

ISLE OF MAN BANK LIMITED

ANNUAL REPORT AND ACCOUNTS

FOR THE YEAR ENDED

31 DECEMBER 2011

ISLE OF MAN BANK LIMITED

ANNUAL REPORT AND ACCOUNTS 2011

CONTENTS	Page
Company Information	3
Report of the Directors	4-5
Independent Auditor's Report	6
Income Statement	7
Statement of Comprehensive Income	8
Balance Sheet	9
Statement of Changes in Equity	10
Statement of Cash Flows	11
Notes to the Financial Statements	12-46

ISLE OF MAN BANK LIMITED

COMPANY INFORMATION

REGISTERED OFFICE

2 Athol Street
Douglas
Isle of Man
IM99 1AN

Telephone : 01624 637000

DIRECTORS

Stephen John CAMM
Emer Anne DILLEEN
Adrian John GILL
George Anthony SCHOFIELD
William Catto SHIMMINS
Paul Thomas SMITH

SECRETARY

Kenneth Ian MADDRELL

AUDITORS

Deloitte LLP
Douglas
Isle of Man

ISLE OF MAN BANK LIMITED

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report and the audited financial statements for Isle of Man Bank Limited (the "Company") for the year ended 31 December 2011.

ACTIVITIES

The Company provides an extensive range of banking and other financial services.

PLACE OF INCORPORATION

The Company is incorporated in the Isle of Man.

ASSETS

In the opinion of the Directors and from their knowledge of the Company's affairs, the assets shown in the Company's Balance Sheet were realisable in the ordinary course of business at amounts not less than the totals shown, after making allowance for all appropriate costs, including the cost of realisation and financing.

RESULTS AND BUSINESS REVIEW

The profit before taxation for the year amounted to £14,628,000 (2010: £19,642,000).

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

During 2009 The Royal Bank of Scotland Group plc (RBSG), the ultimate parent of the Company received support from the UK Government through HM Treasury which subscribed for shares that provided it with control of The Royal Bank of Scotland Group plc (RBSG). UK Financial Investments Limited is managing the UK Government's shareholding and is now the majority shareholder of Royal Bank of Scotland Group.

The prevailing market and economic conditions pose risks for the Company. These include the level of defaults from customers on outstanding advances as well as the degree of uncertainty in the valuation of other financial assets and liabilities. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, note 21 to the financial statements includes the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities and its exposures to credit risk and liquidity risk.

The Directors are satisfied with the financial position of the Company and believe that they are appropriately placed to manage its business risks successfully. After making enquiries, the Directors believe there are adequate resources for the Company to continue in operational existence for the foreseeable future and that there are sufficient funds to support the current and planned activities and accordingly they continue to adopt the going concern basis in preparing the financial statements.

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

DIVIDENDS

The Directors declared and paid a dividend for the year ended 31 December 2011 of £20,000,000 (2010: £55,000,000).

ISLE OF MAN BANK LIMITED

REPORT OF THE DIRECTORS (continued)

DIRECTORS AND SECRETARY

The current Directors and Secretary of the Company are shown on page 3.

Changes made during 2011 are shown below:

Victoria Kate McENEANEY	Resigned	09 May 2011
Alistair James BISHOP	Resigned	05 September 2011
William Catto SHIMMINS	Appointed	10 May 2011

DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

Isle of Man company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board. The financial statements are required by law to be properly prepared in accordance with the Companies Act 1931 to 2004.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, Directors are also required to:

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

The Directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1931 to 2004. They are also responsible for the system of internal control, for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the Isle of Man governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

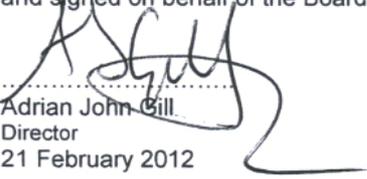
AUDITOR

In accordance with Section 12(2) of the Isle of Man Companies Act 1982, the auditors, Deloitte LLP, offer themselves for reappointment at the forthcoming Annual General Meeting.

RISK MANAGEMENT & DERIVATIVES

The Board has delegated its authority for day to day risk management to the executive management sitting on committees as detailed in note 21. The Board approves any changes in interbank lending lines and in limits governing currency and interest rate exposures. The Board policy is not to enter into derivative transactions for trading purposes, but to undertake such contracts to hedge or reduce the volatility in interest income and foreign exchange. The Company's actual derivative transactions are outlined in note 14 to these financial statements. Further details of the Company's risk management policies are highlighted in note 21.

Approved by the Board of Directors
and signed on behalf of the Board


Adrian John Gill
Director
21 February 2012


Stephen John Camm
Director

ISLE OF MAN BANK LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ISLE OF MAN BANK LIMITED

We have audited the financial statements of Isle of Man Bank Limited for the year ended 31 December 2011 which comprise the Income Statement; the Statement of Comprehensive Income; the Balance Sheet; the Statement of Changes in Equity; the Statement of Cash Flows and related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board.

This report is made solely to the Company's members, as a body, in accordance with section 15 of the Companies Act 1982. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

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

Scope of the audit of the financial statements

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

Opinion on the financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as issued by the International Accounting Standards Board; and
- have been properly prepared in accordance with the Companies Act 1931 to 2004.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 1931 to 2004 requires us to report to you if, in our opinion:

- proper books of account have not been kept by the Company and that proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the books of account and returns; or
- we have not received all the information and explanations which to the best of our knowledge and belief, are necessary for the purpose of our audit; or
- certain disclosures of Directors' loans and remuneration specified by law have not been complied with.

Deloitte LLP
Deloitte LLP
Chartered Accountants
Douglas
Isle of Man

22nd February 2012

ISLE OF MAN BANK LIMITED

Income Statement for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Interest receivable		37,710	35,732
Interest payable		(11,651)	(9,343)
Net interest income		26,059	26,389
Fees and commissions receivable		5,141	9,632
Fees and commissions payable		-	(4)
Other operating income		252	-
Non-interest income		5,393	9,628
Total income		31,452	36,017
Staff costs	3	5,262	5,308
Other administrative costs	3	10,753	10,170
Depreciation	3, 11	497	498
Operating expenses		16,512	15,976
Operating profit before impairment losses		14,940	20,041
Impairment losses	10	312	399
Profit before tax		14,628	19,642
Tax	6	1,043	1,395
Profit for the year attributable to the owners of the parent		13,585	18,247

The notes on pages 12 to 46 form an integral part of these financial statements.

ISLE OF MAN BANK LIMITED

Statement of Comprehensive Income for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Profit for the year		13,585	18,247
Actuarial (losses)/gains on defined benefit pension schemes	4	(2,654)	6,385
Total comprehensive income for the year		<u>10,931</u>	<u>24,632</u>
Attributable to:			
Owners of the parent		10,931	24,632
		<u>10,931</u>	<u>24,632</u>

The notes on pages 12 to 46 form an integral part of these financial statements.

ISLE OF MAN BANK LIMITED

Balance Sheet as at 31 December 2011

	Notes	2011 £'000	2010 £'000
Assets			
Cash and balances at central banks		15,962	14,092
Loans and advances to banks	8	778,515	952,121
Loans and advances to customers	9	728,781	743,716
Derivatives at fair value	14	15,529	1,593
Deferred taxation assets	18	-	58
Other assets, prepayments and accrued income	13	834	1,351
Non current asset held for sale		-	120
Property, plant and equipment	11	4,139	4,635
Shares in subsidiary undertaking	12	-	-
Retirement benefit assets	4	7,139	7,005
Total assets		1,550,899	1,724,691
Liabilities			
Deposits by banks	15	52,604	68,551
Customer accounts	16	1,356,657	1,506,686
Derivatives at fair value	14	17,812	7,545
Other liabilities, accruals and deferred income	17	2,215	10,716
Current taxation liabilities		1,061	1,506
Deferred taxation liabilities	18	113	110
Retirement benefit liabilities	4	6,112	6,183
Total liabilities		1,436,574	1,601,297
Equity			
Shareholders' equity:			
Called up share capital	19	7,501	7,501
Reserves		106,824	115,893
Total shareholders' equity		114,325	123,394
Total liabilities and equity		1,550,899	1,724,691

The accounts were approved by the Board of Directors on 21 February 2012 and signed on its behalf by

	
Adrian John Gill Director	Stephen John Camm Director

The notes on pages 12 to 46 form an integral part of these financial statements.

ISLE OF MAN BANK LIMITED

Statement of Changes in Equity for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Retained earnings			
At 1 January		115,893	146,261
Profit attributable to owners of the parent		13,585	18,247
Ordinary dividends paid		(20,000)	(55,000)
Actuarial (losses)/gains on defined benefit pension schemes		(2,654)	6,385
At 31 December		106,824	115,893
Total reserves		106,824	115,893
Called up share capital	19	7,501	7,501
Closing shareholders' equity		114,325	123,394

The notes on pages 12 to 46 form an integral part of these financial statements.

ISLE OF MAN BANK LIMITED

Statement of Cash Flows for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Operating activities			
Company operating profit before tax		14,628	19,642
<i>Adjustments for:</i>			
Depreciation	3	497	498
Pension charge for defined benefit schemes	4	405	669
Other non-cash items		(8,186)	(1,355)
Cash contribution to defined benefit pension schemes	4	(3,414)	(3,734)
Net cash inflow from trading activities			
Changes in operating assets	25	174,725	(16,191)
Changes in operating liabilities	25	(155,709)	55,364
Net cash flows from operating activities before tax			
		22,946	54,893
Income taxes paid		(1,449)	(1,317)
Cash flows from operating activities			
	25	21,497	53,576
Investing activities			
Proceeds on disposal of property, plant and equipment		696	-
Purchase of property, plant and equipment	11	(323)	-
Cash flows from investing activities			
		373	-
Financing activities			
Dividends paid	7	(20,000)	(55,000)
Cash flows from financing activities			
		(20,000)	(55,000)
Net increase/(decrease) in cash and cash equivalents			
	26	1,870	(1,424)
Cash and cash equivalents 1 January	26	14,092	15,516
Cash and cash equivalents 31 December			
	26	15,962	14,092

The notes on pages 12 to 46 form an integral part of these financial statements.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies

(a) Accounting convention

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) on the historical cost basis as modified by accounting for the following assets and liabilities at fair value: derivative financial instruments, financial assets that are designated at fair value through profit or loss, available-for-sale financial assets and financial liabilities that are designated at fair value through profit or loss. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

Adoption of new and revised standards

The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these financial statements but may impact the accounting for future transactions and arrangements:

IAS 24 Related party disclosures (revised in 2009) (effective for periods commencing on or after 1 January 2011);

Amendments to IAS 32 financial instruments: Presentation relating to classification of rights issues (effective for periods commencing on or after 1 February 2010);

Amendments to IFRIC 14 relating to prepayments of a minimum funding requirement (effective for accounting periods commencing on or after 1 January 2011);

IFRIC 19 Extinguishing financial liabilities with equity instruments (effective for periods commencing on or after 1 July 2010);

Standards and interpretations in issue but not yet effective

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective for the year ended 31 December 2011:

IFRS 7	Financial Instruments: Disclosures relating to disclosures on transfers of financial assets (Effective 1 July 2011)
IFRS 9	Financial Instruments (Effective 1 Jan 2015)
IFRS 10	Consolidated Financial Statements (Effective 1 January 2013)
IFRS 11	Joint Arrangements (Effective 1 January 2013)
IFRS 12	Disclosure of Interests in Other Entities (Effective 1 January 2013)
IFRS 13	Fair Value Measurement (Effective 1 January 2013)
IAS 12	Recovery of assets underlying deferred tax (Effective 1 January 2012)
IAS 1 (amended)	Presentation of the statement of Other Comprehensive Income (effective 1 July 2012)

The Directors anticipate that all of the above standards and interpretations will be adopted in the financial statements in the appropriate and applicable period and that the adoption of these standards and interpretations will have no material financial impact on the financial statements of the Company in the period of initial application.

The adoption of IFRS 9 which the Company plans not to adopt before the year beginning on 1 January 2013 will impact both the measurement and disclosures of Financial Instruments and the adoption of the amendment to IAS1 will change the presentation of the statement of comprehensive income.

The Directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Company in future periods.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(b) Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the Business Review on page 4. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, note 21 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

After making enquiries about the continued availability of RBS Group plc funding, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

(c) Basis of consolidation

Under the provisions of Section 4 of the Companies Act 1982 the Company has not prepared consolidated financial statements as in the Directors' opinion it would be of no real value to the members of the Company due to the insignificant amounts involved.

The Company itself is a wholly owned subsidiary, and has taken advantage of the exemption available to it under IAS 27 (2008) Consolidated and Separate Financial Statements, Paragraph 10, not to prepare consolidated financial statements.

(d) Revenue recognition

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

Financial assets and financial liabilities designated at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in the Income Statement together with dividends and interest receivable and payable, all within the category of fees and commissions.

Commitment and utilisation fees are determined as a percentage of the facility. These fees are deferred and included in the effective interest rate on the advance. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken upfront to the Income Statement.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

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

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(e) Pensions and other post-retirement benefits

The Company provides post-retirement benefits in the form of pensions to eligible employees. The cost of defined benefit pension schemes and healthcare plans is assessed by independent professionally qualified actuaries and recognised on a systematic basis over employees' service lives.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the Balance Sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the Income Statement and presented in the Statement of Comprehensive Income.

There is no contractual agreement or policy on the way that the cost of Royal Bank of Scotland International Pension Trust defined benefit pension scheme is allocated to the Company. It therefore accounts for the charges it incurs as payments to a defined contribution scheme.

Contributions to defined contribution pension schemes are recognised in the Income Statement when payable.

(f) Property, plant and equipment

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

Depreciation is charged to the Income Statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold buildings	50 years
Property adaptation costs	10 years
Computer equipment	up to 5 years
Other equipment	5 to 15 years

(g) Impairment of property, plant and equipment

At each reporting date, the Company assesses whether there is any indication that property, plant and equipment are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit, discounted at a rate that reflects market interest rates adjusted for risks specific to the asset that have not been reflected in the estimation of future cash flows. If the recoverable amount of an asset is less than its carrying value, an impairment loss is recognised immediately in the Income Statement and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(h) Foreign currencies

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

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date.

Foreign exchange differences arising on translation are recognised in the Income Statement. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates that the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in the Income Statement except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in the Statement of Comprehensive Income unless the asset is the hedged item in a fair value hedge.

(i) Leases

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

Finance lease receivables are stated in the Balance Sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairments. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rentals payable under operating leases are charged to the Income Statement on a straight line basis over the term of the lease.

(j) Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate. Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Company.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

(k) Financial assets

Financial assets are classified into available for sale financial assets, loans and receivables or designated at fair value through profit and loss.

Available-for-sale – financial assets that are not classified as held-to-maturity; held for trading; designated at fair value through profit and loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in the Income Statement. Other changes in the fair value of available-for-sale financial assets are reported in the Statement of Comprehensive Income. Interest calculated using the effective interest rate (see note 1(d) above) is recognised in the Income Statement.

Loans and receivables – non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables except those that are classified as held-to-maturity, held for trading or designated as fair value through profit and loss.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(k) Financial assets (continued)

Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method less any impairment losses.

Designated at fair value through profit or loss – financial assets that the Company designates on initial recognition as being at fair value through profit and loss are recognised at fair value with transaction costs being recognised in the Income Statement and are subsequently measured at fair value. Gains and losses on financial assets that are designated at fair value through profit or loss are recognised in the Income Statement as they arise.

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

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date. Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

(l) Impairment of financial assets

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

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually for financial assets that are individually significant. Future cash flows from these financial assets are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of current observable data, to reflect the effects of current conditions not affecting the period of historical experience.

Impairment losses are recognised in the Income Statement and the carrying amount of the financial asset reduced by establishing an allowance for impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

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

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(l) Impairment of financial assets (continued)

Derecognition of financial assets – The Company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognises its retained interest in the asset and an associated liability for amounts it may have to pay.

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

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the Income Statement.

(m) Financial liabilities

Designated at fair value through profit or loss – financial liabilities that the Company designates on initial recognition as being at fair value through profit and loss are recognised at fair value with transaction costs being recognised in the Income Statement and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated at fair value through profit or loss are recognised in the Income Statement as they arise. All other financial liabilities are measured at amortised cost using the effective interest method (see note 1(d)).

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

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

Derecognition of financial liabilities – The Company derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

(n) Derivatives and hedging

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

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract, unless the entire contract is carried at fair value through profit or loss.

Gains and losses arising from changes in fair value of a derivative are recognised as they arise in the Income Statement unless the derivative is the hedging instrument in a qualifying hedge. The Company has entered into fair value hedge relationships which account for changes in the fair value of a recognised asset or liability or firm commitment.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

1. Accounting policies (continued)

(n) Derivatives and hedging (continued)

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

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

(o) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with banks.

(p) Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Company continue to be shown on the Balance Sheet and the sale proceeds recorded as a deposit. Securities acquired in a reverse sale and repurchase transaction under which the Company is not exposed to substantially all the risks and rewards of ownership are not recognised on the Balance Sheet and the consideration is recorded in Loans and advances to banks or Loans and advances to customers as appropriate.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the Balance Sheet or lent securities derecognised. Cash collateral received or given is treated as a loan or deposit, collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

(q) Netting

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

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

2. Critical accounting estimates and judgements

The reported results of the Company for 2011 are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Company's principal accounting policies are set out on pages 12 to 19. Isle of Man company law and IFRS require the Directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent.

Where accounting standards are not specific and management have to choose a policy, International Accounting Standard ("IAS") 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires them to adopt policies that will result in information that is relevant, reliable, free from bias, prudent and complete in all material respects.

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

Impairment provisions – financial assets

The Company provides for losses existing in its lending book so as to state its loan portfolio at its expected ultimate net realisable value.

Provisions against large exposures are established individually whilst those for smaller balances are established collectively.

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

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

Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within the performing portfolio before it is identified and reported as such, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life.

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

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

Collective Component

This is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

2. Critical accounting estimates and judgements (continued)

Collective Component (continued)

These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within the performing portfolio before it is identified and reported as such.

Pensions

The Company operates two defined benefit pension schemes, the Isle of Man Bank Pension Fund and the Isle of Man Bank Widows' and Orphans' Fund. The assets of the defined benefit schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any surplus or deficit of scheme assets over liabilities is recognised in the Balance Sheet as an asset (surplus) or liability (deficit). An asset is only recognised to the extent that the surplus can be recovered through reduced contributions in the future or through refunds from the scheme.

In determining the value of scheme liabilities, assumptions are made as to price inflation, dividend growth, pension increases, earnings growth and employees. There is a range of assumptions that could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the deficit recognised in the Balance Sheet and the pension cost charged to the Statement of Comprehensive Income. The assumptions underlying the 2011 deficit and pension cost are set out in Note 4 to the financial statements.

In relation to the Royal Bank of Scotland International Pension Trust any contributions made are treated as defined contribution schemes in accordance with IAS19.

Fair value

Financial instruments designated at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. In the Balance Sheet, financial assets carried at fair value are included within Loans and advances to banks. Financial liabilities carried at fair value are included within the caption Customer accounts. Derivative assets and derivative liabilities are shown separately on the face of the Balance Sheet. Gains or losses arising from changes in fair values of financial instruments designated at fair value through profit or loss are included in the Income Statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in the Statement of Comprehensive Income unless an impairment loss is recognised. The carrying value of a financial asset or a financial liability carried at cost or amortised cost that is the hedged item in a qualifying hedge relationship is adjusted by the gain or loss attributable to the hedged risk.

Fair value is the value at which a position could be closed out or sold in a transaction to a willing and knowledgeable counterparty over a reasonable period of time under current market conditions. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates.

Financial Assets carried at fair value include advances to banks and derivatives. Financial liabilities carried at fair value include deposits and derivatives. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Where observable prices are not available, fair value is based on appropriate valuation techniques or management estimates.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

2. Critical accounting estimates and judgements (continued)

Fair value (continued)

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

The Company's non-trading derivatives are valued using appropriate valuation techniques.

3. Operating expenses

	2011 £'000	2010 £'000
Administrative expenses		
Staff costs		
Wages, salaries and other staff costs	4,857	4,639
Pension costs (see note 4)	405	669
	<u>5,262</u>	<u>5,308</u>
Other administrative expenses	10,753	10,170
	<u>10,753</u>	<u>10,170</u>
Depreciation		
Property plant and equipment (see Note 11)	497	498
	<u>497</u>	<u>498</u>
Directors' remuneration		
Amounts paid to the Directors	12	12
	<u>12</u>	<u>12</u>
Auditors' remuneration		
Amounts paid to the auditors for statutory audit and other services were as follows:		
Audit services		
– Statutory audit	54	42
– Regulatory audit	16	13
	<u>70</u>	<u>55</u>
Total	<u>70</u>	<u>55</u>

The average number of persons employed by the Company during the year, excluding temporary staff, was 149 (2010 – 147).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

4. Pension costs

Defined Benefit Schemes

The Company operates a number of pension schemes, which are predominantly defined benefit schemes whose assets are independent of the Company's finances. It also contributes to defined contribution schemes. In 2007 the defined benefit schemes were closed to new entrants.

The total pension costs for the Company were as follows:

	2011 £'000	2010 £'000
Amount charged to income statement		
Expected return on pension scheme assets	(4,214)	(4,099)
Interest on pension scheme liabilities	4,098	4,535
Current service cost	692	674
Defined contribution and other defined benefit schemes	59	37
Contribution received from other group entities	(145)	(563)
(Under)/ overprovision in respect of prior year	(85)	85
Net pension cost defined benefit schemes	405	669
	2011	2010
	£'000	£'000
The total net pension costs are included in the income statement as follows:		
Staff costs	405	669
Total net pension costs (see note 3)	405	669

Interim valuations of the Company's schemes were prepared to 31 December 2011 and 31 December 2010 by independent actuaries. The rate of increase in salaries (per annum) is capped at 2% and the following assumptions were used :

	2011 Company Schemes	2010 Company Schemes
Rate of increase in salaries (per annum)	1.75%	1.75%
Rate of increase in pensions in payment (per annum)	3.00%	2.50%
Discount rate (per annum)	5.00%	5.50%
Inflation assumption (per annum)	3.00%	3.30%

The assets and liabilities of the schemes were as follows:

	2011 Company Schemes £'000	% of plan Assets	2010 Company Schemes £'000	% of plan Assets
Equities	27,768	32%	25,544	33%
Index linked bonds	5,136	6%	4,367	6%
Government fixed interest bonds	38,408	44%	33,433	44%
Corporate and other bonds	15,418	18%	13,297	17%
Total market value of assets	86,730	100%	76,641	100%
Present value of scheme liabilities	(85,703)		(75,819)	
Net surplus in the schemes	1,027		822	
Deferred tax (liability) (note 18)	(103)		(82)	
Net pension surplus	924		740	

The assumptions for long-term rates of return on the principal classes of assets at 31 December 2011 were equities 7.7%, gilts and index linked bonds 3.1%, other bonds 4.7% (2010 - equities 7.7%, gilts and index linked bonds 4.2%, other bonds 5.5%).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

4. Pension costs (continued)

Included within the net pension surplus is a retirement benefit asset of £7,139,000 (2010: £7,005,000) in relation to the Isle of Man Bank Widows' & Orphans' Fund and a retirement benefit liability of £6,112,000 (2010: £6,183,000) in respect of the Isle of Man Bank Pension Fund.

	2011 £'000	2010 £'000
Amount recognised in the Statement of Comprehensive Income		
Actual return less expected return on pension scheme assets	5,757	2,904
Experience gains arising on scheme liabilities	-	3,359
Changes in assumptions underlying the present value of scheme liabilities	(8,390)	1,157
Movement in deferred tax (note 18)	(21)	(1,035)
Actuarial (losses)/gains recognised on post-retirement benefit schemes	(2,654)	6,385

The cumulative actuarial amounts recognised in the statement of other comprehensive income since the date of transition to IFRS for Isle of Man Bank Pension Fund (IOMBPF) is a loss of £2,460,000 (2010: gain of £5,082,000) and for the Isle of Man Bank Widows' and Orphans' Fund (IOMBWOF) a loss of £193,000 (2010: loss of £1,820,000).

For the IOMBPF and the IOMBWOF schemes, the mortality assumptions are based on standard mortality tables which allow for future mortality improvements. These assumptions estimate life expectancies from age 60, for active members who are currently age 40, as 29.0 years for males and 30.4 years for females. The corresponding figures used for disclosures at 31 December 2010 were 28.3 for current active males and 30.8 for current active females.

Movement in the present value of defined benefit obligations were as follows:

	2011 £'000	2010 £'000
At 1 January	75,819	77,926
Service cost	692	674
Interest cost	4,098	4,535
Actuarial losses/(gains)	8,390	(4,516)
Benefits paid in plan or company assets	(3,296)	(2,800)
At 31 December	85,703	75,819

Movement in the fair value of scheme assets were as follows:

	2011 £'000	2010 £'000
At 1 January	76,641	68,401
Expected return on scheme assets	4,214	4,099
Actuarial gains	5,757	2,904
Employer contribution	3,414	4,037
Benefits paid from plan or company assets	(3,296)	(2,800)
At 31 December	86,730	76,641

The latest formal valuation carried out by independent actuaries was as at 31 December 2009. The contribution rate for 2011 is 29.3% (IOMBPF) and nil% (IOMBWOF) of pensionable salaries. Contributions for 2011 include lump sum amounts totalling £2.664 million paid into the funds in addition to the monthly contributions (2010 - £3.065m).

The employer contribution to be made in 2012 is £3,672,000. This amount includes a funding payment of £3m for the IOMBPF, which is to be paid annually for the next 10 years. The IOMBWOF is taking a contributions holiday due to it being in a surplus position as at 31 December 2011.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

4. Pension costs (continued)

History of experience adjustments is as follows:

	2011	2010	2009	2008	2007
	Company	Company	Company	Company	Company
	Schemes	Schemes	Schemes	Schemes	Schemes
	£'000	£'000	£'000	£'000	£'000
Total market value of assets	86,730	76,641	68,401	55,947	60,377
Present value of scheme liabilities	(85,703)	(75,819)	(77,926)	(59,476)	(72,378)
Net Pension surplus/(deficit)	1,027	822	(9,525)	(3,529)	(12,001)
Difference between expected and actual return on scheme assets:					
Amount	5,757	2,904	2,106	(7,604)	(898)
Percentage of scheme assets	7%	4%	3%	14%	1%
Experience gains and losses on scheme liabilities:					
Amount	-	(3,359)	-	-	(110)
Percentage of the present value of scheme liabilities:	0%	4%	0%	0%	0%

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

	Increase/(decrease)		Increase/(decrease)	
	in pension		in obligation	
	cost for the year		at 31 December	
	2011	2010	2011	2010
	£'000	£'000	£'000	£'000
0.25% increase in discount rate	(58)	(50)	(4,142)	(2,492)
0.25% increase in inflation	142	57	2,828	559
0.25% additional rate of increase in pensions payment	103	82	2,055	1,487
0.25% additional rate of increase in deferred pensions	38	34	753	607
0.25% additional rate of increase in salaries	62	139	676	2,114

The Company also participates in The Royal Bank of Scotland International Pension Trust (RBSIPT). This is a defined benefit scheme whose assets are independent of the Company's finances. The pension costs of this scheme are assessed across its membership as a whole, and it is not possible to determine the share of the scheme's assets and liabilities that relates to the Company. Accordingly, the requirements of IAS 19 "Employee Benefits" relating to multi-employer schemes apply and the Company accounts for its contributions to the schemes as if they were defined contribution schemes.

The latest full valuation for RBSIPT was carried out on 1 July 2009 and the rate of contribution for the year ended 31 December 2011 was 28.4% (2010: 28%). In accordance with IAS 19 this valuation was updated to 31 December 2011, using actuarial bases and assumptions consistent with the requirements of that standard and showed scheme assets representing 95.0% of scheme liabilities.

The Company contributes a percentage of employees' earnings to the above scheme which cost £265,894 for the year (2010: £206,477). No contributions were outstanding or prepaid at this or the previous year-end.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

5. Operating profit before tax

Operating profit before tax is stated after taking account of the following:	2011 £'000	2010 £'000
Net profit on financial assets/financial liabilities at fair value through profit or loss		
Net gains on financial assets	4,437	761
Net (losses) on financial liabilities	(4,437)	(761)
Net profit	-	-
Income		
Gain on the sale of fixed assets	252	-
Related party transactions		
Expenses:		
Group Management recharge from RBS International Ltd	8,981	8,906
Income:		
Interest income from RBS Group plc	12,738	11,307
Interest paid to RBS Group plc	1,991	1,952
Remuneration paid to key management personnel:		
Short-term employee benefits -		
Salary and other benefits	1,968	1,719
Long-term employee benefits -		
Pension contributions	362	388
Accrued pension benefits attributable to key management personnel as at 31 December	6,240	7,805
Deposits from key management personnel	1,372	1,217
Loans to key management personnel	2,111	1,980
Interest paid to key management personnel	21	5
Interest received from key management personnel	40	13

Key management personnel

Key management personnel are considered to be the Directors of the Company and the members of the RBSI Group "Executive Committee Offshore" (ECO). Not all Directors and ECO members are directly employed by the Company and accordingly the disclosures above relate to remuneration received from and balances held at the consolidated Royal Bank of Scotland International (Holdings) Limited level.

Share-based payments

The cost of share-based awards granted to executives who are primarily employed by the Royal Bank of Scotland Group ("the Group"), in common with employment costs, is not charged to subsidiaries.

The Company is advised that costs of share based awards for all its key management are shared with other members of the Royal Bank of Scotland Group and there is no material share-based payment cost in respect of other employees. Accordingly, the Company does not report any share-based payment expense.

Key management have banking relationships with Group entities which are entered into in the normal course of business.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

6. Tax on operating profit

	2011 £'000	2010 £'000
Current taxation:		
Income tax charge for the year	1,061	1,506
Over provision in respect of prior periods	(58)	(132)
Current tax charge for the year	1,003	1,374
Deferred taxation:		
Charge for the year	40	21
Tax charge for the year	1,043	1,395

The actual tax charge differs from the expected tax charge computed by applying the standard rate of income tax of 10% (2010: 10%) as follows:

	2011 £'000	2010 £'000
Operating profit before tax	14,628	19,642
Expected tax charge at standard rate of 10%	1,463	1,964
Deferred taxation	40	21
Profits Taxed at 0%	(147)	(163)
Other	(313)	(427)
Actual tax charge	1,043	1,395

7. Ordinary dividends

	2011 £'000	2010 £'000
Final for previous year declared during current year	20,000	55,000
Total dividends on ordinary equity shares	20,000	55,000

8. Loans and advances to banks

	2011 £'000	2010 £'000
Designated as at fair value through profit or loss	19,862	15,425
Loans and receivables	765,635	936,696
	778,515	952,121
Amounts above include:		
Amounts due from RBS Group plc	755,352	934,109
Amounts due from RBS International Limited entities	20,271	15,803

Designated as at fair value through profit or loss:

Certain equity-linked products totalling £19,682,029 (2010: £15,425,000) before fair value adjustments have been designated as fair value through profit or loss. The carrying value of financial assets recorded in the financial statements, which is net of impairment losses, represent the Company's maximum exposure to credit risk.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

9. Loans and advances to customers

	2011 £'000	2010 £'000
Loans and receivables	<u>728,781</u>	<u>743,716</u>

As at 31 December 2011 there are seven (2010: seven) credit exposures (including guarantees) which individually exceed 10% of the adjusted capital base. The total value of these credit exposures is £301,258,000 (2010: £256,241,000).

10. Impaired financial assets

	2011 Cost £'000	2011 Provision £'000	2011 Net book value £'000
Loans and receivables			
Loans and advances to customers	<u>351</u>	<u>351</u>	-
	2010 Cost £'000	2010 Provision £'000	2010 Net book value £'000
Loans and receivables			
Loans and advances to customers	<u>506</u>	<u>479</u>	<u>27</u>

A management review indicates that the amount of financial assets past due as to principal or interest payments, but not impaired was not significant as at 31 December 2011 and 2010. The fair value of security held against these loans and advances to customers amounted to £nil.

	2011 £'000	2010 £'000
<i>Impairment losses charged to income statement</i>		
Loans and receivables		
Loans and advances (see table below)	<u>312</u>	399
Total	<u>312</u>	399

The following table shows impairment provisions for loans and advances classified as loans and receivables.

	2011 Total £'000	2010 Total £'000
At 1 January	709	827
Amounts written off	(457)	(557)
Recoveries of amounts previously written off	57	47
Charge to income statement	312	399
Unwind of discount	(2)	(7)
At 31 December	<u>619</u>	<u>709</u>

Interest income accrued on impaired assets for the year was £5,634 (2010: £5,649).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

11. Property, plant and equipment

	Freehold premises £'000	Property adaptation costs £'000	Computers and other equipment £'000	Total £'000
Cost:				
At 1 January 2011	4,783	5,630	404	10,817
Inter Group transfer	369	-	-	369
Disposal	(369)	-	-	(369)
At 31 December 2011	4,783	5,630	404	10,817
Accumulated depreciation:				
At 1 January 2011	849	5,010	322	6,181
Inter Group transfer	46	-	-	46
Disposal	(46)	-	-	(46)
Depreciation charge for the year	66	397	34	497
At 31 December 2011	915	5,407	356	6,678
Net book value at 31 December 2011	3,868	223	48	4,139

	Freehold premises £'000	Property adaptation costs £'000	Computers and other equipment £'000	Total £'000
Cost:				
At 1 January 2010	4,783	5,630	404	10,817
At 31 December 2010	4,783	5,630	404	10,817
Accumulated depreciation:				
At 1 January 2010	784	4,614	286	5,684
Depreciation charge for the year	65	397	36	498
At 31 December 2010	849	5,011	322	6,182
Net book value at 31 December 2010	3,934	619	82	4,635

12. Shares in subsidiary undertaking

The subsidiary undertaking of the Company is:

	Nature of Business	Country of Incorporation	Holding Ordinary Shares of £1	Percentage Share Holding
Isle of Man Bank Nominees Limited	Nominee	Isle of Man	100	100%

13. Other assets, prepayments and accrued income

	2011 £'000	2010 £'000
Due from RBS International Limited entities	611	1,104
Other assets	223	247
	834	1,351

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

14. Derivatives at fair value

The Company enters into various off-balance sheet financial instruments (derivatives) as principal to manage balance sheet foreign exchange and interest rate risk. Derivatives include swaps, forwards and options. They may be traded over-the-counter (OTC).

Swaps include currency swaps, interest rate swaps, and equity and index swaps. A swap is an agreement to exchange cash flows in the future in accordance with a pre-arranged formula. In currency swap transactions, interest payment obligations are exchanged on assets and liabilities denominated in different currencies; the exchange of principal may be notional or actual. Interest rate swap contracts generally involve exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts.

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

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

The Company enters into fair value hedges. Fair value hedges principally involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities.

	Notional £'000	2011 Fair value	
		Assets £'000	Liabilities £'000
Exchange rate contracts:			
Spot & forwards – RBS plc Group entities	57,949	179	163
Spot & forwards – Third party	904	10	13
Interest rate swaps:			
RBS plc Group entities	76,614	15,340	17,636
Total	135,467	15,529	17,812
Included in the above are fair value hedging derivatives as follows:			
Interest rate swaps	50,772	-	11,436
	Notional £'000	2010 Fair value	
		Assets £'000	Liabilities £'000
Exchange rate contracts:			
Spot & forwards – RBS plc Group entities	81,528	304	290
Spot & forwards – Third party	1,013	20	9
Interest rate swaps:			
RBS plc Group entities	65,839	1,269	7,246
Total	148,380	1,593	7,545
Included in the above are fair value hedging derivatives as follows:			
Interest rate swaps	35,994	-	5,727

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

14. Derivatives at fair value (continued)

Included within the interest rate swaps above is a fair value hedge. Gains and losses that have been recorded in the Income Statement relating to this swap and the hedged item are as follows:

	2011 £'000	2010 £'000
Gains recognised on the interest rate swap used as a hedge	5,708	2,100
(Losses) recognised on the item being hedged	(8,501)	(2,961)

15. Deposits by banks

	2011 £'000	2010 £'000
Amortised cost	52,604	68,551
Amounts above include: Deposits taken from RBS Group plc	46,553	59,771

16. Customer accounts

	2011 £'000	2010 £'000
Designated as fair value through profit or loss	19,862	15,425
Amortised cost	1,343,777	1,491,261
	<u>1,356,657</u>	<u>1,506,686</u>

Designated at fair value through profit or loss:

Certain equity-linked products totalling £19,682,029 (2010: £15,425,000) before fair value adjustments have been designated as fair value through profit or loss. The carrying value of financial assets recorded in the financial statements, which is net of impairment losses, represent the Company's maximum exposure to credit risk.

17. Other liabilities, accruals and deferred income

	2011 £'000	2010 £'000
Due to RBS International Limited entities	227	9,136
Other liabilities	1,988	1,580
	<u>2,215</u>	<u>10,716</u>

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

18. Deferred taxation

The deferred tax liability arises as follows:

	Pension £'000	Accelerated capital allowances £'000	Provisions £'000	Total £'000
At 1 January 2010	(953)	44	(95)	(1,004)
Charge to income statement	-	(16)	37	21
Charge to equity directly	1,035	-	-	1,035
	82	28	(58)	52
The above is analysed as follows:				
- Deferred tax assets	-	-	(58)	(58)
- Deferred tax liabilities	82	28	-	110
At 1 January 2011	82	28	(58)	52
Charge to income statement	-	(18)	58	40
Charge to equity directly	21	-	-	21
At 31 December 2011	103	10	-	113
The above is analysed as follows:				
- Deferred tax assets	-	-	-	-
- Deferred tax liabilities	103	10	-	113
- Deferred tax liabilities	103	10	-	113

19. Called up share capital

	Allotted, called up and fully paid		Authorised	
	31 December 2011 £'000	31 December 2010 £'000	31 December 2011 £'000	31 December 2010 £'000
Equity shares				
Ordinary shares of £1	7,501	7,501	15,000	15,000
Preference shares of £1	-	-	5	5
Total share capital	7,501	7,501	15,005	15,005
Number of shares				
Equity shares				
Ordinary shares of £1	7,501,000	7,501,000	15,000,000	15,000,000
Preference shares of £1	-	-	5,000	5,000
Total share capital	7,501,000	7,501,000	15,005,000	15,005,000

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

20. Leases

Minimum amounts receivable and payable under non-cancellable leases

	2011			Total £'000
	Year in which receipt or payment will occur			
	Within 1 year £'000	After 1 year but within 5 years £'000	After 5 Years £'000	
(i) Finance lease assets:				
Amounts receivable	3,407	13,628	44,293	61,329
Present value adjustment	(178)	(2,318)	(20,593)	(23,090)
Present value amounts receivable	<u>3,229</u>	<u>11,310</u>	<u>23,700</u>	<u>38,239</u>
(ii) Operating lease obligations:				
Amounts payable				
Premises	<u>164</u>	<u>656</u>	<u>3,444</u>	<u>4,264</u>

	2010			Total £'000
	Year in which receipt or payment will occur			
	Within 1 year £'000	After 1 year but within 5 years £'000	After 5 years £'000	
(i) Finance lease assets:				
Amounts receivable	3,407	13,628	47,700	64,735
Present value adjustment	(178)	(2,318)	(22,773)	(25,269)
Present value amounts receivable	<u>3,229</u>	<u>11,310</u>	<u>24,927</u>	<u>39,466</u>
(ii) Operating lease obligations:				
Amounts payable				
Premises	<u>168</u>	<u>672</u>	<u>3,696</u>	<u>4,536</u>

	2011 £'000	2010 £'000
Amounts recognised as income and expense		
Operating lease payable – minimum payments	<u>168</u>	<u>163</u>

Residual value exposures

There are no unguaranteed residual values included in the carrying value of finance lease receivables.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial instruments

Risk management

Risk appetite is an expression of the maximum level of risk that we are prepared to accept to deliver our business objectives. Risk and balance sheet management across the Company is based on the Risk Appetite approved by the Board, who ultimately will agree this for each division and regularly reviews the Company's performance in relation to risk.

Risk appetite is defined in both quantitative and qualitative terms, which serve as a way of setting appetite and managing risk performance as we implement an agreed strategy.

- Quantitative: encompassing capital, funding and liquidity, credit, country, market, operational, regulatory and business risks underpinned by stress testing.
- Qualitative: ensuring that the Company applies the correct principles, policies and procedures, manages reputational risk with sound controls and a strong risk culture.

As discussed in the Directors' Report, the authority for day to day risk management has been delegated to the Asset and Liability Committee ("ALCO"), the Executive Committee Offshore ("ECO"), the Offshore Audit Committee ("OAC"), the Offshore Risk Management Committee ("ORMC") and the Offshore Board Credit Committee ("OBCC").

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

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

The Company has capital adequacy requirements imposed by the Isle of Man Financial Supervision Commission. The Company is required to report a risk asset ratio to the regulator on a periodic basis. The ratio is calculated as being the percentage of capital to assets, based on the regulator's definitions of capital and assets. This risk asset ratio is required at all times to be above a benchmark % provided by the regulator. The Company has been in compliance with capital adequacy requirements in respect of the years ending 31 December 2011 and 2010.

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

The Company's overall strategy remains unchanged from 2010.

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

The maturity analysis of the Company's financial liabilities is disclosed in the table on page 36, 'Maturity Analysis of Financial Liabilities'. For further details about financial assets not quoted in an active market and the liquidity implications of this, refer to page 39

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

The Company maintains daily liquidity reporting of positions to RBS Group plc.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial instruments (continued)

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

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

The day-to-day management of credit risk is devolved to a specialist credit function, which performs regular appraisals of counterparty credit quality through the analysis of qualitative and quantitative information. Credit authority is based on defined limits with responsibility for significant transactions residing with the OBCC.

If the Company requires collateral, this may be cash, or more commonly, security over a customer's assets.

Under IAS39 provisions are assessed by the Company under the following two categories:

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

Latent loss provisions - are the provisions held against the estimated impairment in the performing portfolio, which has yet to be identified and reported as at the balance sheet date. To assess the latent loss within the portfolio, the Company has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

A management review has shown that the majority of the Company's lending book is covered in excess of 100% of the carrying value by the fair value of security. The fair values of security are based on the most recent open market valuation of each item of security and an ongoing review process is in place to ensure that all security remains valid. Unsecured Personal Lending totalled £22,057,074 as at 31 December 2011 (2010: £27,792,144) – all unsecured lending is made subsequent to checking customer credit ratings and banking histories.

Impaired financial assets relating to credit risk are analysed in note 10.

Operational risk Operational risk arises from the potential of inadequate systems, errors, poor management, breaches in internal controls, fraud and external events to result in financial loss or reputational damage. The Company's business units manage this risk through appropriate risk controls and loss mitigation actions. These actions include a balance of policies, procedures, internal controls and business continuity arrangements.

Market risk Market risk is the risk that changes in the level of interest rates, the rate of exchange between currencies or the price of financial contracts including derivatives will have an adverse impact.

The Company's management of its exposure to market risk recognises a fundamental distinction between the core (retail) lending and deposits and the Company's foreign exchange and money market (wholesale) activities. Refer to the Value-at-Risk section below for discussion of the management of market risk.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial Instruments (continued)

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

Currency risk All transactional (or non-structural) currency exposure risk is managed by the Treasury unit and there remains a small immaterial open position which is measured on a daily basis within set limits. The principal non-sterling currencies in which the Company has transactional currency exposure are US Dollar and the Euro. These are reported on page 37 in the table, 'Balance Sheet by currency'.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial Instruments (continued)

Maturity Analysis of Financial Liabilities:

2011	Sight – 8 days	8 days – 1 month	1-3 months	3-6 months	6-12 months	1-3 years	3- 5 years	Over 5 years	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Remaining maturity									
Liabilities									
Deposits by banks	8,602	4,885	4,288	32,307	285	-	-	-	50,367
Items in the course of transmission to other banks	2,237	-	-	-	-	-	-	-	2,237
Customer accounts	989,360	38,566	81,410	43,912	111,744	-	91,665	-	1,356,657
Derivatives at fair value	-	138	14	4	-	-	33	17,623	17,812
Other liabilities, accruals, deferred income and current taxation liabilities	2,215	-	-	-	1,061	-	-	113	3,389
Post-retirement benefit liabilities	-	-	-	-	-	-	-	6,112	6,112
	1,002,414	43,589	85,712	76,223	113,090	-	91,698	23,848	1,436,574

2010	Sight – 8 days	8 days – 1 month	1-3 months	3-6 months	6-12 months	1-3 years	3- 5 years	Over 5 years	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Remaining maturity									
Liabilities									
Deposits by banks	19,154	10,969	26,164	9,583	442	-	-	-	66,312
Items in the course of transmission to other banks	2,239	-	-	-	-	-	-	-	2,239
Customer accounts	1,116,796	141,449	76,923	51,267	30,601	36,449	53,201	-	1,506,686
Derivatives at fair value	-	291	8	1	-	-	630	6,615	7,545
Other liabilities, accruals, deferred income and current taxation liabilities	10,716	-	-	-	1,506	-	-	110	12,332
Post-retirement benefit liabilities	-	-	-	-	-	-	-	6,183	6,183
	1,148,905	152,709	103,095	60,851	32,549	36,449	53,831	12,908	1,601,297

Value-at-Risk:

The Company manages the market through value-at-risk (VaR) limits as well as stress testing, position and sensitivity limits. VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at a given confidence level. The table below sets out the VaR for the Company, which assumes a 95% confidence level and a one-day time horizon.

VaR	Average £'000	Year end £'000	Maximum £'000	Minimum £'000
31 December 2011	63	67	86	50
31 December 2010	73	64	81	58

The Company VaR should be interpreted in light of the limitations of the methodologies used. These limitations include:

- Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.
- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.
- VaR using a 99% confidence level does not reflect the extent of potential losses beyond that percentile.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial instruments (continued)

- The Company largely computes the VaR of the trading portfolios at the close of business and positions may change substantially during the course of the trading day. Controls are in place to limit the Company's intra-day exposure such as the calculation of VaR for selected portfolios.

These limitations and the nature of the VaR measure mean that the Company cannot guarantee that losses will not exceed the VaR amounts indicated nor that losses in excess of the VaR amounts will not occur more frequently than once in 20 business days.

Balance Sheet by currency:

2011 Sterling Equivalent	Sterling £'000	US Dollars £'000	Euro £'000	Other £'000	Total £'000
Assets					
Cash and balances at central banks	15,930	18	9	5	15,962
Loans and advances to banks	647,958	54,858	49,244	26,455	778,515
Loans and advances to customers	728,675	106	-	-	728,781
Derivatives at fair value	15,511	18	-	-	15,529
Deferred taxation assets	-	-	-	-	-
Other assets, prepayments and accrued income	834	-	-	-	834
Non current assets held for sale	-	-	-	-	-
Property, plant and equipment	4,139	-	-	-	4,139
Shares in subsidiary undertaking	-	-	-	-	-
Retirement benefit asset	7,139	-	-	-	7,139
Total assets	1,420,186	55,000	49,253	26,460	1,550,899
Liabilities and equity					
Deposits by banks	48,364	348	2,130	1,762	52,604
Customer accounts	1,232,447	54,432	46,267	23,511	1,356,657
Derivatives at fair value	17,794	18	-	-	17,812
Other liabilities, accruals, deferred income and current taxation	3,276	-	-	-	3,276
Deferred taxation liability	113	-	-	-	113
Post-retirement benefit liabilities	6,112	-	-	-	6,112
Shareholders' equity	114,325	-	-	-	114,325
Total liabilities and equity	1,422,431	54,798	48,397	25,273	1,550,899
2010					
2010 Sterling Equivalent	Sterling £'000	US Dollars £'000	Euro £'000	Other £'000	Total £'000
Assets					
Cash and balances at central banks	14,055	9	18	10	14,092
Loans and advances to banks	678,907	92,003	131,697	49,514	952,121
Loans and advances to customers	743,715	-	1	-	743,716
Derivatives at fair value	1,292	292	9	-	1,593
Deferred taxation assets	58	-	-	-	58
Other assets, prepayments and accrued income	1,351	-	-	-	1,351
Non current assets held for sale	120	-	-	-	120
Property, plant and equipment	4,635	-	-	-	4,635
Retirement benefit assets	7,005	-	-	-	7,005
Total assets	1,451,138	92,304	131,725	49,524	1,724,691
Liabilities and equity					
Deposits by banks	62,165	3,613	945	1,828	68,551
Customer accounts	1,234,267	98,888	128,634	44,897	1,506,686
Derivatives at fair value	7,244	292	9	-	7,545
Other liabilities, accruals, deferred income and current taxation	12,222	-	-	-	12,222
Deferred taxation liability	110	-	-	-	110
Post-retirement benefit liabilities	6,183	-	-	-	6,183
Shareholders' equity	123,394	-	-	-	123,394
Total liabilities and equity	1,445,585	102,793	129,588	46,725	1,724,691

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial instruments (continued)

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

Industry and regional analysis of financial assets as at 31 December 2011:

	Loans and advances to banks and customers £'000	Derivatives £'000	Other £'000	Total £'000
UK				
Central and local government	191,373	-	-	191,373
Manufacturing	2,990	-	-	2,990
Construction	3,526	-	-	3,526
Finance	780,417	15,529	15,962	811,908
Service industry and business activities	9,937	-	-	9,937
Agriculture, forestry and fishing	6,245	-	-	6,245
Property	83,421	-	-	83,421
Individuals	4,563	-	-	4,563
Home mortgages	348,736	-	-	348,736
Other	38,532	-	-	38,532
Finance leases and instalment credit	38,175	-	-	38,175
Total domestic	1,507,915	15,529	15,962	1,539,406
Total gross financial instruments	1,507,915	15,529	15,962	1,539,406
Provisions and impairment (note 10)	(619)	-	-	(619)
Total financial instruments	1,507,296	15,529	15,962	1,538,787

Industry and regional analysis of financial assets as at 31 December 2010:

	Loans and advances to banks and customers £'000	Derivatives £'000	Other £'000	Total £'000
UK				
Central and local government	171,453	-	-	171,453
Manufacturing	4,323	-	-	4,323
Construction	2,943	-	-	2,943
Finance	962,585	1,593	14,092	978,270
Service industry and business activities	11,698	-	-	11,698
Agriculture, forestry and fishing	5,034	-	-	5,034
Property	94,916	-	-	94,916
Individuals	4,232	-	-	4,232
Home mortgages	359,629	-	-	359,629
Other	39,764	-	1,351	41,115
Finance leases and instalment credit	39,969	-	-	39,969
Total domestic	1,696,546	1,593	15,443	1,713,582
Total gross financial instruments	1,696,546	1,593	15,443	1,713,582
Provisions and impairment (note 10)	(709)	-	-	(709)
Total financial instruments	1,695,837	1,593	15,443	1,712,873

The balances included above have been grossed up by £57,975,910 (2010: £54,573,113) in order to comply with the offsetting rules of IAS32.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

21. Financial instruments (continued)

Offsetting:

In accordance with IAS 32, balances with a counterparty are not offset unless there is a legally enforceable right of offset and there is an intention to settle net, or to realise the asset and settle the liability at the same time.

Fair value instruments recognised in the Balance Sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	2011			Total
	Level 1 £'000	Level 2 £'000	Level 3 £'000	£'000
Financial assets at fair value through profit or loss				
Derivative financial assets	-	15,529	-	15,529
Non-derivative financial assets held for trading	-	19,862	-	19,862
Total	-	35,391	-	35,391
Financial liabilities at fair value through profit or loss				
Customer accounts	-	19,862	-	19,862
Derivative financial liabilities	-	17,812	-	17,812
Total	-	37,674	-	37,674

	2010			Total
	Level 1 £'000	Level 2 £'000	Level 3 £'000	£'000
Financial assets at fair value through profit or loss				
Derivative financial assets	-	1,593	-	1,593
Non-derivative financial assets held for trading	-	15,425	-	15,425
Total	-	17,018	-	17,018
Financial liabilities at fair value through profit or loss				
Customer accounts	-	15,425	-	15,425
Derivative financial liabilities	-	7,545	-	7,545
Total	-	22,970	-	22,970

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

22. Asset quality

Internal reporting and oversight of risk assets is principally differentiated by credit ratings. Internal ratings are used to assess the credit quality of borrowers. Customers are assigned an internal credit grade based on various credit grading models that reflect the probability of default. All credit ratings across the Group map to a Group level asset quality scale, namely master grade scaling (MGS).

Expressed as an annual probability of default, the upper and lower boundaries for each of these Group level asset quality grades are as follows:

Annual probability of default		
MGS	Lower	Upper
1	0.0000%	0.0060%
2	0.0060%	0.0120%
3	0.0120%	0.0170%
4	0.0170%	0.0240%
5	0.0240%	0.0340%
6	0.0340%	0.0480%
7	0.0480%	0.0670%
8	0.0670%	0.0950%
9	0.0950%	0.1350%
10	0.1350%	0.1900%
11	0.1900%	0.2690%
12	0.2690%	0.3810%
13	0.3810%	0.5380%
14	0.5380%	0.7610%
15	0.7610%	1.0760%
16	1.0760%	1.5220%
17	1.5220%	2.1530%
18	2.1530%	3.0440%
19	3.0440%	4.3050%
20	4.3050%	6.0890%
21	6.0890%	8.6110%
22	8.6110%	12.1770%
23	12.1770%	17.2220%
24	17.2220%	24.3550%
25	24.3550%	34.4430%
26	34.4430%	100.0000%
27	100.0000%	

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

22. Asset quality (continued)

The following table provides an analysis of the credit quality of financial assets by the Company's internal credit ratings.

MGS	2011				
	Cash and balance at central banks	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments
	£'000	£'000	£'000	£'000	£'000
1	15,962	1,958	50,042	-	9,279
2	-	854	186,175	-	34,521
3	-	-	-	-	-
4	-	62	-	-	-
5	-	-	-	-	-
6	-	18	14,746	-	2,734
7	-	-	-	-	-
8	-	-	-	-	-
9	-	-	169	-	31
10	-	-	1,550	-	287
11	-	-	1,720	-	319
12	-	-	7,447	-	1,381
13	-	-	8,324	-	1,543
14	-	-	16,639	-	3,085
15	-	-	392,398	-	72,762
16	-	-	15,534	-	2,880
17	-	-	8,067	-	1,496
18	-	-	17,514	-	3,248
19	-	-	88	-	16
20	-	-	-	-	-
21	-	-	409	-	76
22	-	-	762	-	141
23	-	-	-	-	-
24	-	-	1,178	-	218
25	-	-	-	-	-
26	-	-	373	-	69
27	-	-	2,582	-	479
	15,962	2,892	725,717	-	134,565
InterGroup					
Position with RBS					
Group	-	775,623	-	15,529	-
Past Due	-	-	3,331	-	-
Non Accrual	-	-	352	-	-
Impairment	-	-	(619)	-	-
Provision					
Total	15,962	778,515	728,781	15,529	134,565

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

22. Asset quality (continued)

MGS	2010				
	Cash and balance at central banks	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments
	£'000	£'000	£'000	£'000	£'000
1	14,092	1,253	45,413	-	10,810
2	-	799	163,174	-	40,094
3	-	-	-	-	-
4	-	13	-	-	-
5	-	-	-	-	-
6	-	21	14,050	-	3,452
7	-	-	-	-	-
8	-	-	-	-	-
9	-	-	470	-	115
10	-	-	1,240	-	305
11	-	-	3,726	-	916
12	-	-	12,371	-	3,040
13	-	-	3,166	-	778
14	-	-	18,525	-	4,552
15	-	-	76,999	-	18,920
16	-	-	377,038	-	92,644
17	-	-	6,185	-	1,520
18	-	-	6,751	-	1,659
19	-	-	137	-	34
20	-	-	-	-	-
21	-	-	737	-	181
22	-	-	-	-	-
23	-	-	81	-	20
24	-	-	652	-	160
25	-	-	-	-	-
26	-	-	138	-	34
27	-	-	501	-	123
	14,092	2,086	731,354	-	179,357
InterGroup Position with RBS Group	-	950,035	-	1,593	-
Past Due	-	-	12,562	-	-
Non Accrual	-	-	509	-	-
Impairment Provision	-	-	(709)	-	-
Total	14,092	952,121	743,716	1,593	179,357

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

23. Maturity analysis of assets

The following asset tables report the amounts expected to be recovered or settled within set time periods after the balance sheet date and more than twelve months after the balance sheet date.

2011									
Remaining maturity	Sight – 8 days £'000	8 days – 1 month £'000	1-3 months £'000	3-6 months £'000	6-12 months £'000	1-3 years £'000	3- 5 years £'000	Over 5 years £'000	Total £'000
Assets									
Cash and balances at central banks	15,962	-	-	-	-	-	-	-	15,962
Loans and advances to banks	491,474	4,511	6,472	34,749	50,250	63,213	112,846	15,000	778,515
Loans and advances to customers	32,142	6,469	1,532	4,565	24,313	22,610	26,470	610,680	728,781
Derivatives at fair value	-	175	19	14	-	-	-	15,321	15,529
Deferred taxation assets	-	-	-	-	-	-	-	-	-
Other assets, prepayments and accrued income	74	760	-	-	-	-	-	-	834
Non-Current assets held for sale	-	-	-	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	-	-	4,139	4,139
Shares in subsidiary undertaking	-	-	-	-	-	-	-	-	-
Retirement benefit assets	-	-	-	-	-	-	-	7,139	7,139
Total assets	539,652	11,915	8,023	39,328	74,563	85,823	139,316	652,279	1,550,899

2010									
Remaining maturity	Sight – 8 days £'000	8 days – 1 month £'000	1-3 months £'000	3-6 months £'000	6-12 months £'000	1-3 years £'000	3- 5 years £'000	Over 5 years £'000	Total £'000
Assets									
Cash and balances at central banks	14,092	-	-	-	-	-	-	-	14,092
Loans and advances to banks	720,503	9,985	30,966	20,897	51,400	23,055	74,315	21,000	952,121
Loans and advances to customers	45,660	4,414	2,697	4,560	4,633	53,516	16,908	611,328	743,716
Derivatives at fair value	-	316	8	1	1	4	687	576	1,593
Deferred taxation assets	-	-	-	-	-	-	-	58	58
Other assets, prepayments and accrued income	122	1,229	-	-	-	-	-	-	1,351
Non-Current assets held for sale	-	-	-	-	-	-	-	120	120
Property, plant and equipment	-	-	-	-	-	-	-	4,635	4,635
Shares in subsidiary undertaking	-	-	-	-	-	-	-	-	-
Retirement benefit assets	-	-	-	-	-	-	-	7,005	7,005
Total assets	780,377	15,944	33,671	25,458	56,034	76,575	91,910	644,722	1,724,691

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

24. Commitments and contingent obligations

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

	2011 £'000	2010 £'000
Contingent liabilities:		
Various	<u>944</u>	<u>1,145</u>
Commitments:		
Undrawn formal standby facilities, credit lines and other commitments to lend	<u>134,565</u>	<u>179,357</u>

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

(a) Contingent liabilities

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

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

(b) Commitments

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

Commitments under non-cancellable operating leases are detailed in note 20.

(c) Litigation

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

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

25. Net cash inflow from operating activities

	2011 £'000	2010 £'000
Operating profit	14,628	19,642
Decrease in prepayments and accrued income	517	199
Decrease in accruals and deferred income	(8,501)	(1,673)
Provisions on impairment losses	312	399
Foreign exchange	(515)	(280)
Pensions charge for defined benefit schemes	406	669
Depreciation of tangible fixed assets	497	498
Net cash inflow from trading activities	7,344	19,454
Decrease/(increase) in loans and advances to banks	173,606	(857)
Decrease/(increase) in loans and advances to customers	14,935	(14,135)
Increase in other assets	(13,816)	(1,199)
Changes in operating assets	174,725	(16,191)
(Decrease)/increase in deposits by banks	(15,947)	11,508
(Decrease)/increase in customer accounts	(150,029)	40,441
Increase in other liabilities	10,267	3,415
Changes in operating liabilities	(155,709)	55,364
Cash contribution to defined benefit pension schemes	(3,414)	(3,734)
Total income taxes paid		
Income taxes paid in respect of operating activities	(1,449)	(1,317)
Net cash inflow/(outflow) from operating activities	21,497	53,576

26. Analysis of cash and cash equivalents

	2011 £'000	2010 £'000
At 1 January	14,092	15,516
Net cash inflow/(outflow)	1,870	(1,424)
At 31 December	15,962	14,092
Comprising:		
Cash and balances at central banks	15,962	14,092
	15,962	14,092

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2011

27. Related party transactions

Note 5 'Operating profit before tax' provides information on key management and transactions with related parties. The balances payable to and receivable from related parties are included within the notes as appropriate.

28. Holding company

The Isle of Man Bank Limited is a wholly owned subsidiary of The Royal Bank of Scotland International (Holdings) Limited which is itself an indirect wholly owned subsidiary of The Royal Bank of Scotland Group plc which is registered in Scotland and which the Directors regard as the ultimate holding and controlling parent company.

On 1 December 2008, the UK Government through HM Treasury acquired a controlling shareholding in The Royal Bank of Scotland Group plc. The UK Government shareholdings in banks are managed by UK Financial Investments Limited, a company wholly owned by the UK Government.

29. Depositors Compensation Scheme

The Company is required to participate in the Isle of Man Depositors' Compensation Scheme ('the Scheme'), as set out in the Compensation of Depositors Regulations 2008 (as amended) and subsequently, the Depositors' Compensation Scheme Regulations 2010.

On 8 October 2008, the Board of Kaupthing, Singer & Friedlander (Isle of Man) Limited ('KSF IOM') declared that it was unable to pay its debts. At a hearing in the Isle of Man High Court on 27 May 2009, a winding up order was made placing the company into liquidation.

During 2009 the Company paid an initial contribution of £350,000 to the Scheme and made a provision amounting to £700,000 in respect of estimated future contributions to the Scheme. In both 2010 and 2011 the Company made further £350,000 annual contributions to the Scheme which have been offset against the £700,000 provision made in 2009, leaving a £nil provision in the Balance Sheet as at 31 December 2011. To the best of our knowledge at the current time from the publicly available information, the Directors believe that there is no further liability to the scheme at this time.

During 2009, Isle of Man Bank Limited also received notification that a refund would be due from the Depositors' Compensation Scheme of 1991 following the liquidation of Bank of Credit & Commerce International SA resulting in a refund of £274,226 in 2010. No further refund or notification of refund has been received by the Company in 2011.

30. Subsequent events

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