionalism in ensuring an orderly and smooth handover to EY.

The external auditors have attended each meeting of the GAC in 2016 and have provided the GAC with quarterly reports and ad hoc updates on specific topics as required. I am pleased to confirm that the 2016 evaluation of the external auditor found that EY were performing the audit of RBS effectively.

Key priorities for 2017

Moving into 2017 the GAC will continue its focus on RBS's accounting and financial reporting. The GAC will continue to consider developments in accounting policy and regulations impacting RBS, including IFRS 9 in particular. The impact of developments in the macro economic environment on the credit portfolio and

financial results will also remain a priority, as will the Control Environment and the GAC will continue to monitor these throughout 2017.

Accounting issues and disclosures relating to legacy litigation and conduct issues are also expected to be an important area of attention during 2017 as had been demonstrated by the provision RBS announced on 26 January 2017 in relation to RMBS litigation and investigations.

I would like to take this opportunity to thank my fellow GAC members for their continued support and focus during 2016.

Brendan Nelson

Chairman of the Group Audit Committee

23 February 2017

Report of the Group Audit Committee

Report of the Group Audit Committee

Membership

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

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

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

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

The Board is satisfied that all GAC members have recent and relevant financial experience and that each member of the GAC is independent as defined in the SEC rules under the US Securities Exchange Act of 1934 (the “Exchange Act”) and related guidance. The Board has further determined that Brendan Nelson, Committee Chairman, and Baroness Noakes are both ‘financial experts’ for the purposes of compliance with the Exchange Act Rules and the requirements of the New York Stock Exchange, and that they have competence in accounting and auditing as required under the Disclosure Guidance and Transparency Rules. Full biographical details of GAC members are set out on pages 59 to 65.

During 2016 GAC meetings were attended by the Chief Executive and Chief Financial Officer; the Group Chairman; the Internal and External Auditors; and Finance, Legal and Risk Management executives. Other executives, subject matter experts and external advisers were also invited to attend, as required, to present and advise on reports commissioned by the GAC. The GAC also met privately with the external auditors and separately with Internal Audit management.

Purpose of the Group Audit Committee

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

Meetings and visits

The GAC held seven scheduled meetings during 2016, four of which were held immediately prior to the submission of the quarterly financial statements to the Board. The GAC also convened three ad hoc meetings to consider:

- the trading statement issued in January 2016;
- documentation relating to disclosures in the 2015 Annual Report and Accounts; and
- disclosure issues relating to the H1 2016 results, including the developments on Payment Protection Insurance.

During 2016, in conjunction with members of the Board Risk Committee, members of the GAC took part in an annual programme of visits to businesses and control functions in order to gain a deeper understanding of the risks and issues they face. This programme comprised two visits to Risk and Restructuring; Conduct and Regulatory Affairs and Internal Audit plus visits to: Personal & Business Banking; Commercial & Private Banking; NatWest Markets (formerly CIB); Capital Resolution, Services; and Finance.

Report of the Group Audit Committee

Allocation of Group Audit Committee agenda time during 2016 was as follows:

| | |
|---|------|
| Financial affairs of the group | 39% |
| Standards of internal control | 21% |
| Internal audit | 13% |
| External audit | 9% |
| Regulatory relationships and compliance | 13% |
| Governance and procedural | 5% |
| Total | 100% |

Performance evaluation

The performance of the GAC is evaluated annually, and at least once every three years is facilitated by an external party. Following an externally facilitated evaluation in 2015, the evaluation of the GAC's performance in 2016 was conducted internally. The evaluation process involved the completion of questionnaires by both GAC members and members of management and follow up interviews to discuss the findings. The Board and the GAC have considered and discussed the outcomes of this evaluation. Overall the review concluded that the GAC continued to operate effectively. A number of recommendations for improvement were made which were approved by the GAC and the Board; progress against these will be tracked in 2017.

Report of the Group Audit Committee

Matters considered by the Committee in 2016

| Key area | | Matters considered and action taken by the Committee |
|---|--|--|
| Financial affairs of the Group | | |
| Accounting judgements and reporting issues considered in the preparation of financial reports | | <p>The Group Audit Committee focused on a number of salient judgements and reporting issues in the preparation of the financial results throughout 2016, including the quarterly, half year and full year results and the Annual Report and Accounts. In particular, the Committee considered, discussed and, where appropriate, challenged:</p> <ul style="list-style-type: none"> • provision and disclosure for ongoing regulatory and litigation actions including: Payment Protection Insurance claims, RMBS investigations and litigation, UK shareholder actions, the FCA's investigation into RBS's former Global Restructuring Group, the Central Bank of Ireland's review of Irish tracker mortgages and investigations into alleged foreign exchange rate manipulation. During 2016 RBS has recognised £5.9 billion of litigation and conduct provisions; • the adequacy of loan impairment provisions, focusing in particular on judgements and methodology applied to provisions. The Committee was satisfied that the overall loan impairment provisions and underlying assumptions and methodologies were reasonable and applied consistently; • valuation methodologies and assumptions for financial instruments carried at fair value including RBS's credit market exposures and own liabilities assessed at fair value; • judgements made by management in relation to the carrying value of intangible assets. In particular, in light of changes to economic forecasts, the GAC considered whether any adjustments were required to the carrying value of goodwill and of RBS's investment in subsidiaries |

within the stand-alone parent company accounts; in its Q3 2016 results RBSG reduced the carrying value of its investment in subsidiaries by £6.0 billion to £44.7 billion in light of the deterioration in the economic outlook. The GAC also challenged the processes and the models used to assess the value of these assets;

- judgements made by management in assessing the recoverability of deferred tax assets, in light of continued execution of the RBS's strategy and changes to the UK corporate tax system. A £300 million impairment of deferred tax assets was recognised in RBS's Q3 2016 results;

- management's assessment of the adequacy of internal controls over financial reporting, and identified deficiencies. Remediation of identified weaknesses in relation to privileged access controls for certain IT applications and in relation to legal entity recharge accounting for the allocation of ATM fees was monitored and tracked by the GAC during 2016;

- the quality and transparency of financial and risk disclosures;

- the viability statement in the 2016 report and accounts. The GAC considered the process to support the assessment of principal risks; assessed the company's prospects in the light of its current position and the identified principal risks; selected the time period to be covered by the statement; and reviewed the disclosure on behalf of the Board;

- the going concern basis of accounting including consideration of evidence of RBS's capital, liquidity and funding position. The GAC supported the directors' going concern conclusion. Further information is set out on page 164; and

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

Having considered the above, the Committee recommended the quarterly, interim and full year results announcements and the Annual Report and Accounts to the Board for approval.

Report of the Group Audit Committee

| Key area | | Matters considered and action taken by the Committee |
|--------------------------------------|--|--|
| Standards of internal control | | |
| Annual Risk and Control report | | The GAC considered the effectiveness of RBS's internal control system, including any significant failings or weaknesses. The Williams & Glyn divestment programme and the NatWest Markets control environment were both identified as weaknesses, these have both been closely monitored and reviewed by the Board Risk Committee and are discussed further in the report of the Board Risk Committee. The GAC also considered RBS's disclosure on internal control matters in conjunction with the related guidance from the Financial Reporting Council. |
| Control Environment Certification | | The GAC considered the outputs of bi-annual self-assessments of the robustness of the internal control environment for RBS's customer-facing businesses, and its support and control functions. This informs the control environment disclosure in the annual report and accounts. |
| Integrated Risk Assessment Approach | | The GAC reviewed work undertaken on the bank's integrated risk assessment approach which is designed to provide a single approach to the assessment of risk mind sets and behaviours and risk capabilities, leading to a more effective and simplified approach to the assessment of risk culture, the three lines of defence and performance assessments. |
| Whistleblowing | | The GAC received updates on whistleblowing activity and the performance of RBS's whistleblowing service. It monitored the effectiveness of the whistleblowing framework and enquired as to any trends or themes. It also received updates on communications and awareness activity relating to whistleblowing and testing of the framework. The GAC was also advised of the actions RBS has taken to ensure compliance with the new FCA and PRA whistleblowing regulations which applied to RBS from 7 September 2016. In March 2016 the GAC Chairman was appointed as Whistleblowing Champion for RBS, in line with the requirements outlined in the PRA and FCA regulations; this role carries the responsibility for ensuring and overseeing the integrity, independence and effectiveness of the firm's whistleblowing arrangements. |

| | | |
|---------------------------------|--|---|
| Ledger Transformation Programme | | The GAC received updates in relation to the delivery of the new general ledger, the introduction of which has been overseen by the GAC. The new ledger replaces previous legacy systems and supports new functionality such as discrete legal entity views and multi-currency accounting on a single ledger platform. The GAC was provided with updates on the recommended actions and plans to deliver the programme and the key risks and challenges it presented. |
| Taxation | | The GAC reviewed RBS's tax position, including a deep dive on Tax in October 2016 which covered; the structure of the Tax team, Tax Risk within the Risk Management Framework, material tax risks and disputes, UK Corporate tax compliance, deferred tax assets, VAT risks and challenges, external tax developments and the key projects on which the tax team are engaged. |
| Litigation and Regulation | | The GAC considered regular reports on most significant legal risks and developments affecting RBS, including relevant updates on ongoing major litigation and investigations, privacy and competition issues, legal risks within structural reform and recovery and resolution planning, as well as material emerging legal risks and/or changes in law or regulation and any recent provisions and settlements or recoveries. Key themes and observations from RBS's Sensitive Investigations Unit were also highlighted to the GAC. |
| Notifiable Event Process | | The GAC received bi-annual reports on control breaches which are captured by RBS's notifiable event process. Process-related errors were the main root cause of Major notifiable events escalated in 2016. Throughout 2016 senior management has actively promoted an open culture around raising GNEPs and regularly reinforced that these are integral in helping the bank's employees learn from their mistakes. Under this process all Board directors were alerted to the most significant breaches. |
| Fraud | | The GAC reviewed management's processes for identifying and responding to the risk of fraud. |
| Sarbanes-Oxley Act of 2002 | | The GAC considered RBS's compliance with the requirements of the Sarbanes-Oxley Act of 2002, and was satisfied in this respect. RBS had no Material Weaknesses as at 31 December 2016, however Significant Deficiencies were identified relating to legal entity recharge arrangements and action is being taken by Management to improve these processes. The GAC has also overseen RBS's drive to continue to improve its SOX processes. |

Report of the Group Audit Committee

| Key area | | Matters considered and action taken by the Committee |
|------------------------------------|--|--|
| Systems of internal control | | |
| Market Abuse Regulation | | The GAC considered the impact of the Market Abuse Regulation which took effect in July 2016. The GAC noted the main changes to disclosure requirements and the processes implemented by RBS to address these. This included the establishment of a sub-committee of the executive disclosure committee to consider potential instances of inside information, including whether there are any grounds for delaying disclosure under the Market Abuse Regulation, and escalate these as required to the GAC and Board. |
| Internal audit | | |
| Reports and Opinions | | The GAC received quarterly reports and opinions from Internal Audit throughout 2016. These reports and opinions updated the GAC on the effectiveness of the governance, risk management and internal control framework, ongoing issues and the adequacy of remediation activity. The full year and half year reports included Internal Audit's opinion in relation to RBS's Risk & Control Environment and its Risk & Control Awareness. Internal Audit are now using the new simplified bank-wide risk and control rating metrics, which came into effect on 1 January 2016. The new metrics align the way RBS assesses its risks and controls across the first, second and third lines of defence. The GAC received updates on management's response to Internal Audit's findings and challenged management as to progress on remediating such findings. |
| Annual Plan and Budget | | The GAC considered and approved Internal Audit's plan for 2017, which is focused on the highest risks faced by RBS. The GAC also considered Internal Audit's budget and was satisfied that this was sufficient to allow Internal Audit to deliver the plan. |
| Internal Audit Charter | | Updates to Internal Audit's charter, to reflect changes in reporting structures and amendments to the Institute of Internal Auditors |

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| | | International Standards, were approved by the GAC and the GAC confirmed the independence of Internal Audit. |
| Visits | | During two visits to Internal Audit in 2016, the GAC received updates on a variety of issues impacting the internal audit function, including; resourcing, bench strength, risk mindset and behaviours, strategic priorities, use of data analytics and internal quality assurance. |
| Chief Audit Executive | | The Chief Audit Executive continued to report to the Chairman of the GAC, with a secondary reporting line to the Chief Executive for administrative purposes. The GAC assessed the annual performance (including risk performance) of the Chief Audit Executive. |
| Annual Evaluation | | The annual review of effectiveness of Internal Audit was undertaken internally in 2016. Under the evaluation process feedback on Internal Audit was provided by GAC members and attendees (including the external auditors), chairmen of subsidiary audit committees, key members of business risk committees and other key members of management. The evaluation concluded that Internal Audit had operated effectively during the year. Certain recommendations were made to aid continuous improvement within the function; these will be implemented during 2017 and progress will be tracked by the GAC. |
| Relationship with regulators | | |
| Regulatory Relationships, Risk of Enforcement and Upstream Risk | | The GAC received a report on the status of RBS's relationships with its key regulators, the status of regulatory reviews, including any reviews at risk of potential enforcement action in 2016, and key upstream risk developments. The GAC Chairman also attended continuous assessment meetings with the PRA and FCA, meetings with the Bank of England and other audit committee chairmen and trilateral meetings with the PRA and external auditor. |
| | External audit | |
| Transition of auditors | | The GAC supervised the transition of the external auditor from Deloitte to EY during 2016 with EY assuming the role of external auditor for RBS at the end of March 2016. The Board will recommend the appointment of EY as external auditor to shareholders for approval at the Annual General Meeting. |
| External Audit Reports | | Jon Bourne has been EY's lead audit partner for RBS since EY assumed the role of external auditor in March 2016. Jon Bourne attends each meeting of the GAC and reports to the GAC on the external auditor's observations and conclusions from the year-end audit and half-year review of The Royal Bank of Scotland Group plc, The Royal Bank of Scotland plc and National Westminster Bank Plc, work in connection with the Q1 and Q3 financial results and any recommendations for enhancements to RBS's reporting and controls. |
| Audit Plan and fees | | The GAC received updates in relation to the external auditor's 2016 plan and approved the 2016 audit fees including the fee for the 2016 interim results. The GAC was authorised by shareholders at the Annual General Meeting to fix the remuneration of the external auditors. |
| | | |

Report of the Group Audit Committee

| Key area | | Matters considered and action taken by the Committee |
|-------------------------------------|--|--|
| External audit | | |
| Annual Evaluation | | The GAC conducted an internal evaluation to assess the independence and objectivity of the external auditor during 2016. This review included an evaluation of the effectiveness of the audit process and sought the views of the GAC members, attendees and other key members of management. Regard was had to the external auditor's mindset and culture, skills, character and knowledge, quality control and judgement. The evaluation concluded that the external auditor was operating effectively. A number of recommendations for continuous improvement were identified which the external auditor has agreed to take forward during 2017. Following the evaluation the GAC recommended that the Board seek the reappointment of EY as external auditor at the next annual general meeting. |
| CASS Opinions | | At the GAC's request the external auditor presented the results of its assurance procedures on compliance with the FCA's Client Asset Rules for RBS's regulated legal entities for the year ended 31 December 2015. The GAC also considered the CASS Audit plan for 2017, the findings of which will be reported to the GAC once the audit is complete. |
| External Audit Report to the PRA | | The GAC considered the 'dry run' report to the PRA by the external auditor for the 2015 year end. The report responded to specific questions posed by the PRA. This report was produced in preparation for implementation of auditor reporting for the largest UK banks which is required for 2016 year ends, in line with the proposals set out in PRA consultation paper CP8/15. |
| Audit and non-audit services | | |
| Non-audit services policy | | To help safeguard the objectivity and independence of the external auditor, the GAC maintains a policy that sets out the circumstances in which the external auditor is permitted to supply audit and non-audit services. EY were appointed RBS's external auditors in March 2016 but they have been subject to the policy since becoming independent from RBS in 2015 in the lead up to their appointment. |

The GAC reviews the non-audit services policy at least annually to ensure it remains fit for purpose. During 2016 the GAC approved a number of amendments to the policy to ensure it met the requirements of the EU Audit Regulation and also to streamline to operation of the policy.

In accordance with the policy, all audit services and permitted non-audit services are approved in advance.

Under the policy certain services are classed as Audit-Related Services and these may be approved by the Director of Finance, on behalf of the GAC, up to a limit of £100,000 each financial quarter. Engagements for Audit-Related Services in excess of this quarterly limit require the approval of the GAC Chairman. All Audit-Related Services are reported to the GAC quarterly.

The GAC has also delegated authority to the Director of Finance to approve the provision of services by the external auditor to non-consolidated subsidiaries of RBS within an annual cap and to approve engagements with the external auditor where RBS has limited or no influence in the selection process. All such engagements are reported to the GAC each quarter.

For all other permitted non-audit service engagements, where the fee is below £5,000 approval by the Director of Finance is required. Where the fee is above £5,000 but below £100,000 approval by the GAC Chairman is required. For engagements where the fee is expected to exceed £100,000 a competitive tender process must be held and approval of the full GAC is required. In addition all engagements must be approved by the Director of Finance and by Supply Chain Services. All such ad hoc approvals of non-audit services are ratified by the GAC each quarter.

Report of the Group Audit Committee

| | Key area | Matters considered and action taken by the Committee |
|-------------------------------------|---------------------------|--|
| Audit and non-audit services | | |
| | Non-audit Services Policy | <p>During 2016, the current and previous external auditors were approved to undertake the significant engagements set out below whilst in the role of external auditor:</p> <ul style="list-style-type: none"> • Deloitte were engaged to prepare an audit opinion, required by the PRA confirming the level of asset run down in RBS Capital Resolution, taking into accounting outstanding liabilities/indemnities to any disposed asset; details of any residual assets and how these will be managed following the closure of RBS Capital Resolution; and details of any ongoing obligations RBS will have to any disposed assets; • Deloitte's role as Reporting Accountant for Williams & Glyn was extended, to permit them to prepare a financial 'fact pack' to support the trade sale marketing of Williams & Glyn; • Deloitte were engaged to support Williams & Glyn with validation, review, quality assurance and documentation activities in relation to Williams and Glyn's capital stress plan; • Deloitte were engaged to support the first phase of a Central Bank of Ireland mandated investigation into tracker mortgages in Ulster Bank Rol. This first phase comprised the development and submission of a detailed plan for conducting the investigation and ensuring that appropriate governance was in place; • EY were engaged to review historical and prospective financial information for certain parts of the business; • EY were engaged to provide an assurance opinion for an information request from the European Commission in connections with its competition |

investigation into pre-2012 FX currency trading; and

- EY were engaged to audit the control environment and control objectives for RBS and Ulster Bank's internal reporting procedures relating to the Scottish & Northern Ireland Banknote Rules 2011 and the Note Circulation Scheme Rules, as required by the Bank of England.

The decision to approve the engagement of the external auditor for the services noted above was due to factors including synergies and efficiencies relating to the audit work, their existing knowledge of RBS which allowed work to commence quickly and with minimal disruption and the benefits in maintaining consistency between similar engagements. In each case the GAC was satisfied that the engagement did not impact the external auditor's independence.

Although RBS's previous external auditors are no longer subject to independence requirements, they do have an ongoing role to consent to the release of its prior period audit opinions for US reporting purposes (statutory and comfort letter related). Given any requirement to perform additional audit work for historic periods would require previous external auditors to re-establish independence, a number of safeguards relating to their appointment remain in place under the policy, including the requirement for engagements with Deloitte to be approved by the GAC or on its behalf by the Director of Finance (depending on the value of the engagement. Since Deloitte have been removed from independence requirements with these safeguards in place they have been engaged as follows:

- to provide additional quality assurance over management's assessment of the adequacy of SOX 404 control design and management's testing of the effective operation of SOX 404 controls;
- as the skilled person to support the Bank's ring-fencing programme;
- in relation to the remediation of the tracker mortgage book in Ulster Bank;

| | | |
|---|--|--|
| | | <ul style="list-style-type: none"> • to provide resource support to help technology teams to implement and embed a new Technology delivery framework and; • to support the second phase of the Central Bank of Ireland mandated investigation into tracker mortgages in Ulster Bank. This second phase of work involves a review of Ulster Bank Ireland DAC's 2001-2015 mortgage loan book in line with the Central Bank of Ireland 'Framework for Conducting the Tracker Mortgage Examination'. <p>Further details of the non-audit services that are prohibited and permitted under the policy can be found on rbs.com. Information on fees paid in respect of audit and non-audit services carried out by the external auditor can be found in Note 5 on the consolidated accounts on page 412.</p> |
| <p>Brendan Nelson Chairman of the Group Audit Committee</p> | | |

Report of the Board Risk Committee

Letter from Baroness Noakes

Chairman of the Board Risk Committee

“RBS as a whole is on a journey towards a robust, well managed control environment”

Dear Shareholder,

Executive Committee

The Committee had a challenging programme of risk issues to consider in 2016 and the report that follows provides details of the topics reviewed and debated by the Committee during the year. The Committee reviewed and provided oversight of the risk profile of the bank relative to the bank's strategy and risk appetite against the backdrop of an economic environment which is challenging for the bank and which was made more uncertain following the outcome of the EU referendum.

Strategic Risk and Transformation

The Committee continued to devote considerable attention to the demanding bank-wide transformation programme in 2016. In particular, it considered execution and delivery risk on behalf of the Board and monitored the amount of change risk faced by the business. We focused on the impact of transformation plans on the bank's control environment and on the control transformation workstream which is a key part of the overall programme. End to end risk and control assessments for material processes were carried out during 2016 and in 2017 we will be overseeing the improvement actions which are needed. The broader cost and control objectives of the transformation programme will continue to be a key priority in 2017 and future years.

Delivery of the Williams & Glyn separation programme remained a significant area of focus of the Committee in the first half of the year. In light of the delivery challenges, the Board decided to change its strategic direction and the committee subsequently focused on the wind-down of the programme.

As the year progressed, increasing agenda time was devoted to the implementation of the bank's ring-fencing programme as the programme moved from the design phase into the execution phase. The Committee reviewed the revised baseline plan before submission to the regulator and oversaw the development of an integrated assurance programme for the project involving Risk, Internal Audit and external third party assurance.

Control Environment

RBS as a whole is on a journey towards a robust, well-managed control environment and the Committee reviews the control ratings of significant business areas twice a year. Challenges are greatest within the bank's NatWest Markets (formerly CIB) franchise and we reviewed management's plans to strengthen substantively its control environment and address known weaknesses. We will oversee the effective delivery of those plans, relying in particular on more detailed challenge in the second line of defence.

Report of the Board Risk Committee

Risk Appetite

The bank's risk appetite framework provides a structured approach to risk taking and the committee reviewed proposed enhancements to the framework prior to Board approval. We have extended our detailed examination beyond the suite of strategic risks to all material risk categories via a series of in depth reviews of the individual risk appetite statements and related metrics. These sessions enabled essential preparatory work to be undertaken prior to transitioning to a Board approval framework for these material risks in 2017. We will continue to supervise closely the maturing risk appetite framework, including remediation where breaches of material risk appetite are identified, in the year ahead.

Stress Testing

The bank conducted a number of stress tests in 2016 including the European Banking Authority and Bank of England stress tests in addition to its own internal stress tests. The Committee played a vital role in reviewing the scenarios and assumptions deployed and in ensuring that the outputs of the tests were subjected to a high degree of scrutiny and challenge. The Committee also oversaw enhancements to the bank's stress testing capability and this will remain a priority in 2017.

Other

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

- conduct risk and the oversight of on-going regulatory investigations and remediation;
- the capital and liquidity position of RBS and related regulatory submissions;
- cyber security including the outcome of RBS's participation in a cyber testing initiative led by the Bank of England (CBEST);
- risk culture, the three lines of defence model and risk performance assessments, now being combined into an integrated risk assessment process; and
- continued refinements to risk reporting.

Key priorities for 2017

The bank has made significant advances this year towards its goal of becoming a stronger, simpler and fairer bank. However, while progress has been made, more work is required before the bank will be operating fully within risk appetite and the Committee will keep this under review in 2017. In the coming year the Committee will also continue to oversee the work being carried out under the bank's significant change programmes and the impact of those initiatives on the risk profile of the bank. Other areas of focus of the Committee will include cyber risk, IT resilience and assessing the impact of external factors on the

bank's risk profile.

I would like to conclude by welcoming Frank Dageard to the Committee and by thanking my fellow Committee members for their continued support and diligence throughout the year. I would also like to extend my gratitude to Robert Gillespie, who stood down as a member in August, for his valuable contribution.

Baroness Noakes

Chairman of the Board Risk Committee

23 February 2017

Report of the Board Risk Committee

Report of the Board Risk Committee

The role and responsibilities of the Board Risk Committee

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

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

Membership

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

55 to 57.

| | | Attended/ scheduled |
|----------------------------|-----|------------------------|
| Baroness Noakes (Chairman) | 9/9 | |
| Frank Dangeard (1) | 3/3 | |
| Morten Friis | 9/9 | |
| Penny Hughes | 9/9 | |
| Brendan Nelson | 9/9 | |
| Former Members | | |
| Robert Gillespie(2) | 6/6 | |

Notes:

(1) Appointed to the committee on 4 August 2016.

(2) Stood down from the committee on 4 August 2016.

Brendan Nelson is chairman of the Group Audit Committee of which Baroness Noakes and Morten Friis are also members. Penny Hughes is chairman of the Sustainable Banking Committee. This common membership across Committees helps to ensure effective governance across the committees.

BRC meetings are also attended by the RBS Chairman, relevant executives, including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Chief Conduct & Regulatory Affairs Officer, Chief Legal Officer and General Counsel and Chief Audit Executive, and the lead partner of the External Auditor. External advice is sought by the BRC, where appropriate.

Report of the Board Risk Committee

Meetings and visits

Nine scheduled meetings and six ad hoc meetings were held in 2016. The ad hoc meetings were required to consider: the results of various phases of internal and external stress tests; the Ring-Fencing Revised Baseline Plan; and the draft budgets and related stress test outputs.

In 2016, members of the BRC, in conjunction with members of the Group Audit Committee, undertook a programme of visits to focus on various businesses and control functions including bi-annual visits to Risk and C&RA. The purpose and scope of this programme is discussed in detail in the Report of the Group Audit Committee above.

The BRC also held in-depth sessions on risk reporting and the legal entity framework and associated capital requirements.

Performance Evaluation

The annual review of the effectiveness of the Board and its senior Committees, including the Board Risk Committee, was conducted internally in 2016. The BRC has considered and discussed the outcomes of this evaluation and accepts the findings. Overall the review concluded that the Board Risk Committee continued to operate effectively. However, certain recommendations for action were recognised including the need to: rebalance the agenda of the BRC to ensure sufficient focus on the most pertinent risks and reduce the length of meetings; place more reliance on executive committees to reduce pressure on the BRC' agenda; and hold Executives to account for sign-posting key issues and escalating a unified position from all three lines of defence.

The review included a small number of general recommendations which are relevant for both the Board and its senior committees. Key themes and actions arising from these general recommendations are set out in the Board report on page 74 and will be considered, and addressed as appropriate, at Board level.

The outcomes of the evaluation have been reported to the Board and the BRC will track progress on its 2017 priorities during the year.

Allocation of Board Risk Committee agenda time:

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| Current risk profile and issues | 26% |
| Change agenda and large projects | 10% |
| Process, policies and risk appetite | 15% |
| Regulatory returns and stress testing | 15% |
| Accountability and remuneration | 6% |
| Risk, conduct and regulatory affairs focus sessions | 13% |
| Franchise and function focus sessions | 15% |
| Total | 100% |

Report of the Board Risk Committee

Matters considered by the Committee in 2016

| Key area | Issues considered and Action taken by the BRC |
|--------------------------|---|
| Risk Profile | |
| Reporting | <ul style="list-style-type: none"> • Provided oversight of RBS's risk profile relative to RBS's strategy and risk appetite through the review of emerging risks and changes in RBS's most significant portfolios and operations, as presented within the comprehensive Risk Management Report. In order to focus on changes in the RBS's risk profile and to highlight trends, the BRC transitioned during the year to taking this report on a quarterly basis. A short form risk report was considered at all other meetings. • Received oral updates from the Chief Risk Officer and Chief Conduct and Regulatory Affairs Officer on the most current and material risks at each meeting. This enabled the BRC to discuss RBS's top risks and whether these were being managed effectively; whether RBS was operating within risk appetite; and whether business change was being managed effectively. • Held an in-depth session on risk reporting in October 2016 which led to additional recommendations for refinements to the form and content of reporting. Management will progress these improvements during 2017. |
| External developments | <ul style="list-style-type: none"> • Received reports from the Chief Risk Officer at each meeting highlighting external developments with the potential to affect RBS's ability to meet its strategic objectives or continue its operations. This included updates on the global economic environment, including developments in the US, Europe and China and associated impacts on financial markets; regulatory proposals for potential future capital requirements; and preparation for, and the impact of, the EU referendum result. |
| General Counsel's report | <ul style="list-style-type: none"> • The General Counsel reported to the BRC at each meeting on current and emerging key legal developments and risk and significant litigation risks affecting RBS. |
| US Risk Committee | <ul style="list-style-type: none"> • Received quarterly reports from the Chairman of the US Risk Committee on the key matters discussed at that forum. The US Risk Committee was established in May 2016 in response to US regulatory requirements and comprises Morten Friis as Chairman, the Chairman of the Board Risk Committee and the RBS Chief Financial Officer. It provides oversight of the risk management framework of RBS's combined US operations, including the review and approval of US risk management policies and material submissions to US regulators. |
| Strategic Risk | |

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| Transformation | <ul style="list-style-type: none"> Kept the execution risk of the RBS-wide transformation programme under review, receiving regular updates from the transformation team on progress, including independent opinions from Risk, C&RA and Internal Audit. Considered progress against plan and reviewed interdependencies with other significant change programmes and key threats to delivery. In particular, the impact of the Williams & Glyn programme on transformation was monitored. Reviewed the impact of 2016 cost reductions and the 2017 budget restrictions on the programme. Requested focus sessions on the controls transformation workstream, in particular the prioritisation and completion of the Risk and Control Assessments planned in 2016. A report was received from Internal Audit on the robustness of the assessments and the BRC will oversee management's plans to enhance processes and to remediate control weaknesses identified through completion of the exercise. |
| Williams & Glyn | <ul style="list-style-type: none"> In Q1 2016, exercised oversight of the risks and challenges to the planned physical separation of assets in advance of the divestment of Williams & Glyn, confirming appropriate governance and assurance processes were in place for the programme. Received independent reports on progress from Risk and Internal Audit, supplemented by independent third party assurance on progress. Received updates on the wind-down of the separation programme after the decision of the Board not to proceed with this method of divestment and considered the impact of the decision upon people, costs, records management and security. Reviewed the impact of the change in strategic direction upon other key deliverables. |
| Ring-fencing Implementation plan | <ul style="list-style-type: none"> Considered the key risks of the implementation of the ring-fencing programme as it moved from the design phase into execution in H2 2016, including reviewing the revised baseline plan and endorsing its submission to the PRA. Oversaw the development of an integrated assurance programme involving Risk, Internal Audit and external third party assurance. |

Report of the Board Risk Committee

| Key area | Matters considered and action taken by the BRC |
|---|---|
| Strategic Risk | |
| Change Risk | <ul style="list-style-type: none"> Discussed the change risk profile of RBS and the prioritisation and impact of mandatory change programmes and considered the agreed risk appetite statement and measures used to assess change risk across RBS. Suggested refinements to the processes for assessing change risk and the acceptable volume of change. |
| Client Pricing for Assets and Liabilities | <ul style="list-style-type: none"> Reviewed the client pricing process against regulatory requirements to ensure that the pricing of liabilities and assets takes into account RBS's business model and risk strategy. The BRC noted that additional testing would be undertaken and enhancements made to the process. An annual review will be undertaken in future years. |
| Enterprise Wide Risk | |
| Risk appetite | <ul style="list-style-type: none"> Reviewed the risk appetite governance framework for 2016; provided feedback on the mechanism for managing and escalating breaches of risk appetite; and made suggestions in relation to simplification of the framework, before recommending this to the Board for approval. Reviewed risk appetite for strategic risks (earnings volatility, RBS-wide and functions, funding and equity investors) and subject to suggested refinements, recommended this to the Board for approval. Refreshed governance arrangements for material risks and put in place plans to transition to a Board approval framework for the most significant risks in 2017. This involved a number of in depth reviews of risk appetite throughout the year in relation to the following risk areas: tax, pensions, records management, payment processing, IT stability & resilience, people, reputational, traded market risk, non-traded market risk, business risk, financial reporting, legal entity risk, operational risk, information and cyber security, retail credit, mortgage risk, wholesale credit, commercial real estate, acquisition risk, settlement risk and conduct risk. Reviewed the cascade of RBS-wide risk appetite to franchises and functions and the alignment between strategic and material risk appetite statements. Considered the use of risk capacity (being the parameters within which risk appetite is set) and agreed risk capacity limits for strategic risks. |
| Stress testing | |

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| | <ul style="list-style-type: none"> • In Q1 2016, the BRC considered the results of the 2015 budget and forecast stress testing and reviewed Internal Audit's planned activity for assessing stress testing in 2016. • During the year, the BRC considered the underlying assumptions and scenario selection for the external Bank of England stress test, including Internal Audit's opinion, making recommendations to the Board as appropriate. • Provided challenge and scrutiny to the results of the three phases of the 2016 EBA stress test and the results of the 2016 Bank of England stress test. • Reviewed the results of the reverse stress test and made recommendations to the Board in this regard. • In H2 2016, the BRC considered the 2016 budget and forecast base and stress scenarios together with opinions from the three lines of defence and draft outputs and made recommendations to the Board in this regard. • Oversaw enhancements to RBS's stress testing capability, in particular the remediation actions taken in response to the PRA review of stress testing capability. |
| Model risk framework | <ul style="list-style-type: none"> • Oversaw the development of a new model risk framework designed to deliver improvements in the management of model risk. This included reviewing progress in remediating areas of identified weaknesses such as model validation and the restructure of model risk management team. |
| Integrated risk assessment process | <ul style="list-style-type: none"> • Reviewed work undertaken by RBS to understand its risk culture and approaches to its assessment against a clearly articulated target culture. Considered the proposed Integrated Risk Assessment approach which was designed to provide a single approach to the assessment of risk mindsets and behaviours and risk capabilities leading to a more effective and simplified approach to the assessment of risk culture, the three lines of defence and performance assessments. • The BRC reviewed the output of the pilot of the revised approach within certain functions and franchises and Risk. |
| RDAR | <ul style="list-style-type: none"> • Monitored progress towards full compliance with the Basel Principles on Effective Risk Data Aggregation and Reporting (RDAR). Received a report from Internal Audit on material compliance with RDAR principles and oversaw communications with the PRA in this regard. The BRC will continue to ensure that areas requiring additional improvement are remediated in 2017 alongside plans to achieve full compliance. |

Report of the Board Risk Committee

| Key area | Matters considered and Action taken by the BRC |
|--|--|
| Enterprise Wide Risk | |
| Risk Assurance | <ul style="list-style-type: none"> Received quarterly reports on issues highlighted by reviews conducted in each of the three franchises by Credit Quality Assurance, Market Quality Assurance, Control Assurance and a newly created Stress Testing Assurance team. |
| Market, Credit and Operational Risk | |
| Credit, Market and Operational risk MI | <ul style="list-style-type: none"> Reviewed RBS's risk profile relative to credit, market and operational risk, and examined detailed management information (MI) within the Risk Management report in this regard. |
| Control Environment Certification | <ul style="list-style-type: none"> Received bi-annual reports on the Control Environment of the franchises and functions and sought management's assurance that appropriate measures were in place to ensure that the businesses could continue to operate safely, where control weaknesses had been identified. |
| NatWest Markets (formerly CIB) Control Environment Remediation | <ul style="list-style-type: none"> Reviewed and challenged management plans to remediate and strengthen the conduct and control environment across the NatWest Markets franchise. Received reports on specific remediation issues and control issues including, Trade and Transaction Reporting; Collateral Management Algorithmic Trading and Intra-Day Risk; IMA waiver and capital implications; and surveillance measures and potential enhancements. Reviewed management's transformation plans for the business, including how these would impact remediation, mandatory change and the control environment. Received reports following challenge by the second line of defence and the Technical Executive Risk Forum of management's views of progress against expected outcomes. |
| Payments | <ul style="list-style-type: none"> Received progress reports in relation to the payments transformation programme, designed to remediate weaknesses in the payments infrastructure and provide a platform to support mandatory change. Requested updates on compliance with the Payment Card Industry Data Security Standards and Wire Transfer Regulations (WTR) and considered an Internal Audit report on WTR compliance. |
| Resilience, security and cyber risk | <ul style="list-style-type: none"> The BRC received bi-annual reports on security and resilience and requested a separate update on cyber security. This included a report on the controls and defences in place, an update on improvements identified via RBS's participation in CBEST (a cyber testing initiative led by the Bank of England), and a summary of the alignment of the RBS's security policy with |

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| | the ISO standards. |
| Material credit exposures | <ul style="list-style-type: none"> • Oversaw the Executive Credit Group (ECG) receiving a summary of the decisions made by the ECG in the period. Reviewed the most material credit decisions made in 2015 and examined trends in the market. • Approved a revised governance for large credit exposure decisions, designed to enhance the level of BRC and Board oversight. |
| Other operational risks | <p>The BRC also reviewed reports in relation to:</p> <ul style="list-style-type: none"> • the potential risks posed by end of life software; • simplification of the RBS Policy Framework. The BRC requested that greater analysis of the volume of exceptions to policy be undertaken; and • data quality. Following review of progress against a detailed plan, the BRC was pleased to note significant progress in this area. |
| Capital and Liquidity Risk | |
| ICAAP and ILAAP | <ul style="list-style-type: none"> • In Q2 2016 the BRC reviewed the draft Internal Capital Adequacy Assessment process (ICAAP) along with an Internal Audit review and recommended the document to the Board for approval subject to certain enhancements. • In Q3 2016 the BRC reviewed both the scenarios assumptions for the 2016 Internal Liquidity Adequacy Assessment Process (ILAAP) and the final ILAAP submission and, after due consideration, recommended them to the Board. |
| Recovery and Resolution planning | <ul style="list-style-type: none"> • Oversaw the first part of a two year remediation process in designed to deliver a recovery plan in line with industry best practice. • Examined and commented upon the draft 2016 recovery plan and resolution pack and recommended them to the Board for approval. Approved the final version of the recovery plan under delegated authority from the Board. |
| Capital Management | <ul style="list-style-type: none"> • |