

ISLE OF MAN BANK LIMITED

ANNUAL REPORT AND ACCOUNTS

FOR THE YEAR ENDED

31 DECEMBER 2008

ISLE OF MAN BANK LIMITED

ANNUAL REPORT AND ACCOUNTS 2008

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ISLE OF MAN BANK LIMITED

COMPANY INFORMATION

REGISTERED OFFICE

2 Athol Street
Douglas
Isle of Man
IM99 1AN

DIRECTORS

George Anthony SCHOFIELD
James Leonard MORRIS
Geoffrey Keith GELLING
Paul Thomas SMITH
Victoria Kate McENEANEY
Stephen John CAMM
Ronald John GORDON

SECRETARY

Kenneth Ian MADDRELL

AUDITORS

Deloitte & Touche
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 2008.

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.

BUSINESS REVIEW

The profit before taxation for the year amounted to £24,879,000 (2007: £21,469,000). The retained profit for the year of £23,111,000 (2007: £19,677,000) was transferred to reserves.

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.

The prevailing market and economic conditions also 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, having made such enquiries as they considered appropriate, have prepared the financial statements on a going concern basis. They considered the financial statements of The Royal Bank of Scotland Group plc for the year ended 31 December 2008, approved on 25 February 2009, which were prepared on a going concern basis.

DIVIDENDS

The Directors declared and paid dividends of £20,000,000 for the year ended 31 December 2008 (2007: £25,000,000).

EMPLOYEES

The average number of persons employed during the year was 164 (2007: 164) and the aggregate remuneration paid or payable to such employees for the year was £6,078,000 (2007: £5,894,000).

DIRECTORS AND SECRETARY

The current Directors and Secretary of the Company as at 31 December 2008 are shown on page 3. Changes made during 2008 are shown below:

David Mark LEWIN	Resigned	07 May 2008
Paul NAYAR	Resigned	11 July 2008
Stephen John CAMM	Appointed	29 September 2008
Ronald John GORDON	Appointed	02 October 2008

ISLE OF MAN BANK LIMITED

REPORT OF THE DIRECTORS (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Isle of Man company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit or loss of the Company for that year. In preparing those financial statements, the Directors are required to:

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

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Acts 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.


AUDITORS

In accordance with Section 12(2) of the Isle of Man Companies Act 1982 the auditors, Deloitte & Touche, 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 13 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



Director



Director

20 March 2009

ISLE OF MAN BANK LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ISLE OF MAN BANK LIMITED

We have audited the Company financial statements (the "financial statements") of Isle of Man Bank Limited for the year ended 31 December 2008 which comprise the income statement, the balance sheet, the statement of recognised income and expense, the cash flow statement, and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein.

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 auditors' 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

The directors' responsibilities for preparing the financial statements in accordance with applicable Isle of Man law and International Financial Reporting Standards as issued by the International Accounting Standards Board are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant Isle of Man legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with the relevant framework and are properly prepared in accordance with the Companies Acts 1931 to 2004. We also report if, in our opinion, the directors' report is not consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' transactions with the company is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with International Financial Reporting Standards, of the state of the Company's affairs as at 31 December 2008 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Acts 1931 to 2004.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
Douglas
Isle of Man

Date 26 March 2009

ISLE OF MAN BANK LIMITED

Income Statement for the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Interest receivable		90,547	85,544
Interest payable		(54,935)	(53,429)
Net interest income		35,612	32,115
Fees and commissions receivable		9,090	8,726
Fees and commissions payable		(30)	(30)
Other operating income		-	102
Non-interest income		9,060	8,798
Total income		44,672	40,913
Staff costs	3	6,078	5,894
Other administrative costs	3	12,974	13,011
Depreciation	3, 11	504	549
Operating expenses		19,556	19,454
Operating profit before impairment charges		25,116	21,459
Impairment losses	10	237	630
Operating profit		24,879	20,829
Profit on disposal of fixed asset		-	640
Operating profit before tax		24,879	21,469
Tax on operating profit	6	1,768	1,792
Profit for the year	19	23,111	19,677

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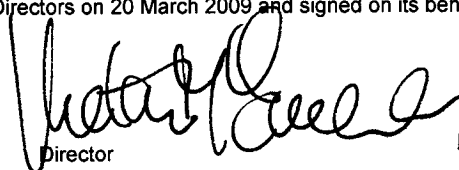
Balance Sheet as at 31 December 2008

	Notes	2008 £'000	2007 £'000
Assets			
Cash and balances at central banks		16,753	15,221
Loans and advances to banks	8	1,056,867	1,000,176
Loans and advances to customers	9	722,042	683,333
Property, plant and equipment	11	5,632	6,136
Derivatives at fair value	13	1,627	761
Deferred taxation assets	17	315	812
Other assets, prepayments and accrued income	12	7,252	4,909
Total assets		1,810,488	1,711,348
Liabilities			
Deposits by banks	14	115,808	64,637
Customer accounts	15	1,520,524	1,480,705
Derivatives at fair value	13	7,956	1,958
Other liabilities, accruals and deferred income	16	13,648	14,178
Retirement benefit liabilities	4	3,529	12,001
Current taxation liabilities		2,089	1,787
Total liabilities		1,663,554	1,575,266
Equity			
Shareholders' equity:			
Called up share capital	18	7,501	7,501
Reserves	19	139,433	128,581
Total shareholders' equity	19	146,934	136,082
Total liabilities and equity		1,810,488	1,711,348

The accounts were approved by the Board of Directors on 20 March 2009 and signed on its behalf by



Director



Director

ISLE OF MAN BANK LIMITED

Statement of Recognised Income and Expense for the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Actuarial gains/(losses) on defined benefit pension schemes	4	7,582	(3,631)
Net income/(losses) recognised directly in equity		7,582	(3,631)
Profit for the year		23,111	19,677
Total recognised income and expense for the year		30,693	16,046

ISLE OF MAN BANK LIMITED

Cash Flow Statement for the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Operating activities			
Company operating profit before tax		24,879	21,469
<i>Adjustments for:</i>			
Depreciation	3	504	549
Pension charge for defined benefit schemes	4	1,601	972
Other non-cash items		(2,632)	(2,645)
Net cash inflow from trading activities			
Changes in operating assets	25	(96,266)	(19,005)
Changes in operating liabilities	25	96,988	28,098
Net cash flows from operating activities before tax		25,074	29,438
Income taxes paid		(1,682)	(1,800)
Cash flows from operating activities	25	23,392	27,638
Investing activities			
Sale of property, plant and equipment		-	3,000
Cash contribution to defined benefit pension schemes	4	(1,860)	(1,863)
Cash flows from investing activities		(1,860)	1,137
Financing activities			
Dividends paid	7	(20,000)	(25,000)
Cash flows from financing activities		(20,000)	(25,000)
Net increase in cash and cash equivalents	26	1,532	3,775
Cash and cash equivalents 1 January	26	15,221	11,446
Cash and cash equivalents 31 December	26	16,753	15,221

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

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 stating 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.

The Directors have considered new and revised standards and interpretations and believe that IAS 1 "Presentation of Financial Statements" is the only standard to affect the Company and will be adopted after the effective date of 1 January 2009. The amendments to the presentation requirements for financial statements are not expected to have material effect on the Company.

(b) Going Concern

The financial statements, which should be read in conjunction with the Director's report, are prepared on a going concern basis.

(c) 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 profit or loss 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 profit or loss.

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.

(d) 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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

1. Accounting policies (continued)

(d) Pensions and other post-retirement benefits (continued)

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit 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 profit or loss and presented in the statement of recognised income and expense.

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.

(e) 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 profit or loss on a straight-line basis so as to write off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. 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

(f) 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 profit or loss 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.

(g) 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 included in net profit or loss for the year. 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 included in net profit or loss for the year except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in the fair value reserve in equity unless the asset is the hedged item in a fair value hedge.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

1. Accounting policies (continued)

(h) 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 income on a straight line basis over the term of the lease.

(i) 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.

(j) Financial assets

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

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 profit or loss 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 profit or loss 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.

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

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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

1. Accounting policies (continued)

(k) 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 receivable 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 profit or loss 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 equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to an event subsequent to when the impairment was recognised.

(l) 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 profit or loss 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 profit or loss as they arise. All other financial liabilities are measured at amortised cost using the effective interest method (see policy (b) above).

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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

1. Accounting policies (continued)

(m) 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 profit or loss 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.

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 profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss 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 profit or loss over the life of the hedged item using a recalculated effective interest rate.

(n) Cash and cash equivalents

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

(o) 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 Group 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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

1. Accounting policies (continued)

(p) 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.

2. Critical accounting estimates and judgements

The reported results of the Company for 2008 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 11 to 16. 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'.

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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

2. Critical accounting estimates and judgements (continued)

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 profit and loss account. The assumptions underlying the 2008 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 equity 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.

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 majority of the Company's non-trading derivatives are valued using appropriate valuation techniques.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

3. Operating expenses

	2008 £'000	2007 £'000
Administrative expenses		
Staff costs		
Wages, salaries and other staff costs	4,477	4,922
Pension costs (see note 4)	1,601	972
	<u>6,078</u>	<u>5,894</u>
 Other administrative expenses	 <u>12,974</u>	 <u>13,011</u>
 Depreciation		
Property plant and equipment (see Note 11)	<u>504</u>	<u>549</u>
 Directors' remuneration		
Amounts paid to the Directors	12	12
 Auditors' remuneration		
Amounts paid to the auditors for statutory audit and other services were as follows:		
Audit services		
– Statutory audit	41	43
– Regulatory audit	8	6
	<u>49</u>	<u>49</u>
Total		

The average number of persons employed by the Company during the year, excluding temporary staff, was 164 (2007 – 164).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

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. During the year the defined benefit schemes remained closed to new entrants.

The total pension costs for the Company were as follows:

	2008 £'000	2007 £'000
Amount charged to income statement		
Expected return on pension scheme assets	(3,600)	(3,431)
Interest on pension scheme liabilities	4,310	3,508
Current service cost	1,107	895
Contributions to Group scheme	238	-
Contributions received from other group entities	(454)	-
Net pension cost defined benefit schemes	1,601	972
	2008 £'000	2007 £'000
The total net pension costs are included in the income statement as follows:		
Staff costs	1,601	972
Total net pension costs (see note 3)	1,601	972

Interim valuations of the Company's schemes were prepared to 31 December 2008 and 31 December 2007 by independent actuaries, using the following assumptions:

	2008 Company Schemes	2007 Company Schemes
Rate of increase in salaries (per annum)	3.85%	4.45%
Rate of increase in pensions in payment (per annum)	2.60%	3.20%
Discount rate (per annum)	6.50%	6.00%
Inflation assumption (per annum)	2.60%	3.20%

The assets and liabilities of the schemes were as follows:

	2008 Company Schemes £'000	2007 Company Schemes £'000
Equities	18,353	22,066
Index linked bonds	3,779	4,183
Government fixed interest bonds	24,487	24,383
Corporate and other bonds	9,328	9,745
Total market value of assets	55,947	60,377
Present value of scheme liabilities	(59,476)	(72,378)
Deficit in the schemes	(3,529)	(12,001)
Effect of surplus capital	-	-
Net deficit in the schemes	(3,529)	(12,001)
Deferred tax asset (note 17)	353	1,200
Net pension deficit	(3,176)	(10,801)

The assumptions for long-term rates of return on the principal classes of assets at 31 December 2008 were equities 8.4%, gilts and index linked bonds 3.9%, other bonds 6.1% (2007 - equities 8.1%, gilts and index linked bonds 4.5%, other bonds 5.5%; 2006 - equities 8.1%, gilts and index linked bonds 4.5%, other bonds 5.3%).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

4. Pension costs (continued)

	2008 £'000	2007 £'000
Amount recognised in the statement of recognised income and expense		
Actual return less expected return on pension scheme assets	(7,604)	(898)
Experience gains and losses arising on scheme liabilities	-	(110)
Changes in assumptions underlying the present value of scheme liabilities	16,033	(3,110)
Adjustment due to surplus capital	-	-
Movement in deferred tax (note 17)	(847)	487
Actuarial gains/(losses) recognised in post-retirement benefit schemes	7,582	(3,631)

For the IOMPF and IOMWO 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 27.9 years for males and 30.7 years for females. The corresponding figures used for disclosures at 31 December 2007 were 27.9 for current active males and 30.7 for current active females.

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

	2008 £'000	2007 £'000
At 1 January	72,378	66,632
Service cost	1,107	895
Interest cost	4,310	3,508
Actuarial (gains)/losses	(16,033)	3,220
Benefits paid in plan or company assets	(2,286)	(2,106)
Service costs through P&L reserves	-	229
At 31 December	59,476	72,378

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

	2008 £'000	2007 £'000
At 1 January	60,377	58,087
Expected return on scheme assets	3,600	3,431
Actuarial losses	(7,604)	(898)
Employer contribution	1,860	1,863
Benefits paid from plan or company assets	(2,286)	(2,106)
At 31 December	55,947	60,377

The latest formal valuation carried out by independent actuaries was as at 31 December 2003. The preliminary results of a subsequent valuation, as at 31 December 2006, have been released but are not yet finalised; as such the contribution rate for 2008 has remained the same for the schemes and is 21.1% of pensionable salaries. Contributions for 2008 include lump sum amounts totalling £0.9 million paid into the funds in addition to the monthly contributions (2007 - £0.9m).

The estimated employer contribution to be made in 2009 is £1,780,000.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

4. Pension costs (continued)

History of experience adjustments is as follows:

	2008 Company Schemes £'000	2007 Company Schemes £'000	2006 Company Schemes £'000	2005 Company Schemes £'000	2004 Company Schemes £'000
Total market value of assets	55,947	60,377	58,087	55,283	47,895
Present value of scheme liabilities	(59,476)	(72,378)	(66,632)	(68,975)	(58,818)
	(3,529)	(12,001)	(8,545)	(13,692)	(10,923)
Difference between expected and actual return on scheme assets:					
Amount	(7,604)	(898)	126	4,569	1,180
Percentage of scheme assets	14%	1%	0%	8%	3%
Experience gains and losses on scheme liabilities:					
Amount	-	(110)	-	-	2,026
Percentage of the present value of scheme liabilities:	0%	0%	0%	0%	4%

Defined Contribution Scheme

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 the 1 July 2006 and showed scheme assets representing 90% of scheme liabilities. The rate of contribution for the year ended 31 December 2008 was 20% (2007: 20%). In accordance with IAS 19 this valuation was updated to 31 December 2008, using actuarial bases and assumptions consistent with the requirements of that standard, showing scheme assets representing 81.0% of scheme liabilities.

The company contributes a percentage of employees' earnings to the above scheme which cost £233,400 for the year (2007: £259,265). 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 2008

5. Operating profit before tax

Operating profit before tax is stated after taking account of the following:	2008	2007
	£'000	£'000
Net profit on financial assets/financial liabilities at fair value through profit or loss		
Net (losses)/gains on financial assets	(183)	751
Net gains/(losses) on financial liabilities	183	(751)
Net profit	-	-
Expenses		
Staff costs	6,532	5,894
Depreciation of property, plant and equipment	504	549
Related party transactions		
Expenses:		
Group Management recharge	11,942	12,181
Income:		
Interest income from group banking companies	52,665	48,275
Interest paid to group banking companies	4,285	2,367
Remuneration paid to key management personnel:		
Short-term employee benefits -		
Salary	2,320	2,187
Bonuses	1,144	803
Profit share	201	169
Other benefits	33	49
Long-term employee benefits -		
Pension contributions	396	325
Accrued pension benefits attributable to key management personnel as at 31 December	9,890	8,250
Deposits from key management personnel	470	308
Loans to key management personnel	1,442	1,736
Interest paid to key management personnel	76	13
Interest received from key management personnel	17	69

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 2008

6. Tax on operating profit

	2008 £'000	2007 £'000
Current taxation:		
Income tax charge for the year	2,316	1,822
Over provision in respect of prior periods	(198)	-
Current tax charge for the year	2,118	1,822
Deferred taxation:		
Credit for the current year	(8)	(30)
Credit for prior year	(342)	-
Tax charge for the year	1,768	1,792

The actual tax charge differs from the expected tax charge computed by applying the standard rate of income tax of 10% (2007: 10%) as follows:

	2008 £'000	2007 £'000
Operating profit before tax	24,879	21,469
Expected tax charge at standard rate of 10%	2,488	2,147
Short term timing differences	-	-
Expenses not allowable for tax purposes	-	-
Adjustments in respect of prior periods	-	-
Deferred taxation	(350)	(30)
Profits Taxed at 0%	(299)	(296)
Other	(71)	(29)
Actual tax charge	1,768	1,792

7. Ordinary dividends

	2008 £'000	2007 £'000
Interim for previous year declared during current year	20,000	-
Final for previous year declared during current year	-	25,000
Total dividends on ordinary equity shares	20,000	25,000
Dividends per ordinary equity shares	2.67	3.33

8. Loans and advances to banks

	2008 £'000	2007 £'000
Designated as at fair value through profit or loss	15,266	21,542
Loans and receivables	1,041,601	978,634
	1,056,867	1,000,176
Amounts above include:		
Amounts due from group banking companies	1,054,812	996,984

Designated as at fair value through profit or loss:

Certain equity-linked products totalling £13,174,718 (2007: £18,426,507) before fair value adjustments had been designated as at fair value through profit or loss.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

9. Loans and advances to customers

	2008 £'000	2007 £'000
Loans and receivables	722,042	683,333

As at 31 December 2008 there are seven (2007: four) credit exposures (including guarantees) which individually exceed 10% of the adjusted capital base. The total value of these credit exposures is £235,464,000 (2007: £187,368,000).

10. Impaired financial assets

	2008 Cost £'000	2008 Provision £'000	2008 Net book value £'000
Loans and receivables	1,218	877	341
Loans and advances to customers			
	2007 Cost £'000	2007 Provision £'000	2007 Net book value £'000
Loans and receivables	1,225	941	284
Loans and advances to customers			

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 2008 and 2007. The fair value of security held against these loans and advances to customers amounted to £145,000.

	2008 £'000	2007 £'000
<i>Impairment losses charged to profit or loss</i>		
Loans and receivables	237	630
Loans and advances (see table below)		
Total	237	630

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

	2008 Total £'000	2007 Total £'000
At 1 January	1,232	1,193
Amounts written off	(441)	(600)
Recoveries of amounts previously written off	63	46
Charge to profit and loss account	237	630
Unwind of discount	(9)	(37)
At 31 December	1,082	1,232

Interest income accrued on impaired assets for the year was £7,000 (2007: £37,000).

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

11. Property, plant and equipment

	Freehold premises £'000	Property adaptation costs £'000	Computers and other equipment £'000	Total £'000
Cost:				
At 1 January 2008	4,783	5,630	404	10,817
At 31 December 2008	4,783	5,630	404	10,817
Accumulated depreciation and amortisation:				
At 1 January 2008	654	3,822	205	4,681
Depreciation charge for the year	65	395	44	504
At 31 December 2008	719	4,217	249	5,185
Net book value at 31 December 2008	4,064	1,413	155	5,632

	Freehold premises £'000	Property adaptation costs £'000	Computers and other equipment £'000	Total £'000
Cost:				
At 1 January 2007	7,293	5,630	404	13,327
Disposals	(2,510)	-	-	(2,510)
At 31 December 2007	4,783	5,630	404	10,817
Accumulated depreciation and amortisation:				
At 1 January 2007	704	3,421	157	4,282
Disposals	(150)	-	-	(150)
Depreciation charge for the year	100	401	48	549
At 31 December 2007	654	3,822	205	4,681
Net book value at 31 December 2007	4,129	1,808	199	6,136

12. Other assets, prepayments and accrued income

	2008 £'000	2007 £'000
Due from group banking companies	7,090	4,545
Other assets	162	364
	7,252	4,909

13. 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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

13. Derivatives at fair value (continued)

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 swaptions. 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	2008 Fair value	
		Assets £'000	Liabilities £'000
Exchange rate contracts:			
Spot & forwards – RBS plc Group entities	115,073	362	1,568
Spot & forwards – Third party	25,771	1,265	34
Interest rate swaps:			
RBS plc Group entities	38,251	-	6,354
Total	179,095	1,627	7,956
Included in the above are fair value hedging derivatives as follows:			
Interest rate swaps	38,251	-	6,354
	Notional £'000	2007 Fair value	
		Assets £'000	Liabilities £'000
Exchange rate contracts:			
Spot & forwards – RBS plc Group entities	85,848	202	742
Spot & forwards – Third party	18,024	559	-
Interest rate swaps:			
RBS plc Group entities	39,291	-	1,216
Total	143,163	761	1,958
Included in the above are fair value hedging derivatives as follows:			
Interest rate swaps	39,291	-	1,216

Included within the interest rate swaps above is a fair value hedge. The fair value of the item being hedged by the swap has been brought onto the balance sheet and sits within loans and receivables. The hedge was effective during 2008. Gains and losses that have been recorded in the income statement relating to this swap and the hedged item are as follows:

	2008 £'000	2007 £'000
Gains/(losses) recognised on the interest rate swap used as a hedge	4,990	(20)
(Losses)/gains recognised on the item being hedged	(5,138)	122

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

14. Deposits by banks

	2008 £'000	2007 £'000
Amortised cost	<u>115,808</u>	<u>64,637</u>
Amounts above include: Deposits taken from group banking companies	<u>106,188</u>	<u>61,213</u>

15. Customer accounts

	2008 £'000	2007 £'000
Designated at fair value through profit or loss	21,124	21,542
Amortised cost	<u>1,499,400</u>	<u>1,459,163</u>
	<u>1,520,524</u>	<u>1,480,705</u>

Designated at fair value through profit or loss:

Certain equity-linked products totalling £19,032,141 (2007: £18,426,507) before fair value adjustments had been designated as at fair value through profit or loss.

16. Other liabilities, accruals and deferred income

	2008 £'000	2007 £'000
Due to group banking companies	12,527	12,361
Other liabilities	<u>1,121</u>	<u>1,817</u>
	<u>13,648</u>	<u>14,178</u>

17. Deferred taxation

The deferred tax asset arises as follows:

	Pension £'000	Accelerated capital allowances £'000	Total £'000
At 1 January 2007	(713)	436	(277)
Charge to income statement	18	(48)	(30)
Charge to equity directly	(505)	-	(505)
At 1 January 2008	(1,200)	388	(812)
Charge to income statement	-	(350)	(350)
Charge to equity directly	847	-	847
At 31 December 2008	(353)	38	(315)
The above is analysed as follows:			
- Deferred tax assets	(353)	(18)	(371)
- Deferred tax liabilities	-	56	56
- Deferred tax (assets)/ liabilities	(353)	38	(315)

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Notes to the Accounts for the year ended 31 December 2008

18. Called up share capital

	Allotted, called up and fully paid		Authorised	
	31 December 2008 £'000	31 December 2007 £'000	31 December 2008 £'000	31 December 2007 £'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

	Allotted, called up and fully paid		Authorised	
	2008	2007	2008	2007
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

19. Reserves

	2008 £'000	2007 £'000
Profit and loss account		
At 1 January	128,581	137,739
Profit attributable to ordinary shareholders	23,111	19,677
Ordinary dividends paid	(20,000)	(25,000)
Pension charge to P&L reserves	159	(204)
Actuarial gains/(losses) recognised in post-retirement benefit schemes (note 4)	7,582	(3,631)
At 31 December	139,433	128,581
Total reserves	139,433	128,581
Called up share capital (note 18)	7,501	7,501
Closing shareholders' equity	146,934	136,082

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

20. Leases

Minimum amounts receivable and payable under non-cancellable leases

	2008			
	Year in which receipt or payment will occur			Total
	Within 1 year	After 1 year but within 5 years	After 5 Years	
	£'000	£'000	£'000	£'000
(i) Finance lease assets:				
Amounts receivable	3,408	13,628	54,517	71,553
Present value adjustment	(179)	(2,319)	(27,323)	(29,821)
Present value amounts receivable	<u>3,229</u>	<u>11,309</u>	<u>27,194</u>	<u>41,732</u>
(ii) Operating lease obligations:				
Amounts payable	160	640	3,997	4,797
Premises				

	2007			
	Year in which receipt or payment will occur			Total
	Within 1 year	After 1 year but within 5 years	After 5 years	
	£'000	£'000	£'000	£'000
(i) Finance lease assets:				
Amounts receivable	3,408	13,628	57,921	74,957
Present value adjustment	(179)	(2,319)	(29,687)	(32,185)
Present value amounts receivable	<u>3,229</u>	<u>11,309</u>	<u>28,234</u>	<u>42,772</u>
(ii) Operating lease obligations:				
Amounts payable	160	640	4,157	4,957
Premises				

	2008 £'000	2007 £'000
Amounts recognised as income and expense		
Operating lease payable – minimum payments	<u>160</u>	-

Residual value exposures

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

21. Financial instruments

Risk management

Through its normal operations, the Company's financial instruments are exposed to a number of risks, the most significant of which are capital, liquidity, credit, operational and market risk. Responsibility for these is vested in the Board and, 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 Board Credit Committee ("OBCC") and the Offshore Risk Management Committee ("ORMC"), all delegated committees of the Board of Directors.

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 notes 18 and 19 respectively.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial instruments (continued)

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 2007 and 2008.

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

The Company's overall strategy remains unchanged from 2007.

Liquidity risk The ultimate parent company, The Royal Bank of Scotland Group plc ("RBS Group plc"), 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, and measures and manages its cash flow on a daily basis in order to meet this requirement. Quarterly reports are made to ALCO and the Board covering sterling and currency liquidity. RBS Group plc 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 and the Company to meet its obligations as they fall due.

The Company complies with the above limits and maintains daily liquidity reporting of positions to RBS Group plc.

The maturity analysis of the Company's financial liabilities is disclosed in the table below, 'Maturity Analysis of Financial Liabilities'.

Credit risk The Company has exposure to RBS Group plc entities by making placements and advances to those counterparties. The Board of Directors review the placement of deposits to RBS Group plc. RBS Group plc draws on support provided by governments and central banks where required in order to meet its commitments including those to the Company

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations. The most important step in managing this risk is the initial decision whether or not to extend credit. The Company'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 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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial Instruments (continued)

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 £18,876,000 as at 31 December 2008 (2007: £15,868,000) – 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) balance sheet 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.

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 derivatives 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 in the following table, 'Balance sheet by currency'.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial Instruments (continued)

Maturity Analysis of Financial Liabilities:

2008									
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
Liabilities									
Deposits by banks	7,964	16,472	62,388	10,235	16,727	-	-	-	113,786
Items in the course of transmission to other banks	2,022	-	-	-	-	-	-	-	2,022
Customer accounts	987,626	258,403	134,873	70,789	56,750	6,452	5,631	-	1,520,524
Derivatives at fair value	7,956	-	-	-	-	-	-	-	7,956
Other liabilities, accruals, deferred income and current taxation liabilities	15,737	-	-	-	-	-	-	-	15,737
Post-retirement benefit liabilities	-	-	-	-	-	-	-	3,529	3,529
	1,021,305	274,875	197,261	81,024	73,477	6,452	5,631	3,529	1,663,554
2007									
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
Liabilities									
Deposits by banks	6,455	11,123	33,888	989	8,759	-	-	-	61,214
Items in the course of transmission to other banks	3,423	-	-	-	-	-	-	-	3,423
Customer accounts	993,013	296,487	129,267	26,668	15,823	12,356	7,091	-	1,480,705
Derivatives at fair value	1,958	-	-	-	-	-	-	-	1,958
Other liabilities, accruals, deferred income and current taxation liabilities	15,965	-	-	-	-	-	-	-	15,965
Post-retirement benefit liabilities	-	-	-	-	-	-	-	12,001	12,001
	1,020,814	307,610	163,155	27,657	24,582	12,356	7,091	12,001	1,575,266

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 Group, which assumes a 95% confidence level and a one-day time horizon.

VaR	Average £'000	Year end £'000	Maximum £'000	Minimum £'000
31 December 2008	12	28	28	2
31 December 2007	3	7	7	1

The historical methodology is employed by the Company to calculate the daily risk numbers. 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 95% confidence level does not reflect the extent of potential losses beyond that percentile.
- 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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial instruments (continued)

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:

2008	Sterling	US Dollars	Euro	Other	Total
Sterling Equivalent	£'000	£'000	£'000	£'000	£'000
Assets					
Cash and balances at central banks	16,713	11	24	5	16,753
Loans and advances to banks	773,466	142,218	86,069	55,114	1,056,867
Loans and advances to customers	719,394	2,647	1	-	722,042
Property, plant and equipment	5,632	-	-	-	5,632
Derivatives at fair value	1,627	-	-	-	1,627
Deferred taxation assets	315	-	-	-	315
Other assets, prepayments and accrued income	7,252	-	-	-	7,252
Total assets	1,524,399	144,876	86,094	55,119	1,810,488
Liabilities and equity					
Deposits by banks	111,735	3,551	522	-	115,808
Customer accounts	1,233,023	147,109	85,103	55,289	1,520,524
Derivatives at fair value	7,956	-	-	-	7,956
Other liabilities, accruals, deferred income and current taxation	15,723	5	6	3	15,737
Post-retirement benefit liabilities	3,529	-	-	-	3,529
Shareholders' equity	146,934	-	-	-	146,934
Total liabilities and equity	1,518,900	150,665	85,631	55,292	1,810,488
2007	Sterling	US Dollars	Euro	Other	Total
Sterling Equivalent	£'000	£'000	£'000	£'000	£'000
Assets					
Cash and balances at central banks	15,168	13	33	7	15,221
Loans and advances to banks	836,709	82,953	56,562	23,952	1,000,176
Loans and advances to customers	683,172	120	-	41	683,333
Property, plant and equipment	6,136	-	-	-	6,136
Derivatives at fair value	761	-	-	-	761
Deferred taxation assets	812	-	-	-	812
Other assets, prepayments and accrued income	4,886	23	-	-	4,909
Total assets	1,547,644	83,109	56,595	24,000	1,711,348
Liabilities and equity					
Deposits by banks	63,678	70	322	567	64,637
Customer accounts	1,313,878	87,108	56,104	23,615	1,480,705
Derivatives at fair value	1,958	-	-	-	1,958
Other liabilities, accruals, deferred income and current taxation	15,931	24	7	3	15,965
Post-retirement benefit liabilities	12,001	-	-	-	12,001
Shareholders' equity	136,082	-	-	-	136,082
Total liabilities and equity	1,543,528	87,202	56,433	24,185	1,711,348

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial instruments (continued)

Industry and regional analysis of financial assets as at 31 December 2008:

Maximum credit risk exposure and significant concentrations of credit risk are illustrated in the table below, 'Industry and regional analysis of financial assets'.

	Loans and advances to banks and customers £'000	Derivatives £'000	Other £'000	Total £'000
UK				
Central and local government	142,392	-	-	142,392
Manufacturing	5,433	-	-	5,433
Construction	2,446	-	-	2,446
Finance	1,065,217	1,627	16,753	1,083,597
Service industry and business activities	41,885	-	-	41,885
Agriculture, forestry and fishing	6,046	-	-	6,046
Property	57,208	-	-	57,208
Individuals	9,986	-	-	9,986
Home mortgages	340,142	-	-	340,142
Other	66,988	-	7,252	74,240
Finance leases and instalment credit	42,248	-	-	42,248
Total domestic	1,779,991	1,627	24,005	1,805,623
Total gross financial instruments	1,779,991	1,627	24,005	1,805,623
Provisions and impairment (note 10)	(1,082)	-	-	(1,082)
Total financial instruments	1,778,909	1,627	24,005	1,804,541

The balances included above have been grossed up by £49,668,761 (2007: £46,887,161) in order to comply with the offsetting rules of IAS32.

Industry and regional analysis of financial assets as at 31 December 2007:

	Loans and advances to banks and customers £'000	Derivatives £'000	Other £'000	Total £'000
UK				
Central and local government	167,394	-	-	167,394
Manufacturing	6,330	-	-	6,330
Construction	3,552	-	-	3,552
Finance	1,003,722	761	15,221	1,019,704
Service industry and business activities	27,247	-	-	27,247
Agriculture, forestry and fishing	5,004	-	-	5,004
Property	64,201	-	-	64,201
Individuals	6,633	-	-	6,633
Home mortgages	330,922	-	-	330,922
Other	26,427	-	4,909	31,336
Finance leases and instalment credit	43,309	-	-	43,309
Total domestic	1,684,741	761	20,130	1,705,632
Total gross financial instruments	1,684,741	761	20,130	1,705,632
Provisions and impairment (note 10)	(1,232)	-	-	(1,232)
Total financial instruments	1,683,509	761	20,130	1,704,400

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

21. Financial instruments (continued)

Fair value analysis:

Carrying values are considered to be the same as fair values for all financial instruments as at 31 December 2008.

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.

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

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 Company map to a Company level asset quality scale.

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

Asset quality grade	Annual probability of default		
	Minimum %	Midpoint %	Maximum %
AQ1	0.00	0.10	0.20
AQ2	0.21	0.40	0.60
AQ3	0.61	1.05	1.50
AQ4	1.51	3.25	5.00
AQ5	5.01	52.50	100.00

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

2008	AQ1	AQ2	AQ3	AQ4	AQ5	Accruing past due	Non-accrual	Impairment provision	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cash and balance at central banks	16,753	-	-	-	-	-	-	-	16,753
Loans and advances to banks	1,056,797	44	26	-	-	-	-	-	1,056,867
Loans and advances to customers	78,734	52,484	581,647	6,674	1,032	2,553	-	(1,082)	722,042
Derivatives	1,627	-	-	-	-	-	-	-	1,627
Other financial instruments	7,252	-	-	-	-	-	-	-	7,252
	1,161,163	52,528	581,673	6,674	1,032	2,553	-	(1,082)	1,804,541
Commitments	-	-	168,915	-	-	-	-	-	168,915
Contingent liabilities	2,483	-	827	-	-	-	-	-	3,310
Total off-balance sheet	2,483	-	169,742	-	-	-	-	-	172,225

2007	AQ1	AQ2	AQ3	AQ4	AQ5	Accruing past due	Non-accrual	Impairment provision	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cash and balance at central banks	15,221	-	-	-	-	-	-	-	15,221
Loans and advances to banks	997,242	1,704	1,213	17	-	-	-	-	1,000,176
Loans and advances to customers	146,002	104,539	423,884	7,857	1,152	826	305	(1,232)	683,333
Derivatives	761	-	-	-	-	-	-	-	761
Other financial instruments	4,909	-	-	-	-	-	-	-	4,909
	1,164,135	106,243	425,097	7,874	1,152	826	305	(1,232)	1,704,400
Commitments	-	-	158,888	-	-	-	-	-	158,888
Contingent liabilities	5,539	-	616	-	-	-	-	-	6,155
Total off-balance sheet	5,539	-	159,504	-	-	-	-	-	165,043

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

23. Maturity analysis of assets

The following asset tables report the amounts expected to be recovered or settled no more than twelve months after the balance sheet date and more than twelve months after the balance sheet date.

2008									
Remaining maturity	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
Assets									
Cash and balances at central banks	16,753	-	-	-	-	-	-	-	16,753
Loans and advances to banks	322,669	165,124	222,882	125,658	127,494	39,940	20,000	33,100	1,056,867
Loans and advances to customers	226,674	15,952	95,194	10,450	58,496	7,714	11,326	296,236	722,042
Property, plant and equipment	-	-	-	-	-	-	-	5,632	5,632
Derivatives at fair value	1,627	-	-	-	-	-	-	-	1,627
Deferred taxation assets	-	-	-	-	-	-	-	315	315
Other assets, prepayments and accrued income	1,395	-	-	-	-	3,061	2,796	-	7,252
Total assets	569,118	181,076	318,076	136,108	185,990	50,715	34,122	335,283	1,810,488

2007									
Remaining maturity	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
Assets									
Cash and balances at central banks	15,221	-	-	-	-	-	-	-	15,221
Loans and advances to banks	1,000,176	-	-	-	-	-	-	-	1,000,176
Loans and advances to customers	227,488	15,900	75,986	1,167	52,531	10,159	14,509	285,593	683,333
Property, plant and equipment	-	-	-	-	-	-	-	6,136	6,136
Derivatives at fair value	761	-	-	-	-	-	-	-	761
Deferred taxation assets	-	-	-	-	-	-	-	812	812
Other assets, prepayments and accrued income	4,802	-	-	107	-	-	-	-	4,909
Total assets	1,248,448	15,900	75,986	1,274	52,531	10,159	14,509	292,541	1,711,348

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

24. Commitments and contingents

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.

	2008 £'000	2007 £'000
Contingent liabilities:		
Various	<u>3,310</u>	<u>6,155</u>
Commitments:		
Undrawn formal standby facilities, credit lines and other commitments to lend	<u>168,915</u>	<u>158,888</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.

(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.

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.

(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 2008

25. Net cash inflow from operating activities

	2008 £'000	2007 £'000
Operating profit	24,879	21,469
Increase in prepayments and accrued income	(2,343)	(2,821)
(Decrease)/increase in accruals and deferred income	(530)	568
Provisions on impairment losses	237	630
Profit on sale of tangible fixed assets	-	(640)
Foreign exchange	4	(382)
Pensions charge for defined benefit schemes	1,601	972
Depreciation of tangible fixed assets	504	549
Net cash inflow from trading activities	24,352	20,345
 (Increase)/decrease in loans and advances to banks	 (56,691)	 35,380
Increase in loans and advances to customers	(38,708)	(53,703)
Increase in other assets	(867)	(682)
Changes in operating assets	(96,266)	(19,005)
 Increase in deposits by banks	 51,171	 183
Increase in customer accounts	39,819	27,366
Increase in other liabilities	5,998	549
Changes in operating liabilities	96,988	28,098
 Total income taxes paid	 (1,682)	 (1,800)
Income taxes paid in respect of operating activities	(1,682)	(1,800)
Net cash inflow from operating activities	23,392	27,638

26. Analysis of cash and cash equivalents

	2008 £'000	2007 £'000
At 1 January	15,221	11,446
Net cash inflow	1,532	3,775
At 31 December	16,753	15,221
 Comprising:		
Cash and balances at central banks	16,753	15,221
	16,753	15,221

ISLE OF MAN BANK LIMITED

Notes to the Accounts for the year ended 31 December 2008

27. 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 has announced that its shareholdings in banks will be managed by UK Financial Investments Limited a company wholly-owned by the UK Government.

28. Contingent liabilities

The Company is required to participate in any Isle of Man Depositors' Compensation Scheme (the 'Scheme') as set out in the Compensation of Depositors Regulations 2008 (as amended). The Company therefore has a contingent liability to any calls on the Scheme.

On 8 October 2008, the Board of Kaupthing Singer & Friedlander (Isle of Man) Limited ('KSF IOM'), declared that the bank was unable to pay its debts, and an application was made to the Isle of Man High Court which has appointed a provisional liquidator of KSF IOM.

As at 31 December 2008, the Scheme Manager had not declared a default of KSF IOM for the purposes of the Scheme. In the event that a default of KSF IOM is declared, Isle of Man Bank Limited, under the terms of the scheme, will be obliged to pay Scheme contributions up to a maximum of £350,000 per annum.

At the date of signing these accounts, this matter is uncertain in respect of its outcome and the amount of any contingent liability. No provision has been made in these accounts in respect of this matter.

29. Post balance sheet note

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.