

Company Registered Number: 2304

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS

31 December 2016

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

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THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

BOARD OF DIRECTORS AND SECRETARY

DIRECTORS: Louis Philip Chetwynd Taylor (Chairman)
Stephen John Camm
Lynn Ann Cleary
Andrew Martin McLaughlin
Stephen James Reilly

SECRETARY: Christopher Ian Nicol

REGISTERED OFFICE: Royal Bank House
71 Bath Street
St Helier
Jersey
JE4 8PJ

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

REPORT OF THE DIRECTORS

The directors of The Royal Bank of Scotland International Limited ("the Company") present their report, together with the audited financial statements of the Company for the year ended 31 December 2016. The financial statements are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

ACTIVITIES AND BUSINESS REVIEW

Principal activities

The main activity of the Company is the provision of banking services, including the taking of deposits and lending.

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

Business review

The Company's financial performance is presented in the Income Statement on page 6.

The operating profit before tax for the year was £247m (2015: £216m).

Other matters

The Company's principal business activities are banking services including the taking of deposits and lending in the Channel Islands, Isle of Man and Gibraltar. Deposits not used to provide third party lending are placed with fellow subsidiaries of The Royal Bank of Scotland Group plc ("RBS"). The financial position of these, and hence ultimate recoverability of these placements, is a key exposure of the Company.

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 within the Accounting policies.

Risk management

The prevailing market and economic conditions pose risks for the Company. These include the level of defaults from customers on outstanding advances as well as the degree of uncertainty in the valuation of other financial assets and liabilities. The financial position of the Company, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 6 and 16 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 hedging activities and its exposures to credit and liquidity risks.

The Board has delegated its authority for day-to-day risk management to the executive management sitting on committees as detailed in note 16. The Board approves any changes in inter-bank lending lines and in limits governing currency and interest rate exposures. The Board policy is not to enter into derivative transactions for trading purposes, but to undertake such contracts to hedge or reduce the volatility in interest income and foreign exchange. The Company's actual derivative transactions are outlined in note 11 to these financial statements. Further details of the Company's risk management policies are highlighted in note 16 to the financial statements.

Outlook

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

The purpose of this report is to provide information to the members of the Company and it is addressed to them as such. Forward looking statements by their nature involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such statements.

GOING CONCERN

The Company's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the Business Review. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, notes 6 and 16 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 hedging activities; and its exposures to credit risk and liquidity risk.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

REPORT OF THE DIRECTORS

GOING CONCERN (continued)

The directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the Report of the Directors and the financial statements.

REGULATION

The Company is licensed under the Financial Services (Jersey) Law 1998 to conduct deposit taker business, fund services business, general insurance mediation business, investment business and money services business, under classes A, B, C, Q, X, Z, DC and 02 of this law. The Company operates in different jurisdictions through its branches and is subject to the following laws and regulations:

Guernsey

- Banking Supervision (Bailiwick of Guernsey) Law 1994;
- Protection of Investors (Bailiwick of Guernsey) Law 1987;
- The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law 2002;
- The Banking Deposit Compensation Scheme (Liability of Participants to Compensation Levy) (Bailiwick of Guernsey) Regulations 2010.

Isle of Man

- Financial Services Act 2008.

Gibraltar

- Banking Act 1992;
- Financial Services (Markets in Financial Instruments) Act 2006.

DIRECTORS AND SECRETARY

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

From 1 January 2016 to date, the following changes have taken place:

	Appointed	Resigned
Directors		
Michael John Morley	-	31 January 2017

STAFF

The directors wish to thank all the management and staff for the contribution made by them towards achieving these results.

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 AGM.

By order of the Board:



Andrew Martin McLaughlin
Director



Lynn Ann Cleary
Director

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

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

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

The directors are also responsible for compliance with the Banking Business (Jersey) Law 1991, the Financial Services (Jersey) Law 1998 and their Codes of Practice.

By order of the Board:



Andrew Martin McLaughlin
Director



Lynn Ann Cleary
Director

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

We have audited the financial statements of The Royal Bank of Scotland International Limited for the year ended 31 December 2016 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards.

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards;
- have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991;
- have been prepared in accordance with the requirements of the Banking Business (Jersey) Law 1991;
- have been prepared in accordance with the requirements of the Financial Services (Trust and Company and Investment Business (Accounts, Audits and Reports)) (Jersey) Order 2007;
- have been prepared in accordance with the requirements of the Financial Services (Fund Services Business (Accounts, Audits and Reports)) (Jersey) Order 2007; and
- have been prepared in accordance with the requirements of the Financial Services (General Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005.

Matters on which we are required to report by exception

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

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



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

20 February 2017

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

INCOME STATEMENT *for the year ended 31 December 2016*

Continuing operations	Notes	2016 £m	2015 £m
Interest receivable		331	332
Interest payable		(33)	(69)
Net interest income	1	298	263
Fees and commission receivable		80	77
Fees and commission payable		-	(1)
Other operating income	2	7	11
Non-Interest income		87	87
Total income		385	350
Operating expenses	3	(136)	(133)
Operating profit before impairment loss		249	217
Impairment	7	(2)	(1)
Operating profit before tax		247	216
Tax charge	5	(25)	(22)
Profit for the year		222	194

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED**STATEMENT OF COMPREHENSIVE INCOME** *for the year ended 31 December 2016*

	Notes	2016 £m	2015 £m
Profit for the year		222	194
Items that will not be reclassified subsequently to profit or loss:			
Actuarial (losses)/gains on defined pension schemes	4	(52)	8
Deferred taxation on actuarial movements on defined benefit pension schemes	13	(3)	(1)
Other comprehensive (losses)/gains for the year after tax		(55)	7
Total comprehensive income for the year		167	201

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

BALANCE SHEET as at 31 December 2016

	Notes	2016 £m	2015 £m
Assets			
Cash and balances at central banks	6	44	54
Loans and advances to banks	6	16,912	16,817
Loans and advances to customers	6	7,254	5,689
Derivatives	6,11	51	22
Property, plant and equipment	6,9	35	36
Intangible assets	6,10	10	1
Prepayments, accrued income and other assets	6	6	4
Deferred tax assets	6,13	-	3
Total assets		24,312	22,626
Liabilities			
Deposits by banks	6	247	704
Customer accounts	6	21,900	19,920
Derivatives	6,11	52	23
Accruals, deferred income and other liabilities	6,12	61	62
Current tax	6	17	14
Deferred tax liabilities	6,13	1	-
Retirement benefit liabilities	4,6	2	38
Total liabilities		22,280	20,761
Equity			
Shareholders' equity:			
Called up share capital	14	97	97
Reserves		1,935	1,768
Total equity	6	2,032	1,865
Total liabilities and equity		24,312	22,626

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

The financial statements were approved and authorised for issue by the Board of Directors on ~~17 Feb 2017~~ and signed on its behalf by:



Andrew Martin McLaughlin
Director



Lynn Ann Cleary
Director

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

STATEMENT OF CHANGES IN EQUITY for the year ended 31 December 2016

	Notes	2016 £m	2015 £m
Called up share capital			
At 1 January and 31 December		97	97
Share premium			
At 1 January and 31 December		5	5
Retained earnings			
At 1 January		1,763	1,562
Actuarial (losses)/gains recognised in defined benefit schemes	4	(52)	8
Deferred taxation on actuarial movements recognised in defined benefit schemes	13	(3)	(1)
Profit for the year		222	194
At 31 December		1,930	1,763
Shareholders' equity at 31 December		2,032	1,865

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED
CASH FLOW STATEMENT *for the year ended 31 December 2016*

	Notes	2016 £m	2015 £m
Operating activities			
Operating profit for the year before tax	18	247	216
Adjustments for:			
Pension charge for defined benefit schemes	4	5	9
Cash contribution to defined benefit pension schemes	4	(93)	(17)
Gain on sale of assets		(2)	(3)
Depreciation of property, plant and equipment	9	7	7
Loan impairment provisions net of recoveries		(3)	(28)
Other non-cash items		(28)	12
Net cash inflows from trading activities		133	196
Changes in operating assets and liabilities	18	(151)	(115)
Net cash flows from operating activities before tax		(18)	81
Tax paid	18	(19)	(25)
Net cash flows from operating activities		(37)	56
Investing activities			
Purchases of property, plant and equipment	9	(10)	(3)
Proceeds on disposal of property, plant and equipment		7	5
Purchase of intangible assets	10	(10)	-
Net cash flows from investing activities		(13)	2
Effect of exchange rate changes on cash and cash equivalents		27	(11)
Net increase in cash and cash equivalents		(23)	47
Cash and cash equivalents 1 January		206	159
Cash and cash equivalents 31 December	19	183	206

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

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).

The financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: financial assets and financial liabilities designated at fair value through profit or loss, equity shares, available-for-sale financial assets and derivative financial instruments. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

The Company is incorporated and registered in Jersey, Channel Islands.

The Company adopted a number of new and revised IFRS effective 1 January 2016:

IAS 19 'Defined Benefit Plans: Employee Contributions' was issued in November 2013. This amendment distinguishes the accounting for employee contributions that are related to service from that for those that are independent of service.

Annual Improvements to IFRS 2010-2012 and 2011-2013 cycles were issued in December 2013 making a number of minor amendments to IFRS.

The implementation of these requirements has not had a material effect on the Company's financial statements.

2. Consolidated financial statements

The financial statements contain information about the Company as an individual company and do not contain consolidated financial information as the parent of a group. The Company is exempt under IFRS 10 'Consolidated Financial Statements' from the requirement to prepare consolidated financial statements as the Company and its subsidiaries are included by full consolidation in the IFRS consolidated financial statements of its ultimate holding company, The Royal Bank of Scotland Group plc, a company registered in Scotland.

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities other than those at fair value through profit or loss is 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. Calculation of the effective interest rate takes into account fees payable or receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities designated as fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in the income statement.

Commitment and utilisation fees are determined as a percentage of the facility. These fees are deferred and included in the effective interest rate on the advance. If it is unlikely that a specific lending arrangement will be entered into, such fees are recognised in the income statement over the life of the facility.

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. 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 period end for services provided but not charged.

Investment management fees: 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 an expense as the related revenue is recognised.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

4. Pensions and other post-retirement benefits

The Company provides post-retirement benefits in the form of pensions to eligible employees.

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

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

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

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

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

In 2015, the Company voluntarily changed its accounting policy for the recognition of the surpluses in its defined benefit pension schemes: in particular, the policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. Where the Company has a right to a refund, this is not deemed unconditional if pension fund trustees can use a scheme surplus to enhance benefits for plan members. As a result of this change, a minimum funding requirement to cover an existing shortfall in a scheme may give rise to an additional liability and surpluses may not be recognised in full. The revised accounting policy, by taking account of the powers of pension trustees in assessing the economic benefit available as a refund, provides more relevant information about effect on the Company's financial position of its defined pension benefit schemes.

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

5. Property, plant and equipment

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

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives.

The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated. The estimated useful lives are as follows:

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

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

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

6. Intangible assets

Intangible assets acquired by the Company are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	5 years
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Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

7. Impairment of intangible assets and property, plant and equipment

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

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

8. 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 recognised in the income statement except for differences arising on financial liabilities hedging net investments in foreign operations. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into Sterling at foreign exchange rates ruling at the dates the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in the income statement except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in other comprehensive income unless the asset is the hedged item in a fair value hedge.

9. Leases

As lessor

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

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

Rental income from operating leases is recognised in income on a receivable basis over the term of the lease. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

9. Leases (continued)

As lessee

Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the term of the relevant lease.

10. 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.

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. When the Company vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

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

11. Tax

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

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, taking into account relief for overseas tax where appropriate.

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 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.

12. Financial assets

On initial recognition financial assets are classified into 'designated at fair value through profit or loss'; 'loans and receivables' or 'available-for-sale' financial assets.

Designated at fair value through profit or loss – financial assets may be designated as at fair value through profit or loss only if such designation: (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Company manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial assets and liabilities that the Company designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in the income statement and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in the income statement as they arise.

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 classified as available-for-sale or designated as at 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 less any impairment losses.

ACCOUNTING POLICIES

12. Financial assets (continued)

Available-for-sale - financial assets that are not classified as loans and receivables or designated at fair value through profit or loss are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of monetary available-for-sale financial assets denominated in a foreign currency are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy 3). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

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 multiplied by 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.

13. 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, available-for-sale or 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.

Impairment losses are assessed individually for financial assets that are individually significant. Future cash flows from these financial assets are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in the income statement 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 period, 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. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write 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 period in which they are received.

Financial assets carried at fair value – when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through the income statement, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

For certain categories of financial assets, such as credit facilities, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of credit facilities could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

14. Financial liabilities

On initial recognition financial liabilities are classified into designated at fair value through profit or loss or 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.

Designated at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Company manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Company designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in the income statement and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in the income statement as they arise.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 3).

Fair value - fair value for a net open position in a financial liability that is quoted in an active market is the current offer price multiplied by the number of units of the instrument held or issued. Fair values for financial liabilities 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 liabilities.

15. Derecognition

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

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

16. Netting

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

17. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value through the income statement.

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

The Company enters into one type of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges).

ACCOUNTING POLICIES

17. Derivatives and hedging (continued)

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

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

18. Cash and cash equivalents

Cash and cash equivalents comprise cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

19. Investment in group undertakings

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

20. Assets under administration

Assets and liabilities held in a fiduciary capacity are not included in these financial statements.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

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. 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 'Conceptual Framework for Financial Reporting'.

The judgements and assumptions involved in the Company's accounting policies that are considered by the Board of Directors 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 provides for losses existing in its lending book so as to state its loan portfolio at its expected ultimate net recoverable value.

Individual assessment of loans and advances comprise a review of the financial condition of the borrower and any guarantor and takes into account the customer's debt capacity and financial flexibility; the level and quality of earnings; the amount and sources of cash flows; the industry in which the customer operates; and the realisable value of any security held. The most significant estimates that affect the quantum of any specific provision are the amounts and timing of receipts from the borrower or recoveries from any security held.

All provisions are quantified on an effective interest rate basis so that the loan will yield a consistent return over its expected remaining life. The discounting required in the calculation of a provision is included in the initial charge; the discount unwinds through interest receivable in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

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 the performing portfolio before it is identified and reported as such, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life.

At 31 December 2016, gross impaired loans and advances to customers totalled £16m (2015: £24m) and customer loan impairment provisions (excluding the latent provision) amounted to £8m (2015: £11m). The fair value of security held against the loans and advances to customers above amounted to £4m (2015: £12m).

Evaluating estimates of provisions involves significant judgement, as receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions. Additionally, the security may not be readily marketable.

The future credit quality of the Company's lending book is subject to uncertainties that could cause actual credit losses to differ materially from reported loan loss provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends and changes in the Company's portfolios.

Pensions

The Company operates a pension scheme: The Royal Bank of Scotland International Pension Trust ("RBSIPT"). The assets of the defined benefit scheme are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit credit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any surplus or deficit of scheme assets over liabilities is recognised on the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increase, earnings growth and the longevity of scheme members. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised on the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Company's pensions scheme is set out in note 4 to the financial statements, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension liability of £2m was recognised on the balance sheet at 31 December 2016 (2015: £38m).

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

Critical accounting policies and key sources of estimation uncertainty (continued)

Provisions for liabilities

As set out in note 12, at 31 December 2016 the Company recognised provisions for liabilities totalling £14m (2015: £18m). Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Company can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates.

Financial assets carried at fair value include advances to banks, asset backed and corporate debt obligations, corporate equity shares and derivatives. Financial liabilities carried at fair value include deposits and derivatives. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Where observable prices are not available, fair value is based on appropriate valuation techniques.

The Company's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. The fair value of over-the-counter instruments is derived from pricing models, which take account of contract terms, including maturity, as well as quoted market parameters such as interest rates and volatilities. Most of the Company's pricing models do not entail material subjectivity because the methodologies utilised do not incorporate significant judgement and the parameters included in the models can be calibrated to actively quoted market prices. Values established from pricing models are adjusted for credit risk, liquidity risk and future operational costs.

Deferred tax

The Company makes provision for deferred tax on short-term and other temporary differences where tax recognition occurs at a different time from accounting recognition. Tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future taxable profits against which the losses can be utilised.

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2016 that would affect Group from 1 January 2017 or later.

Effective for 2017

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities. The amendment is effective from 1 January 2017.

In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses. The amendment is effective from 1 January 2017.

Neither of these amendments is expected to have a material effect on the Group's financial statements.

Effective after 2017 – 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 Group is continuing its assessment of the standard's effect on its financial statements.

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.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

Accounting developments (continued)

Classification and measurement

Financial assets

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

- 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.
- 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.
- Other financial assets are measured at fair value through profit and 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 Group continues to evaluate the overall effect, but expects that the measurement basis of the majority of the Group'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 as 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.

Hedge accounting

Hedge accounting requirements are designed to align accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The basic mechanics of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework. The Group is actively considering its implementation approach.

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 lease receivables and 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 Group 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.

A single bank-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 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 are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

Accounting developments (continued)

IFRS 9

Attribute	IFRS 9	IAS 39	Regulatory
Default / credit impairment	<p>To determine the risk of a default occurring, management intends to apply a default definition that is consistent with the Basel/Regulatory definition of default.</p> <p>Assets that are defaulted will be shown as credit impaired. RBS intends to use 90 days past due as a consistent measure for default across all product classes.</p>	<p>Default aligned to loss events, by classing all financial assets for which an impairment event has taken place as nonperforming. Nonperforming assets are defined as those that have a 100% probability of default and an internal asset quality grade of AQ10.</p> <p>Impaired financial assets are those for which there is objective evidence that the amount or timing of future cash flows have been adversely impacted since initial recognition.</p>	<p>A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place:</p> <ul style="list-style-type: none"> - RBS considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; - the customer is past due more than 90 days. <p>For retail exposures, the definition of default may be applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.</p>
Probability of default (PD)	<p>PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.</p>	<p>PDs are used in the latent provision calculation.</p>	<p>The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.</p> <p>PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels.</p>
Significant increase in credit risk	<p>A framework is being established that incorporates both quantitative and qualitative measures and is aligned to RBS's current risk management framework. Decisions in relation to credit deterioration will be management decisions, subject to approval by governing bodies such as RBS Provisions Committee.</p> <p>The staging assessment requires a definition of when a significant increase in credit risk has occurred; this moves the loss calculation for financial assets from a 12 month horizon to a lifetime horizon. Management propose to establish an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined, these include the Risk of Credit Loss framework and binary triggers (examples includes the use of payday lending, forbearance and 30 days past due).</p> <p>In most cases, management expect an asset that has demonstrated a doubling of its lifetime probability of default would be considered to have a significant increase in credit risk.</p> <p>IFRS 9 includes an option that permits assets that are 'low risk' to be excluded from this assessment; RBS does not intend to apply this option.</p>	<p>Not applicable</p>	<p>Not applicable</p>

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

ACCOUNTING POLICIES

Accounting developments (continued)

<p>Forward-looking and multiple scenarios</p>	<p>The evaluation of future cash flows, the risk of default and impairment loss should take into account expectations of economic changes that are reasonable.</p> <p>More than one outcome should be considered to ensure that the resulting estimation of impairment is not biased towards a particular expectation of economic growth.</p> <p>Management have developed the default modelling capability for IFRS 9 to simulate multiple economic forecasts as part of the model outcomes for PD, LGD and exposure.</p>	<p>Financial asset carrying values based upon the expectation of future cash flows.</p>	<p>Follows financial accounting.</p>
<p>Loss given default (LGD)</p>	<p>LGD is a current assessment of the amount that will be recovered in the event of default, taking account of future conditions. It may occasionally equate to the regulatory view.</p>	<p>Regulatory LGD values are used for calculating collective and latent provisions.</p>	<p>An estimate of the amount that will not be recovered in the event of default, plus the cost of debt collection activities and the delay in cash recovery. LGD is a downturn based metric, representing a prudent view of recovery in adverse economic conditions.</p>
<p>Exposure at default (EAD)</p>	<p>EAD represents expected balance sheet exposure at default. It differs from the regulatory method as follows:</p> <ul style="list-style-type: none"> - it includes the effect of amortisation; - it caps exposure at the contractual limit. 	<p>EAD is assessed as the current drawn balance plus future committed drawdowns.</p>	<p>EAD models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.</p>
<p>Date of initial recognition (DOIR)</p>	<p>The reference date used to assess a significant increase in credit risk is as follows.</p> <p><i>Term lending:</i> the date the facility became available to the customer.</p> <p><i>Wholesale revolving products:</i> the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer.</p> <p><i>Retail Cards:</i> the account opening date or, if later, the date the card was subject to a regular 3-year review or the date of any subsequent limit increases.</p> <p><i>Current Accounts/ Overdrafts:</i> the account opening date or, if later, the date of initial granting of overdraft facility or of limit increases.</p>	<p>Not applicable for impairment but defined as the date when the entity becomes a party to the contractual provisions of the instrument.</p>	<p>Generally follows financial accounting.</p>
<p>Modification</p>	<p>A modification occurs when the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in derecognition. A modification requires immediate recognition in the income statement of any impact on the carrying value and EIR. Examples of modification events include forbearance and distressed restructuring. The financial impact is recognised in the income statement as an impairment release/(loss).</p>	<p>Modification is not separately defined but accounting impact arises as an EIR adjustment on changes that are not derecognition or impairment events.</p>	<p>Not applicable</p>

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ACCOUNTING POLICIES

Accounting developments (continued)

Assets	IAS 39			IFRS 9		
	AC(1)	FVTPL(2)	FVOCI(3)	AC(1)	FVTPL(2)	FVOCI(3)
Cash and balances at central banks						
Non held for trading	x			x		
Loans and advances to banks						
Held for trading		x			x	
Non held for trading	x			x		
Loans and advances to customers						
Held for trading		x			x	
Non held for trading	x	x		x	x	x
Debt securities						
Held for trading		x			x	
Non held for trading: Held to maturity	x			x		
Available-for-sale			x		x	x
Other	x	x		x	x	
Equity shares						
Held for trading		x			x	
Non held for trading		x	x		x	x
Settlement balances						
Non held for trading	x			x		
Derivatives						
Held for trading		x			x	

Notes:

- (1) Amortised cost
- (2) Fair value through profit and loss
- (3) Fair value other comprehensive income

Effective after 2017 – 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.

IFRS 16 Leases was issued in January 2016 to replace IAS 17 'Leases'. Accounting for finance leases will remain substantially the same. Operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. The effective date is 1 January 2019.

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

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

1. Net interest income

	2016 £m	2015 £m
Interest receivable from group undertakings	137	162
Loans and advances to customers	194	170
Interest receivable	331	332
Customer accounts	(26)	(60)
Interest payable to group undertakings	(7)	(9)
Interest payable	(33)	(69)
Net interest income	298	263

2. Other operating income

	2016 £m	2015 £m
Intercompany fees received	5	8
Gain on the sale of property, plant and equipment	2	3
Other operating income	7	11

3. Operating expenses

	2016 £m	2015 £m
Staff costs		
Wages, salaries and other staff costs	68	59
Provision for restructuring costs (see note 12)	1	1
Pension costs:		
- defined benefit schemes (see note 4)	5	9
- defined contribution schemes (see note 4)	1	1
- contributions to RBS operated pension schemes	2	1
	77	71
Other expenses		
Premises and equipment	19	13
Administration ⁽¹⁾	33	42
	52	55
Depreciation		
Property, plant and equipment depreciation (see note 9)	6	7
Intangible assets (see note 10)	1	-
	7	7
Operating expenses	136	133

(1) Administrative costs include provisions for possible product redress.

	2016 £'000	2015 £'000
Auditors' remuneration		
Statutory audit work	420	296
Regulatory audit work	44	59
	464	355

The average number of persons employed by the Company during the year, excluding temporary staff was 1,276 (2015: 1,176).

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

4. Pension costs

The Company made contributions of £1m to its own defined contribution schemes in 2016 (2015: £1m).

Eligible employees of the Company can participate in membership of RBS operated pension schemes. The principal defined benefit scheme in the UK 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 the RBS pension schemes is available in the RBS Annual Report and Accounts 2016.

The Company operates a defined benefit pension scheme (final salary), The Royal Bank of Scotland International Pension Trust ("RBSIPT"), the assets of which are independent of the Company's finances.

The Company's defined benefit scheme was closed to new entrants in 2006.

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

The RBSIPT's corporate trustee is RBS International Employees' Pension Trustees Limited ("RBSIEPTL"), a subsidiary of The Royal Bank of Scotland International (Holdings) Limited. RBSIEPTL is the legal owner of the RBSIPT's assets which are held separately from the assets of the Company. The Board of RBSIEPTL comprises two trustee directors nominated by members selected from eligible active staff and pensioner members who apply; three directors appointed by the Company; and one independent Trustee. The Board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Company, but who still have benefits in the scheme.

Full valuations of the Company's scheme are carried out every 3 years.

Interim valuations of the Company's scheme were prepared to 31 December 2016 by independent actuaries, using the following assumptions:

Principal actuarial assumptions at 31 December	2016	2015
Discount rate	2.70%	3.70%
Rate of increase in salaries	1.75%	1.75%
Rate of increase in pensions in payment	2.95%	2.80%
Inflation assumption	3.20%	2.95%

Discount rate

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

Major classes of plan assets as a percentage of total plan assets	2016	2015
Quoted assets		
Equities	34%	42%
Index-linked bonds	31%	22%
Corporate and other bonds	12%	15%
Government fixed interest bonds	13%	8%
Unquoted assets		
Hedge funds	2%	2%
Property	4%	5%
Derivatives	2%	3%
Other	2%	3%
	100%	100%

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

4. Pension costs (continued)

Post-retirement mortality assumptions	2016	2015
Longevity at age 60 for current pensioners (years)		
Males	29.1	29.0
Females	30.3	30.2
Longevity at age 60 for future pensioners currently ages 40 (years)		
Males	31.0	30.9
Females	32.3	32.2

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

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension liability £m
Changes in value of net pension liability			
At 1 January 2016	460	(498)	(38)
<i>Income statement:</i>			
Expected return	20	-	20
Interest cost	-	(19)	(19)
Current service cost	-	(5)	(5)
	20	(24)	(4)
<i>Statement of comprehensive income:</i>			
Actuarial losses due to experience gains	110	-	110
Actuarial gains due to changes in financial assumptions	-	(214)	(214)
Actuarial gains due to changes in demographic assumptions	-	52	52
	110	(162)	(52)
Contributions by employer	93	-	93
Benefits paid	(29)	29	-
Expenses paid	(1)	-	(1)
At 31 December 2016	653	(655)	(2)

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension liability £m
Changes in value of net pension liability			
At 1 January 2015	466	(519)	(53)
<i>Income statement:</i>			
Expected return	17	-	17
Interest cost	-	(18)	(18)
Current service cost	-	(8)	(8)
	17	(26)	(9)
<i>Statement of comprehensive income:</i>			
Actuarial gains due to experience gains	(15)	(8)	(23)
Actuarial losses due to changes in financial assumptions	-	28	28
Actuarial losses due to changes in demographic assumptions	-	3	3
	(15)	23	8
Contributions by employer	17	-	17
Benefits paid	(24)	24	-
Expenses paid	(1)	-	(1)
At 31 December 2015	460	(498)	(38)

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

4. Pension costs (continued)

Of the expense for the year, £4m (2015: £9m) has been included in the income statement within staff costs (see note 3).

The Company expects to contribute £4m to its defined benefit pension schemes in 2017.

The weighted average duration of the Company's defined benefit obligation is 26 years.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
History of defined benefit scheme					
Present value of defined benefit obligations	(655)	(498)	(519)	(419)	(386)
Fair value of plan assets	653	460	466	395	345
Net deficit	(2)	(38)	(53)	(24)	(41)
Experience (losses)/gains on plan liabilities	-	(8)	-	-	33
Experience (losses)/gains on plan assets	109	(15)	47	24	10
Actual return on pension scheme assets	128	2	66	40	28

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

	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2016	2015	2016	2015
	£m	£m	£m	£m
0.25% increase in the discount rate	(2)	(1)	(43)	(29)
0.25% increase in inflation	1	1	36	22
0.25% additional rate of increase in pensions in payment	1	1	28	19
0.25% additional rate of increase in deferred pensions	-	1	13	8
0.25% additional rate of increase in salaries	-	-	5	3
Longevity increase of one year	1	1	28	14

5. Taxation

	2016	2015
	£m	£m
Current taxation:		
Charge for the year	25	22
Tax charge for the year	25	22

The actual tax charge differs from the expected tax charge computed by applying the standard rate of income tax of 10% (2015: 10%) as follows:

	2016	2015
	£m	£m
Operating profit before tax	248	216
Expected tax charge	25	21
<i>Factors affecting the charge for the year:</i>		
Non-deductible items	4	1
Non-taxable items	(3)	-
Rate differences on current tax	(1)	-
Actual tax charge for the year	25	22

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

6. Financial instruments

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

	Financial instruments at fair value through profit or loss ⁽¹⁾	Available-for-sale	Loans and receivables ⁽²⁾	Other (amortised cost)	Other assets/liabilities	Total
	£m	£m	£m	£m	£m	£m
2016						
Assets						
Cash and balances at central banks	-	-	44	-	-	44
Loans and advances to banks ⁽³⁾	112	-	16,800	-	-	16,912
Loans and advances to customers	-	-	7,254	-	-	7,254
Derivatives	51	-	-	-	-	51
Other assets	-	-	-	-	51	51
	163	-	24,098	-	51	24,312
Liabilities						
Deposits by banks	-	-	-	247	-	247
Customer accounts ⁽⁴⁾	112	-	-	21,788	-	21,900
Derivatives	52	-	-	-	-	52
Other liabilities	-	-	-	-	79	79
Retirement benefit liabilities	-	-	-	-	2	2
	164	-	-	22,035	81	22,280
Equity						2,032
						24,312

	Financial instruments at fair value through profit or loss ⁽¹⁾	Available-for-sale	Loans and receivables ⁽²⁾	Other (amortised cost)	Other assets/liabilities	Total
	£m	£m	£m	£m	£m	£m
2015						
Assets						
Cash and balances at central banks	-	-	54	-	-	54
Loans and advances to banks ⁽³⁾	261	-	16,556	-	-	16,817
Loans and advances to customers	-	-	5,689	-	-	5,689
Derivatives	22	-	-	-	-	22
Other assets	-	-	-	-	44	44
	283	-	22,299	-	44	22,626
Liabilities						
Deposits by banks	-	-	-	704	-	704
Customer accounts ⁽⁴⁾	261	-	-	19,659	-	19,920
Derivatives	23	-	-	-	-	23
Other liabilities	-	-	-	-	76	76
Retirement benefit liabilities	-	-	-	-	38	38
	284	-	-	20,363	114	20,761
Equity						1,865
						22,626

⁽¹⁾ For the equity linked loans and deposits, the interest is based on the return of an underlying equity, which can be a single stock, basket of stocks, or an equity index. The value of the equity linked products will be based on the value of the underlying equity, time to maturity, volatility and interest rates.

⁽²⁾ Loans and receivables include cash and cash equivalents.

⁽³⁾ Items relating to the group

⁽⁴⁾ The carrying amount of other customer accounts designated as at fair value through profit or loss is £1 million (2015 - £1 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

6. Financial instruments (continued)

The following tables show the financial instruments carried at fair value on the Balance Sheet by valuation hierarchy - Level 1, Level 2 and Level 3:

	2016				2015			
	Level 1 ⁽¹⁾ £m	Level 2 ⁽²⁾ £m	Level 3 ⁽³⁾ £m	Total £m	Level 1 ⁽¹⁾ £m	Level 2 ⁽²⁾ £m	Level 3 ⁽³⁾ £m	Total £m
Assets								
Loans and advances to banks	-	112	-	112	-	261	-	261
Derivatives	42	9	-	51	14	8	-	22
Total	42	121	-	163	14	269	-	283
Liabilities								
Customer accounts	-	112	-	112	-	261	-	261
Derivatives	42	10	-	52	14	9	-	23
Total	42	122	-	164	14	270	-	284

(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:

- a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
- b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

Level 2 instruments include non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.

(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.

The following table shows the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost: all assets and liabilities carried at amortised cost on the balance sheet fall within level 3 of the valuation methodologies, as set out above.

	2016 Carrying value £m	2016 Fair value £m	2015 Carrying value £m	2015 Fair value £m
Financial assets				
Cash and balances at central banks	44	44	54	54
Loans and advances to banks				
Loans and receivables	16,800	16,800	16,556	16,556
Loans and advances to customers				
Loans and receivables	7,254	6,855	5,689	5,633
Financial liabilities				
Deposits by banks	247	247	704	704
Customer accounts	21,788	21,788	19,659	19,659

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

6. Financial instruments (continued)

Differences between the carrying value and the fair value of loans and receivables above relate specifically to certain advances that are at fixed interest rates and fixed maturity dates. There is no intention to break any of these advances prior to maturity and the difference between carrying value and fair value is never expected to be realised.

The fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgements covering repayments, credit risk and discount rates.

Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement. As a wide range of valuation techniques are available, it may be inappropriate to compare the Company's fair value information to independent markets or other financial institutions' fair values.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are set out below:

The fair value of financial instruments that are of short maturity (3 months or less) approximate their carrying value. This applies mainly to 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 and demand deposits.

The Company uses a number of methodologies to determine the fair values of financial instruments for which observable prices in active markets for identical instruments are not available. These techniques include: relative value methodologies based on observable prices for similar instruments; present value approaches where future cash flows from the asset or liability are estimated and then discounted using a risk-adjusted interest rate; option pricing models (such as Black-Scholes or binomial option pricing models) and simulation models such as Monte-Carlo.

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

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.
- Interest rates - these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.

Loans and advances to banks and customers

Fair value is estimated by grouping loans into homogeneous portfolios and applying a discount rate to the cash flows. The discount rate is based on the market rate applicable at the balance sheet date for a similar portfolio with similar maturity and credit risk characteristics.

Deposits by banks and customer accounts

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

Remaining maturity of financial assets and liabilities

2016	Less than 12 months £m	More than 12 months £m	Total £m
Assets			
Cash and balances at central banks	44	-	44
Loans and advances to banks	13,796	3,116	16,912
Loans and advances to customers	3,793	3,461	7,254
Derivatives	25	26	51
Liabilities			
Deposits by banks	247	-	247
Customer accounts	21,776	124	21,900
Derivatives	25	27	52

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

6. Financial instruments (continued)

Remaining maturity of financial assets and liabilities (continued)

2015	Less than 12 months £m	More than 12 months £m	Total £m
Assets			
Cash and balances at central bank	54	-	54
Loans and advances to banks	13,566	3,251	16,817
Loans and advances to customers	1,609	4,080	5,689
Derivatives	14	8	22
Liabilities			
Deposits by banks	704	-	704
Customer accounts	19,804	116	19,920
Derivatives	14	9	23

7. Financial assets - impairments

The following table shows analysis of impaired financial assets:

	2016			2015		
	Cost £m	Provision £m	Net book value £m	Cost £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and advances to customers	16	(8)	8	24	(11)	13

The above provision is with respect to the impaired book and excludes the latent provision.

The fair value of security held against these loans and advances to customers amounted to £3m (2015: £12m).

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

7. Financial assets - impairments (continued)

The following tables show the movement in the provision for impairment losses for loans and advances:

	Latent £m	Specific £m	Total £m
At 1 January 2016	1	11	12
Amounts written off	-	(5)	(5)
Charge to the income statement	1	1	2
Recoveries of amounts previously written off	-	-	-
Currency translation adjustment	-	1	1
At 31 December 2016	2	8	10

	Latent £m	Specific £m	Total £m
At 1 January 2015	2	37	39
Amounts written off	-	(29)	(29)
Charge to the income statement	(1)	2	1
Recoveries of amounts previously written off	-	1	1
At 31 December 2015	1	11	12

The following tables show an analysis of past due but not impaired:

	Past due 1–29 days £m	Past due 30–59 days £m	Past due 60–89 days £m	Past due more than 90 days £m	Total £m
2016					
Loans and advances to customers	27	6	3	10	46
2015					
Loans and advances to customers	34	7	1	7	49

The majority of the past due loans are fully secured.

8. Investments in group undertakings

	2016 £'000	2015 £'000
At 1 January and 31 December	-	12

At 31 December 2015, the following companies were the principal undertakings of the Company and were wholly owned:

Name of undertaking	Place of incorporation	Principal activity
Gosport Limited	Gibraltar	Investment holding
Rimford Corporation (wholly owned by Gosport Limited)	Delaware, USA	Property holding
Sotomar Limited	Gibraltar	Investment holding

All of the above undertakings were disposed off during the year.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

9. Property, plant and equipment

2016	Freehold Premises £m	Long leasehold premises £m	Computers and other equipment £m	Total £m
Cost:				
At 1 January	17	3	86	106
Additions	7	-	3	10
Disposals	(6)	-	-	(6)
At 31 December	18	3	89	110
Accumulated depreciation and amortisation:				
At 1 January	3	2	65	70
Disposals	-	-	(1)	(1)
Depreciation charge for the year	-	-	6	6
At 31 December	3	2	70	75
Net book value at 31 December 2016	15	1	19	35

2015	Freehold Premises £m	Long leasehold premises £m	Computers and other equipment £m	Total £m
Cost:				
At 1 January	19	3	86	108
Additions	1	-	2	3
Disposals	(3)	-	(2)	(5)
At 31 December	17	3	86	106
Accumulated depreciation and amortisation:				
At 1 January	3	2	61	66
Disposals	-	-	(3)	(3)
Depreciation charge for the year	-	-	7	7
At 31 December	3	2	65	70
Net book value at 31 December 2015	14	1	21	36

There are no differences in fair value of premises to the carrying value in current and prior year.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

10. Intangible assets

	Software development £m	Other intangibles £m	Total £m
2016			
Cost:			
At 1 January	1	-	1
Additions	4	6	10
Disposals	-	-	-
At 31 December	5	6	11
Amortisation:			
At 1 January	-	-	-
Disposals	-	-	-
Charge for the year	1	-	1
At 31 December	1	-	1
Net book value at 31 December 2016	4	6	10
2015			
Cost:			
At 1 January	1	-	1
Additions	-	-	-
Disposals	-	-	-
At 31 December	1	-	1
Amortisation:			
At 1 January	-	-	-
Disposals	-	-	-
Charge for the year	-	-	-
At 31 December	-	-	-
Net book value at 31 December 2015	1	-	1

The amortisation cost for the year was £645k (2015: £163k). The amortisation period for software development costs is 5 years. The amortisation is calculated using the straight line method.

11. Derivatives

The Company enters into various derivatives to manage year end foreign exchange and interest rate risks. Derivatives include swaps, forwards and options. They may be traded over-the-counter (OTC).

Swaps include currency swaps, interest rate swaps and equity and index swaps. A swap is an agreement to exchange cash flows in the future in accordance with a pre-arranged formula. Interest rate swap contracts generally involve exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts.

Forwards include forward foreign exchange contracts and forward rate agreements. A forward contract is a contract to buy or sell a specified amount of a physical or financial commodity, at an agreed price, on an agreed future date. Forward foreign exchange contracts are contracts for the delayed delivery of currency on a specified future date. Forward rate agreements are contracts under which two counterparties agree on the interest to be paid on a notional deposit of a specified maturity at a specific future date; there is no exchange of principal.

Options include OTC currency options, interest rate caps and floors and swap options. They are contracts that give the holder the right but not the obligation to buy or sell a specified amount of the underlying physical or financial commodity at an agreed price on an agreed date or over an agreed period.

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NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2016*

11. Derivatives (continued)

The Company enters into fair value hedges and hedges of net investments in foreign operations. Fair value hedges principally involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. The Company hedges its net investment in foreign operations with currency borrowings.

Included in the table below are derivatives entered into during the normal course of business with customers and other RBS companies.

	2016			2015		
	Notional amounts £m	Assets £m	Liabilities £m	Notional amounts £m	Assets £m	Liabilities £m
Exchange rate contracts						
Spots and forwards - RBS entities	1,602	27	35	1,234	11	7
Spots and forwards - third party	528	15	7	346	3	6
Currency swaps and options - RBS entities	-	-	-	5	-	-
Currency swaps and options - third party	4	-	-	5	-	-
Interest rate swaps						
RBS entities	38	9	10	93	8	8
Third party	-	-	-	30	-	1
Interest rate options						
RBS entities	-	-	-	50	-	1
Third party	-	-	-	50	-	-
	2,172	51	52	1,813	22	23

Included in the above are fair value hedge accounting derivatives as follows:

Spot forwards and futures	4					
Interest rate swaps	38	9	10	52	8	7

Gains and losses that have gone through the income statement in relation to interest rate swaps and fair value hedged items are as follows:

	2016 £m	2015 £m
Gains recognised on the hedge accounting interest rate swap	2	1
Losses recognised on the item being hedged	(2)	(1)

12. Accruals, deferred income and other liabilities

	2016 £m	2015 £m
Accruals and deferred income	47	44
Other liabilities	14	18
	61	62

Provisions of £14m (2015: £18m) are included in other liabilities.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

12. Accruals, deferred income and other liabilities (continued)

	Property (1) £m	Integrated restructuring (2) £m	Customer redress (3) £m	Total £m
At 1 January 2015	6	3	9	18
Charged to the income statement	-	1	8	9
Released during the year	(2)	-	-	(2)
Utilised in year	-	(3)	(4)	(7)
At 1 January 2016	4	1	13	18
Charged to the income statement	3	2	1	6
Released during the year	(2)	(1)	(4)	(7)
Utilised in year	-	(1)	(2)	(3)
At 31 December 2016	5	1	8	14

(1) Property provision

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

(2) Integrated restructuring provision

The Company has reviewed its organisational design and how it is managed to ensure it has the most effective and efficient cost base. To this end £2m has been charged in the year.

(3) Customer redress provision

The Company has provided for customer redress in relation to payment protection insurance, interest rate hedging products and other retail products.

13. Deferred taxation

	Pension £m	Accelerated capital allowances £m	Total £m
At 1 January 2015	5	(1)	4
Credit to other comprehensive income	(1)	-	(1)
At 1 January 2016	4	(1)	3
Charge to income statement	-	(1)	(1)
Credit to other comprehensive income	(3)	-	(3)
At 31 December 2016	1	(2)	(1)

Total deferred taxation is analysed as follows:

	2016 £m	2015 £m
Deferred taxation assets	-	3
Deferred taxation liabilities	(1)	-
	(1)	3

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14. Share capital

	Allotted, called up and fully paid		Authorised	
	31 December 2016	31 December 2015	2016	2015
	£m	£m	£m	£m
<i>Equity shares:</i>				
Ordinary shares of £1	97	97	300	300
Total share capital	97	97	300	300

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

15. Leases

The Company provides asset finance to its customers through acting as a lessor. It purchases plant and equipment, renting them to customers under lease agreements that, depending on their terms, qualify as either operating or financial leases.

Financial leases are set out in the table below:

Amounts receivable under non-cancellable leases:

Year in which receipt will occur:	Finance lease contracts					
	2016			2015		
	Gross amounts	Present value adjustments	Present value	Gross amounts	Present value adjustments	Present value
£m	£m	£m	£m	£m	£m	
Within 1 year	7	(1)	6	7	-	7
After 1 year but within 5 years	44	(9)	35	37	(7)	30
After 5 years	46	(22)	24	62	(29)	33
	97	(32)	65	106	(36)	70

Operating leases are set out in the table below:

Minimum amounts payable under non-cancellable leases:

Year in which payment will occur:	2016				2015			
	Within 1 year	After 1 year		Total	Within 1 year	After 1 year		Total
		but within 5 years	After 5 years			but within 5 years	After 5 years	
£m	£m	£m	£m	£m	£m	£m	£m	
<i>Operating lease obligations:</i>								
Premises	3	8	13	24	4	17	43	64

	2016	2015
	£m	£m
Amounts recognised as income and expense		
Operating lease payables – minimum payments	5	6

Residual value exposures

The unguaranteed residual values included in the carrying value of finance lease receivables (see above) and operating lease assets (2016: £1m, 2015: £1m) will be recovered after 5 years.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

16. Risk management

The major risks associated with The Royal Bank of Scotland International (Holdings) Limited and its subsidiaries (together the "Group") are market, liquidity, credit, regulatory, operational and pension risk. The Group has established a comprehensive framework for managing these risks which is continually evolving as the Group's business activities change in response to market, credit, product and other developments. The Company is a wholly owned subsidiary of The Royal Bank of Scotland International (Holdings) Limited.

As discussed in the Report of the Directors, the authority for day-to-day risk management has been delegated to the Investment Risk Committee ("IRC"), the Offshore Asset and Liability Committee ("ALCO"), the Executive Committee Offshore ("ExCo"), and the Offshore Audit Committee ("OAC").

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 Group's financial condition or results.

Market risk includes:

Interest rate risk

Interest rate risk arises as a result of timing differences on the re-pricing of assets and liabilities, unexpected changes in the slope and shape of the yield curves and changes in the correlation of interest rates between different financial instruments. In addition to interest rate risk positions managed within controlled risk limits by the Treasury unit, structural interest rate risk arises in the consolidated balance sheet as a result of fixed rate, variable rate and non-interest bearing assets and liabilities. Exposure to interest rate movements arises when there is a mis-match between interest rate sensitive assets and liabilities. The Group closely monitors interest rate movements, the interest rate and re-pricing maturity structure of its interest bearing assets and liabilities and the level of non-interest bearing assets and liabilities. In order to reduce the effect of fluctuating interest rates on net interest income, the composition of non-trading interest rate risk is assessed and funding positions or other derivative transactions are hedged with RBS.

Currency risk

Non-trading currency risk exposure arises principally due to investments in overseas operations. Movements in the exchange rates of the operational currency of the overseas investment will impact the consolidated balance sheet and the income statement unless the investment is financed by borrowings in the same currency. These currency exposures are referred to as structural currency exposures of which the Group has a limited exposure in relation to its foreign-based subsidiaries.

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

Value-at-Risk ("VaR")

The Group manages market risk through VaR limits as well as stress testing, position and sensitivity limits. VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at a given confidence level. The table below sets out the VaR for the Company, which assumes a 99% confidence level and a one-day time horizon.

	31 December 2016	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.05	0.13	0.01	0.04
	31 December 2015	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.01	0.04	0.01	0.02

16. Risk management – value-at-risk (continued)

Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations. These limitations are listed below:

- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.
- VaR using a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- The Group largely computes the VaR of the trading portfolios at the close of business and positions may change substantially during the course of the trading day. Controls are in place to limit the Group's intra-day exposure such as the calculation of VaR for selected portfolios.

These limitations and the nature of the VaR measure mean that the Group cannot guarantee that losses will not exceed the VaR amounts indicated or that losses in excess of the VaR amounts will not occur more frequently than once in 20 business days.

Liquidity risk

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost. The Group performs daily liquidity monitoring to ensure compliance with limits set by the regulators in the jurisdiction within which it operates. Quarterly reports are made to ALCO and the Board covering Sterling and currency liquidity.

The ultimate parent company, The Royal Bank of Scotland Group plc, is required by the Financial Conduct Authority to meet its Sterling obligations without recourse to the wholesale money market for a period of at least five business days. RBS manages its capital and liquidity, including drawing on support provided by the UK government and central banks in response to market conditions, in a responsible manner that continues to provide sufficient capital resources and liquidity for the Group to meet its obligations as they fall due.

The Group maintains daily liquidity reporting of positions to RBS.

The liquidity schedule is extracted from the Prudential returns submitted to the regulators in Jersey and Isle of Man.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

16. Risk management (continued)

Liquidity risk (continued)

The following table shows, by contractual maturity, the undiscounted cash flows payable up to a period of 20 years from the balance sheet date, including future payments of interest.

	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-20 years £m
2016					
Assets by contractual maturity					
Cash and balances at central banks	44	-	-	-	-
Loans and advances to banks	12,707	1,070	1,612	1,505	-
Total maturing assets	12,751	1,070	1,612	1,505	-
Loans and advances to customers	789	2,991	1,203	781	1,477
Total assets	13,540	4,061	2,815	2,286	1,477
Liabilities by contractual maturity					
Deposits by banks	210	27	-	-	-
Total maturing liabilities	210	27	-	-	-
Customer accounts	21,275	443	114	-	-
Total liabilities	21,485	470	114	-	-
Maturity gap	(7,945)	3,591	2,701	2,286	1,477
Cumulative maturity gap	(7,945)	(4,354)	(1,653)	633	2,110
Guarantees and commitments notional amount					
Guarantees	(277)	-	-	-	-
Commitments ⁽¹⁾	(3,163)	-	-	-	-
	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-20 years £m
2015					
Assets by contractual maturity					
Cash and balances at central banks	54	-	-	-	-
Loans and advances to banks	12,220	1,178	1,839	1,420	166
Total maturing assets	12,274	1,178	1,839	1,420	166
Loans and advances to customers	546	1,387	1,811	701	1,223
Total assets	12,820	2,565	3,650	2,121	1,389
Liabilities by contractual maturity					
Deposits by banks	508	62	-	4	115
Total maturing liabilities	508	62	-	4	115
Customer accounts	19,291	290	74	-	-
Total liabilities	19,799	352	74	4	115
Maturity gap	(6,979)	2,213	3,576	2,117	1,274
Cumulative maturity gap	(6,979)	(4,766)	(1,190)	927	2,201
Guarantees and commitments notional amount					
Guarantees	(277)	-	-	-	-
Commitments ⁽¹⁾	(3,182)	-	-	-	-

Notes:

⁽¹⁾ The Group 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 Group does not expect all facilities to be drawn, and some may lapse before drawdown.

16. Risk management (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. For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

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

Derivative assets amounting to £51m (2015: £22m) and derivative liabilities amounting to £52m (2015: £23m) have been excluded from the tables.

Credit risk (including counterparty risk)

Credit risk is the risk that the Group will incur losses owing to the failure of customers to meet their financial obligations to the Group. The most important step in managing this risk is the initial decision whether or not to extend credit. The Group's strong credit culture extends to the management of resultant exposures via individual counterparty and concentration limits and the monitoring of counterparty credit worthiness as described below.

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

The day-to-day management of credit risk is devolved to a specialist credit function, which perform regular appraisals of counterparty credit quality through the analysis of qualitative and quantitative information. Credit authority is based on defined limits. If the Group requires collateral, this may be cash, or more commonly, security over a customer's assets.

Under IAS 39 provisions are assessed by the Group under the following two categories:

Individually assessed provisions

Individually assessed provisions are the provisions required for individually significant impaired assets which are assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor. This incorporates an estimate of the discounted value of any recoveries and realisation of security or collateral. The asset continues to be assessed on an individual basis until it is repaid in full or written off.

Latent loss provisions

Latent loss provisions are the provisions held against the estimated impairment in the performing portfolio, which has yet to be identified and reported as at the year end date. To assess the latent loss within the portfolio, the Group 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.

A management review has shown that the majority of the Group's lending book is covered in excess of 100% of the carrying value by the fair value of security. The fair values of security are based on the most recent open market valuation of each item of security and an ongoing review process is in place to ensure that all security remains valid. Unsecured Personal Lending totalled £57m as at 31 December 2016 (2015: £24m) – all unsecured lending is made subsequent to checking customer credit ratings and banking histories.

Impaired financial assets relating to credit risk are analysed in note 7. There are no other net significant exposures to credit risk.

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Selective hedging is used within the Group to manage risk concentrations at both the relationship and industry levels.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

16. Risk management - credit risk (continued)

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

2016	Gross loans and advances to banks and customers £m	Derivatives £m	Total £m	Netting and offset ⁽¹⁾	Exposure post netting and offset £m
UK, Crown Dependencies and Gibraltar					
Central and local government	9	-	9	-	9
Manufacturing	11	-	11	-	11
Construction	80	-	80	-	80
Finance	19,976	51	20,027	(1)	20,026
Service industries and business activities	53	-	53	(7)	46
Agriculture, forestry and fishing	4	-	4	-	4
Property	1,491	-	1,491	-	1,491
Individuals	693	-	693	-	693
Home mortgages	1,274	-	1,274	-	1,274
Other	254	-	254	-	254
Total UK, Crown Dependencies and Gibraltar	23,845	51	23,896	(8)	23,888
Europe					
Central and local government	50	-	50	-	50
Manufacturing	-	-	-	-	-
Construction	20	-	20	-	20
Finance	2	-	2	-	2
Service industries and business activities	3	-	3	-	3
Agriculture, forestry and fishing	-	-	-	-	-
Property	55	-	55	-	55
Individuals	6	-	6	-	6
Home mortgages	175	-	175	-	175
Other	28	-	28	-	28
Total Europe	339	-	339	-	339
Total					
Central and local government	59	-	59	-	59
Manufacturing	11	-	11	-	11
Construction	100	-	100	-	100
Finance	19,978	51	20,029	(1)	20,028
Service industries and business activities	56	-	56	(7)	49
Agriculture, forestry and fishing	4	-	4	-	4
Property	1,546	-	1,546	-	1,546
Individuals	699	-	699	-	699
Home mortgages	1,449	-	1,449	-	1,449
Other	282	-	282	-	282
	24,184	51	24,235	(8)	24,227

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

16. Risk management - credit risk (continued)

2015	Gross loans and advances to banks and customers £m	Derivatives £m	Total £m	Netting and offset ⁽¹⁾	Exposure post netting and offset £m
UK, Crown Dependencies and Gibraltar					
Central and local government	78	-	78	-	78
Manufacturing	11	-	11	-	11
Construction	101	-	101	(7)	94
Finance	19,368	22	19,390	(1)	19,389
Service industries and business activities	49	-	49	(4)	45
Agriculture, forestry and fishing	4	-	4	-	4
Property	1,209	-	1,209	-	1,209
Individuals	208	-	208	-	208
Home mortgages	964	-	964	-	964
Other	236	-	236	-	236
Total UK, Crown Dependencies and Gibraltar	22,228	22	22,250	(12)	22,238
Europe					
Central and local government	50	-	50	-	50
Manufacturing	-	-	-	-	-
Construction	1	-	1	-	1
Finance	2	-	2	-	2
Service industries and business activities	3	-	3	-	3
Agriculture, forestry and fishing	-	-	-	-	-
Property	30	-	30	-	30
Individuals	184	-	184	-	184
Home mortgages	4	-	4	-	4
Other	28	-	28	-	28
Total Europe	302	-	302	-	302
Total					
Central and local government	128	-	128	-	128
Manufacturing	11	-	11	-	11
Construction	102	-	102	(7)	95
Finance	19,370	22	19,392	(1)	19,391
Service industries and business activities	52	-	52	(4)	48
Agriculture, forestry and fishing	4	-	4	-	4
Property	1,239	-	1,239	-	1,239
Individuals	392	-	392	-	392
Home mortgages	968	-	968	-	968
Other	264	-	264	-	264
	22,530	22	22,552	(12)	22,540

⁽¹⁾ This column shows the amount by which the Company's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Company a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Company holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Company obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

Gross assets of £20bn (2015: £19bn) and gross liabilities of £8m (2015: £12m), are subject to netting arrangements. The asset balances included above have been offset with the full amount of the liability balances liabilities of £8m (2015: £12m) in accordance with the offsetting rules of IAS 32.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

16. Risk management - credit risk (continued)

Credit risk asset quality

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

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

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

The mapping to the S&P ratings is used by the Group as one of several benchmarks for its wholesale portfolios, depending on customer type and the purpose of the benchmark. The mapping is based on all issuer types rated by S&P. It should therefore be considered illustrative and does not, for instance, indicate that exposures reported against S&P ratings either have been or would be assigned those ratings if assessed by S&P. In addition, the relationship is not relevant for retail portfolios, smaller corporate exposures or specialist corporate segments given that S&P does not typically assign ratings to such entities.

The following table provides an analysis of the credit quality of third party financial assets by probability of default:

2016	Cash and balances at central banks	Loans and advances to banks	Loans and advances to customers and assets held for sale	Derivatives	Commitments
	£m	£m	£m	£m	£m
AQ 1	44	16,897	2,086	51	1,085
AQ 2	-	-	614	-	512
AQ 3	-	3	792	-	342
AQ 4	-	12	670	-	388
AQ 5	-	-	724	-	235
AQ 6	-	-	1,865	-	305
AQ 7	-	-	414	-	290
AQ 8	-	-	25	-	5
AQ 9	-	-	-	-	1
AQ 10	-	-	12	-	-
Accruing past due	-	-	46	-	-
Impaired loans	-	-	16	-	-
Less impairment provision	-	-	(10)	-	-
Total	44	16,912	7,254	51	3,163

16. Risk management - credit risk asset quality (continued)

2015	Cash and balances at central banks £m	Loans and advances to banks £m	Loans and advances to customers and assets held for sale £m	Derivatives £m	Commitments £m
AQ 1	54	16,813	344	22	415
AQ 2	-	-	1,058	-	618
AQ 3	-	1	855	-	784
AQ 4	-	3	1,025	-	747
AQ 5	-	-	597	-	276
AQ 6	-	-	1,622	-	320
AQ 7	-	-	92	-	19
AQ 8	-	-	14	-	1
AQ 9	-	-	1	-	1
AQ 10	-	-	19	-	-
Accruing past due	-	-	50	-	-
Impaired loans	-	-	24	-	-
Less impairment provision	-	-	(12)	-	-
Total	54	16,817	5,689	22	3,181

Regulatory risk

The Company manages its capital to ensure that entities in the Company will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of equity attributable to equity holders of the ultimate parent, comprising issued capital, reserves and retained earnings as disclosed in the Statement of Changes in Equity.

The Company has capital adequacy requirements imposed by the following regulators - the Jersey Financial Services Commission, the Guernsey Financial Services Commission, the Financial Supervision Commission Isle of Man and the Financial Services Commission Gibraltar. Company entities are required to report a risk asset ratio to regulators on a periodic basis. The ratio is calculated as being the percentage of capital to assets, based on the regulators' definitions of capital and assets. This risk asset ratio is required at all times to be above a benchmark percentage provided by each of the regulators. All Company entities have been in compliance with capital adequacy requirements in respect of the years ending 31 December 2016 and 2015.

The Jersey Financial Service Commission (JFSC) has established in the Codes of Practice for Deposit-taking Business, that a registered person's minimum risk to asset ratio must be maintained at all times at or above 10% or such other higher ratio as has been prescribed by the JFSC.

ALCO reviews the capital structure of the Company's entities on a quarterly basis. As part of this review, the committee considers the cost of capital and the risks associated with each class of capital, along with considering compliance of regulatory requirements. Based on recommendations of the committee, the Company will balance its overall capital structure through the payment of dividends, new share issues and share buy-backs as well as the issue of new debt or the redemption of existing debt.

The Company's overall strategy remains unchanged from 2015.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people, systems or from external events. The Company's business units manage this risk through appropriate risk controls and loss mitigation actions. These actions include a balance of policies, procedures, internal controls and business continuity arrangements.

16. Risk management (continued)

Pension risk

Pension risk is the risk to the Company arising from its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees, for those of a related company or otherwise.

The Company is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility for the Company's pension schemes is separate from the Company's management. The Company is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Company could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

The International Pensions Trust ("IPT") is the largest of the schemes and the main source of pension risk. It operates under a trust deed under which the corporate trustee is a subsidiary of the Company. The trustee board comprises three directors selected by the Company, two directors nominated by members and one independent director.

Risk appetite and investment policy are agreed by the trustees with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustees also consult with the Company to obtain its view on the appropriate level of risk within the pension funds. The Company independently monitors risk within its pension funds as part of the Internal Capital Adequacy Assessment Process. The RBS Pension Committee (PC), acting as a sub-committee of the RBS Asset and Liability Committee (ALCO), formulates the RBS view of pension risk. A sub-committee of PC has responsibility for oversight of the IPT as a material RBS pension scheme; considering mechanisms that could potentially be used for managing risk within the IPT as well as financial strategy, and also reviews actuarial assumptions from a sponsor perspective as appropriate.

The trustee boards are solely responsible for the investment of the schemes' assets which are held separately from the assets of the Company. The Company and the trustee board discuss and agree on the investment principles and the funding plan. The schemes are invested in diversified portfolios of equity, government and corporate fixed-interest and index-linked bonds. The IPT asset strategy has been reviewed over 2015 and 2016 to increase the level of interest rate and inflation hedging in the scheme.

Risk has been mitigated in the schemes in a number of ways as follows:

- In 2006, the schemes were closed to new employees.
- From April 2010, the Company confirmed that it was making changes to the schemes by limiting the amount by which pensionable salary increases (the "pensionable salary cap") to 2% per annum (or CPI inflation, if lower).
- In October 2012, RBSI confirmed that it was offering employees in the schemes the choice between an increase of 5% of salaries to the charge made for scheme membership and an increase in Normal Pension Age from 60 to 65 in respect of service from October 2012 with no additional charge.

A funding valuation of the IPT was undertaken with an effective date of 31 March 2012. Under the terms of the deficit Recovery Plan, the Company agreed to pay contributions to repay the deficit at the rate of £13.5m p.a. until March 2018, with a further payment of £11.25m in 2019. A funding valuation as at 31 March 2015 is ongoing and expected to be finalised in early 2017.

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

17. Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2016. 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.

	2016 £m	2015 £m
Contingent liabilities:		
Guarantees	277	277
Other contingent liabilities	47	84
Total contingent liabilities	324	361
Commitments:		
Undrawn formal standby facilities, credit lines and other commitments to lend:	3,006	3,182
Total commitments	3,006	3,182

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.

Contingent liabilities

These include standby letters of credit, supporting customer debt issues, contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities and obligations to The Royal Bank of Scotland plc.

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, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Commitments under non-cancellable operating leases are detailed in note 15.

Litigation

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

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18. Net cash inflow from operating activities

	2016 £m	2015 £m
Operating profit	248	216
Loan impairment provisions net of recoveries	(3)	(28)
Gain on sale of assets	(2)	(3)
Foreign exchange	(27)	11
Pension charge for defined benefit schemes	4	9
Cash contribution to defined benefit schemes	(93)	(17)
Depreciation of property, plant and equipment	7	7
Other non-cash items	(1)	1
Net cash inflows from trading activities	133	196
Decrease/(increase) in loans and advances to banks and customers	(1,669)	(749)
Increase/(decrease) in derivatives at fair value	(29)	5
Increase/(decrease) in prepayments, accrued income and other assets	(2)	2
Changes in operating assets	(1,700)	(742)
Increase in deposits by banks and customers	1,523	612
(Decrease)/increase in derivatives at fair value	29	(12)
Increase in accruals, deferred income and other liabilities	(3)	27
Changes in operating liabilities	1,549	627
Tax paid	(19)	(25)
Net cash inflow from operating activities	(37)	56

19. Analysis of cash and cash equivalents

	2016 £m	2015 £m
At 1 January		
Cash and balances at central banks	54	52
Cash equivalents	152	107
	206	159
Net cash flow	(50)	58
Effect of exchange rate changes on cash and cash equivalents	27	(11)
At 31 December	183	206
Comprising:		
Cash and balances at central banks	44	54
Loans and advance to banks and debt securities	139	152
	183	206

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NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2016

20. Other Cash flow information

	2016 £m	2015 £m
Interest received	327	324
Interest paid	(36)	(70)
	<u>291</u>	<u>254</u>

21. Related parties

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

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

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.

(a) Directors and key managers

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

	2016 £'000	2015 £'000
Loans and advances to customers	2,696	2,827
Customer accounts	441	482
Interest received	51	56
Interest paid	2	2

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) Related party transactions

	2016 £m	2015 £m
Assets		
Loans and advances to banks:		
RBS International group entities	<u>16,886</u>	16,810
Liabilities		
Deposits by banks:		
RBS entities	<u>246</u>	704
Income		
Interest received:		
RBS entities	137	162
Fees received from RBS entities	5	8
Total income	<u>142</u>	<u>170</u>
Expenses		
Interest paid:		
RBS entities	7	9
Administration expenses paid to RBS entities	5	5
Total expenses	<u>12</u>	<u>14</u>

THE ROYAL BANK OF SCOTLAND INTERNATIONAL LIMITED

NOTES TO THE FINANCIAL STATEMENTS *for the year ended 31 December 2016*

21. Related parties (continued)

(c) Compensation of key management

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

	2016 £'000	2015 £'000
Short term benefits	2,661	1,791
Post employment benefits	202	173
Long term benefits	562	265
	<u>3,425</u>	<u>2,229</u>