

Summary report of the skilled person on the proposed ring-fencing transfer scheme to transfer business from National Westminster Bank Plc (“NatWest Bank”) to NatWest Markets Plc (“NatWest Markets”)

Prepared by Oliver Grundy

11 May 2018

Important – Your attention is drawn to the limitations under which this report has been prepared as set out in Appendix 1

Contents

1	Introduction	3
2	Conclusion	6
3	Overview and purpose of the Scheme	7
4	My role as the skilled person	12
5	Effect on Transferring Counterparties	13
6	Effects on other Stakeholders	28
7	Legal entity considerations - financial	29
8	Legal entity considerations - other	32
	Appendix 1 – Background to skilled person reporting	37
	Appendix 2 - Glossary	44
	Appendix 3 - Ring-fencing timeline	53

1 Introduction

The largest UK banks, including RBS are required by law to separate their retail banking services from their investment and international banking activities by 1 January 2019. This is known as ring-fencing. The aim of ring-fencing is to protect the core retail services on which customers rely from shocks originating elsewhere in the group and in global financial markets. The legislation requires the separation of deposits from retail and small and medium enterprises from activities perceived to be more risky, including market making and complex hedging arrangements. When ring-fencing has been implemented, services like current accounts, savings accounts and payments will be offered from within a ring-fenced body ("RFB"), with more complex activities being offered from within a non ring-fenced body ("NRFB").

Implementing ring-fencing requires RBS to restructure its activities and work to achieve this will continue through 2018. It is a major project for the RBS Group and comprises many different areas of activity and change. One element of that programme of work is called a ring-fencing transfer scheme ("RFTS"), which is a process that government has created through which banks can apply to the courts to transfer a large number of separate legal relationships with customers en masse between different legal entities. This RFTS (the "Scheme") is in respect of the proposed transfer of certain existing Derivative Transactions and arrangements in place between counterparties and NatWest Bank to NatWest Markets (together the "Scheme Companies").

When an RFTS is submitted to the Court for approval, it has to be accompanied by a report (the "Scheme Report") from an independent skilled person. I have been appointed as the skilled person to provide the required report on the transfers proposed by the Scheme.

This Summary Scheme Report provides counterparties and any other affected persons (together the "Stakeholders") with a summarised version of my full Scheme Report as skilled person. In particular, it summarises my opinion on the potential effect of the Scheme on Stakeholders and explains my rationale for reaching this opinion.

Legislation requires that my full Scheme Report states (a) whether anyone with the exception of NatWest Bank itself, the "transferor", is likely to be adversely affected by the Scheme and, (b) if so, whether the Adverse Effect is likely to be greater than is reasonably necessary to implement whichever of the ring-fencing purposes is relevant. This is known as the "Statutory Question" and, as can be seen, comprises two parts, (a) and (b).

I have answered the Statutory Question by considering effects of the Scheme on customers, counterparties and other affected persons (together the "Stakeholders"). Effects of the Scheme can be both positive and negative. Although I have considered all effects identified, I have only considered part (b) of the Statutory Question where I believe a negative effect is "material" having taken into account the size and nature of the effect, the likelihood of occurrence and whether there are any mitigating actions being taken to reduce the negative effect. My assessment of effects is qualitative in nature and dependent on particular circumstances although my conclusions have been based on consideration of these factors:

- **Factor A – the size and nature of effect.** Effects of the Scheme can vary in size and nature and I have considered whether each negative effect will be material to any group of Stakeholders affected. What is "material" depends on the matter being considered and the particular circumstances. I have made my assessment from the perspective of any group of Stakeholders affected and the ability of the various types of Stakeholders to bear or mitigate negative effects. For example, if a negative effect of the Scheme is that certain counterparties each have to perform a straightforward additional administrative task, I may regard this as simply an inconvenience rather than an adverse effect in relation to the Statutory Question. If however, the Scheme results in a negative effect such as a financial penalty for a Stakeholder group, I may consider this to be an adverse effect in relation to the Statutory Question. As my

assessment is made from the perspective of the Stakeholder, my conclusion may be different depending on the composition of the Stakeholder group. Therefore my conclusion may be dependent on whether those affected are, for example, small businesses, where I may conclude that a negative effect is material as opposed to a situation where the only group of Stakeholders are large financial institutions where, depending on facts and circumstances, I may conclude that a negative effect is not material.

- **Factor B – likelihood of occurrence.** Where an effect is material from a size and nature perspective, as in Factor A, I have then considered the likelihood of occurrence. For example, if an effect is potentially material in size and nature, but is highly unlikely to occur, I may not consider this to be an adverse effect in relation to the Statutory Question. If however an effect is potentially material in size and nature and is more probable than not to occur, I would consider this to be an adverse effect in relation to the Statutory Question and hence consider Factor C below.

This means that my approach results in consideration of effects which are less probable than not to occur where I consider this to be a realistic possibility. I believe that this is also consistent with the principles adopted by the England and Wales High Court on 9 March 2018 in the matter of Barclays Bank plc and Woolwich Plan Managers Limited.

- **Factor C – mitigating activities.** Where having considered the size, nature and likelihood, I believe that there may remain an adverse effect in relation to the Statutory Question, I have then considered whether there are any mitigating activities or measures that RBS proposes to take to reduce the adverse nature of the effect.

Whilst I have not considered the effects of wider activities that will occur to ensure compliance with ring-fencing requirements, I have considered the effects of activities that are undertaken because of the Scheme. For example I consider mitigating activities undertaken to minimise the effect of the Scheme to themselves be effects of the Scheme. For example, I consider that the communication with customers is itself an effect of the Scheme.

Where, having considered these factors, I believe that an effect remains which is likely adversely to affect Stakeholders (an "Adverse Effect"), I have answered part (b) of the Statutory Question. I have therefore made use of a "materiality concept". My approach to the consideration of adverse effects is in line with the PRA Statement of Policy and the FCA Guidance in respect of skilled persons reports on ring-fencing transfer schemes which refer to consideration of material effects.

In answering part (b) of the Statutory Question, I have assessed whether I believe that the Adverse Effect is greater than reasonably necessary in order to achieve the relevant ring-fencing purpose. This is set out in Section 106B(3)(a) of FSMA, which for the purposes of the Scheme is "enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions". In making my assessment I have considered whether alternative arrangements or specific mitigating measures could reasonably have been put in place to reduce the Adverse Effect and still achieve the relevant ring-fencing purpose. In making my assessment of what is reasonable, I have considered a number of factors, depending on particular facts and circumstances. Some key principles in my assessment are set out below:

- In respect of each Adverse Effect, I have considered whether it would be reasonable to undertake an activity or put a measure in place to mitigate the Adverse Effect. For example, if I believe that a mitigating action is relatively simple to put in place, such as the waiving of additional rights that any one or more of the Scheme Companies may gain which it previously did not have, I may consider that it would be unreasonable not to put such a mitigation in place. I note that the Scheme Document reflects RBS's final decisions on the design of the Scheme and in a number of cases, negative outcomes have been mitigated and hence I have not had to conclude on part (b) of the Statutory Question in respect of these cases.
- In respect of each Adverse Effect, I have considered whether alternative arrangements could have reasonably been put in place to reduce the Adverse Effect. Alternative arrangements may have different effects on different groups of Stakeholders and in making my assessment, I

have considered whether the alternative arrangements may result in an Adverse Effect for one group of Stakeholders being reduced only for other negative outcomes to be created for other Stakeholders. For example, if the Adverse Effect is relatively small and an alternative arrangement would create larger negative outcomes for other Stakeholders, I may conclude that the planned course of action is reasonable.

This Summary Scheme Report considers the effects of the Scheme for the Stakeholders of the Companies, and sets out my findings. I am not required to, and do not, consider the position of each Stakeholder, but I have reviewed the consequences for each group of Stakeholders at the level I regard necessary to satisfy the requirements of the PRA Statement of Policy and FCA Guidance.

This is intended to be a standalone summary of my Scheme Report, but Stakeholders may wish to read my Scheme Report, which provides more details of the Scheme and its effect on Stakeholders, and a more comprehensive explanation for my opinions. Section 1 of my Scheme Report provides details of the scope, areas of reliance and limitations of my work and why I believe that my work has been prepared in line with the relevant regulatory and professional guidance. This information in that section applies equally to this Summary Scheme Report and is summarised in Appendix 1. The full version of my Scheme Report can be obtained online at **www.rbs.com/ring-fencing** or can be requested free of charge from RBS. Commercial and corporate customers can also contact their relationship managers, and RBS intends to establish a dedicated helpdesk for personal and business banking customers without dedicated relationship managers. RBS has briefed its customer-facing staff to deal with queries concerning the Scheme.

The Scheme will be submitted to the Court at a First Hearing scheduled for 15 May 2018. If approved at the Final Hearing, it is expected to become effective on 13 August 2018. I will continue to assess the effect of the Scheme in the run up to its submission to the Court and will produce a Supplementary Report, if required, outlining any factors that have changed my assessment of the Scheme or my opinion. Once complete, this Supplementary Report will also be made available online and on request.

2 Conclusion

For the reasons set out in the remainder of this Summary Scheme Report, I have concluded that, save in respect of certain matters set out in Section 5, (a) persons other than the transferor are not likely to be adversely affected by the Scheme and, in relation to the matters set out in Section 5 where I have identified an Adverse Effect, (b) if they are likely to be adversely affected, the Adverse Effect is not likely to be greater than is reasonably necessary in order to achieve the specific purpose of enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions (Section 106B(3)(a) of FSMA).

I have set out in this Summary Scheme Report the basis of my conclusions in respect of different groups of Stakeholders, communications with them and a range of cross-Stakeholder matters:

- In Section 5 I have considered the effects of the Scheme on Stakeholders transferring from NatWest Bank to NatWest Markets and I have concluded that there are certain Adverse Effects. Hence I have considered part (b) of the Statutory Question, and I have concluded that where there is an Adverse Effect, it is not likely to be greater than is reasonably necessary to achieve the specific purpose of Section 106B(3)(a) of FSMA;
- In Section 6 I have considered the effects of the Scheme on a range of other Stakeholders, and I have concluded that there is no Adverse Effect;
- In Sections 7 and 8 I have considered a range of cross-Stakeholder matters such as financial considerations, tax, governance and communications.

In setting out my opinions in this Summary Scheme Report, I confirm that I understand my duty to the Court and that I must help the Court on matters within my expertise. I believe that I have complied, and will continue to comply, with this duty. I confirm that I have made clear which facts and matters referred to in this Summary Scheme Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

This conclusion should be read in conjunction with the limitations I have set out in Appendix 1 of this Summary Scheme Report.

Oliver Grundy MA, FCA
11 May 2018

3 Overview and purpose of the Scheme

As stated above, there are a number of ring-fencing requirements that need to be complied with. The ring-fencing legislation is wide-ranging and as set out in Section 3.2, RBS is conducting various activities in order to ensure compliance with the legislation by the deadline of 1 January 2019.

Under the ring-fencing legislation, RFBs are prohibited from undertaking certain "excluded activities", including the regulated activity of "dealing in investments as principal", subject to certain exceptions (Article 4 of The Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions Order) 2014 ("EAPO")). For these purposes, "dealing in investments as principal" generally has the meaning given to it in Article 14 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO"). The relevant definition includes "buying, selling, subscribing for or underwriting securities or contractually based investments as principal", unless such dealing falls within certain exceptions in the RAO (some of which are "switched off" for the purposes of the ring-fencing legislation).

For these purposes, derivative transactions are contractually based investments where the value of the contract is determined by fluctuations in one or more underlying reference rates ("Derivative Transactions"). Buying or selling a Derivative Transaction will therefore constitute dealing in investments as principal unless an exception applies. As a result, RFBs are not permitted to buy or sell Derivative Transactions as principal unless an exception applies.

It is derivative business (and specifically, buying and selling Derivative Transactions as principal) which is relevant to this Scheme.

The EAPO sets out various exceptions which allow RFBs to deal in Derivative Transactions as principal if certain criteria are met. In particular, client-facing transactions satisfying the criteria in Articles 9 to 12 of the EAPO ("Eligible Derivative Transactions") may be carried out by RFBs. These exceptions do not apply, however, if the counterparty is a relevant financial institution as defined in Article 2 of EAPO, which comprises broadly financial institutions, such as non ring-fenced banks, investment firms, investment funds and managers thereof ("RFI"). This exclusion is set out in Article 9 of EAPO.

There are also certain transitional provisional arrangements ("Grandfathering Provisions") set out in Article 21 of the EAPO. These permit certain types of Derivative Transactions which would normally be excluded under the above criteria to be held in the RFB. These Derivative Transactions must mature no later than 31 December 2020. RBS intends to utilise these provisions for any interest rate Derivative Transactions that fall within this window (and hence they are included within the definition of "Eligible Derivative Transactions" for the purposes of this Summary Scheme Report). RBS does not intend to utilise these Grandfathering Provisions for any 'qualifying' foreign exchange ("FX") Derivative Transactions, and the reasons are discussed in Section 5.1.2.1.

The Grandfathering Provisions also provide an exception to the RFI exclusion in Article 9. These provisions permit any Derivative Transaction with an RFI that matures on or before 31 December 2020 to be held by an RFB. Therefore, subject to the FX exclusion detailed above, these Derivative Transactions are also included in the definition of "Eligible Derivative Transactions".

The ring-fencing legislation, as set out in Article 6 of the EAPO, also permits a RFB to continue to hold and execute Derivative Transactions which are used for its own risk management purposes ("Risk Management Derivative Transactions"). As discussed below, these Risk Management Derivative Transactions are not being transferred as part of the Scheme.

In addition, for operational reasons, RBS will also exclude any Derivative Transaction maturing prior to 31 August 2018 ("Excluded Derivative Transactions"). RBS has extended the exclusion period to minimise execution risk of the Scheme arising from Derivative Transactions settling on or

shortly after the Effective Date. Any such Derivative Transaction can remain with NatWest Bank as it will mature in advance of the ring-fencing legislation coming into force on 1 January 2019.

Any Derivative Transaction, other than those defined above as either Eligible Derivative Transactions, Risk Management Derivative Transactions or Excluded Derivative Transactions, is considered an Ineligible Derivative Transaction. This also includes any Derivative Transactions entered into after the cut-off date for the opt-out process (as detailed in Section 12.5 of my Scheme Report), unless such a Derivative Transaction matures prior to 31 August 2018, as it will be considered an Excluded Derivative Transaction. Any such Ineligible Derivative Transaction will not be eligible for opt out and will transfer under the Scheme.

For illustration purposes, examples of Eligible Derivative Transactions are simple interest rate swaps, currency swaps, overnight index swaps, forward rate agreements, foreign exchange forwards and foreign exchange swaps. Examples of Ineligible Derivative Transactions are dual rate swaps, discount swaps, inflation linked Derivative Transactions and foreign exchange time options.

3.1 Proposed Scheme transfers

As part of the RBS Group’s overall strategy to achieve compliance with the ring-fencing legislation, RBS has taken the strategic decision to conduct customer derivative business from NatWest Markets, where the majority of existing Derivative Transactions reside and with whom the majority of existing Derivative Transaction counterparties currently transact. To facilitate the execution of this strategy, the Scheme is being used to transfer certain existing Derivative Transactions and arrangements in place between counterparties and NatWest Bank to NatWest Markets. The Scheme Document sets out full details of the agreements, assets and liabilities that are transferring as part of the Scheme. It is proposed that both Eligible and Ineligible Derivative Transactions will transfer as part of the Scheme although counterparties will be offered the opportunity to leave Eligible Derivative Transactions within NatWest Bank, if they so choose. This is discussed further in Section 5 of this report.

Risk Management Derivative Transactions and Excluded Transactions will also not transfer as part of the Scheme.

The following contracts and arrangements are intended to transfer through the Scheme:

	Category	Description	Eligible Derivative Transactions (indicative volumes at 28 February 2018)	Ineligible Derivative Transactions (indicative volumes at 28 February 2018)
1)	Transactions governed by ISDA Master Agreements	Transactions entered into between a counterparty and NatWest Bank will transfer as part of the Scheme together with the applicable ISDA Master Agreement governing those transactions, schedules, long and short form confirms and title transfer collateral arrangements.	2,089	1,726
2)	Transactions entered into on the “Agile	Agile Markets is an electronic web-based interface that allows counterparties to transact business with RBS. Transactions entered into between a counterparty and NatWest Bank on Agile	5,035	6,270

	Markets" system	Markets will transfer as part of the Scheme together with the associated Agile Markets terms of business and confirmations generated by that system.		
3)	Standalone Derivative Transactions which are not covered by a master agreement	Transactions governed by RBS's standalone Derivative Transaction terms.	830	616
4)	Secured Empty Arrangements	Any ISDA Master Agreement or "Agile Markets" terms of business between NatWest Bank and a counterparty where there are no live transactions at the Effective Date, but where there is an all monies security arrangement in place.	N/A	N/A

In addition:

5)	Litigation	Any existing claims or litigation associated with the transferring business will transfer along with the business, with the exception of any claim or litigation associated with any opted-out Derivative Transactions or related arrangements which will remain in NatWest Bank.
6)	Collateral	Any collateral posted against transferring transactions will transfer along with the transactions.

3.2 Other activities to achieve ring-fencing

The Scheme is only one of the activities that the RBS Group is undertaking in order to ensure compliance by 31 December 2018 with all ring-fencing requirements. Whilst my Scheme Report covers the Scheme, for information purposes I have summarised my understanding of the other key activities that have occurred or are occurring related to achieving compliance with the ring-fencing requirements. These descriptions are only included for information purposes as my Scheme Report only considers adverse effects caused by the Scheme. Whilst these other activities are not the subject of this Scheme Report, I believe that it is important that the Stakeholders are aware of the wider reorganisation so that the effect of the Scheme can be considered in the context of these wider activities.

I have not commented on whether other adverse effects may be caused by these wider activities.

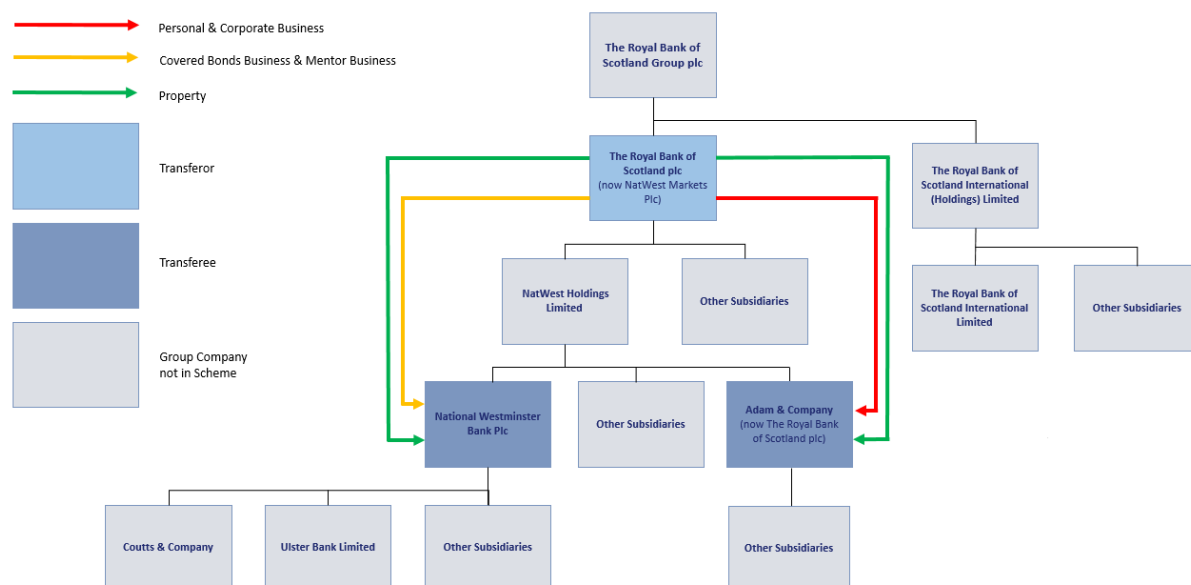
Key other activities outside the Scheme include:

First ring-fencing transfer scheme

RBS has implemented another ring-fencing transfer scheme which took effect on 30 April 2018 and transferred the personal and corporate banking business of RBS plc to Adam & Company, transferred the Covered Bonds Business and Mentor Business of RBS plc to NatWest Bank and transferred property from RBS plc to both Adam & Company and NatWest Bank. As the Scheme

was implemented, RBS plc was renamed NatWest Markets, and Adam & Company was renamed RBS plc. This was separate to the Scheme being considered in this Summary Scheme Report and was subject to a separate skilled person's scheme report and Court process.

The First Scheme transfers are shown in Figure 3-1 below:



Employees

On 1 May 2018 the majority of employees that support the RFB Subgroup transferred from RBS plc (now NatWest Markets) to NatWest Bank. NatWest Bank is now the main employing entity for the RFB Subgroup (for itself, and as the provider of shared services to the RFB Subgroup and the entities outside the ring-fence).

This transfer occurred on the basis of a "service provision change" under the Transfer of Undertakings (Protection of Employment) Regulations 2006. There was a termination of any existing service provider arrangements between RBS plc (now NatWest Markets) and other relevant group companies, and NatWest Bank has been appointed the new employment services provider for the relevant entities within the RFB Subgroup, including shared services staff, some of whom will provide services to entities outside the ring-fence.

RBS Group reorganisation

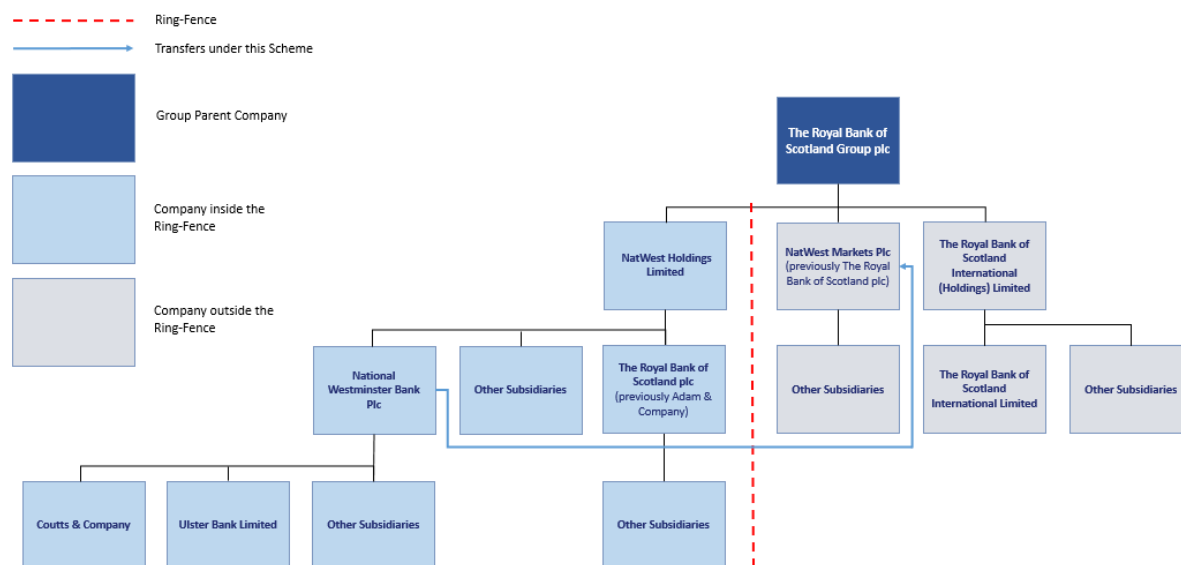
In 2018, following the effective date of the First Scheme but prior to the Effective Date of this Scheme, the RFB Subgroup will be "separated" from NatWest Markets. NatWest Markets will become an NRFB and will reside outside the ring-fence along with other entities such as The Royal Bank of Scotland International (Holdings) Limited which was transferred to RBSG plc on 1 January 2017 so that it became a direct subsidiary of RBSG plc.

As part of the plan to achieve this, NatWest Markets proposes to implement a capital reduction. The company will therefore apply to the Court for a reduction of capital under Section 641 of the Companies Act 2006. This application will seek approval to reduce share capital and certain undistributable reserves of NatWest Markets. If sanctioned by the Court, it is intended that the capital will be returned to its shareholder, RBSG, through the transfer of NatWest Markets' ownership of NatWest Holdings and its subsidiaries to RBSG and also in cash, with any balance remaining as distributable reserves.

As such a reduction will require the approval of the Court, NatWest Markets will make a separate application for this approval (separate, that is, from the application for the Court’s approval of this Scheme).

In deciding whether to approve NatWest Markets’ application, the Court will consider the interests of creditors, the effect the capital reduction will have on their position as creditors, and NatWest Markets’ ability to continue to be able to settle its liabilities to those creditors. As that Court process is separate from the Scheme, it is not within the scope of this Summary Scheme Report.

Following this, the RFB Subgroup will become a direct subsidiary of RBSG plc, as shown in Figure 3-1 below.



Other business transfers

There are a number of other business transfers that are planned to occur prior to 31 December 2018 in order to ensure compliance with ring-fencing requirements. These include the migration of certain customers from NatWest Bank to The Royal Bank of Scotland International Limited (“RBSI”) and the migration of certain customers and activities from other entities which will form part of the RFB Subgroup (e.g. Ulster Bank Limited (“Ulster Bank”), Coutts & Company (“Coutts”)) to either NatWest Markets or RBSI. These are in relation to activities that will not be permitted in RFB entities post the implementation of ring-fencing requirements. These transfers are occurring by client consent and are not within the scope of the Scheme.

Operations, systems and infrastructure

In order to comply with ring-fencing requirements, certain central functions and other support services will be reorganised so that they are all provided by NatWest Bank, both to itself and to the rest of the RBS Group, including the NRFB. Current service arrangements will be replaced by a new servicing structure, underpinned by a series of intra-group service agreements entered into by the RBS Group entities.

As a result, certain infrastructure such as systems and contracts will be moved to NatWest Bank. This will occur outside the scope of the Scheme.

4 My role as the skilled person

The purpose of my Scheme Report is to provide an independent assessment of the effect of the Scheme on customers and counterparties of products and services provided by RBS plc as well as on any other party affected by the Scheme, to assist the Court in deciding whether to sanction the Scheme. I am independent of RBS, and my appointment has been approved by the Prudential Regulation Authority ("PRA"), one of the bodies that regulates the UK banking industry. The PRA consulted with the Financial Conduct Authority ("FCA") as part of the process to approve my appointment.

In making this judgement, I have considered whether the Scheme results in an Adverse Effect in:

- Services to Stakeholders and operational continuity for Stakeholders: being the effect of the Scheme on the services provided to the Stakeholder, the quality of the operational continuity arrangements of the entities to which Stakeholders are exposed or connected and the ability of the entities to continue to provide these services to those Stakeholders;
- Financial Considerations: being the effect of the Scheme from a financial perspective on Stakeholders. This will include for example consideration of the effect of the Scheme on: i) terms and conditions and other financial effects on rates and fees; ii) the capital position of the entities to which Stakeholders are exposed or connected on a risk weighted and leveraged basis; iii) the liquidity and funding position of the entities to which Stakeholders are exposed or connected; iv) the effect on the business-model viability and sustainability of the entities to which Stakeholders are exposed or connected; and v) the position of persons other than the transferor in the creditor hierarchy;
- Risk management and governance: being the effect of the Scheme on the quality of governance arrangements and the quality of risk management and the systems and controls of the entities to which Stakeholders are exposed or connected; and
- Recovery and Resolution: being the effect of the Scheme on recovery planning, and the ability of the RBS Group to be resolved.

I have set out below key matters of note within this Summary Scheme Report. I have considered the effect that the Scheme will have on individual Stakeholder groups in the following sections of my Summary Scheme Report:

- Section 5: Customers and counterparties transferring from NatWest Bank to NatWest Markets under the Scheme (Effect on Transferring Customers); and
- Section 6: Other Stakeholders, including existing customers and counterparties of NatWest Bank and NatWest Markets (Effect on other Stakeholders).

Within each of these broad groups, I have considered separately the interests of different sub-groups, since the factors influencing them are different.

Some considerations affect multiple groups of Stakeholders. As such I have set out my key considerations and conclusions in Sections 7 and 8. Financial considerations are set out in Section 7, and Section 8 covers my assessment of Governance and Risk Management arrangements, overall Operational Continuity considerations, Resolvability considerations, Tax considerations and how RBS plans to communicate the Scheme to Stakeholders.

5 Effect on Transferring Counterparties

5.1 Counterparties with Derivative Transactions

In considering Counterparties with Derivative Transactions at the time of transfer, I have covered three possible scenarios:

- Counterparties with only Ineligible Derivative Transactions.
- Counterparties with only Eligible Derivative Transactions (including those with grandfathered interest rate Derivative Transactions).
- Counterparties with both Ineligible and Eligible Derivative Transactions

5.1.1 Contracted rates/fees

The proposed Scheme will not result in any changes to obligations in the Derivative Transaction contracts with no changes to contracted rates and fees. The obligations throughout the life of the contract will not change and the calculation of such obligations will remain unchanged. I therefore do not consider that there is an Adverse Effect in this respect.

5.1.2 Credit risk

Whilst the contracted obligations will not change as a result of the Scheme, open Derivative Transaction contracts are proposed to be transferred from NatWest Bank to NatWest Markets. Counterparties to the Derivative Transactions will therefore contract with a different legal entity following the Scheme. Both entities are regulated banks which have to meet regulatory requirements and, as set out in Section 7, RBS's financial projections for NatWest Markets indicate that it will be able to continue to meet minimum regulatory requirements in the future period considered by RBS management. As a result I do not consider that the Scheme results in the Derivative Transaction counterparties being transferred to an entity that is unable to meet its obligations as they fall due.

However whilst NatWest Markets is still expected to be able to meet its obligations as they fall due, there may be other effects on counterparties during the term of the instruments. As set out in Section 3, NatWest Markets will be outside the ring-fenced sub-group and as at the date of this report, the public announcements by the credit rating agencies indicate that it is likely that NatWest Markets will have a lower credit rating than NatWest Bank. For the purpose of my analysis, the credit ratings that have been considered are the long-term unsecured debt ratings, which are typically used by counterparties.

As at the date of this Summary Scheme Report, public announcements^[1] have been made by three credit rating agencies in respect of the ratings of NatWest Bank and NatWest Markets following the restructuring of the RBS Group to comply with ring-fencing rules by 1 January 2019:

- One credit rating agency has stated that the outlook for the credit rating of NatWest Bank is positive and that the outlook for the credit rating of NatWest Markets is stable, which indicates an expectation that at some point in the future NatWest Bank will be rated one notch higher than NatWest Markets;
- One credit rating agency has recently upgraded the credit rating of NatWest Bank by one notch and left the credit rating of NatWest Markets unchanged, resulting in a one notch difference as a result of ring-fencing plans; and

^[1] <http://investors.rbs.com/fixed-income-investors/credit-ratings.aspx>

- One credit rating agency has recently upgraded the credit rating of NatWest Bank by one notch and downgraded the credit rating of NatWest Markets by two notches, resulting in a three notch difference as a result of ring-fencing.

It is not clear when all rating changes will be made but it is likely that the Scheme will result in negative effects for Derivative Transaction counterparties as they are being transferred to an entity which is likely to have a lower credit rating. An effect may arise in relation to the fair valuation of Derivative Transactions that counterparties may record for their financial reporting purposes. Derivative Transactions are generally fair valued for accounting purposes and such valuations contain an adjustment that takes into account the risk of default of the entity that is party to the transaction (the "Credit Valuation Adjustment" or "CVA"). There are different methodologies to calculate a CVA but these are often linked to the credit rating of the entity. For example, if a Derivative Transaction had a positive fair valuation in the books and records of a counterparty, it may be expected that the fair valuation may be reduced due to the fact the counterparty was, after the Scheme, contracting with a lower rated entity. The Credit Valuation Adjustment in this example would be greater reducing the overall fair valuation. The corresponding entry in the books and records of the counterparty in this case would be to reduce its profits. As noted below, whilst the effect could be limited, it will depend on various factors such as the profile of future exposures, the maturity of the contracts and the CVA methodology used by the counterparty.

Such an effect would not affect all Derivative Transaction counterparties. For example:

- where Derivative Transactions have a positive fair valuation in the books and records of RBS. In such cases there may not be a CVA although I note that fair valuations can change over time and so a Derivative Transaction which currently has a positive fair valuation for RBS could in the future have a positive fair valuation for the counterparty and hence require a CVA.
- Derivative Transaction counterparties which are fully collateralised against the credit risk of RBS will not be affected by this issue as the existence of collateral mitigates the need for a CVA.

I note that the effect on the fair valuation of Derivative Transactions may be limited compared to the effect of changes in other market variables that affect the fair valuation of a Derivative Transaction.

Similarly there may be some effect on Derivative Transaction counterparties that are financially regulated where the transfer of contracts to a lower rated entity results in additional regulatory capital requirements. Again, as set out in the public announcements made to date by the credit rating agencies, the expected difference in the credit ratings of NatWest Bank and NatWest Markets may be up to three notches.

As a result there may be some negative effects on certain counterparties in respect of both fair valuation and regulatory capital as a result of the transfer to a bank with a lower credit rating.

I have therefore considered whether this results in an Adverse Effect for counterparties with different types of derivative transactions.

5.1.2.1 Counterparties with only Ineligible Derivative Transactions

As Ineligible Derivative Transactions will be transferred by the Scheme and as a result there may be negative effects on certain counterparties from the transfer to a bank with a lower credit rating, I have concluded that there is an Adverse Effect and have therefore considered Part (b) of the Statutory Question.

As Ineligible Derivative Transactions cannot remain in the RFB, in addressing Part (b) of the Statutory Question, I have considered whether the transfers could have been made to another entity or made in a manner which prevented any additional credit risk:

- NatWest Markets is the main Derivative Transaction trading entity of the RBS Group and the entity with which most Derivative Transaction counterparties of the RBS Group already trade.

As a result, I have concluded that it is reasonable for Derivative Transactions to be transferred into this entity, rather than for example setting up a completely new entity.

- The credit rating of NatWest Markets is influenced by many factors and given the size and nature of the business in the entity, I do not consider that there is a simple action or set of actions that could have been taken to eliminate the difference in credit rating between NatWest Bank and NatWest Markets.

I have also considered the possibility of collateralising the Derivative Transaction exposures:

- Putting two way collateral agreements in place for all transferring counterparties would reduce the effect for counterparties who are owed money by RBS but would result in a financial cost for counterparties who owe a debt to RBS and I do not consider this to be a reasonable alternative.
- Putting in place one way collateral agreements whereby only RBS posted collateral would largely eliminate credit risk without a cost for counterparties who owe a debt to RBS. However:
 - Counterparties currently have a credit risk exposure to NatWest Bank through the Derivative Transactions. The introduction of a one way collateral agreement would eliminate this credit risk; hence counterparties would receive a benefit greater than the negative effect caused by the additional credit risk of a transfer to an entity rated lower than NatWest Bank.
 - Collateralisation would require counterparties to enter into additional collateralisation agreements, put in place systems and controls to accept and safeguard collateral received and to monitor movements and to make payments back to RBS. Not all counterparties will have such systems and controls in place and there would be a cost of putting those in place.

Having considered the issues associated with collateralisation, I am satisfied that RBS's decision not to offer collateralisation is reasonable, especially since RBS will offer counterparties the ability to terminate the Derivative Transactions at market value or novate to a third party. This would take away future credit risk relating to NatWest Markets if the trades were terminated. Of course the future cash flows could be different (higher or lower for a counterparty) than current expectations and hence this would have to be carefully considered by counterparties. Such a termination may create other issues, such as leaving the counterparty economically unhedged.

I have also considered the fact that any Derivative Transaction, except Excluded Derivative Transactions, entered into after the opt-out cut-off date will transfer regardless of the nature or type of the Derivative Transaction. As counterparties will be made aware of the future transfer of any Derivative Transaction prior to entering into the trade, I am satisfied that any counterparty entering into such transactions will be aware of the potential Adverse Effects. Therefore I am satisfied that this is a reasonable course of action for RBS to adopt.

Overall I consider that the Adverse Effect itself is relatively limited when considering the credit risk that currently exists in comparison with the additional credit risk that would be created through the Scheme. As set out above, having considered the actual nature of the Adverse Effect, the need to transfer the Ineligible Derivative Transactions, the limited ability to transfer the Derivative Transactions into an entity other than one which has a lower rating, the advantages and disadvantages of collateralisation and the additional mitigation offered, I have concluded that whilst there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

I note that the ring-fencing legislation contains Grandfathering Provisions which permit the RFB to continue to hold certain Ineligible Derivative Transactions if they were entered into prior to 1 January 2019 and mature no later than 31 December 2020. Within the Ineligible Derivative Transactions population, there are certain Ineligible FX Derivative Transactions that would fall into this category. RBS has decided not to apply these Grandfathering Provisions to Ineligible FX Derivative Transactions which are all being transferred to NatWest Markets. As a result, I have considered whether it is reasonable to transfer Ineligible FX Derivative Transactions maturing no

later than 31 December 2020 as part of the Scheme when a decision could have been made to use the Grandfathering Provisions to maintain such Derivative Transactions in NatWest Bank

Given the short term nature of such Derivative Transactions, the effect of any such transfer from a credit risk perspective is reduced. However an effect still remains and I have set out my considerations in respect of the Grandfathering Provisions in Section 5.1.3.1.

5.1.2.2 Counterparties with only Eligible Derivative Transactions

The transfer of Eligible Derivative Transactions by the Scheme may result in negative effects on certain counterparties from the transfer to a bank with a lower credit rating. Whilst counterparties affected by this issue have the ability to opt Eligible Derivative Transactions out of the Scheme, as counterparties affected by this issue may nevertheless elect to transfer, I have concluded that there is an Adverse Effect which I need to consider. I have therefore addressed Part (b) of the Statutory Question.

In this respect, having considered the actual nature of the Adverse Effect, the limited ability to transfer the Derivative Transactions into an entity other than one which has a lower rating, the advantages and disadvantages of collateralisation and the additional mitigation offered, I have concluded that the decisions made by RBS in respect of the proposed transfers are reasonable. Overarching this is the fact that RBS has offered counterparties the ability to opt Eligible Derivative Transactions out of the proposed transfer. As a result the Adverse Effects related to the credit risk of NatWest Markets can be avoided by counterparties in respect of the Eligible Derivative Transactions within the Scheme.

5.1.2.3 Counterparties with both Ineligible and Eligible Derivative Transactions

Certain counterparties may hold a portfolio that contains both Ineligible and Eligible Derivative Transactions. As the Scheme will result in the transfer of Derivative Transactions, this may result in negative effects on certain counterparties as a result of the transfer to a bank with a lower credit rating. I have therefore concluded that there is an Adverse Effect and have addressed Part (b) of the Statutory Question.

For the reasons set out in Sections 5.1.2.1 and 5.1.2.2, I have concluded that whilst there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

I note that should a counterparty with both Ineligible and Eligible Derivative Transactions choose not to transfer Eligible Derivative Transactions, there will be other implications to consider as a result of their portfolio being split across NatWest Bank and NatWest Markets. This is discussed in Section 5.1.5.3 (Close-Out Netting) and 5.1.5.7 (Payment Netting).

5.1.2.4 Conclusion

Overall, for the reasons set out above, I have concluded that whilst there may be an Adverse Effect with regard to credit risk as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

5.1.3 Hedge accounting

Counterparties will often try to reduce or mitigate the financial effects of risks that could have an impact upon the counterparty's core business. The counterparty will often enter into Derivative Transaction contracts which will be structured to minimise these risks. For example if a counterparty is obliged to pay a floating interest rate on a loan, it may enter into an interest rate

swap whereby it receives payments based on floating interest rates and is obliged to pay a fixed amount thereby economically minimising the risk of interest rate increases for a certain period in the future. Similarly a counterparty may be required to make payments in a foreign currency and may enter into an FX Derivative Transaction to mitigate against future movements in the foreign currency.

As stated above, the transfer of Derivative Transactions through the Scheme will not change the obligations that RBS and the counterparty have in relation to the Derivative Transactions and therefore from an economic perspective the Derivative Transaction should continue to act as an economic hedge both before and after the Scheme if it was used for such a purpose by the counterparty.

A Derivative Transaction that is an economic hedge may, if appropriate, be treated as a hedge for accounting purposes by a counterparty and if this is achieved, volatility in the profit and loss account may be reduced. However a number of criteria need to be met to achieve hedge accounting. Whilst the transfer of Derivative Transactions through the Scheme does not change the future obligations, the Scheme does result in the RBS entity that is party to the transaction changing to an entity likely to have a lower credit rating. Each counterparty will need to make an assessment in respect of whether, from an accounting perspective, the Derivative Transaction can continue to be treated as an accounting hedge. The accounting standards that govern hedge accounting are dependent upon the individual circumstances of each counterparty and the effect of a transfer to a lower rated counterparty may be interpreted differently. There is therefore a possibility that this could result in a "break" in hedge accounting treatment, potentially resulting in increased volatility in the financial results of the counterparty. As the accounting interpretation may differ from one counterparty to another, some counterparties may conclude that this does not create an accounting issue, others may conclude that it does.

This issue may only apply to certain counterparties. I have set out below whether I consider this to result in an Adverse Effect for counterparties with different types of derivative transactions.

5.1.3.1 Counterparties with only Ineligible Derivative Transactions

As Ineligible Derivative Transactions will be transferred by the Scheme there may be negative effects for certain counterparties in respect of hedge accounting. Whilst this issue may only apply to certain counterparties rather than all counterparties, I have nonetheless concluded that this is an Adverse Effect of the Scheme and hence I have considered Part b) of the Statutory Question.

Overall, as Ineligible Derivative Transactions cannot remain in the RFB, I am satisfied that a transfer to NatWest Markets is a reasonable course of action in the context of the RBS Group, even if this entity has a lower credit rating than NatWest Bank. RBS has concluded that there is no other action that could reasonably be taken to mitigate the potential accounting issue that may be created for certain counterparties. I concur with this assessment.

In making this assessment I have considered the Grandfathering Provisions within the ring-fencing legislation:

- The ring-fencing legislation contains Grandfathering Provisions which permit the RFB to continue to hold certain Ineligible Derivative Transactions if they were entered into prior to 1 January 2019 and mature no later than 31 December 2020. Within the Ineligible Derivative Transactions population, there are certain Ineligible FX Derivative Transactions that would fall into this category. RBS has decided not to apply these grandfathering provisions to Ineligible FX Derivative Transactions which are all being transferred to NatWest Markets. As a result, I have considered whether it is reasonable to transfer Ineligible FX Derivative Transactions maturing no later than 31 December 2020 as part of the Scheme when a decision could have been made to use the Grandfathering Provisions to maintain such Derivative Transactions in NatWest Bank.

NatWest Markets is currently the main investment banking entity within the RBS Group and the entity where the vast majority of Derivative Transaction trading is performed and this will continue to be the case following the implementation of the ring-fencing legislation. NatWest Markets will maintain the operational processes and infrastructure for the derivative business following the implementation of the ring-fencing legislation and this has been a key determinant in RBS's decision to transfer existing Derivative Transactions to NatWest Markets. Following the implementation of the ring-fencing legislation on 1 January 2019, NatWest Bank, as an RFB will not be able to rely on NatWest Markets as the NRFB for operational support and so would need either to maintain its own systems and processes or rely on another entity, such as a service company, outside the NRFB in order to book, settle and risk manage transactions. RBS has determined that for Eligible Derivative Transactions (which for these purposes includes grandfathered interest rate Derivative Transactions), such Derivative Transactions can be booked, settled and managed appropriately on existing systems of NatWest Bank and hence will offer counterparties the option not to transfer all their Eligible Derivative Transactions if they so choose in order to mitigate Adverse Effects that may arise on transfer.

RBS has stated that for Ineligible FX Derivative Transactions, replicating the required systems and processes in NatWest Bank would be complex. The Ineligible FX Derivative Transactions are more complex in nature than Eligible Derivative Transactions and need different personnel, systems and processes to book, settle and risk manage such transactions. Having considered the costs, feasibility and risks associated with doing so, I have concluded that RBS's decision to transfer all Ineligible FX Derivative Transactions, including those that could have been grandfathered, through the Scheme is reasonable.

I have also considered the fact that any Derivative Transaction, other than Excluded Derivative Transactions, entered into after the opt-out cut-off date will transfer regardless of the nature or type of the Derivative Transaction. As counterparties will be made aware of the future transfer of any Derivative Transaction prior to entering into the trade, I am satisfied that any counterparty entering into such transactions will be aware of the potential Adverse Effects. Therefore I am satisfied that this is a reasonable course of action for RBS to adopt.

5.1.3.2 Counterparties with only Eligible Derivative Transactions

The transfer of Eligible Derivative Transactions by the Scheme may result in negative effects on certain counterparties in respect of hedge accounting. Whilst counterparties affected by this issue have the ability to opt Eligible Derivative Transactions out of the Scheme, as counterparties affected by this issue may nevertheless elect to transfer, I have concluded that there is an Adverse Effect which I need to consider. I have therefore addressed Part (b) of the Statutory Question.

The hedge accounting issue may only apply to certain counterparties. As RBS will offer counterparties the opportunity for Eligible Derivative Transactions not to be transferred as part of the Scheme, counterparties have the ability to avoid this Adverse Effect if they choose. For this reason, whilst I have concluded that there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

5.1.3.3 Counterparties with both Ineligible and Eligible Derivative Transactions

Certain counterparties may hold a portfolio that contains both Ineligible and Eligible Derivative Transactions. As the Scheme will result in the transfer of Derivative Transactions, this may result in negative effects on certain counterparties in respect of hedge accounting. I have therefore concluded that there is an Adverse Effect and have addressed Part (b) of the Statutory Question.

For the reasons set out above in Sections 5.1.3.1 and 5.1.3.2, I have concluded that whilst there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

I note that should a counterparty with both Ineligible and Eligible Derivative Transactions choose not to transfer Eligible Derivative Transactions, there will be other implications to consider as a result of their portfolio being split across NatWest Bank and NatWest Markets. This is discussed in Section 5.1.5.3 (Close-Out Netting) and 5.1.5.7 (Payment Netting).

5.1.3.4 Conclusion

Overall, for the reasons set out above, I have concluded that whilst there may be an Adverse Effect with regard to hedge accounting as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

5.1.4 Shared security

Certain customers have granted security to NatWest Bank which covers more than one exposure for example as both security for loans and Derivative Transactions. In the event of default or insolvency of the customer, this security would be enforceable by NatWest Bank with respect to the total amount of the secured exposure. Customers who have provided security on an 'all monies' basis which secures some or all of their liabilities to NatWest Bank, including any Derivative Transactions entered into by them from time to time (which would include any new Derivative Transactions entered into after the Scheme takes effect), but who have no live transactions which will be outstanding after 31 August 2018 are also affected by this change.

Following the Scheme, the total secured exposure of these customers will be split between NatWest Bank and NatWest Markets with, for example, their existing Derivative Transaction (or, if they have no live transactions, their Secured Empty Arrangements) transferring to NatWest Markets but their existing loan remaining in NatWest Bank.

There will be an amendment, under the Scheme, to ensure that such security secures the total exposure for the RBS Group, even if owed to multiple companies after the Scheme, such security to be held by NatWest Bank as trustee for those relevant RBS Group companies. There will also be an inter-creditor agreement which will set out the treatment to be followed between NatWest Bank, NatWest Markets and other relevant RBS Group companies. As a result I have concluded that there is no Adverse Effect on the relevant Stakeholders:

- From a customer perspective, neither the total amount of the security nor the amount owed will change, although it will be owed to a greater number of companies. Whilst there may now be two parties with differing objectives who may exercise these rights, the total amount of the security will not change;
- No significant additional obligations will be imposed on the customer under either the security agreement or the inter-creditor agreement; and
- From the perspective of NatWest Bank and NatWest Markets, their aggregate commercial position will be unchanged before and after the Scheme as they will, between them, have the benefit of the same security for the same exposures (including exposures incurred after the Effective Time which would have been secured by such shared security had the Scheme not taken effect). As between each other, the benefit of such security will be shared proportionately by reference to each entity's secured exposures, so their proportionate recovery on the security will be unchanged before and after the Scheme, although an inter-creditor agreement will contain some new inter-creditor provisions on arm's length terms as required under ring-fencing legislation.

I have relied upon legal advice provided to RBS in relation to the proposed shared security mechanism.

5.1.5 Set-off rights

5.1.5.1 Customer/ counterparty set-off – additional set-off rights for the RBS Group

A bank set-off right is the right of a bank, in certain circumstances, to apply a liability owed by it to a customer (for instance an obligation to repay money deposited with it, such as in a deposit account) against a debt the same customer owes that becomes repayable, such as under a Derivative Transaction.

There could be situations where, following the Scheme, additional set-off rights are created for NatWest Markets. For example this could occur where before the Scheme, NatWest Bank was owed a debt from a customer and NatWest Markets owed a debt to the customer. Before the Scheme no set-off would generally be available under many statutory insolvency set-off regimes owing to a lack of mutuality. However, following the Effective Date and the implementation of the Scheme, the requisite mutuality would be created whereby set-off of the two claims could be possible in an insolvency of the customer. This could leave NatWest Markets with a set-off right in insolvency following the Scheme, which it otherwise would not have had.

The Scheme Document states that after the Effective Date, for a period of three months, NatWest Markets will not be able to exercise these additional rights, for example to apply money it owes in respect of deposits received against debts transferred to it on Derivative Transaction contracts as a consequence of the Scheme. RBS does not believe any such situations exist but will offer this additional protection as a precaution. The decision to waive these additional rights for three months is in line with precedent in certain other banking business transfer schemes under Part VII of FSMA and the First Scheme. In addition, RBS will also offer the customer a period of three months from the Effective Date to move money, including longer term contracts such as fixed term deposits, without any charge or loss of interest.

As no such positions are thought to exist and due to the additional protection offered, I have concluded that there is no Adverse Effect as a result of the Scheme.

5.1.5.2 Customer/ counterparty insolvency – loss of set-off rights for the RBS Group

There could be situations where, following the Scheme, the RBS Group has reduced set-off rights in the event of the customer becoming insolvent. For example this could occur in a scenario where NatWest Bank was owed a debt through a loan or mortgage and owed a debt to the same counterparty through a Derivative Transaction contract. In the event of insolvency of the counterparty, the debt owed by NatWest Bank would be offset against the debt owed to NatWest Bank. If, as a result of the Scheme, the debt owed through the Derivative Transaction transferred to NatWest Markets, NatWest Bank would cease to have the direct benefit of this amount and accordingly lose the ability to make such offsets.

This would not be an Adverse Effect for counterparties being transferred as the debt owed to and from the counterparty would not change. From RBS’s perspective, RBS has performed an analysis of those counterparties in difficulties who also have a Derivative Transaction position where the mark-to-market valuation is in favour of the customer. This analysis shows that the impact of this loss of set-off would be minimal, and as a result I do not consider that there is an Adverse Effect for Stakeholders in this respect.

5.1.5.3 Insolvency or resolution of RBS Group companies – loss of customer set-off rights

There could be situations where, following the Scheme, customers lose set-off rights in the event of insolvency or resolution of companies in the RBS Group. For example, pre-Scheme, a customer could have a debt owed by NatWest Bank and a debt owed to NatWest Bank. As a result of the Scheme, a debt owed from NatWest Bank, such as a Derivative Transaction could be transferred to NatWest Markets whilst the debt owed to NatWest Bank such as a loan or mortgage is not. In the event of insolvency or resolution of NatWest Markets, the customer would still owe the debt to NatWest Bank but may not be able to offset the amount against that owed from NatWest Markets.

I have assessed below situations where customers have contracted for set-off rights and situations where no contractual set-off exists.

Close-out Netting

Under an ISDA Master Agreement positions on multiple Derivative Transactions held between two counterparties may be offset under netting arrangements ("Netting"). A subset of specific transactions between two counterparties may also be established known as a Netting Set. Close-out netting under an ISDA Master Agreement is the process of calculating and netting the termination values of transactions following an event of default or termination event to produce a single amount payable between the parties and this applies with respect to all transactions governed by an ISDA Master Agreement. For counterparties with only Ineligible Derivative Transactions or counterparties with only Eligible Derivative Transaction, as Netting Sets will be maintained under the Scheme, I have concluded that there is no Adverse Effect in this respect.

In respect of counterparties with both Ineligible and Eligible Derivative Transactions, it is expected that Eligible Derivative Transactions will be transferred as part of the Scheme alongside Ineligible Derivative Transactions unless the counterparty decides that Eligible Derivative Transactions will remain in NatWest Bank. If a counterparty decides that Eligible Derivative Transactions should not be transferred as part of the Scheme, existing Netting Sets could be broken. I do not consider it likely that either NatWest Bank or NatWest Markets will become insolvent and therefore on this basis I consider any impact to be limited and by itself would not represent an Adverse Effect. However the Netting Sets may affect the calculation of Credit Valuation Adjustments against Derivative Transactions exposures and therefore I have concluded that there may be an Adverse Effect of the Scheme in this respect.

I have therefore considered part (b) of the Statutory Question.

Counterparties could choose for all Eligible Derivative Transactions to be transferred in which case there would be no changes to Netting Sets and so no Adverse Effect. There is however a potential Adverse Effect for those counterparties that choose to leave Eligible Derivative Transactions with NatWest Bank whilst also holding Ineligible Derivative Transactions that are transferred by the Scheme. This decision may be driven by counterparties desiring to maintain hedge accounting or due to the effect of the transfer on the fair valuation of Derivative Transactions. Overall I consider that the primary Adverse Effects of the Scheme are in respect of hedge accounting and fair valuation and the option to leave Eligible Derivative Transactions in NatWest Bank is designed to negate these Adverse Effects, which I note are fairly limited in themselves and may only effect certain counterparties. Although there will be potentially a loss of payment netting if such an election is made, as this is driven by the choice of the counterparty and a requirement to transfer Ineligible Derivative Transactions, I am satisfied that this is a reasonable course of action for RBS to have followed. Therefore, whilst I have concluded that there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

Other contractual set-off

RBS has conducted an analysis which has not identified any arrangements containing such customer contractual set-off rights. I also note that contractual set-off would only be exercisable in

the event of the default of the relevant legal entities, which I do not consider to be probable. As a result, I do not consider that the Scheme would lead to an Adverse Effect.

Non-contractual set-off

Where a customer has no contractual rights of set-off, the general UK insolvency law will still in some circumstances allow or require set-off of reciprocal claims between a customer and an entity. There are equivalent statutory set-off rules in the modified forms of insolvency/resolution proceedings which can also apply to banks under the Banking Act 2009. English statutory insolvency set-off rules rely on the concept of "mutuality". This requires that there have been "mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt" in liquidation or administration. Therefore if the Scheme results in a debt owed by a customer to an entity to be separated from the debt owed from that entity, mutuality would no longer exist.

For there to be a financial detriment to customers in this respect:

- the RBS entity would have to be put into insolvency or resolution;
- the customer would itself still be solvent at the time that the RBS entity defaulted; and
- at the time of the RBS entity default, there would have to be debts owed to that entity from the customer which could have been offset against debts owed from the entity which could have been offset if the Scheme had not occurred.

I do not consider that these events are likely to occur. In particular I note that I do not consider that it is likely that NatWest Markets will be put into insolvency, and in any event since the introduction of the Banking Act 2009, it is likely that other methods (such as the bail-in of liabilities) may be used rather than a traditional insolvency or administration proceeding. In addition I note that many Stakeholders would be considered more likely to default than a regulated bank and also that as at the date of this Summary Scheme Report, in many instances there is no such set-off position as the current value of outstanding Derivative Transaction positions is in favour of RBS. I note that this could change in the future.

As well as the above situation being unlikely, I have considered the fact customers did not originally negotiate such express contractual arrangements.

Having taken all these factors into account, I do not consider there to be an Adverse Effect for customers in this respect.

5.1.5.4 All monies

An "all monies" clause allows a mortgage or charge to be used as security for all debts owed to the lender, not just the specific loan or mortgage. A provision has been made in the Scheme Document for such arrangements as, after the Effective Date, all monies clauses in existing NatWest Markets agreements will not apply to debts transferred from NatWest Bank and all monies clauses in agreements transferred from NatWest Bank will not apply to existing debts owed to NatWest Markets or new NatWest Markets debts incurred after the Effective Date (unless the terms on which debts are contracted specifically state that they are so secured). I have therefore concluded that there is no Adverse Effect of the Scheme in this respect.

5.1.5.5 Consolidation rights

A "consolidation clause" permits a lender to retain the security until all debts owed to the lender have been repaid. A provision has been made in the Scheme Document for such arrangements as, after the Effective Date, consolidation clauses in existing NatWest Markets agreements will not apply to prevent the release of the security until all obligations have been satisfied under any obligation transferred from NatWest Bank. Equally consolidation clauses in agreements transferred from NatWest Bank will not apply to prevent the release of the security until all obligations have

been satisfied under any existing agreement with NatWest Markets, unless the terms of the agreement permits consolidation between agreements with NatWest Bank and agreements with NatWest Markets. I have therefore concluded that there is no Adverse Effect of the Scheme in this respect.

5.1.5.6 Cross-default

A "cross-default" clause provides for a customer to be automatically in breach of the borrowing or account terms and conditions if in breach of certain other agreements. This may give rise to a right of early termination or a right to demand early repayment of any sum due to the bank. The Scheme Document states that, after the Effective Date, where a customer has products with both NatWest Bank and NatWest Markets, one of which contains a cross-default right, unless it would have done so prior to the Effective Date, a breach of an existing NatWest Markets agreement will not give rise to a breach of any transferred NatWest Bank agreement; and unless it would have done so prior to the Effective Date, a breach of a transferred NatWest Bank agreement will not give rise to a breach of any existing NatWest Markets agreement. I note that the Scheme Document will not restrict cross-default rights where, immediately before the Effective Date, the relevant agreement would treat a breach of an agreement with the other bank as being a breach of that agreement. I have therefore concluded that there is no Adverse Effect of the Scheme in this respect.

5.1.5.7 Payment netting

Payment netting under an ISDA Master Agreement allows the parties on an intra-day basis during the life of a transaction to net amounts payable and receivable on the same day and in the same currency either in respect of the same transaction or two or more transactions. For counterparties with only Ineligible Derivative Transactions or counterparties with only Eligible Derivative Transaction, as Netting Sets will be maintained under the Scheme I have concluded that there is no Adverse Effect in this respect.

In respect of counterparties with both Ineligible and Eligible Derivative Transactions, it is expected that Eligible Derivative Transactions will be transferred as part of the Scheme alongside Ineligible Derivative Transactions unless the counterparty decides that Eligible Derivative Transactions will remain in NatWest Bank. If a counterparty decides that Eligible Derivative Transaction contracts should not be transferred as part of the Scheme, existing Netting Sets could be broken and this could result in separate payments being required to be made to separate entities. I consider this an Adverse Effect of the Scheme as, although this would be at the choice of the counterparty, it would be the Scheme transferring Derivative Transactions that results in the breaking of Netting Sets.

I have therefore considered part b) of the Statutory Question.

Counterparties could choose for Eligible Derivative Transactions to be transferred in which case there would be no changes to Netting Sets and so no Adverse Effect.

As noted above, there is a potential adverse effect for those counterparties that choose to have Eligible Derivative Transactions remain with NatWest Bank whilst also holding Ineligible Derivative Transactions that are transferred by the Scheme. This, for example, may be driven by counterparties desiring to maintain hedge accounting or due to the effect of the transfer on the fair valuation of Derivative Transactions. Overall I consider that the primary Adverse Effects of the Scheme are in respect of hedge accounting and fair valuation and the option to leave Eligible Derivative Transactions in NatWest Bank is designed to negate these Adverse Effects which I note are fairly limited in themselves and may only effect certain counterparties. Although there will be potentially a loss of payment netting if such an election is made, as this is driven by the choice of the counterparty and a requirement to transfer Ineligible Derivative Transactions, I am satisfied that this is a reasonable course of action for RBS to have followed. Therefore, whilst I have

concluded that there is an Adverse Effect as a result of the Scheme, I do not consider that this is likely to be greater than is reasonably necessary in order to achieve the relevant purpose of Section 106B(3)(a).

5.1.6 Operational and service effects

In respect of operational and service effects:

- The existing contracts and arrangements will transfer as part of the Scheme and there will be no changes to the payments in respect of these contracts with the exception that payments will involve a new account with NatWest Markets after the Effective Date. This will require counterparties to change Standard Settlement Instructions in respect of payments made in respect of Derivative Transactions (including in respect of associated collateral arrangements). I understand that this is a task which is administrative in nature and so I have concluded that this does not represent an Adverse Effect of the Scheme.

5.1.7 Access to products

New Derivative Transactions entered into after the Effective Date will be made with NatWest Markets rather than NatWest Bank as NatWest Bank will no longer offer such products. Whilst there will be a product curtailment in NatWest Bank this is a strategic decision and is not driven by the Scheme itself and so I do not consider that this is an Adverse Effect of the Scheme. I also note that RBS has stated that all products will continue to be offered by NatWest Markets and so there will be no product curtailment for Derivative Transaction counterparties.

5.1.8 Other contractual provisions

If approved, the Scheme will provide that all references to NatWest Bank will, following the Effective Date, be read as being references to NatWest Markets in the case of business transferring to NatWest Markets. The administrative changes required to allow the transferred business to operate from NatWest Markets following the Effective Date include the following changes as set out in the Scheme Document:

- any reference to NatWest Bank's company registration number, banking license number, country of incorporation, address or other contact details shall be read as reference to NatWest Markets' company registration number, banking license number, address or other contact details;
- any reference to NatWest Bank and all or any of its affiliates shall be construed as a reference to NatWest Markets and such affiliates of NatWest Markets;
- any reference to any director, officer, representative or employee of NatWest Bank shall be construed as a reference to the directors, officers, representatives or employees of NatWest Markets; and
- any reference to a rate, charge, tariff or scale of fees or to terms or conditions of NatWest Bank, or the ability to set or publish such rates, shall be read as references to the same for NatWest Markets.

RBS has undertaken a legal due diligence exercise with respect to the transferring business in order to:

- identify any potential breaches of agreements or contractual rights triggered by the Scheme which, subject to any jurisdictional issues, the Scheme, subject to Court sanction, will override;
- identify the terms of any agreements which the Scheme, subject to Court sanction, will amend to make the relevant agreement work when transferred to NatWest Markets; and

- identify any issues which might form the basis of an objection to the Scheme or which may constitute an Adverse Effect on a customer or Stakeholder.

I have considered the results of the legal due diligence undertaken and overall I have concluded that there is no Adverse Effect. Key issues that I have considered are set out below:

5.1.8.1 Non-UK law

The Scheme operates on the basis of transferring an identified business, such that all assets and liabilities in the transferring business line will transfer pursuant to the Scheme, unless they are expressly carved out as set out in the Scheme Document.

The transferring business includes certain transactions which are wholly or partly governed by a non-UK law. Where these transactions, or any part of them, are governed by a non-UK law which does not recognise the effect of the Scheme, it is intended that the affected non-UK law governed parts of these transactions will be transferred only once any necessary manual transfer and perfection steps have been completed outside the Scheme. This is referred to in the Scheme Document as a "Subsequent Transfer Date".

For example, there are certain transactions where the Derivative Transaction agreement is governed by a UK law but the transaction includes some documents governed by a non-UK law, notably foreign law security. In relation to these transactions, the UK law elements will transfer on the Effective Date with the foreign law elements being classified as a "Residual Asset" or a "Residual Liability" to the extent that the relevant foreign law does not recognise the effect of the Scheme. In this way, an English law governed agreement will transfer to NatWest Markets at the Effective Date but may become "de-linked" from the supporting security, guarantees or other transaction elements which are governed by a non-UK law which will become Residual Assets or Residual Liabilities. Where both the arrangement and the security are governed by a non-UK law, they may transfer at separate times if the necessary manual transfer and perfection steps are completed at different points. These Residual Assets will be held on trust for the benefit of NatWest Markets (or, where such trust is not recognised in the relevant non-UK jurisdiction, NatWest Bank will agree to be subject to a duty to account to NatWest Markets for the Residual Assets or Residual Liabilities). As the security provided by the customer does not change, I do not consider that there is an Adverse Effect from this arrangement.

5.1.8.2 Restrictions on transfer

The legal due diligence has identified a number of contractual provisions which will be overridden through the Scheme's transfer process. These include:

- Restriction on transfers: there are certain contracts where transfers are prohibited; and
- Consent to transfer from counterparty: there are certain contracts where consent to transfer is required from the counterparty.

I also note that certain contracts contain either a requirement to give notice of transfer to the counterparty, or a requirement for consent from either the counterparty or a third party.

These contractual provisions would be overridden if the Scheme were approved and I have taken this into account when reaching my conclusions in respect of Adverse Effects. Where I do not consider there to be an Adverse Effect for transferring counterparties, I do not consider there to be an Adverse Effect for counterparties that have certain rights overridden by the Scheme.

5.1.8.3 Effects of changes in credit rating

The legal due diligence has also identified instances in certain transferring agreements where a transfer to a lower rated counterparty gives rise to termination rights for a counterparty or

ongoing obligations on NatWest Markets to take particular action or range of possible actions, for example the posting of collateral.

I do not consider that the Scheme has an Adverse Effect in this respect as RBS has elected to preserve the rights such as termination and other enforceable actions that were contractually predetermined. Therefore the counterparty continues to have such rights as a result of the Scheme.

5.1.8.4 ISDA Master Agreement provisions

ISDA Master Agreements generally contain a number of termination provisions, including those which give counterparties the right to terminate contracts when certain requirements are met (including the occurrence of certain creditworthiness or other credit related events). If these provisions would otherwise be triggered by the circumstances arising from the Scheme, the rights would not be enforceable as a matter of law.

RBS has concluded that there are no such ISDA termination events triggered as a result of transfers that will be effected through the Scheme. I have reviewed RBS's reasons for reaching this conclusion, and based on this review I have concluded there is no Adverse Effect in this respect.

5.1.9 Conclusion

Other than the matters set out in Sections 5.1.2, 5.1.3 and 5.1.5, I am satisfied that there are no Adverse Effects as a result of the Scheme in respect of Counterparties with Derivative Transactions. In respect of the matters in Sections 5.1.2, 5.1.3 and 5.1.5, I am satisfied that the Adverse Effect is not likely to be greater than is reasonably necessary in order to achieve the specific purpose of enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions (Section 106B(3)(a) of FSMA).

5.2 Counterparties with no Derivative Transactions at the time of transfer

Any Secured Empty Arrangements between NatWest Bank and a counterparty where there are no Derivative Transactions in existence but where there is a shared security arrangement in place will transfer as part of the Scheme.

As there are no live trades between NatWest Bank and the counterparty, there are no credit risk, hedge accounting or set-off issues.

The only consideration for these counterparties is shared security.

5.2.1 Shared security

Certain customers have granted security to NatWest Bank which covers more than one exposure for example as both security for loans and Derivative Transactions. In the event of default or insolvency of the customer, this security would be enforceable by NatWest Bank with respect to the total amount of the secured exposure. Customers who have provided security on an 'all monies' basis which secures some or all of their liabilities to NatWest Bank, including any Derivative Transactions entered into by them from time to time (which would include any new Derivative Transactions entered into after the Scheme takes effect), but who have no live Derivative Transactions which will be outstanding after 31 August 2018 are also affected by this change.

Following the Scheme, the total secured exposure of these customers will be split between NatWest Bank and NatWest Markets with, for example, their Secured Empty Arrangements transferring to NatWest Markets but their existing loan remaining in NatWest Bank.

There will be an amendment, under the Scheme, to ensure that such security secures the total exposure for the RBS Group, even if owed to multiple companies after the Scheme, such security to be held by NatWest Bank as trustee for those relevant RBS Group companies. There will also be an inter-creditor agreement which will set out the treatment to be followed between NatWest Bank, NatWest Markets and other relevant RBS Group companies. As a result I have concluded that there is no Adverse Effect on the relevant Stakeholders:

- From a customer perspective, neither the total amount of the security nor the amount owed will change, although it will be owed to a greater number of companies. Whilst there may now be two parties with differing objectives who may exercise these rights, the total amount of the security will not change;
- No significant additional obligations will be imposed on the customer under either the security agreement or the inter-creditor agreement; and
- From the perspective of NatWest Bank and NatWest Markets, their aggregate commercial position will be unchanged before and after the Scheme as they will, between them, have the benefit of the same security for the same exposures (including exposures incurred after the Effective Time which would have been secured by such shared security had the Scheme not taken effect). As between each other, the benefit of such security will be shared proportionately by reference to each entity’s secured exposures, and so their proportionate recovery on the security will be unchanged before and after the Scheme, although the inter-creditor agreement will contain some new inter-creditor provisions on arm’s length terms as required under ring-fencing legislation.

I have relied upon legal advice provided to RBS in relation to the proposed shared security mechanism.

5.2.2 Conclusion

I am satisfied that there are no Adverse Effects as a result of the Scheme in respect of Counterparties with no Derivative Transactions at the time of transfer.

5.3 Litigants and other claimants against NatWest Bank

Under the Scheme any litigation or claim that is associated with the transferring NatWest Bank customer derivative business will transfer with the business to NatWest Markets. This approach is set out in the Scheme Document and will also be explained to Stakeholders in the Scheme communications (as covered in Section 8.8 of this Summary Scheme Report and Section 12 of my Scheme Report).

There will be no operational change for any transferring ongoing claims. The claims handling process and contacts will remain the same as before the Scheme.

Any claim or litigation associated with a Derivative Transaction where the counterparty chooses to exit at market value will transfer to NatWest Markets along with the transferring business. However, any claim or litigation associated with an Eligible Derivative Transaction that is opted out of the Scheme will remain with NatWest Bank.

In any situation where a claim or litigation specifically relates to more than one Derivative Transaction and where some of those Derivative Transactions will transfer to NatWest Markets but some will remain with NatWest Bank, the claim or litigation will by default transfer to NatWest Markets under the Scheme, unless RBS agrees to a request from the counterparty for it to remain with NatWest Bank.

5.3.1 Conclusion

Based on my assessment of the financial position of NatWest Markets as set out in more detail in Section 7 (Financial Considerations), I do not consider that the Scheme results in an Adverse Effect on litigants that are being transferred to NatWest Markets.

6 Effects on other Stakeholders

6.1 Remaining NWB Customers

As this Scheme is small in size and specific to certain Derivative Transaction products and counterparties, the potential impact to the Remaining NWB Customers is expected to be limited from both an operational and a financial perspective. The transferring business currently represents less than 1% of the Balance Sheet of NatWest Bank, and as a result the transfer will not significantly change the profitability, capital or liquidity position of the entity.

For these reasons I am satisfied that there is no Adverse Effect as a result of the Scheme in respect of remaining NatWest Bank customers.

6.2 Existing NWM Customers

As this Scheme is small in size and specific to certain Derivative Transaction products and counterparties, the potential impact to Existing NWM Customers is expected to be limited from both an operational and a financial perspective. The transferring business currently equates to less than 1% of the Balance Sheet of NatWest Markets, and as a result the transfer will not significantly change the profitability, capital or liquidity position of the entity.

For these reasons I am satisfied that there is no Adverse Effect as a result of the Scheme in respect of Existing NWM Customers.

6.3 Employees of NatWest Bank and NatWest Markets

Employees of NatWest Bank and NatWest Markets are not affected by the Scheme.

6.4 Pensions

RBS operates a number of defined benefit ("DB") and defined contribution ("DC") pension arrangements.

Under a DB pension scheme, the member receives a specific retirement benefit amount which is usually based on salary and years of service. Employee members generally pay a specified contribution whilst the sponsoring company meets the balance of the cost, and therefore bears the funding risks of ensuring benefits are able to be paid to the beneficiaries.

Under a DC pension scheme, contributions from the employee member and sponsoring company are paid in to an investment account which is used to provide benefits to the member on retirement. Since there is no funding risk to the sponsoring company in relation to DC pension arrangements, I do not consider that the Scheme has an Adverse Effect on the DC Stakeholders.

In respect of the DB stakeholders:

- The transfer of business and assets under the Scheme is immaterial in size to NatWest Bank.
- In any case, in relation to RBS's main DB pension scheme (the Royal Bank of Scotland Group Pension Fund) the transfer is between two participating employers and therefore the scheme will continue to have direct access to the combined assets and earnings.

As such I do not consider that the Scheme will materially affect the DB pension schemes of RBS.

Accordingly, I am therefore satisfied that RBS's pension schemes will not suffer an Adverse Effect as a result of the Scheme.

6.5 Suppliers

The Scheme does not have any direct effect on supplier contracts. Based on my assessment of the effect of the Scheme on the financial position of NatWest Bank and NatWest Markets as set out in more detail in Section 7 (Financial Considerations), I do not consider that the Scheme results in an Adverse Effect on suppliers.

6.6 Creditors of NatWest Bank

As the Scheme is not material to the financial position of NatWest Bank, I do not consider that the Scheme has an Adverse Effect on creditors of NatWest Bank.

6.7 Creditors of NatWest Markets

As the Scheme is not material to the financial position of NatWest Bank, I do not consider that the Scheme has an Adverse Effect on creditors of NatWest Bank.

6.8 RBSG plc shareholders

Numerous factors influence the share price of an entity and share prices take into account expectations in respect of future performance and events. The ring-fencing requirements which come into effect at the end of 2018 have been a matter of public knowledge for some time, as are some of the expected costs of ring-fencing which as set out in the Independent Commission on Banking ("ICB") Final Report Recommendations of September 2011 include increased funding costs for banking groups and the cost of implementation itself. Therefore it is my expectation that the share price will have taken some account of these events.

The Scheme itself is only one part of ensuring compliance with the ring-fencing legislation and due to the forward looking nature of a share price, I do not consider it possible to separate and quantify any effect that the Scheme would have although I note that by itself, it largely results in a transfer of assets and liabilities between RBS Group companies. Therefore I do not consider that the Scheme has an Adverse Effect on RBSG plc shareholders.

6.9 RBSG plc bondholders

As the Scheme itself is only transferring businesses between underlying RBS Group companies, I do not consider that the Scheme itself has an Adverse Effect on RBSG plc bondholders.

7 Legal entity considerations - financial

A key part of bank regulation is to make sure that firms operating in the industry are prudently managed. Regulatory rules set out the level of capital that banks need to hold with the objective of ensuring continuation of a safe and efficient service. In addition to capital, banks have to maintain appropriate levels of liquidity. Liquidity is a measure of how easily a bank can turn its assets to cash in order to meet its obligations. A simple example being to meet the needs of the customers who wish to withdraw cash on a day to day basis.

Banks hold capital resources at or above their internally set risk appetite levels. These levels are set above the level required to meet minimum capital requirements and holdings of capital buffers in order to avoid regulatory breaches. In making my assessment, where there are capital resources in excess of the risk appetite of any company, I placed limited weight on it as it could potentially be removed at any future point, for example by the payment of dividends. However I do expect that capital resources should meet the levels required by the risk appetite of a company (where set) and I expect that these levels should be above the minimum capital ratio requirements including buffers so that a capital surplus is maintained.

For example, if Stakeholders are transferred from a company with higher capital ratios to another company with lower capital ratios but these are still well in excess of minimum regulatory requirements, I would not immediately consider this to be an Adverse Effect for Stakeholders as the capital resources required by the transferee's risk appetite may provide an acceptable minimum ongoing level of financial strength and cannot be weakened arbitrarily in future. If however Stakeholders are transferred to a company where the capital ratio is marginally above the minimum capital requirements, I may consider this to be an Adverse Effect. My assessment of Adverse Effects is made by groups of Stakeholders and effects on capital resources may have different consequences for different Stakeholder groups. For example, a change in capital resources may affect the fair value of a financial instrument without having a significant effect on whether the obligations on a financial instrument (e.g. interest and principal repayments) can be met.

In making my assessment, I have considered the following:

- **Effect of Transfers.** The Effective Date is expected to be 13 August 2018. At close of business on 12 August 2018, certain assets and liabilities of NatWest Bank will be transferred to NatWest Markets. I have therefore analysed the forecast position of the affected entities as at 12 August 2018, being the expected last day preceding the Scheme, and 13 August 2018, being the expected first day of the implementation of the Scheme; and
- **Financial Viability.** As well as assessing the effect of the Scheme from a capital and liquidity perspective both before and immediately after the Effective Date, I have considered the effect of the transfers on the business-model viability and sustainability of the entities. I have made this assessment by considering whether the planned financial performance of the entities indicates concerns that they would not be able to meet regulatory requirements following the Scheme.

I note that the financial position at the Effective Date cannot be predicted with certainty. The capital position of the Scheme Companies at the Effective Date will therefore differ from the projections I have considered. As the information from these projections is not public, it has not been reproduced here. I will continue to keep the position under review in the period leading up to the Final Hearing, and, if required by the Court, will prepare further information in a Supplementary Report.

7.1 Effect of transfer – capital adequacy

This section sets out my considerations in relation to the immediate effect of the Scheme on the capital resources of the Scheme Companies as at the Effective Date. I have been provided and considered the effect of the Scheme on all relevant capital ratios.

7.1.1 NatWest Markets

Due to the small size of the transferring business, the Scheme has a very limited effect on the capital ratios of NatWest Markets. Therefore I do not consider that the Scheme will have an Adverse Effect to the entity in terms of capital adequacy.

7.1.2 NatWest Bank

Due to the small size of the transferring business, the Scheme has a very limited effect on the capital ratios of NatWest Bank. Therefore I do not consider that the Scheme will have an Adverse Effect to the entity in terms of capital adequacy.

7.2 Effect of transfer – liquidity

As noted in 7.1.1 and 7.1.2 above, due to the small size of the transferring business, the Scheme has a very limited effect on the liquidity position of both NatWest Bank and NatWest Markets.

In addition, at the Effective Date, NatWest Bank and NatWest Markets will both be members of the existing liquidity sub-group. As a result, the overall liquidity position will remain unchanged. There is therefore no Adverse Effect as at the Effective Date.

Changes to the liquidity sub-group will occur at a later stage. It is expected that NatWest Markets will be leaving the sub-group in November 2018. After this event, separate minimum liquidity requirements will apply to NatWest Markets and the sub-group. I have considered future projections and minimum liquidity requirements in reaching my conclusion that there is no Adverse Effect from the Scheme.

7.3 The Capital Support Deed

NatWest Bank and NatWest Markets are parties to a capital support deed ("CSD"), whose overall purpose is to ensure that these banks can easily move capital amongst themselves if that is required for any reason. Under its terms, each entity may be required to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to amounts in excess of those needed to meet capital requirements.

Additionally, each entity taking part in the CSD may also be required to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD.

The arrangement also provides that, in certain circumstances, any funding received by an entity from other entities which are also parties to the arrangement would become immediately repayable, with the repayment obligation limited to the available resources of the receiving entity.

The continuation of the CSD immediately after the Scheme is another reason that I do not consider that the Scheme creates an Adverse Effect in respect of how the entities meet their regulatory requirements.

Changes to the CSD in November 2018 are considered below.

7.4 Effect of Scheme on business viability and sustainability

As stated above, I have considered the effect of the Scheme on the business viability and sustainability of the entities involved.

The future business performance of any entity and ability to meet regulatory requirements will be affected by a number of other changes both internal and external. For example:

- By the time of the Effective Date there will have been a reduction of capital in NatWest Markets and transfer of underlying subsidiaries;
- The ring-fencing regulations that come into effect at the end of 2018 will significantly restrict the RFB Subgroup from funding entities outside the ring-fence. Therefore even if immediately following the Scheme NatWest Markets can continue to be funded by other RBS Group companies, the implementation of the ring-fencing legislation in the future will cause funding arrangements to change. The current DoLSub structure will change in November 2018 and

NatWest Markets will no longer have the same access to funding from the RFB Subgroup. In order to deal with this, RBS plans to fund through MREL downstreaming from RBSG plc level and issuance of debt instruments directly from NatWest Markets. In addition, alternative and contingent funding options have been considered by NatWest Markets which have been outlined in the funding plans that I have reviewed;

- In November 2018, the existing CSD will cease to exist. NatWest Bank will become party to a new CSD. NatWest Markets will, however, not be a party to the new CSD; and
- Capital requirements change over time such as the known changes to the capital conservation buffer that will be required in 2019.

Therefore it is not possible to quantify the changes to business performance that are purely the result of the Scheme as there are many other factors that will affect future financial performance.

My assessment of the effect of the Scheme is therefore qualitative. I have concluded that the Scheme does not affect the assessment of the viability and sustainability of the entities as RBS's financial projections indicate that the regulatory capital and liquidity requirements will be met by the entities in the future period considered by RBS and there will be surpluses above these minimum requirements. Due to the small size of the transferring business, the Scheme has a very limited effect on the capital and liquidity positions of both NatWest Bank and NatWest Markets. In addition, financial projections show that the entities remain above the relevant hurdle rates in a range of internally prepared stress testing scenarios. I note that these are the RBS's internal projections and internal stress testing processes. I have not set out details of the financial projections in this Summary Scheme Report as these projections are not published information.

I note that financial projections have inherent limitations and as such can be affected by unforeseen events, consequently resulting in significantly different outcomes.

8 Legal entity considerations - other

8.1 Governance

NatWest Markets currently has an established board and governance structure that will not change as a result of the Scheme. The established structure will remain after the Scheme, although certain changes are planned during 2018 with regards to the executive personnel given the wider ring-fencing activities and requirements, including recently announced changes to the board membership of NatWest Markets.

As the Scheme is transferring no new types of products or services into NatWest Markets and the assets and liabilities are relatively limited in size compared to the existing business activities, I do not consider that any changes are required in respect of the skills, knowledge and expertise of the Board members. I have therefore concluded that there is no Adverse Effect on governance as a result of the Scheme.

NatWest Bank currently has an established board and governance structure that will not change as a result of the Scheme. However, as with NatWest Markets, certain NatWest Bank board membership changes have been announced in order to address compliance with the PRA rules on ring-fencing in line with the RFB structure being implemented.

I do not consider that there will be any Adverse Effect as a result of the Scheme. In addition I consider the wider amendments to the governance structure to be an enhancement of the entity governance arrangements for NatWest Bank.

8.2 Risk Management

The Scheme will result in the transfer of exposures between legal entities. As such it will be important to ensure that these exposures can be and are immediately managed from the Effective Date as well as on an ongoing basis. I have considered plans at the legal entity level including the setting of risk appetite, how the changed risk exposures will be managed immediately after the Scheme, as well as the plans for changes to ongoing risk management procedures required.

Based on the plans I have seen, I am satisfied that there will be no Adverse Effect from a risk management perspective as a result of the Scheme.

8.3 IT change

The scope of my work is limited to the review of planning, design build, state of preparedness and governance in relation to the IT change required to support the transfer of the existing customer Derivative Transactions from NatWest Bank to NatWest Markets.

The programme of work has been designed to minimise the extent and effect of IT change required, and to continue to book trades within the same systems as currently. This approach aims to reduce the overall complexity of the IT design, which is commonly the largest driver of IT execution failure risk. In respect of the IT programme, I note that:

- As Derivative Transactions of NatWest Bank counterparties are booked in the same systems used by NatWest Markets there is no requirement for a system-related migration over the implementation weekend.
- For all trades in scope for migration over the implementation weekend (i.e. those customers that have not elected to opt-out), the migration will involve a two-step process of "legal entity migration and cancellation". This process involves the cancellation of the trade in the NatWest Bank portfolio and a rebooking of the trade in a NatWest Markets portfolio.
- As such, no data migration is due to occur and the trade migrations do not require technical system changes. The business processes being used to support migrations are well established and involve less risk and complexity than technical migrations.
- For opted-out Eligible Derivative Transactions, there is no requirement for any kind of migration (whether system, book or legal entity-related) over the course of the implementation weekend.
- The IT changes identified take the form of small updates to reference data to reflect new legal entity structures and ownership. These changes are in general simple with limited effect and can be characterised as routine business-as-usual type changes.
- Technology involvement in this Scheme is limited to support, with no technology development work required.
- RBS's IT function will not be restructured as part of the Scheme, and will maintain a continuity of service as it did prior to implementation of the Scheme. No effects are therefore expected to IT operations, level of service, resourcing or staffing as a direct consequence of the Scheme.
- The IT programme of work is being managed in accordance with RBS's standard programme and project management methodologies and governance processes which provide control over the full systems development process. The Scheme programme is supplemented by additional governance forums to ensure consistency and involvement from all affected franchises and functions. This is in addition to RBS's standard programme governance structures.
- Two Dress Rehearsal tests will be carried out in order to test the programme-wide implementation activity and the implementation weekend schedule of events. As these tests are scheduled to take place after the date of my Scheme Report, I will address them further in my Supplementary Report.

Based on the above, I am satisfied that there is no Adverse Effect on IT services, arising from IT changes planned as a result of the Scheme.

8.4 Operational support

8.4.1 Counterparties transferring to NatWest Markets

As the customer derivative business of NatWest Bank is moving to NatWest Markets, all operational support for this business will be provided by NatWest Markets following the Effective Date.

All transferring Derivative Transaction types are also currently offered by NatWest Markets, and as a result NatWest Markets will require no operational developments in order to receive and support the transferring population.

8.4.2 Counterparties electing to opt out

As the customer derivative business of NatWest Bank is moving to NatWest Markets and as NatWest Markets will sit outside the ring-fence, NatWest Bank will no longer be able to access the operational support provided by NatWest Markets after 1 January 2019.

To facilitate the ability to opt out of the Scheme, RBS has developed an operational plan for providing ongoing operational support for the remaining population.

Whilst no new customer derivative business will be originated by NatWest Bank in the future, any Derivative Transactions not transferring under the Scheme will need to be managed by NatWest Bank until the earlier of scheduled maturity or early termination of the Derivative Transactions. Currently, other than the transferring customer derivative business, the only Derivative Transaction capability within NatWest Bank is the Treasury Markets function, which performs risk management for RBS. Treasury Markets will continue to execute and manage Risk Management Derivative Transactions, which, as mentioned in Section 3, are permitted to remain within the ring-fence.

Following the Effective Date, counterparties that have opted out Eligible Derivative Transactions will be informed of a new NatWest Bank contact to support the ongoing management of the opted out Derivative Transactions. Any counterparties that use Agile Markets will not be able to review live trade data for any Eligible Derivative Transactions that have been opted out of the Scheme. Ongoing support for these Derivative Transactions will be provided by the new NatWest Bank contacts, both in terms of provision of trade information or any requests for early termination. Users of Agile Markets will, however, still be able to view historic information for opted out trades.

There are certain other operational changes required in order for Treasury Markets to manage any opted out Derivative Transactions, such as amendments to certain regulatory trade volume reporting, and RBS will agree any changes with the relevant regulators prior to the Effective Date.

I am satisfied that RBS has a plan in place to maintain the opted out trades in NatWest Bank. The remaining trades will be supported by an established function of NatWest Bank, that any changes required to enable this support are not significant, and that the plans for these changes are in place.

8.5 Collateral

The operational implications for any collateral depend upon any election by a counterparty to use the opt-out.

If a counterparty transfers all Derivative Transactions under the Scheme then any collateral held by NatWest Bank will be transferred from NatWest Bank to NatWest Markets along with the governing title transfer collateral arrangement ("TTCA").

If a counterparty has only Eligible Derivative Transactions and elects to opt out of the Scheme, then any collateral and governing TTCA will remain with NatWest Bank.

For any counterparty that has both Ineligible Derivative Transactions and Eligible Derivative Transactions, and has elected to opt out the Eligible Derivative Transactions, RBS may need to split any collateral. Where the collateral is held by NatWest Bank, the collateral will be split proportionally in relation to transferring and non-transferring exposures, and NatWest Bank will transfer the relevant proportion of collateral to NatWest Markets. As the counterparty will still require a TTCA with NatWest Bank this will not be transferred, however the TTCA will be replicated in NatWest Markets to reflect the split exposure.

8.6 Resolvability

The overall strategy for the resolution of RBS Group is not anticipated to change as a result of the implementation of the Scheme (though this is ultimately the decision of the Bank of England). It will remain a so-called 'Single Point of Entry' resolution that is undertaken Group-wide from RBS Group plc downwards. I am satisfied that there is no Adverse Effect as a result of the Scheme in respect of resolvability considerations.

8.7 Tax

I have concluded that there are no Adverse Effects with regard to tax implications on the Companies or from a customer taxation perspective as a result of the Scheme.

One area of potential Adverse Effect is whether the transfer of Derivative Transactions under the Scheme involves a Derivative Transaction counterparty being deemed for tax purposes to have disposed of their rights under the Derivative Transaction contract with NatWest Bank in consideration for new rights under a Derivative Transaction contract with NatWest Markets (a "realisation event"). Such a deemed disposal could potentially crystallise a tax charge for the counterparty. This will depend on the local tax rules of the jurisdiction in which the counterparty is tax resident and on the particular circumstances of the counterparty.

RBS has obtained tax advice stating the unlikelihood of the Scheme being considered a realisation event. I also note that RBS will offer counterparties the right to terminate Derivative Transaction contracts at market value thereby providing a mechanism to realise a gain with which to settle any tax that may be payable.

Based on the above, I am satisfied that the approach taken by RBS is a reasonable one and as changes to the tax circumstances of a Derivative Transaction counterparties involved in the Scheme are unlikely to occur, I do not expect the Scheme to cause any Adverse Effects from a tax perspective.

8.8 Communications

RBS must satisfy the Court as to the adequacy of its communications plan. In addition, RBS must comply with specific notice requirements issued by the Court concerning the Scheme, which will be determined at the First Hearing. RBS will follow the approach to communications set out in the PRA Statement of Policy and the FCA Guidance and the present practice of the Court in relation to transfers under Part VII of FSMA.

In my Scheme Report I have outlined RBS's proposed communication plan and, in my view, whether any persons likely to suffer an Adverse Effect are properly identified in RBS's

communication plan and will receive information on the proposed Scheme which is clear, fair and not misleading (in line with Principle 7 of the FCA Handbook).

I have also set out RBS's proposed plan to communicate the option to terminate existing Derivative Transactions or to opt out of the Scheme, RBS's plan to review and respond to any elections to opt out, and my consideration of whether this plan is reasonable.

My review is based on RBS plans and draft notifications prepared as at the date of this Summary Scheme Report. The advertisements for the Scheme are to be approved by the Court at the First Hearing.

Following my review I am satisfied that persons likely to be affected by the Scheme have been properly identified to receive notification of the Scheme.

Subject to review of any changes to the proposed notification plans or communication materials, I am satisfied that the proposed notifications and communication of the Scheme are reasonable and are set out in in way that is clear, fair and not misleading.

I am satisfied that RBS's planned communications will be provided in a timely manner to inform persons likely to be affected by the Scheme of the process to request termination or opt-out. It will also inform persons likely to be affected by the Scheme of the process make representations or object to the Scheme (following the process detailed in Appendix 1).

Appendix 1 – Background to the skilled person report

When a RFTS is submitted to the Court for approval, it has to be accompanied by a report (the "Scheme Report") from an independent skilled person. This is a requirement of Section 109A of the Financial Services and Markets Act 2000 ("FSMA") and the Scheme Report must be made in a form approved by the Prudential Regulation Authority ("PRA") having consulted the Financial Conduct Authority ("FCA"), together the "Regulators".

I have been appointed as the skilled person to provide the required report on the ring-fencing transfer scheme for The Royal Bank of Scotland Group plc ("RBSG plc") and its subsidiaries (together "RBS" or "RBS Group") for the transfer of the customer derivative business from National Westminster Bank Plc ("NatWest Bank") to NatWest Markets Plc ("NatWest Markets") - (the "Scheme"). NatWest Markets Plc was formerly known as The Royal Bank of Scotland plc. The companies involved in this ring-fencing transfer scheme proposed by the RBS Group (the "Scheme Companies") are entities within the RBS Group.

I have been appointed as the skilled person for the Scheme (the "Skilled Person") jointly by RBSG plc, NatWest Bank and NatWest Markets (together, the "Companies") and my costs have been borne by RBS. My appointment has been approved by the PRA, having consulted with the FCA.

I am a Fellow of The Institute of Chartered Accountants in England and Wales ("ICAEW"), having qualified in 1985. I have been an audit partner for 25 years at Deloitte LLP ("Deloitte"), and was the Partner in Charge of the UK Banking & Securities Audit Group of Deloitte for ten years. I have carried out a wide range of advisory work and have been appointed as an expert under Section 166 of FSMA and as a Reporting Accountant to predecessor regulatory bodies. I am a member of the Council of the ICAEW (appointed 2015) and also sit on the ICAEW Risk and Regulation Committee (appointed 2015). Previous appointments also include being a member of the ICAEW Appeal Committee (2013 to 2015) and the ICAEW Disciplinary Committee and Tribunal Chairman (2007 to 2013).

Independence

Neither I, nor my immediate family hold any deposits, credit or loan agreements, mortgages, shareholdings or any other financial interests with NatWest Bank or any member of the RBS Group. I have not advised the RBS Group on any significant project in the past which I believe would affect the subject matter of the Scheme Report.

From 2000 to 2015, Deloitte acted as auditor to the RBS Group. Ernst & Young LLP have been the auditor for the RBS Group for the years ended 31 December 2016 and 2017.

Deloitte does, and will continue to, provide a range of advisory and consulting services to the RBS Group. In respect of potential services and business relationships, Deloitte has well established firm-wide systems and controls for identifying those services and relationships that may fall within, or close to, the perimeter of the subject matter of my review of the Scheme as the Skilled Person. Such potential services and relationships are and have been notified to me to consider; this consideration will include assessing whether effective safeguards exist to mitigate any actual or perceived threat to an acceptable level. Where threats cannot be mitigated to an acceptable level, or no effective safeguard exists, the service or relationship has not and will not proceed.

I note that I was the skilled person for another RBS ring-fencing transfer scheme (the "First Scheme"), which was announced on the 21 November 2017 and approved by the Court of Session, the supreme civil court of Scotland (the "Court") on 22 March 2018.

I do not believe that any of these assignments compromise my independence, create a conflict of interest, or compromise my ability to report on the proposed Scheme.

Deloitte has not acted for the RBS Group in developing any aspects of the Scheme, and has not carried out any of the calculations or the development of any of the underlying financial models connected with the Scheme.

Regulatory and professional guidance

The ICAEW has issued technical releases which apply to work undertaken by skilled persons. I have prepared this Scheme Report with the intention that it should meet the requirements of ICAEW Technical Release for Section 166 FSMA Skilled Person's Reports – TECH 15/14 FSF, specifically in relation to 'Review and Recommend' types of report. I believe that it does so in all material respects and I have applied all of the principles outlined in ICAEW TECH 15/14 in reaching the opinions stated in my Scheme Report and this Summary Scheme Report.

In preparing this Scheme Report, I have also considered the PRA Statement of Policy "The implementation of ring-fencing: the PRA's approach to ring-fencing transfer schemes" published in March 2016 (the "PRA Statement of Policy") and the FCA Finalised Guidance 16/1 "Guidance on the FCA's approach to the implementation of ring-fencing and ring-fencing transfer schemes" published in March 2016 (the "FCA Guidance").

The Scope of my Scheme Report and this Summary Scheme Report

Overview

The Scheme will be submitted to the Court, for sanction under Section 111 of FSMA. If approved, it is expected that the Scheme will become operative and take effect on 13 August 2018 (the "Effective Date"). My Scheme Report and any supplementary report (my "Supplementary Report" and, together with my Scheme Report, my "Scheme Reports") will be presented to the Court and the Court will consider the contents of these Scheme Reports in deciding whether to sanction the Scheme. My Scheme Report will be presented to the Court at the first hearing ("First Hearing") and any supplementary report will be presented to the Court at the hearing to decide whether to sanction the Scheme ("Final Hearing").

The Statutory Question

The legislation requires that the Scheme Report addresses the statutory question (the "Statutory Question") of:

- (a) whether persons other than the transferor concerned are likely to be adversely affected by the scheme; and
- (b) if so, whether the adverse effect is likely to be greater than is reasonably necessary in order to achieve whichever of the purposes mentioned in Section 106B(3) of FSMA is relevant.

The purposes in Section 106B(3) of FSMA are:

- (a) enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions;
- (b) enabling the transferee to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions;
- (c) making provision in connection with the implementation of the proposals that would involve a body corporate whose group includes the body corporate to whose business the scheme relates becoming a ring-fenced body while one or more other members of its group are not ring-fenced bodies; and

- (d) making provision in connection with the implementation of proposals that would involve a body corporate whose group includes the transferee becoming a ring-fenced body while one or more members of the transferee's group are not ring-fenced bodies.

In relation to this Scheme, the transferor is NatWest Bank, the transferee is NatWest Markets (together the "Scheme Companies") and the relevant purpose is Section 106B(3)(a) of FSMA i.e. enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions.

Effects of the Scheme

The Scheme is only one of the activities that the RBS Group is undertaking in order to ensure compliance with all ring-fencing requirements by 31 December 2018.

My Scheme Report only covers the effects of the Scheme itself. I note that there may be other effects for Stakeholders, including those which may be adverse, which are the result of the other activities being undertaken by RBS to ensure ring-fencing compliance. I have not commented on whether other adverse effects may be caused by these other activities as these are outside of the scope of my work.

Whilst my Summary Scheme Report only covers the effects of the Scheme, for information purposes I have summarised in Section 3 my understanding of the other key activities that are occurring related to achieving compliance with the ring-fencing requirements. These other activities include the First Scheme which transferred the personal and corporate banking business of NatWest Markets to The Royal Bank of Scotland plc ("RBS plc", formerly known as Adam & Company plc), the Covered Bonds Business to NatWest Bank, and property from NatWest Markets to both RBS plc and NatWest Bank. This is separate to the Scheme being considered in this Summary Scheme Report and was subject to a separate skilled person's scheme report, which as noted in 1.2 was prepared by me, and Court application. There will also be a reorganisation of the RBS Group legal entity structure, transfers of contracts by novation, transfers of systems and other operational infrastructure and changes to RBS employer companies.

My consideration of the effects of the Scheme covers both existing contractual relationships that Stakeholders may have, together with the Scheme Companies' "invitations to treat," being offers to enter into a contract with the Scheme Companies. I note that RBS has the ability to make changes post the Scheme which may affect matters such as the setting of rates and charges and products offered. Such decisions are driven by a wide variety of factors and management of RBS can decide to change its strategy in the future. My Scheme Report only covers the effects of the Scheme and I cannot comment on future strategic decisions that may be made.

My duties

In reporting on the Scheme as the Skilled Person, I recognise that I owe a duty to the Court to assist on matters within my expertise. This duty overrides any obligation to the Companies. I believe that I have complied, and confirm that I will continue to comply, with this duty.

Readers of my Scheme Report may find it helpful to read some of the other related Scheme documents (see Appendix 4 of my Scheme Report for details on these documents, which can be obtained online or will be mailed on request). I have reviewed the Scheme related documents to ensure they are consistent with my own findings and I note in Appendix 4 of my Scheme Report where I have relied specifically upon a document or opinion.

Sources of information

In performing my review and preparing my Scheme Report, I have relied on the accuracy and completeness of data and information provided to me, both written and oral, by management of

the RBS Group. A description of the categories of data and information provided is included in Appendix 4 of the Scheme Report.

Although I have not verified the data and information provided to me, I have reviewed it for reasonableness and consistency using my experience of the banking industry. In doing this, I have:

- Considered the source of the data and information provided and RBS’s governance process in respect of the data and information provided;
- Corroborated the data and information provided, as appropriate, through interviews with individuals within the RBS Group with knowledge of the issues under consideration; and
- Reviewed the results of the legal due diligence exercise performed by the RBS Group in respect of the ability to transfer the business, assets and liabilities and the legal effects of the Scheme. This work has been undertaken by legal professionals in the RBS Group legal department. I have reviewed the results of the work undertaken and considered the results in my Scheme Report. Although I did not check the underlying work performed, I asked the RBS Group to explain the approach undertaken, including the scope of the Stakeholders covered by the work, and to explain or clarify the results as appropriate. This included holding discussions with members of the RBS Group legal department.

In performing the procedures above, I can confirm that all my queries have been answered to my satisfaction.

Due to a combination of legal, regulatory and commercial sensitivities, some of the information I have relied upon to reach my conclusions cannot be disclosed in a publicly available report such as this. However I can confirm that appropriate detailed information has been provided to me to enable me to form the opinions I express to the Court in my Scheme Report.

Further details are provided below:

Financial position

My analysis of the financial position of NatWest Bank and NatWest Markets is based on profitability projections and capital and liquidity calculations; the capital and liquidity requirements being set out in UK regulations. The estimates have been prepared by the RBS Group and are referred to in the Scheme Report. I have not checked these estimates or the processes used to calculate them and have relied on them in carrying out my analysis. I believe this is reasonable since the models, processes, and data used to estimate the pre- and post-Scheme positions of NatWest Bank and NatWest Markets are well established and where processes have been amended in order to update estimates for the purpose of the Scheme, these have been subject to additional governance procedures within the RBS Group.

Although I did not check the figures or the underlying processes:

- RBS has confirmed to me that the underlying forecast financial data had been estimated using established RBS forecasting processes and models;
- I reviewed how RBS has estimated the effects of the Scheme on the underlying financial data and the effects on individual legal entity projections. This has included for example, understanding the key assumptions, consideration of the transfers of assets and liabilities as a result of the Scheme and associated financial effects such as revenue allocations, cost allocations, funding implications and the proposed allocation of specific one-off items; and
- I have reviewed the results of the stress testing performed by RBS in respect of the financial projections. RBS have confirmed that this has been subject to RBS governance processes.

I asked RBS to explain, check and/or clarify any results that seemed to me unreasonable or inconsistent with other data and information. All such queries have been answered to my satisfaction.

As part of my analysis, I have considered financial projections provided by the RBS Group of the expected capital and liquidity position of the Scheme Companies at the proposed Effective Date. I note that the financial position at the Effective Date cannot be predicted with certainty. The capital position of NatWest Bank and NatWest Markets at the Effective Date will therefore likely differ to some degree from the projections I have considered. For that reason I will continue to keep the position under review in the period leading up to the Final Hearing, and will prepare further information in a Supplementary Report as appropriate.

Legal advice

The RBS Group has undertaken legal due diligence in respect of the ability to transfer business and customers and the legal effects of the Scheme. As stated above, I have reviewed the results of the work undertaken and considered the results in my Scheme Report. As I am not a qualified legal professional, where I believe that the effects of the Scheme are dependent on the operation of a matter that involves legal judgement, I have been provided with legal advice on the matter. I note that this has been provided by Linklaters LLP, a legal adviser retained by the RBS Group to provide advice in respect of the Scheme. Linklaters LLP is a large legal firm and it is my view that they have the relevant and appropriate qualifications and knowledge of the laws and regulations governing banking transfers in the UK in order to provide such advice. I am therefore satisfied that it is appropriate for me to rely on the conclusions of Linklaters LLP on the relevant matters.

Future plans

As my Scheme Report is written before the Effective Date, in reaching my conclusions I have relied on data and information provided by the RBS Group in respect of activities that are planned to occur in the future. As these plans have been approved through the RBS Group's internal governance process, I believe that it is appropriate for me to reach my conclusions on the basis that these plans will be delivered by the RBS Group.

Although the future plans remain the responsibility of the RBS Group, I asked the RBS Group to explain the process by which the plans had been drawn up, how plans were put in place to cover Scheme changes, the governance process over the plans and how the delivery and implementation of plans will be monitored. All such queries have been answered to my satisfaction.

There are certain approvals from regulatory and other bodies that may need to be obtained prior to the Effective Date. RBS believes that all required approvals should be given. The conclusions in my Scheme Report are based on the assumption that such approvals will be obtained.

I note that future plans can change. I will continue to keep the position under review in the period leading up to the Final Hearing, and will update my conclusions in a Supplementary Report as appropriate.

Communication plans

As my Scheme Report is written before the Effective Date, in reaching my conclusions I have taken into account planned communications to Stakeholders. Where already drafted, I have reviewed the planned communications. Where communications will be finalised in the future, I have reviewed the high level content of the communication and the governance structure in place to ensure that the communication is made as planned.

I note that future plans can change. I will continue to keep the position under review in the period leading up to the Final Hearing, and will update my conclusions in a Supplementary Report as appropriate.

Limitations

This Summary Scheme Report and my Scheme Report has been prepared solely for the use of the Companies and the Court, and solely for the purpose of assisting in determining whether the Scheme should be permitted.

This Summary Scheme Report and my Scheme Report is subject to the terms and limitations, including limitations of liability set out in my engagement letter dated 25 January 2018.

For the avoidance of doubt neither I nor Deloitte, its partners and staff owe or accept any duty to any other party and shall not be liable for any loss, damage or expense (including interest) of whatever nature which is caused by any other party's reliance on representations in this Summary Scheme Report and my Scheme Report.

Both Deloitte and I have excluded liability to avoid having potential liability to an unlimited number of people. Without this exclusion, neither Deloitte nor I would be able to do this work. If any readers are concerned with the content of this Summary Scheme Report or any part of my analysis they should take advice and raise the matter with the Court. If any reader thinks that they would be adversely affected by the carrying out of the Scheme, they have two alternative ways of making sure the Court considers their views: lodging formal objections with the Court or making informal objections in writing or in person.

If a person wishes to lodge formal written objections (known as "Answers") with the Court, they should seek independent legal advice. Answers are a formal Court document which must comply with the rules of the Court and are normally prepared by Scottish legal counsel. Answers must be lodged with the Court at Parliament House, Parliament Square, Edinburgh EH1 1RQ, within 42 days of the publication of the last of the notices relating to the Scheme, which is expected to be on or around 18 May 2018. The deadline for lodging Answers is 29 June 2018. In addition, Answers must also be accompanied by a fee to the Court.

The Court will also consider any other informal objections to the Scheme which are made in writing or in person at the Final Hearing. If a person wishes to object in writing or in person at that hearing, they need to send a written statement of their views to all of the following:

- By post or by hand to the Court at the above address;
- NatWest Bank, either
 - by post or by hand to 250 Bishopsgate, London, EC2M 4AA; or
 - by email to ringfencing@natwestmarkets.com; and
- the Prudential Regulation Authority, either:
 - by post or by hand to National Westminster Bank, Prudential Regulation Authority, Bank of England, Threadneedle Street, London EC2R 8AH; or
 - by submitting it online at <http://www.bankofengland.co.uk/pru/Pages/authorisations/structuralreform/representations.aspx>

They need to do this by 5pm on 11 July 2018 in order to ensure the Court will consider their objection at the Final Hearing. No fee is payable to the Court for objecting in this way.

The Court is also likely to consider any objections whether made in writing or in person at the Final Hearing, although it might not do so if the process for objecting described above has not been followed.

This Summary Scheme Report should be considered in its entirety, as parts taken in isolation may be confusing. A copy of my Scheme Report is being provided to the following parties:

- The Court, to assist in determining whether the Scheme should be approved;
- The Regulators, for the purposes of the performance of their statutory obligations under FSMA; and
- Legal advisers of NatWest Bank and NatWest Markets in connection with the Scheme Report provided that NatWest Bank and NatWest Markets inform them that neither Deloitte nor I accept any responsibility or liability to them in respect of any use they may make of the Scheme Report.

A copy of this Summary Scheme Report is to be published on the websites of the Companies and made available for inspection at the following offices of the Companies and two offices of the Companies' Scottish legal advisers, CMS Cameron McKenna Nabarro Olswang LLP.

- NatWest Bank: 250 Bishopsgate, London EC2M 4AA
- NatWest Markets: 36 St. Andrew Square, Edinburgh EH2 2YB
- CMS Cameron McKenna Nabarro Olswang LLP: Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EN and Cannon Place, 78 Cannon Street, London EC4N 6AF

A copy of this Scheme Report will be provided by RBS upon request to any person who considers they may be adversely affected by the Scheme. Otherwise, this Summary Scheme Report (or any extract from it) should not be published without the prior written consent of Deloitte. This Summary Scheme Report will be made available by the Companies to the customers of the Scheme Companies with an interest in the Scheme. No other summary of my Scheme Report may be made without the prior written consent of Deloitte.

Appendix 2 - Glossary

Term	Means
Adverse Effect	Has the meaning as described in section 1 of this Summary Scheme Report
Agile Markets	An electronic web-based interface with RBS that allows counterparties to transact business with it in a range of FX Derivative Transactions.
Answers	Formal written objections lodged with the Court at; Parliament House, Parliament Square, Edinburgh EH1 1RQ, by 29 June 2018
Available Stable Funding or ASF	The portion of capital and liabilities that are classified as stable over a one year period
Board	The board of directors of the relevant entity from time to time
BoE	Bank of England
BRRD	EU Banking Recovery and Resolution Directive 2014/59/EU
Capital Support Deed or CSD	A capital support deed is an agreement, under which the participating entities may be required to provide capital support to each other by means of distributions on, or repurchase or redeem, their ordinary shares. This obligation is limited to amounts in excess of a participant’s required regulatory capital requirements.
Capital Conservation Buffer or CCB	The capital conservation buffer is a capital buffer of 2.5% of a bank’s total exposures that needs to be met with an additional amount of Common Equity Tier 1 capital.
Countercyclical Capital Buffer or CCyB	The Basel III countercyclical capital buffer is calculated as the weighted average of the buffers in effect in the jurisdictions to which banks have a credit exposure. It is implemented as an extension of the capital conservation buffer.
CET1	Common Equity Tier 1 is the highest quality of capital. This is comprised of ordinary shares and reserves, less certain regulatory adjustments and deductions.
Companies	RBSG plc, NatWest Bank and NatWest Markets
Core Deposit	Deposits as defined under Article 2(2) The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014, which under the ring-fencing regulations are required to be

Term	Means
	provided by a ring-fenced body within a UK banking group in scope of the legislation. These are deposits within a bank account located in the EEA principally held by individuals and small businesses. Deposits comprise products such as current accounts, instant access savings accounts, fixed term savings, children's savings accounts, junior ISAs, and instant access and fixed term ISAs
Court	The Court of Session in Scotland
Coutts	Coutts & Company, a company incorporated in England and Wales with company number 36695
Covered Bonds Business	Debt security instruments that are secured on an underlying pool of assets, typically mortgage loans or public-sector debt
Credit Support Annex	Provides credit protection by setting forth the rules governing the mutual posting of collateral. The main purpose of a Credit Support Annex is to regulate the collateral held by two parties entering into an ISDA master agreement.
Credit Valuation Adjustment or CVA	An adjustment made when calculating the fair value of a Derivative Transaction to ensure that the risk of default of the counterparty to the transaction is incorporated into the fair valuation of the Derivative Transaction.
Deloitte	Deloitte LLP
Derivative Transaction	A transaction entered into under an ISDA Master Agreement or equivalent agreement, which is a contract between two or more parties where the value of the contract is determined by fluctuations in one or more underlying assets. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes.
DoLSub	A group of two or more banks, including their subsidiaries, within the same banking group regulated and supervised as a single subgroup for liquidity purposes rather than on an individual basis.
D-SRB	Domestic Systemic Risk Buffer
Effective Date	Expected to be 00:01 on 13 August 2018
EEA	European Economic Area
Eligible Derivative Transactions	Derivative Transactions which satisfy the criteria set out in Articles 9, 10, 11 and 12 of the EAPO and are therefore permitted for ring-fenced banks. Also includes prohibited Interest Rate Derivative Transactions that satisfy the 'Grandfathering' provisions.

Term	Means
Excluded Activities and Prohibitions Order 2014 or EAPO	The Financial Services and Markets Act 2000 (Excluded Activities Prohibitions) Order 2014 as amended by the Financial Markets Act 2000 (Ring-fenced Bodies, Core Activities, Excluded Activities and Prohibitions) (Amendment) Order 2016
Excluded Activity	Activity prohibited in the RFB
Excluded Derivative Transaction	Any Derivative Transaction maturing after the Effective Date but prior to 31 August 2018
Existing NWM Customers	Existing customers and counterparties of NatWest Markets
FCA	The Financial Conduct Authority or such successor governmental department, regulatory authority or other official body from time to time exercising supervisory powers in relation to financial services in the UK
FCA Guidance	FCA Finalised Guidance 16/1 "Guidance on the FCA's approach to the implementation of ring-fencing and ring-fencing transfer schemes" published in March 2016
Final Hearing	The hearing at the Court at which the final decision whether or not to approve the Scheme is made
First Hearing	The preliminary hearing at the Court of the application relating to the Scheme
First Scheme	The transfer of business from NatWest Markets to RBS plc and NatWest Bank under Section 106B of FSMA, approved by the Court on 22 March 2018.
FSMA	The Financial Services and Markets Act 2000
FX	Foreign exchange
Grandfathering Provisions	<p>The provisions of Article 21 of the EAPO which is a transitional provision stating that a ring-fenced body does not carry on an excluded activity or contravene a prohibition imposed by the EAPO by holding or selling any investments on or after 1st January 2019 provided that:</p> <ul style="list-style-type: none"> • The investment in question was created or acquired by the ring-fence body before 1st January 2019; and • The period remaining until the investment matures is less than two years at 1st January 2019.
G-SIB	Global Systemically Importance Buffer

Term	Means
G-SII	Global Systemically Important Institution
Hedge Accounting	An accounting tool that allows an entity, when it has entered into a hedging transaction, to eliminate or reduce the income statement volatility that otherwise would arise if the hedged item and the hedging instrument were accounted for separately, without regard to the hedge's business purpose.
HQLA	High Quality Liquid Assets are securities that are deemed to be easily and immediately converted into cash in private markets, and include government bonds and other securities.
ICAEW	The Institute of Chartered Accountants in England and Wales
ICB	The Independent Commission on Banking inquiry of the UK government which looked at structural and related non-structural reforms to the UK banking sector to promote financial stability and competition in the wake 2007-2008 financial crisis. One of the ICB's key recommendations was that British banks should 'ring-fence' their retail banking divisions from their investment banking arms to safeguard against riskier banking activities.
Ineligible Derivative Transactions	Derivative Transactions other than Eligible Derivative Transactions
ISDA	The International Swaps and Derivatives Association which is a trade organisation of participants in the market for over-the-counter Derivative Transactions
ISDA Master Agreements	The ISDA Master Agreement is a commonly used master service agreement for over-the-counter (OTC) Derivative Transactions internationally. It is part of a framework of documents, designed to enable OTC Derivative Transactions to be documented fully and flexibly. The ISDA Master Agreement is published by the International Swaps and Derivatives Association.
LCR	Liquidity Coverage Ratio is a measure of the ability of a bank to cover the net cash outflows that would experience under a stress scenario over the next thirty calendar days with a pool of defined High Quality Liquid Assets.
Leverage	The use of debt, instead of equity, in order to finance the purchase of assets and other investments.
Leverage Ratio	Leverage Ratio represents the bank's Tier 1 capital divided by its Total Exposure Measure or TEM with this ratio expressed as a percentage.
MREL	Minimum Requirement For Own Funds and Eligible Liabilities: The minimum level of financial resources to be held by each EU bank to

Term	Means
	absorb losses and recapitalise the continuing business in the event of Resolution.
NatWest Holdings	NatWest Holdings Limited, the intermediate holding company heading up the RFB Subgroup and is registered in England and Wales with registration number 10142224
NatWest Bank or NWB	National Westminster Bank Plc which is a licensed bank registered in England and Wales with registration number 929027
NatWest Markets or NWM	NatWest Markets Plc, which is a licensed bank registered in Scotland with registration number SC090312. NatWest Markets Plc was previously named The Royal Bank of Scotland plc.
NatWest Markets Franchise	NatWest Markets is the marketing and trading name under which RBS operates its financing, risk management and trading solutions businesses within RBS
Net Stable Funding Ratio or NSFR	A measure of resilience of banks over the medium-term and requires banks to maintain more stable sources of funding over the long-term and avoid the mismatch and reliance of funding long-term assets with short-term liabilities
Netting	Offsetting the value of multiple positions or payments due to be exchanged between two or more parties. It can be used to determine which party is owed remuneration in a multiparty agreement
Netting Set	A group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement
NRFB	Non Ring-fenced Body or Non Ring-fenced Bank
OCIR	Operational Continuity in Resolution
OTC	Over-The-Counter is a security traded in some context other than on a formal exchange
Pillar 1 capital requirements	Set of requirements defining the amount of capital that banks need to hold at all times to cover unexpected credit losses for credit risk, market risk and operational risk.
Pillar 2A capital requirements	Set of regulatory requirements, additional to Pillar 1 capital requirements, defining the amount of capital that banks need to hold at all times aimed to address risks not fully captured in Pillar 1. As opposed to Pillar 1 requirements, Pillar 2A capital requirements are firm-specific and are calibrated by the PRA.

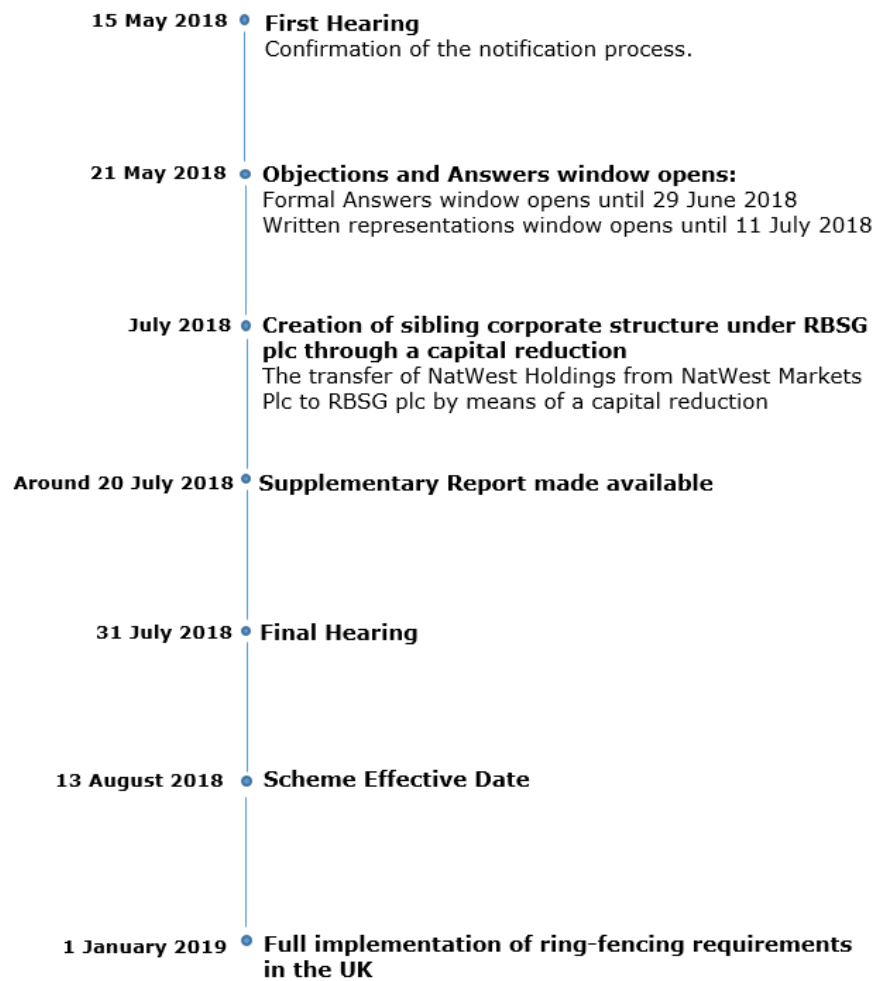
Term	Means
PRA	The Prudential Regulation Authority or such successor governmental department, regulatory authority or other official body from time to time exercising prudential regulatory and supervisory powers in relation to financial services in the UK
PRA Statement of Policy	PRA Statement of Policy "The implementation of ring-fencing: the PRA's approach to ring-fencing transfer schemes" published in March 2016
RBS or RBS Group	RBSG plc and its subsidiaries and subsidiary undertakings
RBS plc	The Royal Bank of Scotland plc, which is a licensed bank registered in Scotland with registration number SC083026. RBS plc was previously named Adam & Company PLC.
RBSG plc	The Royal Bank of Scotland Group plc, which is the ultimate parent company of the RBS Group and is registered in Scotland with registration number SC045551
RBSI	The Royal Bank of Scotland International Limited, which is a licensed bank registered in Jersey with registration number 2304
Regulators	Together the PRA and the FCA
Relevant Financial Institution or RFI	Relevant Financial Institution as defined in Article 2 of EAPO, which comprises broadly financial institutions, such as non ring-fenced banks, investment firms, investment funds and managers thereof. RFIs do not include other ring-fenced banks or building societies.
Remaining NWB Customers	Remaining customers and counterparties of NatWest Bank
Required Stable Funding or RSF	The portion of capital and liability that is necessary, dependent on the liquidity risk characteristics of the different assets that a bank holds
Residual Asset	An asset transferring under the Scheme which does not transfer until after required formalities have been completed or approvals have been obtained.
Residual Liability	A liability transferring under the Scheme which does not transfer until after required formalities have been completed or approvals have been obtained.
Resolution	The status of a financial institution triggered by regulatory authorities when it has reached a point of non-viability and needs to be resolved under the direction of the authorities

Term	Means
RFB	Ring-fenced Body, i.e. a ring-fenced bank
RFB Risk Management Derivative Transactions	Derivative Transactions held by the RFB which are used for its own risk management purposes
RFB Subgroup	The ring-fenced sub-group of companies comprising NatWest Holdings and its subsidiaries and subsidiary undertakings
RFTS	A ring-fencing transfer scheme under Part VII of FSMA
Risk Appetite	The level of risk that an organisation is prepared to accept in pursuit of its objectives, and before action is deemed necessary to reduce the risk. Risk Appetite limits are applied to a number of areas of the business, which are monitored on an ongoing basis.
RWA	Risk-Weighted Assets are used to determine the minimum amount of capital that must be held by banks. It is calculated by assigning “weights” to the bank’s assets reflecting the probability that such assets generate losses in relation to credit risk, counterparty credit risk, market risk and operational risk.
Scheme	The proposed transfer of business from NatWest Bank to NatWest Markets under Section 106B of FSMA, in its present form or with any modification thereof, or addition thereto, or condition approved or imposed by the Court.
Scheme Companies	The companies participating in the Scheme; namely NatWest Bank and NatWest Markets
Scheme Document	A detailed description of the terms of the Scheme
Scheme Report	The report on the Scheme prepared by the Skilled Person pursuant to Section 109A of FSMA and submitted to the Court to assist the Court in its decision whether or not to approve the Scheme
Scheme Reports	Supplementary Report and the Scheme Report
Secured Empty Arrangement	Any ISDA Master Agreement or “Agile Markets” terms of business between NatWest Bank and a counterparty where there are no live transactions at the Effective Date, but where there is an all monies security arrangement in place.
Skilled Person	Oliver Grundy of Deloitte LLP whose appointment has been approved by the Regulators. The Skilled Person and Deloitte LLP has prepared Scheme Report pursuant to Section 109A of FSMA.
Stakeholders	All persons potentially affected by the Scheme including depositors, customers, counterparties and other affected persons

Term	Means
Standalone Derivative Transactions	Derivative Transactions not covered by a master agreement
Standard Settlement Instructions or SSI	Agreements between two financial institutions which fix the receiving agents of each counterparty in ordinary trades
Statutory Question	The question that the Scheme Report must specifically address, required under Section 109A of FSMA 2000. Namely whether persons other than the Transferor are likely to be adversely affected by the RFTS and if so whether the adverse effect is likely to be greater than is reasonably necessary
Subsequent Transfer Date	The relevant date of the transfer of a Residual Asset or a Residual Liability, which is after the Effective Date
Summary Scheme Report	A summary of the Scheme Report
Supplementary Report	A report produced in advance of the Final Hearing, to consider the effect on the Skilled Person's conclusions of events that have happened subsequent to the release of the Scheme Report.
Tier 1 capital	Tier 1 capital is comprised of Common Equity Tier 1 capital and Additional Tier 1 capital. Core Tier 1 capital is mainly comprised of ordinary shares and reserves less certain regulatory adjustments and deductions. Additional Tier 1 capital include perpetual subordinated debt instruments with conversion features
Tier 2 capital	Tier 2 capital consists of other, non-equity types of investment in a bank and are generally less permanent in nature. These instruments are designed to increase the ability of a bank to absorb losses. Examples of Tier 2 capital include corporate bonds and other long term debt issued by the bank, which may be subordinated to all other debt owed by the bank
TLAC	The amount of loss absorbing capacity required to be held by global systemically important banks in the form of capital and eligible liabilities, in order to absorb losses and recapitalise banks in the event of Resolution
Total Exposure Measure	Total Exposure Measure for the Leverage Ratio represents the sum of the total value of the bank's total assets with some additional adjustments to account, for example, for certain exposures that are not accounted in the balance sheet
Transferor	NatWest Bank

Term	Means
Transferring Counterparties	Counterparties in respect of their business transferring from NatWest Bank to NatWest Markets under the Scheme
TUPE Regulations	Transfer of Undertakings (Protection of Employment) Regulations 2006
Ulster Bank	Ulster Bank Limited, which is a licensed bank registered in Northern Ireland with registration number R0000733

Appendix 3 - Ring-fencing timeline





This document is confidential and it is not to be copied or made available to any other party. Deloitte LLP does not accept any liability for use of or reliance on the contents of this document by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities).

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London, EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NWE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2018 Deloitte LLP. All rights reserved.