

Company Registered Number: SC083026

ADAM & COMPANY PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 December 2017

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BOARD OF DIRECTORS AND COMPANY SECRETARY

DIRECTORS:

The Rt Hon Lord Waldegrave of North Hill, PC (Chairman, Non-executive Director)
Graham Storrie (Executive Director)
Michael Robert Regan (Executive Director)
Peter Gordon Flavel (Executive Director)
Mark Lund (Non-executive Director)
Francesca Barnes (Non-executive Director)
Linda Hamilton Urquhart OBE (Non-executive Director)

COMPANY SECRETARY:

Fiona Mary Mackay

REGISTERED OFFICE:

25 St Andrew Square
Edinburgh
Scotland
EH2 1AF

AUDIT COMMITTEE:

Francesca Barnes (Chair)
Donald MacDonald
Linda Hamilton Urquhart OBE
Mark Lund

RISK COMMITTEE:

Francesca Barnes (Chair)
Donald MacDonald
Linda Hamilton Urquhart OBE
Mark Lund

INDEPENDENT AUDITOR:

Ernst & Young LLP
Statutory Auditor
25 Churchill Place
London
United Kingdom
E14 5EY

Registered in Scotland

STRATEGIC REPORT

The directors of Adam & Company plc ("the Company") present their annual report, together with audited financial statements for the year ended 31 December 2017. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

ACTIVITIES AND BUSINESS REVIEW

Principal activities

The principal activity of the Company continues to be the provision of a range of banking and financial services.

The Company continues to focus on its core activities of supplying wealth management and banking services to high net worth individuals and their businesses and will continue to concentrate on improving the quality and depth of the services provided, whilst leveraging its connection with The Royal Bank of Scotland Group plc (RBS). In doing so, it provides progressive private banking, tailoring its services and solutions to match each client and their unique needs. This is measured through three lenses: customer satisfaction, employee engagement and financial returns.

On 1 October 2017, the Company acquired two subsidiaries: Adam & Company Investment Management Limited and Adam & Company Nominees Limited from Adam & Company Group Plc for a consideration of £17m. This has not resulted in a significant change to the Company's financial performance.

The directors expect a material change to the activities of the Company in April 2018 as a result of the RBS Group's restructuring to effect the ring-fencing legislation as described in the Ring-fencing section. The Company's strategic targets will change fundamentally through the on boarding of RBS plc's retail and commercial businesses, with the new strategic agenda being set by the incoming Board.

The Company is a subsidiary of RBS which provides support and access to all central resources. The annual report of RBS reviews these matters on a group basis. Copies can be obtained from Corporate Governance and Regulatory Affairs, RBS Gogarburn, Edinburgh EH12 1HQ, the Registrar of Companies or through the RBS website, www.rbs.com.

Business review

The directors are satisfied with the progress made during the year. Against the three primary KPIs: the decline in RoE was largely driven by an increase in impairments and the economic/competitive environment, staff engagement has improved by 6 points approaching the global financial services norm, and the Company NPS (Net Promoter Score) grew strongly by 11 points to 26.

	2017	2016
RoE	3.8%	8.2%
Engagement index	78	72
NPS	26	15

<i>Performance highlights</i>	2017 £m	2016 £m
Total income	28	30
Operating expenses	(22)	(22)
Underlying profit before provisions	6	8
Impairment (loss)/release	(1)	2
Operating profit before tax	5	10
Profit and total comprehensive income for the year	3	7
Loans and advances to customers	706	660
Customer accounts	1,871	1,777
Cost:income ratio	78.7%	73.9%
Return on equity	3.8%	8.2%
Customer loan:deposit ratio	37.7%	37.1%

STRATEGIC REPORT**Business review (continued)***Financial performance*

The Company's financial performance is presented in the Statement of Comprehensive Income on page 15.

The Company reported a fall of £4m in its retained profit for the year after tax (£7m to £3m), driven by a £2m reduction in income, a £3m increase in impairments and an associated reduction in tax of £1m.

Total income decreased by £2m (2016: £2m) as the growth in customer deposits and lending has only partly offset the low rate environment and competitive pressure.

Loans and advances to customers increased by £46m (2016: £9m) and Customer accounts increased by £94m (2016: £137m), increasing the customer loan: deposit ratio to 37.7% (2016: 37.1%).

Other matters

The principal source of funds for the Company is its core customer deposits gathered from private clients. The Company is a net provider of funds to RBS. Deposits placed with RBS Group companies amounted to £1,476m (2016: £1,375m).

Ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019. To comply with these requirements it is RBS's intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets plc will be a separate non ring-fenced bank and RBSI Holdings will also be placed outside the ring-fence, both as direct subsidiaries of RBS.

The final ring-fenced legal structure and the actions to be taken to achieve it, remain subject to, amongst other factors, additional regulatory, Board and other approvals as well as employee information and consultation procedures. All such actions and their respective timings may be subject to change, or additional actions may be required, including as a result of external and internal factors including further regulatory, corporate or other developments.

During 2017 the RBS Group made a number of key changes to its legal entity structure to support the move towards a ring-fenced structure, including transferring ownership of the Company to NatWest Holdings Limited.

On 21 November 2017, The Royal Bank of Scotland plc (RBS plc) applied to the Court of Session in Edinburgh (the Court) to initiate a "Ring-Fencing Transfer Scheme" (RFTS) under the Financial Services and Markets Act 2000, including:

- Transfer the UK Retail & Commercial banking business to Adam & Company plc;
- Transfer the covered bonds in issue and Mentor business to NatWest; and
- Transfer branches and other properties to either NatWest or Adam & Company plc.

The RFTS is expected to take effect over the weekend of 28-29 April 2018. Adam & Company plc will be renamed "The Royal Bank of Scotland plc" and assume banknote-issuing responsibility.

Once the RFTS, other restructuring and the ring-fencing legislation is in force:

- RBS plc (previously Adam & Company plc) will manage the RBS branded banking business in its UK branch network;
- NatWest will operate as the shared service provider to the rest of the group and will act as the market-facing arm for the ring-fenced banking group's payments and hedging activities; and
- Adam will continue to be a trading name of RBS plc (previously Adam & Company plc) and will continue to operate its private banking and wealth management activities.

Accounting policies

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Company's critical accounting policies and key sources of estimation uncertainty are included in the accounting policies on page 24 & 25.

Capital management

Capital management is the process by which the Company ensures it has sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, maintaining credit ratings and supporting strategic goals. The Company is a part of RBS Group-wide end to end framework for capital management.

STRATEGIC REPORT*Capital management (continued)*

Capital consists of reserves and instruments issued that are available that have a degree of permanency and are capable of absorbing losses. The determination of what instruments and financial resources are eligible to be counted as capital is laid down by applicable regulation under two tiers (Tier 1 and Tier 2) according to the degree of permanency and the ranking in absorbing losses.

In preparation for the RFTS, the Company will issue capital instruments necessary for an efficient capital structure.

Risk management

The principal risks associated with the Company's businesses are currency, interest rate, conduct, liquidity, credit, regulatory, reputational and operational risk. The Company has established a comprehensive framework for managing these, which is continually evolving as the business activities change in response to market, credit, product and other developments.

The Company's policies for managing each of these risks and its exposure thereto are detailed in note 17 to the financial statements. These policies and processes are compliant with the RBS Group's framework, and will be able to be merged seamlessly once the ring-fencing changes have taken place.

Governance

RBS Group Committees are relevant to all RBS Group companies. Further information can be found in the RBS Group financial statements at rbs.com.

Our Board

The Board has seven directors comprising the Chairman, three executive directors and three independent non-executive directors, one of whom is the chair of the Audit and Risk Committees.

The Board is collectively responsible for the long-term success of the Company, and delivery of sustainable shareholder value. Its role is to provide leadership within a framework of prudent and effective controls which enables risks to be assessed and managed. In order to provide effective oversight and leadership, the Board has an Audit Committee and a Risk committee.

Audit Committee

Assists the Board in discharging its responsibilities for monitoring the quality of the financial statements. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Company, and its systems and standards of internal controls, monitoring 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 and future risk strategy. It reviews compliance with approved risk appetite and oversees the operation of the Policy Framework and submissions to regulators.

Group Nominations Committee

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

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 the Company's businesses, reviewing and debating relevant items before consideration by the Board. It is responsible for developing and delivering the Company's strategy and it monitors and manages financial performance, capital allocation, risk strategy and policy, risk management, operational issues and customer issues for the Company.

RBS Performance and Remuneration Committee

Responsible for approving remuneration policy and reviewing the effectiveness of its implementation across the RBS Group.

STRATEGIC REPORT**Outlook**

The Company will continue to serve the needs of high net worth individuals, deepen relationships with commercial clients and provide private banking services to successful business owners and entrepreneurs.

The vote to leave the EU was widely expected to have a negative impact on the economy. So far, consumer spending has remained robust, and growth has continued. The UK has not yet left the EU, and the terms of its departure are not known and the long-term impact remains impossible to predict. The Company's prime focus through this uncertain period has been, and will continue to be, to provide high quality banking and investment services to its clients and to help them to understand the implications of change.

The directors remain confident that the Company is well positioned to meet the continuing challenges of the evolving regulatory environment it operates within today, external pressures and changing customer needs. They consider the Company to be in a stable financial position and confirm that they have adequate resources to continue in business for the foreseeable future. After the ring-fencing changes, the Company's strategic markets will change fundamentally through the on boarding of RBS plc's retail and commercial businesses. The new strategic agenda is being set by the incoming board in relation to the ring-fenced activities as noted in the ring-fencing section.

Employee policies*Staff involvement*

The Company has adopted RBS employee policies and processes.

The Company values the input of its employees and actively seeks opportunities to engage with staff at all levels and invites them to contribute to on-going dialogue and activities. Where colleagues have concerns relating to wrong doing or misconduct they are encouraged to raise matters via Speak Up, the bank's whistleblowing service.

The semi-annual survey of employee opinions, known as Our View, provides valuable data to decision makers across the Company in support of improving employee engagement and satisfaction. In addition we run an annual Working Together Survey where a representative sample provides feedback on the services provided by our support functions. The results of these employee surveys surpassed targets.

In 2015, the Company launched 'Determined to Lead'. It is the means by which leaders put our values into practice every day and is transforming the way we operate by creating a common language, consistent operating rhythm and improving the competence of our leaders across the Company. It provides consistent tools to lead and engage our people. This programme has continued to date.

Employees across the Company continue to widely support, both financially and through volunteering, many community and other worthy causes. Such giving is encouraged by the use of payroll giving and staff charity funds which support worthy causes at local, national and international level.

Employment of disabled persons

The Company's policy is that disabled persons are considered for employment and subsequent training, career development and promotion based on merit. RBS's disability plan is to become a disability smart organisation by 2018. It addresses areas for improvement including branch access, accessible services, improving employee adjustment processes and inserting disability checkpoints into our key processes and practices.

Diversity

The Company values and promotes diversity in all areas of recruitment and employment. Building a working environment where all our employees can develop to their full potential is important to us irrespective of their age, belief, disability, ethnic or national origin, gender, gender identity, marital or civil partnership status, political opinion, race, religion or sexual orientation. We work hard to avoid limiting potential through bias, prejudice or discrimination. We base the employment relationship on the principles of fairness, respect and inclusion. We comply with local laws on equality and Our Code to build and develop an inclusive workforce in order to understand and respond to our diverse customer base.

STRATEGIC REPORT**Employee policies (continued)***Safety, health and wellbeing*

Wellbeing is an integral part of how we create a great place to work.

The Company offers a wide range of health benefits and services to help maintain physical and mental health, and support our people if they become unwell.

In 2017, the focus was on physical and mental health and social wellbeing. Opportunities to improve the efficiency and effectiveness of safety, health and wellbeing management policies and services were monitored and, where relevant, implemented.

Details of the number of employees and related costs can be found in note 3.

Environmental and ethical policies

The Company leverages the RBS Group policies and resources on anti-bribery and corruption, human rights and modern slavery and sustainability. Further information can be found in the RBS Group financial statements at rbs.com.

Anti-Bribery & Corruption (ABC)

The Company is committed to ensuring it acts responsibly and ethically, both when pursuing its own business opportunities and when awarding business. It considers ABC risk in its business processes where there could be a risk of offering an improper advantage or being perceived to do so, including but not limited to, corporate donations, charitable sponsorships, political activities and commercial sponsorships.

To mitigate against bribery and corruption risks, ABC policy and supporting mandatory procedures require employees to assess bribery and corruption risk, and conduct the appropriate level of ABC due diligence on business activities. All employees are required to complete ABC training on an annual basis, with targeted training appropriate for specific roles. The Company aims to protect the interests of its customers, shareholders and employees.

Human rights and Modern Slavery Act

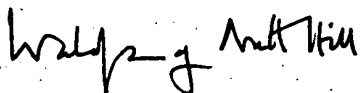
The Company takes a proactive approach to upholding our commitment to respect human rights and our approach is centred on identifying and mitigating potential human rights risks across our business and our sphere of influence. The Modern Slavery Act 2015 (MSA) forms part of our approach to human rights as this regulation brings together the serious criminal offences of slavery, servitude, forced or compulsory labour and human trafficking together under one piece of legislation.

Our approach is underpinned by Our Values and Our Standards. For employees this is via the Code of Conduct, including a clear commitment to respect human rights, supported by 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.

Sustainability

As part of the RBS Group, the Company takes direction from the centrally run Sustainable Banking Committee (SBC). The principal responsibilities of the SBC are Culture and People, Customer, Brand & Communications, Environmental social and ethical issues. The SBC sets strategic direction on these matters and the Executive Committee ensures it is embedded in the Company's operating procedures.

By order of the Board:



The Rt Hon Lord Waldegrave of North Hill, PC
Chairman, Non-executive Director
Date: 24 April 2018

DIRECTORS' REPORT

The Strategic Report includes the financial review of the year including outlook, risk management and employee policies.

Share capital

Analysis of share capital can be found in note 16 to the financial statements.

Directors and company secretary

The names of the current members of the Board of Directors and Company Secretary are shown on page 1.

From 1 January 2017 to date, the following changes have taken place:

	Appointed	Resigned
Director		
Francesca Barnes	11 July 2017	-
The Rt Hon Lord Waldegrave of North Hill, PC	11 July 2017	-
Mark Lund	11 July 2017	-
Miller Mclean	-	11 July 2017
Alexa Henderson	-	19 January 2018
Secretary		
Fiona Mary Mackay	15 June 2017	-
Morven Gow	-	24 July 2017

In accordance with the Articles of Association, all directors are expected to resign by 27 April 2018 in advance of the RFTS weekend.

Directors' indemnities

In terms of Section 236 of the Companies Act 2006, all directors listed on page 1 have been granted Qualifying Third Party Indemnity Provisions by RBS.

Political contributions

No contributions were made to any political party (2016: £nil).

Going concern

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

The financial position of the Company, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 8, 17 and 26 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and its exposures to credit and liquidity risks.

The directors, having made such enquiries as they considered appropriate, having reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future, have prepared the financial statements on a going concern basis. In reaching their conclusion they considered the announcement of results by RBS for the year ended 31 December 2017, approved on 22 February 2018, which were prepared on a going concern basis. The incoming board have assessed the Company's capital raising plans to maintain the capital ratios required for regulatory compliance.

Dividends

No interim dividends were paid during the year (2016: £10m). The directors do not recommend the payment of a final dividend (2016: £nil) as the company will need to be recapitalised as part of the ring-fenced transfer scheme.

Post balance sheet events

Post balance sheet events are described in note 25 to the financial statements.

DIRECTORS' REPORT

Directors' disclosure to auditor

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the director has taken all steps he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

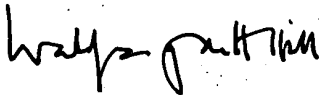
This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Auditor

Ernst & Young LLP has expressed its willingness to continue in office as auditor.

A resolution to re-appoint Ernst & Young LLP as the Company's auditor will be proposed at the forthcoming Annual General Meeting.

By order of the Board:



The Rt Hon Lord Waldegrave of North Hill, PC
Chairman, Non-executive Director
Date: 24 April 2018

STATEMENT OF DIRECTORS' RESPONSIBILITIES

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 10.

The directors are responsible for the preparation of the Annual Report and Financial Statements which include the Strategic Report, Directors' Report and the accounts. The Directors, as permitted by the Companies Act 2006, have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Company. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- make an assessment of the Company's ability to continue as a going concern.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the Annual Report and Financial Statements complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the Strategic Report (incorporating the Business review) and the Directors' Report include a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

By order of the Board:



The Rt Hon Lord Waldegrave of North Hill, PC
Chairman, Non-executive Director
Date: 24 April 2018

INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF ADAM & COMPANY PLC

Opinion

We have audited the financial statements of Adam & Company PLC (the "Company") for the year ended 31 December 2017 which comprise the Statement of Comprehensive Income for the year then ended, the Balance Sheet as at 31 December 2017, the Statement of Changes in Equity and the Cash Flow Statement for the year then ended and related notes, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2017 and of profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Use of our report

This report is made solely to the company's member, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's member those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's member as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

In relation to the ISAs (UK) which require us to report to you, we have nothing to report in respect of the following matters:

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

Overview of our audit approach

Key Audit Matters	• Impairment of loans and advances. • Legal entity recharges.
Audit scope	• We performed an audit of the complete financial information of the entity.
Materiality	• Overall Company's materiality has been set at £1.72 million which represents 2% of total equity.

Key audit matters

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF ADAM & COMPANY PLC

Risk	Our response to the risk
Impairment of loans and advances A significant degree of judgement is required to determine the timing and amount of impairment to recognise with respect to loans and advances. At year end the Company reported total gross loans and advances of £709.42 million (2016: £662.82 million) and impairment provisions of £3.85 million (2016: £2.58 million). We have focused on the following significant judgements and estimates which could give rise to material misstatement or management bias: • Completeness and timing of recognition of loss events in accordance with criteria set out in IAS 39; • For individually assessed provisions, the measurement of the provision may be dependent on the valuation of collateral, estimates of exit values and the timing of cash flows.	We tested the design and operating effectiveness of key controls focusing on the following: • Identification of loss events, including early warning indicators; • Annual credit reviews; • Assessment and approval of individual impairment provisions. In addition, we periodically attended and observed risk committee meetings. For loans individually assessed for impairment we based our sample on factors including collateral held. With input from our valuation specialists we formed an independent view of collateral or exit values, cash flow assumptions and exit strategies. We re-performed the discounted cash flow calculations and compared our measurement outcome to that prepared by management and investigated any differences arising. To test the completeness of the identification of loans with loss events we selected a sample of performing loans and independently assessed whether any IAS 39 loss indicators were present. We assessed the appropriateness and presentation of disclosures against relevant accounting standards.

Key observations communicated to the Audit Committee

We are satisfied that credit impairment provisions were reasonable and in compliance with IFRS. We highlighted the following:

- For individually assessed impairments, in a few instances we reported judgemental differences in respect of the extent of the impairment identified, however none of these differences were considered material.
- Our testing of completeness of identification of loans with loss events highlighted differences in classification of loans that impacted the Financial Statements disclosure. However none of these differences were considered material, and were consequently not adjusted by management. Overall, we were satisfied with the completeness of the identification of loss events.

Relevant references in the Annual Report and Financial Statements

Accounting policies (page 19)

Note 8 of the financial statements (page 30)

Risk	Our response to the risk
Legal entity recharges The majority of RBS group-wide costs are paid centrally by the ultimate holding company, RBS plc and recharged to other RBS Group companies, including the Company. RBS Group implemented transfer pricing methodology for calculation of legal entity recharges. The multi-layered nature of the RBS Group operating structure combined with the total volume and value of transactions means there is a risk that recharged costs are inaccurate and therefore the total cost reported in the Company may not be complete. In addition, we consider there to be a risk of recharged costs not being calculated in accordance with RBS Group transfer pricing methodology.	We tested the design and operating effectiveness of the Company's key controls over the completeness and accuracy of cost recharges. This included understanding RBS Group's recharging processes and controls, including how management ensures the assessment is complete. Transfer pricing methodology was reviewed by our tax experts. We reconciled amounts recharged to intercompany balances. We also tested a sample of cost recharged and agreed them to supporting documentation.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF ADAM & COMPANY PLC

Key observations communicated to the Audit Committee

We are satisfied that costs in the Company which have been charged from other RBS Group companies are reasonable. We identified misstatements that affect current and prior year financial statements, which were not considered material both for the current and prior year and were consequently not adjusted by management.

Relevant references in the Annual Report and Financial Statements

Accounting policies (page 19)

Note 3 of the financial statements (page 27).

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Our application of materiality

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

Materiality

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

We determined materiality for the Company to be £1.72 million (2016 materiality: £1.66 million), which is 2% of the total equity of the Company. We considered that equity represented a relevant measure used by the shareholder, regulators and other stakeholders when assessing the performance of the Company.

Performance materiality

The application of materiality at the individual account or balance level is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and corrected misstatements exceed materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% of our planning materiality, namely £1.29 million (2016: £0.83 million). We have set performance materiality at this percentage (which is at the highest end of the range of our audit methodology) based on various considerations including the past history of misstatements, our ability to assess the likelihood of misstatements, the effectiveness of the control environment and other factors affecting the entity and its financial reporting. In 2016 our performance materiality was 50% of our planning materiality as this was the first year of audit.

Reporting threshold

An amount below which identified misstatements are considered to be clearly trivial.

We agreed with the Audit Committee that we would report to them all corrected and uncorrected audit misstatements in excess of £0.09 million (2016: £0.08 million), which is set at 5% of planning materiality, as well as misstatements below that threshold that, in our view, warranted reporting on qualitative grounds.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF ADAM & COMPANY PLC

Other information

The other information comprises the information included in the Annual Report and Financial Statements, including the Strategic Report (set out on pages 2 to 6), Report of the Directors (set out on pages 7 to 8), and Board of Directors and Company Secretary (set out on page 1) other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of directors

As explained more fully in the directors' responsibilities statement (set out on page 9), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for the implementation of such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBER OF ADAM & COMPANY PLC

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

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

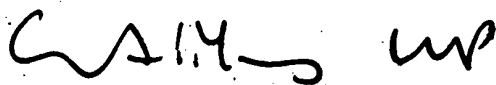
Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and have a direct impact on the preparation of the financial statements. We determined that the most significant are:
 - Companies Act 2006
 - Financial Reporting Council (FRC) and the UK Corporate Governance Code
 - Tax Legislation (governed by HM Revenue and Customs)
 - Financial Conduct Authority (FCA) rules
 - Prudential Regulatory Authority (PRA) rules
- We understood how the Company is complying with those frameworks by reviewing the Company's documented policies and procedures, holding discussions with the Audit Committee and Company Secretary, external counsel, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Chief Executive Officer, Financial Director, Chief Operating Officer, Head of Legal, Head of Lending and Capital Management, Head of Risk, Audit Committee Chair, and Non-executive Directors.
- As part of our audit procedures, we were aware of the risk of fraud, especially in the areas of estimation and those we assessed as having the risk of management override.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.

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

Other matters we are required to address

- Following the recommendation of the RBS Group Audit Committee we were appointed by the Company at its annual general meeting on 4 May 2016 to audit the financial statements of the Company for the period ending 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 2 years, covering periods from our appointment through 31 December 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit
- The audit opinion is consistent with the additional report to the Audit Committee.



Michael-John Albert (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

24th April 2018

STATEMENT OF COMPREHENSIVE INCOME *for the year ended 31 December 2017*

	Notes	2017 £'000	2016 £'000
Continuing operations			
Interest receivable		27,861	29,806
Interest payable		(3,826)	(5,342)
Net interest income	1	24,035	24,464
Fees and commission receivable		3,472	4,320
Fees and commission payable		(332)	(157)
Income from trading activities		1,154	1,172
Non-interest income	2	4,294	5,335
Total income		28,329	29,799
Operating expenses	3	(22,294)	(22,008)
Operating profit before impairment		6,035	7,791
Impairment (losses)/releases on loans and advances	9	(1,306)	1,764
Profit before tax		4,729	9,555
Tax charge	6	(1,423)	(2,790)
Profit and total comprehensive income for the year		3,306	6,765

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

BALANCE SHEET as at 31 December 2017

	Notes	2017 £'000	2016 £'000
Assets			
Cash and balances at central banks	8	109	229
Loans and advances to banks	8	1,487,199	1,384,668
Loans and advances to customers	8	705,574	660,235
Settlement balances	8	508	1,207
Investments in Group undertakings	10	16,729	-
Property, plant and equipment	8, 11	512	563
Prepayments, accrued income and other assets	8, 12	21,690	24,426
Deferred tax asset	8, 13	48	130
Total assets		2,232,369	2,071,458
Liabilities			
Deposits by banks	8	229,904	182,150
Customer accounts	8	1,871,393	1,777,292
Settlement balances	8	1	3
Accruals, deferred income and other liabilities	8, 14	42,826	27,325
Provisions for liabilities and charges	8, 15	2,199	1,948
Total liabilities		2,146,323	1,988,718
Equity			
Shareholders' equity:			
Called up share capital	16	19,548	19,548
Retained earnings and reserves		66,498	63,192
Total equity	8	86,046	82,740
Total liabilities and equity		2,232,369	2,071,458

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

The financial statements were approved by the Board of Directors on 24 April 2018 and signed on its behalf by:

The Rt Hon Lord Waldegrave of North Hill, PC
Chairman, Non-executive Director
Date: 24 April 2018

Michael Robert Regan
Executive Director
Date: 24 April 2018

STATEMENT OF CHANGES IN EQUITY *for the year ended 31 December 2017*

	Notes	2017 £'000	2016 £'000
Called up share capital			
At 1 January and 31 December	16	19,548	19,548
Retained earnings			
At 1 January		62,977	66,212
Profit for the year		3,306	6,765
Dividends paid	7	-	(10,000)
At 31 December		66,283	62,977
Revaluation reserves			
At 1 January and 31 December		215	215
Shareholders' equity at 31 December		86,046	82,740

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

CASH FLOW STATEMENT for the year ended 31 December 2017

	Notes	2017 £'000	2016 £'000
Operating activities			
Operating profit for the year before tax		4,729	9,555
Adjustments for:			
Loss on disposal of property, plant and equipment		-	110
Elimination of foreign exchange differences		12	25
Depreciation and amortisation		51	97
Impairment loss/ (release)		1,306	(1,764)
Movement in loans and advances net of impairment provision		200	(824)
Provisions for liabilities and charges		434	-
Other non-cash items		(230)	(203)
Changes in operating assets and liabilities	19	34,883	79,450
Tax paid		(2,816)	(481)
Net cash flows from operating activities		38,569	85,965
Investing activities			
Acquisition of subsidiary	10	(16,729)	-
Net cash flows used in investing activities		(16,729)	-
Financing activities			
Equity dividends paid	7	-	(10,000)
Net cash flows used in financing activities		-	(10,000)
Effect of exchange rate changes		(8,803)	17,097
Net increase in cash and cash equivalents		13,037	93,062
Cash and cash equivalents 1 January	21	914,879	821,817
Cash and cash equivalents 31 December	21	927,916	914,879

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

ACCOUNTING POLICIES for the year ended 31 December 2017**1. Presentation of financial statements**

The financial statements are prepared on a going concern basis and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together IFRS) as adopted by the European Union (EU).

The financial statements are prepared on the historical cost basis.

The Company is a public limited company, incorporated and domiciled in the United Kingdom and registered in Scotland. The Company's financial statements are presented in accordance with the Companies Act 2006.

The UK ring-fencing legislation requires the separation of essential banking services from investment banking activities with effect from 1 January 2019. As part of the RBS Group's proposals to implement the legislation the Company would be recapitalised and on 29 April 2018, it would acquire substantially all of the retail and commercial banking activities now carried out by RBS plc. Further details of the implementation are provided in the Directors' Report.

The Company is exempt from the requirement to prepare and deliver consolidated financial statements according to section 400 of Companies Act 2006. Details of its parent undertakings are set out in note 24.

Adoption of new and revised standards

The Company adopted two revisions to IFRSs effective 1 January 2017:

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities.

In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses.

Neither of these amendments has had a material effect on the Company's financial statements.

Effective 1 January 2018 - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas.

The principle features of IFRS 9 are as follows:

Recognition and derecognition

The material in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments has been included unamended in IFRS 9.

Classification and measurement

Financial assets - There are three classifications for financial assets in IFRS 9: amortised cost; fair value through other comprehensive income; and fair value through profit or loss.

a) Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.

b) Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is achieved by holding financial assets to collect their cash flow and selling them are measured at fair value through other comprehensive income.

c) Other financial assets are measured at fair value through profit or loss.

However, at initial recognition, any financial asset may be irrevocably designated as measured at fair value through profit or loss if such designation eliminates a measurement or recognition inconsistency.

The company continues to evaluate the overall effect, but expects that the measurement basis of the majority of the company's financial assets will be unchanged on application of IFRS 9.

Financial liabilities - IFRS 9's requirements on the classification and measurement of financial liabilities are largely unchanged from those in IAS 39. However, there is a change to the treatment of changes in the fair value attributable to own credit risk of financial liabilities designated at fair value through profit or loss which are recognised in other comprehensive income and not in profit or loss as required by IAS 39.

ACCOUNTING POLICIES for the year ended 31 December 2017**1. Presentation of financial statements (continued)***Credit impairment*

IFRS 9's credit impairment requirements apply to financial assets measured at amortised cost, to those measured at fair value through other comprehensive income, to certain loan commitments and financial guarantee contracts. On initial recognition a loss allowance is established at an amount equal to 12-month expected credit losses ('ECL') that is the portion of life-time expected losses resulting from default events that are possible within the next 12 months.

Where a significant increase in credit risk since initial recognition is identified, the loss allowance increases so as to recognise all expected default events over the expected life of the asset. The Company expects that financial assets where there is objective evidence of impairment under IAS39 will be credit impaired under IFRS 9, and carry loss allowances based on all expected default events.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted: determined by evaluating at the reporting date for each customer or loan portfolio a range of possible outcomes using reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions. The estimation of ECL also takes into account the time value of money. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

An RBS Group-wide programme has been established to implement the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes; this programme is led jointly by RBS Risk and Finance. The inclusion of loss allowances on all financial assets will tend to result in an increase in overall impairment balances when compared with the existing basis of measurement under IAS 39.

Transition

The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative period.

In summary, on 1 January 2018:

- There is no reclassification of financial instruments necessary.
- The change in impairment methodology will lead to a £1.4m pre tax reduction in equity.
- The net tax impact is a £0.2m increase in equity.
- This results in a £1.2m net post tax reduction in equity.

There will be no restatement of accounts prior to 2018.

The Group has opted to early adopt the IFRS 9 amendment on negative compensation with effect from 1 January 2018; this is expected to be endorsed for use in the EU in early 2018.

Effective 1 January 2018 – other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. It is effective from 1 January 2018 and is not expected to have a material impact on shareholders' equity.

Effective after 2018

IFRIC Interpretation 23 'Uncertainty over income tax treatments' was issued in June 2017 to clarify how to apply judgement in assessing the tax position of the reporting entity. The effective date is 1 January 2019.

In October 2017, the IASB amended IAS 28 'Investments in associates and joint ventures' to require long term, non-equity interests in these investments to be tested for impairment first in accordance with IFRS 9 and then in accordance with IAS 28. The effective date of the amendment is 1 January 2019.

This is not expected to have a material impact on shareholders' equity.

ACCOUNTING POLICIES for the year ended 31 December 2017**2. Revenue recognition**

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities other than those measured at fair value are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculations of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities classified as fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in the Statement of Comprehensive Income.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss otherwise they are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. Brokerage commissions are recognised in revenues when trades are processed. Fees charged for managing investments are recognised as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised. The application of this policy to significant fee types is outlined below:

Payment services: this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account monthly or quarterly in arrears. Income is accrued at year end for services provided but not charged.

Fees and commissions payable: fees and commissions are payable in respect of services provided by third party intermediaries. These are charged through the profit and loss over the life of the underlying product.

3. Employee benefits

This policy should be read in conjunction with note 4 on page 28.

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

RBS provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees on behalf of the Company.

There is no contractual agreement or policy on the way that the cost of RBS defined benefit pension schemes and healthcare plans are allocated to the Company. It therefore accounts for the charges it incurs as payments to a defined contribution scheme.

Contributions to defined contribution pension schemes are recognised in the income statement when payable.

4. Property, plant and equipment

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

Depreciation is charged to the Statement of Comprehensive Income on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment over their estimated useful lives.

ACCOUNTING POLICIES for the year ended 31 December 2017**4. Property, plant and equipment (continued)**

The depreciable amount is the cost of an asset less its residual value. The estimated useful lives of the Company's property, plant and equipment are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	Unexpired period of the lease
Computer equipment	Up to 5 years
Other equipment	4 to 15 years

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

5. Revaluation reserve

The revaluation reserve represents the cumulative gains and losses on the revaluation of property occupied by Company's businesses, included within property, plant and equipment. If the revaluation results in an increase in value, it should be credited to other comprehensive income and accumulated in equity unless it represents the reversal of a revaluation decrease of the same asset previously recognised as an expense, in which case it should be recognised in profit and loss. The revaluation reserve is not distributable.

6. Impairment of property, plant and equipment

At each reporting date, the Company assesses whether there is any indication that property, plant and equipment are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss, if any.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value-in-use. Value-in-use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of a tangible asset is less than its carrying value, an impairment loss is recognised immediately in the Statement of Comprehensive Income and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised.

7. Foreign currencies

The Company's financial statements are presented in Sterling, which is the functional currency of the Company.

Transactions in foreign currencies are translated into Sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are reported in income from trading activities.

8. Provisions and contingent liabilities

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

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

If the Company has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Company's contractual obligations exceed the expected economic benefits.

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

ACCOUNTING POLICIES for the year ended 31 December 2017**9. Taxation**

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

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

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

10. Financial assets

On initial recognition financial assets are classified into loans and receivables.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are designated as fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 2) less any impairment losses.

Fair value – fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

11. Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost – if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Impairment losses are recognised in the Statement of Comprehensive Income and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent year, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written-off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Company concludes that there is no longer any realistic prospect of recovery of part or all of the loan. The timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs will be prompted by bankruptcy, insolvency, renegotiation and similar events.

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

ACCOUNTING POLICIES for the year ended 31 December 2017**12. Financial liabilities**

On initial recognition financial liabilities are classified into amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

Amortised cost - all financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 2).

13. Cash and cash equivalents

In the Cash Flow Statement, cash and cash equivalents comprise cash and demand deposits with banks together with short-term highly liquid investments, that are disclosed as part of loans and advances to banks, readily convertible to known amounts of cash and subject to insignificant risk of change in value such as cash collateral held with banks and settlement systems.

14. Financial guarantee contracts

Under a financial guarantee contract, the Company, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with accounting policy 8. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

15. Investments in Group undertakings

The Company's investments in its subsidiaries are stated at cost less any accumulated impairment losses. The Company assesses at each balance sheet date whether there is any objective evidence that an investment in Group undertakings is impaired.

Critical accounting policies and key sources of estimation uncertainty

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

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

Loan impairment provisions

The Company's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired where there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial position has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; deteriorating trading performance; the borrower's payment status; and observable data about relevant macroeconomic measures. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2017, gross loans and advances to customers totalled £709,427k (2016: £662,812k) and customer loan impairment provisions amounted to £3,853k (2016: £2,577k).

ACCOUNTING POLICIES for the year ended 31 December 2017**Critical accounting policies and key sources of estimation uncertainty (continued)**

There are two components to the Company's loan impairment provisions: individual and latent.

Individual component – all loans are individually assessed for impairment. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Latent component – this is made up of loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provision). Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Company has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

Sensitivity of impairments to assumptions

Key assumptions relating to impairment levels are economic conditions, the interest rate environment, the ease and timing of enforcing loan agreements in varying legal jurisdictions and the level of customer co-operation. In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

1. Net interest income

	2017 £'000	2016 £'000
Loans and advances to customers	19,094	19,529
Loans and advances to banks	8,767	10,277
Interest receivable	27,861	29,806
Customer accounts	(1,693)	(3,219)
Deposits by banks	(2,133)	(2,123)
Interest payable	(3,826)	(5,342)
Net interest income	24,035	24,464

2. Non-interest income

	2017 £'000	2016 £'000
Bank charges	1,196	1,273
Other banking income	750	729
Custody income	611	1,370
Visa income	294	303
Arrangement and processing fees	238	160
Brokerage	175	200
Investment management income	139	204
Acceptance and guarantee fees	69	81
Fees and commission receivable	3,472	4,320
Brokerage	(208)	(37)
Other banking expense	(124)	(120)
Fees and commission payable	(332)	(157)
Foreign exchange ⁽¹⁾	1,154	1,172
Income from trading activities	1,154	1,172
Non-interest income	4,294	5,335

(1) Foreign exchange includes spot and forward foreign exchange contracts.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

3. Operating expenses

	2017 £'000	Restated 2016 ⁽¹⁾ £'000
Wages, salaries and other staff costs	6,702	5,368
Social security costs	578	230
Pension costs	786	587
Staff costs	8,066	6,185
Property, plant and equipment depreciation (see note 11)	51	97
Depreciation & amortisation	51	97
Premises and equipment	4	511
Other administrative expenses ⁽²⁾	14,173	15,215
Other expenses	14,177	15,726
Operating expenses	22,294	22,008

(1) Minor classification changes have been made in the comparative figures, resulting in a reallocation of 2016 costs totalling £1,185k from Other administrative expenses to Staff costs. This 2016 reallocation resulted in increases in Wages, salaries and other staff costs of £1,221k and Pension costs of £145k, and a decrease in Social security costs of £181k.

(2) The majority of Other administrative expenses relate to recharges from other RBS group entities.

The average number of persons employed by the Company during the year was made up as follows:

Employee numbers	2017 Number	2016 Number
Managers	49	42
Clerical and other staff	76	80
	125	122

Auditor's remuneration

Amounts paid to the Company's auditors for statutory audit and other services are set out below. All audit-related and other services are approved by the RBS Group Audit Committee and are subject to strict controls to ensure the external auditor's independence is unaffected by the provision of other services. The RBS Group Audit Committee recognises that for certain assignments the auditors are best placed to perform the work economically; for other work the Company selects the supplier best placed to meet its requirements. The Company's auditors are permitted to tender for such work in competition with other firms where the work is permissible under audit independence rules.

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

	2017 £'000	2016 £'000
Audit services:		
- Fees payable to the Company's auditors for the audit of the Company's annual financial statements	63	63
- Other services ⁽¹⁾	54	52
	117	115

(1) Other assurance services pursuant to legislation

In addition the auditor's remuneration for Company's reporting audit work of £42k (2016: £62k) was borne by RBS, the ultimate parent company of the Company.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017**4. Pension costs**

Eligible employees of the Company can participate in membership of RBS operated pension schemes. The principal defined benefit scheme was The Royal Bank of Scotland Group Pension Fund (the "Main scheme"). The Main scheme was closed to new entrants in October 2006 and since then employees have been offered membership of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. Detailed disclosure of RBS's pension schemes is available in RBS's Annual Report and financial statements 2017. There is no contractual agreement or policy on the way that the cost of RBS defined benefit pension schemes and healthcare plans are allocated to the Company. It therefore accounts for the charges it incurs as payments to a defined contribution scheme.

5. Emoluments of directors

	2017 £'000	2016 £'000
Chairman and non-executive directors - emoluments	86	73
Executive directors - emoluments	556	486
	642	559

Number of directors to whom retirement benefits are accruing in respect of qualifying service:

- money purchase schemes	3	3
- defined benefit schemes	-	-

The total emoluments of the highest paid director were £462k (2016: £409k). This includes long-term benefits consisting of long-term incentive plans and deferred pay awards.

The executive directors may also participate in the RBS's executive share plans and share save schemes.

6. Taxation

	2017 £'000	2016 £'000
Current taxation:		
<i>United Kingdom corporation tax at 19.25% (2016: 20%)</i>		
Charge for the year	1,313	2,787
Under/(over) provision in respect of prior periods	28	(11)
Total current taxation	1,341	2,776
Deferred taxation:		
Charge/(credit) for the year	105	(6)
(Over)/under provision in respect of prior periods	(23)	20
Total deferred taxation	82	14
Tax charge for the year	1,423	2,790

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

6. Taxation (continued)

The actual tax charge differs from the expected tax charge computed by applying the blended rate of UK corporation tax of 19.25% (2016: standard tax rate of 20%) as follows:

	2017 £'000	2016 £'000
Operating profit before tax	4,729	9,555
Expected tax charge	910	1,910
<i>Factors affecting the charge for the year:</i>		
Non-deductible items	92	76
Surcharge on banking companies	417	796
Reduction in deferred tax asset following change in rate of UK Corporation Tax	(1)	-
Movement in deferred tax asset following introduction of surcharge on banking companies	-	(1)
Prior year adjustments	5	9
Actual tax charge for the year	1,423	2,790

The effective tax rate for the year was 30.10% (2016: 29.2%).

The main rate of UK Corporation Tax has reduced from 20% to 19% from 1 April 2017 and will reduce further to 17% from 1 April 2020. As this is a banking company, the Banking Surcharge rate of 8% also applies. Deferred tax assets and liabilities at 31 December 2017 take into account the banking surcharge inclusive rate in respect of banking temporary differences and, where appropriate, the reduced main rate in respect of tax losses and non-banking temporary differences.

7. Ordinary Dividends

	2017 £'000	2016 £'000
An interim dividend of nil (2016: 51.2p) per share	-	10,000

No final dividend was declared and paid during the year (2016: £nil).

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

8. Financial instruments

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in International Accounting Standards (IAS) 39 'Financial Instruments: Recognition and Measurement'. Assets and Liabilities outside the scope of IAS 39 are shown separately.

	Loans and receivables	Amortised cost	Other assets	Non financial assets / liabilities	Total
	£'000	£'000	£'000	£'000	£'000
2017					
Assets					
Cash and balances at central banks	109	-	-	-	109
Loans and advances to banks ⁽¹⁾	1,487,199	-	-	-	1,487,199
Loans and advances to customers	705,574	-	-	-	705,574
Settlement balances	508	-	-	-	508
Investments in Group undertakings	-	-	16,729	-	16,729
Property, plant and equipment	-	-	-	512	512
Prepayments, accrued income and other assets	-	-	-	21,690	21,690
Deferred tax asset	-	-	-	48	48
	2,193,390	-	16,729	22,250	2,232,369
Liabilities					
Deposits by banks ⁽²⁾	-	229,904	-	-	229,904
Customer accounts	-	1,871,393	-	-	1,871,393
Settlement balances	-	1	-	-	1
Accruals, deferred income and other liabilities	-	-	-	42,826	42,826
Provisions for liabilities and charges	-	-	-	2,199	2,199
	-	2,101,298	-	45,025	2,146,323
Equity					86,046
					2,232,369

	Loans and receivables	Amortised cost	Other assets	Non financial assets / liabilities	Total
	£'000	£'000	£'000	£'000	£'000
2016					
Assets					
Cash and balances at central banks	229	-	-	-	229
Loans and advances to banks ⁽¹⁾	1,384,668	-	-	-	1,384,668
Loans and advances to customers	660,235	-	-	-	660,235
Settlement balances	1,207	-	-	-	1,207
Property, plant and equipment	-	-	-	563	563
Prepayments, accrued income and other assets	-	-	-	24,426	24,426
Deferred tax asset	-	-	-	130	130
	2,046,339	-	-	25,119	2,071,458
Liabilities					
Deposits by banks ⁽²⁾	-	182,150	-	-	182,150
Customer accounts	-	1,777,292	-	-	1,777,292
Settlement balances	-	3	-	-	3
Accruals, deferred income and other liabilities	-	-	-	27,325	27,325
Provisions for liabilities and charges	-	-	-	1,948	1,948
	-	1,959,445	-	29,273	1,988,718
Equity					82,740
					2,071,458

(1) Includes items in the course of collection from other banks of RBS £1,812k (2016: £355k).

(2) Includes items in the course of transmission to other banks of RBS £297k (2016: £683k).

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

8. Financial instruments (continued)

IAS 39 requires the disclosure of the fair value of financial instruments not carried at fair value. The following tables show the carrying values and the fair values of financial instruments carried at amortised cost on the balance sheet.

	Items where fair value approximates carrying value £'000	Carrying value £'000	Fair value £'000	Fair value hierarchy level		
				Level 1 ⁽¹⁾ £'000	Level 2 ⁽²⁾ £'000	Level 3 ⁽³⁾ £'000
2017						
Financial assets						
Cash and balances at central banks	109	-	-	-	-	-
Loans and advances to banks	927,807	559,392	556,299	-	-	556,299
Loans and advances to customers	64,672	640,902	633,809	-	-	633,809
Settlement balances asset	508	-	-	-	-	-
Financial liabilities						
Deposits by banks	13,350	216,554	215,079	-	-	215,079
Customer accounts	1,871,393	-	-	-	-	-
Settlement balances liability	1	-	-	-	-	-
	Items where fair value approximates carrying value £'000	Carrying value £'000	Fair value £'000	Fair value hierarchy level		
				Level 1 ⁽¹⁾ £'000	Level 2 ⁽²⁾ £'000	Level 3 ⁽³⁾ £'000
2016 (restated)						
Financial assets						
Cash and balances at central banks	229	-	-	-	-	-
Loans and advances to banks ⁽⁴⁾	376,647	1,008,021	1,006,861	-	-	1,006,861
Loans and advances to customers	73,823	586,412	584,089	-	-	584,089
Settlement balances asset	1,207	-	-	-	-	-
Financial liabilities						
Deposits by banks ⁽⁴⁾	8,674	173,476	173,967	-	-	173,967
Customer accounts ⁽⁴⁾	1,777,292	-	-	-	-	-
Settlement balances liability	3	-	-	-	-	-

For notes relating to this table, refer to page 32

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

8. Financial instruments (continued)

- (1) Valued using unadjusted quoted prices in active markets for identical financial instruments.
- (2) Valued using techniques based significantly on observable market data. Instruments in this category are valued using:
 - quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
 - valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.
- (3) Instruments in this category have been valued using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Company determines a reasonable level for the input.
- (4) During 2017, the Company performed a review on its fair value disclosures which identified the need for adjustments in loans and advances to banks, deposits by banks and customer accounts. These have been adjusted for items where carrying value approximates fair value.

	Fair Value As reported £'000	Adjustment £'000	As restated ⁽¹⁾ £'000
2016			
Financial Assets			
Loan and advances to banks	1,384,668	(1,160)	1,383,508
Financial Liabilities			
Deposits by banks	182,150	491	182,641
Customer accounts	1,759,116	18,176	1,777,292

(1) Restated fair value comprises items where fair value approximates carrying value and portion of balances that are classified as level 3.

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

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

Short-term financial instruments

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

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

- (a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing.
- (b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products.

Deposits by banks and customer accounts

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

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

8. Financial instruments (continued)

Remaining maturity

	Less than 12 months £'000	More than 12 months £'000	Total £'000
2017			
Assets			
Cash and balances at central banks	109	-	109
Loans and advances to banks	1,109,230	377,969	1,487,199
Loans and advances to customers	215,829	489,745	705,574
Settlement balances	508	-	508
Liabilities			
Deposits by banks	36,392	193,512	229,904
Customer accounts	1,871,393	-	1,871,393
Settlement balances	1	-	1
2016			
Assets			
Cash and balances at central banks	229	-	229
Loans and advances to banks	1,060,308	324,360	1,384,668
Loans and advances to customers	246,515	413,720	660,235
Settlement balances	1,207	-	1,207
Liabilities			
Deposits by banks	55,187	126,963	182,150
Customer accounts	1,777,292	-	1,777,292
Settlement balances	3	-	3

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

9. Financial Assets - impairments

The following table shows the movement in the provision for impairment losses for loans and advances:

	Individually assessed £'000	Latent £'000	Total £'000
At 1 January 2017	2,392	185	2,577
Recovery of amounts previously written-off	235	-	235
Amounts written-off	(35)	-	(35)
Charge to the income statement	753	553	1,306
Unwind of discount	(230)	-	(230)
At 31 December 2017	3,115	738	3,853

	Individually assessed £'000	Latent £'000	Total £'000
At 1 January 2016	3,843	1,525	5,368
Recovery of amounts previously written-off	301	-	301
Amounts written-off	(1,125)	-	(1,125)
Credit to the income statement	(424)	(1,340)	(1,764)
Unwind of discount	(203)	-	(203)
At 31 December 2016	2,392	185	2,577

The following table shows analysis of impaired financial assets:

	2017			2016		
	Cost £'000	Provision £'000	Net book value £'000	Cost £'000	Provision £'000	Net book value £'000
Impaired financial assets						
Loans and advances to customers	12,059	(3,115)	8,944	7,600	(2,392)	5,208

The following tables show an analysis of past due but not impaired. The loans are classified as accruing loans as no impairment loss is expected:

	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
2017					
Loans and advances to customers	3,778	-	-	1,069	4,847

	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
2016					
Loans and advances to customers	2,640	-	532	3,655	6,827

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

10. Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Based on the assessment at the balance sheet date, there is no objective evidence that an investment in Group undertakings is impaired.

	2017 £'000	2016 £'000
At 1 January	-	-
Additions	16,729	-
At 31 December	16,729	-

The Company's subsidiaries at 31 December 2017, all of which are unlisted and wholly owned, are listed below:

Undertaking	Country of incorporation	Proportion of ownership interest %	Proportion of voting power held %	Nature of business
Adam & Company Investment Management Limited	Scotland	100	100	Investment Management
Adam & Company Nominees Limited	Scotland	100	100	Banking and Trust

The registered office of both subsidiaries is at 25 St Andrew Square, Edinburgh, Scotland, EH2 1AF.

11. Property, plant and equipment

	Freehold Premises £'000	Short leasehold £'000	Computers and other equipment £'000	Total £'000
2017				
Cost:				
At 1 January 2017	520	37	457	1,014
Additions	-	-	-	-
Disposals	-	-	(13)	(13)
At 31 December 2017	520	37	444	1,001
Accumulated depreciation and amortisation:				
At 1 January 2017	85	17	349	451
Charge for the year	11	2	38	51
Disposals	-	-	(13)	(13)
At 31 December 2017	96	19	374	489
Carrying amount at 31 December 2017	424	18	70	512

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

11. Property, plant and equipment (continued)

2016	Freehold Premises £'000	Short leasehold £'000	Computers and other equipment £'000	Total £'000
Cost:				
At 1 January 2016	520	214	4,267	5,001
Additions	-	-	-	-
Disposals	-	(177)	(3,810)	(3,987)
At 31 December 2016	520	37	457	1,014
Accumulated depreciation and amortisation:				
At 1 January 2016	71	181	3,979	4,231
Charge for the year	14	13	70	97
Disposals	-	(177)	(3,700)	(3,877)
At 31 December 2016	85	17	349	451
Carrying amount at 31 December 2016	435	20	108	563

There was a loss of £nil on disposal of assets during the year (2016: £110k).

12. Prepayments, accrued income and other assets

	2017 £'000	2016 £'000
Due within 12 months:		
Prepayments and accrued income	2,986	3,259
Other assets ⁽¹⁾	18,704	21,167
	21,690	24,426

(1) Balances primarily consist of unsettled customer transactions on clearing accounts.

13. Deferred taxation

Provision for deferred taxation has been made as follows:

	2017 £'000	2016 £'000
Deferred tax asset	48	130

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

13. Deferred taxation (continued)

	Accelerated capital allowances £'000	Provisions £'000	Other provision £'000	Total £'000
At 1 January 2016	70	23	51	144
Credit/(charge) to income statement	5	(17)	(2)	(14)
At 1 January 2017	75	6	49	130
Charge to income statement	(27)	(6)	(49)	(82)
At 31 December 2017	48	-	-	48

The provision for UK deferred taxation has been calculated at 27% (2016: 27%), inclusive of the 8% Banking Surcharge. A deferred tax asset of £48k has been recognised for the Company at 31 December 2017 (2016: £130k). This asset has been recognised in the financial statements following the deferral of capital allowances. The directors are of the opinion, based on recent and forecasted trading, that the tax due on future profits in the current and next financial year will exceed the value of the deferred tax asset.

14. Accruals, deferred income and other liabilities

	2017 £'000	2016 £'000
Due within 12 months:		
Taxation	1,301	2,776
Accruals and deferred income	2,055	1,782
Other liabilities ⁽¹⁾	39,470	22,767
	42,826	27,325

(1) Balances primarily consist of unsettled customer transactions on clearing accounts.

15. Provision for liabilities and charges

	Provision for severance £'000 ⁽¹⁾	Other provisions £'000 ⁽²⁾	Total provisions £'000
At 1 January 2017	183	1,765	1,948
Charged to income statement	298	136	434
Utilised in year	(183)	-	(183)
At 31 December 2017	298	1,901	2,199

(1) The Company continues to review the operating model of the organisation to ensure it has the most cost effective and efficient cost base. To this end, in 2017 a provision amounting to £298k has been taken to cover plans for restructuring which is expected to be utilised in 2018. These provisions are management's best estimate of the anticipated costs of redress and related administrative expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management.

(2) Other provisions comprise amounts due in respect of litigation. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement.

16. Called-up share capital

	Allotted, called-up and fully paid		Authorised	
	31 December 2017 £'000	31 December 2016 £'000	31 December 2017 £'000	31 December 2016 £'000
Equity shares:				
Ordinary shares of £1	19,548	19,548	25,000	25,000
Total called-up share capital	19,548	19,548	25,000	25,000

	Allotted, called-up and fully paid		Authorised	
	2017 Thousands	2016 Thousands	2017 Thousands	2016 Thousands
Number of shares				
Equity shares:				
Ordinary shares of £1	19,548	19,548	25,000	25,000

NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2017***17. Risk management**

The major risks associated with the Company's businesses are credit, market, conduct, liquidity, regulatory, reputational and operational risk. The Company has established a comprehensive framework for managing these risks which is continually evolving as the Company's business activities change in response to credit, market, product and other developments.

The Company has established clear risk policies, including limits, reporting lines and control procedures. This framework is designed to provide tight control and is reviewed regularly by the Board and the Audit and Risk Committee.

Market Risk

Market risk is the risk that changes in interest rates, foreign exchange rates, prices, volatilities and correlations may have an adverse financial impact on the Company's financial condition or results.

The Company does not maintain any material proprietary trading positions and consequently has limited exposure to market risk. The market risk that arises through the provision of products and services to customers, being principally interest rate and foreign exchange risk, is predominantly hedged. Unhedged market risk is small in accordance with policy limits.

The Company does not maintain material open currency positions.

Foreign currency risk

The Company up streams all foreign currency balances to their parent and as such the risk is managed at this level, residual mismatches are monitored on an ongoing basis and are reported to the Private Banking Asset and Liability Management Committee (ALCO) at least quarterly.

The Company's exposure to foreign exchange risk is provided in the table below. The amounts shown are the foreign exchange gaps in each currency and take into account the effect of forward foreign exchange contracts entered into to manage currency exposures.

	2017	2016
	Total	Total
	£'000	£'000
US Dollar	(18)	(37)
Euro	20	(1)
Other currencies	152	167
At 31 December	154	129

Interest rate risk

Non traded interest rate risk arises from the provision to customers of a range of products that have differing interest rate characteristics. Mismatches in these products and their characteristics give rise to volatility in net interest income as rates vary. Oversight and governance for the Company is provided by the ALCO supported by RBS Treasury.

Liquidity risk

RBS has built an appropriate liquidity risk management framework that supports the management of the Company's short, medium and long-term funding and liquidity management requirements. The Company, with the support of RBS, manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The contractual maturity of assets and liabilities, shown in the following tables, highlight the maturity transformation which underpins the role of banks to lend longer-term but funded predominantly by short-term liabilities such as customer deposits. In practice, the behaviour profile of many assets and liabilities differs from the contractual maturity.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17. Risk management (continued)

Liquidity risk (continued)

The table below analyses the contractual cash flows receivable and payable up to a period of 20 years from the balance sheet date, including future payments of interest. This table is an analysis of the contractual maturity and does not represent customer behaviour. Financial assets have been reflected in the time band of the latest date on which they could be repaid, unless earlier repayment can be demanded by the Company. Financial liabilities are included at the earliest date on which the counterparty can require repayment, regardless of whether or not such early repayment results in a penalty:

2017	0-3 months £'000	3-12 months £'000	1-3 years £'000	3-5 years £'000	5-10 years £'000	10-20 years £'000
Assets by contractual maturity						
Cash and balances at central banks	109	-	-	-	-	-
Loans and advances to banks	930,290	184,429	206,824	167,943	10,008	-
Total maturing assets	930,399	184,429	206,824	167,943	10,008	-
Loans and advances to customers	130,647	112,653	166,936	101,202	149,280	113,473
Total assets	1,061,046	297,082	373,760	269,145	159,288	113,473
Liabilities by contractual maturity						
Deposits by banks	12,936	24,509	95,113	73,939	28,989	-
Total maturing liabilities	12,936	24,509	95,113	73,939	28,989	-
Customer accounts	1,815,012	56,724	-	-	-	-
Total liabilities	1,827,948	81,233	95,113	73,939	28,989	-
Maturity gap	(766,902)	215,849	278,647	195,206	130,299	113,473
Cumulative maturity gap	(766,902)	(551,053)	(272,406)	(77,200)	53,099	166,572
Guarantees and commitments - notional amount						
Guarantees ⁽²⁾	14,162	-	-	-	-	-
Commitments ⁽³⁾	105,757	-	-	-	-	-
	119,919	-	-	-	-	-

For notes relating to this table, refer to page 40.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17 Risk management (continued)

Liquidity risk (continued)

	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2016 (restated)	£'000	£'000	£'000	£'000	£'000	£'000
Assets by contractual maturity						
Cash and balances at central banks	229	-	-	-	-	-
Loans and advances to banks ⁽¹⁾	915,126	146,910	162,200	165,322	626	1
Total maturing assets	915,355	146,910	162,200	165,322	626	1
Loans and advances to customers ⁽¹⁾	153,648	111,543	165,813	81,957	112,396	91,511
Total assets	1,069,003	258,453	328,013	247,279	113,022	91,512
Liabilities by contractual maturity						
Deposits by banks ⁽¹⁾	9,397	50,797	70,375	46,628	16,414	-
Total maturing liabilities	9,397	50,797	70,375	46,628	16,414	-
Customer accounts ⁽¹⁾	1,730,500	47,071	-	-	-	-
Total liabilities	1,739,897	97,868	70,375	46,628	16,414	-
Maturity gap	(670,894)	160,585	257,638	200,651	96,608	91,512
Cumulative maturity gap	(670,894)	(510,309)	(252,671)	(52,020)	44,588	136,100

Guarantees and commitments -
notional amounts

Guarantees ⁽²⁾	17,066	-	-	-	-	-
Commitments ⁽³⁾	112,769	-	-	-	-	-
	129,835	-	-	-	-	-

(1) During 2017, the Company performed a review of management information sources which identified inconsistencies in the maturity of undiscounted cash flows for all products except cash balance. These have been adjusted for the future interest amount; changes have been made to the 2016 disclosure. Totals in Maturity gap and Cumulative maturity gap were updated and restated respectively.

(2) The Company is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Company expects most guarantees it provides to expire unused.

(3) The Company has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Company does not expect all facilities to be drawn, and some may lapse before drawdown.

	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2016	£'000	£'000	£'000	£'000	£'000	£'000
Assets by contractual maturity						
Loans and advances to banks						
As reported	914,650	145,658	159,882	164,478	-	-
Adjustment	476	1,252	2,318	844	626	1
As restated	915,126	146,910	162,200	165,322	626	1
Loans and advances to customers						
As reported	147,028	99,487	148,816	71,470	193,434	-
Adjustment	6,620	12,056	16,997	10,487	(81,038)	91,511
As restated	153,648	111,543	165,813	81,957	112,396	91,511
Liabilities by contractual maturity						
Deposits by banks						
As reported	7,493	47,694	64,968	45,581	16,414	-
Adjustment	1,904	3,103	5,407	1,047	-	-
As restated	9,397	50,797	70,375	46,628	16,414	-
Customer accounts						
As reported	1,730,373	46,919	-	-	-	-
Adjustment	127	152	-	-	-	-
As restated	1,730,500	47,071	-	-	-	-

NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2017***17. Risk management (continued)****Liquidity risk (continued)**

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

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

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

Credit risk

Credit risk is the risk of financial loss owing to the failure of clients or counterparties to meet their obligations to the Company. The quantum and nature of credit risk assumed in the Company's different business activities vary considerably, while the overall credit risk outcome usually exhibits a degree of correlation to the macroeconomic environment.

Credit risk organisation

The existence of a strong credit risk management organisation is vital to support the goals of the Company. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and a focus on the importance of sustainable lending practices. The role of the credit risk management organisation is to provide the business with the support necessary to develop and maintain a sound lending franchise within risk appetite while providing strong independent oversight and challenge.

Responsibility for development of RBS-wide policies, credit risk frameworks, Company-wide portfolio management and assessment of provision adequacy sits within the functional RBS Credit Risk Organisation (RBSCRO) within RBS under the management of the RBS Chief Credit Officer. The Company works together with RBSCRO to ensure that the Board's expressed credit risk appetite is met within a clearly defined and managed control environment. Activities within credit risk include credit approval, transaction and portfolio analysis, early problem recognition and setting standards for ongoing credit risk stewardship within the business areas.

Credit risk mitigation

The Company employs a number of structures and techniques to mitigate credit risk. Unsecured facilities are carefully considered as to affordability and repayment and generally represent only the lower value exposures within the Company's books. A large part of the Company's credit exposures are covered by security, written at a discount to the assessed value at point of origination in accordance with stated credit policies. These include a range of transactions, from retail mortgage lending to commercial financing, with a security interest in a physical or financial asset.

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the Company cover: general requirements, including acceptable credit risk mitigation types and any conditions or restrictions applicable to those mitigants; the means by which legal certainty is to be established, including required documentation and all necessary steps required to establish legal rights; acceptable methodologies for the initial and any subsequent valuations of collateral and the frequency with which they are to be revalued; actions to be taken in the event the current value of mitigation falls below required levels; management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation; management of concentration risks, for example, setting thresholds and controls on exposure to a single borrower, the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

Provision analysis

Early and active management of problem exposures ensures that credit losses are minimised. Specialised units are used to ensure that appropriate action to mitigate risk is taken in a timely manner.

Provisions are reassessed regularly as part of the Company's ongoing monitoring process.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17. Risk management (continued)

Credit risk (continued)

Credit risk asset quality

Credit risk assets consist of loans and advances (including overdraft facilities), guarantees issued on behalf of clients and financial instruments (measured at mark to market value) across all customer types. Where relevant, and unless otherwise stated, data reflects the effect of credit mitigation techniques.

The Company has made the decision to adopt the standardised approach to credit capital calculations. Under the standardised approach there is no requirement for probability of default (PD) to be calculated. Due to this decision, the assets lent do not have a probability of default rating and have been classified into asset quality bands based on a set of assessment criteria and the expert judgement of credit professionals.

Asset Quality Grade	Minimum PD	Maximum PD
AQ1	0.00	0.03
AQ2	0.03	0.05
AQ3	0.05	0.10
AQ4	0.10	0.38
AQ5	0.38	1.08
AQ6	1.08	2.15
AQ7	2.15	6.09
AQ8	6.09	17.22
AQ9	17.22	100.00
AQ10	100.00	-

Larger commercial clients are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades map to both an RBS Group level asset quality scale (illustrated above), used for external financial reporting by the Company, and a master grading scale for wholesale exposures used for internal management reporting across portfolios.

The following tables provide an analysis of the credit quality of third party financial assets by asset quality grade:

	Cash and balances at central banks £'000	Loans and advances to banks £'000	Loans and advances to customers £'000	Commitments £'000	Contingent liabilities £'000
2017					
Intra-group balances with parent	-	1,478,355	-	-	-
AQ1	109	8,844	57,786	37,479	4,461
AQ2	-	-	156,696	-	-
AQ3	-	-	95,471	-	-
AQ4	-	-	109,725	19,312	3,472
AQ5	-	-	16,803	21,781	5,242
AQ6	-	-	21,247	22,397	787
AQ7 ⁽⁴⁾	-	-	192,805	4,627	200
AQ8	-	-	9,025	40	-
AQ9	-	-	-	121	-
AQ10 ⁽¹⁾	-	-	32,963	-	-
Accruing past due ⁽²⁾	-	-	4,847	-	-
Non-accrual ⁽³⁾	-	-	12,059	-	-
Impairment provisions	-	-	(3,853)	-	-
Total	109	1,487,199	705,574	105,757	14,162

For notes relating to this table, refer to page 43.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17. Risk management (continued)

Credit risk (continued)

	Cash and balances at central banks	Loans and advances to banks	Loans and advances to customers	Commitments	Contingent liabilities
2016	£'000	£'000	£'000	£'000	£'000
Intra-group balances with parent	-	1,372,844	-	-	-
AQ1	229	11,824	83,040	31,594	2,720
AQ2	-	-	75,408	-	-
AQ3	-	-	219,132	-	-
AQ4	-	-	121,766	34,987	3,188
AQ5	-	-	59,721	22,204	8,146
AQ6	-	-	32,918	21,773	2,987
AQ7 ⁽⁴⁾	-	-	28,782	1,153	-
AQ8	-	-	888	498	-
AQ9	-	-	-	560	25
AQ10 ⁽¹⁾	-	-	26,730	-	-
Accruing past due ⁽²⁾	-	-	6,827	-	-
Non-accrual ⁽³⁾	-	-	7,600	-	-
Impairment provisions	-	-	(2,577)	-	-
Total	229	1,384,668	660,235	112,769	17,066

(1) Balances included in this band represent potential problem loans and other non-performing loans. Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment loss is expected. Non-performing loans are loans classified as Risk elements in lending. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

(2) Accruing past due balances represent Loans and advances to customers which are past due but no impairment loss is expected as disclosed in note 9.

(3) Non-accrual balances represent Loans and advances to customers that are impaired as disclosed in note 9. Impaired loans are all loans for which impairment provision has been established.

(4) The AQ7 banding has increased pending the completion of final credit grading of a number of new clients.

Collateral and other credit enhancements received

Within its secured portfolios, the Company has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to the Company arising from the failure of a customer or counterparty to meet their obligations. These include: cash deposits; charges over residential and commercial property, debt securities, equity shares and other financial collateral; and third-party guarantees. The existence of collateral may affect the pricing of a facility and its regulatory capital requirement. When a collateralised financial asset becomes impaired, the impairment charge directly reflects the realisable value of collateral and any other credit enhancements.

Retail exposures

All borrowing applications, whether secured or not, are subject to appropriate credit risk underwriting processes including an assessment of affordability and sources of repayment. Pricing is typically higher on unsecured than secured loans.

The value of a property intended to secure a mortgage is assessed during the loan underwriting process using industry-standard methodologies. Property values supporting home equity lending reflect individual appraisal valuations unless the lending value is very low.

The existence of collateral has an impact on provisioning levels. Once a secured loan is classified as non-performing, the realisable net present value of the underlying collateral allowing for the costs associated with repossession are used to estimate the provision required.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17 Risk management (continued)

Retail exposures (continued)

The tables below show period-end weighted LTVs for the Company's residential mortgage portfolio split between performing and non-performing.

	2017 £'000	2016 £'000
Non-performing residential mortgages by average loan to value (LTV)		
<70%	8,527	5,928
>70% and ≤90%	1,878	1,890
>90% and ≤110%	737	-
Total	11,142	7,818
Total non-performing portfolio average by LTV	59.3%	62.3%
Other mortgages	-	93
Total	11,142	7,911
	2017 £'000	2016 £'000
Performing residential mortgages by average loan to value (LTV)		
<70%	378,073	326,471
>70% and ≤90%	131,775	93,008
>90% and ≤110%	4,734	5,858
>110% and ≤130%	-	-
>130%	-	954
Total	514,582	426,291
Total performing portfolio average by LTV	57.0%	55.4%
Other mortgages	6,457	2,377
Total	521,039	428,668

Commercial exposures

The type of collateral taken by the Company's commercial businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- **Physical assets:** These include business assets such as stock, plant and machinery and vehicles. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.
- **Real estate:** The Company takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically be at a discount to the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer.
- **Receivables:** When taking a charge over receivables, the Company assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.
- **Other assets:** When taking a mortgage debenture, the Company can capture intangible asset values such as the future value of cash flow arising from the collection of intellectual property rights, royalties, licence fees, debtors etc.

The security charges may be floating or fixed, with the type of security likely to impact (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

The Company does not recognise certain asset classes as collateral: for example, short-leasehold property and equity shares of the borrowing company. Collateral with value that is correlated to the status of the obligor is assessed on a case-by-case basis and, where necessary, additional collateral may be required.

The Company uses industry-standard loan and security documentation wherever possible. Non-standard documentation is typically prepared by external lawyers on a case-by-case basis. The Company's business and credit teams are supported by an in-house specialist legal team.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

17. Risk management (continued)

Commercial exposures (continued)

The existence of collateral has an impact on provisioning. Where the Company no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net present value of the realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

The following tables show year end loan-to-value (LTV) for part of the Company's book. Commercial real estate mortgages represent the largest product type within Commercial exposures and the largest portion of the non-performing book. Non-performing loans represent loans where no interest payments or principal repayments are being received by the Company. The remaining elements not shown are corporate lending of £13m (2016: £30m) and non-mortgage retail lending of £128m (2016: £153m).

	2017		2016	
	Performing	Non-performing	Performing	Non-performing
Commercial real estate by average loan to value (LTV)	£'000	£'000	£'000	£'000
<70%	29,488	1,011	27,751	2,510
>70% and <=90%	1,772	2,499	2,032	4,184
>90% and <=110%	-	-	-	730
>110%	638	-	634	1,592
Total with LTVs	31,898	3,510	30,417	9,016
Unsecured	-	-	2,619	272
Total book	31,898	3,510	33,036	9,288
Total portfolio weighted average LTV	55.0%	76.4%	52.0%	86.8%

	2017		2016	
	Loans	Provisions	Loans	Provisions
Non-performing corporate loans (excluding commercial real estate)	£'000	£'000	£'000	£'000
Secured	1,162	61	980	83
Unsecured	37	37	27	27

Regulatory risk

Regulatory risk is the risk of material loss or liability, legal or regulatory sanctions, or reputational damage, resulting from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards in which the Bank operates.

The Company believes that maintaining a strong regulatory risk framework is fundamental to ensuring sustainable growth, building its reputation and maintaining stakeholder confidence. Accordingly, the Company's stated regulatory risk and compliance risk appetite is for no material or widespread breaches of rules, expectations, regulations or laws, individually or in aggregate. However, it also recognises that genuine errors occur, and so the Company accepts limited, non-material regulatory risk in line with appetite.

The Company manages regulatory risk under the 'Three Lines of Defence' model in line with RBS. This model defines responsibilities and accountabilities in accordance with the following principles:

- The business units (including business areas and support functions) are the first 'Line of Defence'. They are accountable for owning and managing, within a defined risk appetite, the risks which exist in their business area;
- Independent monitoring and control functions are the second 'Line of Defence'. They are accountable for owning and developing the risk and control frameworks and tools which the business uses to discharge its responsibilities; and
- RBS Internal Audit and an independent Credit Quality Assurance function is the third 'Line of Defence' and provide independent assurance over the key risks to the organisation, which includes an assessment of the entire control framework.

NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2017***17. Risk management (continued)****Conduct risk**

Conduct risk is the risk that the behaviour of the Company and its staff towards its customers, or in the markets in which it operates, leads to unfair or inappropriate customer outcomes and can result in reputational damage, financial loss or both. The damage or loss may be the result of breaches of regulatory rules or laws, or of failing to meet customers' or regulators' expectations.

Conduct risk exists across all stages of the Company's relationships with its customers, from the development of its business strategies, through governance arrangements, to post-sales processes. The activities through which conduct risk may arise are varied and include product design, marketing and sales, complaint handling, staff training and handling of confidential Insider Information. Conduct risk also exists if the Company does not take effective action to prevent fraud, bribery and money laundering.

The Conduct Risk Appetite Framework was established in 2015 and continued to be embedded across the Company during 2017. Key elements included:

- Migration to simpler, principle-based policies with accountable executives identified and roles, accountabilities and responsibilities defined;
- Roll-out of RBS-wide policies, processes and strategic systems to identify and manage conflicts of interest better;
- Enhancement of the RBS-wide surveillance programme;
- Significant investment in anti-money laundering controls, governance and training.

Aligned with the customer-focused vision to be the leading UK bank for trust, customer service and advocacy by 2020, Risk and Conduct provides trusted advice and challenge to the business, supporting sustainable growth, protecting customers and standing up for fairness. The Company continued to embed the conduct risk appetite framework in 2017. The framework ensures that conduct risk exposures are understood and managed in accordance with agreed risk appetite. The Company's conduct risk appetite is based on its strategic risk objectives, with quantitative targets supplemented by qualitative criteria focused on attaining good customer outcomes, upholding market integrity, meeting stakeholder expectations and promoting a strong risk culture. Whilst the Company took provisions in respect of conduct and litigation this year, these relate to legacy matters, which are not expected to recur. This includes those in relation to cases where the Company have provided investment advice to some of its customers.

The Risk and Conduct function, reporting into the Chief Risk and Conduct officer, is responsible for setting the Company wide conduct and compliance policy and standards, providing relevant, accurate and timely conduct, compliance and financial crime advice and guidance to the business and ensuring controls are effective for managing regulatory affairs, compliance, conduct and financial crime risks across RBS.

Risk and Conduct ensures appropriate reporting of all material regulatory reviews and other regulatory developments worldwide to the appropriate Company committees, including the Board, the Audit Committee, and the Risk Committee.

The level of regulatory risk remained high during 2017, as policymakers and regulators continued to strengthen regulation and supervision.

Reputational risk

Currently the Company manages reputational risk through a number of functions principally being Risk and Conduct and legal but also including those such as the Communications & Corporate Services division.

At an RBS level there is an RBS Sustainability management function and also an Environmental, Social and Ethical (ESE) Risk management function. This latter function is responsible for assessing ESE risks associated with business engagements and divisions. The risk is viewed as material given the key nature of the Company's market reputation in achieving its strategic risk objectives.

NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2017***17 Risk management (continued)****Concentration risk**

Four formal frameworks are used to manage credit concentration risk. These are Product/Asset class, Sector, Single Name and Country concentration risks.

Frameworks are maintained at an RBS Group level to ensure that the risk of an outsized loss due to concentration to a particular borrower, sector, product type or country remains within appetite. The credit frameworks are aligned to the RBS Group's risk appetite framework.

The Company uses a product and asset class framework to control credit risk for its Personal businesses. The framework sets limits that measure and control the quality of both existing and new business for each relevant franchise or segment. These risks and the limits set associated with them are assessed for appropriateness on a regular basis.

The Company operates in the UK private banking sector and the directors consider this a single class of business.

The nature of the business is supplying lending services, amongst other services to high net worth individuals, thus the most significant concentration risk is credit risk. Please refer to the credit risk section within this note.

Anti-Money Laundering

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

Operational risk

Operational risks are inherent in the Company's business. Operational risk losses occur as the result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour or from external events. The Company is highly dependent on its information technology systems and has been and will continue to be subject to cyber attacks which could expose the Company to loss of customer data or other sensitive information and combined with other failures of the Company's information technology systems could hinder its ability to service its clients which could result in long-term damage to the Company's business and brand. The key mitigating processes and controls include risk and control assessment, scenario analysis, loss data collection, new product approval process, key risk indicators, notifiable events process and the self certification process. The implementation of these processes and controls is facilitated and overseen by operational risk teams, with internal audit providing independent evaluation of the control framework.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

18. Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding as at 31 December 2017. Although the Company is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Company's expectation of future losses.

	2017 £'000	2016 £'000
Contingent liabilities:		
Guarantees and assets pledged as collateral security:		
Guarantees and irrevocable letters of credit	14,162	17,066
Total contingent liabilities	14,162	17,066
Commitments:		
Undrawn formal standby facilities, credit lines and other commitments to lend:-		
Less than one year	57,608	56,128
One year and above	48,149	56,641
Total commitments	105,757	112,769

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Company's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table. These commitments and contingent obligations are subject to the Company's normal credit approval processes and any potential loss is taken into account in assessing provisions for bad and doubtful debts in accordance with the Company's provisioning policy.

Commitments

Commitments to lend – under a loan commitment the Company agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines and unutilised overdraft facilities.

Contingent liabilities

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

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

Additional contingent liabilities arise in the normal course of the Company's business. It is not anticipated that any material loss will arise from these transactions.

Litigation

As a participant in the financial services industry, the Company operates in a highly regulated environment. At any moment in time it is likely that the Company will be involved in investigations and disputes. Such matters are subject to many uncertainties and their outcome is often difficult to predict, particularly in the early stages. The directors of the Company have reviewed these actual, threatened and known potential claims and proceedings and, after consulting with the relevant legal advisers are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Company's consolidated net assets, results of operations or cash flows.

The Company records a provision for a liability in relation to such matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

18. Memorandum items (continued)

Litigation (continued)

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the proceedings and investigations or as a result of adverse impacts or restrictions on the Company's reputation, business and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The Company cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

There are situations where the Company may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which the Company believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the Company has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

An increase in obligations to support pension schemes

The value of pension scheme assets may not be adequate to fund pension scheme liabilities. The actuarially determined obligations in the RBS Group pension scheme may therefore increase, requiring the bank to increase its current and future cash contributions. Depending on the economic and monetary conditions and longevity of scheme members prevailing at that time, the funding requirements may increase at subsequent valuations.

The Financial Service Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the FCA (Financial Conduct Authority). In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

Capital Support Deed

The Company, together with other members of RBS, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Company may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Company's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Company may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Company from other parties to the CSD becomes immediately repayable, such repayment being limited to the Company's available resources.

19. Changes in operating assets and liabilities

	2017 £'000	2016 £'000
Increase in loans and advances to banks and customers	(127,198)	(50,922)
Decrease/(increase) in prepayments, accrued income and other assets	3,435	(1,468)
Changes in operating assets	(123,763)	(52,390)
Increase in deposits by banks and customers	141,855	141,562
Increase/(decrease) in accruals, deferred income and other liabilities	16,791	(9,722)
Changes in operating liabilities	158,646	131,840
Changes in operating assets and liabilities	34,883	79,450

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

20. Interest received and paid

	2017 £'000	2016 £'000
Interest received	28,078	30,352
Interest paid	(3,895)	(5,840)
	24,183	24,512

21. Analysis of cash and cash equivalents

	2017 £'000	2016 £'000
At 1 January		
Cash	229	377
Cash equivalents	914,650	821,440
	914,879	821,817
Net cash inflow	21,840	75,965
Effect of exchange rate changes on cash and cash equivalents	(8,803)	17,097
At 31 December	927,916	914,879
Comprising:		
Cash and balances at central banks	109	229
Loans and advances to banks	927,807	914,650

22. Divisional analysis

The Company operates in the private banking sector, with 100% of business derived in the United Kingdom.

The directors consider private banking a single class of business.

23. Transactions with directors

For the purposes of IAS 24 'Related Party Disclosure', Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Key management comprise directors of the Company and members of the Executive Committee. As at 31 December 2017, the aggregate amounts outstanding in relation to the transactions, arrangements and agreements entered into by the Company in relation to loans to directors, including connected persons, or officers of the Company is nil (2016: £nil).

24. Related parties

UK Government

The UK Government through HM Treasury is the ultimate controlling party of The Royal Bank of Scotland Group plc. Its shareholding is managed by UK Financial Investments Limited, a company it wholly-owns and as a result, the UK Government and UK Government controlled bodies are related parties of the Company.

Transactions between the company, the UK Government and UK Government controlled bodies, consisted solely of Corporation Tax and Value Added Tax.

Group undertakings

The Company's ultimate holding company is The Royal Bank of Scotland Group plc, and its immediate parent company is NatWest Holdings Limited. Both companies are incorporated in the UK and registered in Scotland.

As at 31 December 2017, the Company has been consolidated into The Royal Bank of Scotland Group plc. Copies of the consolidated financial statements may be obtained from Corporate Governance and Regulatory Affairs, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

24. Related parties (continued)

(a) Directors and key managers

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

(b) Compensation of key management

The aggregate remuneration of the directors and executive committee key management during the year was as follows:

	2017 £'000	2016 £'000
Short term benefits	524	561
Post-employment benefits	84	80
Long term benefits ⁽¹⁾	217	47
	825	688

(1) Long term benefits consists of Long Term Incentive Plans (LTIPs)

(c) Related party transactions

	2017 £'000	2016 £'000
Assets		
Loans and advances:		
Parent companies	1,476,930	1,373,199
Other related parties, including fellow subsidiaries	-	1,711
	1,476,930	1,374,910
Liabilities		
Deposit by banks:		
Parent companies	261	-
Other related parties, including fellow subsidiaries	51,648	95,323
	51,909	95,323
Other liabilities, accruals and deferred income:		
Parent companies	1,234	1,631
Other related parties, including fellow subsidiaries	1,632	965
	2,866	2,596
Total liabilities	54,775	97,919

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2017

24. Related parties (continued)

	2017 £'000	2016 £'000
Income		
Interest receivable:		
Parent companies	8,764	9,806
Other related parties, including fellow subsidiaries	-	479
	8,764	10,285
Interest payable:		
Parent companies	-	(1)
Other related parties, including fellow subsidiaries	(1,038)	(1,557)
	(1,038)	(1,558)
Total income	7,726	8,727
Expenses		
Operating expenses:		
Parent companies	6,557	7,232
Other related parties, including fellow subsidiaries	7,215	7,103
Total expenses	13,772	14,335

25. Post balance sheet events

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

26. Capital resources (unaudited)

The following table analyses the Company's regulatory capital resources at 31 December :

	Unaudited ⁽¹⁾ 2017 £'000	Unaudited ⁽¹⁾ 2016 £'000
Tier 1:		
Shareholders' equity	86,046	82,740
Deductions:		
Other regulatory adjustments	(2,947)	(5,952)
Total Tier 1 capital	83,099	76,788
Risk weighted assets by risk		
Credit risk	377,774	395,434
Market risk	205	241
Operational risk	67,168	66,736
Total risk weighted assets	445,147	462,411
Key capital ratios ⁽²⁾		
Tier 1	18.7%	16.6%
Total capital	18.7%	16.6%

(1) The capital metrics included in the above table have not been audited for the financial years ended 31 December 2017 and 31 December 2016.

(2) Key capital ratios represent capital as a proportion of risk weighted assets.