# ANNUAL REPORT & ACCOUNTS 2021

Coutts

# STRATEGIC REPORT



The directors of Coutts & Company (the Bank) present their Annual Report, together with audited consolidated financial statements of the Bank and its subsidiaries (together the Group) for the year ended 31 December 2021. The financial statements are prepared in accordance UK adopted International Accounting Standards (IAS).

### Principal activities

The principal activity of the Group is to provide banking, lending and wealth management services to UK connected high net worth individuals and their business interests. We continue to focus on delivering the best client experience through a proactive engagement model. Our client centric strategy is focussed on improving returns by deepening client relationships and improving our digital banking capabilities.

The Group earns income from interest on loans to clients, fees from client transactions and through our asset management service. We also pay interest to clients who have placed interest bearing deposits with us.

The Group is a subsidiary of NatWest Group plc, which provides support and access to all central resources. The Group leverages its relationship with its immediate parent National Westminster Bank Plc (NWB Plc), NatWest Holdings Limited (NWH Ltd), the parent of the ring-fenced sub-group and the NatWest Group, which comprises NatWest Group plc and its subsidiary and associated undertakings, to continue to improve the quality and efficiency of the services and products provided. Copies of the Annual Report and Accounts of NatWest Group plc can be obtained from Legal, Governance and Regulatory Affairs, Gogarburn, Edinburgh EH12 1HQ, the Registrar of Companies or through the NatWest Group website, natwestgroup.com.

### Financial review

Our vision is to be the best Wealth Manager for the UK. *Our Purpose* is to champion potential, helping people, families and businesses to thrive. To deliver on *Our Purpose* and drive sustainable returns to our shareholder we have four strategic priorities:

- Support our clients at every stage of their lives by remaining relevant to them and by building deeper relationships as we evolve our propositions to meet their needs throughout their lives;
- Continue to become a much simpler bank through a focus on great client service, technology and improving our clients experience;
- Utilise relationships with third parties and innovation, using new technology and digital expertise, to deliver an excellent client experience;
- Allocate our capital effectively to drive growth and optimise returns from a safe and secure base.

We deliver these priorities from a robust balance sheet and capital generative business, which give us the flexibility to adapt to an uncertain outlook, supporting our clients and delivering sustainable returns to our shareholder.
As a certified B Corporation (B Corp), we consider the impact of our decisions on a wide range of stakeholders, not just shareholders but our clients, our colleagues, the wider community and the environment. Further details of our B Corp accreditation can be found on page 7.

We have continued to provide intensified levels of support to our clients, colleagues and communities throughout the Coronavirus Disease 2019 (COVID-19) crisis whilst making good progress against all our strategic priorities.

Our Net Promoter Score (NPS) continued to improve, reaching a new high.

We have performed strongly in what continues to be a challenging low interest environment with operating profit increasing to £254 million compared with £127 million in 2020. We have benefitted from loan impairment releases of £57 million in the year driven by an improved economic outlook. Our Return on Equity (RoE) increased by 5.9 percentage points to 12.5% and our capital position remains strong with a Common Equity Tier 1 (CET1) ratio of 11.9% with strong growth seen across deposits, lending and investments.

We are the Centre of Expertise (CoE) for Assets under Management and Administration (AuMA) for the whole of NatWest Group. Our AuMA increased by £4.9 billion during the year as a result of net new inflows of £3.0 billion and positive market movements. Our digital channel also continues to deliver growth through our Coutts, NatWest and RBS Invest proposition.

We continue to be guided by *Our Purpose* and create a positive impact through our three areas of focus: climate, enterprise and learning where we seek to make a meaningful contribution to our clients, colleagues and communities.

*Climate*

We strive to be a leader in the fight against climate change playing an active role in the transition to a net zero economy.

Through our collaboration with global asset manager BlackRock we are able to set the investment strategy and Environmental, Social and Governance (ESG) policy for our funds. Following the launch of the BlackRock managed funds at the end of 2020, we increased our voting activity five-fold and we continue to engage with more than 500 companies in the UK, EU and North America, supported by our stewardship partner EOS at Federated Hermes. We will continue to progress embedding risk management in our asset management portfolio.

In June 2021 we launched a green mortgage incentivising clients to improve the energy efficiency of their homes and have been recognised by the Green Finance Institutes as a Pioneer of the UK Green Home Finance Principles

Further information on our climate related activity can be found on page 6.

# STRATEGIC REPORT

*Enterprise*

We champion businesses in the UK. By removing barriers to enterprise and providing more opportunities, we will not only help companies grow but we will also help the economy to build back stronger.

We collaborated with BGF Group to launch the UK Enterprise Fund and provide additional growth funding and support to SMEs across the UK. In 2021, over 100 clients invested a combined £42 million and Coutts and BGF Group intend to launch a further fund in 2022.

We also launched our first full-scale brand and television campaign primarily aimed at increasing awareness amongst younger (35-44), female and entrepreneurial audiences. The campaign ‘real success takes true character’, focused on the duality of acting in the right way being the reason for achieving long-term success and played into the progress we have made to become a B Corp and our responsible investing credentials.

*Learning*

For our colleagues, this year we focused on personal growth, creating a coaching culture across the business by upskilling our team leaders in performance coaching whilst supporting them with their own leadership coach.

*Digital and client journeys*

We continue to utilise innovative technology to simplify and improve our clients experience.

This year we launched our first digital Junior ISA, which so far has enabled over 4,000 clients to start saving for their children’s future.

We have integrated biometrics into our new mobile app to create a more secure and easy-to-use digital channel for our clients. The latest digital tools have enabled clients to self-serve and simplify the onboarding process.

We continue to develop our digital capabilities and have seen strong growth in digital sales with over 26% of net new money now being executed through digital channels.  We also continue to meet the more complex lending and investment needs of our clients through face-to-face specialist advisers and we welcomed an increase of 29% new clients in 2021 compared with 2020.

*Industry recognition*

We continue to be recognised externally receiving numerous commendations in 2021 including:

- Best Private Bank in the UK - Global Finance - Worlds Best Private Bank Awards 2021
- Best Wealth Manager, UK for ESG – WealthBriefing European Awards 2021
- Multi-Asset Manager of the Year and ESG Multi-Asset Fund of the Year – Sustainable Investment Awards 2021
- ESG multi-asset fund of the year - Environmental Finance Sustainable Investment Awards 2021
- Multi-asset manager of the year - Environmental Finance Sustainable Investment Awards 2021
- Princess Royal 2021 Training Award
- Best D&I Initiative - PIMFA Diversity & Inclusion Awards 2021

Risk Management

A continuous process is used to identify and manage our top and emerging risks. These are risks that could have a significant impact on our ability to operate or meet our strategic goals.

Details of our principal risks can be found in the Risk and Capital Management section on page 9.

# STRATEGIC REPORT

| *Performance highlights* | 2021 £m | 2020 £m | Variance £m | Variance % |
|---|---|---|---|---|
| Total income | 658 | 634 | 24 | 3.8% |
| Operating expenses | (461) | (399) | (62) | 15.5% |
| Impairment releases/(losses) | 57 | (108) | 165 | 152.8% |
| **Operating profit before tax** | 254 | 127 | 127 | 100.0% |
| Tax charge | (66) | (33) | (33) | 100.0% |
| Profit and total comprehensive income for the year | 188 | 94 | 94 | 100.0% |
| Loans to customers - amortised cost | 17,705 | 16,317 | 1,388 | 8.5% |
| Customer deposits | 36,971 | 30,142 | 6,829 | 22.7% |
| Customer loan:deposit ratio | 47.9% | 54.1% | | |
| AuMA | 35,175 | 30,246 | 4,929 | 16.3% |
| Return on Equity(1) | 12.5% | 6.6% | | |
| Cost:income ratio (C:I ratio) | 70.1% | 62.9% | | |
| Net interest margin (NIM) | 2.40% | 2.68% | | |

(1) RoE is calculated using annual profit for the period attributable to ordinary shareholders' and owner's equity at the year end.

## Financial performance

The Group's financial performance is presented in the Consolidated Statement of Comprehensive Income on page 55.

RoE has increased 5.9 percentage points, up from 6.6% to 12.5% due to improved economic conditions.

Operating profit before tax increased from £127 million in 2020 to £254 million in 2021, driven predominately by the release of impairment provisions as a result of the improved economic outlook.

Income has increased on the prior year driven by higher AuMA and lending volumes, offset partially by the impact of the low interest rate environment.

NIM decreased 28 bps from 2.68% in 2020 to 2.40% in 2021 as a result of the lower funding benefit we received on our deposits.

We have continued to grow our loan book with balances increasing £1.4 billion from £16.3 billion in 2020 to £17.7 billion in 2021, driven by strong net new lending.

Deposit balances grew by £6.9 billion from £30.1 billion in 2020 to £37.0 billion in 2021 as a result of strong personal and commercial inflows as our clients continue to build and hold higher levels of liquidity in a recovering economic environment.

We managed AuMA portfolios totalling £35.2 billion as at 31 December 2021 (2020 - £30.2 billion), with £8.7 billion of these assets relating to clients of other NatWest Group members for which the Bank receives a management fee. AuMAs have increased on prior year driven by net new inflows of £3.0 billion in the year, positive market movements and investment performance. Our online investment product series, Personal Portfolio funds, grew significantly and more than doubled from £0.9 billion in 2020 to £1.9 billion in 2021.

Operating expense increased £62 million from £399 million in 2020 to £461 million in 2021 driven by the non-repeat of £33 million litigation and conduct provisions releases in 2020. Service charges from other NatWest Group companies increased £22 million in the year reflecting continued investment in the Bank.

We recognised net loan impairment releases of £57million (2020 – £108 million charge), mainly due to expected credit losses (ECL) provision releases in non-default portfolios reflecting the improved economic outlook.

The CET1 ratio as at 31 December 2021 was 11.9% down 0.1% on the previous year reflecting our continued robust capital position. Risk Weighted Assets (RWAs) increased by £0.2 billion in 2021 to £10.4 billion driven by asset growth.

The principal source of funds for the Group is its client deposits. The balance sheet at 31 December 2021 showed total liabilities and equity of £46.9 billion (2020 - £38.4 billion), including client deposits of £37.0 billion (2020 - £30.1 billion).

## Accounting policies

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of estimation uncertainty are included in the accounting policies on page 62.

## Stakeholder engagement and s.172 (1) statement

In this statement we describe how our directors have had regard to the matters set out in section 172(1) (a) to (f) of the Companies Act 2006 (section 172) when performing their duty to promote the success of the company.

As a subsidiary of NatWest Group our operations are aligned to the strategy and purpose of NatWest Group plc and we follow the policies and procedures of NatWest Group plc, which are reflected, as appropriate in the disclosures below.

## Clients

Meeting the needs of clients is central to our long-term success and is a constant feature of Board discussions and decisions. Client NPS is regularly reviewed by the Board and Executive Committee and represents a key performance metric. During the year the Board received regular updates on client matters through reports from the Chief Executive Officer (CEO) and spotlights from the business areas. The directors met with clients throughout the year to enhance relationships and understand their views.

We operate a Client Council, bringing together clients from across the spectrum of our client base. Through the Client Council we undertake research during the year to better understand our clients' views and test developments which helps us to evolve in line with their needs.

## Colleagues

As at 31 December 2021, NWB had seconded 1,750 colleagues to the Group (2020 – 1,724) (full time equivalent basis, including temporary workers). Details of the increase in staff numbers and their related costs are included in note 3 to the consolidated accounts.

### Engaging our colleagues

A highly engaged workforce is crucial in helping us to achieving our vision. Twice yearly our colleagues are asked to share their views on what it is like to work for us via a collective opinion survey. Our latest survey results, benchmarked against the Global Financial Services norms, shows us ahead in the majority of categories with colleagues valuing flexibility, support and work life balance.

### Colleague voice

The Board promotes colleague voice in the boardroom through a variety of channels, including an ‘open chair’, which provides the opportunity for junior colleagues to attend board and committee meetings. The People Council, made up of circa 50 colleagues, represents colleagues at all levels and acts as custodian of our culture plan. It provides an opportunity for our Executive Committee and Board to engage directly with colleagues.

### Speak Up

One of the ways colleagues can report concerns relating to wrong-doing or misconduct is by raising their concerns via Speak Up, our whistleblowing service. The 2021 colleague opinion survey showed that our colleagues are more confident than ever in raising concerns. We believe this is due to our promotion of the speak up policy and encouraging all colleagues to challenge inappropriate behaviour.

### Rewarding our colleagues

Individual performance objectives are clearly linked to our vision, strategy and purpose. We take a balanced approach to managing performance which is linked to reward. This includes taking into account the conduct and behaviour of individuals in addition to financial performance. Delivering for our clients is key, as is the management of risk. This balanced approach to reward recognises both what the individual has achieved and how they have achieved it.

### Health and wellbeing of our colleagues

As an employer we want to make sure our colleagues have the right support to be healthy and happy at work (regardless of location) and feel able to bring their whole self to work. We have continued to roll out wellbeing programmes, initiatives and products that focus on physical, mental and financial wellbeing.

### Developing our colleagues

We believe everyone has the right to be supported to reach their full potential. We invest in the future with ongoing coaching, training, support and encouragement. Every colleague has a personal development plan and access to a personal development coach.

In September 2021 we welcomed 14 graduates into our graduate schemes, plus 8 interns on an 8-week virtual programme. Gender balance and diversity are critical for these schemes to support a balanced workforce for the future. In 2021 we had at least 50% ethnically diverse representation on all early career programmes. Gender balance was at or above 50% representation for female participation on all programmes except one.

### Employment of people with disabilities

We ensure that prospective candidates with disabilities are considered equally for employment. On becoming a colleague we are committed to training, career development and promotion based on merit. If a colleague becomes disabled during their career, it is our policy, wherever possible, to retain colleagues in their existing role or to re-deploy to a more suitable role.

### Inclusion

Our vision to be the best Wealth Manager for the UK is dependent on having the best people that reflect both our client base and wider society. It is essential that we continue to build a diverse and inclusive organisation. We have a strong and active Respect, Diversity & Inclusion Council that is made up of colleagues who lead the employee led networks covering faith, disability, ethnicity, gender, LGBT+ and social mobility.

This year the spotlight has remained firmly on inclusion, not only the continued focus on ethnically diverse colleagues but right across the inclusion agenda. We have hosted several bank wide listening events that have been supported by the CEO and other Executive Committee members.

The Board monitors diversity and inclusion on a quarterly basis to check progress against key measures. Internal policies such as recruitment and promotion support this agenda. Our aim is to have a full gender balance in our CEO-3 and above global roles by 2030 and 14% of roles at CEO-4 and above to be held ethnically diverse colleagues by 2025. The latest data demonstrates good progress towards both targets over the last two years: Females within the top 3 levels of the organisation have increased from 25% to 32.8% and ethnically diverse colleagues in the top 4 levels of the organisation have increased from 7% to 11.7%. Both aims remain a top priority on the people agenda, as we build a fully inclusive organisation.

NatWest Group has an additional ambition to have Black colleagues occupying 3% of CEO-5 and above UK roles by 2025. This is not measured at an individual business level. Gender and ethnicity pay gap data now forms part of NatWest Group’s Annual Report and Accounts.

## Community

We have a long and distinguished history of supporting philanthropic causes. We draw on this legacy through our support of the Coutts Charitable Foundation (“the Foundation”). The Foundation was established to support sustainable solutions that tackle the causes and consequences of poverty. The core focus of the Foundation is supporting women and girls in the UK and the performing arts community.

Our award-winning Coutts Institute has also continued to support clients with their philanthropic needs.

We support our communities in a variety of ways, including the donation of over £480,000 from both colleague fundraising and our clients via our Thank You from Coutts reward programme. This year our colleague charity of the year was Future Frontiers, a charity which supports disadvantaged children through education and provides them with the skills for further education or employment.

We have continued our support of St Saviour’s & St Olave’s, a local girl’s school, and via our Thank You from Coutts rewards programme our clients have donated 169 iPads to assist students during the pandemic. Over 90 students have participated in our mentoring programme which supports students to achieve their individual goals.

## Climate

Climate change is a critical global issue which has significant implications for all our stakeholders. We have a responsibility to address emerging climate risks and support the wider NatWest Group climate ambitions.

Our ambitions, which support NatWest Group's, include:

- to reach net zero emissions across our managed investments by the end of 2050;
- to halve the level of carbon intensity of our discretionary portfolios and funds by the end of 2030 (compared to 31 December 2019):
- 50% of our mortgage book to be secured against homes with an Energy Performance Certificate (EPC) rated C or above by the end of 2030;
- exclusive use of renewable electricity in our direct operations by 2025.

We reduced the carbon intensity of equity holdings of all funds and discretionary[1] portfolios by an average of 38%[2] (compared to 31 December 2019).

Carbon intensity is calculated as carbon emissions per $1 million of sales. As of 31 December 2021, this is only measured for equity holdings as data availability is better than for other asset classes. On average, as of 31 December 2021, equity holdings make up 60% of the total assets in all funds and discretionary portfolios. Carbon intensity data is sourced from third party sources, at fund and underlying company level, and is used to calculate the weighted average carbon intensity for all in-scope assets under management. Where external data isn't available, proxies are selected that match the company/fund characteristics[3].

### *Governance*

The Board oversees our response to climate-related risk and opportunities. During 2021 the Board has discussed our climate strategy and received targeted training to support ongoing oversight.

The Private Banking Climate Change Working Group ('PBCCWG') is a sub-committee of the Wealth Businesses Risk Committee, established to ensure we are embedding climate-related activity within the business, focusing on the development of our strategy, risk management framework, setting of our risk appetite and performance against appetite with respect to climate risks. The overall response to climate-related risk is managed by the Wealth Businesses Executive Committee.

Climate-related risks and opportunities within our asset management business are managed by the Investment Committee and the Asset Management Risk Forum. Relevant output from these meetings is presented to the PBCCWG before progressing to the Wealth Businesses Risk Committee. Our Responsible Investing Policy and Stewardship Policy, which are available on coutts.com, set out our approach to integrating ESG into our investment decision-making process.

### *Climate strategy*

Most of our carbon footprint is as a result of our investment and lending activities. We are already taking significant steps to reduce this.

We plan to reduce the level of carbon intensity of our discretionary portfolios and funds by 50% by the end of 2030 (compared to 31 December 2019). To support this ambition, we have divested from high-impact fossil fuels in our funds managed by Blackrock excluding any companies that derive more than 5% of their revenue from thermal coal extraction, Arctic oil and gas and tar sands and more than 25% of revenue from thermal coal generation.

We are a member of the Net Zero Asset Managers Initiative, a global alliance of 128 asset managers collaborating to achieve net zero emissions by 2050 or sooner.

We are also part of the Institutional Investors Group on Climate Change, a leading global investor membership body and the largest one focusing specifically on climate change. We are actively working with other investors to tackle climate change and to encourage the whole asset management industry to drive real progress by 2030.

We are striving to make our lending more sustainable. Our ambition is that 50% of our mortgage loan book will be secured against homes with an Energy Performance Certificate (EPC) rated C or above by the end of 2030.

To support this ambition, we offer green mortgages to clients to incentivise them to improve the energy efficiency of their homes. Our green mortgage product offers relevant clients a discounted arrangement fee for purchasing a more energy efficient home (EPC Grade A or B) or making improvements to their home to make it more energy efficient (EPC Grade C and above). As at 31 December 2021 we had received 179 applications for Coutts Green Mortgage products. This represents 7.4% of total mortgage applications in the year.

We launched a collaboration with Octopus Energy which intends to make it simple for clients and colleagues to move to electric vehicles. Through this initiative Octopus offers tailored advice, charging infrastructure funding solutions and access to some of the latest renewable technologies in a single solution to help clients and colleagues move to electric vehicles.

We were also among the first investment houses to buy into the UK government's debut green gilts issuance. These are a form of government debt where the proceeds are earmarked solely to be invested in environmentally beneficial projects.

We are founding supporters of the Queen's Green Canopy tree planting initiative and signatories of The Terra Carta, which aims to give fundamental rights and values to nature and create a more sustainable future.

### *Risk Management*

Climate-related risk, in addition to the threat of financial loss, includes potential adverse non-financial impacts associated with climate change and the associated political, economic and environmental responses. Physical risks may arise from climate and weather-related events such as heatwaves, droughts, floods, storms, and a rise in sea level. They can potentially result in financial losses, impairing asset values and the creditworthiness of borrowers. Transition risks may arise as borrowers adjust their business models towards a low-carbon economy. Changes in policy, technology and sentiment may prompt reassessment of customers' financial risk and may lead to falls in the value of a large range of assets.

Identified financial risk from climate change, is being embedded into our existing enterprise-wide risk management frameworks. This will help to enable informed risk-based decisions that support the delivery of our strategic objectives within the Board-approved risk appetite.

Climate related risks are being incorporated into our Risk Appetite Statement monitoring document.

[1] In 2021, funds and discretionary portfolios represented £27 billion or 91% of our assets under management.

[2] External data used in calculations is based on data at 30 September 2021.

[3] Climate metrics, particularly targets, projections, forecasts and other forward-looking climate metrics, used in this document merit special caution about their usefulness in decision-making as they are more uncertain than, say, historical financial information.

For asset management, our strategic asset allocation is predominantly focused on equities and bonds. We source data[3] from external data providers MSCI and Morningstar for the external investment funds in our multi-asset portfolios and funds. This helps us assess climate risk exposure within these assets. An overview of our risk process is provided in our stewardship policy, which is available on coutts.com.

We have a detailed fund research process and have developed our approach to assessing ESG risks and opportunities, combining qualitative and quantitative datapoints and insights. The framework looks at the approach to responsible investing at three levels: firm, investment strategy and stewardship. Framework results are fed into our fund due diligence process and annual reviews. The insights gained throughout the due diligence process form the basis of our engagement with fund managers, and we track progress and incorporate this into our responsible investing score.

We have a responsibility to tackle climate issues through the investments we manage on behalf of our clients. One of the most important tools we have to create positive change is our own voice. Through our engagement provider, EOS at Federated Hermes, we engage with the companies we invest in about the issues our clients care about.

**Supporting effective Board discussions and decision-making**

Our Board Terms of Reference reinforce the importance of considering both *Our Purpose* and the matters set out in section 172 in Board discussions and decision-making. Our Board and Board Committee paper template includes a section for paper authors to explain how the proposal or update aligns with *Our Purpose* and a separate section for them to include an assessment of the relevant stakeholder impacts for the directors to consider.

Our directors are mindful that it is not always possible to achieve an outcome which meets the requirements, needs and expectations of all stakeholders who are, or may be, impacted. For decisions which are particularly challenging or complex, we piloted an additional page to our template this year which provides directors with further information to support purposeful decision making. This additional page uses the framework of Blueprint for Better Business (an independent charity which aims to enable a better society through better business) as a base and is aligned to our broader purpose framework.

Principal decisions are those decisions taken by the Board that are material, or of strategic importance, to the Bank, and also those that are significant to key stakeholders. One such principal decision taken by the Board during the year was becoming a B Corp certified bank.

**Case Study – becoming a certified B Corp**

In July 2021, we officially became a B Corp, which is a key step in our journey to meet the highest standards of social and environmental performance across the business. This was a carefully considered decision by the Board which sought to embed sustainability and *Our Purpose* ambitions into the strategy.

To support the Board in its decision-making, it received comprehensive papers prepared by management on ESG topics and how these may be embedded within the strategy, as well as the specifics of the B Corp accreditation process. During its discussions, the Board noted the stakeholder impacts of the proposal as well as acknowledging the potential opportunities which may arise, for example in terms of stimulating innovative thinking in relation to ESG and broader stakeholder issues.

Throughout consideration of the proposal, the directors remained mindful of their duties under section 172 including the impact on community and environment. The Board discussed in detail the various stakeholders that would be impacted, with management engaging directly with the certifying body ('B Lab') and NatWest Group, providing feedback to the Board on any additional considerations identified as a result. Considering relevant stakeholder interests is key to purposeful decision-making.

As a certified B Corp our articles of association were amended to require the Board to balance profit with purpose.

Following achievement of B Corp status, the Board has continued to receive regular updates on B Corp as well as broader ESG matters and how these support our strategic aims. In 2022, the Board expects to receive regular updates in relation to key climate matters.

This year Coutts was a founding member of the 'B Finance UK Coalition' which was launched at COP26 and also supported B Lab UK's Boardroom 2030 initiative.

**Regulators**

The Board recognises the importance of open and continuous dialogue with regulators. The Chair, CEO and Chair of the Risk and the Audit Committees meet regularly with the Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA) through Continuous Assessment and Proactive Engagement meetings.

**Suppliers**

The Board is mindful of the role suppliers play in ensuring a reliable service is delivered to clients, and of the importance of relationships with key suppliers, particularly in the current environment. The Board received updates on its suppliers on an ad hoc basis.

Information on NatWest Group's Supplier Charter, Modern Slavery Act Statement and Human Rights Statement can be found in the NatWest Group plc 2021 Annual Report and Accounts.

**Shareholder**

The Bank recognises the benefits that being part of the wider Group provides, for example in terms of the ability to call on extensive IT and other specialist resources, including in relation to cyber-crime defences. The shareholder's perspective is provided through interactions at both management and Board levels. Cross referrals between clients of the Bank and clients of the wider NatWest Group have continued to increase.

**Board changes**

Following an external recruitment process, Sharmila Nebhrajani OBE was appointed to the Coutts & Co Board as a non-executive director in May 2021. Francesca Barnes stepped down as a non-executive director in October 2021, with Sharmila Nebhrajani OBE succeeding her as Chairman of the Coutts & Co Audit Committee and Coutts & Co Risk Committee.

By order of the Board:

Waldegrave of North Hill
Waldegrave of North Hill (Mar 15, 2022 17:36 GMT)

The Rt Hon Lord Waldegrave of North Hill
Chair

Date: 15 March 2022
Coutts & Company is registered in England and Wales No. 00036695

# BOARD OF DIRECTORS AND SECRETARY

**Chair and Independent Non-Executive Director**
The Rt Hon Lord Waldegrave of North Hill
Remuneration, Nominations (Chair)

**Executive Directors**
Peter Gordon Flavel
Chief Executive

Andrew Richard Kyle
Finance Director

**Non-Executive Directors**
Mark Joseph Lund
Audit, Risk, Remuneration, Nominations

Linda Hamilton Urquhart OBE
Audit, Risk, Remuneration (Chair), Nominations

Sharmila Nebhrajani OBE
Audit (Chair), Risk (Chair), Remuneration, Nominations

**Non-Independent Non-Executive Director**
Matthew Edward James Waymark
Audit, Risk

**Company Secretary**
Mark Elliott

| | |
|---|---|
| Audit | Member of the Audit Committee |
| Risk | Member of the Risk Committee |
| Remuneration | Member of the Performance and Remuneration Committee |
| Nominations | Member of the Nominations Committee |

For additional detail on the activities of the Committees above, refer to the Report of the directors.

**Appointments & Resignations**
Mark Elliott (Company Secretary) appointed on 19 March 2021

Ralph Ricks (Company Secretary) resigned on 19 March 2021

Francesca Barnes (Independent Non-Executive Director) resigned on 31 October 2021

Sharmila Nebhrajani OBE (Non-Executive Director) appointed on 28 May 2021

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

**Registered office**
440 Strand
London
United Kingdom
WC2R 0QS

**Coutts & Company**
Registered in England and Wales No. 00036695

# RISK AND CAPITAL MANAGEMENT



### Presentation of information

Risk and capital management are generally conducted on an overall basis within NatWest Group such that common policies, procedures, frameworks and models apply across NatWest Group. Therefore, for the most part, discussion on these qualitative aspects reflects those in NatWest Group as relevant for the businesses and operations in the Group.

### Update on COVID-19

While the immediate disruption diminished during the year, the ongoing impacts of the global pandemic remained a significant focus for risk management in 2021 and uncertainty in the operating environment continued. The Group remained committed to supporting its clients while operating safely and soundly in line with its strategic objectives.

Despite the backdrop of a slowly-recovering economy, the credit risk profile of the Group remains resilient.

While the direct impact on the Group's operational risk profile reduced, the Group continued to closely monitor the second-order impacts on its transformation agenda, with a significant focus on managing resource to protect key regulatory deliveries. The continued evolution of the Group's ways of working – to include large-scale working from home – also required significant operational risk focus, particularly in terms of business resilience.

As a result of its strong balance sheet and prudent approach to risk management, the Group remains well placed to withstand these aftershocks as well as providing support to clients when they need it most.

## Risk management framework

### Introduction

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

The framework ensures that the Group's principal risks – which are detailed in this section – are appropriately controlled and managed. It sets out the standards and objectives for risk management as well as defining the division of roles and responsibilities.

This seeks to ensure a consistent approach to risk management across the Group. It aligns risk management with the Group's overall strategic objectives.

The framework, which is designed and maintained by NatWest Group's independent Risk function, is owned by the NatWest Group Chief Risk Officer. It is reviewed and approved annually by the NatWest Group Board. The framework incorporates risk governance, NatWest Group's three lines of defence operating model and the Risk function's mandate.

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

While all the Group colleagues are responsible for managing risk, the Risk function provides oversight and monitoring of risk management activities, including the implementation of the framework and adherence to its supporting policies, standards and operational procedures. The Chief Risk Officer plays an integral role in providing the Board with advice on the Group's risk profile, the performance of its controls and in providing challenge where a proposed business strategy may exceed risk tolerance.

In addition, there is a process to identify and manage top risks, which are those that could have a significant negative impact on the Group's ability to meet its strategic objectives. A complementary process operates to identify emerging risks. Both top and emerging risks may incorporate aspects of – or correlate to – a number of principal risks and are reported alongside them to the Board on a regular basis.

### Culture

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

**Risk management framework** continued

*Training*

A wide range of learning, both technical and behavioural, is offered across the risk disciplines. This training can be mandatory, role specific or for personal development. Mandatory learning for all staff is focused on keeping employees, clients and the Group safe.

*Our Code*

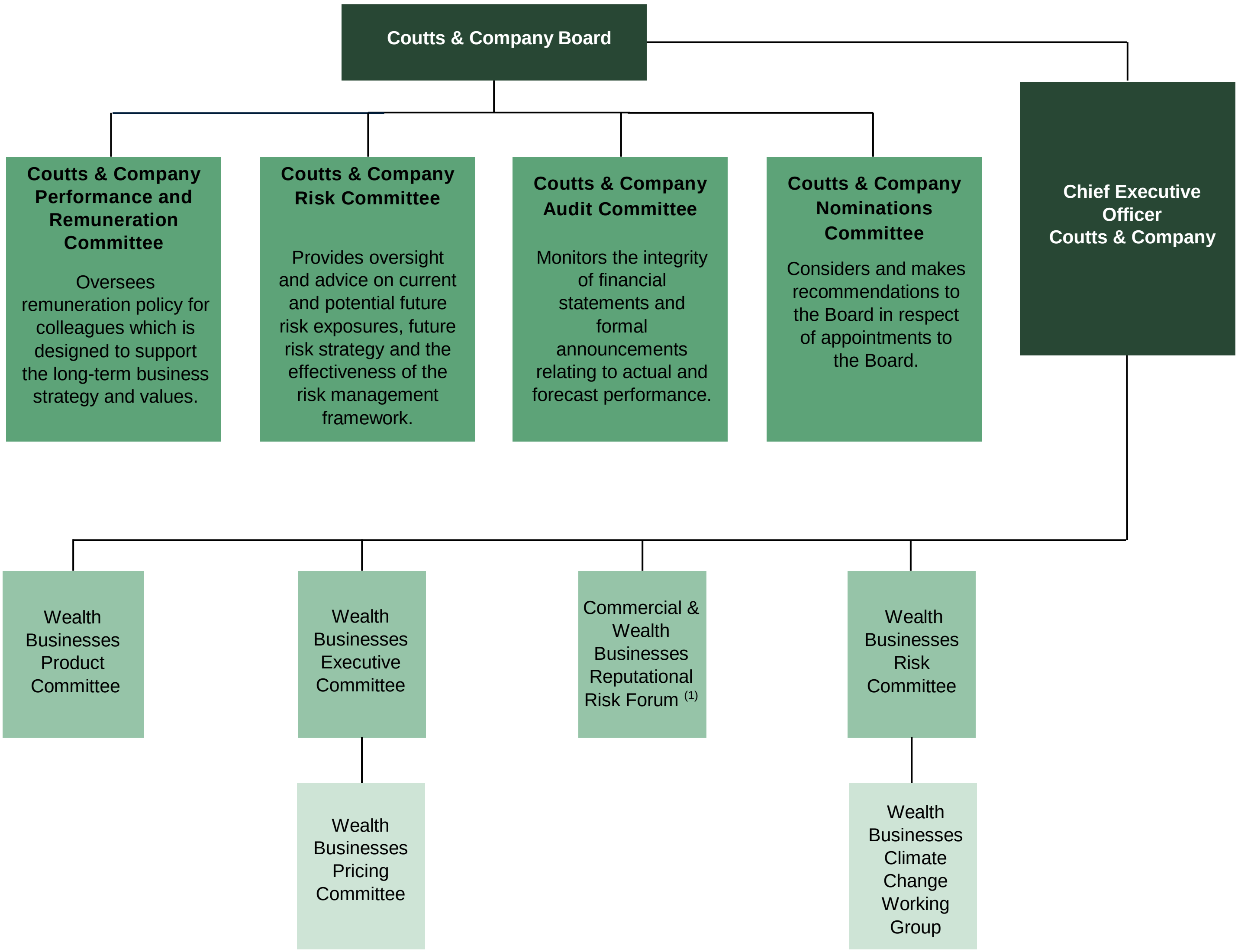
NatWest Group's conduct guidance, Our Code, provides direction on expected behaviour and sets out the standards of conduct that support the values. The code explains the effect of decisions that are taken and describes the principles that must be followed.

These principles cover conduct-related issues as well as wider business activities. They focus on desired outcomes, with practical guidelines to align the values with commercial strategy and actions. The embedding of these principles facilitates sound decision-making and a clear focus on good client outcomes.

## Governance

*Committee structure*

The diagram shows the Group's risk committee structure in 2021 and the main purposes of each committee.

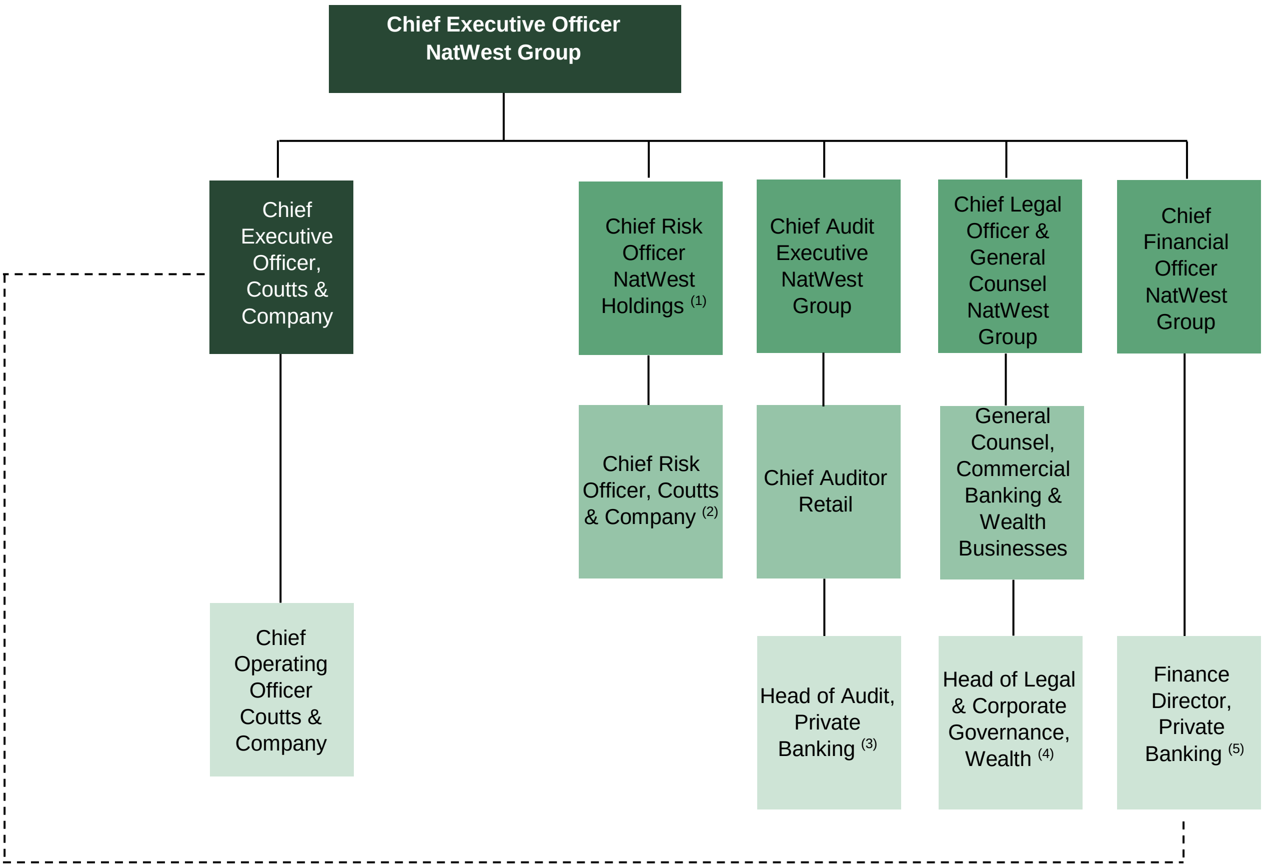



(1) The Commercial & Wealth Businesses Reputational Risk Forum is accountable to the Chief Executive Officer, Coutts & Company and the Chief Executive Officer, Commercial Banking.

**Risk management framework** continued

*Management structure*

The diagram shows the Group's risk management structure in 2021.




(1) The Chief Risk Officer NatWest Holdings is also NatWest Group's Chief Risk Officer.
(2) The Chief Risk Officer Coutts & Company reports directly to the Chief Risk Officer NatWest Holdings. The Chief Risk Officer, Coutts & Company also has a right of access to the Coutts & Company Risk Committee.
(3) The Head of Audit, Private Banking reports directly to the Chief Auditor, Retail.
(4) The Head of Legal & Corporate Governance, Wealth reports directly to the General Counsel, Commercial Banking & Wealth Businesses.
(5) The Finance Director, Private Banking reports directly to the Chief Financial Officer, with a secondary reporting line to the Chief Executive Officer, Coutts & Company.

**Risk management framework** continued

## Three lines of defence

NatWest Group uses the industry-standard three lines of defence model to articulate accountabilities and responsibilities for managing risk. This supports the embedding of effective risk management throughout the organisation.

*First line of defence*

The first line of defence incorporates most roles in NatWest Group, including Technology and Services as well as support functions such as Human Resources, Legal and Finance.

The first line of defence is empowered to take risks within the constraints of the risk management framework and policies as well as the risk appetite statements set by NatWest Group and measures set by the Board.

The first line of defence is responsible for managing its direct risks. With the support of specialist functions such as Legal, Human Resources and Technology, it is also responsible for managing its consequential risks by identifying, assessing, mitigating, monitoring and reporting risks.

*Second line of defence*

The second line of defence comprises the Risk function and is independent of the first line.

The second line of defence is empowered to design and maintain the risk management framework and its components. It undertakes proactive risk oversight and continuous monitoring activities to confirm that NatWest Group engages in permissible and sustainable risk-taking activities.

The second line of defence advises on, monitors, challenges, approves, escalates and reports on the risk-taking activities of the first line, ensuring that these are within the constraints of the risk management framework and policies as well as the risk appetite statements set by NatWest Group and measures set by the Board.

*Third line of defence*

The third line of defence is the Internal Audit function and is independent of the first and second lines.

The third line of defence is responsible for providing independent and objective assurance to the Board, its subsidiary legal entity boards and executive management on the adequacy and effectiveness of key internal controls, governance and the risk management in place to monitor, manage and mitigate the key risks to NatWest Group and its subsidiary companies achieving their objectives.

The third line of defence executes its duties freely and objectively in accordance with the Chartered Institute of Internal Auditors' Code of Ethics and International Standards.

## Risk appetite

Risk appetite defines the type and aggregate level of risk the Group is willing to accept in pursuit of its strategic objectives and business plans. Risk appetite supports sound risk taking, the promotion of robust risk practices and risk behaviours, and is calibrated annually.

For certain principal risks, risk capacity defines the maximum level of risk the Group can assume before breaching constraints determined by regulatory capital and liquidity requirements, the operational environment, and from a conduct perspective. Establishing risk capacity helps determine where risk appetite should be set, ensuring there is a buffer between internal risk appetite and the Group's ultimate capacity to absorb losses.

*Risk appetite framework*

The risk appetite framework supports effective risk management by promoting sound risk-taking through a structured approach, within agreed boundaries. It also ensures emerging risks and risk-taking activities that might be out of appetite are identified, assessed, escalated and addressed in a timely manner.

To facilitate this, a detailed annual review of the framework is carried out. The review includes:

- Assessing the adequacy of the framework when compared to internal and external expectations.
- Ensuring the framework remains effective and acts as a strong control environment for risk appetite.
- Assessing the level of embedding of risk appetite across the organisation.

The Board approves the risk appetite framework annually.

*Establishing risk appetite*

In line with NatWest Group's risk appetite framework, risk appetite is maintained across the Group through risk appetite statements. These are in place for all principal risks and describe the extent and type of activities that can be undertaken.

Risk appetite statements consist of qualitative statements of appetite supported by risk limits and triggers that operate as a defence against excessive risk-taking. Risk measures and their associated limits are an integral part of the risk appetite approach and a key part of embedding risk appetite in day-to-day risk management decisions. A clear tolerance for each principal risk is set in alignment with business activities.

The annual process of reviewing and updating risk appetite statements is completed alongside the business and financial planning process. This ensures that plans and risk appetite are appropriately aligned.

The Board sets risk appetite for all principal risks to help ensure the Group is well placed to meet its priorities and long-term targets even in challenging economic environments. This supports the Group in remaining resilient and secure as it pursues its strategic business objectives.

The Group's risk profile is frequently reviewed and monitored. Management focus is concentrated on all principal risks as well as the top and emerging risk issues which may correlate to them. Risk profile relative to risk appetite is reported regularly to senior management and the Board.

NatWest Group policies directly support the qualitative aspects of risk appetite. They define the qualitative expectations, guidance and standards that stipulate the nature and extent of permissible risk taking and are consistently applied across NatWest Group and its subsidiaries.

## Identification and measurement

Identification and measurement within the risk management process comprise:

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

### Risk management framework continued

The financial and non-financial risks that the Group faces are detailed in its Risk Directory. This provides a common risk language to ensure consistent terminology is used across the Group. The Risk Directory is subject to annual review to ensure it continues to fully reflect the risks that the Group faces.

#### Mitigation

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

#### Testing and monitoring

Targeted risk processes and controls – including controls within the scope of Section 404 of the Sarbanes-Oxley Act 2002 – are subject to independent testing and monitoring.

This activity is carried out to confirm to both internal and external stakeholders – including the Board, senior management, Internal Audit and the Group's regulators – that such processes and controls are being correctly implemented and operate adequately and effectively. A consistent testing and monitoring methodology is in place across the Group.

Testing and monitoring activity focuses on processes and controls relating to credit risk, financial crime risk, operational resilience, and compliance and conduct risk. However, a range of controls and processes relating to other risk types is also subject to testing and monitoring activity as deemed appropriate within the context of a robust control environment.

The NatWest Group Risk Testing & Monitoring Forum assesses and validates the annual plan as well as the ongoing programme of reviews.

#### Stress testing

*Stress testing – capital management*

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

Stress testing includes:

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

The process for stress testing consists of four broad stages:

| | |
|---|---|
| Define scenarios | • Identify macro and NatWest Group specific vulnerabilities and risks.<br>• Define and calibrate scenarios to examine risks and vulnerabilities.<br>• Formal governance process to agree scenarios. |
| Assess impact | • Translate scenarios into risk drivers.<br>• Assess impact to current and projected P&L and balance sheet across NatWest Group. |
| Calculate results and assess implications | • Aggregate impacts into overall results.<br>• Results form part of the risk management process.<br>• Scenario results are used to inform NatWest Group's business and capital plans. |
| Develop and agree management actions | • Scenario results are analysed by subject matter experts.<br>• Appropriate management actions are then developed.<br>• Scenario results and management actions are reviewed by the relevant Executive Risk Committees and Board Risk Committees, and agreed by the relevant Boards. |

Specific areas that involve capital management include:

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

*Capital sufficiency – going concern forward-looking view*

Going concern capital requirements are examined on a forward-looking basis – including as part of the annual budgeting process – by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states. These assessments include assumptions about regulatory and accounting factors (such as IFRS 9). They incorporate economic variables and key assumptions on balance sheet and P&L drivers, such as impairments, to demonstrate that NatWest Group and its operating subsidiaries maintain sufficient capital. A range of future states are tested. In particular, capital requirements are assessed:

- Based on a forecast of future business performance, given expectations of economic and market conditions over the forecast period.
- Based on a forecast of future business performance under adverse economic and market conditions over the forecast period. Scenarios of different severity may be examined.

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

**Risk management framework** continued

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

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

*Capital allocation*

NatWest Group has mechanisms to allocate capital across its legal entities and businesses. These aim to optimise the use of capital resources taking into account applicable regulatory requirements, strategic and business objectives and risk appetite. The framework for allocating capital is approved by the CFO with support from the Asset & Liability Management Committee.

*Governance*

Capital management is subject to substantial review and governance including approval of and stress testing of capital plans.

Stress testing – liquidity

*Liquidity risk monitoring and contingency planning*

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

*Internal assessment of liquidity*

Under the liquidity risk management framework, NatWest Group maintains the Internal Liquidity Adequacy Assessment Process. This includes assessment of net stressed liquidity outflows under a range of severe but plausible stress scenarios. Each scenario evaluates either an idiosyncratic, market-wide or combined stress event as described in the table below.

| Type | Description |
|---|---|
| Idiosyncratic scenario | The market perceives NatWest Group to be suffering from a severe stress event, which results in an immediate assumption of increased credit risk or concerns over solvency. |
| Market-wide scenario | A market stress event affecting all participants in a market through contagion, potential counterparty failure and other market risks. NatWest Group is affected under this scenario but no more severely than any other participants with equivalent exposure. |
| Combined scenario | This scenario models the combined impact of an idiosyncratic and market stress occurring at once, severely affecting funding markets and the liquidity of some assets. |

NatWest Group uses the most severe outcome to set the internal stress testing scenario which underpins its internal liquidity risk appetite. This complements the regulatory liquidity coverage ratio requirement.

Stress testing – recovery and resolution planning

The NatWest Group recovery plan explains how NatWest Group and its subsidiaries – as a consolidated group – would identify and respond to a financial stress event and restore its financial position so that it remains viable on an ongoing basis.

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

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

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

Fire drill simulations of possible recovery events are used to test the effectiveness of NatWest Group and individual legal entity recovery plans. The fire drills are designed to replicate possible financial stress conditions and allow senior management to rehearse the responses and decisions that may be required in an actual stress event. The results and lessons learnt from the fire drills are used to enhance NatWest Group's approach to recovery planning.

Under the resolution assessment part of the PRA rulebook, NatWest Group is required to carry out an assessment of its preparations for resolution, submit a report of the assessment to the PRA and publish a summary of this report.

Resolution would be implemented if NatWest Group was assessed by the UK authorities to have failed and the appropriate regulator put it into resolution. The process of resolution is owned and implemented by the Bank of England (as the UK resolution authority). A multi-year programme is in place to further develop resolution capability in line with regulatory requirements.

**Risk management framework** continued

### Stress testing – non-traded market risk

Non-traded exposures are reported to the PRA on a quarterly basis. This provides the regulator with an overview of NatWest Group's banking book interest rate exposure. The report includes detailed product information analysed by interest rate driver and other characteristics, including accounting classification, currency and counterparty type.

Scenario analysis based on hypothetical adverse scenarios is performed on non-traded exposures as part of the Bank of England and European Banking Authority stress test exercises. NatWest Group also produces an internal scenario analysis as part of its financial planning cycles.

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

Non-traded market risk stress results are combined with those for other risks into the capital plan presented to the Board. The cross-risk capital planning process is conducted once a year, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios and macroeconomic scenarios identified by NatWest Group.

Vulnerability-based stress testing begins with the analysis of a portfolio and expresses its key vulnerabilities in terms of plausible, vulnerability scenarios under which the portfolio would suffer material losses. These scenarios can be historical, macroeconomic or forward-looking/hypothetical. Vulnerability-based stress testing is used for internal management information and is not subject to limits. The results for relevant scenarios are reported to senior management.

### Internal scenarios

During 2021, NatWest Group continuously refined and reviewed a series of internal scenarios – benchmarked against the Bank of England's illustrative scenario – as the impact of COVID-19 evolved, including actual and potential effects on economic fundamentals. These scenarios included:

- The impact of travel restrictions, social distancing policies, self-isolation and sickness on GDP, employment and consumer spending.
- The impacts on business investment in critical sectors.
- The effect on house prices, commercial real estate values and major project finance.
- The effect of government interventions such as the Job Retention Scheme and the Coronavirus Business Interruption Loan Scheme.

Applying the macro-scenarios to NatWest Group's earnings, capital, liquidity and funding positions did not result in a breach of any regulatory thresholds.

Internal scenarios were also used to assess the potential impacts of severe weather events on NatWest Group's operations in the UK and India.

### Regulatory stress testing

In 2021, NatWest Group participated in the regulatory stress tests conducted by the Bank of England following their suspension in 2020 as a result of COVID-19. The scenario was hypothetical in nature and does not represent a forecast of NatWest Group's future business or profitability. The results of regulatory stress tests are carefully assessed and form part of the wider risk management of NatWest Group. Following the UK's exit from the European Union on 31 December 2020, only relevant European subsidiaries of NatWest Group will take part in the European Banking Authority stress tests going forward. NatWest Group itself will not participate.

NatWest Group also took part in the Bank of England's Climate Biennial Exploratory Scenario (CBES). This exercise was designed to assess the resilience of the largest UK banks and insurers to the physical and transition risks associated with climate change. The CBES used three 30-year scenarios to explore the risks – Early Action (in which the transition to a net-zero emissions economy gets underway with carbon taxes and associated policies intensifying gradually), Late Action (in which the transition is delayed until 2031, with a sudden increase in the intensity of carbon taxes and climate policy leading to a recession) and No Additional Action (in which no new climate policies are introduced and the physical impacts of climate change are most severe). The Bank of England is expected to publish aggregate findings in 2022 though, given the exploratory nature of the exercise, it will not use CBES to set capital requirements.

## Credit risk

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

### Sources of risk
The principal sources of credit risk are lending and related undrawn commitments.

The Group has both Retail and Commercial portfolios, with exposure materially concentrated within Retail.

### Governance
The Credit Risk function provides oversight and challenge of frontline credit risk management activities on behalf of the Group. Governance activities include:

- Defining credit risk appetite measures for the management of concentration risk and credit policy to establish the key causes of risk in the process of providing credit and the controls that must be in place to mitigate them.
- Approving and monitoring operational limits for business segments and credit limits for clients.
- Oversight of the first line of defence to ensure that credit risk remains within the appetite set by the Board and that controls are being operated adequately and effectively.
- Assessing the adequacy of expected credit loss (ECL) provisions including approving key IFRS 9 inputs (such as significant increase in credit risk (SICR) thresholds) and any necessary in-model and post model adjustments through provisions and model committees.
- Development and approval of credit grading models.
- Monitoring of credit sanctioning and underwriting standards to ensure they remain adequate in the current market environment.

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

*Retail*

The Retail credit risk appetite framework sets limits that control the quality and concentration of both existing and new business for each relevant business segment. These risk appetite measures consider the segments' ability to grow sustainably and the level of losses expected under stress. Credit risk is further controlled through operational limits specific to client or product characteristics.

*Commercial*

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

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

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

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

### Identification and measurement
*Credit stewardship*

Risks are identified through relationship management and credit stewardship of clients and portfolios.

Credit risk stewardship takes place throughout the client relationship, beginning with the initial approval. It includes the application of credit assessment standards, credit risk mitigation and collateral, ensuring that credit documentation is complete and appropriate, carrying out regular portfolio or client reviews and problem debt identification and management.

*Asset quality*

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

### Mitigation
Mitigation techniques, as set out in the appropriate credit policies and transactional acceptance standards, are used in the management of credit portfolios across the Group. These techniques mitigate credit concentrations in relation to an individual client, a borrower group or a collection of related borrowers. Where possible, client credit balances are netted against obligations. Mitigation tools can include structuring a security interest in a physical or financial asset and the use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Property is used to mitigate credit risk across a number of portfolios, in particular residential mortgage lending and commercial real estate (CRE).

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

*Residential mortgages* – the Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages. The Group values residential property individually during the loan underwriting process, either by obtaining an appraisal by a suitably qualified appraiser (for example Royal Institution of Chartered Surveyors (RICS)) or using a statistically valid model. In both cases, a sample of the valuation outputs are periodically reviewed by an independent RICS qualified appraiser. The Group updates residential property values using the relevant residential property index, for example, the Office for National Statistics House Price Index.

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

**Credit risk** continued

## Assessment and monitoring

Practices for credit stewardship – including credit assessment, approval and monitoring as well as the identification and management of problem debts – differ between the Retail and Commercial portfolios.

*Retail*

To ensure that lending decisions are made consistently, the Group analyses internal credit information as well as external data supplied by credit reference agencies (including historical debt servicing behaviour of clients with respect to both the Group and other lenders). The Group then sets its lending rules accordingly, developing different rules for different products.

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

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

The actual performance of each portfolio is tracked relative to operational limits. The limits apply to a range of credit risk-related measures including projected credit default rates across products and the loan-to-value (LTV) ratio of the mortgage portfolios. Where operational limits identify areas of concern management action is taken to adjust credit or business strategy.

*Commercial*

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

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

In response to COVID-19, a new framework was introduced to categorise clients in a consistent manner across the Commercial portfolio, based on the effect of COVID-19 on their financial position and outlook in relation to the sector risk appetite. This framework has been retained and updated to consider viability impacts beyond those directly related to COVID-19 and classification via the framework is now mandatory and must be refreshed annually. The framework extends to all Commercial borrowing clients and supplements the Risk of Credit Loss framework in assessing whether clients exhibit a SICR, if support is considered to be granting forbearance and the time it would take for clients to return to operating within transactional acceptance standards.

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

Credit grades and loss given default (LGD) are reviewed and, if appropriate, reapproved.

## Problem debt management

### Retail

*Early problem identification*

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

Retail clients experiencing financial difficulty are managed by the Risk Management team. If the Risk Management team is unable to provide appropriate support after discussing suitable options with the client, management of that client moves to the Recoveries team. If at any point in the collections and recoveries process, the client is identified as being potentially vulnerable, the client will be separated from the regular process and supported by a specialist team to ensure the client receives appropriate support for their circumstances.

*Collections*

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

*Recoveries*

The Recoveries team will issue a notice of intention to default to the client and, if appropriate, a formal demand, while also registering the account with credit reference agencies where appropriate. Following this, the client's debt may then be placed with a third-party debt collection agency, or alternatively a solicitor, in order to agree an affordable repayment plan with the client. Exposures subject to formal debt recovery are defaulted and, under IFRS 9, categorised as Stage 3.

### Commercial

*Early problem identification*

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

**Credit risk** continued

*Risk of Credit Loss framework*

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

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

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

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

*Restructuring*

Where clients are categorised as Risk of Credit Loss and the lending exposure is above £1 million, relationships are supported by the Restructuring team. The objective of Restructuring is to protect the Group's capital. Restructuring does this by working with corporate and commercial client in financial difficulty to help them understand their options and how their restructuring or repayment strategies can be delivered. Helping the client return to financial health and restoring a normal banking relationship is always the preferred outcome, however, where a solvent outcome is not possible, insolvency may be considered as a last resort.

Restructuring will always aim to recover capital fairly and efficiently. Throughout Restructuring's involvement, the mainstream relationship manager will remain an integral part of the client relationship. Restructuring's work helps the Group remain safe and sustainable, contributing to its ability to champion potential.

### Forbearance

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

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

A credit exposure may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms.

Loans are reported as forborne until they meet the exit criteria as detailed in the appropriate regulatory guidance. These include being classified as performing for two years since the last forbearance event, making regular repayments and the loan/debt being less than 30 days past due.

### Types of forbearance

*Retail*

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

*Commercial*

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

### Monitoring of forbearance

*Retail*

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

*Commercial*

In the Commercial portfolio, client PDs and facility LGDs are reassessed prior to finalising any forbearance arrangement.

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

### Credit grading models

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

Credit grading models are designed to provide:

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

### Impairment, provisioning and write-offs

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

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

**Credit risk** continued

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

Model build:

- The determination of economic indicators that have most influence on credit loss for each portfolio and the severity of impact (this leverages existing stress testing models which are reviewed annually).
- The build of term structures to extend the determination of the risk of loss beyond 12 months that will influence the impact of lifetime loss for exposures in Stage 2.

Model application:

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

IFRS 9 ECL model design principles

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

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

- Unbiased – material regulatory conservatism has been removed from IFRS 9 parameters to produce unbiased estimates.
- Point-in-time – IFRS 9 parameters reflect actual economic conditions at the reporting date instead of long-run average or downturn conditions.
- Forward-looking – IFRS 9 PD estimates and, where appropriate, EAD and LGD estimates reflect forward-looking economic conditions.

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

For assets originated before IFRS 9 was introduced, comparable lifetime origination PDs did not exist. These have been retrospectively created using the relevant model inputs applicable at initial recognition.

The Group bases its calculations on the most appropriate NWB risk models; in particular NWB Premier for Retail and NWB Wholesale for Commercial.

The output of credit risk models is used in the credit approval process – as well as for ongoing assessment, monitoring and reporting – to inform risk appetite decisions. These models are divided into different categories. Where the calculation method is on an individual counterparty or account level, the models used will be:

- PD, based on the prevailing economic conditions.
- LGD, current assessment of the amount that will be recovered in the event of a default, taking into account future conditions.
- EAD, expected balance sheet EAD including the effects of amortisation, exposure is capped at the contractual limit.

Lifetime PDs are used in the assessment of a SICR, which also considers quantitative and qualitative measures.

PD estimates

*Retail models*

Retail PD models use the Exogenous, Maturity and Vintage (EMV) approach to model default rates. The EMV approach separates portfolio default risk trends into three components: vintage effects (quality of new business over time), maturity effects (changes in risk relating to time on book) and exogenous effects (changes in risk relating to changes in macro-economic conditions). The EMV methodology has been widely adopted across the industry because it enables forward-looking economic information to be systematically incorporated into PD estimates.

*Commercial models*

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

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

LGD estimates

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

*Retail*

Forward-looking information has only been incorporated for the secured portfolios, where changes in property prices can be readily accommodated. Analysis has shown minimal impact of economic conditions on LGDs for the other Retail portfolios.

*Commercial*

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

EAD estimates

*Retail*

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

- Amortising products use an amortising schedule, where a formula is used to calculate the expected balance based on remaining terms and interest rates.
- There is no EAD model for Retail loans. Instead, debt flow (i.e. combined PD x EAD) is modelled directly.

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

*Commercial*

For Commercial, EAD values are projected using product specific credit conversion factors (CCFs), closely following the product segmentation and approach of the respective Basel model. However, the CCFs are estimated over multi-year time horizons and contain no regulatory conservatism or downturn assumptions.

**Credit risk** continued

No explicit forward-looking information is incorporated, on the basis of analysis showing the temporal variation in CCFs is mainly attributable to changes in exposure management practices rather than economic conditions.

### Governance and post model adjustments

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

- Economic uncertainty – ECL adjustments primarily arising from uncertainties associated with multiple economic scenarios (also for 2020) and credit outcomes as a result of the effect of COVID-19 and the consequences of government support schemes. In both cases, management judged that additional ECL was required until further credit performance data became available on the behavioural and loss consequences of COVID-19.
- Other adjustments – ECL adjustments where it was judged that the modelled ECL required to be amended.

Post model adjustments will remain a key focus area of the Group's ongoing ECL adequacy assessment process. A holistic framework has been established including reviewing a range of economic data, external benchmark information and portfolio performance trends, particularly with more observable outcomes from the unwinding of COVID-19 support schemes. A key part of the assessment is also understanding the current levels of ECL coverage (portfolio by portfolio) against pre-COVID-19 levels, recognising changes in portfolio/sector mix.

### ECL post model adjustments

The table below shows ECL post model adjustments.

| ECL post model adjustments | 2021 £m | 2020 £m |
|---|---|---|
| Economic uncertainty (primarily within Commercial) | 5 | 8 |
| Other adjustments | — | — |
| Total | 5 | 8 |
| Of which: | | |
| *- Stage 1* | — | — |
| *- Stage 2* | 5 | 8 |
| *- Stage 3* | — | — |

### Significant increase in credit risk (SICR)

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

The framework comprises the following elements:

IFRS 9 lifetime PD assessment (the primary driver) – in commercial modelled portfolios the assessment is based on the relative deterioration in forward-looking lifetime PD and is assessed monthly. To assess whether credit deterioration has occurred, the residual lifetime PD at balance sheet date (which PD is established at date of initial recognition) is compared to the current PD. If the current lifetime PD exceeds the residual origination PD by more than a threshold amount deterioration is assumed to have occurred and the exposure transferred into Stage 2 for a lifetime loss assessment. For Commercial, a doubling of PD would indicate a SICR subject to a minimum PD uplift of 0.1%. For Retail portfolios, a simplified backstop based SICR method is used.

Qualitative high-risk backstops – the PD assessment is complemented with the use of qualitative high-risk backstops to further inform whether significant deterioration in lifetime risk of default has occurred. The qualitative high-risk backstop assessment includes features such as forbearance support, Commercial exposures managed within the Risk of Credit Loss framework, and adverse credit bureau results for Retail clients. Where a Retail client was granted a payment deferral in response to COVID-19, they were not automatically transferred into Stage 2. However, a subset of Retail clients who had accessed payment deferral support, and where their risk profile was identified as relatively high risk, were collectively migrated to Stage 2 (if not in Stage 2 already). Any support provided beyond completion of the second payment deferral was considered forbearance.

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

- Criteria effectiveness – the criteria should be effective in identifying significant credit deterioration and prospective default population.
- Stage 2 stability – the criteria should not introduce unnecessary volatility in the Stage 2 population.
- Portfolio analysis – the criteria should produce results which are intuitive when reported as part of the wider credit portfolio.

### Provisioning for forbearance

*Retail*

The methodology used for provisioning in respect of Retail forborne loans will differ depending on whether the loans are performing or non-performing.

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

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

For ECL provisioning, all forborne but performing exposures are categorised as Stage 2 and are subject to a lifetime loss provisioning assessment. Where the forbearance treatment includes the cessation of interest on the client balance (i.e. non-accrual), this will be treated as a Stage 3 default.

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

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

**Credit risk** continued

*Commercial*

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

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

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

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

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

### Asset lifetimes

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

The date of initial recognition reflects the date that a transaction (or account) was first recognised on the balance sheet; the PD recorded at that time provides the baseline used for subsequent determination of SICR as detailed above.

For asset duration, the approach applied (in line with IFRS 9 requirements) is:

- Term lending – the contractual maturity date, reduced for behavioural trends where appropriate (such as, expected prepayment and amortisation).
- Revolving facilities – for Retail portfolios, asset duration is based on behavioural life and this is normally greater than contractual life (which would typically be overnight). For Commercial portfolios, asset duration is based on annual client review schedules and will be set to the next review date.

### Economic loss drivers

#### Introduction

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

The most material economic loss drivers for the Retail portfolios include house price index and base rate for the UK.

In addition, world GDP is a primary loss driver for the Commercial portfolios.

### Economic scenarios

At 31 December 2021, the range of anticipated future economic conditions was defined by a set of four internally developed scenarios and their respective probabilities. In addition to the base case, they comprised upside, downside and extreme downside scenarios. The scenarios primarily reflected a range of outcomes for the path of COVID-19 as well as recovery, and the associated effects on labour and asset markets.

The four scenarios were deemed appropriate in capturing the uncertainty in economic forecasts and the non-linearity in outcomes under different scenarios. The scenarios were developed to provide sufficient coverage across potential changes in unemployment, asset price and the degree of permanent damage to the economy, around which there are pronounced levels of uncertainty at this stage.

Upside – This scenario assumes a very strong recovery through 2022 as consumers dip into excess savings built up over the last two years. The labour market remains resilient, with the unemployment rate falling below pre-COVID-19 levels. Inflation is higher than the base case but eventually comes back close to the target. The strong economic recovery enables tightening to be quicker than the base case. The housing market continues its recent strong performance.

Base case – COVID-19 related risks remain contained. After a strong recovery in 2021, the growth moderates in 2022. Most of the furloughed workers can go back to their existing job or find a new job very quickly, with the unemployment rate reaching 4.1% by the end of 2022. Inflation initially increases but retreats over 2022. Interest rates are raised, starting in early 2022. There is a gradual cool down in the housing market but activity is still at healthy levels.

Downside – This scenario assumes a reversal in recovery as inflation build up leads to a lessening of expectations. Interest rates are raised aggressively to counter the inflation risks. However, starting in 2023, the interest hikes are reversed to assist the recovery. Unemployment is higher than the base case and there is a modest decline in house prices.

Extreme downside – This scenario assumes a resurgence of COVID-19 related risks. There is a renewed downturn with declines in consumer spending and business investment. Interest rates are reduced into negative territory to -0.5%. There is wide-spread job shedding in the labour market while asset prices see deep corrections, with housing market falls higher than those seen during previous episodes. The recovery is tepid throughout the five-year period, meaning only a gradual decline in joblessness.

The approach of using four scenarios is similar to that as at 31 December 2020. Previously, the Group used five discrete scenarios to characterise the distribution of risks in the economic outlook. For 2021, the four scenarios were deemed appropriate in capturing the uncertainty in economic forecasts and the non-linearity in outcomes under different scenarios. These four scenarios were developed to provide sufficient coverage across potential rises in unemployment, inflation, asset price falls and the degree of permanent damage to the economy, around which there remains pronounced levels of uncertainty.

**Credit risk** continued

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

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

| Main macroeconomic variables | 2021 | | | | 2020 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Five-year summary | Upside % | Base case % | Downside % | Extreme downside % | Upside 2 % | Upside 1 % | Base case % | Downside 1 % | Downside 2 % |
| GDP - CAGR | 2.4 | 1.7 | 1.4 | 0.6 | 3.6 | 3.1 | 2.8 | 1.3 | 3.6 |
| Unemployment - average | 3.5 | 4.2 | 4.8 | 6.7 | 4.4 | 5.7 | 7.1 | 9.7 | 4.4 |
| House price index - total change | 22.7 | 12.1 | 4.3 | (5.3) | 12.5 | 7.6 | 4.4 | (19.0) | 12.5 |
| Bank of England base rate - average | 1.5 | 0.8 | 0.7 | (0.5) | 0.2 | - | (0.1) | (0.5) | 0.2 |
| Commercial real estate price - total change | 18.2 | 7.2 | 5.5 | (6.4) | 4.3 | 0.7 | (12.0) | (31.5) | 4.3 |
| World GDP - CAGR | 3.5 | 3.2 | 2.6 | 0.6 | 3.5 | 3.4 | 2.9 | 2.8 | 3.5 |
| Probability weight | 30.0 | 45.0 | 20.0 | 5.0 | 20.0 | 40.0 | 30.0 | 10.0 | 20.0 |

(1) The five year period starts after Q3 2021 for 2021 and Q3 2020 for 2020.

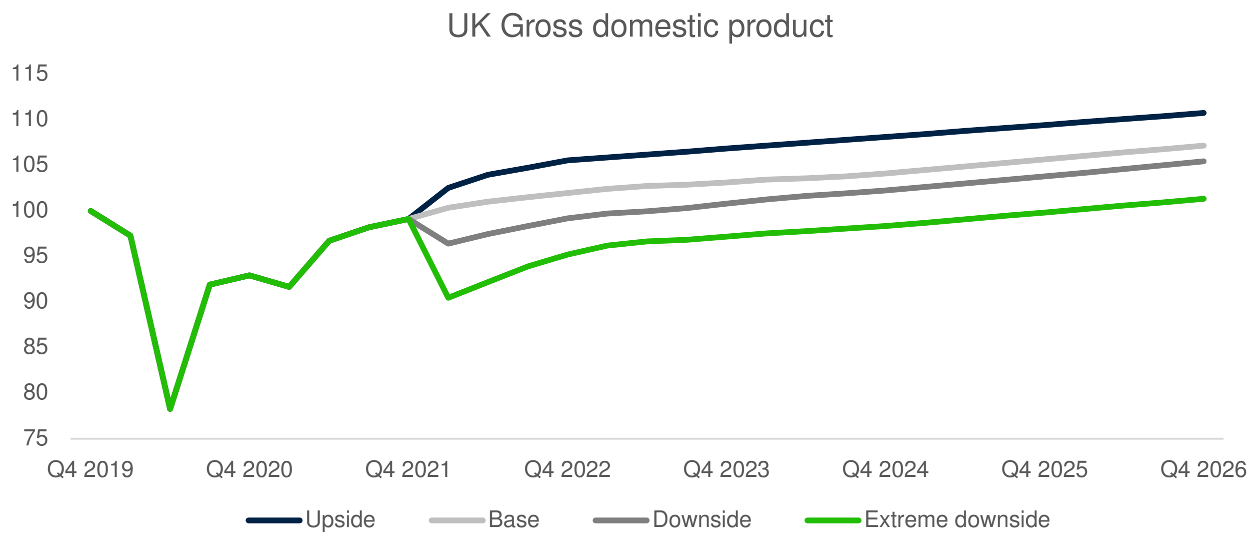
### Probability weightings of scenarios

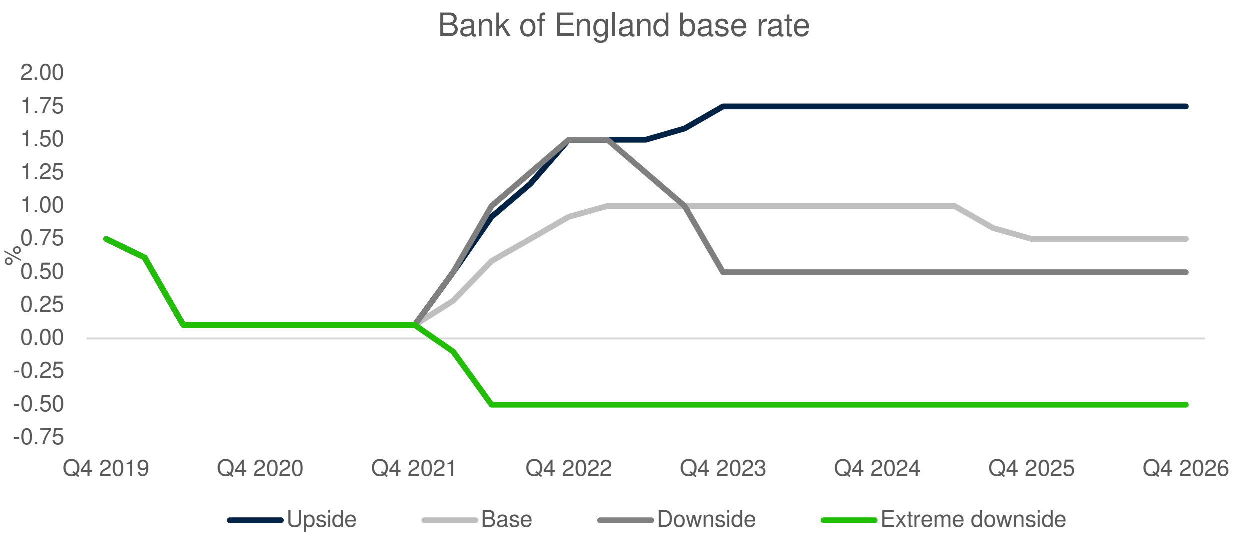
The Group's approach to IFRS 9 multiple economic scenarios (MES) involves selecting a suitable set of discrete scenarios to characterise the distribution of risks in the economic outlook and assigning appropriate probability weights. The scale of the economic impact of COVID-19 and the range of recovery paths necessitates a change of approach to assigning probability weights from that used in recent updates. Prior to 2020, GDP paths for the Group's scenarios were compared against a set of 1,000 model runs, following which a percentile in the distribution was established that most closely corresponded to the scenario.

Instead, the Group has subjectively applied probability weights, reflecting expert views within the Group. The probability weight assignment was judged to present good coverage to the central scenarios and the potential for a robust recovery on the upside and exceptionally challenging outcomes on the downside. A 30% weighting was applied to the upside scenario, a 45% weighting applied to the base case scenario, a 20% weighting applied to the downside scenario and a 5% weighting applied to the extreme downside scenario. The Group assessed the downside risk posed by COVID-19 to be diminishing over the course of 2021, with the vaccination roll-out and positive economic data being observed since the gradual relaxing of lockdown restrictions. The Group therefore judged it was appropriate to apply a higher probability to upside-biased scenarios than at 31 December 2020. However, compared to 31 December 2020, the base case has a higher weight reflecting reduction in uncertainty as the path of economy recovery became clearer.

The 25% weighting to the two downside scenarios gives appropriate consideration to the threats posed to the recovery, including inflation, supply and COVID-19-related risks. Balanced against that is the adaptability of the UK economy to successive waves of COVID-19, and the resilience of labour and asset markets. The potential for further better than expected outcomes is reflected in the 30% probability weighting applied to the upside scenario.

**Credit risk** continued



**Credit risk** continued

Annual figures

GDP - annual growth

| | Upside | Base case | Downside | Extreme downside |
|---|---|---|---|---|
| | % | % | % | % |
| 2021 | 7.0 | 7.0 | 7.0 | 7.0 |
| 2022 | 8.1 | 5.0 | 1.5 | (3.6) |
| 2023 | 2.1 | 1.6 | 2.4 | 4.1 |
| 2024 | 1.2 | 0.9 | 1.6 | 1.2 |
| 2025 | 1.2 | 1.3 | 1.4 | 1.4 |
| 2026 | 1.2 | 1.5 | 1.6 | 1.5 |

Unemployment rate - annual average

| | Upside | Base case | Downside | Extreme downside |
|---|---|---|---|---|
| | % | % | % | % |
| 2021 | 4.6 | 4.6 | 4.6 | 4.6 |
| 2022 | 3.5 | 4.1 | 5.1 | 8.3 |
| 2023 | 3.3 | 4.0 | 5.2 | 8.8 |
| 2024 | 3.4 | 4.1 | 4.7 | 6.6 |
| 2025 | 3.4 | 4.2 | 4.5 | 5.2 |
| 2026 | 3.6 | 4.2 | 4.5 | 4.9 |

House price index - four quarter growth

| | Upside | Base case | Downside | Extreme downside |
|---|---|---|---|---|
| | % | % | % | % |
| 2021 | 6.9 | 6.9 | 6.9 | 6.9 |
| 2022 | 7.9 | 1.6 | (2.9) | (20.4) |
| 2023 | 4.2 | 1.6 | (0.2) | (2.6) |
| 2024 | 3.1 | 2.9 | 1.7 | 13.0 |
| 2025 | 3.0 | 2.7 | 3.0 | 4.7 |
| 2026 | 3.0 | 2.7 | 3.0 | 3.6 |

Commercial real estate price - four quarter growth

| | Upside | Base case | Downside | Extreme Downside |
|---|---|---|---|---|
| | % | % | % | % |
| 2021 | 8.4 | 8.4 | 8.4 | 8.4 |
| 2022 | 10.2 | 4.4 | (2.7) | (29.8) |
| 2023 | 3.4 | 1.9 | 4.2 | 17.2 |
| 2024 | 1.7 | 0.2 | 1.7 | 5.2 |
| 2025 | 0.6 | (0.8) | 0.3 | 3.5 |
| 2026 | (0.8) | (0.8) | (0.2) | 3.2 |

Bank of England base rate – annual average

| | Upside | Base case | Downside | Extreme downside |
|---|---|---|---|---|
| | % | % | % | % |
| 2021 | 0.1 | 0.1 | 0.1 | 0.1 |
| 2022 | 1.0 | 0.6 | 1.1 | (0.4) |
| 2023 | 1.6 | 1.0 | 1.1 | (0.5) |
| 2024 | 1.8 | 1.0 | 0.5 | (0.5) |
| 2025 | 1.8 | 0.9 | 0.5 | (0.5) |
| 2026 | 1.8 | 0.8 | 0.5 | (0.5) |

Worst points

| | 31 December 2021 | | | | 31 December 2020 | | | |
|---|---|---|---|---|---|---|---|---|
| | Downside | | Extreme downside | | Downside | | Extreme downside | |
| | % | Quarter | % | Quarter | % | Quarter | % | Quarter |
| GDP | (1.8) | Q1 2022 | (7.9) | Q1 2022 | (5.1) | Q1 2021 | (10.4) | Q1 2021 |
| Unemployment rate (peak) | 5.4 | Q1 2023 | 9.4 | Q4 2022 | 9.4 | Q4 2021 | 13.9 | Q3 2021 |
| House price index | (3.0) | Q3 2023 | (26.0) | Q2 2023 | (11.2) | Q2 2021 | (32.0) | Q4 2021 |
| Commercial real estate price | (2.5) | Q1 2022 | (29.8) | Q3 2022 | (28.9) | Q2 2021 | (40.4) | Q2 2021 |
| Bank of England base rate | 1.5 | Q4 2022 | (0.5) | Q2 2022 | (0.1) | Q3 2021 | (0.5) | Q1 2021 |

(1) For the unemployment rate, the figures show the peak levels. For the Bank of England base rate, the figures show highest or lowest levels. For other parameters, the figures show falls relative to the starting period. The calculations are performed over five years, with a starting point of Q3 2021 for 31 December 2021 scenarios.

**Credit risk** continued

Use of the scenarios in Retail lending

Retail lending follows a discrete scenario approach. The PD and LGD values for each discrete scenario are calculated using product specific econometric models. Each account has a PD and LGD calculated as probability weighted averages across the suite of economic scenarios.

Use of the scenarios in Commercial lending

The Commercial lending ECL methodology is based on the concept of credit cycle indices (CCIs). The CCIs represent, similar to the exogenous component in Retail, all relevant economic loss drivers for a region/industry segment aggregated into a single index value that describes the loss rate conditions in the respective segment relative to its long-run average. A CCI value of zero corresponds to loss rates at long-run average levels, a positive CCI value corresponds to loss rates below long-run average levels and a negative CCI value corresponds to loss rates above long-run average levels.

The four economic scenarios are translated into forward-looking projections of CCIs using a set of econometric models. Subsequently the CCI projections for the individual scenarios are averaged into a single central CCI projection according to the given scenario probabilities. The central CCI projection is then overlaid with an additional mean reversion assumption i.e. that after reaching their worst forecast position the CCIs start to gradually revert to their long-run average of zero.

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

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

UK economic uncertainty

Treatment of COVID-19 relief mechanisms

Use of COVID-19 relief mechanisms does not automatically merit identification of SICR and trigger a Stage 2 classification in isolation.

For Commercial clients, the Group continues to provide support, where appropriate, to existing clients. Those who are deemed either (a) to require a prolonged timescale to return to within the Group's risk appetite, (b) not to have been viable pre-COVID-19, or (c) not to be able to sustain their debt once COVID-19 is over, will trigger a SICR and, if concessions are sought, be categorised as forborne, in line with regulatory guidance. Payment holiday extensions beyond an aggregate of 12 months in an 18 month period to cover continuing COVID-19 business interruption are categorised as forbearance, including for clients where no other SICR triggers are present.

Model monitoring and enhancement

The severe economic impact from COVID-19 and the ensuing government support schemes have disrupted the normal relationships between key economic loss drivers and credit outcomes. While most government support schemes have now been phased out and economic conditions are normalising, the effect of this disruption is still evident in model monitoring and accounted for in judgments applied to the use and recalibrations of models.

Most significantly, latest PD model monitoring shows general overprediction across all key portfolios, i.e., observed default rates still at or even below pre-COVID-19 levels despite increased PD estimates from a deterioration in several key economic variables.

Model recalibrations to adjust for this overprediction have been deferred based on the judgment that default rate actuals are distorted due to government support.

In addition, to account for residual model uncertainty and the risk of eventual default emergence hitherto supressed by government support, lag assumptions of up to 12 months are applied in the models. These assumptions are consistent with and unchanged from previous disclosures in 2021, although their effective impact gradually reduces over time.

*Industry sector detail – Commercial only*

The economic impact of COVID-19 is highly differentiated by industry sector, with hospitality and other contact-based leisure, service, travel and passenger transport activities significantly more affected than the overall economy. On the other hand, the corporate and commercial econometric forecasting models used in Commercial are sector agnostic. Sector performance was monitored throughout the year and additional post model adjustments were recognised where a risk of higher than expected future default levels, including their timing and value, was identified.

Measurement uncertainty and ECL sensitivity analysis

The recognition and measurement of ECL is complex and involves the use of significant judgment and estimation, particularly in times of economic volatility and uncertainty. This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9. The ECL provision is sensitive to the model inputs and economic assumptions underlying the estimate.

The focus of the simulations is on ECL provisioning requirements on performing exposures in Stage 1 and Stage 2. The simulations are run on a stand-alone basis and are independent of each other; the potential ECL impacts reflect the simulated impact at 31 December 2021. Scenario impacts on SICR should be considered when evaluating the ECL movements of Stage 1 and Stage 2. In all scenarios the total exposure was the same but exposure by stage varied in each scenario.

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

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

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

**Credit risk** continued

Measurement uncertainty and ECL sensitivity analysis

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

| 2021 | Actual | Base case | Upside | Downside | Extreme downside |
|---|---|---|---|---|---|
| Stage 1 modelled exposure (£m) | | | | | |
| Commercial | 3,171 | 3,195 | 3,195 | 3,194 | 3,001 |
| Stage 1 modelled ECL (£m) | | | | | |
| Commercial | 5 | 5 | 5 | 5 | 5 |
| Stage 1 coverage (%) | | | | | |
| Commercial | 0.16% | 0.16% | 0.16% | 0.16% | 0.17% |
| Stage 2 modelled exposure (£m) | | | | | |
| Commercial | 775 | 751 | 751 | 752 | 945 |
| Stage 2 modelled ECL (£m) | | | | | |
| Commercial | 26 | 25 | 25 | 25 | 30 |
| Stage 2 coverage (%) | | | | | |
| Commercial | 3.35% | 3.33% | 3.33% | 3.32% | 3.17% |
| Stage 1 and Stage 2 modelled exposure (£m) | | | | | |
| Commercial | 3,946 | 3,946 | 3,946 | 3,946 | 3,946 |
| Stage 1 and Stage 2 modelled ECL (£m) | | | | | |
| Commercial | 31 | 30 | 30 | 30 | 35 |
| Stage 1 and Stage 2 coverage (%) | | | | | |
| Commercial | 0.79% | 0.76% | 0.76% | 0.76% | 0.89% |
| Reconciliation to Stage 1 and Stage 2 ECL (£m) | | | | | |
| ECL on modelled exposures | 31 | 30 | 30 | 30 | 35 |
| ECL on non-modelled exposures | 7 | 7 | 7 | 7 | 7 |
| Total Stage 1 and Stage 2 ECL | 38 | 37 | 37 | 37 | 42 |
| Variance – (lower)/higher to actual total Stage 1 and Stage 2 ECL | | (1) | (1) | (1) | 4 |

(1) Variations in future undrawn exposure values across the scenarios are modelled, however the exposure position reported is that used to calculate modelled ECL as at 31 December 2021 and therefore does not include variation in future undrawn exposure values.
(2) Reflects ECL for all modelled exposure in scope for IFRS 9. The analysis excludes non-modelled portfolios and exposures relating to bonds and cash.
(3) All simulations are run on a stand-alone basis and are independent of each other, with the potential ECL impact reflecting the simulated impact as at 31 December 2021. The simulations change the composition of Stage 1 and Stage 2 exposure but total exposure is unchanged under each scenario as the loan population is static.
(4) Refer to the Economic loss drivers section for details of economic scenarios.
(5) Refer to the Group 2020 Annual Report and Accounts for 2020 comparatives.

Measurement uncertainty and ECL adequacy

The improvement in the economic outlook and scenarios used in the IFRS 9 MES framework in 2021 resulted in a release of modelled ECL. Given that continued uncertainty remains due to COVID-19 despite the improved economic outlook, the Group utilised a framework of quantitative and qualitative measures to support the directional change and levels of ECL coverage, including economic data, credit performance insights and problem debt trends. This was particularly important for consideration of post model adjustments.

As government support schemes continued to conclude during 2021, the Group anticipates further credit deterioration in the portfolios. However, the income statement effect of this will be mitigated by the forward-looking provisions retained on the balance sheet as at 31 December 2021.

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

- The ongoing trajectory of lockdown restrictions within the UK and any future repeated lockdown requirements.
- The progress of the COVID-19 vaccination roll-out and its effectiveness against new variants.
- The long-term efficacy of the various government support schemes in terms of their ability to defray client defaults is yet to be proven over an extended period.
- The impact on client affordability in the event of sustained inflationary pressures.
- The level of revenues lost by corporate clients and pace of recovery of those revenues may affect the Group's clients' ability to service their borrowing, especially in those sectors most exposed to the effects of COVID-19.

**Credit risk** continued
Banking activities

This section details the credit risk profile of the Group and Bank's banking activities. Refer to Accounting policy 13 and Note 8 to the accounts for policies and critical judgments relating to impairment loss determination.

### Financial instruments within the scope of the IFRS 9 ECL framework

Refer to Note 7 to the accounts for balance sheet analysis of financial assets that are classified as amortised cost or fair value through other comprehensive income (FVOCI), the starting point for IFRS 9 ECL framework assessment.

| | 31 December 2021 | | | 31 December 2020 | | |
|---|---|---|---|---|---|---|
| | Gross £m | ECL £m | Net £m | Gross £m | ECL £m | Net £m |
| Balance sheet total gross amortised cost | 18,127 | | | 16,787 | | |
| In scope of IFRS 9 ECL framework | 18,174 | | | 16,841 | | |
| % in scope | 100% | | | 100% | | |
| Loans to customers - in scope - amortised cost | 17,831 | 75 | 17,756 | 16,508 | 134 | 16,374 |
| Loans to banks - in scope - amortised cost | 343 | - | 343 | 333 | - | 333 |
| Total loans - in scope | 18,174 | 75 | 18,099 | 16,841 | 134 | 16,707 |
| Stage 1 | 16,969 | 11 | 16,958 | 14,675 | 30 | 14,645 |
| Stage 2 | 942 | 27 | 915 | 1,881 | 67 | 1,814 |
| Stage 3 | 263 | 37 | 226 | 285 | 37 | 248 |
| Out of scope of IFRS 9 ECL framework | (47) | na | (47) | (54) | na | (54) |
| Loans to customers - out of scope - amortised cost | (50) | na | (50) | (57) | na | (57) |
| Other financial assets - out of scope - amortised cost | 3 | na | 3 | 3 | na | 3 |

na = not applicable

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

- Cash balances and other non-credit risk assets of £(47) million (2020 – £(54) million). These were assessed as having no ECL unless there was evidence that they were defaulted.

In scope assets also include £28,429 million (2020 – £21,343 million) of inter-Group assets not shown in the table above.

**Credit risk** continued

**Sector analysis - portfolio summary**

The table below shows financial assets gross of ECL, related ECL provisions, impairment and past due by sector and asset quality.

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | Retail | Commercial | Total | Retail | Commercial | Total |
| 2021 | £m | £m | £m | £m | £m | £m |
| Loans by asset quality [1] | 14,147 | 4,027 | 18,174 | 13,832 | 4,002 | 17,834 |
| *- AQ1-AQ4* | *5,067* | *1,270* | *6,337* | *4,908* | *1,245* | *6,153* |
| *- AQ5-AQ8* | *8,584* | *2,669* | *11,253* | *8,446* | *2,669* | *11,115* |
| *- AQ9* | *271* | *50* | *321* | *265* | *50* | *315* |
| *- AQ10* | *225* | *38* | *263* | *213* | *38* | *251* |
| Loans by stage | 14,147 | 4,027 | 18,174 | 13,832 | 4,002 | 17,834 |
| *- Stage 1* | *13,752* | *3,217* | *16,969* | *13,457* | *3,191* | *16,648* |
| *- Stage 2* | *170* | *772* | *942* | *163* | *773* | *936* |
| *- Stage 3* | *225* | *38* | *263* | *212* | *38* | *250* |
| Loans - past due analysis | 14,147 | 4,027 | 18,174 | 13,832 | 4,002 | 17,834 |
| *- Not past due* | *13,888* | *3,995* | *17,883* | *13,588* | *3,970* | *17,558* |
| *- Past due 1-30 days* | *25* | *3* | *28* | *23* | *3* | *26* |
| *- Past due 31-90 days* | *17* | *25* | *42* | *16* | *25* | *41* |
| *- Past due 91-180 days* | *101* | *-* | *101* | *97* | *-* | *97* |
| *- Past due > 180 days* | *116* | *4* | *120* | *108* | *4* | *112* |
| Loans - Stage 2 | 170 | 773 | 943 | 163 | 773 | 936 |
| *- Not past due* | *136* | *745* | *881* | *131* | *745* | *876* |
| *- Past due 1-30 days* | *23* | *3* | *26* | *22* | *3* | *25* |
| *- Past due 31-90 days* | *11* | *25* | *36* | *10* | *25* | *35* |
| Weighted average life* | | | | | | |
| - ECL measurement (years) | 2 | 3 | 3 | 2 | 3 | 3 |
| Weighted average 12 month PDs* | | | | | | |
| IFRS 9 (%) | 0.6 | 2.6 | 2.1 | 0.6 | 2.6 | 2.1 |
| Basel (%) | 1.7 | 1.5 | 1.7 | 1.7 | 1.5 | 1.7 |
| ECL provisions by stage | 25 | 50 | 75 | 23 | 50 | 73 |
| *- Stage 1* | *5* | *6* | *11* | *3* | *8* | *11* |
| *- Stage 2* | *2* | *25* | *27* | *2* | *25* | *27* |
| *- Stage 3* | *18* | *19* | *37* | *18* | *17* | *35* |
| ECL provisions coverage (%) | 0.2 | 1.2 | 0.4 | 0.2 | 1.3 | 0.4 |
| *- Stage 1 (%)* | *-* | *0.2* | *0.1* | *-* | *0.3* | *0.1* |
| *- Stage 2 (%)* | *1.2* | *3.2* | *2.9* | *1.2* | *3.2* | *2.9* |
| *- Stage 3 (%)* | *8.0* | *50.0* | *14.1* | *8.5* | *44.7* | *14.0* |
| ECL charges/(releases) - Third party | 1 | (53) | (52) | 1 | (53) | (52) |
| ECL loss rate (%) | - | (1.32) | (0.29) | - | (1.32) | (0.29) |
| Amounts written-off | 2 | 4 | 6 | 2 | 4 | 6 |

*Not within audit scope.

For the notes to this table refer to page 30.

**Credit risk** continued

| 2021 | Group Total credit exposure £m | Stage 2 - past due exposures Past due 1-30 days £m | Past due > 30 days £m | Total £m | Stage 3 £m | ECL provisions £m |
|---|---|---|---|---|---|---|
| Retail | 14,147 | 23 | 11 | 34 | 225 | 25 |
| Commercial | 3,684 | 3 | 25 | 28 | 38 | 50 |
| *of which Property* | *1,738* | - | *1* | *1* | *27* | *18* |
| Loans to customers | 17,831 | 26 | 36 | 62 | 263 | 75 |
| Loans to banks | 343 | - | - | - | - | - |
| Total financial assets | 18,174 | 26 | 36 | 62 | 263 | 75 |
| Total contingent liabilities and commitments | 2,065 | - | - | - | - | - |
| Total exposure | 20,239 | 26 | 36 | 62 | 263 | 75 |

Included within total retail exposures of £14,147 million at 31 December 2021 were £12,503 million of balances which were covered by collateral and £1,619 million of balances which were exposed to credit risk without any collateral.

Included within total commercial exposures (including loans to banks) of £4,027 million at 31 December 2021 were £3,261 million of balances which were covered by collateral and £715 million of balances which were exposed to credit risk without any collateral.

| 2021 | Bank Total credit exposure £m | Stage 2 - past due exposures Past due 1-30 days £m | Past due > 30 days £m | Total £m | Stage 3 £m | ECL provisions £m |
|---|---|---|---|---|---|---|
| Retail | 13,832 | 22 | 10 | 32 | 212 | 23 |
| Commercial | 3,681 | 3 | 25 | 28 | 38 | 50 |
| *of which Property* | *1,736* | - | *1* | *1* | *27* | *20* |
| Loans to customers | 17,513 | 25 | 35 | 60 | 250 | 73 |
| Loans to banks | 321 | - | - | - | - | - |
| Total financial assets | 17,834 | 25 | 35 | 60 | 250 | 73 |
| Total contingent liabilities and commitments | 2,065 | - | - | - | - | - |
| Total exposure | 19,899 | 25 | 35 | 60 | 250 | 73 |

**Credit risk** continued

| 2020 | Group Retail £m | Group Commercial £m | Group Total £m | Bank Retail £m | Bank Commercial £m | Bank Total £m |
|---|---|---|---|---|---|---|
| Loans by asset quality [1] | 12,508 | 4,333 | 16,841 | 12,079 | 4,306 | 16,385 |
| *- AQ1-AQ4* | *4,678* | *1,262* | *5,940* | *4,475* | *1,240* | *5,715* |
| *- AQ5-AQ8* | *7,346* | *3,030* | *10,376* | *7,162* | *3,025* | *10,187* |
| *- AQ9* | *234* | *6* | *240* | *223* | *6* | *229* |
| *- AQ10* | *250* | *35* | *285* | *219* | *35* | *254* |
| Loans by stage | 12,508 | 4,333 | 16,841 | 12,079 | 4,306 | 16,385 |
| *- Stage 1* | *12,117* | *2,558* | *14,675* | *11,723* | *2,532* | *14,255* |
| *- Stage 2* | *141* | *1,740* | *1,881* | *137* | *1,739* | *1,876* |
| *- Stage 3* | *250* | *35* | *285* | *219* | *35* | *254* |
| Loans - past due analysis | 12,508 | 4,333 | 16,841 | 12,079 | 4,306 | 16,385 |
| *- Not past due* | *12,229* | *4,325* | *16,554* | *11,832* | *4,298* | *16,130* |
| *- Past due 1-30 days* | *18* | *-* | *18* | *18* | *-* | *18* |
| *- Past due 31-90 days* | *30* | *1* | *31* | *30* | *1* | *31* |
| *- Past due 91-180 days* | *144* | *-* | *144* | *130* | *-* | *130* |
| *- Past due > 180 days* | *87* | *7* | *94* | *69* | *7* | *76* |
| Loans - Stage 2 | 141 | 1,740 | 1,881 | 137 | 1,739 | 1,876 |
| *- Not past due* | *113* | *1,739* | *1,852* | *109* | *1,738* | *1,847* |
| *- Past due 1-30 days* | *17* | *-* | *17* | *17* | *-* | *17* |
| *- Past due 31-90 days* | *11* | *1* | *12* | *11* | *1* | *12* |
| Weighted average life* | | | | | | |
| - ECL measurement (years) | 2 | 4 | 4 | 2 | 4 | 4 |
| Weighted average 12 month PDs* | | | | | | |
| IFRS 9 (%) | 0.1 | 5.6 | 1.5 | 0.1 | 5.6 | 1.5 |
| Basel (%) | 1.8 | 1.3 | 1.7 | 1.8 | 1.3 | 1.6 |
| ECL provisions by stage | 26 | 108 | 134 | 23 | 108 | 131 |
| *- Stage 1* | *6* | *24* | *30* | *6* | *24* | *30* |
| *- Stage 2* | *2* | *65* | *67* | *2* | *65* | *67* |
| *- Stage 3* | *18* | *19* | *37* | *15* | *19* | *34* |
| ECL provision coverage (%) | 0.2 | 2.5 | 0.8 | 0.2 | 2.5 | 0.8 |
| *- Stage 1 (%)* | *-* | *0.9* | *0.2* | *0.1* | *1.0* | *0.2* |
| *- Stage 2 (%)* | *1.4* | *3.7* | *3.6* | *1.5* | *3.7* | *3.6* |
| *- Stage 3 (%)* | *7.2* | *54.3* | *13.0* | *6.8* | *54.3* | *13.4* |
| ECL charges/(releases) - Third party | (4) | 104 | 100 | (4) | 104 | 100 |
| ECL loss rate (%) | - | 2.43 | 0.59 | - | 2.40 | 0.62 |
| Amounts written-off | - | 3 | 3 | - | 3 | 3 |

*Not within audit scope.

(1) AQ bandings are based on Basel PDs and mapping is as follows:.

| Internal asset quality band | PD range |
|---|---|
| AQ1 | 0% - 0.034% |
| AQ2 | 0.034% - 0.048% |
| AQ3 | 0.048% - 0.095% |
| AQ4 | 0.095% - 0.381% |
| AQ5 | 0.381% - 1.076% |
| AQ6 | 1.076% - 2.153% |
| AQ7 | 2.153% - 6.089% |
| AQ8 | 6.089% - 17.222% |
| AQ9 | 17.222% - 100% |
| AQ10 | 100% |

**Credit risk** continued

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | | Stage 2 - past due exposures | | | | |
| 2020 | Total credit exposure £m | Past due 1-30 days £m | Past due > 30 days £m | Total £m | Stage 3 £m | ECL provisions £m |
| Retail | 12,508 | 17 | 11 | 28 | 250 | 26 |
| Commercial | 4,000 | - | 1 | 1 | 35 | 108 |
| *of which Property* | *2,085* | - | *1* | *1* | *30* | *55* |
| Loans to customers | 16,508 | 17 | 12 | 29 | 285 | 134 |
| Loans to banks | 333 | - | - | - | - | - |
| Total financial assets | 16,841 | 17 | 12 | 29 | 285 | 134 |
| Total contingent liabilities and commitments | 3,360 | - | - | - | - | - |
| Total exposure | 20,201 | 17 | 12 | 29 | 285 | 134 |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | | Stage 2 - past due exposures | | | | |
| 2020 | Total credit exposure £m | Past due 1-30 days £m | Past due > 30 days £m | Total £m | Stage 3 £m | ECL provisions £m |
| Retail | 12,079 | 17 | 11 | 28 | 219 | 23 |
| Commercial | 3,994 | - | 1 | 1 | 35 | 108 |
| *of which Property* | *2,085* | - | *1* | *1* | *30* | *55* |
| Loans to customers | 16,073 | 17 | 12 | 29 | 254 | 131 |
| Loans to banks | 312 | - | - | - | - | - |
| Total financial assets | 16,385 | 17 | 12 | 29 | 254 | 131 |
| Total contingent liabilities and commitments | 3,360 | - | - | - | - | - |
| Total exposure | 19,745 | 17 | 12 | 29 | 254 | 131 |

**Retail portfolio**

Mortgages represent the largest product in the loan portfolio. The table below shows the spread and risk of these exposures. LTV ratios were split by stage under IFRS 9.

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 £m | 2020 £m | 2021 £m | 2020 £m |
| Gross new mortgage lending [(1)] | 2,790 | 2,078 | 2,790 | 2,078 |
| Owner occupied exposure | 2,509 | 1,860 | 2,509 | 1,860 |
| Weighted average LTV | 65% | 66% | 65% | 66% |
| Buy-to-let | 281 | 218 | 281 | 218 |
| Weighted average LTV | 65% | 62% | 65% | 62% |
| Interest only - variable | 811 | 1,053 | 811 | 1,053 |
| Interest only - fixed | 1,532 | 675 | 1,532 | 675 |
| Retail lending | | | | |
| Mortgages [(2)] | 12,210 | 10,345 | 11,895 | 9,915 |
| Owner occupied | 10,712 | 9,092 | 10,440 | 8,712 |
| Buy-to-let | 1,499 | 1,253 | 1,456 | 1,203 |
| Interest only - variable | 4,714 | 4,203 | 4,583 | 4,020 |
| Interest only - fixed | 5,707 | 4,509 | 5,619 | 4,392 |
| ECL provisions | 7 | 5 | 7 | 5 |
| Other lending | 1,937 | 2,163 | 1,937 | 2,164 |
| ECL provisions | 18 | 21 | 18 | 18 |
| Total Retail lending | 14,147 | 12,508 | 13,832 | 12,079 |
| Mortgage LTV ratios | | | | |
| - Total portfolio | 59% | 58% | 59% | 59% |
| *- Stage 1/performing* | *59%* | *58%* | *59%* | *58%* |
| *- Stage 2/performing* | *59%* | *62%* | *59%* | *62%* |
| *- Stage 3/non-performing* | *64%* | *64%* | *65%* | *65%* |
| - Buy-to-let | 57% | 56% | 58% | 56% |
| *- Stage 1* | *58%* | *56%* | *58%* | *56%* |
| *- Stage 2* | *55%* | *59%* | *55%* | *57%* |
| *- Stage 3* | *53%* | *53%* | *53%* | *53%* |

(1) Excludes additional lending to existing clients.
(2) Includes a portion of Private Banking lending secured against residential real estate, in line with ECL calculation methodology.

The Group holds collateral in respect of net exposures. For individual loans and advances to banks and clients, the collateral includes mortgages over property and charges over business assets.

**Credit risk** continued

### Flow statements

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

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

| | Stage 1 | | Stage 2 | | Stage 3 | | Total | |
|---|---|---|---|---|---|---|---|---|
| Group | Financial assets £m | ECL £m | Financial assets £m | ECL £m | Financial assets £m | ECL £m | Financial assets £m | ECL £m |
| At 1 January 2021 | 14,393 | 30 | 1,916 | 67 | 257 | 37 | 16,566 | 134 |
| Currency translation and other adjustments | (194) | 2 | (12) | (1) | 25 | (2) | (181) | (1) |
| Transfers from Stage 1 to Stage 2 | (993) | (5) | 993 | 5 | - | - | - | - |
| Transfers from Stage 2 to Stage 1 | 1,473 | 28 | (1,473) | (28) | - | - | - | - |
| Transfers to Stage 3 | (81) | - | (54) | (1) | 135 | 1 | - | - |
| Transfers from Stage 3 | 45 | - | 4 | - | (49) | - | - | - |
| Income statement (releases)/charges | 1,901 | (44) | (428) | (15) | (91) | 7 | 1,382 | (52) |
| Amounts written-off | - | - | - | - | (6) | (6) | (6) | (6) |
| At 31 December 2021 | 16,544 | 11 | 946 | 27 | 271 | 37 | 17,761 | 75 |
| Net carrying amount | 16,533 | | 919 | | 234 | | 17,686 | |

### Capital, liquidity and funding risk

Definitions

Capital

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

Capital adequacy risk is the risk that there is or will be insufficient capital and other loss absorbing debt instruments to operate effectively, including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting its strategic goals.

Liquidity and Funding

Liquidity consists of assets that can be readily converted to cash within a short timeframe at a reliable value. Liquidity risk is the risk of being unable to meet financial obligations as and when they fall due.

Funding consists of on-balance sheet liabilities that are used to provide cash to finance assets. Funding risk is the risk of not maintaining a diversified, stable and cost-effective funding base.

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that the Bank performs. The risks are dependent on factors such as:

- Maturity profile;
- Composition of sources and uses of funding;
- The quality and size of the liquidity portfolio;
- Commercial market conditions; and
- Depositor and investor behaviour.

#### Sources of risk

Capital

The eligibility of instruments and financial resources as regulatory capital is laid down by applicable regulation. Capital is categorised by applicable regulation under two tiers (Tier 1 and Tier 2) according to the ability to absorb losses on either a going or gone concern basis, degree of permanency and the ranking of absorbing losses.

There are three broad categories of capital across these two tiers:

- CET1 capital - CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings.
- Additional Tier 1 (AT1) capital - This is the second type of loss absorbing capital and must be capable of absorbing losses on a going concern basis. The instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached.
- Tier 2 capital - Tier 2 capital is supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years.

Minimum requirement for own funds and eligible liabilities (MREL) - In addition to capital, other specific loss absorbing instruments, including senior notes issued by the Bank, may be used to cover certain gone concern capital requirements which, in the EU, is referred to as MREL. Gone concern refers to the situation in which resources must be available to enable an orderly resolution, in the event that the BoE deems that the Bank has failed or is likely to fail.

Liquidity

Liquidity risk is managed as part of the UK Domestic Liquidity Sub Group (UK DoLSub), which is regulated by the PRA and comprises NWH's four licensed deposit taking UK banks: National Westminster Bank Plc, The Royal Bank of Scotland plc, Coutts & Company, and Ulster Bank Limited.

NWH maintains a prudent approach to the definition of liquidity resources. NWH manages its liquidity to ensure it is always available when and where required, taking-into-account regulatory, legal and other constraints.

Liquidity resources are divided into primary and secondary liquidity as follows:

- Primary liquid assets include cash and balances at central banks, Treasury bills and other high quality government and US agency bonds.
- Secondary liquid assets are eligible as collateral for local central bank liquidity facilities. These assets include own-issued securitisations or whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

Funding

The Bank is funded principally by its client deposits. Through NWB, the Bank retains access to a diversified set of funding sources, including Tier 2 capital and subordinated debt. The Bank also retains access to BoE funding facilities.

Managing capital requirements

In line with paragraph 135 of IAS 1 'Presentation of Financial Statements', the Bank manages capital having regard to regulatory requirements. Regulatory capital is monitored and reported on an individual basis by the Bank.

Risk management

Capital

Capital management is the process by which the Bank ensures that it has sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite, maintaining credit ratings and supporting strategic goals. Capital management is critical in supporting the Bank's business.

Capital planning is integrated into the Bank's wider annual budgeting process and is assessed and updated at least monthly. Other elements of capital management, including risk appetite and stress testing, are set out on pages 12 and 13 respectively.

Liquidity

Liquidity risk takes-into-account regulatory, legal and other constraints to ensure sufficient liquidity is available where required to cover liquidity stresses. The size of the liquidity portfolio held in the UK DoLSub is determined by referencing NWH's liquidity risk appetite. NWH retains a prudent approach to setting the composition of the liquidity portfolio, which is subject to internal policies and limits over quality of counterparty, maturity mix and currency mix.

NWB manages the majority of the UK DoLSub's liquidity portfolio under the responsibility of the NatWest Group Treasurer.

Funding

The Bank manages funding risk through a comprehensive framework which measures and monitors the funding risk on the balance sheet. Client deposits provide substantially more funding than client loans utilise.

**Capital, liquidity and funding risk** continued

## Minimum capital requirements

### Capital adequacy ratios

The Bank is subject to minimum capital requirements relative to RWAs. The table below summarises the minimum ratios of capital to RWAs that the Bank is expected to have to meet.

| Type | CET 1 | Total Tier 1 | Total capital |
|---|---|---|---|
| Minimum capital requirements | 4.50% | 6.00% | 8.00% |
| Capital conservation buffer | 2.50% | 2.50% | 2.50% |
| UK countercyclical capital buffer (1) | - | - | - |
| Total (2) | 7.00% | 8.50% | 10.50% |

(1) In response to COVID-19, many countries reduced their CCyB rates. In December 2021, the Financial Policy Committee announced an increase in the UK CCyB rate from 0% to 1%. This rate will come into effect from December 2022 in line with the 12 month implementation period.
(2) The minimum requirements do not include any capital that the Bank may be required to hold as a result of the Pillar 2 assessment.

### Liquidity and funding ratios

The Bank is a member of the UK DoLSub, which is collectively subject to the minimum Liquidity Coverage Ratio requirement of 100%. Following the publication of PS 22/21 on 14 October 2021, a binding NSFR minimum requirement of 100% will be effective from 1 January 2022.

### Net stable funding ratio

Following the publication of PS 22/21 on 14 October 2021, a binding NSFR minimum requirement of 100% will be effective from 1 January 2022.

# RISK AND CAPITAL MANAGEMENT

**Capital, liquidity and funding risk** continued

Measurement

Capital

(Unaudited)

| | Bank 2021 | Bank 2020 |
|---|---|---|
| Composition of regulatory capital | £m | £m |
| Shareholders' equity | 1,521 | 1,456 |
| Other equity instruments | (200) | (200) |
| | 1,321 | 1,256 |
| Regulatory adjustments and deductions | | |
| Goodwill and other intangible assets | (50) | (28) |
| Cash flow hedging reserve | (1) | - |
| Adjustments under IFRS 9 transition arrangements | 29 | 80 |
| Other regulatory adjustments | (64) | (81) |
| | (86) | (29) |
| CET1 capital | 1,235 | 1,227 |
| Additional Tier 1 capital | | |
| Qualifying instruments and related share premium | 202 | 202 |
| Tier 1 capital | 1,437 | 1,429 |
| Qualifying Tier 2 capital | | |
| Paid up capital instruments and subordinated loans | 266 | 266 |
| Tier 2 capital | 266 | 266 |
| Total regulatory capital | 1,703 | 1,695 |
| Risk-weighted assets by risk | | |
| Credit risk | 9,284 | 9,107 |
| Counterparty risk | 5 | 31 |
| Market risk | 4 | 6 |
| Operational risk | 1,074 | 1,068 |
| Total risk-weighted assets | 10,367 | 10,212 |
| Key capital ratios (1) | | |
| CET1 | 11.9% | 12.0% |
| Tier 1 | 13.9% | 14.0% |
| Total capital | 16.4% | 16.6% |

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

(2) Includes an IFRS 9 transitional adjustment of £29 million (2020 - £80 million). Excluding this adjustment, the CET1 ratio would be 11.7% (2020 – 11.3%). The amended article for the prudential treatment of software assets was implemented in December 2020. Excluding this adjustment, the CET1 ratio would be 11.8% (2020 – 11.8%).

**Capital, liquidity and funding risk** continued

### Liquidity and funding risk

Key liquidity and related metrics monitored in relation to the UK DoLSub includes:

- Liquidity coverage ratio;
- Stressed outflow coverage;
- Net stable funding ratio; and
- Loan-to-deposit ratio.

These metrics are compiled in line with regulatory guidance or industry standards, with own interpretation applied where appropriate. Monitoring of these measures allows for ongoing assessment of the position of the overall UK DoLSub liquidity portfolio, and ensures regulatory targets are, at minimum met or exceeded. The Bank's Liquidity metrics are monitored at the NWH Asset and Liabilities Committee.

### Contractual maturity

The table shows the residual maturity of third party financial instruments, based on contractual date of maturity of the Group's banking activities.

| | Group | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2021 | Less than 1 month £m | 1-3 months £m | 3-6 months £m | 6 months - 1 year £m | 1-3 years £m | 3-5 years £m | More than 5 years £m | Impairment provision £m | Total £m |
| Cash and balances at central banks | 3 | - | - | - | - | - | - | - | 3 |
| Loans to banks | 281 | - | 62 | - | - | - | - | - | 343 |
| Loans to customers | 1,575 | 321 | 451 | 695 | 2,944 | 3,052 | 8,742 | (75) | 17,705 |
| Total financial assets | 1,859 | 321 | 513 | 695 | 2,944 | 3,052 | 8,742 | (75) | 18,051 |
| Bank deposits | 2 | - | - | - | - | - | - | - | 2 |
| Customer deposits | 35,192 | 946 | 786 | 45 | 2 | - | - | - | 36,971 |
| Lease liabilities | - | - | - | - | 2 | 1 | 64 | - | 67 |
| Total financial liabilities | 35,194 | 946 | 786 | 45 | 4 | 1 | 64 | - | 37,040 |

| | Group | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2020 | Less than 1 month £m | 1-3 months £m | 3-6 months £m | 6 months - 1 year £m | 1-3 years £m | 3-5 years £m | More than 5 years £m | Impairment provision £m | Total £m |
| Cash and balances at central banks | 3 | - | - | - | - | - | - | - | 3 |
| Loans to banks | 284 | - | - | 49 | - | - | - | - | 333 |
| Loans to customers* | 1,416 | 304 | 409 | 795 | 2,783 | 3,007 | 7,735 | (132) | 16,317 |
| Total financial assets | 1,703 | 304 | 409 | 844 | 2,783 | 3,007 | 7,735 | (132) | 16,653 |
| Bank deposits | 4 | - | - | - | - | - | - | - | 4 |
| Customer deposits | 27,953 | 1,144 | 1,007 | 38 | - | - | - | - | 30,142 |
| Lease liabilities | - | - | - | - | 2 | 1 | 63 | - | 66 |
| Total financial liabilities | 27,957 | 1,144 | 1,007 | 38 | 2 | 1 | 63 | - | 30,212 |

For the notes to this table refer to the following page.

**Capital, liquidity and funding risk** continued

Contractual maturity continued

| | Bank | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2021 | Less than 1 month £m | 1-3 months £m | 3-6 months £m | 6 months - 1 year £m | 1-3 years £m | 3-5 years £m | More than 5 years £m | Impairment provision £m | Total £m |
| Cash and balances at central banks | 3 | - | - | - | - | - | - | - | 3 |
| Loans to banks | 259 | - | 62 | - | - | - | - | - | 321 |
| Loans to customers | 1,563 | 318 | 447 | 686 | 2,851 | 2,983 | 8,613 | (73) | 17,388 |
| Total financial assets | 1,825 | 318 | 509 | 686 | 2,851 | 2,983 | 8,613 | (73) | 17,712 |
| | | | | | | | | | |
| Bank deposits | 2 | - | - | - | - | - | - | - | 2 |
| Customer deposits | 35,192 | 946 | 786 | 45 | 2 | - | - | - | 36,971 |
| Lease liabilities | - | - | - | - | 2 | 1 | 64 | | 67 |
| Total financial liabilities | 35,194 | 946 | 786 | 45 | 4 | 1 | 64 | - | 37,040 |

| | Bank | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2020 | Less than 1 month £m | 1-3 months £m | 3-6 months £m | 6 months - 1 year £m | 1-3 years £m | 3-5 years £m | More than 5 years £m | Impairment provision £m | Total £m |
| Cash and balances at central banks | 3 | - | - | - | - | - | - | - | 3 |
| Loans to banks | 263 | - | 49 | - | - | - | - | - | 312 |
| Loans to customers* | 1,385 | 295 | 399 | 780 | 2,729 | 2,864 | 7,564 | (129) | 15,887 |
| Total financial assets | 1,651 | 295 | 448 | 780 | 2,729 | 2,864 | 7,564 | (129) | 16,202 |
| | | | | | | | | | |
| Bank deposits | 4 | - | - | - | - | - | - | - | 4 |
| Customer deposits | 27,953 | 1,144 | 1,007 | 38 | - | - | - | - | 30,142 |
| Lease liabilities | - | - | - | - | 2 | 1 | 63 | - | 66 |
| Total financial liabilities | 27,957 | 1,144 | 1,007 | 38 | 2 | 1 | 63 | - | 30,212 |

*2020 contractual maturity has been restated as a result of improvements in the financial reporting process implemented in the year. The change results in maturities 3 years or less being reduced by £3,753 million for Group and £3,626 million for Bank and maturities greater than 3 years increased by £3,753 million for Group and £3,626 million for Bank.

## Non-traded market risk

### Definition

Non-traded market risk is the risk to the value of assets or liabilities outside the trading book, or the risk to income, that arises from changes in market prices such as interest rates, foreign exchange rates and equity prices, or from changes in managed rates.

### Sources of risk

The key sources of non-traded market risk largely comprise interest rate risk and foreign exchange risk.

### Governance

Responsibility for identifying, measuring, monitoring and controlling market risk arising from non-trading activities lies with the relevant business. Non-traded market risk sets out the governance and risk management framework.

### Risk appetite

The Group's qualitative appetite is set out in the non-traded market risk appetite statement. Its quantitative appetite is expressed in terms of exposure limits. These limits are approved and monitored by the Asset & Liability Management Committee.

### Interest rate risk

Non-traded interest rate risk (NTIRR) arises from the provision to clients of a range of banking products with differing interest rate characteristics. When aggregated, these products form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market interest rates. Mismatches can give rise to volatility in net interest income as interest rates vary.

NTIRR comprises the following three primary risk types:

- Gap risk – arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
- Basis risk – captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.
- Option risk – arises from option derivative positions or from optional elements embedded in assets, liabilities and/or off-balance sheet items, where the Group or its client can alter the level and timing of their cash flows.

NTIRR can be measured from either an economic value-based or earnings-based perspective, or a combination of the two. Value-based approaches measure the change in value of the balance sheet assets and liabilities including all cash flows. Earnings-based approaches measure the potential impact on the income statement of changes in interest rates over a defined horizon, generally one to three years.

The Group uses VaR as its value-based approach and sensitivity of net interest earnings as its earnings-based approach.

### Value-at-risk

VaR is a statistical estimate of the potential change in the market portfolio (and, thus the impact on the income statement) over a specified time horizon at a given confidence level.

The Group has no foreign subsidiaries and manages its exposures to overseas suppliers within specified limits.

### Sensitivity of net interest earnings

Net interest earnings are sensitive to changes in the level of interest rates, mainly because maturing structural hedges are replaced at higher or lower rates and changes to coupons on managed rate client products do not match changes in market rates of interest or central bank policy rates.

Earnings sensitivity is derived from a market-implied forward rate curve. Assumptions are applied to this curve to derive central bank policy rates. A simple scenario is shown that projects forward earnings over a 12-month period based on the 31 December 2021 balance sheet. An earnings projection is derived from the market-implied rate curve, which is then subject to interest rate shocks. The difference between the market-implied projection and the shock gives an indication of underlying sensitivity to interest rate movements.

Reported sensitivities should not be considered a forecast of future performance in these rate scenarios. Actions that could reduce interest earnings sensitivity include changes in pricing strategies on client loans and deposits as well as hedging. Management action may also be taken to stabilise total income also taking into account non-interest income.

The sensitivity of net interest earnings table on next page shows the expected impact of an immediate upward or downward change of 25 basis points and an upward change of 100 basis points to all interest rates. The downward rate scenario at 31 December 2021 allows interest rates to fall to negative rates. The downward rate scenario at 31 December 2020 assumed that interest rates would floor at 0%, or the then negative rate. The reduction in sensitivity to the upward 25-basis-point and 100-basis-point rate shifts reflects the higher level of interest rates at 31 December 2021 compared to 31 December 2020.

**Non-traded market risk** continued

| | Group | | | | |
|---|---|---|---|---|---|
| | Euro | Sterling | US Dollar | Other | Total |
| 2021 | £m | £m | £m | £m | £m |
| +25bps shift in yield curves | - | 14 | 9 | - | 23 |
| -25bps shift in yield curves | - | (18) | (3) | - | (21) |
| +100bps shift in yield curves | 5 | 42 | 25 | 2 | 74 |
| | | | | | |
| 2020 | | | | | |
| +25bps shift in yield curves | 1 | 31 | 2 | - | 34 |
| -25bps shift in yield curves | - | (3) | (3) | - | (6) |
| +100bps shift in yield curves | 4 | 77 | 10 | 1 | 92 |

### Foreign exchange risk

Non-traded foreign exchange risk arises from client transactions and profits and losses that are in a currency other than the functional currency of the transacting operation.

## Compliance & conduct risk

### Definition

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

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

### Sources of risk

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

### Key developments in 2021

- Risk appetite statements and measures were updated with an enhanced focus to provide better visibility of key risks across NatWest Group.
- Participated in the Group-wide launch of digital rule mapping and horizon scanning platform which is now live. All new products and change to be routed through the platform, with plans being made for delivery of legacy rule mapping, all of which will enable more efficient management of regulatory compliance matters and support intelligent risk taking.
- Continued collaboration across NatWest Group to deliver good client outcomes with a focus on enhancing forbearance strategies.
- Oversight and management of major compliance programmes including work to upgrade NatWest Group's internal ratings based approach for credit risk in order to build better outcomes for clients.
- NatWest Group has mobilised an enterprise-wide programme to plan for the implementation of new rules relating to consumer duty.

### Governance

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

### Risk appetite

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

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

### Monitoring and measurement

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

### Mitigation

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

## Financial crime risk

### Definition

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

### Sources of risk

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

### Key developments in 2021

- Significant investment continued to be made across NatWest Group to support delivery of the multi-year financial crime risk management transformation plan.
- Enhancements were also made to technology and data analytics to improve the effectiveness of systems used to monitor customers and transactions across NatWest Group, including the Group itself.
- A new financial crime and fraud goal was introduced for NatWest Group's most senior 150 employees – including employees within the Group – to further embed financial crime risk management culture, behaviours, and accountabilities.

### Governance

Financial crime matters are discussed initially at the Wealth Financial Crime Forum. Formal decisions are taken by Wealth Risk Committee with further escalations to the Coutts Risk Committee. In addition the Group participates in NatWest Group's Financial Crime Executive Steering Group, which is jointly chaired by NatWest Group's Group Chief Risk Officer and Group Chief Administrative Officer. It oversees financial crime risk management, operational performance, and transformation matters, including decision-making and, where appropriate, escalations to the NatWest Group Executive Risk Committee and the NatWest Group Board Risk Committee. While fraud risk is managed separately in the first line of defence, the second line Financial Crime risk function provides oversight.

### Risk appetite

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

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

### Monitoring and measurement

Financial crime risks are identified and reported through continuous risk management and regular reporting to the Coutts Board Risk Committee as well as to NatWest Group's senior risk committees and the NatWest Group Board. Quantitative and qualitative data is reviewed and assessed to measure whether financial crime risk is within risk appetite.

### Mitigation

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

## Climate risk

### Definition

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

### Sources of risk

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

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

### Key developments in 2021

- The Bank officially became a B Corp, amending its articles of association to require the board of directors to ensure a balance between profit and purpose.
- The Group significantly reduced the carbon intensity of the equity holdings of its funds and discretionary portfolios.
- A principles-based climate risk policy was approved by the NatWest Group Board Risk Committee and introduced in April 2021.
- In December 2021, the NatWest Group Board approved a number of first-generation quantitative climate risk appetite measures, specific allocations for the Group will be agreed during 2022. These will enable reporting of climate risk appetite and link business-as-usual risk management to NatWest Group's strategic goals and priorities.
- NatWest Group participated in the Bank of England's Climate Biennial Exploratory Scenario (CBES) exercise. In doing so, NatWest Group's capabilities regarding climate scenario analysis were strengthened in 2021 with increased coverage across the balance sheet.
- A new Climate Centre of Excellence was established to provide strategic horizon scanning, guidance and specialist climate expertise across NatWest Group.

**Climate risk** continued

Governance

The NatWest Group Board is responsible for monitoring and overseeing climate-related risk within NatWest Group's overall business strategy and risk appetite. The potential impact, likelihood and preparedness of climate-related risk is reported regularly to the NatWest Group Board Risk Committee and the NatWest Group Board.

The NatWest Group Chief Risk Officer shares accountability with the NatWest Group CEO under the Senior Managers and Certification Regime for identifying and managing the financial risks arising from climate change. This includes ensuring that the financial risks from climate change are adequately reflected in risk management frameworks, and that NatWest Group can identify, measure, monitor, manage, and report on its exposure to these risks.

The Climate Change Executive Steering Group is responsible for overseeing the direction of and progress against NatWest Group's climate-related commitments. During 2021, the Executive Steering Group focused on overseeing the Group Climate Change Programme (GCCP), which was tasked with continuing to deliver both NatWest Group's climate strategy and the climate-related mandatory change agenda. The GCCP will close and transition activity into business-as-usual operations across NatWest Group's franchises and functions. The Executive Steering Group will continue to supervise strategic implementation and delivery, supported by the Climate Centre of Excellence.

Risk appetite

NatWest Group's ambition is to be a leading bank in the UK in helping to address climate change. The climate ambition is underpinned by activity to reduce NatWest Group's climate impact of financing activity by at least 50% by 2030 and to do what is necessary to achieve alignment with the 2015 Paris Agreement.

Work continued in 2021 to integrate climate-related risk into the risk management framework, including the development of appropriate risk appetite metrics. In December 2021, the NatWest Group Board approved the adoption of three first-generation climate risk appetite measures into the enterprise-wide risk management framework, for integration into business-as-usual risk management. Combined with franchise specific operational limits, this suite of metrics will enable reporting of climate risk appetite to senior risk management forums and links risk management to NatWest Group's strategic goals and priorities.

Monitoring and measurement

NatWest Group has focused on developing the capabilities to use scenario analysis to identify the most material climate risks and opportunities for its clients, seeking to harness insights to inform risk management practices and maximise the opportunities arising from a transition to a net zero economy.

Scenario analysis allows NatWest Group to test a range of possible future climate pathways and understand the nature and magnitude of the risks they present. The purpose of scenario analysis is not to forecast the future but to understand and prepare to manage risks that could arise.

In 2021, activity was dominated by the Bank of England's CBES exercise. NatWest Group applied three climate scenarios to quantify climate risk across its balance sheet, including the full portfolio of Commercial clients and its entire UK commercial real estate and residential (retail) mortgage portfolio.

NatWest Group regularly considers existing and emerging regulatory requirements related to climate change. It continues to participate in several industry-wide initiatives to develop consistent risk measurement methodologies. NatWest Group is a founding signatory of the United Nations Environment Programme Finance Initiative Principles for Responsible Banking, which aims to promote sustainable finance around the globe. In addition, NatWest Group is also represented on the Climate Financial Risk Forum established by the PRA and FCA to shape the financial service industry's response to the challenges posed by climate risk.

## Operational risk

Definition

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. It arises from day-to-day operations and is relevant to every aspect of the business.

Sources of risk

Operational risk may arise from a failure to manage operations, systems, transactions and assets appropriately. This can take the form of human error, an inability to deliver change adequately or on time, the non-availability of technology services, or the loss of client data. Systems failure, theft of Group property, information loss and the impact of natural, or man-made, disasters – as well as the threat of cyber attacks – are sources of operational risk. Operational risk can also arise from a failure to account for changes in law or regulations or to take appropriate measures to protect assets.

Key developments in 2021

- Aligned to the implementation of the enterprise-wide risk management framework, a new operational risk policy was approved in April 2021. The new policy sets out the qualitative expectations, guidance and standards that stipulate the nature and extent of permissible risk-taking for operational risk.
- The operational risk appetite was enhanced using a quantitative modelling approach to determine a meaningful quantitative expression of the maximum level of operational risk the Group is willing to accept.
- There was also a continued focus on operational resilience to ensure planning, controls and operational activities remained robust and appropriate, with continuing attention on the potential operational risks arising from changes in working practices.
- The security threat and the potential for cyber-attacks on the Group and its supply chain continue to be closely monitored. During 2021, there was further investment in the Group's defences in response to the evolving threat. There was also continuing focus on assuring the security of the supply chain.

Governance

The risk governance arrangements in place for operational risk are aligned to the requirements set out in the enterprise-wide risk management framework and are consistent with achieving safety, soundness and sustainable risk outcomes. Significant operational risk issues are escalated to the Risk Committee and reported regularly to NatWest Group's Executive Risk Committee and Board Risk Committee.

Risk appetite

Operational risk appetite supports effective management of all operational risks. It expresses the level and types of operational risk the Group is willing to accept to achieve its strategic objectives and business plans. The Group's operational risk appetite statement encompasses the full range of operational risks faced.

**Operational risk** continued

### Mitigation

The Control Environment Certification (CEC) process is a half-yearly self-assessment by the CEO. It provides a consistent and comparable view on the adequacy and effectiveness of the internal control environment.

CEC covers material risks and the underlying key controls, including financial, operational and compliance controls, as well as supporting risk management frameworks. The CEC outcomes, including forward-looking assessments for the next two half-yearly cycles and progress on control environment improvements, are reported to Risk Committee. They are also shared with external auditors.

The CEC process helps to ensure compliance with the NatWest Group Policy Framework, Sarbanes-Oxley 404 requirements concerning internal control over financial reporting (as referenced in the Compliance report of the NatWest Group Annual Report and Accounts), and certain requirements of the UK Corporate Governance Code.

Risks are mitigated by applying key preventative and detective controls, an integral step in the risk assessment methodology which determines residual risk exposure. Control owners are accountable for the design, execution, performance and maintenance of key controls. Key controls are regularly assessed for adequacy and tested for effectiveness. The results are monitored and, where a material change in performance is identified, the associated risk is re-evaluated.

### Monitoring and measurement

Risk and control assessments are used across all business areas and support functions to identify and assess material operational and conduct risks and key controls. All risks and controls are mapped to the NatWest Group's Risk Directory. Risk assessments are refreshed at least annually to ensure they remain relevant and capture any emerging risks and also ensure risks are reassessed.

The process is designed to confirm that risks are effectively managed in line with risk appetite. Controls are tested at the appropriate frequency to verify that they remain fit-for-purpose and operate effectively to reduce identified risks.

The Group uses the standardised approach to calculate its Pillar 1 operational risk capital requirement. This is based on multiplying three years' average historical gross income by coefficients set by the regulator based on business line.

As part of the wider Internal Capital Adequacy Assessment Process an operational risk economic capital model is used to assess Pillar 2A, which is a risk-sensitive add-on to Pillar 1. The model uses historical loss data (internal and external) and forward-looking scenario analysis to provide a risk-sensitive view of the Group's Pillar 2A capital requirement.

Scenario analysis is used to assess how severe but plausible operational risks will affect the Group as part of the NatWest Group process. It provides a forward-looking basis for evaluating and managing operational risk exposures.

Refer to the Capital, liquidity and funding risk section for operational risk capital requirement figures.

### Operational resilience

The Group manages and monitors operational resilience through its risk and control assessment methodology. This is underpinned by setting and monitoring risk indicators and performance metrics for key business services. Progress continues on the response to regulator expectations on operational resilience, with involvement in a number of industry-wide operational resilience forums. This enables a more holistic view of the operational resilience risk profile and the pace of ongoing innovation and change, both internally and externally.

### Event and loss data management

The operational risk event and loss data management process ensures the Group captures and records operational risk financial and non-financial events that meet defined criteria. Loss data is used for regulatory and industry reporting and is included in capital modelling when calculating economic capital for operational risk. The most serious events are escalated in a simple, standardised process to all senior management, by way of a Group Notifiable Event Process.

## Model risk

The Group uses a variety of models in the course of its business activities. Examples include the use of model outputs to support client decisioning, measuring and assessing risk exposures. A governance framework is in place to ensure policies and processes relating to models are appropriate and effective.

The NatWest Group Model Risk Oversight Committee provides a direct escalation route to the NatWest Group Executive Risk Committee and, where applicable, onwards to the NatWest Group Board Risk Committee.

## Reputational risk

### Definition

Reputational risk is defined as the risk of damage to stakeholder trust due to negative consequences arising from internal actions or external events.

### Sources of risk

Reputational risks originate from internal actions and external events. The three primary drivers of reputational risk have been identified as: failure in internal execution; a conflict between the Group's values and the public agenda; and contagion (when the Group's reputation is damaged by failures in the wider financial sector).

**Reputational risk** continued

### Key developments in 2021

- Reputational risk registers were introduced at NatWest Group level in order to enhance monitoring of the most material reputational risks.
- An updated reputational risk appetite statement was introduced with a specific focus on public trust.
- The correlation between reputational risk and climate change issues remained a significant area of focus during 2021.

### Governance

A reputational risk policy supports reputational risk management across NatWest Group. The NatWest Group's Reputational Risk Committee – which has delegated authority from the NatWest Group Executive Risk Committee – opines on cases, issues, sectors and themes that represent a material reputational risk. The NatWest Group Board Risk Committee oversees the identification and reporting of reputational risk. The NatWest Group Sustainable Banking Committee has a specific focus on environmental, social and ethical issues.

### Risk appetite

The Group manages and articulates its appetite for reputational risk through a qualitative reputational risk appetite statement that sets expectations around the identification, measurement and management of reputational risk exposures arising from internal actions and external events.

### Monitoring and measurement

Relevant internal and external factors are monitored through regular reporting to the Reputational Risk Committee and escalated, where appropriate, to NatWest Group Reputational Risk Committee, NatWest Group Board Risk Committee or the NatWest Group Sustainable Banking Committee.

### Mitigation

Standards of conduct are in place across NatWest Group requiring strict adherence to policies, procedures and ways of working to ensure business is transacted in a way that meets – or exceeds – stakeholder expectations.

External events that could cause reputational damage are identified and mitigated through NatWest Group's top and emerging risks process as well as through the NatWest Group and franchise-level risk registers.

# REPORT OF THE DIRECTORS

The directors present their report together with the audited accounts for the year ended 31 December 2021. It should be read in conjunction with the Strategic report.

### Directors and secretary

The names of the current members of the Board of Directors are shown on page 8.

From 1 January 2021 to date, changes that have taken place are shown under 'Appointments and Resignations' on page 8.

### Share capital

Analysis of share capital and paid-in equity can be found in notes 15 and 16 respectively to the financial statements.

### Dividends

An interim dividend of £105 million was paid during the year (2020 - nil).

The Bank declared coupon payments of £12 million during the year (2020 - £12 million) on Additional Tier 1 notes.

During the year, the Bank received a dividend of £15 million from Coutts Finance Co (2020 - £25 million).

The directors do not recommend the payment of a final dividend (2020 - nil).

### Going concern

The Group business activities and financial position, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 2 to 7.

Having reviewed the content of these and the Bank forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Bank will continue in operational existence for a period of 12 months from the date of this report. Accordingly, the financial statements of the Bank have been prepared on a going concern basis.

## Governance

### Our Board

The Board has seven directors comprising the Independent Non-Executive Chair, two Executive Directors, one Non-Independent Non-Executive Director and three Independent Non-Executive Directors. Director biographies can be found at coutts.com.

The Board is collectively responsible for the long-term success of the Bank; approving the strategic priorities and delivering sustainable value to its shareholder. It monitors and maintains the consistency of the Bank's activities within the strategic direction of NatWest Group. It reviews and approves risk appetite for strategic and material risks in accordance with NatWest Group Risk Appetite Framework, and it monitors performance against risk appetite for the Bank. It approves the Bank's key financial objectives and keeps the capital and liquidity positions of the Bank under review. The Board is also responsible for purpose and culture, which underpins all of the Bank's activities and its long-term sustainability.

In order to extend its effective oversight and leadership, the Board has an Audit Committee, Risk Committee, Nominations Committee and Performance and Remuneration Committee.

### Audit Committee

The Committee is responsible for discharging the Board's responsibilities for monitoring the quality of the financial statements. It reviews the accounting policies, financial reporting and relevant compliance practices of the Bank. It also reviews the Bank's systems and standards of internal controls and monitors the Bank's processes for internal and external audit.

### Risk Committee

The Committee provides oversight and advice to the Board on current and potential risk exposures and on future risk strategy. It reviews compliance with approved risk appetite and oversees the operation within the Bank of NatWest Group's Risk Policy Framework.

### Performance and Remuneration Committee

The Committee is responsible for overseeing the implementation within the Bank of NatWest Group's remuneration policy, and of performance and remuneration arrangements.

### Nominations Committee

The Committee is responsible for assisting the Board in the formal selection and appointment of directors. It reviews the structure, size and composition of the Board, and the membership and chairmanship of Board committees.

### Executive Committee

The Board is supported by the Executive Committee comprising the executive directors and other senior executives. It supports the Chief Executive Officer (CEO) in managing the Bank's businesses and reviewing relevant items before consideration by the Board. It is responsible for developing and delivering the Bank's strategy and culture as well as monitoring and managing financial performance, capital allocation, risk strategy and policy, risk management, operational issues and client issues for the Bank.

### Directors' indemnities

In terms of Section 236 of the Companies Act 2006, all directors listed on page 8 have been granted Qualifying Third Party Indemnity Provisions by NatWest Group.

### The Wates Corporate Governance Principles

The Companies (Miscellaneous Reporting) Regulations 2018 introduced new statutory reporting requirements for financial years beginning on or after 1 January 2019. As a result of these new requirements, the directors of the Bank are required to provide a statement in the Report of the directors stating which corporate governance code the Bank followed during the year, how it applied the code and any part of the code it did not follow.

For the financial year ended 31 December 2021 the Bank has chosen to report against the Wates Corporate Governance Principles for Large Private Companies, published by the FRC in December 2018 and available on the FRC website (the Wates Principles). The disclosures below explain how the Bank has applied the Wates Principles in the context of its corporate governance arrangements.

# REPORT OF THE DIRECTORS

## 1. Purpose and Leadership

Aligned to NatWest Group, the Bank's purpose is to champion potential, helping people, families and businesses to thrive. Further information on NatWest Group's purpose can be found on natwestgroup.com.

The purpose and strategy for the NatWest Group is approved by the NatWest Group Board and cascaded to subsidiaries. The Board of the Bank approves and monitors the purpose and strategic direction of the Bank within the parameters set by the NatWest Group.

The Bank's vision is to be the best Wealth Manager for the UK, measured through client satisfaction, colleague engagement and financial returns. The Board oversees the execution of strategy and holds management to account for its delivery. This is done through a mix of reporting, Board and other meetings and Board strategy sessions.

Building a healthy culture that embodies Our Values is also a core priority for the Bank as well as the NatWest Group more generally. Our Values, which guide the way NatWest Group identifies the right people to serve clients well, and how to manage, engage and reward colleagues, are at the heart of Our Code (the NatWest Group-wide Code of Conduct).

There is regular reporting to the Board on culture which allows the Board to have appropriate oversight of culture matters. This includes 6-monthly reviews of 'Our View' colleague survey results and culture measurement reports, as well as of the Bank's risk culture. Additional engagement with colleagues was also undertaken, and support provided, in response to the COVID-19 pandemic. The Board also considers the overall alignment of purpose and strategy with culture and values.

## 2. Board Composition

Details on the Board and its Committees are presented in the section Governance above (see page 44).

The Board's Nominations Committee reviews the structure, size and composition of the Board, and ensures there is an appropriate mix of skills, knowledge, experience and diversity, as well as independence. The Nominations Committee further supports the Board in succession planning.

Board diversity is supported by a Boardroom Inclusion Policy, which includes gender and ethnicity diversity targets. The policy sets out the aspiration to meet the targets set by the Hampton-Alexander Report on "FTSE100 Women Leaders" (33% female balance) and the Parker Report "Beyond 1 by '21" (at least one director from an ethnic minority background to be included on the list of candidates by 2020/21). Board diversity improved in 2021 as a result of changes in Board composition however, it remains below the gender target. The Board remains focused on developing its diversity, both across gender and ethnic diversity, and has factored these considerations into its current succession planning activities.

The size of the Board is considered appropriate, taking into account the size and scale of the Bank's business.
The independent non-executive directors combine broad business and commercial experience with independent and objective judgment and provide independent challenge to the executive directors and the leadership team. The balance between independent non-executive and executive directors enables the Board to provide clear and effective leadership across the Bank's business activities. The role of the Chair is to lead the Board and ensure its overall effectiveness and is distinct and separate from that of the CEO, who manages the business day-to-day.

A review of the effectiveness of the Board is conducted at least annually. The 2021 evaluation was facilitated by the Company Secretary in December 2021, with conclusions finalised the following month. The evaluation examined a number of areas, including the Board's continued response to COVID-19; its focus on purpose, strategy and stakeholders; the Board's culture, dynamics and operation; and relationship with the NatWest Group. Positive feedback was given across all these areas, and the evaluation concluded that the Board had operated effectively throughout 2021. A number of recommendations were also agreed for the Board to focus on during 2022.

Non-executive directors participate in scheduled Board training sessions and other external sessions, as required. An active Board training programme was maintained through 2021, with a particular focus on climate change training. Other topics included Financial Crime, Cyber Risk, Diversity & Inclusion and Asset Management developments. Directors also request individual in-depth briefings from time to time on areas of particular interest and would ordinarily also undertake visits to regional offices – albeit none were undertaken in 2021 on account of the pandemic. An induction programme is provided for all new directors, which is tailored to their specific experience and knowledge.

## 3. Director Responsibilities

All directors receive guidance on their statutory duties under the Companies Act 2006 and are supported in the discharge of their duties by the Company Secretary.

NatWest Group has a Corporate Governance Framework, including a Corporate Governance Policy, which sets out the key aspects of the governance framework as they relate to its key subsidiaries. The Corporate Governance Policy provides high-level guidance to the Board on how the Bank should be managed in line with NatWest Group policy and best practice.

The Board and its Committees have Terms of Reference which clearly map out their respective authority, responsibilities and accountabilities. Each director has a role profile which clearly articulates their responsibilities and accountabilities, and any additional regulatory responsibilities are set out in their Statement of Responsibilities, as provided for under the UK's Senior Managers Regime. The Board holds regular quarterly meetings, a number of strategy sessions, and other meetings as required.

Directors' conflicts of interest are managed in accordance with conflicts of interest guidance. The Bank maintains a register of directors' interests and appointments, and this is presented at each quarterly Board meeting for review.

The Chair, CEO and Company Secretary are responsible for the quality and integrity of information provided to directors. The Board receives regular information on key aspects of the business, including monthly reports from the CEO, in addition to reporting provided to the quarterly Board meetings.

Extensive internal processes are in place to ensure that the quality and integrity of information provided to the Board is reliable and able to support effective decision-making. This is supported by assurance undertaken by second and third lines of defence teams, who respectively provide quarterly Risk and Internal Audit opinions to the quarterly Board Risk and Audit Committees.

# REPORT OF THE DIRECTORS

4. Opportunity and Risk

The role of the Board is to promote the long-term, sustainable success of the Bank, which already has a heritage of over 300 years. Opportunities are primarily identified through regular Board reviews of the different parts of the Bank's business and an annual Board strategy session, drawing on client and external market insights, and are framed within the overall strategy of the NatWest Group.

The Board reviews and approves risk appetite for strategic and material risks in accordance with the NatWest Group Risk Appetite Framework, monitors performance against risk appetite for the Bank, considers any material risks and approves, as appropriate, recommended actions escalated by the Coutts Board Risk Committee.

The Bank's risk strategy is informed and shaped by an understanding of the risk landscape including a range of significant risks and uncertainties in the external economic, political and regulatory environments.

The Bank complies with NatWest Group's risk appetite framework, which is approved annually by the NatWest Group plc Board, in line with NatWest Group's risk appetite statements, frameworks and policies. NatWest Group risk appetite is set in line with overall strategy.

NatWest Group operates an integrated risk management framework, which is centred around the embedding of a strong risk culture. The framework ensures the tools and capability are in place to facilitate sound risk management and decision-making across the organisation.

During 2021, a number of enhancements to the risk management framework were developed. The increasing significance of climate risk was considered as part of these developments and will be fully integrated as part of the implementation of the enhanced framework in 2022.

The Bank also complies with the NatWest Group Policy Framework, the purpose of which is to ensure that NatWest Group establishes and maintains NatWest Group-wide policies that adequately address the material inherent risks it faces in its business activities.

Further information on the Bank's risk management framework including risk culture, risk governance, risk appetite, risk controls and limits, and risk identification and measurement can be found in the Risk and Capital management section of this report (pages 9 to 43).

5. Remuneration

The NatWest Group Remuneration Policy provides a consistent policy across all companies in NatWest Group and ensures compliance with regulatory requirements. The remuneration policy is aligned with the business strategy, objectives, values and long-term interests of the Bank. The policy supports a culture where individuals are rewarded for delivering sustained performance in line with risk appetite and for demonstrating the right conduct and behaviours.

The Bank has a Performance & Remuneration Committee (RemCo) with non-executive directors as members. In addition to reviewing remuneration for executives of the Bank, the RemCo considers reports on the wider workforce including annual pay outcomes and diversity information. The RemCo helps to ensure that the remuneration policies, procedures and practices being applied are appropriate at the Bank level.

Executive remuneration structures incentivise individuals to deliver sustainable performance based on strategic objectives for the NatWest Group and the Bank. Performance is assessed against a balanced scorecard of financial and non-

financial measures and variable pay is subject to deferral as well as malus and clawback provisions to ensure rewards are justified in the long-term.

The NatWest Group is committed to providing a fair wage for the role performed. The Bank is a fully accredited Living Wage Employer with rates of pay that continue to exceed the Living Wage Foundation Benchmarks.

6. Stakeholder Relationships and Engagement

The Bank is committed to engaging with its stakeholders and to bringing their voice into key decisions, as well as managing the wider social, environmental and economic impacts of its operations, as a cornerstone of building a sustainable business.

The Board recognises the importance of engaging with stakeholders and discussions at Board meetings are focused around the impact that the Bank's activities may have on key stakeholder groups. For further details on the Board's engagement with colleagues, clients, suppliers and others, and how these stakeholder interests have been taken into account, see pages 4 to 7 of the Strategic report, which includes a section 172(1) statement.

**Post balance sheet events**

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

**Political donations**

During 2021, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

**Directors' disclosure to auditor**

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

- so far as the director is aware, there is no relevant audit information of which the Group and the Bank's auditor is unaware; and
- the directors have taken all steps they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Group and the Bank's auditor is aware of that information.

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

**Auditor**

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

A resolution to re-appoint Ernst & Young LLP as the Group's auditor will be proposed at the forthcoming Annual General Meeting.
By order of the Board:

Waldegrave of North Hill
Waldegrave of North Hill (Mar 15, 2022 17:36 GMT)

The Rt Hon Lord Waldegrave of North Hill
Chair
Date: 15 March 2022
Coutts & Company is registered in England and Wales No. 00036695

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 48.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required to prepare Group financial statements, and as permitted by the Companies Act 2006 have elected to prepare Bank financial statements, for each financial year in accordance with UK adopted International Accounting Standards. They are responsible for preparing financial statements that present fairly the financial position, financial performance and cash flows of Group and Bank. In preparing those financial statements, the directors are required to:

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

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

Under applicable law and regulations, the directors are also responsible for preparing a Strategic report and Directors' report, that comply with that law and those regulations. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with UK adopted International Accounting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and
- the Strategic report and Directors' report (incorporating the Financial review) includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board:

Waldegrave of North Hill
Waldegrave of North Hill (Mar 15, 2022 17:36 GMT)

The Rt Hon Lord Waldegrave of North Hill
Chair

Date: 15 March 2022

**Board of Directors**

| **Chair, Non-Executive Director** | **Executive Directors** | **Non-Executive Directors** |
|---|---|---|
| The Rt Hon Lord Waldegrave of North Hill | Peter Gordon Flavel | Mark Joseph Lund |
| | Andrew Richard Kyle | Linda Hamilton Urquhart OBE |
| | | Matthew Edward James Waymark |
| | | Sharmila Nebhrajani OBE |

### Opinion

In our opinion:

- the financial statement of Coutts & Company (the 'Bank') and its subsidiaries (together, the 'Group') give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK adopted international accounting standards;
- the Bank's financial statements have been properly prepared in accordance with UK adopted international accounting standards as applied in accordance with section 408 of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of the Bank and the Group for the year ended 31 December 2021 which comprise:

| Group | Bank |
|---|---|
| • Consolidated balance sheet as at 31 December 2021;<br>• Consolidated statement of comprehensive income for the year then ended;<br>• Consolidated statement of changes in equity for the year then ended;<br>• Consolidated cash flow statement for the year then ended;<br>• Related notes 1 to 23 to the financial statements;<br>• Accounting Policies on pages 59 to 62; and<br>• Information included in the Risk and capital management section identified as 'audited'. | • Balance sheet as at 31 December 2021;<br>• Statement of changes in equity for the year then ended;<br>• Cash flow statement for the year then ended;<br>• Related notes 1 to 23 to the financial statements, as applicable to the Bank;<br>• Accounting Policies on pages 59 to 62, as applicable to the Bank; and<br>• Risk and capital management section identified as 'audited', as applicable to the Bank. |

The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, and, as regards to the Bank financial statements, as applied in accordance with section 408 of the Companies Act 2006.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Independence

We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

### Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the Group and Bank's ability to continue to adopt the going concern basis of accounting included:

- In conjunction with our walkthrough of the Group's financial close process, we confirmed our understanding of the directors' going concern assessment process and also engaged with the directors early to ensure all key factors were considered in their assessment;
- We evaluated the directors' going concern assessment, which covered a period of 12 months from the date these financial statements are authorised for issue, by reviewing their evaluation of long-term business and strategic plans, capital adequacy, liquidity and funding positions. In addition, we also assessed these positions considering internal stress tests which included consideration of principal and emerging risks. The Group's risk profile and risk management practices were considered including credit risk, market risk, compliance and conduct risk, and operational risk. We also evaluated the accuracy of the group forecasts and assessed their reasonableness;
- We evaluated the director's assessment by using economic specialists in assessing the macroeconomic assumptions in the forecast through benchmarking to institutional forecasts;
- We considered the Group's operational resilience, including the operations of its third-party providers and the dependencies of the Bank to the Natwest Group; and
- We reviewed the Group's going concern disclosures included in the annual report in order to assess that the disclosures were appropriate and in conformity with the reporting standards.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and Bank's ability to continue as a going concern for a period up to 15 March 2023, being not less than twelve months from when the financial statements are authorised for issue.

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

### Overview of our audit approach

| | |
|---|---|
| Audit scope | • We performed an audit of the complete financial information of the Group |
| Key audit matters | • Impairment of loans<br>• Legal entity recharges, including intercompany balances |
| Materiality | • Overall Group materiality has been set at £14 million which represents 8% of adjusted profit before tax. |

### Tailoring the audit scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Group. We take into account the size and risk profile of the Bank's subsidiaries and its activities, the organisation of the Group and effectiveness of Group wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed. The audit scope is consistent with prior year.

As a result of the continued impact of the COVID-19 outbreak and resulting lockdown restrictions for part of the year, we continued with the audit strategy developed in prior year in order to allow for the audit to be performed remotely. This approach was supported through remote user access to the Group's financial systems and the use of EY software collaboration platforms for the secure and timely delivery of requested audit evidence.

### Climate change

There has been increasing interest from stakeholders as to how climate change will impact companies. The Group has determined that the most significant future impacts from climate change on its operations will be from credit risk, and investment risk. These are explained in the Climate Risk related section in the Strategic Report, and in the Climate Risk section within the Risk and capital management section, which form part of the "Other information". Our procedures on these disclosures consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated.

As explained in the Accounting Policy note with regards to accounting judgments and estimates, the Group has concluded that the impacts arising from climate risk will be longer term in nature, with an inherent level of uncertainty, and have limited effect on accounting judgments and estimates for the current period.

Our audit effort in considering climate change was focused on reviewing and challenging the Group's conclusion that there were limited effects of climate risks in the assets and liabilities valuations as disclosed in the Accounting Policy note.

Whilst the Group has stated its commitment to the aspirations of the Paris Agreement to achieve net zero emissions by 2050, as stated above the impacts arising will be longer term in nature, and there is an inherent level of uncertainty in determining the full future economic impact on their business model, operational plans and customers.

### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters. The Key audit matters are consistent with prior year with the exception of "Provision for conduct, litigation and regulatory matters" which was removed this year following our updated assessment of the nature, magnitude, and likelihood of any related matter.

| Risk | Our response to the risk |
|---|---|
| **Impairment of loans** | |
| At 31 December 2021 the Group reported total gross loans of £18.17 billion (2020: £16.84 billion) and £75 million (2020: £134 million) of expected credit loss provisions.<br><br>Management's judgements and estimates are especially subjective due to uncertainty associated with the assumptions used. Uncertainty associated with the path to recovery from COVID-19 and the impact of climate change were considered in our risk assessment.<br><br>Aspects with increased complexity in respect of the timing and measurement of expected credit losses (ECL) include:<br><br>• Staging - Allocation of assets to stage 1, 2, or 3 on a timely basis using criteria in accordance with IFRS 9;<br>• Model estimations - Accounting interpretations, modelling assumptions and data used to build and select the most appropriate models that calculate the ECL;<br>• Economic scenarios - Inputs, assumptions and weightings used to estimate the impact of multiple economic scenarios particularly those influenced by COVID-19 including any changes to scenarios required through 31 December 2021;<br>• Adjustments - Appropriateness, completeness and valuation of model adjustments including any COVID-19 specific adjustments due to the ongoing uncertainty which increases the risk of management override;<br>• Individual provisions - Measurement of individual provisions including the assessment of multiple scenarios considering the impact of COVID-19 on exit strategies, collateral valuations and time to collect; and<br>• Disclosure - The completeness and preparation of disclosures considering the key judgments, sources of data and the design of the disclosures. | Controls testing - We tested the design and operating effectiveness of controls across the processes relevant to ECL, including the judgements and estimates noted. These controls, among others, included:<br>• the allocation of assets into stages including management's monitoring of stage effectiveness;<br>• model governance including monitoring, the governance and model validation;<br>• data accuracy and completeness;<br>• credit monitoring;<br>• multiple economic scenarios;<br>• individual provisions and<br>• production of journal entries and disclosures.<br><br>In evaluating the governance process we observed the executive finance and risk committee meetings where the inputs, assumptions and adjustments to the ECL were discussed and approved, among other procedures.<br><br>Overall assessment - We performed an overall assessment of the ECL provision levels by stage to assess if they were reasonable by considering the overall credit quality of the Group's portfolios, risk profile, impact of the COVID-19 including geographic considerations and high risk industries.<br><br>Based on our assessment of the key judgments we used EY specialists to support the audit team in the areas of economics, modelling and collateral and business valuations. We performed peer benchmarking where available to assess overall staging and provision coverage levels.<br><br>Staging - We evaluated the criteria used to allocate a financial asset to stage 1, 2 or 3 in accordance with IFRS 9; this included peer benchmarking to assess staging levels. We recalculated the assets in stage 1, 2 and 3 to assess if they were allocated to the appropriate stage and performed sensitivity analysis to assess the impact of different criteria on the ECL. and also considered the impact of performing collective staging downgrades to industries.<br><br>To test credit monitoring which drives the probability of default estimates used in the staging calculation, we recalculated the risk ratings for a sample of performing loans and focused our testing on high-risk industries. For commercial exposures, we also assessed the timing of the annual review performed by management to evaluate whether it appropriately considered risk factors by considering independent publicly available information.<br><br>Model estimations - We involved modelling specialists to assist us to test a sample of ECL models by testing the assumptions, inputs and formulae used. This included a combination of assessing the appropriateness of model design and formulae used, alternative modelling techniques, recalculating the Probability of Default, Loss Given Default and Exposure at Default, and model implementation. We also considered the results of internal model validation results.<br><br>We also assessed and challenged the appropriateness of the models selected by management and evaluated the justification for their use.<br><br>To evaluate data quality, we agreed a sample of ECL calculation data points to source systems, including balance sheet data used to run the models and historic loss data to monitor models. We also tested the ECL data points from the calculation engine through to the general ledger and disclosures.<br><br>Economic scenarios - We involved economic specialists to assist us to evaluate the base case and alternative economic scenarios, including evaluating probability weights and comparing these to other scenarios from a variety of external sources. This assessment included the latest developments related to COVID-19 as at 31 December 2021. We assessed whether forecasted macroeconomic variables were complete and appropriate, such as GDP, unemployment rate, interest rates and the House Price Index. With the support of our modelling specialists, we evaluated the correlation and translation of the macroeconomic factors to the ECL. |

| Risk | Our response to the risk |
|---|---|
| **Impairment of loans continued** | |
| | Adjustments - We tested material post-model adjustments including those which were applied as a result of COVID-19. With our modelling specialists, we assessed the completeness of these adjustments and their appropriateness by considering the data, judgments, methodology, sensitivities, and governance of these adjustments as well as considering model shortcomings.<br><br>Individual provisions - We involved valuation specialists to recalculate a sample of individual provisions including the alternative scenarios and evaluating probability weights assigned. The sample was based on a number of factors, including higher risk sectors such as commercial real estate and retail. We considered the impact that COVID-19 and climate change had on collateral valuations and time to collect as well as whether planned exit strategies remained viable.<br><br>Disclosure - We tested the data used to populate the disclosures and assessed the adequacy of disclosures for compliance with the accounting standards and regulatory considerations. |

**Key observations communicated to the Audit Committee**

We are satisfied that the provision for the impairment of loans were reasonable and recognised in compliance with IFRS 9. We highlighted the following matters to the Audit Committee:

- Our testing on the IFRS 9 staging criteria identified errors in the data inputs resulting in differences related to the Bank's staging allocation. These disclosure differences remained uncorrected and were considered by management not to be material, including the associated ECL impact. We concurred with management.
- Our testing of the selection of Models, Model estimations, Economic scenarios, Adjustments and Individual provisions. We identified judgemental differences which remained uncorrected and were considered by management not to be material. We concurred with management.

We continue to note certain data quality related control deficiencies, some of which were identified in prior periods.
We identified and tested compensating controls with no issues noted.

**Relevant references in the Annual Report and Accounts**

Credit risk section of the Risk and Capital management section
Accounting policies
Note 8 on the financial statements

| Risk | Our response to the risk |
|---|---|
| **Legal entity recharges, including intercompany balances** | |
| The majority of Natwest Group-wide costs are paid centrally by the ultimate holding company, and recharged to other Natwest Group companies, including the Bank. Natwest Group recharges currently constitute the majority of the Bank's total cost base (2021: £213 million, 2020: £212 million). These costs are recharged in line with the Inter-group Agreements ("IGA") and transfer pricing policy.<br><br>Accounting and reporting risk arising includes:<br>• recharged costs may not be calculated in accordance with the revised NatWest Group IGA and transfer pricing methodology;<br>• risk of errors in the computation of recharges; and<br>• inappropriate or inadequate reconciliation of recharges and intercompany transactions and resultant balances among entities of the NatWest Group. | We tested the design and operating effectiveness of the Group's key controls over the completeness and accuracy of cost recharges, including the review of the service catalogue, the allocation metrics and net recharge balance by management as well as the application controls to calculate the allocation of costs and the mark-ups applied. This included understanding Natwest Group's recharging processes and controls, including how management ensures the assessment is complete.<br><br>The transfer pricing methodology was reviewed by our tax specialists.<br><br>We tested the intercompany reconciliation process at year-end and confirmed the year-end intra-group balances.<br><br>We also tested a sample of costs recharged and agreed them to supporting documentation. |

**Key observations communicated to the Audit Committee**

We are satisfied that the cost recharged in the year were reasonable.
Our testing highlighted errors with regards to the amounts charged to the Group which remained uncorrected and were considered by management not to be material. We concurred with management.

**Relevant references in the Annual Report and Accounts**

Accounting policies
Note 3 of the financial statements

### Our application of materiality

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

### Materiality

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

We determined materiality for the Group to be £14 million (2020: £15 million), which is 8% of profit before tax of the Group adjusted for certain loan impairment releases arising from COVID-19 and conduct costs. We believe that this basis is consistent with the basis from the prior year and we believe it reflects the most useful measure for users of the financial statements.

### Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% of our planning materiality (2020: 75%), namely £7 million (2020: £11 million). We have decreased the percentage of performance materiality from the prior year considering the past history of misstatements, the effectiveness of the control environment and other factors affecting the Group and its financial reporting.

### Reporting threshold

*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.7 million (2020: £0.7 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

### Other information

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

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

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

We have nothing to report in this regard.

### Opinions on other matters prescribed by the Companies Act 2006

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

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

### Matters on which we are required to report by exception

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

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

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

### Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 47, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### Auditor's responsibilities for the audit of the financial statements

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

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

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

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant are the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA); Tax Legislation as governed by HM revenue and Customs; and Companies Act 2006.
- We understood how the Group is complying with those frameworks by making inquiries of management, internal audit and those responsible for legal and compliance matters. We also reviewed correspondence between the Group and regulatory bodies; reviewed minutes of the Risk Committees; and gained an understanding of the Group's governance framework.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by considering the controls established to address risks identified to prevent or detect fraud. We also identified the risks of fraud in our key audit matters as described above and in other identified areas that we considered relevant when performing our fraud procedures, such as cybersecurity, the impact of remote working, valuation of investment property, and the appropriateness of sources used when performing confirmation testing on accounts such as cash and loans.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiries of legal counsel, executive management, and internal audit. We also tested controls and performed procedures to respond to the fraud risks as identified in our key audit matters.
- The Group operates in the banking industry which is a highly regulated environment. As such, the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, involving specialists where appropriate.

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

### Other matters we are required to address

- We were appointed by the Group at its annual general meeting on 4 May 2016 to audit the financial statements of the Group for the period ending 31 December 2016 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 6 years, covering periods from our appointment through 31 December 2021.

The audit opinion is consistent with the additional report to the Audit Committee.

### Use of our report

This report is made solely to the company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company’s 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.

Ernst & Young LLP

Andrew Bates (Mar 15, 2022 18:31 GMT)

*Andrew Bates (Senior Statutory Auditor)*
*for and on behalf of Ernst & Young LLP, Statutory Auditor*
*London*
*Date: 15 March 2022*

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2021

| | Note | 2021 £m | 2020 £m |
|---|---|---|---|
| Interest receivable | | 493 | 520 |
| Interest payable | | (72) | (101) |
| Net interest income | 1 | 421 | 419 |
| Fees and commissions receivable | | 245 | 223 |
| Fees and commissions payable | | (33) | (25) |
| Other operating income | | 25 | 17 |
| Non-interest income | 2 | 237 | 215 |
| Total income | | 658 | 634 |
| Staff costs | | (150) | (149) |
| Premises and equipment | | (36) | (20) |
| Depreciation & amortisation | | (19) | (18) |
| Other administrative expenses | | (256) | (212) |
| Operating expenses | 3 | (461) | (399) |
| Profit before impairment releases/(losses) | | 197 | 235 |
| Impairment releases/(losses) on loans and advances | 8 | 57 | (107) |
| Impairment losses on other assets | | - | (1) |
| Operating profit before tax | | 254 | 127 |
| Tax charge | 6 | (66) | (33) |
| Profit and total comprehensive income for the year | | 188 | 94 |

The accompanying notes, on pages 63 to 83, and the accounting policies, on pages 59 to 62, form an integral part of these financial statements.

## CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2021

| | 2021 £m | 2020 £m |
|---|---|---|
| Profit for the year | 188 | 94 |
| Items that do qualify for reclassification | | |
| Cash flow hedges | 1 | - |
| | 1 | - |
| Other comprehensive income after tax | 1 | - |
| Total comprehensive income for the year | 189 | - |
| | | |
| Attributable to: | | |
| Ordinary shareholders | 177 | 82 |
| Paid-in equity holders | 12 | 12 |
| | 189 | 94 |

## BALANCE SHEETS AS AT 31 DECEMBER 2021

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | 2021 | 2020 | 2021 | 2020 |
| | Note | £m | £m | £m | £m |
| **Assets** | | | | | |
| Cash and balances at central banks | 7 | 3 | 3 | 3 | 3 |
| Loans to banks - amortised cost | 7 | 343 | 333 | 321 | 312 |
| Loans to customers - amortised cost | 7 | 17,705 | 16,317 | 17,388 | 15,887 |
| Amount due from holding companies and fellow subsidiaries | 7 | 28,433 | 21,343 | 28,682 | 21,714 |
| Derivatives | 7, 9 | 14 | 29 | 14 | 29 |
| Investment in Group undertakings | 7, 10 | - | - | 110 | 110 |
| Other assets | 7, 12 | 415 | 409 | 397 | 391 |
| Total assets | | 46,913 | 38,434 | 46,915 | 38,446 |
| **Liabilities** | | | | | |
| Bank deposits | 7 | 2 | 4 | 2 | 4 |
| Customer deposits | 7 | 36,971 | 30,142 | 36,971 | 30,142 |
| Amount due to holding companies and fellow subsidiaries | 7,14 | 8,295 | 6,688 | 8,291 | 6,686 |
| Derivatives | 7, 9 | 12 | 28 | 12 | 28 |
| Other liabilities | 7, 13 | 126 | 137 | 118 | 130 |
| Total liabilities | | 45,406 | 36,999 | 45,394 | 36,990 |
| Owner's equity | | 1,507 | 1,435 | 1,521 | 1,456 |
| Total equity | | 1,507 | 1,435 | 1,521 | 1,456 |
| Total liabilities and equity | | 46,913 | 38,434 | 46,915 | 38,446 |

Owner's equity of the Bank as at 31 December 2021 includes the profit for the year then ended of £181 million (2020 - £93 million).

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement.

The accompanying notes, on pages 63 to 83, and the accounting policies, on pages 59 to 62, form an integral part of these financial statements.

The accounts were approved by the Board of Directors on 15 March 2022 and signed on its behalf by:

Andrew Kyle
Andrew Kyle (Mar 15, 2022 17:32 GMT)

Andrew Richard Kyle
Executive Director

Waldegrave of North Hill
Waldegrave of North Hill (Mar 15, 2022 17:36 GMT)

The Rt Hon Lord Waldegrave of North Hill
Chair

## STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2021

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | 2021 | 2020 | 2021 | 2020 |
| | Note | £m | £m | £m | £m |
| Called-up share capital at 1 January and 31 December | 15 | 41 | 41 | 41 | 41 |
| Paid-in equity at 1 January and 31 December | 16 | 200 | 200 | 200 | 200 |
| Cash flow hedge reserve at 1 January | | - | - | - | - |
| Amount recognised in equity | | 1 | - | 1 | |
| At 31 December | | 1 | - | 1 | - |
| Retained earnings at 1 January | | 855 | 773 | 833 | 752 |
| Profit and total comprehensive income for the year | | 188 | 94 | 181 | 93 |
| Paid-in equity coupon payments | | (12) | (12) | (12) | (12) |
| Ordinary dividends paid | | (105) | - | (105) | - |
| At 31 December | | 926 | 855 | 897 | 833 |
| Capital contribution at 1 January and 31 December | 19 | 339 | 339 | 382 | 382 |
| Owner's equity at 31 December | | 1,507 | 1,435 | 1,521 | 1,456 |

The accompanying notes, on pages 63 to 83, and the accounting policies, on pages 59 to 62, form an integral part of these financial statements.

## CASH FLOW STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | 2021 | 2020 | 2021 | 2020 |
| | Note | £m | £m | £m | £m |
| Cash flows from operating activities | | | | | |
| Operating profit before tax | | 254 | 127 | 241 | 119 |
| Adjustments for: | | | | | |
| Depreciation and amortisation | | 19 | 25 | 19 | 25 |
| Impairment (releases)/losses | | (57) | 107 | (57) | 107 |
| Other non-cash items | | 2 | - | 3 | - |
| Provision releases | | (3) | (28) | (3) | (28) |
| Elimination of foreign exchange differences | | 30 | 57 | 30 | 57 |
| Interest on subordinated liabilities and debt securities in issue | | 12 | - | 12 | - |
| Dividends receivable from subsidiaries | | - | - | (15) | (25) |
| Net cash flows from trading activities | | 257 | 288 | 230 | 255 |
| Decrease/(increase) in derivative assets | | 15 | (7) | 15 | (7) |
| Decrease/(increase) in net loans to banks | | 49 | (11) | 49 | (11) |
| Increase in net loans to customers | | (1,336) | (1,632) | (1,449) | (1,822) |
| Decrease in amounts due from holding companies and fellow subsidiaries | | 9,413 | 159 | 9,513 | 315 |
| Increase in other assets | | (4) | (18) | (2) | (17) |
| Decrease in bank deposits | | (2) | (8) | (2) | (8) |
| Increase in customer deposits | | 6,829 | 3,752 | 6,829 | 3,752 |
| Increase in amounts due to holding companies and fellow subsidiaries | | 1,363 | 650 | 1,360 | 648 |
| (Decrease)/increase in derivative liabilities | | (16) | 8 | (16) | 8 |
| Increase in other liabilities | | 9 | 5 | 5 | 3 |
| Changes in operating assets and liabilities | | 16,320 | 2,898 | 16,302 | 2,861 |
| Income taxes paid | | (78) | (97) | (71) | (85) |
| Net cash flows from operating activities[1] | | 16,499 | 3,089 | 16,461 | 3,031 |
| Cash flows from investing activities | | | | | |
| Purchase of property, plant and equipment | | (4) | (10) | (4) | (10) |
| Sale of property, plant & equipment | | 3 | - | 3 | - |
| Purchase of intangible assets | | (27) | (20) | (27) | (20) |
| Sale of intangible assets | | 1 | 1 | 1 | - |
| Dividends received from subsidiaries | | - | - | 15 | 25 |
| Net cash flows from investing activities | | (27) | (29) | (12) | (5) |
| Cash flows from financing activities | | | | | |
| Issue of debt securities in issue | | 252 | - | 252 | - |
| Interest on subordinated liabilities and debt securities in issue | | (12) | - | (12) | - |
| Paid-in equity coupon payments | | (12) | (12) | (12) | (12) |
| Dividends paid | | (105) | - | (105) | - |
| Net cash flows from financing activities | | 123 | (12) | 123 | (12) |
| Effects of exchange rate changes on cash & cash equivalents | | (38) | (57) | (38) | (57) |
| Net increase in cash and cash equivalents | | 16,557 | 2,991 | 16,534 | 2,957 |
| Cash and cash equivalents 1 January | | 12,223 | 9,232 | 12,160 | 9,203 |
| Cash and cash equivalents 31 December | 20 | 28,780 | 12,223 | 28,694 | 12,160 |

The accompanying notes, on pages 63 to 83, and the accounting policies, on pages 59 to 62, form an integral part of these financial statements.

(1) Includes interest received for Group of £493 million (2020 - £535 million) and interest paid of £74 million (2020 - £107 million), and for Bank interest received of £486 million (2020 - £523 million) and interest paid of £74 million (2020 - £107 million).

## 1. Presentation of accounts

The Bank, a private unlimited company, is incorporated in the UK and registered in England and Wales. The accounts are presented in the functional currency, pounds sterling.

The consolidated accounts incorporate the results of the Bank and the entities that are controlled by the Group (its subsidiaries). Control arises when Group has the power to direct the activities of an entity so as to affect the return from the entity. Control is assessed by reference to our ability to enforce our will on the other entity, typically through voting rights. The consolidated accounts are prepared under uniform accounting policies.

Transactions and balances between Group companies are eliminated in the consolidated accounts so as to show only the information external to the Group.

The audited accounts are set out on pages 55 to 83 and the audited sections of the Business review: Risk and capital management on pages 9 to 43, are prepared on a going concern basis (see the Report of the directors, page 44) and in accordance with UK adopted IAS.

The significant accounting policies and related judgments are set out below. Except for certain financial instruments as described in Accounting policies 8, 12, 14 and 15 and investment property, the accounts are presented on a historical cost basis.

Accounting policies are generally considered on an overall basis within NatWest Group such that common accounting policies, assumptions and estimates apply across Group and Bank. Therefore, for the most part, the accounting policies, assumptions, and estimates reflect those in NatWest Group as relevant for the businesses and operations in the Group and Bank.

### Accounting changes effective 1 January 2021

The IASB amended IFRS 16 Leases through “COVID-19 amendments on lease modifications – Amendments to IFRS 16 – Leases (IFRS 16)” The effect of the amendment on Group’s accounts is immaterial.

## 2. Revenue recognition

Interest income and expense are recognised in the income statement using the effective interest rate method for all financial instruments measured at amortised cost and debt instruments classified as fair value through other comprehensive income, the effective part of any related accounting hedging instruments, and finance lease income recognised at a constant periodic rate of return before tax on the net investment on the lease. Negative interest on financial assets is presented in interest payable and negative interest on financial liabilities is presented in interest receivable.

Other interest relating to financial instruments measured at fair value is recognised as part of the movement in fair value and is reported in income from trading activities or other operating income as relevant.

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

## 3. Staff costs

Employee costs, such as salaries, paid absences, and other benefits are recognised over the period in which the employees provide the related services to Group. Employees may receive variable compensation by cash, by debt instruments or ordinary shares of NatWest Group plc. NatWest Group operates a number of share-based compensation schemes under which it awards NatWest Group plc shares and share options to its employees.

Variable compensation that is settled in cash or debt instruments is charged to statement of comprehensive income on a straight-line basis over the vesting period, taking account of forfeiture and clawback criteria. The value of the employee services received in exchange for NatWest Group plc shares and share options is recognised as an expense over the vesting period, with a corresponding increase in equity. The fair value of the instruments granted is based on market prices at the grant date.

NatWest Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible colleagues on behalf of the Group.

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

Contributions to defined contribution pension schemes are recognised in profit or loss when payable.

## 4. Intangible assets and goodwill

Intangible assets acquired by the Group, excluding goodwill, are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the statement of comprehensive income over the assets’ estimated economic lives.

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

Intangible assets include goodwill arising on the acquisition of subsidiaries. Goodwill on the acquisition of a subsidiary from a third party is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary’s net assets over the net fair value of the subsidiary’s identifiable assets, liabilities and contingent liabilities.

Where a subsidiary acquires a business from a NatWest Group company, goodwill is acquired at the value inherited from NatWest Group’s accounts.

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.

## 5. Property, plant and equipment

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

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

The estimated useful lives of the Group's property, plant and equipment are:

| | |
|---|---|
| Freehold buildings | 50 years |
| Long leasehold property (leases with more than 50 years to run) | 50 years |
| Short leaseholds | unexpired period of lease |
| Property adaptation costs | 10 to 15 years |
| Computer equipment | up to 5 years |
| Other equipment | 4 to 15 years |
| Right of use | unexpired period of lease |

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.

### 6. Impairment of non-financial assets

At each balance sheet date, the Group assesses whether there is any indication that its intangible assets, rights of use or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and compares it to its balance sheet value to calculate if an impairment loss should be charged to the statement of comprehensive income. The balance sheet value of the asset is reduced by the amount of the impairment loss. A reversal of an impairment loss on intangible assets or property, plant and equipment is recognised in the statement of comprehensive income provided the increased carrying value is not greater than it would have been had no impairment loss been recognised.

Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. Impairment losses on goodwill are not reversed.

The recoverable amount of an asset that does not generate cash flows that are independent from those of other assets or groups of assets, is determined as part of the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell or its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been considered in estimating future cash flows.

### 7. Investment property

Investment property comprises leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on the current prices for similar properties in the same location and condition.

Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

### 8. Foreign currencies

Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 18).

Non-monetary items denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items are recognised in profit or loss.

### 9. Leases

#### As lessor

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

Loans to customers include finance lease receivables measured at the net investment in the lease, comprising the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Interest receivable includes finance lease income recognised at a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

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

#### As lessee

On entering a new lease contract, the Group recognises a right of use asset and a lease liability to pay future rentals. The liability is measured at the present value of future lease payments discounted at the applicable incremental borrowing rate. The right of use asset is depreciated over the shorter of the term of the lease and the useful economic life, subject to review for impairment. Short-term and low-value leased assets are expensed on a systematic basis.

### 10. Provisions and contingent liabilities

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

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

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

Tax comprising of current tax and deferred tax, is shown in the income statement except tax on items recognised outside income statement which is charged to other comprehensive income. Any tax related equity instruments are shown in the income statement.

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

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and the carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent their recovery is probable.

Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

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

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

### 12. Financial instruments

Financial instruments are measured at fair value on initial recognition on the balance sheet.

Monetary financial assets are classified into the following subsequent measurement categories (subject to business model assessment and review of contractual cash flow for the purposes of sole payments of principal and interest where applicable):

- amortised cost;
- fair value through other comprehensive income (FVOCI);
- mandatory fair value through profit or loss; and
- designated at fair value through profit or loss.

Financial liabilities are classified into following measurement categories:

- amortised cost; or
- held for trading at; and
- designated at fair value through profit or loss.

Classification by business model reflects how the Group manages its financial assets to generate cash flows. A business model assessment determines if cash flows result from holding financial assets to collect the contractual cash flows, from selling those financial assets, or both.

Business model assessment of assets is made at portfolio level, being the level at which they are managed to achieve a predefined business objective. This is expected to result in the most consistent classification of assets because it aligns with the stated objectives of the portfolio, its risk management, manager's remuneration and the ability to monitor sales of assets from a portfolio.

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

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

### 13. Impairment: expected credit losses

At each balance sheet date each financial asset or portfolio of loans measured at amortised cost or at FVOCI, issued financial guarantee and loan commitment is assessed for impairment. Loss allowances are forward-looking based on 12-month ECL where there has not been a significant increase in credit risk rating, otherwise allowances are based on lifetime expected losses.

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

Judgment is exercised as follows:

- Models – in certain low default portfolios, Basel parameter estimates are also applied for IFRS 9.
- Non-modelled portfolios use a standardised capital requirement under Basel II. Under IFRS 9, they have bespoke treatments for the identification of significant increase in credit risk. Benchmark PDs, EADs and LGDs are reviewed annually for appropriateness. The ECL calculation is based on expected future cash flows, which is typically applied at a portfolio level.
- Multiple economic scenarios (MES) – the central, or base, scenario is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities.
- SICR – IFRS 9 requires that at each reporting date, an entity shall assess whether the credit risk on an account has increased significantly since initial recognition. Part of this assessment requires a comparison to be made between the current lifetime PD (i.e. the current PD over the remaining lifetime) with the equivalent lifetime PD as determined at the date of initial recognition.

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

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

Impaired loans are written off and therefore derecognised from the balance sheet when the Group concludes that there is no longer any realistic prospect of recovery of part, or all, of the loan. For loans that are individually assessed for impairment, the timing of the write off is determined on a case-by-case basis. Such loans are reviewed regularly, and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events. The typical time frames from initial impairment to write off for the Group's collectively assessed portfolios are:

- Retail mortgages – write off usually occurs within five years, or when an account is closed, if earlier.
- Credit cards – the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans – write off occurs within six years.
- Commercial loans – write offs are determined in the light of individual circumstances; the period does not exceed five years.
- Business loans are generally written off within five years.

### 14. Financial guarantee contracts
Under a financial guarantee contract the Group, in return for a fee, undertakes to meet a client's obligations under the terms of a debt instrument if the client fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated at FVPL, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with accounting policy 13. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

### 15. Derecognition
A financial asset is derecognised (removed from the balance sheet) when the contractual right to receive cash flows from the asset has ended or when it has been transferred and the transfer qualifies for derecognition. Conversely, an asset is not derecognised by a contract under which the Group retains substantially all the risks and rewards of ownership.

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

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

### 17. Derivatives and hedging
#### Derivatives
Derivatives are reported on the balance sheet at fair value.

The Bank's client derivatives are economically hedged directly with NWB with no material fair value impact to the profit or loss.

#### Cash flow hedge
The effective portion of the designated hedge relationship is recognised in statement of other comprehensive income and the ineffective portion in the statement of comprehensive income. When the hedged item (forecasted cash flows) results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to the statement of comprehensive income in the same periods in which the hedged forecasted cash flows affect the statement of comprehensive income.

### 18. Cash and cash equivalents
In the cash flow statement, cash and cash equivalents comprise cash and deposits with banks with an original maturity of less than three months together with the 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 Bank's investments in its subsidiaries are stated at cost less any impairment.

### Critical accounting policies and key sources of estimation uncertainty
The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its accounts. UK company law and IFRS require the directors, in preparing the Group's accounts, to select suitable accounting policies, apply them consistently and make judgments and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgments and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results. During 2021, estimation uncertainty has been affected by the COVID-19 pandemic. Consideration of this source of estimation uncertainty has been set out in the notes below (as applicable).

### How Climate risk affects our accounting judgements and estimates
Many of the effects arising from climate change will be longer term in nature, with an inherent level of uncertainty, and have limited effect on accounting judgments and estimates for the current period.

| Critical accounting policy | Note |
|---|---|
| Loan impairment provisions | 8 |

### Future accounting developments
### International Financial Reporting Standards

#### Effective 1 January 2022

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

Other new standards and amendments that are effective for annual periods beginning after 1 January 2023, with earlier application permitted, are set out below.

#### Effective 1 January 2023

- IFRS 17 Insurance Contracts (Amendments to IFRS 17 Insurance Contracts).
- Classification of Liabilities as Current or Non-current (Amendments to IAS 1).
- Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12).
- Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2).
- The Group is assessing the effect of adopting these standards and amendments on its financial statements but do not expect the effect to be material.

### 1. Net interest income

| | 2021 £m | 2020 £m |
|---|---|---|
| Loans to customers - amortised cost | 407 | 393 |
| Amounts due from holding companies and fellow subsidiaries | 86 | 127 |
| Interest receivable | 493 | 520 |
| | | |
| Amounts due to holding companies and fellow subsidiaries | (69) | (70) |
| Customer deposits | (1) | (29) |
| Other liabilities (Note 17) | (2) | (2) |
| Interest payable | (72) | (101) |
| | | |
| Net interest income | 421 | 419 |

Interest income on financial instruments measured at amortised cost is measured using the effective interest rate which allocates the interest income or interest expense over the expected life of the asset or liability at the rate that exactly discounts all estimated future cash flows to equal the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

### 2. Non-interest income

| | 2021 £m | 2020 £m |
|---|---|---|
| Fees and commission receivable | | |
| Investment management | 188 | 175 |
| Payment services | 33 | 26 |
| Credit and debit card fees | 10 | 9 |
| Brokerage | 5 | 6 |
| Lending and financing | 9 | 7 |
| | 245 | 223 |
| | | |
| Fees and commission payable | (33) | (25) |
| | | |
| Other operating income | | |
| Net income from economic hedging | 24 | 22 |
| Operating lease and other rental income | - | 2 |
| Changes in the fair value of investment properties | - | (7) |
| Other income | 1 | - |
| | 25 | 17 |
| | | |
| Non-interest income | 237 | 215 |

# NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2021

### 3. Operating expenses

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Wages, salaries and other staff costs(1) | 105 | 106 |
| Bonus awards | 15 | 13 |
| Temporary and contract costs(1) | 3 | 4 |
| Social security costs | 15 | 14 |
| Pension costs | 12 | 12 |
| Staff costs | 150 | 149 |
| | | |
| Premises and equipment | 36 | 20 |
| Depreciation & amortisation | 18 | 17 |
| Other administrative expenses(2) | 256 | 212 |
| Administrative expenses | 310 | 249 |
| Impairment of intangible assets | 1 | 1 |
| | | |
| Operating expenses | 461 | 399 |

(1) In 2020, wages, salaries and other staff costs was inclusive of temporary and contract costs (£4 million), disclosed separately in 2021.
(2) Other administrative expenses include recharges from NatWest Group companies and other miscellaneous costs, including litigation and conduct costs. Further details of litigation and conduct costs are provided in Note 13.

The average number of colleagues, 1,721 (2020 - 1,686) are contractually employed by NWB Plc with all related staff costs paid by the Group.

### 4. Auditor's remuneration

All audit-related and other services are approved by the NatWest Group Audit Committee and are subject to strict controls to ensure the external auditor's independence is unaffected by the provision of other services. The NatWest Group Audit Committee recognises that for certain assignments the auditor is best placed to perform the work economically; for other work the Group selects the supplier best placed to meet its requirements. The Group's auditor is permitted to tender for such work in competition with other firms where the work is permissible under audit independence rules. The Bank's Audit Committee reviews the amount of audit and non audit services provided by the Group's auditor.

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

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Fees payable for the audit of the Group's annual accounts | 0.5 | 0.5 |
| - Non audit work | - | - |
| - Other services pursuant to legislation | 0.2 | 0.2 |
| Total audit and audit-related assurance services fees | 0.7 | 0.7 |

In addition, the auditor received remuneration of £0.4 million (2020 - £0.4 million) for NatWest Group plc reporting audit work; this fee was borne by NatWest Group plc.

### 5. Emoluments of directors

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Chairman and non-executive directors - emoluments | 0.4 | 0.4 |
| Executive directors - emoluments | 1.1 | 1.2 |
| | 1.5 | 1.6 |
| | | |
| Number of directors to whom retirement benefits are accruing in respect of qualifying service: | | |
| - money purchase schemes | 1 | 1 |

The total emoluments of the highest paid director were £0.8 million (2020 - £0.9 million). This includes long term benefits consisting of Long Term Incentive Plans (LTIPs) and deferred pay awards. The accrued pension attributable to that director was £0.1 million (2020 - £0.1 million). The executive directors may also participate in the NatWest Group plc executive share option and share save schemes.

### 6. Tax

| | 2021 £m | 2020 £m |
|---|---|---|
| **Current tax** | | |
| Charge for the year | 67 | 29 |
| (Over)/under provision in respect of prior years | (2) | 4 |
| | 65 | 33 |
| **Deferred tax** | | |
| Credit for the year | (1) | - |
| Under provision in respect of prior years | 2 | - |
| | 1 | - |
| Tax charge for the year | 66 | 33 |

The actual tax charge differs from the expected tax charge computed by applying the UK corporation tax rate of 19% (2020 - 19%) as follows:

| | 2021 £m | 2020 £m |
|---|---|---|
| Expected tax charge[1] | 48 | 24 |
| Items not allowed for tax | 5 | 7 |
| Non taxable item | (2) | (6) |
| Tax credit paid in equity | (2) | (3) |
| Banking surcharge | 19 | 8 |
| Remeasurement of deferred tax for changes in tax rates | (2) | (1) |
| Adjustments in respect of prior years | - | 4 |
| Actual tax charge | 66 | 33 |

(1) It was announced in the UK Government's Budget on 3 March 2021 that the main UK corporation tax rate will increase from 19% to 25% from 1 April 2023. This legislative change was enacted on 10 June 2021. The Group's closing deferred tax assets and liabilities have therefore been recalculated taking into account this change of rate and the applicable period the deferred tax assets and liabilities are expected to crystallise. It was subsequently announced in the UK Government's Budget on 27 October 2021 that the UK banking surcharge will decrease from 8% to 3% from 1 April 2023. This legislative change was substantively enacted on 2 February 2022. Had this rate reduction been substantively enacted as at the balance sheet date, the estimated rate change impact would not have been material.

**Deferred tax**

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 £m | 2020 £m | 2021 £m | 2020 £m |
| Deferred tax asset | 7 | 8 | 8 | 9 |

Net deferred tax asset comprised:

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | Other temporary differences £m | IFRS Transition £m | Total £m | Other temporary differences £m | IFRS Transition £m | Total £m |
| At 1 January 2020 | 3 | 5 | 8 | 3 | 6 | 9 |
| Credit/ (charge) to income statement | 1 | (1) | - | 1 | (1) | - |
| At 31 December 2020 | 4 | 4 | 8 | 4 | 5 | 9 |
| Charge to income statement | (1) | - | (1) | (1) | - | (1) |
| At 31 December 2021 | 3 | 4 | 7 | 3 | 5 | 8 |

**Deferred tax**

A deferred tax asset of £7 million (2020 - £8 million) has been recognised for the Group at 31 December 2021. This asset has been recognised in the financial statements in respect of the deferral of bonuses under the medium-term incentive plan; the provision for litigation, redress and sundry losses; and fixed asset temporary differences. The Group has considered the carrying value of its deferred tax assets and concluded that, based on management's estimates, sufficient taxable profits will be generated in future years to recover the recognised deferred tax assets.

A deferred tax asset has not been recognised in respect of potential unrealised capital losses in respect of investment properties as uncertainty exists over the existence of future chargeable gains against which these could be offset.

## 7. Financial instruments

### Financial instruments - classification

The following tables analyse financial assets and liabilities in accordance with the categories of financial instruments on an IFRS 9 basis.

| | Group | | | |
|---|---|---|---|---|
| Assets | Mandatory fair value through profit or loss £m | Amortised cost £m | Other assets £m | Total £m |
| Cash and balances at central bank | | 3 | | 3 |
| Loans to banks - amortised cost | | 343 | | 343 |
| Loans to customers - amortised cost | | 17,705 | | 17,705 |
| Amount due from holding companies and fellow subsidiaries | - | 28,429 | 4 | 28,433 |
| Derivatives | 14 | | | 14 |
| Other assets | | | 415 | 415 |
| 31 December 2021 | 14 | 46,480 | 419 | 46,913 |
| | | | | |
| Cash and balances at central bank | | 3 | | 3 |
| Loans to banks - amortised cost | | 333 | | 333 |
| Loans to customers - amortised cost | | 16,317 | | 16,317 |
| Amount due from holding companies and fellow subsidiaries | - | 21,343 | | 21,343 |
| Derivatives | 29 | | | 29 |
| Other assets | | 35 | 374 | 409 |
| 31 December 2020 | 29 | 38,031 | 374 | 38,434 |

| | Group | | | |
|---|---|---|---|---|
| Liabilities | Mandatory fair value through profit or loss £m | Amortised cost £m | Other liabilities £m | Total £m |
| Bank deposits | | 2 | | 2 |
| Customer deposits | | 36,971 | | 36,971 |
| Amount due to holding companies and fellow subsidiaries | - | 8,295 | | 8,295 |
| Derivatives | 12 | | | 12 |
| Other liabilities (1) | | 69 | 57 | 126 |
| 31 December 2021 | 12 | 45,337 | 57 | 45,406 |
| | | | | |
| Bank deposits | | 4 | | 4 |
| Customer deposits | | 30,142 | | 30,142 |
| Amount due to holding companies and fellow subsidiaries | - | 6,688 | | 6,688 |
| Derivatives | 28 | | | 28 |
| Other liabilities (1) | | 69 | 68 | 137 |
| 31 December 2020 | 28 | 36,903 | 68 | 36,999 |

(1) Includes lease liabilities of £67 million (31 December 2020 - £66 million), held at amortised cost.

**7. Financial instruments** continued

**Financial instruments – classification** continued

| | Bank | | | |
|---|---|---|---|---|
| Assets | Mandatory fair value through profit or loss £m | Amortised cost £m | Other assets £m | Total £m |
| Cash and balances at central bank | | 3 | | 3 |
| Loans to banks - amortised cost | | 321 | | 321 |
| Loans to customers - amortised cost | | 17,388 | | 17,388 |
| Amount due from holding companies and fellow subsidiaries | - | 28,678 | 4 | 28,682 |
| Derivatives | 14 | | | 14 |
| Investment in Group undertakings | | | 110 | 110 |
| Other assets | | | 397 | 397 |
| 31 December 2021 | 14 | 46,390 | 511 | 46,915 |
| | | | | |
| Cash and balances at central bank | | 3 | | 3 |
| Loans to banks - amortised cost | | 312 | | 312 |
| Loans to customers - amortised cost | | 15,887 | | 15,887 |
| Amount due from holding companies and fellow subsidiaries | - | 21,714 | - | 21,714 |
| Derivatives | 29 | | | 29 |
| Investment in Group undertakings | | | 110 | 110 |
| Other assets | | 29 | 362 | 391 |
| 31 December 2020 | 29 | 37,945 | 472 | 38,446 |

| | Bank | | | |
|---|---|---|---|---|
| Liabilities | Mandatory fair value through profit or loss £m | Amortised cost £m | Other liabilities £m | Total £m |
| Bank deposits | | 2 | | 2 |
| Customer deposits | | 36,971 | | 36,971 |
| Amount due to holding companies and fellow subsidiaries | - | 8,291 | - | 8,291 |
| Derivatives | 12 | | | 12 |
| Other liabilities (1) | | 68 | 50 | 118 |
| 31 December 2021 | 12 | 45,332 | 50 | 45,394 |
| | | | | |
| Bank deposits | | 4 | | 4 |
| Customer deposits | | 30,142 | | 30,142 |
| Amount due to holding companies and fellow subsidiaries | - | 6,686 | - | 6,686 |
| Derivatives | 28 | | | 28 |
| Other liabilities (1) | | 67 | 63 | 130 |
| 31 December 2020 | 28 | 36,899 | 63 | 36,990 |

(1) Includes lease liabilities of £67 million (31 December 2020 - £66 million), held at amortised cost.

**7. Financial instruments** continued
**Financial instruments – classification** continued

### Interest rate benchmark reform

The NatWest Group IBOR program successfully delivered the conversion of the vast majority of the IBOR exposures to RFR in advance of the cessation date. This encompasses loans, deposits, capital instruments and derivatives, which, have been converted using fallback provisions, switch provisions or as part of market-wide conversion events in the case of derivatives subject to clearing. These instruments will convert at the first repricing date post cessation.

The total amount of exposure for Coutts Group and Bank at 31 December 2021 subject to above conversion provisions is £1,935 million assets , £11 million loan commitment and £779 million derivative notionals.

Despite the significant conversion levels achieved, certain instruments remain in discussion with customers and counterparties to achieve consensual conversion. If consensual conversion is not achieved these instruments will default to synthetic LIBOR in line with relevant legislation.

The level of exposures without explicit or agreed conversion provisions as of 31 December 2021 is as follows:

| | Group and Bank | | | |
|---|---|---|---|---|
| | Rates subject to IBOR reform | | | |
| | GBP LIBOR | USD IBOR (1) | OTHER IBOR (2) | Total |
| 2021 | £m | £m | £m | £m |
| Loans to customers - amortised cost | 115 | 54 | 4 | 173 |

| | Rates subject to IBOR reform | | | | |
|---|---|---|---|---|---|
| | GBP LIBOR | USD IBOR (1) | EURIBOR(2) | OTHER IBOR | Total |
| 2020 | £m | £m | £m | £m | £m |
| Loans to customers - amortised cost | 2,653 | 66 | 54 | 3 | 2,776 |
| Amounts due to holding companies and fellow subsidiaries | 575 | - | - | - | 575 |
| Loan commitments (3) | 96 | 1 | 13 | - | 110 |
| Derivatives notional | 508 | - | 7 | - | 515 |

(1) In 2021 the FCA declared that USD IBOR will be non-representative post 30 June 2023; at the time of preparing the 2020 disclosures this date was expected to be 31 December 2021.
(2) In 2021 management concluded that EURIBOR is not expected to be significantly reformed further and therefore any uncertainty due to interest benchmark rate reform for EURIBOR has ended. December 2020 data includes EURIBOR exposure as subject to reform
(3) Certain loan commitments are multi-currency facilities. Where these are fully undrawn, they are allocated to the principal currency of the facility. Where the facilities are partly drawn, the remaining loan commitment is allocated to the currency with the largest drawn amount.

### AT1 issuances

The Bank has issued certain capital instruments (AT1) under which reset clauses are linked to IBOR rates subject to reform. Where under the contractual terms of the instrument the coupon resets to a rate which has IBOR as a specified component of its pricing structure these are subject to IBOR reform and are shown in Note 16.

### Financial instruments - fair value

All financial instruments carried at fair value are fall within level 2 of the fair value hierarchy (2020: level 2).

In accordance with accounting policy 18, all derivatives are measured at fair value. Instruments subject to fair value measurement are valued using techniques based significantly on observable market data. Instruments in this category are valued using quoted prices for similar instruments.

**7. Financial instruments** continued

**Financial instruments – fair value of financial instruments measured at amortised cost** continued

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 for both Group and Bank.

| | Group | | | |
|---|---|---|---|---|
| | 2021 | 2021 | 2020 | 2020 |
| | Carrying value | Fair value | Carrying value | Fair value |
| 2021 | £m | £m | £m | £m |
| Financial assets | | | | |
| Cash and balances at central banks | 3 | 3 | 3 | 3 |
| Loan to banks | 343 | 343 | 333 | 333 |
| Loan to customers | 17,705 | 17,667 | 16,317 | 16,130 |
| Amount due from holding companies and fellow subsidiaries | 28,429 | 28,407 | 21,343 | 21,373 |
| Other assets | - | - | 35 | 35 |
| Financial liabilities | | | | |
| Bank deposits | 2 | 2 | 4 | 4 |
| Customer deposits | 36,971 | 36,971 | 30,142 | 30,142 |
| Amount due to holding companies and other fellow subsidiaries | 8,295 | 8,295 | 6,688 | 6,740 |
| Other liabilities | - | - | 3 | 3 |

| | Bank | | | |
|---|---|---|---|---|
| | 2021 | 2021 | 2020 | 2020 |
| | Carrying value | Fair value | Carrying value | Fair value |
| | £m | £m | £m | £m |
| Financial assets | | | | |
| Cash and balances at central banks | 3 | 3 | 3 | 3 |
| Loan to banks | 321 | 321 | 312 | 312 |
| Loan to customers | 17,388 | 17,356 | 15,887 | 15,715 |
| Amount due from holding companies and fellow subsidiaries | 28,678 | 28,658 | 21,714 | 21,746 |
| Other assets | - | - | 29 | 29 |
| Financial liabilities | | | | |
| Bank deposits | 2 | 2 | 4 | 4 |
| Customer deposits | 36,971 | 36,971 | 30,142 | 30,142 |
| Amount due to holding companies and other fellow subsidiaries | 8,291 | 8,289 | 6,686 | 6,739 |

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

Short-term financial instruments

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

**7. Financial instruments** continued

**Financial instruments - fair value of financial instruments measured at amortised cost** continued

Loans to banks and customers

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

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

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

Bank and customer deposits

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

Debt securities in issue and subordinated liabilities

Fair values are determined by using internal valuation models or using quoted prices for similar liabilities.

**Financial instruments - maturity analysis**

**Remaining maturity**

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

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | |
| | Less than 12 months £m | More than 12 months £m | Total £m | Less than 12 months £m | More than 12 months £m | Total £m |
| Assets | | | | | | |
| Cash and balances at central bank | 3 | - | 3 | 3 | - | 3 |
| Loans to banks - amortised cost | 343 | - | 343 | 333 | - | 333 |
| Loans to customers - amortised cost | 2,967 | 14,738 | 17,705 | 2,791 | 13,526 | 16,317 |
| Amount due from holding companies and fellow subsidiaries(1) | 17,654 | 10,775 | 28,429 | 13,422 | 7,921 | 21,343 |
| Derivatives | 12 | 2 | 14 | 1 | 28 | 29 |
| Liabilities | | | | | | |
| Bank deposits | 2 | - | 2 | 4 | - | 4 |
| Customer deposits | 36,969 | 2 | 36,971 | 30,142 | - | 30,142 |
| Amount due to holding companies and fellow subsidiaries | 1,796 | 6,499 | 8,295 | 970 | 5,718 | 6,688 |
| Derivatives | 10 | 2 | 12 | 2 | 26 | 28 |
| Lease liabilities | - | 67 | 67 | 1 | 65 | 66 |

(1) Excludes £4 million (2020-nil) of non-financial instruments.

### 7. Financial instruments continued

#### Financial instruments - maturity analysis continued

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | |
| | Less than 12 months £m | More than 12 months £m | Total £m | Less than 12 months £m | More than 12 months £m | Total £m |
| Assets | | | | | | |
| Cash and balances at central bank | 3 | | 3 | 3 | - | 3 |
| Loans to banks - amortised cost | 321 | - | 321 | 312 | - | 312 |
| Loans to customers - amortised cost | 2,942 | 14,446 | 17,388 | 2,730 | 13,157 | 15,887 |
| Amount due from holding companies and fellow subsidiaries[1] | 17,817 | 10,861 | 28,678 | 13,713 | 8,001 | 21,714 |
| Derivatives | 12 | 2 | 14 | 1 | 28 | 29 |
| | | | | | | |
| Liabilities | | - | | | | |
| Bank deposits | 2 | - | 2 | 4 | - | 4 |
| Customer deposits | 36,969 | 2 | 36,971 | 30,142 | - | 30,142 |
| Amount due to holding companies and fellow subsidiaries | 1,792 | 6,499 | 8,291 | 968 | 5,718 | 6,686 |
| Derivatives | 10 | 2 | 12 | 2 | 26 | 28 |
| Lease liabilities | - | 67 | 67 | 1 | 65 | 66 |

(1) Excludes £4 million (2020-nil) of non-financial instruments.

#### Liabilities by contractual cash flows up to 20 years

The tables below show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically repays 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 year end.

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

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

| | Group | | | | | |
|---|---|---|---|---|---|---|
| 2021 | 0-3 months £m | 3-12 months £m | 1-3 years £m | 3-5 years £m | 5-10 years £m | 10-20 years £m |
| Liabilities by contractual maturity up to 20 years | | | | | | |
| Bank deposits | 2 | - | - | - | - | - |
| Customer deposits | 36,138 | 831 | 2 | - | - | - |
| | | | | | | |
| Amounts due to holding companies and fellow subsidiaries | 752 | 1,115 | 3,013 | 2,412 | 1,201 | 37 |
| Lease liabilities | - | 1 | 2 | 1 | 3 | 6 |
| | 36,892 | 1,947 | 3,017 | 2,413 | 1,204 | 43 |
| | | | | | | |
| Guarantees and commitments - notional amounts | | | | | | |
| Guarantees [1] | 60 | - | - | - | - | - |
| Commitments [2] | 1,992 | - | - | - | - | - |
| | 2,052 | - | - | - | - | - |

For the notes to this table refer to the following page.

**7. Financial instruments** continued

**Financial instruments - maturity analysis** continued

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | 0-3 months | 3-12 months | 1-3 years | 3-5 years | 5-10 years | 10-20 years |
| 2020 | £m | £m | £m | £m | £m | £m |
| Liabilities by contractual maturity up to 20 years | | | | | | |
| Bank deposits | 4 | - | - | - | - | - |
| Customer deposits | 29,097 | 1,045 | - | - | - | - |
| Amounts due to holding companies and fellow subsidiaries | 253 | 791 | 2,738 | 2,186 | 933 | 39 |
| Lease liabilities | - | 1 | 1 | 1 | 3 | 6 |
| Total liabilities | 29,354 | 1,837 | 2,739 | 2,187 | 936 | 45 |
| Guarantees and commitments - notional amounts | | | | | | |
| Guarantees (1) | 67 | - | - | - | - | - |
| Commitments (2) | 3,293 | - | - | - | - | - |
| | 3,360 | - | - | - | - | - |

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
(2) The Group has given commitments to provide funds to clients 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.

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 0-3 months | 3-12 months | 1-3 years | 3-5 years | 5-10 years | 10-20 years |
| 2021 | £m | £m | £m | £m | £m | £m |
| Liabilities by contractual maturity up to 20 years | | | | | | |
| Bank deposits | 2 | - | - | - | - | - |
| Customer deposits | 36,138 | 831 | 2 | - | - | - |
| Amounts due to holding companies and fellow subsidiaries | 748 | 1,115 | 3,013 | 2,412 | 1,201 | 37 |
| Lease liabilities | - | 1 | 2 | 1 | 3 | 6 |
| | 36,888 | 1,947 | 3,017 | 2,413 | 1,204 | 43 |
| Guarantees and commitments - notional amounts | | | | | | |
| Guarantees (1) | 60 | - | - | - | - | - |
| Commitments (2) | 1,992 | - | - | - | - | - |
| | 2,052 | - | - | - | - | - |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | 0-3 months | 3-12 months | 1-3 years | 3-5 years | 5-10 years | 10-20 years |
| 2020 | £m | £m | £m | £m | £m | £m |
| Liabilities by contractual maturity up to 20 years | | | | | | |
| Bank deposits | 4 | - | - | - | - | - |
| Customer deposits | 29,097 | 1,045 | - | - | - | - |
| Amounts due to holding companies and fellow subsidiaries | 245 | 791 | 2,738 | 2,186 | 933 | 39 |
| Lease liabilities | - | 1 | 1 | 1 | 3 | 6 |
| Total liabilities | 29,346 | 1,837 | 2,739 | 2,187 | 936 | 45 |
| Guarantees and commitments - notional amounts | | | | | | |
| Guarantees (1) | 67 | - | - | - | - | - |
| Commitments (2) | 3,293 | - | - | - | - | - |
| | 3,360 | - | - | - | - | - |

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

## 8. Loan impairment provisions

### Loan exposure and impairment metrics

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

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Loans - amortised cost | | |
| Stage 1 | 16,969 | 14,675 |
| Stage 2 | 942 | 1,881 |
| Stage 3 | 263 | 285 |
| Inter-Group (1) | 28,429 | 21,343 |
| | 46,603 | 38,184 |
| ECL provisions (2) | | |
| Stage 1 | 11 | 30 |
| Stage 2 | 27 | 67 |
| Stage 3 | 37 | 37 |
| Inter-Group | 5 | 9 |
| | 80 | 143 |
| ECL provision coverage (3,4) | | |
| Stage 1 (%) | 0.1 | 0.2 |
| Stage 2 (%) | 2.9 | 3.6 |
| Stage 3 (%) | 14.1 | 13.0 |
| Inter-Group (%) | - | - |
| | 0.4 | 0.4 |
| Impairment losses/(releases) | | |
| ECL charge/(release) | | |
| Stage 1 | (44) | 26 |
| Stage 2 | (15) | 59 |
| Stage 3 | 7 | 15 |
| Third party | (52) | 100 |
| Inter-Group | (5) | 7 |
| | (57) | 107 |
| ECL loss rate - (basis points) | (29) | 59 |
| Amounts written off | 6 | 3 |

(1) The Group's intercompany assets are classified in Stage 1.
(2) Includes nil (2020 – £2 million) related to contingent liabilities.
(3) ECL provisions coverage is calculated as ECL provisions divided by loans - amortised cost.
(4) ECL provisions coverage and ECL loss rates are calculated on third party loans and related ECL provisions and charge respectively. ECL loss rate is calculated as annualised third party ECL charge divided by loans - amortised cost.
(5) The table shows gross loans only and excludes amounts that are outside the scope of the ECL framework.

### Critical accounting policy: Loan impairment provisions

The loan impairment provisions have been established in accordance with IFRS 9. Accounting policy 14 sets out how the expected loss approach is applied. At 31 December 2021, client loan impairment provisions amounted to £75 million (2020 - £134 million). A loan is impaired when there is objective evidence that the cash flows will not occur in the manner expected when the loan was advanced. Such evidence includes changes in the credit rating of a borrower, the failure to make payments in accordance with the loan agreement; significant reduction in the value of any security; breach of limits or covenants; and observable data about relevant macroeconomic measures.

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

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

Refer to page 19 for IFRS 9 ECL model design principles.

## 9. Derivatives

Companies in the Group transact derivatives to manage balance sheet foreign exchange, interest rate and credit risk.

| | Group and Bank | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | |
| | Notional £m | Assets £m | Liabilities £m | Notional £m | Assets £m | Liabilities £m |
| Exchange rate contracts | 107 | 1 | - | 40 | 1 | 1 |
| Interest rate contracts | 816 | 13 | 12 | 1,069 | 28 | 27 |
| | 923 | 14 | 12 | 1,109 | 29 | 28 |

The Group hedges the exchange rate risk of payments which are denominated in currencies other than the functional currency with forward foreign exchange contracts. The derivatives are documented as cash flow hedges.

## 10. Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment.

| | Bank | |
|---|---|---|
| | 2021 £m | 2020 £m |
| At 1 January and 31 December | 110 | 110 |

The subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary shares which are unlisted.

All of the subsidiary undertakings are owned, directly or indirectly, through intermediate holding companies and are all wholly owned. They are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

| | Proportion of ownership (%) | Nature of business | Country of incorporation |
|---|---|---|---|
| Coutts Finance Co. (1) | 100% | Provision of residential mortgages | Great Britain |
| RBS Asset Management (Dublin) Limited (2) | 100% | Provision of investment management services | Ireland |
| RBS Collective Investment Funds Limited (3) | 100% | Provision of investment management services | Great Britain |
| RBS Asset Management Holdings (1) | 100% | Holding company | Great Britain |
| RBSG Collective Investments Holdings Limited (3) | 100% | Holding company | Great Britain |
| RBSG Collective Investments Nominees Limited (3) | 100% | Nominee | Great Britain |
| Strand Nominees Limited (1) | 100% | Nominee | Great Britain |

No impairment was recognised in 2021 or 2020.

(1) Registered office is 440 Strand, London, WC2R OQS.
(2) Registered office is One Dockland Central, Guild Street, IFSC, Dublin.
(3) Registered office is 6-8 George Street, Edinburgh, EH2 2PF.

### 11. Intangible assets

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | |
| | Goodwill £m | Other (1) £m | Total £m | Goodwill £m | Other (1) £m | Total £m |
| Cost | | | | | | |
| At 1 January | 9 | 64 | 73 | 9 | 45 | 54 |
| Additions | - | 27 | 27 | - | 20 | 20 |
| Disposals | - | (3) | (3) | - | (1) | (1) |
| At 31 December | 9 | 88 | 97 | 9 | 64 | 73 |
| Accumulated amortisation | | | | | | |
| At 1 January | - | 16 | 16 | - | 7 | 7 |
| Disposal of intangible assets | - | (2) | (2) | - | - | - |
| Impairment of intangible assets | - | 1 | 1 | - | 1 | 1 |
| Charge for the year | - | 9 | 9 | - | 8 | 8 |
| At 31 December | - | 24 | 24 | - | 16 | 16 |
| Net book value at 31 December | 9 | 64 | 73 | 9 | 48 | 57 |

| | Bank | |
|---|---|---|
| | 2021 £m | 2020 £m |
| Cost | | |
| At 1 January | 64 | 45 |
| Additions | 27 | 20 |
| Disposals | (3) | (1) |
| At 31 December | 88 | 64 |
| Accumulated amortisation | | |
| At 1 January | 16 | 7 |
| Disposal of intangible assets | (2) | - |
| Impairment of intangible assets | 1 | 1 |
| Charge for the year | 9 | 8 |
| At 31 December | 24 | 16 |
| Net book value at 31 December | 64 | 48 |

(1) Principally internally generated software.

Intangible assets are reviewed for indicators of impairment. In 2021 £1 million (2020 - £1 million) of previously capitalised software was impaired primarily as a result of software which was no longer expected to yield future economic benefit. Refer to accounting policy 7 for further details.

### 12. Other assets

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 £m | 2020 £m | 2021 £m | 2020 £m |
| Due within 12 months: | | | | |
| Prepayments | 2 | 5 | 2 | 5 |
| Accrued income and other assets[1] | 43 | 41 | 33 | 31 |
| Due after 12 months: | | | | |
| Deferred tax (Note 6) | 7 | 8 | 8 | 9 |
| Intangible assets (Note 11) | 73 | 57 | 64 | 48 |
| Property, plant & equipment | 290 | 298 | 290 | 298 |
| | 415 | 409 | 397 | 391 |

(1) Balances primarily consist of accrued fee income.
(2) In 2020 property plant and equipment was disclosed separately on the balance sheet, in the current year given the immaterial nature of the balance this has been included in other assets.

### 13. Other liabilities

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m |
| Lease liabilities (Note 17) | 67 | 66 | 67 | 66 |
| Provisions for liabilities and charges | 7 | 18 | 7 | 18 |
| Accruals and Deferred income | 49 | 37 | 44 | 35 |
| Other liabilities | 3 | 16 | - | 11 |
| | 126 | 137 | 118 | 130 |

Provisions for liabilities and charges:

| | Group and Bank | | |
|---|---|---|---|
| | Provision for severance | Other | Total |
| | £m | £m | £m |
| At 1 January | 3 | 15 | 18 |
| Charge to income statement | - | 9 | 9 |
| Release to income statement | (1) | (11) | (12) |
| Provisions utilised | (1) | (5) | (6) |
| Expected credit loss impairment release | - | (2) | (2) |
| At 31 December | 1 | 6 | 7 |

### 14. Subordinated liabilities

| | Group and Bank | | | | |
|---|---|---|---|---|---|
| | 2021 Interest rate | 2021 £m | 2020 Interest rate | 2020 £m | Maturity |
| £221,000,00 | SONIA + 2.6915% | 220 | LIBOR + 2.38% | 220 | 2027 |
| £45,000,000 | SONIA + 4.163% | 45 | LIBOR + 3.85% | 45 | 2028 |
| | | 265 | | 265 | |

The loans are unsecured and subordinated to the claims of senior creditors. The loan capital is available to absorb losses and ranks ahead of other existing capital in the event of liquidation. Subordinated loan balances are payable to NWB Plc and are included in Amounts due to holding companies and fellow subsidiaries on the balance sheet. The Bank has a contractual obligation to pay interest.

### 15. Share Capital and reserves

| | Group and Bank | | | |
|---|---|---|---|---|
| | Allotted, called up and fully paid | | Authorised | |
| | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m |
| *Equity shares:* | | | | |
| Ordinary shares of £1 | 41 | 41 | 50 | 50 |
| | 41 | 41 | 50 | 50 |

Ordinary shares

During the year, ordinary dividends of £105 million were paid by the Bank (2020 - nil) to NWB Plc.

### 16. Paid-in equity

Paid-in equity comprises equity instruments issued by the Bank other than those legally constituted as shares.

| | Group and Bank | |
|---|---|---|
| | 2021 | 2020 |
| | £m | £m |
| *AT1 instruments:* | | |
| £167 million 6.0% notes repayable from September 2022 | 165 | 165 |
| £35 million SONIA + 6.4015% notes repayable from December 2023 | 35 | 35 |
| | 200 | 200 |

AT1 instruments issued by the Bank having the legal form of debt are classified as equity under IFRS. The coupons on this instrument are non-cumulative and payable at the Bank's discretion. In the event of winding up, any amounts outstanding on the loan will be subordinated.

Equity coupon payments

During the year, equity coupon payments totalling £12 million were paid (2020 - £12 million).

### 17. Leases

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

**Lessees**

| | Group | |
|---|---|---|
| | 2021 | 2020 |
| | £m | £m |
| Amounts recognised in consolidated income statement | | |
| Interest payable | 2 | 2 |
| Depreciation | 1 | 1 |

| | Group and Bank | |
|---|---|---|
| | 2021 | 2020 |
| | £m | £m |
| Amounts recognised on balance sheet | | |
| Right of use assets included in property, plant and equipment | 66 | 65 |
| Lease liabilities[1] | (67) | (66) |

The total cash outflow for leases in 2021 is £2 million (2020 - £2 million).

(1) Contractual cashflows of lease liabilities is shown in Note 7.

## 18. Memorandum items

### Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2021. Although the Group and the Bank are exposed to credit risk in the event of non-performance of the obligations undertaken by clients, the amounts shown do not, and are not intended to, provide any indication of the Group and Bank's expectation of future losses.

| | Group and Bank | |
|---|---|---|
| | 2021 | 2020 |
| | £m | £m |
| Contingent liabilities: | | |
| Guarantees and assets pledged as collateral security: | | |
| - Guarantees and irrevocable letters of credit | 60 | 67 |
| | 60 | 67 |
| Commitments: | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | |
| - 1 year and over | 255 | 347 |
| - Less than 1 year | 1,750 | 2,946 |
| | 2,005 | 3,293 |

Banking commitments and contingent obligations, which have been entered into on behalf of clients and for which there are corresponding obligations from clients, are not included in assets and liabilities. The Group and Bank's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group and Bank's normal credit approval processes.

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

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Bank to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

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

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

Additional contingent liabilities arise in the normal course of the Bank's business, associated with ongoing legal, regulatory or tax situations at both individual client and Bank levels. These situations are monitored by management and where it is possible to quantify reliably, provisions are booked. However, given uncertainties such as establishing detailed fact patterns, legal status and regulatory status, in certain cases this is not feasible until further investigation has been conducted. In relation to such matters, looking at the range of potential outcomes, it is not anticipated that any material loss will arise from these transactions.

### Litigation and regulatory matters

As a participant in the financial services industry, the Group operates in a highly regulated environment. At any moment in time it is likely that the Group will be party to legal proceedings and involved in regulatory matters, including as the subject of investigations and other regulatory and government action ('Matters') in the United Kingdom and other jurisdictions. Such Matters are subject to many uncertainties and their outcome is often difficult to predict, particularly in the early stages.

The directors of the Bank have reviewed actual, threatened and known potential claims and proceedings and, after consulting with the relevant legal advisers are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Group's consolidated net assets, results of operations or cash flows.

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

In many such Matters, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and regulatory matters or as a result of adverse impacts or restrictions on the Group's reputation, business and operations.

Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

**18. Memorandum items** continued

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

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

There were £1 million of net releases in the year for conduct and litigation matters (2020 - £29 million net releases). The Group generally does not disclose information about the establishment or existence of a provision for a particular Matter where disclosure of the information can be expected to prejudice seriously the Group's position in the Matter.

**The Financial Services Compensation Scheme**

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

**Capital Support Deed**

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

### 19. Analysis of changes in financing during the year

| | Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital | | Capital contribution reserve | | Subordinated liabilities | | Debt securities in issue | |
| | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| At 1 January | 241 | 241 | 339 | 339 | 265 | 265 | 310 | 310 |
| Issue of debt securities in issue | | | | | | | 252 | - |
| Interest on subordinated liabilities and debt securities in issue | | | | | (7) | (8) | (5) | (6) |
| Net cash (outflow)/inflow from financing activities | - | - | - | - | (7) | (8) | 247 | (6) |
| Interest on subordinated liabilities and debt securities in issue | | | | | 7 | 8 | 5 | 6 |
| Effects of foreign exchange | | | | | - | - | (8) | - |
| At 31 December | 241 | 241 | 339 | 339 | 265 | 265 | 554 | 310 |

| | Bank | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital | | Capital contribution reserve | | Subordinated liabilities | | Debt securities in issue | |
| | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| At 1 January | 241 | 241 | 382 | 382 | 265 | 265 | 310 | 310 |
| Issue of debt securities in issue | | | | | - | - | 252 | - |
| Interest on subordinated liabilities and debt securities in issue | | | | | (7) | (8) | (5) | (6) |
| Net cash (outflow)/inflow from financing activities | | | | | (7) | (8) | 247 | (6) |
| Interest on subordinated liabilities and debt securities in issue | | | | | 7 | 8 | 5 | 6 |
| Effects of foreign exchange | | | | | - | - | (8) | - |
| At 31 December | 241 | 241 | 382 | 382 | 265 | 265 | 554 | 310 |

### 20. Analysis of cash and cash equivalents

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m |
| At 1 January | | | | |
| - cash | 3 | 3 | 3 | 3 |
| - cash equivalents | 12,220 | 9,229 | 12,157 | 9,200 |
| | 12,223 | 9,232 | 12,160 | 9,203 |
| Net increase in cash and cash equivalents | 16,557 | 2,991 | 16,534 | 2,957 |
| At 31 December | 28,780 | 12,223 | 28,694 | 12,160 |
| | | | | |
| Comprising: | | | | |
| Cash and balances at central bank | 3 | 3 | 3 | 3 |
| Loans to banks including intragroup balances | 28,777 | 12,220 | 28,691 | 12,157 |
| Cash and cash equivalents | 28,780 | 12,223 | 28,694 | 12,160 |

## 21. Related parties

### UK Government

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

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

The Group may participate in a number of schemes operated by the BoE in the normal course of business. Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the BoE amounting to 0.324% of their average eligible liabilities in excess of £600 million. They also have access to BoE reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

### Group undertakings

The Group's ultimate holding company is NatWest Group plc, registered in Scotland, and its immediate parent company is NWB Plc, registered in England and Wales. Both companies are incorporated in Great Britain.

As at 31 December 2021, NatWest Group plc heads the largest group in which the Group is consolidated, and NWB Plc heads the smallest group in which the Group is consolidated. Copies of the consolidated financial statements of both companies may be obtained from Legal, Governance and Regulatory Affairs, Gogarburn, Edinburgh EH12 1HQ.

### (a) Directors and key management

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

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Interest receivable | - | - |

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 colleagues. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

### (b) Compensation of directors and key management

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

| | 2021<br>£m | 2020<br>£m |
|---|---|---|
| Short term benefits | 4 | 4 |
| Post-employment benefits | 1 | 1 |
| Long term benefits(1) | 1 | 1 |
| | 6 | 6 |

(1) Long term benefits consist of LTIPs and deferred pay awards.

**21. Related parties** continued

### (c) Related party transactions

The table below discloses transactions between the Bank and Group and other NatWest Group companies.

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m |
| Interest receivable | 86 | 128 | 88 | 128 |
| Interest payable | 69 | 71 | 69 | 70 |
| Fees and commissions receivable | - | - | 35 | 26 |
| Fees and commissions payable | 4 | 26 | 4 | 26 |
| Dividends receivable | - | - | 15 | 25 |

At the balance sheet dates, the following balances were held with related parties:

| | Group | | Bank | |
|---|---|---|---|---|
| | 2021 | 2020 | 2021 | 2020 |
| | £m | £m | £m | £m |
| Assets | | | | |
| Loans: | | | | |
| Parent companies and fellow subsidiaries | 28,433 | 21,343 | 28,369 | 21,309 |
| Amount due from subsidiary companies | - | - | 313 | 405 |
| Derivatives: | | | | |
| Parent companies | 6 | 1 | 6 | 1 |
| Total assets | 28,439 | 21,344 | 28,688 | 21,715 |
| Liabilities | | | | |
| Deposits: | | | | |
| Parent companies and fellow subsidiaries | 7,476 | 6,113 | 7,472 | 6,111 |
| Subordinated loans: | | | | |
| Parent companies | 265 | 265 | 265 | 265 |
| Debt securities in issue: | | | | |
| Parent companies | 554 | 310 | 554 | 310 |
| Derivatives: | | | | |
| Parent companies | 8 | 27 | 8 | 27 |
| Total liabilities | 8,303 | 6,715 | 8,299 | 6,713 |

Operating expenses includes management recharge of £233 million (2020 - £191 million) from other entities with the NatWest Group. Included in the management recharge are payments of non-cancellable operating leases and pension costs.

### 22. Transactions with directors

At 31 December 2021, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions across the Group, are shown in the table below.

| | 2021 | | 2020 | |
|---|---|---|---|---|
| | Aggregate amount outstanding £m | Number of persons | Aggregate amount outstanding £m | Number of persons |
| Directors: | | | | |
| Loans to customers | 2 | 3 | 1 | 4 |
| Customer deposits | 3 | 4 | 3 | 4 |
| Officers: | | | | |
| Loans to customers | 1 | 7 | 1 | 7 |
| Customer deposits | 2 | 7 | 2 | 7 |

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 colleagues. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

### 23. Post balance sheet events

There have been no other significant events between 31 December 2021 and the date of approval of these accounts which would require a change to or additional disclosure in the financial statements.

# For Signing today - Coutts and Company ARA 2021

Final Audit Report 2022-03-15

| | |
|---|---|
| Created: | 2022-03-15 |
| By: | Neil Henderson (Neil.Henderson1@natwest.com) |
| Status: | Signed |
| Transaction ID: | CBJCHBCAABAAwosh4RiTIGgRXIrytopvxbg5AMxEWRXE |

## "For Signing today - Coutts and Company ARA 2021" History

Document created by Neil Henderson (Neil.Henderson1@natwest.com)
2022-03-15 - 5:25:32 PM GMT- IP address: 155.136.158.8

Document emailed to Waldegrave of North Hill (william.waldegrave@coutts.com) for signature
2022-03-15 - 5:31:20 PM GMT

Document emailed to Andrew Kyle (andrew.kyle@natwest.com) for signature
2022-03-15 - 5:31:20 PM GMT

Document emailed to Andrew Bates (abates@uk.ey.com) for signature
2022-03-15 - 5:31:20 PM GMT

Email viewed by Andrew Kyle (andrew.kyle@natwest.com)
2022-03-15 - 5:31:48 PM GMT- IP address: 155.136.158.11

Document e-signed by Andrew Kyle (andrew.kyle@natwest.com)
Signature Date: 2022-03-15 - 5:32:23 PM GMT - Time Source: server- IP address: 155.136.158.11

Email viewed by Waldegrave of North Hill (william.waldegrave@coutts.com)
2022-03-15 - 5:33:29 PM GMT- IP address: 185.70.90.246

Document e-signed by Waldegrave of North Hill (william.waldegrave@coutts.com)
Signature Date: 2022-03-15 - 5:36:15 PM GMT - Time Source: server- IP address: 185.70.90.246

Email viewed by Andrew Bates (abates@uk.ey.com)
2022-03-15 - 6:02:41 PM GMT- IP address: 85.255.234.226

Document e-signed by Andrew Bates (abates@uk.ey.com)
Signature Date: 2022-03-15 - 6:31:15 PM GMT - Time Source: server- IP address: 165.225.80.224

Agreement completed.

2022-03-15 - 6:31:15 PM GMT