



Investor Report

Citizens Financial Group, Inc.

June 30, 2014

**To the holders of the
4.15% Subordinated Notes due 2022**

**Issued under, and pursuant to the terms of,
an indenture dated as of September 28, 2012
between Citizens Financial Group, Inc. and The
Bank of New York Mellon, as Trustee**

Citizens Financial Group, Inc. is a subsidiary of The Royal Bank of Scotland Group plc. This report is being provided to the holders of the 4.15% Subordinated Notes due 2022 (the "Subordinated Notes") issued by Citizens Financial Group, Inc. under the terms of the Subordinated Note Indenture dated as of September 28, 2012 between Citizens Financial Group, Inc., as issuer, and The Bank of New York Mellon, as Trustee, as amended, supplemented or modified from time to time. This report is not intended for any other purpose.

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Special Note Regarding Forward-Looking Statements

We have made statements in this document that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential” or “continue,” the negative of these terms and other comparable terminology. These forward-looking statements may relate to our financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to expected earnings levels, the adequacy of the allowance for credit losses, delinquency trends, market risk and the impact of interest rate changes, capital market conditions, capital composition and adequacy and liquidity, the effect of legal proceedings and new accounting standards on our financial condition and results of operations. Forward-looking statements are not guarantees of future performance, are based on management’s current expectations and, by their nature, involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which are beyond our control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:

- Our ability to successfully execute our strategic plan, including by increasing revenue, reducing costs and executing our capital initiatives;
- Our ability to remedy regulatory deficiencies and meet supervisory requirements and expectations;
- The rate of growth in the economy and employment levels, as well as general business and economic conditions;
- Changes in interest rates and market liquidity, as well as the magnitude of such changes, which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets;
- Changes in federal bank regulatory and supervisory policies, including required levels of capital;
- The impact of the Dodd-Frank Act on our businesses, business practices and costs of operations;
- The relative strength or weakness of the consumer and commercial credit sectors and of the real estate markets in the markets in which our borrowers are located;
- Competition in the financial services industry; and
- Legislative, tax, accounting or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in such forward-looking statements include the following:

- Negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of nonperforming assets, charge-offs and provision for credit losses;
- Adverse movements and volatility in debt and equity capital markets;
- Changes in market rates and prices, which may adversely impact the value of financial assets and liabilities;
- Liabilities resulting from litigation and regulatory investigations;
- Our ability to grow our core businesses;
- Decisions to downsize, sell or close units or otherwise change our business mix; and
- Management’s ability to identify and manage these and other risks.

More information about factors that could cause actual results to differ materially from those described in the forward-looking statements can be found under “Risk Factors” in our filings with the United States Securities and Exchange Commission.

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report to conform to our prior statements as to actual results or revised expectations.

SELECTED CONSOLIDATED FINANCIAL DATA

We derived the selected consolidated operating data for six months ended June 30, 2014 and 2013 and the selected balance sheet data as of June 30, 2014 and December 31, 2013 from our unaudited interim Consolidated Financial Statements. Our historical results are not necessarily indicative of the results expected for any future period.

In our opinion, the unaudited interim Consolidated Financial Statements have been prepared on the same basis as the audited Consolidated Financial Statements and include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the information set forth herein. Our operating results for the six months ended June 30, 2014 are not necessarily indicative of those to be expected for the year ending December 31, 2014 or for any future period. You should read the following selected consolidated financial data in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and our unaudited interim Consolidated Financial Statements and notes thereto.

	For the Six Months Ended June 30,	
	2014	2013
	(dollars in millions)	
Operating Data:		
Net interest income.....	\$ 1,641	\$ 1,509
Noninterest income.....	998	870
Total revenue.....	2,639	2,379
Provision for credit losses.....	170	202
Noninterest expense.....	1,758	6,073
Noninterest expense, excluding goodwill impairment ⁽¹⁾	1,758	1,638
Income (loss) before income tax expense (benefit)	711	(3,896)
Income tax expense (benefit).....	232	(174)
Net income (loss).....	479	(3,722)
Net income (loss), excluding goodwill impairment ⁽¹⁾	479	358
Net income (loss) per average common share—basic and diluted.....	141,688.40	(1,100,419.53)
Net income (loss) per average common share—basic and diluted, excluding goodwill impairment ⁽¹⁾	141,688.40	105,834.69
Other Operating Data:		
Return on average common equity ⁽²⁾⁽¹¹⁾	4.96%	(13.87)%
Return on average common equity, excluding goodwill impairment ⁽¹⁾⁽¹¹⁾	4.96%	2.98%
Return on average tangible common equity ⁽¹⁾⁽¹¹⁾	7.45%	(24.96)%
Return on average tangible common equity, excluding goodwill impairment ⁽¹⁾⁽¹¹⁾	7.45%	5.37%
Return on average total assets ⁽³⁾⁽¹¹⁾	0.77%	(2.73)%
Return on average total assets, excluding goodwill impairment ⁽¹⁾⁽¹¹⁾	0.77%	0.59%
Return on average total tangible assets ⁽¹⁾⁽¹¹⁾	0.81%	(2.99)%
Return on average total tangible assets, excluding goodwill impairment ⁽¹⁾⁽¹¹⁾	0.81%	0.64%
Efficiency ratio ⁽¹⁾	66.58%	255.24%
Efficiency ratio, excluding goodwill impairment ⁽¹⁾	66.58%	68.80%
Net interest margin ⁽⁴⁾⁽¹¹⁾	2.88%	2.83%

	June 30, 2014	December 31, 2013
	(dollars in millions)	
Balance Sheet Data:		
Total assets.....	\$ 130,279	\$ 122,154
Loans and leases ⁽⁵⁾	88,829	85,859
Allowance for loan and lease losses.....	1,210	1,221
Total securities.....	24,823	21,245
Goodwill.....	6,876	6,876
Total liabilities.....	110,682	102,958
Deposits ⁽⁶⁾	91,656	86,903
Federal funds purchased and securities sold under agreements to repurchase.....	6,807	4,791
Other short-term borrowed funds.....	7,702	2,251
Long-term borrowed funds.....	1,732	1,405
Total stockholders' equity.....	19,597	19,196

Other Balance Sheet Data:

Asset Quality Ratios:		
Allowance for loan and lease losses as a percentage of total loans and leases.....	1.36%	1.42%

	June 30, 2014	December 31, 2013
(dollars in millions)		
Allowance for loan and lease losses as a percentage of nonperforming loans and leases.....	101%	86%
Nonperforming loans and leases as a percentage of total loans and leases	1.35%	1.65%
Capital ratios:		
Tier 1 capital ratio ⁽⁷⁾	13.3%	13.5%
Total capital ratio ⁽⁸⁾	16.2%	16.1%
Tier 1 common equity ratio ⁽⁹⁾	13.3%	13.5%
Leverage ratio ⁽¹⁰⁾	11.1%	11.6%

⁽¹⁾ These measures are non-GAAP financial measures. For more information on the computation of these non-GAAP financial measures, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures."

⁽²⁾ We define "Return on average common equity" as net income (loss) divided by average common equity.

⁽³⁾ We define "Return on average total assets" as net income (loss) divided by average total assets.

⁽⁴⁾ We define "Net interest margin" as net interest income divided by average total interest-earning assets.

⁽⁵⁾ Excludes loans held for sale of \$262 million, \$1.3 billion, \$646 million, \$564 million, \$716 million, and \$456 million as of June 30, 2014 and December 31, 2013, 2012, 2011, 2010, and 2009, respectively.

⁽⁶⁾ Excludes deposits held for sale of \$5.3 billion as of December 31, 2013.

⁽⁷⁾ We define "Tier 1 capital ratio" as Tier 1 capital balance divided by total risk-weighted assets as defined under Basel I.

⁽⁸⁾ We define "Total capital ratio" as total capital balance divided by total risk-weighted assets as defined under Basel I.

⁽⁹⁾ We define "Tier 1 common equity ratio" as Tier 1 capital balance, minus preferred stock, divided by total risk-weighted assets as defined under Basel I.

⁽¹⁰⁾ We define "Leverage ratio" as Tier 1 capital balance divided by quarterly average total assets as defined under Basel I.

⁽¹¹⁾ Operating ratios for the periods ended June 30, 2014 and 2013 are presented on an annualized basis.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including, without limitation, those set forth in "Special Note Regarding Forward-Looking Statements" and the matters set forth in this report generally. The following discussion is based on, and should be read in conjunction with, our unaudited interim and audited Consolidated Financial Statements and related notes, as well as "Selected Consolidated Financial Data" and the other financial information included elsewhere in this report.

Overview

We are the 13th largest retail bank holding company in the United States according to SNL Financial with \$130.3 billion of total assets as of June 30, 2014. Headquartered in Providence, Rhode Island, we deliver a broad range of retail and commercial banking products and services to more than five million individuals, institutions and companies. Our approximately 18,050 employees strive to meet the financial needs of customers and prospects through approximately 1,230 branches and approximately 3,215 ATMs operated in an 11-state footprint across the New England, Mid-Atlantic and Midwest regions and through our online, telephone and mobile banking platforms. We have 90 retail and commercial non-branch offices located both in our geographic footprint and in nine states and the District of Columbia outside our branch footprint. Our 11-state branch banking footprint contains approximately 29.9 million households and 3.1 million businesses according to SNL Financial. We conduct our banking operations through our two wholly owned banking subsidiaries, CBNA and CBPA.

We operate our business through two operating segments: Consumer Banking and Commercial Banking. Consumer Banking accounted for \$46.9 billion and \$45.4 billion, or approximately 53% and 53% of our year-to-date average loan and lease balances (including loans held for sale) for the six months ended June 30, 2014 and 2013, respectively, and \$45.1 billion and \$46.5 billion, or approximately 53% and 53%, as of December 31, 2013 and 2012, respectively. Consumer Banking serves retail customers and small businesses with annual revenues of up to \$25 million through a network that as of June 30, 2014 included approximately 1,230 branches operated in an 11-state footprint across the New England, Mid-Atlantic and Midwest regions, as well as through our online, telephone and mobile banking platforms. Our Consumer Banking products and services include deposit products, mortgage and home equity lending, student loans, auto financing, credit cards, business loans and wealth management and investment services.

Commercial Banking accounted for \$37.0 billion and \$34.2 billion, or approximately 42% and 40% of our year-to-date average loan and lease balances (including loans held for sale) for the six months ended June 30, 2014 and 2013, respectively, and \$34.6 billion and \$32.5 billion, or approximately 40% and 37%, as of December 31, 2013 and 2012, respectively. Commercial Banking offers a broad complement of financial products and solutions, including lending and leasing, trade financing, deposit and treasury management, foreign exchange and interest rate risk management, corporate finance and debt and equity capital markets capabilities.

As of June 30, 2014 and December 31, 2013, we had \$3.5 billion and \$3.8 billion, respectively, of non-core asset balances, which are included in Other along with our treasury function, securities portfolio, wholesale funding activities, goodwill, community development assets and other unallocated assets, liabilities, revenues, provision for credit losses and expenses not attributed to Consumer Banking or Commercial Banking. Non-core assets are primarily loans inconsistent with our strategic goals, generally as a result of geographic location, industry, product type or risk level. We have actively managed these loans down since they were designated as non-core on June 30, 2009, and the portfolio decreased a further 10% as of June 30, 2014 compared to December 31, 2013. The largest component of our non-core portfolio is our home equity products serviced by others portfolio (a portion of which we now service internally).

Recent Events

On June 20, 2014, we closed the sale of certain assets and liabilities associated with our Chicago-area retail branches, small business relationships and select middle market relationships to U.S. Bancorp. The agreement to sell these assets and liabilities to U.S. Bancorp had previously been announced in January 2014. This sale, which we refer to as the "Chicago Divestiture," included 103 branches, including 94 full-service branches, with \$4.8 billion of deposits and \$1.0 billion in loans as of June 30, 2014. We recorded a gain on sale of \$288 million and also incurred related expenses of \$17 million. Management estimates that the Chicago Divestiture has the effect of reducing quarterly net interest income by approximately \$12 million to \$15 million, noninterest income by approximately \$13 million to \$17 million and noninterest expense by approximately \$20 million to \$25 million. We intend to invest the majority of the sale proceeds over time into higher returning activities.

On May 29, 2014, we entered into an agreement with a third party to purchase predominantly prime auto loans, including an initial purchase of \$150 million in principal balances of loans. On the same date, we entered into an agreement with the same party to purchase auto loans for future rolling 90-day periods that automatically renew until termination by either party. For the first year ended May 29, 2015, we are required to purchase a minimum of \$250 million in principal balances of loans up to a maximum of \$600 million in principal balances of loans per rolling 90-day period. After May 29, 2015, the minimum per each rolling 90-day period increases to \$400 million in principal balances of loans, with a maximum of \$600 million in principal balances of loans. We may cancel the agreement at any time at will; however, if we elect to cancel at any time during the first three years of the agreement, we will be charged a variable termination fee.

Key Factors Affecting Our Business

Macro-economic conditions

Our business is affected by national, regional and local economic conditions, as well as the perception of those conditions and future economic prospects. The significant macro-economic factors that impact our business are: the U.S. and global economic landscapes, unemployment rates, the housing markets and interest rates.

The U.S. economy expanded 1.0% in the six months ended June 30, 2014, as gains in consumer spending and business investment in the second quarter of 2014 helped the economy rebound from a slump in the first quarter of 2014 caused by harsh winter weather. This expansion followed considerable improvement in the economic landscape in 2013, with nominal GDP growth averaging 3.1% for the year. The Eurozone economy expanded 0.7% in the three months ended March 31, 2014, after having emerged from recession in the second half of 2013. In addition to the improving picture in the Eurozone and periphery countries, reaccelerating growth in China provided further support. The U.S. unemployment rate dropped from 6.7% at year-end 2013 to 6.1% at June 30, 2014. The overall improvement was partially driven by a decrease in the labor force participation rate, which declined to its lowest level in over 35 years. After a pause in late 2013 and the first quarter of 2014, the housing market continued to strengthen in the second quarter of 2014, as demonstrated by continued price increases, and an increase in existing home sales. The Federal Reserve Board maintained very accommodative monetary policy conditions through a zero to 25 basis point federal funds target at the short end of the curve, and quantitative easing programs designed to reduce longer tenor rates. Interest rates remain relatively low, and financial conditions are supportive of continued growth. See “—Interest rates” below for further discussion of the impact of interest rates on our results.

Credit trends

Credit trends improved during the six months ended June 30, 2014 compared to the same period in 2013, largely driven by improving macro-economic factors as discussed above. Net charge-offs for the six months ended June 30, 2014 of \$155 million decreased \$100 million, or 39%, from \$255 million for the six months ended June 30, 2013. The annualized net charge-offs as a percentage of total average loans improved to 0.36% for the six months ended June 30, 2014, compared to 0.60% for the six months ended June 30, 2013.

Interest rates

Net interest income is our largest source of revenue and is the difference between the interest earned on interest-earning assets (usually loans and investment securities) and the interest expense incurred in connection with interest-bearing liabilities (usually deposits and borrowings). The level of net interest income is primarily a function of the average balance of interest-earning assets, the average balance of interest-bearing liabilities and the spread between the contractual yield on such assets and the contractual cost of such liabilities. These factors are influenced by both the pricing and mix of interest-earning assets and interest-bearing liabilities which, in turn, are impacted by external factors such as local economic conditions, competition for loans and deposits, the monetary policy of the Federal Reserve Board and market interest rates. For further discussion, refer to “—Risk Governance and Quantitative and Qualitative Disclosures About Risk—Market Risk—Non-Trading Risk.”

The cost of our deposits and short-term wholesale borrowings is largely based on short-term interest rates, which are primarily driven by the Federal Reserve Board's actions. However, the yields generated by our loans and securities are typically driven by short-term and long-term interest rates, which are set by the market or, at times, by the Federal Reserve Board's actions. The level of net interest income is therefore influenced by movements in such interest rates and the pace at which such movements occur. In 2013 and through the six months ended June 30, 2014, short-term and long-term interest rates remained at very low levels by historical standards, with many benchmark rates, such as the federal funds rate and one- and three-month LIBOR, near zero. Further declines in the yield curve or a decline in longer-term yields relative to short-term yields (a flatter yield curve) would have an adverse impact on our net interest margin and net interest income. The low interest rate environment has compressed our net interest margin in recent periods.

In 2013 and through the six months ended June 30, 2014, the Federal Reserve Board maintained a highly accommodative monetary policy, and indicated that this policy would remain in effect for a considerable time after its asset purchase program ends and the economic recovery strengthens. As of June 2014, the Federal Reserve was purchasing \$35 billion per month, composed of \$20 billion in Treasury securities and \$15 billion in agency mortgage-backed securities. The Federal Reserve Board announced an end to purchases in October 2014.

Regulatory trends

We are subject to extensive regulation and supervision, which continue to evolve as the legal and regulatory framework governing our operations continues to change. The current operating environment also has heightened regulatory expectations around many regulations including consumer compliance, the Bank Secrecy Act, and anti-money laundering compliance and increased internal audit activities. As a result of these heightened expectations, we expect to incur additional costs for additional compliance personnel or professional fees associated with advisors and consultants.

Dodd-Frank regulation

We are subject to a variety of laws and regulations, including the Dodd-Frank Act. The Dodd-Frank Act is complex, and many aspects of it are subject to final rulemaking that will take effect over several years. The Dodd-Frank Act will continue to impact our earnings through fee reductions, higher costs and imposition of new restrictions on us. The Dodd-Frank Act may also continue to have a material adverse impact on the value of certain assets and liabilities held on our balance sheet. The ultimate impact of the Dodd-Frank Act on our business will depend on regulatory interpretation and rulemaking as well as the success of any of our actions to mitigate the negative impacts of certain provisions. Key parts of the Dodd-Frank Act that will specifically impact our business are the repeal of a previous prohibition against payment of interest on demand deposits, which became effective in July 2011, and the introduction of a stress-testing and capital planning framework developed by the Federal Reserve Board, known as CCAR. As part of our obligations under the Dodd-Frank Act, we, and certain other bank holding companies, will be required to publish results of the Dodd-Frank stress test ("DFAST") during the third quarter of 2014. The DFAST process is used to project net income, loan losses and capital ratios over a nine-quarter horizon under hypothetical, stressful macroeconomic and financial market scenarios developed by the Federal Reserve Board as well as under certain mandated assumptions about capital distributions prescribed in the DFAST rule. Given the purpose of the DFAST process and the assumptions used in order to assess our likely performance during hypothetical economic conditions, the results may include information inconsistent with management expectations in light of the current economic and operating environment.

Repeal of the prohibition on depository institutions paying interest on demand deposits

We began offering interest-bearing corporate checking accounts after the 2011 repeal of the prohibition on depository institutions paying interest on demand deposits. Currently, industrywide interest rates for this product are very low and thus far the impact of the repeal has not had a significant effect on our results. However, market rates could increase more significantly in the future. If we need to pay higher interest rates on checking accounts to maintain current clients or attract new clients, our interest expense would increase, perhaps materially. Furthermore, if we fail to offer interest rates at a sufficient level to retain demand deposits, our core deposits may be reduced, which would require us to obtain funding in other ways or limit potential future asset growth.

Comprehensive Capital Analysis and Review

CCAR is an annual exercise by the Federal Reserve Board to ensure that the largest bank holding companies have sufficient capital to continue operations throughout times of economic and financial stress and robust, forward-looking capital planning processes that account for their unique risks.

As part of CCAR, the Federal Reserve Board evaluates institutions' capital adequacy, internal capital adequacy assessment processes and their plans to make capital distributions, such as dividend payments or stock repurchases. In March 2014, the Federal Reserve Board objected on qualitative grounds to our capital plan submitted as part of the CCAR process. In addition to modifications we may be required to make in connection with our proposed capital distributions through the CCAR process, we may incur additional expenses in connection with the CCAR process that would affect our profitability and results of operations. Refer to "Management's Discussion & Analysis of Financial Condition & Results of Operations Overview – Capital" for further information.

Basel III final rules applicable to us and our banking subsidiaries

In July 2013, the Federal Reserve Board, OCC, and FDIC issued the U.S. Basel III final rules. The final rule implements the Basel III capital framework and certain provisions of the Dodd-Frank Act, including the Collins Amendment. Refer to "Management's Discussion & Analysis of Financial Condition & Results of Operations Overview – Capital" for further information. Certain aspects of the final rules, such as the new minimum capital ratios, will become effective on January 1, 2015. In order to comply with the new capital requirements, we established capital ratio targets that meet or exceed U.S. regulatory expectations under fully phased-in Basel III rules, and as a result our capital requirements were increased.

HELOC Payment Shock

Recent attention has been given by regulators, rating agencies, and the general press regarding the potential for increased exposure to credit losses associated with HELOCs that were originated during the period of rapid home price appreciation between 2003 and 2007. Industrywide, many of the HELOCs originated during this timeframe were structured with an extended interest-only payment period followed by a requirement to convert to a higher payment amount that would begin fully amortizing both principal and interest beginning at a certain date in the future. As of June 30, 2014, approximately 33% of our \$16.2 billion HELOC portfolio, or \$5.3 billion in drawn balances, and \$4.5 billion in undrawn balances, were subject to a payment reset or balloon payment between July 1, 2014 and December 31, 2017, including \$350 million in balloon balances where full payment is due at the end of a ten-year interest only draw period.

To help manage this exposure, in September 2013, we launched a comprehensive program designed to provide heightened customer outreach to inform, educate and assist customers through the reset process as well as to offer alternative financing and forbearance options. Preliminary results indicate that our efforts to assist customers at risk of default have successfully reduced delinquency and charge-off rates compared to our original expectations.

As of June 30, 2014, for the \$668 million of our HELOC portfolio that was originally structured with a reset period in 2013, 93.7% of the balances were refinanced, paid off or were current on payments, 3.4% were past due and 2.9% had been charged off. As of June 30, 2014, for the \$898 million of our HELOC portfolio that was originally structured with a reset period in 2014, 96.4% of the balances were refinanced, paid off or were current on payments, 3.1% were past due and 0.5% had been charged off. HELOC portfolio balances of \$352 million are scheduled to reset in the remainder of 2014. Factors that affect our future expectations for charge-off risk for the portion of our HELOC portfolio subject to reset periods in the future include improved loan-to-value ratios resulting from continued home price appreciation, stable portfolio credit score profiles and more robust loss mitigation efforts.

Factors Affecting Comparability of Our Results

Goodwill

During the 19-year period from 1988 to 2007, we completed a series of more than 25 acquisitions of other financial institutions and financial assets and liabilities. We accounted for these types of business combinations using the acquisition method of accounting. Under this accounting method, the acquired company's net assets are recorded at fair value at the date of acquisition, and the difference between the purchase price and the fair value of the net assets acquired is recorded as goodwill.

Under relevant accounting guidance, we are required to review goodwill for impairment annually, or more frequently if events or circumstances indicate that the fair value of any of our business units might be less than its carrying value. The valuation of goodwill is dependent on forward-looking expectations related to the performance of the U.S. economy and our associated financial performance.

The prolonged delay in the full recovery of the U.S. economy, and the impact of that delay on our earnings expectations, prompted us to record a \$4.4 billion pretax (\$4.1 billion after tax) goodwill impairment as of June 30, 2013 related to our Consumer Banking reporting unit. For segment reporting purposes, the impairment charge is reflected in Other.

Although the U.S. economy has demonstrated signs of recovery, notably improvements in unemployment and housing, the pace and extent of recovery in these indicators, as well as in overall gross domestic product, have lagged behind previous expectations. The impact of the slow recovery is most evident in Consumer Banking. The forecasted lower economic growth for the United States, coupled with increasing costs of complying with the new regulatory framework in the financial industry, resulted in a deceleration of expected growth for Consumer Banking's future income, which resulted in our recording of a goodwill impairment charge during the second quarter of 2013. We have recorded

goodwill impairment charges in the past and any further impairment to our goodwill could materially affect our results in any given period. As of both June 30, 2014 and December 31, 2013, we had a carrying value of goodwill of \$6.9 billion. For additional information regarding our goodwill impairment testing, see Note 5 “Goodwill” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 “Significant Accounting Policies” and Note 8 “Goodwill” to our audited Consolidated Financial Statements.

Investment in the business

We regularly incur expenses associated with investments in our infrastructure, and, from 2009 to year end 2013, we have invested more than \$1.0 billion in infrastructure and technology, with an additional \$250 million planned for each of 2014 and 2015. These investments, which are designed to lower our costs and improve our customer experience, include significant programs to enhance our resiliency, upgrade customer-facing technology and streamline operations. Recent significant investments included the 2013 launch of our new teller system, new commercial loan platform and new auto loan platform and the 2013 upgrade of the majority of our ATM network, including equipping more than 1,450 ATMs with advanced deposit-taking functionality. These investments also involved spending to prepare for the planned rollout of our new mortgage platform. We expect that these investments will increase our long-term overall efficiency and add to our capacity to increase revenue.

Operating expenses to operate as a fully independent public company

As part of our transition to a stand-alone company, we expect to incur one-time expenditures of approximately \$55 million, including capitalized costs of \$18 million, as well as ongoing incremental expenses of approximately \$34 million per year. We expect these ongoing costs will include higher local charges associated with exiting worldwide vendor relationships and incremental expenses to support information technology, compliance, corporate governance, regulatory, financial and risk infrastructure that are necessary to enable us to operate as a fully stand-alone public company.

Principal Components of Operations and Key Performance Metrics Used By Management

As a banking institution, we manage and evaluate various aspects of both our results of operations and our financial condition. We evaluate the levels and trends of the line items included in our balance sheet and statement of operations, as well as various financial ratios that are commonly used in our industry. We analyze these ratios and financial trends against our own historical performance, our budgeted performance and the financial condition and performance of comparable banking institutions in our region and nationally.

The primary line items we use in our key performance metrics to manage and evaluate our statement of operations include net interest income, noninterest income, total revenue, provision for credit losses, noninterest expense and net income (loss). The primary line items we use in our key performance metrics to manage and evaluate our balance sheet data include loans and leases, securities, allowance for credit losses, deposits, borrowed funds and derivatives.

Net interest income

Net interest income is the difference between the interest earned on interest-earning assets (usually loans and investment securities) and the interest expense incurred in connection with interest-bearing liabilities (usually deposits and borrowings). The level of net interest income is primarily a function of the average balance of interest-earning assets, the average balance of interest-bearing liabilities and the spread between the contractual yield on such assets and the cost of such liabilities. Net interest income is impacted by the relative mix of interest-earning assets and interest-bearing liabilities, movements in market interest rates, levels of nonperforming assets and pricing pressure from competitors. The mix of interest-earning assets is influenced by loan demand and by management’s continual assessment of the rate of return and relative risk associated with various classes of interest earning assets.

The mix of interest-bearing liabilities is influenced by management’s assessment of the need for lower cost funding sources weighed against relationships with customers and growth requirements and is impacted by competition for deposits in our market and the availability and pricing of other sources of funds.

Noninterest income

The primary components of our noninterest income are service charges and fees, card fees, trust and investment services fees and securities gains, net.

Total revenue

Total revenue is the sum of our net interest income and our noninterest income.

Provision for credit losses

The provision for credit losses is the amount of expense that, based on our judgment, is required to maintain the allowance for credit losses at an adequate level to absorb probable losses inherent in the loan portfolio at the balance sheet date and that, in management's judgment, is appropriate under relevant accounting guidance. The provision for credit losses includes the provision for loan and lease losses as well as the provision for unfunded commitments. The determination of the amount of the allowance is complex and involves a high degree of judgment and subjectivity. For additional information regarding the provision for credit losses, see "—Critical Accounting Estimates—Allowance for Credit Losses," Note 4 "Allowance for Credit Losses, Nonperforming Assets, and Concentrations of Credit Risk" to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 "Significant Accounting Policies" and Note 5 "Allowance for Credit Losses, Nonperforming Assets, and Concentrations of Credit Risk" to our audited Consolidated Financial Statements.

Noninterest expense

Noninterest expense primarily includes salaries and employee benefits, outside services, occupancy, equipment expense, goodwill impairment, and other operating expenses.

Net income (loss)

We evaluate our net income based on measures including return on average total tangible assets, return on average tangible common equity and efficiency ratio.

Loans and leases

We classify our loans and leases pursuant to the following classes: commercial, commercial real estate, leases, residential (including residential mortgages and home equity loans and lines of credit), home equity products serviced by others (including certain purchased home equity loans and lines of credit), other secured retail (including automobile loans and other installment loans) and unsecured retail (including student loans and credit card).

Loans are reported at the amount of their outstanding principal, net of charge-offs, unearned income, deferred loan origination fees and costs and unamortized premiums or discounts (on purchased loans). Deferred loan origination fees and costs and purchase discounts and premiums are amortized as an adjustment of yield over the life of the loan, using the level yield interest method. Unamortized amounts remaining upon prepayment or sale are recorded as interest income or gain (loss) on sale, respectively. Credit card receivables include billed and uncollected interest and fees.

Leases are classified at the inception of the lease by type. Lease receivables, including leveraged leases, are reported at the aggregate of lease payments receivable and estimated residual values, net of unearned and deferred income, including unamortized investment credits. Lease residual values are reviewed at least annually for other-than-temporary impairment, with valuation adjustments recognized currently against noninterest income. Leveraged leases are reported net of non-recourse debt. Unearned income is recognized to yield a level rate of return on the net investment in the leases.

Mortgage loans held for sale are carried at fair value. Other loans held for sale primarily include loans relating to our Chicago branch network and are carried at the lower of cost or fair value.

Securities

Our securities portfolio is managed to seek return while maintaining prudent levels of quality, market risk and liquidity. Investments in debt and equity securities are carried in four portfolios: available for sale, held to maturity, trading account assets and other investment securities. We determine the appropriate classification at the time of purchase. Securities in our available for sale portfolio will be held for indefinite periods of time and may be sold in response to changes in interest rates, changes in prepayment risk or other factors relevant to our asset and liability strategy. Securities in our available for sale portfolio are carried at fair value, with unrealized gains and losses reported in other comprehensive income ("OCI"), as a separate component of stockholders' equity, net of taxes. Securities are classified as held to maturity because we have the ability and intent to hold the securities to maturity, and are carried at amortized cost. Debt and equity securities that are bought and held principally for the purpose of being sold in the near term are classified as trading account assets and are carried at fair value. Realized and unrealized gains and losses on such assets are reported in noninterest income. Other investment securities are comprised mainly of FHLB stock and Federal Reserve Bank stock, which are carried at cost.

Allowance for credit losses

Our estimate of probable losses in the loan and lease portfolios is recorded in the allowance for loan and lease losses and the reserve for unfunded lending commitments. Together these are referred to as the allowance for credit losses. We evaluate the adequacy of the allowance for credit losses using the following ratios: allowance for loan and lease losses as a percentage of total loans and leases; allowance for loan and lease losses as a percentage of nonperforming loans and leases; and nonperforming loans and leases as a percentage of total loans and leases. For additional information, see “—Critical Accounting Estimates—Allowance for Credit Losses” and Note 1 “Significant Accounting Policies” and Note 5 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk” to our audited Consolidated Financial Statements.

Deposits

Our deposits include on demand, checking with interest, regular savings, money market accounts and term deposits. As of June 30, 2014 and December 31, 2013, total deposits were \$91.7 billion and \$86.9 billion, respectively.

Borrowed funds

Our total short-term borrowed funds include federal funds purchased and securities sold under agreement to repurchase and other short-term borrowed funds. As of June 30, 2014 and December 31, 2013, total short-term borrowed funds were \$14.5 billion and \$7.0 billion, respectively. Our total short-term borrowed funds are offset by \$4.3 billion and \$1.4 billion in excess reserves held at Federal Reserve Banks as of June 30, 2014 and December 31, 2013, respectively.

As of June 30, 2014, our long-term borrowed funds include \$350 million of fixed rate subordinated debt held by external parties and \$1.3 billion of subordinated debt held by the RBS Group. On August 1, 2014, we issued an additional \$333 million of subordinated debt to the RBS Group. Subject to regulatory approval, we plan to continue our strategy of capital optimization by exchanging an additional \$334 million of common equity for preferred stock with the RBS Group in the fourth quarter of 2014, as well as by exchanging an additional \$500 million for subordinated debt in 2015 and \$250 million of common equity for a lesser form of capital in 2016.

Derivatives

Historically, we have used pay-fixed interest rate swaps to synthetically lengthen liabilities, offsetting duration in fixed-rate assets. With our material prepayment of fixed-rate mortgages and home equity loans since 2008, these swaps were no longer needed and have been terminated or allowed to run off, resulting in a reduction in the notional balance of these swaps to \$1.0 billion as of June 30, 2014 from \$1.5 billion as of December 31, 2013.

We also use receive-fixed swaps to minimize the exposure to variability in the interest cash flows on our floating rate assets. As of June 30, 2014, a notional amount of \$4.0 billion receive-fixed swaps had been executed. The assets and liabilities recorded for derivatives designated as hedges reflect the fair value of these hedge instruments.

We also sell interest rate swaps and foreign exchange forwards to commercial customers. Offsetting swap and forward agreements are simultaneously transacted to minimize our market risk associated with the customer derivative products. The assets and liabilities recorded for derivatives not designated as hedges reflect the fair value of these transactions.

Key Performance Metrics and Non-GAAP Financial Measures

We consider various measures when evaluating our performance and making day-to-day operating decisions, as well as evaluating capital utilization and adequacy, including:

- Return on average common equity, which we define as net income (loss) divided by average common equity;
- Return on average tangible common equity, which we define as net income (loss) divided by average common equity excluding average goodwill, net of the deferred tax liability, and average other intangibles;
- Return on average total assets, which we define as net income (loss) divided by average total assets;
- Return on average total tangible assets, which we define as net income (loss) divided by average total assets excluding average goodwill, net of the deferred tax liability, and average other intangibles;
- Efficiency ratio, which we define as the ratio of our total noninterest expense to the sum of net interest income and total noninterest income. We measure our efficiency ratio to evaluate the efficiency of our operations as it helps us monitor how costs are changing compared to our income. A decrease in our efficiency ratio represents improvement; and

- Net interest margin, which we calculate by dividing annualized net interest income for the period by average total interest-earning assets, is a key measure that we use to evaluate our net interest income.

Certain of the above financial measures, including return on average tangible common equity, return on average total tangible assets and the efficiency ratio are not recognized under GAAP. We also present noninterest expense, net income (loss), return on average total tangible assets, return on average tangible common equity, return on average common equity, return on average total assets, and efficiency ratio, net of the \$4.4 billion pretax (\$4.1 billion after tax) goodwill impairment we incurred for the six months ended June 30, 2013. In addition, in the net income (loss) table, we present net income (loss) and return on average tangible common equity, net of goodwill impairment, restructuring charges and special items for the six months ended June 30, 2014, and 2013. We believe these measures provide useful information to investors because these are among the measures used by our management team to evaluate our operating performance and make day-to-day operating decisions. In addition, we believe goodwill impairment in any period does not reflect the operational performance of the business in that period and, accordingly, it is useful to consider these line items with and without goodwill impairment. This presentation also increases comparability of period-to-period results.

We also consider pro forma capital ratios defined by banking regulators but not effective at each period end to be non-GAAP financial measures. Since analysts and banking regulators may assess our capital adequacy using these pro forma ratios, we believe they are useful to provide investors the ability to assess its capital adequacy on the same basis. Other companies may use similarly titled non-GAAP financial measures that are calculated differently from the way we calculate such measures. Accordingly, our non-GAAP financial measures may not be comparable to similar measures used by other companies.

Results of Operations—Six Months Ended June 30, 2014 Compared with Six Months Ended June 30, 2013

Highlights

For the six months ended June 30, 2014:

- net income increased \$4.2 billion to \$479 million compared to a \$3.7 billion loss for the six months ended June 30, 2013;
- net income for the six months ended June 30, 2014 was \$479 million, and included a \$180 million after tax gain related to the Chicago Divestiture and \$72 million after tax in restructuring charges and special noninterest expense items largely related to our separation from the RBS Group and ongoing efforts to improve processes and enhance efficiencies across the organization. 2013 included a goodwill impairment charge of \$4.1 billion after tax. Excluding the Chicago gain, restructuring charges and special noninterest expense items and the goodwill impairment charge, net income increased \$13 million or 4% to \$371 million compared to \$358 million for the same period in 2013;
- net interest income of \$1.6 billion increased \$132 million, or 9%, compared to \$1.5 billion for the six months ended June 30, 2013, largely reflecting the benefit of lower hedging costs, growth in loans and the investment securities portfolio and a reduction in deposit costs as we continued to reduce our reliance on higher cost certificates of deposit and money market funds. These results were partially offset by the impact of declining loan yields given the relatively persistent low-rate environment;
- net interest margin was 2.88% compared to 2.83% for the six months ended June 30, 2013, driven by the benefit of lower hedging costs and lower deposit costs, partially offset by decreased yields on commercial and retail loans and increased long-term borrowing costs largely associated with increased subordinated debt;
- noninterest income for the six months ended June 30, 2014 included a \$288 million pretax gain related to the Chicago Divestiture and increased \$128 million, or 15%, to \$998 million, compared to \$870 million for the six months ended June 30, 2013. Excluding the gain, noninterest income decreased by \$160 million, or 18%, as decreases in mortgage banking fees, securities gains, net, and service charges and fees were partially offset by growth in trust and investment services fees and capital markets fees. No securities gains are expected for the remainder of 2014;
- noninterest expense of \$1.8 billion decreased \$4.3 billion, or 71%, compared to \$6.1 billion for the six months ended June 30, 2013 driven by a \$4.4 billion goodwill impairment charge incurred in the six months ended June 30, 2013, offset by \$115 million of restructuring charges and special items incurred in the six months ended June 30, 2014 which are largely related to our separation from the RBS Group, ongoing efforts to improve processes and enhance efficiencies across the organization, including certain regulatory and compliance programs, and special expense items related to the Chicago Divestiture;
- provision for credit losses totaled \$170 million for the six months ended June 30, 2014, down \$32 million, or 16%, from \$202 million compared to the same period in 2013. Results for the six months ended June 30, 2014

included a net provision build of \$15 million compared with a \$53 million release in the six months ended June 30, 2013;

- our return on average tangible common equity improved to 7.45% from (24.96%) for the six months ended June 30, 2013. Excluding the impact of the goodwill impairment, restructuring charges and special items mentioned above, our return on average tangible common equity improved to 5.77% from 5.37% for the six months ended June 30, 2013;
- average loans and leases of \$87.2 billion increased \$1.5 billion, or 2%, from \$85.7 billion as of June 30, 2013, as commercial loan growth, the purchase of residential mortgages and auto loans more than offset the decrease in home equity loans and lines of credit;
- average interest-bearing deposits of \$61.6 billion decreased \$7.0 billion, or 10%, from \$68.6 billion as of June 30, 2013, driven by the effect of the sale of \$4.0 billion of interest-bearing deposits in the Chicago Divestiture, as well as attrition of higher cost money market and term deposits;
- capital ratios continued to be well above regulatory requirements: our total capital ratio increased slightly to 16.2% from 16.1% as of December 31, 2013, and our Tier 1 capital ratio decreased slightly to 13.3% from 13.5% as of December 31, 2013 as a result of our plan to rebalance our capital structure;
- net charge-offs of \$155 million declined \$100 million, or 39%, from \$255 million for the six months ended June 30, 2013 and the allowance for credit losses totaled \$1.3 billion as of June 30, 2014, up \$15 million, or 1%, from December 31, 2013; and
- net income (loss) per average common share, basic and diluted, was \$141,688.40 for the six months ended June 30, 2014 compared with (\$1,100,419.53) for the six months ended June 30, 2013. Net income per average common share, basic and diluted, excluding goodwill impairment, was \$141,688.40 for six months ended June 30, 2014 compared with \$105,834.69 for the six months ended June 30, 2013.

Net Income (Loss)

We reported net income of \$479 million for the six months ended June 30, 2014, after recording a \$180 million after tax gain related to the Chicago Divestiture and \$72 million after tax of restructuring charges and special items related to our separation from the RBS Group and efforts to improve processes and enhance efficiencies across the organization. These results increased \$4.2 billion from the six months ended June 30, 2013, which included a \$4.1 billion after tax goodwill impairment charge. Excluding the gain, restructuring charges and special items, and impairment charges noted above, net income increased \$13 million, or 4%, from the six months ended June 30, 2013, as the benefit of higher net interest income and lower provision for credit losses was partially offset by the effect of lower noninterest income and increased noninterest expenses.

	Six Months Ended June 30,		Change	Percent
	2014	2013		
	(dollars in millions)			(%)
Operating Data:				
Net interest income	\$1,641	\$1,509	\$132	9%
Noninterest income	998	870	128	15
Total revenue	2,639	2,379	260	11
Provision for credit losses	170	202	(32)	(16)
Noninterest expense	1,758	6,073	(4,315)	(71)
Income (loss) before income tax expense (benefit)	711	(3,896)	4,607	118
Income tax expense (benefit)	232	(174)	406	233
Net income (loss)	\$479	\$(3,722)	\$4,201	113%
Net income, excluding goodwill impairment, restructuring charges and special items ⁽¹⁾	\$371	\$358	\$13	4%
Return on average tangible common equity ⁽¹⁾⁽²⁾	7.45%	(24.96)%	NM	
Return on average tangible common equity, excluding goodwill impairment, restructuring charges and special items ⁽¹⁾⁽²⁾	5.77%	5.37%	40 bps	

⁽¹⁾ This is a non-GAAP financial measure. For more information on the computation of this non-GAAP financial measure, see “—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures.”

⁽²⁾ Ratios for the periods ended June 30, 2014 and 2013 are presented on an annualized basis.

Net Interest Income

The following table shows the major components of net interest income and net interest margin:

	Six Months Ended June 30,						Change	
	2014			2013				
	Average Balances	Income/ Expense	Yields/ Rates	Average Balances	Income/ Expense	Yields/ Rates	Average Balances	Yields/ Rates
	(dollars in millions)							
Assets								
Interest-bearing cash and due from banks and deposits in banks	\$ 1,991	\$ 2	0.23%	\$ 2,725	\$ 7	0.54%	\$ (734)	(31) bps
Taxable investment securities.....	23,980	303	2.53	18,004	228	2.53	5,976	-
Non-taxable investment securities	11	—	2.60	12	—	2.71	(1)	(11)
Total investment securities	23,991	303	2.53	18,016	228	2.53	5,975	-
Commercial	29,402	447	3.03	28,517	442	3.08	885	(5)
Commercial real estate.....	6,991	89	2.53	6,487	89	2.73	504	(20)
Leases	3,720	52	2.79	3,361	53	3.18	359	(39)
Total commercial.....	40,113	588	2.92	38,365	584	3.03	1,748	(11)
Home equity lines of credit	16,216	229	2.85	17,332	243	2.83	(1,116)	2
Residential mortgages.....	10,125	204	4.03	9,091	183	4.03	1,034	—
Home equity loans	5,543	156	5.69	6,674	191	5.77	(1,131)	(8)
Automobile	10,087	126	2.51	8,801	120	2.75	1,286	(24)
Student and other retail	3,482	96	5.52	3,747	102	5.50	(265)	2
Credit cards	1,639	82	10.13	1,651	87	10.57	(12)	(44)
Total retail	47,092	893	3.82	47,296	926	3.95	(204)	(13)
Total loans and leases	87,205	1,481	3.40	85,661	1,510	3.53	1,544	(13)
Loans held for sale	133	2	3.35	478	7	2.95	(345)	40
Other loans held for sale.....	1,062	22	4.06	—	—	—	1,062	406
Interest-earning assets.....	114,382	1,810	3.17	106,880	1,752	3.28	7,502	(11)
Allowance for loan and lease losses	(1,262)			(1,223)			(39)	
Goodwill	6,876			11,287			(4,411)	
Other noninterest-earning assets.....	5,539			5,931			392	
Total noninterest-earning assets	11,153			15,995			(4,842)	
Total assets.....	<u>\$ 125,535</u>			<u>\$ 122,875</u>			<u>\$ 2,660</u>	
Liabilities and Stockholders' Equity								
Checking with interest	\$ 13,562	\$ 4	0.06%	\$ 14,234	\$ 4	0.06%	\$ (672)	— bps
Money market & savings	38,667	33	0.17	43,121	61	0.28	(4,454)	(11)
Term deposits.....	9,376	30	0.64	11,249	52	0.93	(1,873)	(29)
Total interest-bearing deposits	61,605	67	0.22	68,604	117	0.34	(6,999)	(12)
Interest-bearing deposits held for sale	3,953	4	0.22	—	—	—	3,953	22
Federal funds purchased and securities sold under agreements to repurchase ⁽¹⁾	5,708	16	0.55	1,925	115	11.88	3,783	(1,133)
Other short-term borrowed funds.....	4,838	49	2.03	279	1	0.62	4,559	141
Long-term borrowed funds.....	1,412	33	4.60	624	10	3.03	788	157
Total borrowed funds.....	11,958	98	1.63	2,828	126	8.83	9,130	(720)
Total interest-bearing liabilities	77,516	169	0.43	71,432	243	0.68	6,084	(25)
Demand deposits	25,393			24,907			486	
Demand deposits held for sale	932			—			932	
Other liabilities.....	2,205			2,324			(119)	
Stockholders' equity	19,489			24,212			(4,723)	
Total liabilities and stockholders' equity	<u>\$ 125,535</u>			<u>\$ 122,875</u>			<u>\$ 2,660</u>	
Interest rate spread			2.74			2.60		
Net interest income.....		<u>\$ 1,641</u>			<u>\$ 1,509</u>		<u>\$ 132</u>	
Net interest margin			2.88%			2.83%		5 bps

⁽¹⁾ Balances are net of certain short-term receivables associated with reverse repurchase agreements. Interest expense includes the full cost of the repurchase agreements and certain hedging costs. The rate on federal funds purchased is elevated due to the impact from pay-fixed interest rate swaps that are scheduled to run off by the end of 2016. See "—Analysis of Financial Condition—June 30, 2014 Compared with December 31, 2013—Derivatives" for further information.

For the six months ended June 30, 2014, net interest income of \$1.6 billion increased \$132 million, or 9%, from \$1.5 billion for the six months ended June 30, 2013 and reflected a five basis point increase in net interest margin to 2.88%. The increase in net interest income was driven by growth in average interest-earning assets, the benefit of a reduction in interest rate hedging costs, as well as lower funding costs on deposits partially offset by declining loan yields and increased long-term borrowing costs related to our issuance of subordinated debt. Average interest-earning assets increased \$7.5 billion for the six months ended June 30, 2014 compared to the same period in 2013, driven by a \$6.0 billion increase in the investment securities portfolio, a \$1.7 billion increase in total commercial loans, a \$1.0 billion increase in residential mortgages, and a \$1.3 billion increase in auto loans, partially offset by a \$2.2 billion decrease in home equity balances and a \$265 million decrease in student and other retail loans.

The five basis point increase in net interest margin was driven by a 13 basis point benefit from interest rate hedging activity tied to maturing pay-fixed swaps originated prior to the financial crisis as well as lower deposit costs as we reduced our reliance on higher cost certificates of deposit. We do not expect this trend to continue in future periods. This benefit was partially offset by continued pressure on interest-earning asset yields given the effect of the relatively persistent low-rate environment and largely reflected the effect of continued prepayment of higher yielding consumer real estate secured loans and industrywide competition for loans.

Average interest-earning asset yields of 3.17% for the six months ended June 30, 2014 declined 11 basis points compared to 3.28% for the six months ended June 30, 2013, driven by a 13 basis point decline in the loan and lease portfolio yield, largely reflecting prepayments of higher yielding fixed-rate assets, which were replaced by new purchases and originations with lower yields given the relatively persistent low-rate environment. Investment portfolio income of \$303 million for the six months ended June 30, 2014 increased \$75 million, or 33%, compared to the six months ended June 30, 2013, and the yield on the portfolio of 2.53% for the six months ended June 30, 2014 was flat compared to the six months ended June 30, 2013.

Total interest-bearing deposit costs for the six months ended June 30, 2014, decreased \$50 million, or 43%, to \$67 million, from \$117 million for the six months ended June 30, 2013 and reflected a 12 basis point decrease in the rate paid on deposits to 0.22% from 0.34%. Rates on term deposits were 0.64% and 0.93% for the six months ended June 30, 2014 and 2013, respectively, while rates on money market and savings declined from 0.28% for the six months ended June 30, 2013 to 0.17% for the six months ended June 30, 2014. As a result of the historically low interest rate environment, many deposit products have hit pricing floors at or near zero, limiting further rate reduction and thus compressing margins. The total cost of borrowed funds declined \$28 million, or 22%, as higher rate pay-fixed rate swaps matured; the decrease was partially offset by the increased cost of long-term borrowed funds from our issuance of subordinated debt.

Total borrowed funds rates declined to 1.63% for the six months ended June 30, 2014 from 8.83% for the six months ended June 30, 2013. Within the federal funds purchased and securities sold under agreement category and other short-term borrowed funds category, pay-fixed swap expense declined to \$56 million for the six months ended June 30, 2014 compared to \$112 million for the same period in 2013. Over the same period, \$1.7 billion in notional swap balances matured with a remaining balance of \$1.0 billion as of June 30, 2014. Excluding the impact of hedging costs, the total borrowed funds rates were 0.69% and 1.08% for the six months ended June 30, 2014 and 2013, respectively.

Noninterest Income

The following table details the significant components of our noninterest income for the periods indicated:

	Six Months Ended June 30,		Change	Percent
	2014	2013		
	(dollars in millions)			(%)
Service charges and fees.....	\$ 286	\$ 325	\$ (39)	(12)%
Card fees.....	117	114	3	3
Trust and investment services fees	81	72	9	13
Foreign exchange and trade finance fees.....	44	48	(4)	(8)
Mortgage banking fees.....	34	112	(78)	(70)
Capital markets fees	44	23	21	91
Bank-owned life insurance income	23	25	(2)	(8)
Securities gains, net.....	25	94	(69)	(73)
Other income ⁽¹⁾	344	57	287	504
Noninterest income	<u>\$ 998</u>	<u>\$ 870</u>	<u>\$ 128</u>	15%

⁽¹⁾ Includes net impairment losses on securities available for sale recognized in earnings and other income.

Noninterest income of \$998 million increased \$128 million, or 15%, for the six months ended June 30, 2014, compared to \$870 million for the six months ended June 30, 2013. The 2014 results reflected a \$288 million gain on the Chicago Divestiture partially offset by a \$69 million decrease in securities gains and a \$78 million reduction in mortgage banking fees, largely reflecting lower origination volumes, lower levels of mortgage servicing rights valuation recovery and our decision to retain a larger percentage of originations on balance sheet. Results also reflected a \$39 million decrease in service charges and fees driven by a reduction in consumer service charges due to lower personal overdraft fees.

Provision for Credit Losses

For the six months ended June 30, 2014, the provision for credit losses was \$170 million, down from \$202 million for the six months ended June 30, 2013, driven by lower net charge-offs. The provision for loan and lease losses is the result of a detailed analysis performed to estimate an appropriate and adequate allowance for loan and lease losses ("ALLL"). Current credit trends continued to improve with net charge-offs for the six months ended June 30, 2014 of \$155 million compared with \$255 million for the six months ended June 30, 2013. The total provision for credit losses includes the provision for loan and lease losses as well as the provision for unfunded commitments. Refer to "—Analysis of Financial Condition—Allowance for Credit Losses and Nonperforming Assets" for more information.

Noninterest Expense

The following table displays the significant components of our noninterest expense for the periods indicated:

	Six Months Ended June 30,		Change	Percent
	2014	2013		
	(dollars in millions)			(%)
Salaries and employee benefits	\$ 872	\$ 858	\$ 14	2%
Outside services	208	171	37	22
Occupancy	168	164	4	2
Equipment expense	129	138	(9)	(7)
Amortization of software	64	45	19	42
Goodwill impairment	—	4,435	(4,435)	(100)
Other operating expense	317	262	55	21
Noninterest expense	<u>\$ 1,758</u>	<u>\$ 6,073</u>	<u>\$ (4,315)</u>	(71)%

Noninterest expense was \$1.8 billion for the six months ended June 30, 2014 and included \$115 million of restructuring charges and special items largely related to our separation from the RBS Group as well as ongoing efforts to improve processes and enhance efficiencies across the organization. We expect to incur approximately \$40 million to \$80 million during the remainder of 2014 in additional restructuring and special items. During the six months ended June 30, 2013, a \$4.4 billion pretax goodwill impairment charge was recorded. For further discussion, see Note 5 "Goodwill" to our unaudited interim Consolidated Financial Statements included elsewhere in this report. Excluding the restructuring charges and special items in 2014 and the goodwill impairment incurred in 2013, noninterest expense was flat year over year. See Note 23 "Exit Costs and Restructuring Reserves" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

Provision (Benefit) for Income Taxes

The provision (benefit) for income taxes totaled \$232 million for the six months ended June 30, 2014, compared to an income tax benefit of \$174 million for the six months ended June 30, 2013. The provision represents a 33% and 4% effective tax rate for the six months ending June 30, 2014 and 2013, respectively. The increase in the effective rate largely reflected the tax rate impact of the goodwill impairment charge taken in the second quarter of 2013. Goodwill not deductible for tax purposes accounted for 78.4% of the total goodwill impairment charge and generated a reduction of 31% in our effective tax rate for the six months ended June 30, 2013.

At June 30, 2014, we reported a net deferred tax liability of \$403 million, compared to a \$199 million liability at December 31, 2013. The increase in the net deferred tax liability was largely attributable to the utilization of net operating loss and tax credit carryforwards (which decreased the deferred tax asset), as well as a decrease in the unrealized loss reported on securities available for sale, derivative instruments and hedging activities. For further discussion, see Note 10 "Income Taxes" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

Business Segments

The following table presents certain financial data of our business segments as of and for the six months ended June 30, 2014:

	As of and for the Six Months Ended June 30, 2014			
	Consumer Banking	Commercial Banking	Other ⁽⁵⁾	Consolidated
	(dollars in millions)			
Net interest income	\$ 1,083	\$ 520	\$ 38	\$ 1,641
Noninterest income	455	214	329	998
Total revenue	1,538	734	367	2,639
Noninterest expense	1,293	310	155	1,758
Profit before provision for credit losses	245	424	212	881
Provision for credit losses	129	(7)	48	170
Income before income tax expense	116	431	164	711
Income tax expense	40	149	43	232
Net income	\$ 76	\$ 282	\$ 121	\$ 479
Loans and leases and loans held for sale (period-end) ⁽¹⁾	\$ 47,167	\$ 37,541	\$ 4,383	\$ 89,091
Average Balances:				
Total assets	\$ 48,085	\$ 37,491	\$ 39,959	\$ 125,535
Loans and leases and loans held for sale ⁽¹⁾	46,876	36,997	4,527	88,400
Deposits and deposits held for sale	70,473	17,901	3,509	91,883
Interest-earning assets	46,906	37,124	30,352	114,382
Key Metrics:				
Net interest margin ⁽²⁾	4.66%	2.83%	NM	2.88%
Efficiency ratio ⁽³⁾	84.00%	42.25%	NM	66.58%
Average loans to average deposits ratio	66.52%	206.67%	NM	96.21%
Return on average total tangible assets ⁽²⁾⁽³⁾	0.32%	1.52%	NM	0.81%
Return on average tangible common equity ⁽²⁾⁽³⁾⁽⁴⁾	3.35%	13.97%	NM	7.45%

⁽¹⁾ Loans held for sale refer to mortgage loans held for sale recorded in the Consumer Banking segment, as well as the loans relating to the Chicago Divestiture, which are recorded in both the Consumer Banking and Commercial Banking segments.

⁽²⁾ Ratios for the period ended June 30, 2014 are presented on an annualized basis.

⁽³⁾ These are non-GAAP financial measures. For more information on the computation of these non-GAAP financial measures, see “—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures.”

⁽⁴⁾ Operating segments are allocated capital on a risk-adjusted basis considering economic and regulatory capital requirements. We approximate that regulatory capital is equivalent to a sustainable target level for common equity Tier 1 and then allocate that approximation to the segments based on economic capital.

⁽⁵⁾ Includes the financial impact of non-core, liquidating loan portfolios and other non-core assets, our treasury activities, wholesale funding activities, securities portfolio, community development assets and other unallocated assets, liabilities, revenues, provision for credit losses and expenses not attributed to our Consumer Banking or Commercial Banking segments. For a description of non-core assets, see “—Analysis of Financial Condition—June 30, 2014 Compared with December 31, 2013—Loans and Leases—Non-Core Assets.”

We operate our business through two operating segments: Consumer Banking and Commercial Banking. Segment results are derived from our business line profitability reporting systems by specifically attributing managed balance sheet assets, deposits, and other liabilities and their related income or expense. Residual assets and liabilities not attributed to Consumer Banking and Commercial Banking are attributed to Other.

Other includes our treasury function, securities portfolio, wholesale funding activities, goodwill and goodwill impairment, community development assets and other unallocated assets, liabilities, revenues, provision for credit losses and expenses not attributed to Consumer Banking or Commercial Banking. Other also includes our non-core assets. Non-core assets are primarily loans inconsistent with our strategic goals, generally as a result of geographic location, industry, product type or risk level. The non-core portfolio totaled \$3.5 billion as of June 30, 2014, down 10% from December 31, 2013. The largest component of our non-core portfolio is our home equity products currently or formerly serviced by others.

Our capital levels are evaluated and managed centrally; however, capital is allocated to the operating segments to support evaluation of business performance. Operating segments are allocated capital on a risk-adjusted basis considering economic and regulatory capital requirements. We approximate that regulatory capital is equivalent to a sustainable target level for common equity Tier 1 and then allocate that approximation to the segments based on

economic capital. Interest income and expense is determined based on the assets and liabilities managed by the business segment. Because funding and asset liability management is a central function, funds transfer-pricing methodologies are utilized to allocate a cost of funds used, or credit for the funds provided, to all business segment assets, liabilities and capital, respectively, using a matched funding concept. The residual effect on net interest income of asset/liability management, including the residual net interest income related to the funds transfer pricing process, is included in Other.

Provision for credit losses is allocated to each business segment based on actual net charge-offs that have been recognized by the business segment. The difference between the consolidated provision for credit losses and the business segments' net charge-offs is reflected in Other.

Noninterest income and expense directly managed by each business segment, including fees, service charges, salaries and benefits, and other direct revenues and costs are accounted for within each segment's financial results in a manner similar to the Consolidated Financial Statements. Occupancy costs are allocated based on utilization of facilities by the business segment. Generally, operating losses are charged to the business segment when the loss event is realized in a manner similar to a loan charge-off. Noninterest expenses incurred by centrally managed operations or business segments that directly support another business segment's operations are charged to the applicable business segment based on its utilization of those services.

Income taxes are assessed to each business segment at a standard tax rate with the residual tax expense or benefit to arrive at the consolidated effective tax rate included in Other.

Developing and applying methodologies used to allocate items among the business segments is a dynamic process. Accordingly, financial results may be revised periodically as management systems are enhanced, methods of evaluating performance or product lines change, or our organizational structure changes.

Consumer Banking

	As of and for the Six Months Ended June 30,			
	2014	2013	Change	Percent
	(dollars in millions)			(%)
Net interest income	\$ 1,083	\$ 1,090	\$ (7)	(1)%
Noninterest income	455	544	(89)	(16)
Total revenue	1,538	1,634	(96)	(6)
Noninterest expense	1,293	1,262	31	2
Profit before provision for credit losses	245	372	(127)	(34)
Provision for credit losses	129	156	(27)	(17)
Income before income tax expense	116	216	(100)	(46)
Income tax expense	40	76	(36)	(47)
Net income	<u>\$ 76</u>	<u>\$ 140</u>	<u>\$ (64)</u>	(46)
Loans and leases and loans held for sale (period-end) ⁽¹⁾	\$ 47,167	\$ 44,803	\$ 2,364	5
Average Balances:				
Total assets	\$ 48,085	\$ 46,737	\$ 1,348	3
Loans and leases and loans held for sale ⁽¹⁾	46,876	45,440	1,436	3
Deposits and deposits held for sale	70,473	72,499	(2,026)	(3)
Interest-earning assets	46,906	45,467	1,439	3
Key Metrics:				
Net interest margin ⁽²⁾	4.66%	4.83%	(17) bps	—
Efficiency ratio ⁽³⁾	84.00%	77.27%	673 bps	—
Average loans to average deposits ratio	66.52%	62.68%	384 bps	—
Return on average total tangible assets ⁽²⁾⁽³⁾	0.32%	0.60%	(28) bps	—
Return on average tangible common equity ⁽²⁾⁽³⁾⁽⁴⁾	3.35%	6.46%	(311) bps	—

⁽¹⁾ Loans held for sale include mortgage loans held for sale and loans relating to the Chicago Divestiture.

⁽²⁾ Ratios for the periods ended June 30, 2014 and 2013 are presented on an annualized basis.

⁽³⁾ These are non-GAAP financial measures. For more information on the computation of these non-GAAP financial measures, see "—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures."

(4) Operating segments are allocated capital on a risk-adjusted basis considering economic and regulatory capital requirements. We approximate that regulatory capital is equivalent to a sustainable target level for common equity Tier 1 and then allocate that approximation to the segments based on economic capital.

Consumer Banking segment net income of \$76 million for the six months ended June 30, 2014 decreased \$64 million, or 46%, from \$140 million for the six months ended June 30, 2013, as the benefit of lower provision for credit losses was more than offset by lower fee income and higher noninterest expense.

Net interest income of \$1.1 billion for the six months ended June 30, 2014 remained relatively stable with the six months ended June 30, 2013, as the benefit of lower deposit costs and loan growth was largely offset by the effect of continued downward pressure on loan yields and deposit spreads given the relatively persistent low-rate environment. Loan growth reflected higher residential mortgage and auto loan outstandings, partially offset by lower home equity outstandings.

Noninterest income of \$455 million decreased \$89 million, or 16%, from \$544 million for the six months ended June 30, 2013, driven by a decrease in mortgage banking fees. Mortgage banking fees for the six months ended June 30, 2014 decreased \$78 million due to reduction in overall origination volume and our decision to strategically hold more loans on balance sheet. Mortgage banking fees were also negatively impacted by lower mortgage servicing rights valuation recovery compared to the same period in 2013 as long term rates began to increase in the middle of 2013. Service charges and fees were down \$33 million for the six months ended June 30, 2014 compared to the same period in 2013, largely driven by the continued impact of prior regulatory changes, including changes in check posting order. This was partially offset by growth in trust and investment services fees of \$10 million, as well as a \$9 million gain on sale of portions of our Federal Family Education Loan Program portfolio.

Noninterest expense of \$1.3 billion for the six months ended June 30, 2014 increased \$31 million, or 2%, from the six months ended June 30, 2013 driven by increased regulatory and litigation costs, which more than offset the benefit of across the board expense reduction despite continued investment in key growth businesses.

Provision for credit losses of \$129 million for the six months ended June 30, 2014 decreased \$27 million, or 17%, from \$156 million for the six months ended June 30, 2013, driven by improved credit quality within the loan portfolios.

Commercial Banking

	As of and for the Six Months Ended June 30,			
	2014	2013	Change	Percent
	(dollars in millions)			(%)
Net interest income	\$ 520	\$ 508	\$ 12	2%
Noninterest income	214	191	23	12
Total revenue	734	699	35	5
Noninterest expense	310	315	(5)	(2)
Profit before provision for credit losses	424	384	40	10
Provision for credit losses	(7)	(24)	17	71
Income before income tax expense	431	408	23	6
Income tax expense	149	144	5	3
Net income	<u>\$ 282</u>	<u>\$ 264</u>	<u>\$ 18</u>	7
Loans and leases and loans held for sale (period-end) ⁽¹⁾	\$ 37,541	\$ 34,312	\$ 3,229	9
Average Balances:				
Total assets	\$ 37,491	\$ 34,897	\$ 2,594	7
Loans and leases and loans held for sale ⁽¹⁾	36,997	34,189	2,808	8
Deposits and deposits held for sale	17,901	17,332	569	3
Interest-earning assets	37,124	34,302	2,822	8
Key Metrics:				
Net interest margin ⁽²⁾	2.83%	2.99%	(16) bps	—
Efficiency ratio ⁽³⁾	42.25%	45.12%	(287) bps	—
Average loans to average deposits ratio	206.67%	197.26%	941 bps	—
Return on average total tangible assets ⁽²⁾⁽³⁾	1.52%	1.53%	(1) bps	—
Return on average tangible common equity ⁽²⁾⁽³⁾⁽⁴⁾	13.97%	13.76%	21 bps	—

(1) Loans held for sale include loans relating to the Chicago Divestiture.

(2) Ratios for the periods ended June 30, 2014 and 2013 are presented on an annualized basis.

(3) These are non-GAAP financial measures. For more information on the computation of these non-GAAP financial measures, see “—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures.”

(4) Operating segments are allocated capital on a risk-adjusted basis considering economic and regulatory capital requirements. We approximate that regulatory capital is equivalent to a sustainable target level for common equity Tier 1 and then allocate that approximation to the segments based on economic capital.

Commercial Banking net income of \$282 million for the six months ended June 30, 2014 increased \$18 million, or 7%, from \$264 million for the six months ended June 30, 2013, driven by a \$35 million increase in total revenue, partially offset by a \$17 million decrease in the net recovery reflected in the provision for credit losses related to a reduction in recoveries of prior period charge-offs.

Net interest income of \$520 million for the six months ended June 30, 2014 increased \$12 million, or 2%, from \$508 million for the six months ended June 30, 2013, as the benefit of a \$2.8 billion increase in interest-earning assets was partially offset by continued downward pressure on loan yields given the relatively persistent low-rate environment and increased industrywide competition.

Noninterest income of \$214 million for the six months ended June 30, 2014 increased \$23 million, or 12%, from \$191 million for the six months ended June 30, 2013, as a \$37 million increase in leasing income and capital markets fees was partially offset by lower interest-rate product, foreign exchange and trade finance fee income.

Noninterest expense of \$310 million for the six months ended June 30, 2014 decreased \$5 million, or 2%, from \$315 million for the six months ended June 30, 2013 as the benefit of lower employee incentive costs was partially offset by continued investment in the business to drive revenue growth.

Provision for credit losses for the six months ended June 30, 2014 reflected a net recovery of \$7 million compared with a net recovery of \$24 million for the six months ended June 30, 2013, reflecting decreasing monetization of loans or assets that had been charged off in prior periods.

Other

	As of and for the Six Months Ended June 30,			
	2014	2013	Change	Percent
	(dollars in millions)			(%)
Net interest income (expense)	\$ 38	\$ (89)	\$ 127	143%
Noninterest income	329	135	194	144
Total revenue	367	46	321	698
Noninterest expense	155	4,496	(4,341)	(97)
Income (loss) before provision for credit losses.....	212	(4,450)	4,662	105
Provision for credit losses	48	70	(22)	(31)
Income (loss) before income tax expense (benefit)	164	(4,520)	4,684	104
Income tax expense (benefit).....	43	(394)	437	111
Net income (loss)	\$ 121	\$ (4,126)	\$ 4,247	103
Loans and leases and loans held for sale (period-end)	\$ 4,383	\$ 6,320	\$ (1,937)	(31)
Average Balances:				
Total assets	\$ 39,959	\$ 41,241	\$ (1,282)	(3)
Loans and leases and loans held for sale.....	4,527	6,510	(1,983)	(30)
Deposits and deposits held for sale	3,509	3,680	(171)	(5)
Interest-earning assets.....	30,352	27,111	3,241	12

Other recorded net income of \$121 million for the six months ended June 30, 2014 compared with a net loss of \$4.1 billion for the six months ended June 30, 2013, which included an after tax goodwill impairment charge of \$4.1 billion. Excluding the goodwill impairment, the net loss for the six months ended June 30, 2013 was \$46 million. Net income for the six months ended June 30, 2014 included a \$180 million after tax gain related to the Chicago Divestiture partially offset by \$72 million of after tax restructuring charges and special items. Excluding these items, net income increased \$59 million driven by higher net interest income largely reflecting a reduction in pay-fixed swap costs as well as lower noninterest expense and provision for credit losses.

Net interest income for the six months ended June 30, 2014 increased \$127 million to \$38 million compared to an expense of \$89 million for the six months ended June 30, 2013. The increase was driven primarily by the benefit of a \$5.2

billion increase in average investment securities, a reduction in interest rate swap costs, partially offset by a \$1.7 billion decrease in average non-core loan balances.

Noninterest income for the six months ended June 30, 2014 increased \$194 million driven by the \$288 million gain on the Chicago Divestiture. Excluding the gain, noninterest income decreased \$94 million driven by a \$69 million reduction in securities gains and higher net losses on low-income housing investments, which are more than offset by increased tax credits.

Noninterest expense for the six months ended June 30, 2014 of \$155 million included \$115 million of pretax restructuring charges and special items and decreased \$4.3 billion from the six months ended June 30, 2013, which included the \$4.4 billion pretax goodwill impairment charge. Excluding the goodwill impairment, restructuring charges and special items, noninterest expense decreased \$21 million largely reflecting lower employee incentive costs and lower costs related to the non-core loan portfolio. For further information about these special items, including expected additional future costs, see Note 23 "Exit Costs and Restructuring Reserves" to our unaudited interim Consolidated Financial Statements included elsewhere in this report. Noninterest expense excluding goodwill impairment, restructuring charges and special items may increase in the third quarter due to expense expected to be incurred in connection with certain supervisory matters. We are not able to predict the magnitude of these expenses but they could be significant. For further information, see Note 12 "Commitments and Contingencies" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

The provision for credit losses within Other mainly represents the residual change in the consolidated allowance for credit losses after attributing the respective net charge-offs to the Consumer Banking and Commercial Banking segments. It also includes net charge-offs related to the non-core portfolio. The provision for credit losses for the six months ended June 30, 2014 decreased \$22 million to \$48 million compared to \$70 million for the six months ended June 30, 2013 reflecting continued improvement in credit quality and decreased non-core net charge-offs. On a quarterly basis, we review and refine our estimate of the allowance for credit losses, taking into consideration changes in portfolio size and composition, historical loss experience, internal risk ratings, current economic conditions, industry performance trends and other pertinent information. As of June 30, 2014, changes in these factors led to an increase of \$15 million in the allowance for credit losses compared with a release of \$53 million for the six months ended June 30, 2013. The provision also reflected an increase in overall credit exposure associated with growth in our loan portfolio.

Total assets as of June 30, 2014 included \$2.1 billion and \$4.8 billion of goodwill related to the Consumer Banking and Commercial Banking reporting units, respectively. For further information regarding the reconciliation of segment results to GAAP results, see Note 19 "Business Segments" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

Analysis of Financial Condition—June 30, 2014 Compared with December 31, 2013

Loans and Leases

The following table shows the composition of loans and leases, including non-core loans:

	June 30, 2014	December 31, 2013	Change	Percent
		(dollars in millions)		(%)
Commercial	\$ 30,076	\$ 28,667	\$ 1,409	5%
Commercial real estate	7,158	6,948	210	3
Leases	3,740	3,780	(40)	(1)
Total commercial.....	40,974	39,395	1,579	4
Residential, including originated home equity products.....	30,116	29,694	422	1
Home equity products serviced by others	1,972	2,171	(199)	(9)
Other secured retail.....	12,180	10,700	1,480	14
Unsecured retail	3,587	3,899	(312)	(8)
Total retail	47,855	46,464	1,391	3
Total loans and leases ⁽¹⁾⁽²⁾	\$ 88,829	\$ 85,859	\$ 2,970	3%

(1) Excluded from the table above are loans held for sale totaling \$262 million and \$1.3 billion as of June 30, 2014 and December 31, 2013, respectively. Loans held for sale as of December 31, 2013 primarily related to the Chicago Divestiture. For further discussion, see Note 13 "Divestitures and Branch Assets and Liabilities Held for Sale" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

- (2) Mortgage loans serviced for others by the Company's subsidiaries are not included above, and amounted to \$18.3 billion and \$18.7 billion at June 30, 2014 and December 31, 2013, respectively.

Our loans and leases are disclosed in portfolio segments and classes. Our loan and lease portfolio segments are commercial and retail. The classes of loans and leases are: commercial, commercial real estate, leases, residential (includes residential mortgages and home equity loans and lines of credit), home equity products serviced by others (includes certain purchased home equity loans and lines of credit), other secured retail (includes automobile loans and other installment loans) and unsecured retail (includes student loans and credit card).

As of June 30, 2014, our loans and leases portfolio increased \$3.0 billion, or 3%, to \$88.8 billion compared to \$85.9 billion as of December 31, 2013, primarily reflecting increases in total retail loans and total commercial loans and leases. As of June 30, 2014, our total commercial loans and leases grew \$1.6 billion, or 4%, to \$41.0 billion compared to \$39.4 billion as of December 31, 2013 in large part due to growth in commercial loans, primarily in mid-corporate. As of June 30, 2014, our total retail loans increased \$1.4 billion, or 3%, to \$47.9 billion compared to \$46.5 billion as of December 31, 2013, primarily due to increases in our other secured retail portfolio of 14% driven mainly by the purchase of auto loans and stronger originations, and our residential, including originated home equity products of 1%, but offset by decreases in our home equity products serviced by others and unsecured retail of 9% and 8%, respectively, as of June 30, 2014 compared to December 31, 2013. The decrease in our home equity products serviced by others is due to runoff and the decrease in our unsecured loans is due to the sale of student loans.

Non-Core Assets

The table below shows the composition of our non-core assets as of the dates indicated:

	June 30, 2014	December 31, 2013	(Date of Designation) June 30, 2009	Change from 2014-2013	Change from 2014-2009
	(dollars in millions)			(%)	(%)
Commercial	\$ 87	\$ 108	\$ 1,900	(19)%	(95)%
Commercial real estate	297	381	3,412	(22)	(91)
Total commercial	384	489	5,312	(21)	(93)
Residential, including originated home equity products.....	651	705	2,082	(8)	(69)
Home equity products serviced by others.	1,976	2,160	6,180	(9)	(68)
Other secured retail ⁽¹⁾	—	—	4,037	—	(100)
Unsecured retail	382	406	2,490	(6)	(85)
Total retail	3,009	3,271	14,789	(8)	(80)
Total non-core loans	3,393	3,760	20,101	(10)	(83)
Other assets	65	81	378	(20)	(83)
Total non-core assets	\$ 3,458	\$ 3,841	\$ 20,479	(10)%	(83)%

⁽¹⁾ Other secured retail loans were either paid down, charged off, sold or transferred to the core loan portfolio by December 31, 2011.

Non-core assets are primarily loans inconsistent with our strategic goals, generally as a result of geographic location, industry, product type or risk level. We have actively managed these loans down since they were designated as non-core on June 30, 2009. Between that time and June 30, 2014, the portfolio has decreased \$17.0 billion, including principal repayments of \$9.1 billion; charge-offs of \$3.8 billion; transfers back to the core portfolio of \$2.8 billion; and sales of \$1.3 billion.

Transfers from non-core back to core are handled on an individual request basis and managed through the chief credit officer for our non-core portfolio. The rationale can vary and in the past some loan portfolio transfers have been approved after determination that the original decision to place them in non-core was not deemed appropriate. Individual loans can be reconsidered when the customer prospects change—typically related to situations where a non-strategic customer becomes a strategic customer due to growth or a new credit request that was previously considered to be unlikely.

At June 30, 2014, the non-core portfolio totaled \$3.5 billion and has declined 10% since December 31, 2013 and over 83% since the designation of the non-core portfolios in 2009. Commercial non-core loan balances declined 21% compared to December 31, 2013, ending at \$384 million compared to \$489 million at December 31, 2013. Retail non-core loan balances of \$3.0 billion decreased 8% or \$262 million compared to December 31, 2013.

The largest component of our non-core portfolio is our home equity products currently or formerly serviced by other firms, or SBO, portfolio. The SBO portfolio is a liquidating portfolio consisting of pools of home equity loans and lines of credit purchased between 2003 and 2007. Although our SBO portfolio consists of loans that were initially serviced by others, we now service a portion of this portfolio internally. SBO balances serviced externally totaled \$1.2 billion and \$1.3 billion as of June 30, 2014 and December 31, 2013, respectively. The SBO portfolio has been closed to new purchases since the third quarter of 2007, with exposure down to \$2.0 billion as of June 30, 2014 compared to \$2.2 billion as of December 31, 2013. The SBO portfolio represented 6% of the entire real estate portfolio and 4% of the overall retail loan portfolio as of June 30, 2014.

The credit profile of the SBO portfolio is significantly weaker than the core real estate portfolio, with a weighted-average refreshed FICO score of 714 and combined loan to value (CLTV) of 98.6% as of June 30, 2014. The proportion of the portfolio in a second lien (subordinated) position is 95%. The amount of the portfolio in out of footprint geographies is 72.5%, with 28.8% concentrated in California, Nevada, Arizona and Florida.

Credit performance continues to improve due to portfolio liquidation (the lowest performing loans have already been charged off), more effective account servicing and collection strategies, and improvements in the real estate market. The delinquency rate of more than 90 days past due was 1.6% as of June 30, 2014, and decreased by 14 basis points from December 31, 2013. The SBO portfolio had a charge-off rate of 2.4% for the six months ended June 30, 2014 and a cumulative (inception to date) charge-off rate of 26.7% as of June 30, 2014.

Allowance for Credit Losses and Nonperforming Assets

We and our banking subsidiaries, CBNA and CBPA, maintain an allowance for credit losses, consisting of an allowance for loan and lease losses and a reserve for unfunded lending commitments. This allowance is created through charges to income, or provision for credit losses, and is maintained at an appropriate level adequate to absorb anticipated losses and is determined in accordance with GAAP. For further information on our processes to determine our allowance for credit losses, see “—Critical Accounting Estimates—Allowance for Credit Losses,” Note 4 “Allowance for Credit Losses, Nonperforming Assets, and Concentrations of Credit Risk,” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 “Significant Accounting Policies,” to our audited Consolidated Financial Statements.

The allowance for credit losses totaled \$1.3 billion at June 30, 2014 and December 31, 2013. Our allowance for loan and lease losses was 1.36% of total loans and leases and 101% of nonperforming loans and leases as of June 30, 2014 compared with 1.42% and 86% as of December 31, 2013. The total loan portfolio credit performance continued to improve across all credit measures in the six months ended June 30, 2014. Net charge-offs for the six months ended June 30, 2014 of \$155 million decreased 39% compared to \$255 million for the six months ended June 30, 2013, primarily driven by decreases in the non-core, real estate secured and unsecured retail portfolios. The portfolio annualized net charge-off rate declined to 0.36% for the six months ended June 30, 2014 from 0.60% for the six months ended June 30, 2013. The delinquency rate improved to 1.6% as of June 30, 2014 from 1.9% at December 31, 2013. Nonperforming loans and leases totaled \$1.2 billion, or 1.35%, of the total portfolio as of June 30, 2014 as compared to \$1.4 billion, or 1.65%, of the total loan portfolio as of December 31, 2013. At June 30, 2014, \$621 million of nonperforming loans and leases had been designated as impaired and had no specific allowance because they had been written down to the fair value of their collateral. These loans included \$547 million of retail loans and \$74 million of commercial loans. Excluding impaired loans that have been written down to their net realizable value, the allowance to nonperforming loans ratio totaled 209% at June 30, 2014 as compared to 151% at December 31, 2013.

Commercial Loan Asset Quality

Our commercial loan portfolio consists of traditional commercial and commercial real estate loans. The portfolio is focused primarily on in-footprint customers where our local delivery model provides for strong client connectivity.

For commercial loans and leases, we use regulatory classification ratings to monitor credit quality. Loans with a “pass” rating are those that we believe will be fully repaid in accordance with the contractual loan terms. Commercial loans and leases that are “criticized” are those that have some weakness that indicates an increased probability of future loss. See Note 4 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk,” to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

During the six months ended June 30, 2014, the quality of the commercial loan portfolio remained steady. As of June 30, 2014, total criticized loans decreased to 4.3%, or \$1.8 billion, of the commercial loan portfolio compared to 4.9%, or \$1.9 billion, at December 31, 2013. Commercial real estate criticized balances decreased 23% to 6.3%, or \$451 million, of the commercial real estate portfolio compared to 8.4%, or \$582 million, as of December 31, 2013. Commercial real estate accounted for 25.4% of the criticized loans as of June 30, 2014, compared to 30.4% as of December 31, 2013.

Nonperforming balances and charge-offs have displayed a positive trend in the first half of 2014. As of June 30, 2014, nonperforming commercial balances decreased \$70 million, or 26%, to \$195 million, compared to \$265 million as of December 31, 2013, with a 23% decline in commercial real estate nonperforming loans over the same period. As of June 30, 2014, nonperforming commercial loans stood at 0.5% of the commercial loan portfolio compared to 0.7% as of December 31, 2013. Net charge-offs in our commercial loan portfolio for the six months ended June 30, 2014 reflected a net recovery of \$21 million compared to a net recovery of \$2 million for the six months ended June 30, 2013. Charge-off performance continues to be positively influenced by recoveries and lower gross losses driven by improved economic conditions and a strategic focus on high quality new business; however, this favorable trend is expected to reduce as recovery opportunities dissipate. See “—Key Factors Affecting Our Business—Credit Trends” for further details.

Retail Loan Asset Quality

For retail loans, we primarily use the loan’s payment and delinquency status to monitor credit quality. The further a loan is past due, the greater the likelihood of future credit loss. These credit quality indicators are continually updated and monitored. Our retail loan portfolio remains predominantly focused on lending across the New England, Mid-Atlantic and Midwest regions, with continued geographic expansion outside the footprint with the auto finance and student lending portfolios. Originations within the footprint are primarily initiated through the branch network, whereas out-of-footprint lending is driven by indirect auto loans in dealer networks and student loans via our online platform.

The credit composition of our retail loan portfolio at June 30, 2014 remained favorable and well positioned across all product lines with an average refreshed FICO score of 753, down one point from December 31, 2013. Our real estate combined loan to value ratio, or CLTV, is calculated as the mortgage amount divided by the appraised value of the property and was 68.1% as of June 30, 2014 compared to 67.8% as of December 31, 2013. Excluding the SBO portfolio, the real estate CLTV was 65.9% as of June 30, 2014 compared to 65.1% as of December 31, 2013. The net charge-off rate (core and non-core) of 0.76% for the six months ended June 30, 2014 decreased 34 basis points from the same period in 2013. The overall rate of delinquency more than 30 days past due improved 30 basis points to 2.3% as of June 30, 2014, from 2.6% as of December 31, 2013. The improvement was driven by residential mortgage, home equity and student loans.

Nonperforming retail loans as a percentage of total retail loans were 2.1% as of June 30, 2014, an improvement of 38 basis points from December 31, 2013. The improvement in nonperforming retail loans was primarily driven by transfers of troubled debt restructurings (“TDRs”) from nonaccrual to accrual status.

Special Topics—HELOC Payment Shock

For further information regarding the possible HELOC payment shock, see “—Key Factors Affecting Our Business—HELOC Payment Shock.”

Troubled Debt Restructuring

TDR is the classification given to a loan that has been restructured in a manner that grants a concession to a borrower that is experiencing financial hardship that we would not otherwise make. TDRs typically result from our loss mitigation efforts and are undertaken in order to improve the likelihood of recovery and continuity of the relationship. Our loan modifications are handled on a case by case basis and are negotiated to achieve mutually agreeable terms that maximize loan collectability and meet our borrower’s financial needs. The types of concessions include interest rate reductions, term extensions, principal forgiveness and other modifications to the structure of the loan that fall outside lending policy. Depending on the specific facts and circumstances of the customer, restructuring can involve loans moving to nonaccrual, remaining on nonaccrual or continuing on accrual status. As of June 30, 2014, we had \$1.2 billion classified as retail TDRs, of which 31% were in nonaccrual status. Within this nonaccrual population, 53.6% were current in payment. TDRs generally return to accrual status once repayment capacity and appropriate payment history can be established. TDRs are evaluated for impairment individually. Loans are classified as TDRs until paid off, sold or refinanced at market terms.

For additional information regarding the troubled debt restructurings, see Note 4 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 “Significant Accounting Policies” to our audited Consolidated Financial Statements.

The table below presents our retail TDRs in delinquent status as of June 30, 2014:

	June 30, 2014			
	Current	30-89 Days Past Due	90+ Days Past Due	Total
	(in millions)			
Recorded Investment:				
Residential, including originated home equity products.....	\$ 700	\$ 39	\$ 139	\$ 878
Home equity products serviced by others.....	96	8	5	109
Other secured retail.....	27	3	1	31
Unsecured retail.....	187	10	3	200
Total.....	<u>\$ 1,010</u>	<u>\$ 60</u>	<u>\$ 148</u>	<u>\$ 1,218</u>

The table below presents the accrual status of our retail TDRs as of June 30, 2014:

	June 30, 2014		
	Accruing	Nonaccruing	Total
	(in millions)		
Recorded Investment:			
Residential, including originated home equity products.....	\$ 540	\$ 338	\$ 878
Home equity products serviced by others.....	75	34	109
Other secured retail.....	23	8	31
Unsecured retail.....	198	2	200
Total.....	<u>\$ 836</u>	<u>\$ 382</u>	<u>\$ 1,218</u>

Securities

Our securities portfolio is managed to seek return while maintaining prudent levels of quality, market risk and liquidity. The following table presents our securities available for sale and held to maturity portfolios:

	June 30, 2014		December 31, 2013		
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Change in Fair Value
	(dollars in millions)				(%)
Securities Available for Sale:					
U.S. Treasury	\$ 15	\$ 15	\$ 15	\$ 15	—
State and political subdivisions	10	10	11	10	—
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	17,343	17,585	14,970	14,993	17%
Other/non-agency	887	858	992	952	(10)
Total mortgage-backed securities	18,230	18,443	15,962	15,945	16
Total debt securities	18,255	18,468	15,988	15,970	16
Marketable equity securities.....	10	13	10	13	—
Other equity securities.....	12	12	12	12	—
Total equity securities	22	25	22	25	—
Total securities available for sale	\$ 18,277	\$ 18,493	\$ 16,010	\$ 15,995	16%
Securities Held to Maturity:					
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	\$ 3,897	\$ 3,898	\$ 2,940	\$ 2,907	34%
Other/non-agency	1,485	1,500	1,375	1,350	11
Total securities held to maturity	5,382	5,398	4,315	4,257	27
Total securities available for sale and held to maturity	\$ 23,659	\$ 23,891	\$ 20,325	\$ 20,252	18%

As of June 30, 2014, the fair value of the securities available for sale and held to maturity portfolios increased by \$3.6 billion, or 18%, to \$23.9 billion, compared to \$20.3 billion as of December 31, 2013. U.S. Government-guaranteed notes and GSE-issued mortgage-backed securities comprise the majority of the securities portfolio holdings. Reinvestments have been directed predominantly into fixed-rate mortgage-backed securities, and as of June 30, 2014, the portfolio had an average expected life of 4.5 years.

The investment portfolio includes higher quality, highly liquid investments reflecting our ongoing commitment to maintaining appropriate contingent liquidity and pledging capacity. The portfolio composition has also been dominated by holdings backed by mortgages so that they can be pledged to the Federal Home Loan Banks ("FHLBs"). This has become increasingly important due to the enhanced liquidity requirements of the Liquidity Coverage Ratio ("LCR"). Refer to "Management's Discussion & Analysis of Financial Condition & Results of Operations Overview – Liquidity" for further information.

For the six months ended June 30, 2014, the securities portfolio income of the securities available for sale and held to maturity portfolios increased \$74 million, or 35%, to \$286 million compared to \$212 million for the six months ended June 30, 2013, and the yield on the portfolio was 2.48%. The portfolio yield decreased by one basis point, driven by faster prepayments in the mortgage-backed securities portfolio. For the six months ended June 30, 2014, mortgage-backed securities maturities, principal paydowns, and sales totaled \$1.5 billion and mortgage-backed securities purchases totaled \$5.5 billion.

Deposits

The table below presents the major components of our deposits:

	June 30, 2014	December 31, 2013	Change	Percent
		(dollars in millions)		(%)
Demand.....	\$ 26,670	\$ 24,931	\$ 1,739	7%
Checking with interest.....	15,171	13,630	1,541	11
Regular savings.....	7,829	7,509	320	4
Money market accounts.....	31,687	31,245	442	1
Term deposits.....	10,299	9,588	711	7
Total deposits.....	91,656	86,903	4,753	5
Deposits held for sale.....	-	5,277	(5,277)	(100)
Total deposits and deposits held for sale.....	\$ 91,656	\$ 92,180	\$ (524)	(1)%

Including the impact of the sale of the deposits in connection with the Chicago Divestiture, total deposits and deposits held for sale as of June 30, 2014 declined \$524 million, or 1%, compared to December 31, 2013. Excluding the impact of deposits held for sale, total deposits as of June 30, 2014, increased \$4.8 billion, or 5%, to \$91.7 billion compared to \$86.9 billion as of December 31, 2013. All categories of deposits increased, led by demand deposits, which increased \$1.7 billion, or 7%.

Borrowed Funds

The tables below present our borrowed funds.

The following is a summary of our short-term borrowed funds:

	June 30, 2014	December 31, 2013
	(in millions)	
Federal funds purchased.....	\$ —	\$ 689
Securities sold under agreements to repurchase.....	6,807	4,102
Other short-term borrowed funds.....	7,702	2,251
Total short-term borrowed funds.....	\$ 14,509	\$ 7,042

Key data related to short-term borrowed funds is presented in the following table:

	For the Six Months Ended June 30, 2014	For the Year Ended December 31, 2013	For the Six Months Ended June 30, 2013
	(dollars in millions)		
Weighted-average interest rate at period end:			
Federal funds purchased and securities sold under agreements to repurchase	0.12%	0.09%	0.04%
Other short-term borrowed funds	0.27%	0.20%	2.25%
Maximum amount outstanding at month-end during the period:			
Federal funds purchased and securities sold under agreements to repurchase	\$ 7,022	\$ 5,114	\$ 3,371
Other short-term borrowed funds	7,702	2,251	750
Average amount outstanding during the period:			
Federal funds purchased and securities sold under agreements to repurchase	\$ 5,708	\$ 2,400	\$ 1,925
Other short-term borrowed funds	4,838	259	279
Weighted-average interest rate during the period:			
Federal funds purchased and securities sold under agreements to repurchase	0.11%	0.31%	0.04%
Other short-term borrowed funds	0.26%	0.44%	0.26%

The following is a summary of our long-term borrowed funds:

	June 30, 2014	December 31, 2013
	(in millions)	
Citizens Financial Group, Inc.:		
4.150% fixed rate subordinated debt, due 2022	\$ 350	\$ 350
5.158% fixed-to-floating rate subordinated debt, (LIBOR + 3.56%) callable, due 2023 ⁽¹⁾	333	333
4.771% fixed rate subordinated debt, due 2023 ⁽¹⁾	333	333
4.691% fixed rate subordinated debt, due 2024 ⁽¹⁾	334	334
4.153% fixed rate subordinated debt, due 2024 ⁽¹⁾	333	—
Banking Subsidiaries:		
Federal Home Loan advances due through 2033	24	25
Other	25	30
Total long-term borrowed funds	\$ 1,732	\$ 1,405

⁽¹⁾ Intercompany borrowed funds with the RBS Group. See Note 14 "Related Party Transactions" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

Short-term unsecured borrowed funds were minimal as of June 30, 2014. Other short-term borrowed funds include capital instruments and secured FHLB advances. The increase in total short-term borrowed funds relative to the December 31, 2013 balance reflected balance sheet growth, primarily securities. Additionally, asset liquidity is considered strong. As of June 30, 2014, unencumbered high-quality securities totaled \$10.7 billion, unused FHLB capacity was approximately \$1.6 billion and unencumbered loans pledged at the Federal Reserve Banks of \$10.1 billion created additional contingent borrowing capacity of approximately \$22.4 billion.

Access to additional funding through repurchase agreements, collateralized borrowed funds or asset sales is available. Additionally, there is capacity to grow deposits. While access to short-term wholesale markets is limited, we have been able to meet our funding needs for the medium term with deposits and collateralized borrowed funds.

Derivatives

Historically, we have used pay-fixed swaps to synthetically lengthen liabilities and offset duration in fixed-rate assets. Given the material prepayment of fixed-rate mortgages and home equity loans since 2008, these swaps were no longer needed and have been terminated or allowed to run off, resulting in a reduction in the notional balance of these swaps to \$1.0 billion as of June 30, 2014.

We use receive-fixed swaps to minimize the exposure to variability in the interest cash flows on our floating rate assets. This is reflected in the interest rate swaps line in the table below. As of June 30, 2014, a notional amount of \$4.0 billion of receive-fixed swaps had been executed. The assets and liabilities recorded for derivatives designated as hedges reflect the fair value of these hedge instruments.

We also sell interest rate swaps and foreign exchange forwards to commercial customers. Offsetting swap and forward agreements are simultaneously transacted to minimize our market risk associated with the customer derivative products. The assets and liabilities recorded for derivatives not designated as hedges reflect the fair value of these transactions.

The table below presents our derivative assets and liabilities. For additional information regarding our derivative instruments, see Note 11 "Derivatives" to our unaudited interim Consolidated Financial Statements included elsewhere in this report.

	June 30, 2014			December 31, 2013			Changes in Net Liabilities
	Notional Amount ⁽¹⁾	Derivative Assets	Derivative Liabilities	Notional Amount ⁽¹⁾	Derivative Assets	Derivative Liabilities	
	(dollars in millions)						(%)
Derivatives designated as hedging instruments:							
Interest rate swaps.....	\$ 5,000	\$ 23	\$ 223	\$ 5,500	\$ 23	\$ 412	(49)%
Derivatives not designated as hedging instruments:							
Interest rate swaps.....	28,381	611	522	29,355	654	558	(7)
Foreign exchange contracts	8,395	74	69	7,771	94	87	(29)
Other contracts	731	8	14	569	7	10	100
Total derivatives not designated as hedging instruments		693	605		755	655	(12)
Gross derivative fair values		716	828		778	1,067	(61)%
Less: Gross amounts offset in the Consolidated Balance Sheets ⁽²⁾		(81)	(81)		(128)	(128)	
Total net derivative fair values presented in the Consolidated Balance Sheets ⁽³⁾		\$ 635	\$ 747		\$ 650	\$ 939	

⁽¹⁾ The notional or contractual amount of interest rate derivatives and foreign exchange contracts is the amount upon which interest and other payments under the contract are based. For interest rate derivatives, the notional amount is typically not exchanged. Therefore, notional amounts should not be taken as the measure of credit or market risk as they tend to greatly overstate the true economic risk of these contracts.

⁽²⁾ Amounts represent the impact of legally enforceable master netting agreements that allow us to settle positive and negative positions.

⁽³⁾ We also offset assets and liabilities associated with repurchase agreements on our Consolidated Balance Sheets. See Note 2 "Securities" to our unaudited interim Consolidated Financial Statements included elsewhere in this report for further discussion.

Quarterly Results of Operations

The following table sets forth unaudited quarterly Consolidated Statements of Operations data and Consolidated Balance Sheets data as of and for the quarters ended June 30, 2014, March 31, 2014, the four quarters of 2013 and the last two quarters of 2012. We have prepared the statement of operations data and balance sheet data on the same basis as the audited Consolidated Financial Statements and the unaudited interim Consolidated Financial Statements included elsewhere in this report and, in the opinion of management, each statement of operations and balance sheet includes all adjustments, consisting solely of normal recurring adjustments, necessary for the fair statement of the results of operations and balance sheet data as of and for these periods. This information should be read in conjunction with the unaudited interim Consolidated Financial Statements included elsewhere in this report and audited Consolidated Financial Statements and, in each case, the related notes.

Summary Consolidated Financial and Other Data (unaudited)

As of and for the Three Months Ended								
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
(dollars in millions, except per share amounts)								
Operating Data:								
Net interest income.....	\$ 833	\$ 808	\$ 779	\$ 770	\$ 749	\$ 760	\$ 772	\$ 810
Noninterest income.....	640 ⁽¹²⁾	358	379	383	437	433	390 ⁽¹⁹⁾	422
Total revenue	1,473	1,166	1,158	1,153	1,186	1,193	1,162	1,232
Provision for credit losses.....	49	121	132	145	112	90	103	109
Noninterest expense.....	948 ⁽¹³⁾	810	818 ⁽¹⁵⁾	788	5,252 ⁽¹⁷⁾	821	895 ⁽²⁰⁾	791
Income (loss) before income tax expense (benefit).....	476	235	208	220	(4,178)	282	164	332
Income tax expense (benefit).....	163 ⁽¹⁴⁾	69	56 ⁽¹⁶⁾	76	(273) ⁽¹⁸⁾	99	63 ⁽²¹⁾	123
Net income (loss)	\$ 313	\$ 166	\$ 152	\$ 144	\$ (3,905)	\$ 183	\$ 101	\$ 209
Net income (loss) per average common share— basic and diluted (pro forma) (unaudited) ⁽¹⁾	\$ 0.69	\$ 0.36	\$ 0.33	\$ 0.31	\$ (8.56)	\$ 0.40	\$ 0.22	\$ 0.46
Net income (loss) per average common share— basic and diluted (actual).....	\$ 92,601.06	\$ 49,087.34	\$ 44,990.27	\$ 42,297.29	\$ (1,154,559.32)	\$ 54,139.78	\$ 30,048.31	\$ 61,843.18
Other Operating Data:								
Return on average common equity ⁽²⁾⁽³⁾	6.41%	3.48%	3.12%	2.91%	(13.94)%	3.07%	1.65%	3.45%
Return on average total assets ⁽³⁾⁽⁴⁾	0.99%	0.54%	0.50%	0.49%	(2.77)%	0.60%	0.32%	0.65%
Net interest margin ⁽³⁾⁽⁵⁾	2.87%	2.89%	2.83%	2.88%	2.82%	2.84%	2.80%	2.88%
Balance Sheet Data:								
Total assets.....	\$ 130,279	\$ 126,892	\$ 122,154	\$ 120,074	\$ 117,833	\$ 126,044	\$ 127,053	\$ 131,580
Loans and leases ⁽⁶⁾	88,829	87,083	85,859	85,493	85,006	85,782	87,248	86,941
Allowance for loan and lease losses	1,210	1,259	1,221	1,219	1,200	1,219	1,255	1,347
Total securities	24,823	24,804	21,245	20,852	17,408	18,066	19,417	21,341
Goodwill	6,876	6,876	6,876	6,876	6,876	11,311	11,311	11,311
Total liabilities.....	110,682	107,450	102,958	100,661	98,223	101,837	102,924	107,471
Deposits ⁽⁷⁾	91,656	87,462	86,903	93,930	91,361	94,628	95,148	96,481
Federal funds purchased and securities sold under agreements to repurchase	6,807	6,080	4,791	3,424	3,371	3,709	3,601	3,241
Other short-term borrowed funds	7,702	4,950	2,251	2	2	11	501	4,002
Long-term borrowed funds.....	1,732	1,403	1,405	1,064	732	692	694	697
Total stockholders' equity	19,597	19,442	19,196	19,413	19,610	24,207	24,129	24,109
Other Balance Sheet Data:								
Asset Quality Ratios:								
Allowance for loan and lease losses as a percentage of total loans and leases	1.36%	1.45%	1.42%	1.43%	1.41%	1.42%	1.44%	1.55%
Allowance for loan and	101%	92%	86%	72%	69%	67%	67%	75%

As of and for the Three Months Ended

	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
lease losses as a percentage of nonperforming loans and leases.....								
Nonperforming loans and leases as a percentage of total loans and leases	1.35%	1.57%	1.65%	1.98%	2.06%	2.14%	2.14%	2.08%
Capital ratios:								
Tier 1 capital ratio ⁽⁸⁾	13.3%	13.4%	13.5%	14.0%	14.3%	14.5%	14.2%	14.1%
Total capital ratio ⁽⁹⁾	16.2%	16.0%	16.1%	16.3%	16.3%	16.2%	15.8%	15.7%
Tier 1 common equity ratio ⁽¹⁰⁾	13.3%	13.4%	13.5%	13.9%	14.3%	14.2%	13.9%	13.8%
Leverage ratio ⁽¹¹⁾	11.1%	11.4%	11.6%	12.1%	11.8%	12.5%	12.1%	11.9%

⁽¹⁾ Pro forma basic and diluted earnings per share are unaudited and have been computed to give effect to the 134,831.46-for-1 forward stock split to occur prior to closing of this offering.

⁽²⁾ We define "Return on average common equity" as net income (loss) divided by average common equity.

⁽³⁾ Ratios for the periods above are presented on an annualized basis.

⁽⁴⁾ We define "Return on average total assets" as net income (loss) divided by average total assets.

⁽⁵⁾ We define "Net interest margin" as net interest income divided by average total interest-earning assets.

⁽⁶⁾ Excludes loans held for sale of \$262 million, \$1.4 billion, \$1.3 billion, \$307 million, \$429 million, \$550 million, \$646 million and \$594 million as of June 30, 2014, March 31, 2014, December 31, 2013, September 30, 2013, June 30, 2013, March 31, 2013, December 31, 2012 and September 30, 2012, respectively.

⁽⁷⁾ Excludes deposits held for sale of \$5.2 billion and \$5.3 billion as of March 31, 2014 and December 31, 2013, respectively.

⁽⁸⁾ We define "Tier 1 capital ratio" as Tier 1 capital balance divided by total risk-weighted assets as defined under Basel I.

⁽⁹⁾ We define "Total capital ratio" as total capital balance divided by total risk-weighted assets as defined under Basel I.

⁽¹⁰⁾ We define "Tier 1 common equity ratio" as Tier 1 capital balance, minus preferred stock, divided by total risk-weighted assets as defined under Basel I.

⁽¹¹⁾ We define "Leverage ratio" as Tier 1 capital balance divided by quarterly average total assets as defined under Basel I.

⁽¹²⁾ Includes \$288 million of gain on the Chicago Divestiture.

⁽¹³⁾ Includes \$115 million of restructuring charges and special expense items related largely to efficiency initiatives and the Chicago Divestiture.

⁽¹⁴⁾ Includes \$65 million of tax expenses related to the gain on the Chicago Divestiture and restructuring charges and special items.

⁽¹⁵⁾ Includes \$26 million of restructuring charges.

⁽¹⁶⁾ Includes \$9 million of tax benefit related to restructuring charges.

⁽¹⁷⁾ Includes \$4.4 billion of goodwill impairment charge.

⁽¹⁸⁾ Includes \$355 million of tax benefit related to the goodwill impairment charge.

⁽¹⁹⁾ Includes \$23 million loss on the sale of a commercial real estate portfolio.

⁽²⁰⁾ Includes \$77 million settlement of defined benefit pension plan obligations to vested former employees and \$5 million reversal of prior restructuring charges.

⁽²¹⁾ Includes \$33 million of net tax benefit related to the loss on sale of commercial real estate portfolio, settlement of the defined benefit pension plan obligations, and reversal of restructuring charges.

Second Quarter 2014 vs Second Quarter 2013

We reported second quarter net income of \$313 million, up \$4.2 billion from a loss of \$3.9 billion in the second quarter of 2013, which included a \$4.1 billion after-tax goodwill impairment. Second quarter 2014 results included a \$288 million pre-tax net gain (\$180 million after-tax) related to the Chicago Divestiture. This net gain was partially offset by \$115 million in pre-tax (\$72 million after-tax) restructuring charges and special expense items largely related to the Company's separation from the Royal Bank of Scotland Group and efforts to improve processes and enhance efficiencies across the organization. Excluding the restructuring charges and special items, adjusted second quarter 2014 net income increased \$30 million, or 17%, from an adjusted \$175 million in second quarter 2013, reflecting relatively stable revenues and expenses and continued improvement in credit quality.

Second quarter 2014 net interest income of \$833 million increased \$84 million from the second quarter of 2013, reflecting the benefit of higher investment and loan portfolio balances, a reduction in higher cost pay-fixed interest rate swap costs and lower deposit costs, reflecting our efforts to reduce our reliance on higher cost certificates of deposit and money market funds. Results also reflect increased borrowing costs associated with our issuance of subordinated debt and the continued effect of relatively low rates on loans and securities yields. Compared to the second quarter of 2013, net interest margin improved five basis points driven by the benefit of declining pay-fixed swap costs and a reduction in deposit costs, partially offset by lower securities and loan portfolio yields.

Noninterest income of \$640 million in the second quarter of 2014 increased \$203 million from the second quarter of 2013 driven by the \$288 million net gain on the Chicago Divestiture. Excluding the impact of this net gain, adjusted second quarter 2014 noninterest income decreased \$85 million from the second quarter of 2013 as growth in capital markets fee income, trust and investment services fees and card fees was more than offset by a \$53 million decrease in mortgage banking fees and a \$42 million reduction in securities gains.

Provision expense for the second quarter of 2014 was \$49 million, down from \$112 million in the second quarter of 2013.

Noninterest expense in the second quarter of 2014 decreased \$4.3 billion from the second quarter of 2013, which included the effect of a \$4.4 billion goodwill impairment charge. Excluding the goodwill impairment charge, and restructuring charges and special items, adjusted noninterest expense increased \$16 million from the second quarter of 2013 driven largely by continued investments in the business to drive revenue growth.

The Company's effective tax rate was 34% in the second quarter of 2014. The Company's effective tax rate was 7% in the second quarter of 2013 which included a \$355 million tax benefit related to the \$4.4 billion goodwill impairment.

Capital

As a bank holding company and a financial holding company, we are subject to regulation and supervision by the Federal Reserve Board. Our primary subsidiaries are our two insured depository institutions, CBNA, a national banking association whose primary federal regulator is the OCC, and CBPA, a Pennsylvania-chartered savings bank regulated by the Department of Banking of the Commonwealth of Pennsylvania and supervised by the FDIC as its primary federal regulator.

Under current Basel I regulation, the Federal Reserve Board requires us to maintain minimum levels with respect to our total capital, Tier 1 capital and leverage ratios. The minimum standards for the total capital ratio (the ratio of our total risk-based capital, which is the sum of our Tier 1 and Tier 2 capital, as defined by Federal Reserve Board regulation, to total risk-weighted assets) and the Tier 1 capital ratio (the ratio of our Tier 1 capital to total risk-weighted assets) are 8.0% and 4.0%, respectively. The minimum Tier 1 leverage ratio (the ratio of a banking organization's Tier 1 capital to total adjusted quarterly average total assets, as defined for regulatory purposes) is 3.0% for bank holding companies that either have the highest supervisory rating or have implemented the Federal Reserve Board's risk-adjusted measure for market risk. The minimum Tier 1 leverage ratio for all other bank holding companies is 4.0%, unless a different minimum is specified by the Federal Reserve Board.

In July 2013, the U.S. bank regulatory agencies approved final regulatory capital rules that implement the Basel III capital framework and certain provisions of the Dodd-Frank Act. We will be required to comply with these rules beginning on January 1, 2015, with certain aspects of the rules phasing in through 2018.

The table below demonstrates the strength of our regulatory capital ratios as of June 30, 2014. Actual Basel I ratios and pro forma Basel III ratios, which include estimated impacts of fully phased-in Basel III and U.S. standardized approach risk-weighted assets requirements, remain well above current Basel I and future Basel III minima:

Regulatory Ratios as of June 30, 2014 Basel I vs. Basel III Rules						
Regulatory Ratio	Basel I Ratios and Requirements			Pro Forma Basel III Ratios and Requirements (including adoption of U.S. Standardized Approach Risk-Weighted Assets)		
	Actual Basel I Ratio	Required Minimum	Well Capitalized Minimum for Purposes of Prompt Corrective Action	Pro Forma Basel III Ratio ⁽¹⁾	Required Minimum + Required Capital Conservation Buffer for Non-Leverage Ratios	Well Capitalized Minimum for Purposes of Prompt Corrective Action ⁽²⁾
Tier 1 Capital to Risk-Weighted Assets (Tier 1 Capital Ratio)	13.3%	4.0%	6.0%	13.0%	8.5%	8.0%
Total Capital to Risk-Weighted Assets (Total Capital Ratio)	16.2	8.0	10.0	15.8	10.5	10.0
Tier 1 Capital to Average Total Assets (Leverage Ratio)	11.1	3.0	5.0	11.1	4.0	5.0
Common Equity Tier 1 Capital to Risk-Weighted Assets (Common Equity Tier 1 Capital Ratio)	Not Applicable	Not Applicable	Not Applicable	13.0	7.0	6.5

⁽¹⁾ These are non-GAAP financial measures. For more information on these non-GAAP financial measures, see “—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures.”

⁽²⁾ The Basel III well capitalized minima for purposes of prompt corrective action for bank holding companies have not yet been finalized. The percentages shown are the expected well capitalized minima based upon the current well capitalized minima for insured depository institutions.

Our assessment of capital adequacy begins with our risk appetite and risk management framework, which provides for the identification, measurement and management of material risks. Required capital is determined for actual/forecasted risk portfolios using applicable regulatory capital methodologies, including estimated impacts of approved and proposed regulatory changes that will or may apply to future periods. Key analytical frameworks, which enable the comprehensive assessment of capital adequacy versus unexpected loss, supplement our base case forecast. These supplemental frameworks include Integrated Stress Testing, as well as an Internal Capital Adequacy Requirement that builds on internally assessed Economic Capital requirements. Our capital planning process is supported by a robust governance framework. This process includes: capital management policies and procedures that document capital adequacy metrics and limits, as well as our comprehensive capital contingency plan, and the active engagement of both the legal-entity boards and senior management in oversight and decision-making.

Forward-looking assessments of capital adequacy for us and for our banking subsidiaries feed development of capital plans that are submitted to the Federal Reserve Board and other bank regulators. We prepare these plans in full compliance with the Federal Reserve Board’s Capital Plan Rule and participate in the Federal Reserve Board’s annual CCAR stress-testing process. Both we and our banking subsidiaries also participate in semiannual stress tests required by the Dodd-Frank Act. Within this regulatory framework, we may only execute capital actions in accordance with a capital plan that the Federal Reserve Board has reviewed and to which the Federal Reserve Board has not objected. In March 2014, the Federal Reserve Board objected on qualitative grounds to our capital plan submitted as part of the CCAR process. As a result, we are not permitted to increase our capital distributions above 2013 levels until a new capital plan is approved by the Federal Reserve Board. The deadline for our next capital plan submission is January 5, 2015, and we cannot assure you that the Federal Reserve Board will not object to our next capital plan or that, even if it does not object to it, our planned capital distributions will not be significantly modified from 2013 levels.

During the first two quarters of 2014, we completed the following capital actions:

- paid common dividends of \$25 million and \$10 million in the first and second quarter of 2014, respectively; and
- paid a special common dividend of \$333 million to RBS and issued \$333 million of 10-year subordinated debt (4.153% fixed rate subordinated debt due July 1, 2024) to the RBS Group in the second quarter of 2014.

Additionally, on August 1, 2014 we declared and paid a special common dividend of \$333 million to RBS and issued \$333 million of 10-year subordinated debt (4.023% fixed rate subordinated debt, due 2024) to the RBS Group.

During 2013, we completed the following capital actions:

- paid common dividends of \$40 million, \$55 million, \$50 million and \$40 million in the first, second, third and fourth quarters of 2013, respectively;
- redeemed \$289 million of floating rate junior subordinated deferrable interest debentures due March 4, 2034 from a special purpose subsidiary, which caused the redemption of \$280 million of our trust preferred securities from the RBS Group in the second quarter of 2013;
- through CBPA, we redeemed \$10 million of floating rate junior subordinated deferrable interest debentures due April 22, 2032, which caused redemption of \$10 million of our trust preferred securities from third parties in the fourth quarter of 2013;
- paid a special common dividend of \$333 million and issued \$333 million of 10-year subordinated debt (5.158% fixed-to-floating rate callable subordinated debt due June 29, 2023) to RBS in the second quarter of 2013;
- paid a special common dividend of \$333 million to RBS and issued \$333 million of 10-year subordinated debt (4.771% fixed rate subordinated debt due October 1, 2023) to the RBS Group in the third quarter of 2013; and
- paid a special common dividend of \$334 million to RBS and issued \$334 million of 10-year subordinated debt (4.691% fixed rate subordinated debt due January 2, 2024) to the RBS Group in the fourth quarter of 2013.

Special common dividends paired with issuance of a like amount of subordinated debt, as executed in the second through fourth quarters of 2013, the second quarter of 2014 and August 1, 2014 are undertaken to produce a more-balanced capital structure without impacting our overall level of qualifying regulatory capital. Exchanging common equity for the same amount of Tier 2 subordinated debt has no impact on either the level of total capital or the total risk-based capital ratio. From the beginning of 2013 to June 30, 2014, these “exchange transactions” have aggregated to \$1.3 billion. Even after execution of these actions, both Common Equity Tier 1 and Tier 1 Capital, calculated using fully phased-in Basel III definitions, were 13.0% as of June 30, 2014, well above their respective Basel III minima, including the capital conservation buffer, of 7.0% and 8.5%, respectively. Our pro forma Basel III total risk-based capital ratio after giving effect to all Basel III impacts also remained strong at 15.8% versus the Basel III minimum, including the capital conservation buffer, of 10.5%. These pro forma Basel III ratios are non-GAAP financial measures. For more information on computation of these non-GAAP financial measures, see “—Principal Components of Operations and Key Performance Metrics Used By Management—Key Performance Metrics and Non-GAAP Financial Measures.”

As a result of the goodwill impairment recognized by CBNA in the second quarter of 2013, CBNA must request specific approval from the OCC before executing capital distributions. This requirement is expected to remain in place through the fourth quarter of 2015. However, as of June 30, 2014, irrespective of the ability of our subsidiary banks to pay dividends we on a non-consolidated basis had liquid assets in excess of \$399 million compared to an annual interest burden on existing subordinated debt of approximately \$77 million.

Liquidity

We define liquidity as an institution’s ability to meet its cash-flow and collateral obligations in a timely manner, at a reasonable cost. An institution must maintain current liquidity to fund its daily operations and forecasted cash-flow needs as well as contingent liquidity to deliver funding in a stress scenario. We consider the effective and prudent management of liquidity to be fundamental to our health and strength.

We manage liquidity at the consolidated enterprise level and at each material legal entity, including ourselves, CBNA and CBPA.

CFG Liquidity

Our primary sources of cash are (i) dividends from equity investments in our banking subsidiaries and (ii) externally issued subordinated debt (\$350 million). Our uses of liquidity include the following: (i) routine cash flow requirements as a

bank holding company, including payments of dividends, interest and expenses; (ii) needs of subsidiaries, including our banking subsidiaries, for additional equity and, as required, their needs for debt financing; and (iii) extraordinary requirements for cash, such as acquisitions.

On August 1, 2014, we exchanged \$333 million of Tier 1 common equity for Tier 2 subordinated debt, and we plan to continue our strategy of capital optimization by exchanging an additional \$334 million of common equity for preferred stock with the RBS Group in the fourth quarter of 2014, as well as by exchanging an additional \$500 million of common equity for subordinated debt in 2015 and \$250 million of common equity for a lesser form of capital in 2016, subject to regulatory approval. As we increase subordinated debt in exchange for common equity, our funding costs will increase to reflect the incremental debt service.

Our cash and cash equivalents represent a source of liquidity that can be used to meet various needs. As of June 30, 2014, we held cash and cash equivalents of \$399 million. This should be viewed as a liquidity reserve.

Our liquidity risk is low, for four reasons. First, we have no material non-banking subsidiaries and our banking subsidiaries are self-funding. Second, we have no outstanding senior debt. Third, the capital structures of our banking subsidiaries are similar to our capital structure. As of June 30, 2014, our double leverage ratio (the combined equity of our subsidiaries divided by our equity) was 101.9%. Fourth, our other cash flow requirements, such as operating expenses, are relatively small.

Banking Subsidiaries' Liquidity

In the ordinary course of business, the liquidity of CBNA and CBPA is managed by matching sources and uses of cash. The primary sources of bank liquidity include (i) deposits from our consumer and commercial franchise customers; (ii) payments of principal and interest on loans and debt securities; and (iii) as needed and as described below under "Liquidity Risk Management and Governance," wholesale borrowings. The primary uses of bank liquidity include (i) withdrawals and maturities of deposits; (ii) payment of interest on deposits; (iii) funding of loan commitments; and (iv) funding of securities purchases. To the extent that the banks have relied on wholesale borrowings, uses also include payments of related principal and interest.

Our banking subsidiaries' major businesses involve taking deposits and making loans. Hence, a key role of liquidity management is to ensure that customers have timely access to funds from deposits and loans. Liquidity management also involves maintaining sufficient liquidity to repay wholesale borrowings, pay operating expenses and support extraordinary funding requirements when necessary.

In the second quarter of 2014, CBNA issued \$250 million in new subordinated debt to us. Additionally, CBNA issued \$220 million in subordinated debt to us in exchange for common equity held by us and is expected to issue an additional \$440 million in subordinated debt in exchange for common equity in the second half of 2014. Also during 2014, CBPA is expected to issue \$300 million in subordinated debt to us in exchange for common equity held by us. Additionally during 2014, CBPA could issue \$85 million in new subordinated debt to us to support asset growth if required. Because of the increased proportion of subordinated debt versus common equity in the capital structure of both CBNA and CBPA, funding costs will increase to reflect the incremental debt service costs.

Liquidity Risk

We define liquidity risk as the risk that we or either of our banking subsidiaries will be unable to meet our payment obligations in a timely manner. We manage liquidity risk at the consolidated enterprise level, and for each material legal entity including us, CBNA and CBPA. Liquidity risk can arise due to asset liquidity risk and/or funding liquidity risk.

Asset liquidity risk is the risk that market conditions may reduce an entity's ability to liquidate, pledge and/or finance certain assets and thereby substantially reduce the liquidity value of such assets. Drivers of asset liquidity risk include general market disruptions as well as specific issues regarding the credit quality and/or valuation of a security or loan, issuer or borrower and/or asset class.

Funding liquidity risk is the risk that market conditions and/or entity-specific events may reduce an entity's ability to raise funds from depositors and/or wholesale market counterparties. Drivers of funding liquidity may be idiosyncratic or systemic, reflecting impediments to operations and/or undermining of market confidence.

Factors Affecting Liquidity

Given the composition of their assets and borrowing sources, asset liquidity at both CBNA and CBPA would be materially affected by such events as deterioration of financing markets for high-quality securities (e.g., mortgage-backed securities and other instruments issued by the Government National Mortgage Association, or GNMA, Federal National

Mortgage Association, or FNMA, and the Federal Home Loan Mortgage Corporation, or FHLMC), by any incapacitation of the Federal Home Loan Banks, or FHLBs, to provide collateralized advances and/or by a refusal of the Federal Reserve Board to act as lender of last resort in systemic stress. Given the quality of our free securities, which represent unencumbered and liquid obligations, guaranteed explicitly (GNMA) or indirectly (FNMA and FHLMC) by the U.S. government, the positive track record of the FHLBs in stress and the commitment of the Federal Reserve Board to continue as lender of last resort in systemic stress scenarios, we view asset liquidity risk at our banking subsidiaries, both CBNA and CBPA, to be relatively modest.

Given the structure of their balance sheets, funding liquidity of CBNA and CBPA would be materially affected by an adverse idiosyncratic event (e.g., a major loss, causing a perceived or actual deterioration in its financial condition), an adverse systemic event (e.g., default or bankruptcy of a significant capital markets participant), or a combination of both (e.g., the financial crisis of 2008-2010). However, during the financial crisis, our banking subsidiaries reduced their dependence on unsecured wholesale funding to virtually zero. Consequently, and despite ongoing exposure to a variety of idiosyncratic and systemic events, we view our funding liquidity risk to be relatively modest.

An additional variable affecting our access, and the access of our banking subsidiaries, to unsecured wholesale market funds and to large denomination (i.e., uninsured) customer deposits is the credit ratings assigned by such agencies as Moody's, Standard & Poor's and Fitch. The following table presents our credit ratings:

	June 30, 2014		
	Moody's	Standard and Poor's ⁽¹⁾	Fitch
Citizens Financial Group, Inc.:			
Long-term issuer	NR	BBB+	BBB+
Short-term issuer	NR	A-2	F2
Subordinated debt.....	NR	BBB	BBB
Citizens Bank, N.A.:			
Long-term issuer	A3	A-	BBB+
Short-term issuer	P-2	A-2	F2
Citizens Bank of Pennsylvania:			
Long-term issuer	A3	A-	BBB+
Short-term issuer	P-2	A-2	F2

NR = Not rated

(1) On May 7, 2014, Standard & Poor's lowered Citizens Financial Group, Inc.'s stand-alone credit profile to "A-" from "A."

Changes in our public credit ratings could affect both the cost and availability of our wholesale funding. Because of current credit ratings, CBNA and CBPA have limited access to unsecured wholesale funding. As a result and in order to maintain a conservative funding profile, our banking subsidiaries continue to minimize reliance on unsecured wholesale funding. At June 30, 2014, the majority of wholesale funding consisted of secured borrowings using high-quality liquid securities sold under agreements to repurchase (repurchase agreements) and secured FHLB advances using high-quality residential loan collateral. Our dependence on unsecured and credit-sensitive funding continues to be relatively low.

Existing and evolving regulatory liquidity requirements represent another key driver of systemic liquidity conditions and liquidity management practices. The Federal Reserve Board evaluates our liquidity as part of the supervisory process, and the Federal Reserve Board recently issued regulations that will require us to conduct regular liquidity stress testing over various time horizons and to maintain a buffer of highly liquid assets sufficient to cover expected net cash outflows and projected loss or impairment of funding sources for a short-term liquidity stress scenario. In addition, the Basel Committee has developed a set of internationally-agreed upon quantitative liquidity metrics: the LCR and the Net Stable Funding Ratio ("NSFR").

The LCR was developed to ensure banks have sufficient high-quality liquid assets to cover expected net cash outflows over a 30-day liquidity stress period. In October 2013, the U.S. federal banking regulators proposed a rule to implement a modified version of the LCR in the United States, which would apply to large bank holding companies as we are. As compared to the Basel Committee's version of the LCR, the modified version of the LCR includes a narrower definition of high-quality liquid assets, different prescribed cash inflow and outflow assumptions for certain types of instruments and transactions and a shorter phase-in schedule that begins on January 1, 2015 and ends on January 1, 2017. Achieving LCR compliance may require changes in the size and/or composition of our investment portfolio, the configuration of our discretionary wholesale funding portfolio, and our average cash position. While the specific LCR requirements have not yet been finalized, and hence the extent of and impact from related implementation strategies cannot be quantified, at present, we expect to be fully compliant with the LCR by the required implementation date.

The NSFR was developed to provide a sustainable maturity structure of assets and liabilities and has a time horizon of one year. The Basel Committee contemplates that the NSFR, including any revisions, will be implemented as a minimum standard by January 1, 2018; however, the federal banking regulators have not yet proposed rules to implement the NSFR in the United States.

We continue to review these liquidity requirements, and to develop implementation plans and liquidity strategies. We expect to be fully compliant with the final rules on or prior to the applicable effective date.

Liquidity Risk Management and Governance

Liquidity risk is measured and managed by the Wholesale Funding and Liquidity unit within our treasury unit in accordance with policy guidelines promulgated by our Board and the Asset and Liability Management Committee. In managing liquidity risk, the Wholesale Funding and Liquidity unit delivers regular and comprehensive reporting, including current levels vs. threshold limits, for a broad set of liquidity metrics, explanatory commentary relating to emerging risk trends and, as appropriate, recommended remedial strategies.

The mission of our Wholesale Funding and Liquidity unit is to deliver prudent levels of current, projected and contingent liquidity from stable sources, in a timely manner and at a reasonable cost, without significant adverse consequences.

We seek to accomplish this mission by funding loans with stable deposits; by prudently controlling dependence on wholesale funding, particularly unsecured funding; and by maintaining ample available liquidity, including a liquidity buffer of unencumbered high-quality loans and securities. As of June 30, 2014:

- Core deposits continued to be our primary source of funding and our consolidated period-end loan-to-deposit ratio was 97.20% and includes loans and deposits held for sale;
- Unsecured wholesale funding was relatively low, at \$1.1 billion, substantially offset by excess cash balances held at the Federal Reserve Banks, defined as total reserves held less required reserves of \$4.3 billion;
- Asset liquidity remained robust at \$16.6 billion: net overnight position, defined as federal funds sold plus excess balances held at the Federal Reserve Banks minus federal funds purchased, totaled \$4.3 billion; unencumbered liquid securities totaled \$10.7 billion; and available FHLB capacity secured by mortgage loans totaled \$1.6 billion; and
- Available discount window capacity, defined as available total borrowing capacity from the Federal Reserve based on identified collateral, is secured by non-mortgage commercial and consumer loans, and totaled \$10.1 billion. Use of this borrowing capacity would likely be considered only during exigent circumstances.

The Wholesale Funding and Liquidity unit monitors a variety of liquidity and funding metrics, including specific risk threshold limits. The metrics are broadly classified as follows:

- Current liquidity sources and capacities, including excess cash at the Federal Reserve Banks, free and liquid securities and available and secured FHLB borrowing capacity;
- Contingent stressed liquidity, including idiosyncratic, systemic and combined stress scenarios, in addition to evolving regulatory requirements such as the Liquidity Coverage Ratio and the Net Stable Funding Ratio; and
- Current and prospective exposures, including secured and unsecured wholesale funding and spot and cumulative cash-flow gaps across a variety of horizons.

Further, certain of these metrics are monitored for each of us, our banking subsidiaries, and for our consolidated enterprise on a daily basis, including net overnight position, free securities, internal liquidity, available FHLB borrowing capacity and total asset liquidity. In order to identify emerging trends and risks and inform funding decisions, specific metrics are also forecasted over a one-year horizon.

For the six months ended June 30, 2014, our operating activities contributed \$1.0 billion in net cash, including an increase in other liabilities, which added \$354 million, and an increase in depreciation, amortization and accretion, which added \$196 million. For the six months ended June 30, 2014, net cash used by investing activities was \$5.6 billion, primarily reflecting net securities available for sale portfolio purchases of \$4.3 billion, and a net increase in loans and leases of \$2.2 billion, partially offset by proceeds from maturities, paydowns and sales of securities available for sale of \$2.1 billion. Additionally, securities held to maturity portfolio purchases of \$1.2 billion, occurred during the period. Finally, for the six months ended June 30, 2014, cash provided by financing activities was \$7.2 billion, including a net increase in other short-term borrowed funds of \$5.5 billion and a net increase in federal funds purchased and securities sold under agreement to repurchase of \$2.0 billion. These activities represented a cumulative increase in cash and cash equivalents

of \$2.6 billion, which, when added to the cash and cash equivalents balance of \$2.8 billion at the beginning of the period, resulted in an ending balance of cash and cash equivalents of \$5.4 billion as of June 30, 2014.

For the six months ended June 30, 2013, aggregate operating activities contributed \$1.4 billion in net cash. Significant items within this category included net loss of \$3.7 billion and goodwill impairment of \$4.4 billion. For the six months ended June 30, 2013, investing activities contributed net cash of \$4.9 billion, primarily reflecting proceeds from maturities, paydowns and sales of securities available for sale of \$5.3 billion, a decrease in loans and leases of \$2.0 billion, and a decrease in interest-bearing deposits in banks of \$1.1 billion, offset by purchases of securities available for sale of \$3.3 billion. Finally, financing activities utilized net cash of \$4.9 billion, primarily reflecting a decrease in deposits of \$3.8 billion, a net change in other short-term borrowed funds of \$500 million and dividends declared and paid to parent of \$428 million. Together, these activities resulted in a cumulative increase in cash and cash equivalents of \$1.4 billion. When added to the cash and cash equivalents balance of \$3.1 billion at the beginning of the period, the result was an ending cash and cash equivalents balance of \$4.5 billion at June 30, 2013.

For the year ended December 31, 2013, our operating activities contributed \$2.6 billion in net cash, including sales of mortgage loans net of originations which, added \$448 million, and a decrease in other assets, which added \$827 million. For the year ended December 31, 2013, net cash contributed by investing activities decreased by \$2.5 billion, primarily reflecting net securities available for sale portfolio purchases of \$11.0 billion, partially offset by proceeds from maturities, paydowns and sales of securities available for sale of \$8.4 billion. Finally, for the year ended December 31, 2013, cash used in financing activities was \$502 million, including a net decrease in deposits of \$3.0 billion, and \$1.2 billion in dividends paid to RBS. These activities represented a cumulative decrease in cash and cash equivalents of \$306 million, which, when added to cash and cash equivalents of \$3.1 billion at the beginning of the year, resulted in an ending balance of cash and cash equivalents of \$2.8 billion as of December 31, 2013.

Contractual Obligations

The following table presents our outstanding contractual obligations as of December 31, 2013:

	Total	Less than 1 year	1 to 3 years	3 to 5 years	After 5 years
	(in millions)				
Long-term borrowed funds	\$ 1,405	\$ —	\$ 9	\$ 30	\$ 1,366
Operating lease obligations	896	173	307	203	213
Time deposits	9,588	7,444	1,450	687	7
Purchase obligations ⁽¹⁾	581	456	87	38	—
	<u>\$ 12,470</u>	<u>\$ 8,073</u>	<u>\$ 1,853</u>	<u>\$ 958</u>	<u>\$ 1,586</u>

⁽¹⁾ Includes purchase obligations for goods and services covered by non-cancellable contracts and contracts including cancellation fees.

Off Balance Sheet Commitments

The following table presents our outstanding off balance sheet commitments. See Note 12 "Commitments, Guarantees and Contingencies," to our unaudited interim Consolidated Financial Statements for further discussion:

	June 30, 2014	December 31, 2013	Change	Percent
	(dollars in millions)			(%)
Commitment amount:				
Undrawn commitments to extend credit	\$ 54,353	\$ 53,987	\$366	1%
Financial standby letters of credit	2,622	2,556	66	3
Performance letters of credit	118	149	(31)	21
Commercial letters of credit	56	64	(8)	(13)
Marketing rights	54	54	-	-
Risk participation agreements	20	17	3	18
Residential mortgage loans sold with recourse	12	13	(1)	(8)
Total	<u>\$ 57,235</u>	<u>\$ 56,840</u>	<u>\$ 395</u>	<u>1%</u>

On May 29, 2014, we entered into an agreement to purchase auto loans on a quarterly basis in future periods. For the first year, the agreement requires the purchase of a minimum of \$250 million of outstanding balances to a maximum of \$600 million per quarterly period. For quarterly periods after the first year, the minimum and maximum purchases are \$400 million and \$600 million, respectively. The agreement automatically renews until terminated by either party. We may cancel the agreement at will with payment of a variable termination fee. After three years, there is no termination fee. For more information regarding this agreement, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Events."

Critical Accounting Estimates

Our Consolidated Financial Statements are prepared in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires us to establish accounting policies and make estimates that affect amounts reported in our Consolidated Financial Statements.

An accounting estimate requires assumptions and judgments about uncertain matters that could have a material effect on our Consolidated Financial Statements. Estimates are made using facts and circumstances known at a point in time. Changes in those facts and circumstances could produce results substantially different from those estimates. The most significant accounting policies and estimates and their related application are discussed below.

See Note 1 "Significant Accounting Policies" in our audited Consolidated Financial Statements for further discussion of our significant accounting policies.

Allowance for Credit Losses

Management's estimate of probable losses in our loan and lease portfolios including unfunded lending commitments is recorded in the allowance for loan and lease losses and the reserve for unfunded lending commitments, at levels that we believe to be appropriate as of the balance sheet date. Our determination of such estimates is based on a periodic evaluation of the loan and lease portfolios and unfunded credit facilities, as well as other relevant factors. This evaluation is inherently subjective and requires significant estimates and judgments of underlying factors, all of which are susceptible to change.

The allowance for loan and lease losses and reserve for unfunded lending commitments could be affected by a variety of internal and external factors. Internal factors include portfolio performance such as delinquency levels, assigned risk ratings, the mix and level of loan balances, differing economic risks associated with each loan category and the financial condition of specific borrowers. External factors include fluctuations in the general economy, unemployment rates, bankruptcy filings, developments within a particular industry, changes in collateral values and factors particular to a specific commercial credit such as competition, business and management performance. The allowance for loan and lease losses may be adjusted to reflect our current assessment of various qualitative risks, factors and events that may not be measured in our statistical procedures. There is no certainty that the allowance for loan and lease losses and reserve for unfunded lending commitments will be appropriate over time to cover losses because of unanticipated adverse changes in any of these internal, external or qualitative factors.

The evaluation of the adequacy of the commercial and commercial real estate allowance for loan and lease losses and reserve for unfunded lending commitments is primarily based on risk rating models that assess probability of default, loss given default and exposure at default on an individual loan basis. The models are primarily driven by individual customer financial characteristics and are validated against historical experience. Additionally, qualitative factors may be included in the risk rating models. After the aggregation of individual borrower incurred loss, additional overlays can be made based on back-testing against historical losses and forward loss curve ratios.

For nonaccruing commercial and commercial real estate loans with an outstanding balance of \$3 million or greater and for all commercial and commercial real estate TDRs (regardless of size), we conduct specific analysis on a loan level basis to determine the probable amount of credit loss. If appropriate, a specific allowance is established for the loan through a charge to the provision for credit losses. For all classes of impaired loans, individual loan measures of impairment may result in a charge-off to the allowance for loan and lease losses, if deemed appropriate. In such cases, the provision for credit losses is not affected when a specific reserve for at least that amount already exists. Techniques utilized include comparing the loan's carrying amount to the estimated present value of its future cash flows, the fair value of its underlying collateral, or the loan's observable market price. The technique applied to each impaired loan is based on the workout officer's opinion of the most probable workout scenario. Historically this has generally led to the use of the estimated present value of future cash flows approach. The fair value of underlying collateral will be used if the loan is

deemed collateral-dependent. For loans that use the fair value of underlying collateral approach, a charge-off assessment is performed quarterly to write the loans down to fair value.

For most non-impaired retail loan portfolio types, the allowance for loan and lease losses is based upon the incurred loss model utilizing the probability of default ("PD"), loss given default ("LGD") and exposure at default on an individual loan basis. When developing these factors, we may consider the loan product and collateral type, LTV ratio, lien position, borrower's credit, time outstanding, geographic location, delinquency status and incurred loss period. Incurred loss periods are reviewed and updated at least annually, and potentially more frequently when economic situations change rapidly, as they tend to fluctuate with economic cycles. Incurred loss periods are generally longer in good economic times and shorter in bad times.

For home equity lines and loans, a number of factors impact the PD. Specifically, the borrower's current FICO score, the utilization rate, delinquency statistics, borrower income, current combined loan to value ratio and months on books are all used to assess the borrower's creditworthiness. Similarly, the loss severity is also impacted by various factors, including the utilization rate, the combined loan to value ratio, the lien position, the Housing Price Index change for the location (as measured by the Case-Shiller index), months on books and current loan balance.

When we are not in a first lien position, we use delinquency information on the first lien exposures obtained from third-party credit information providers in the credit assessment. For all first liens, whether owned by a third party or by us, an additional assessment is performed on a quarterly basis. In this assessment, the most recent three months' performance of the senior liens is reviewed for delinquency (90 days or more past due), modification, foreclosure and/or bankruptcy statuses. If any derogatory status is present, the junior lien will be placed on nonaccrual status regardless of its delinquency status on our books. This subsequent change to nonaccrual status will alter the treatment in the PD model, thus affecting the reserve calculation.

In addition, the first lien exposure is combined with the second lien exposure to generate a combined LTV. The combined LTV is a more accurate reflection of the leverage of the borrower against the property value, as compared to the LTV from just the junior lien(s). The combined LTV is used for modeling both the junior lien PD and LGD. This also impacts the Allowance for Loan Loss rates for the junior lien HELOCs.

The above measures are all used to assess the PD and LGD for HELOC borrowers for whom we originated the loans. There is also a portfolio of home equity products that were originated and serviced by others ("SBO"); however, we currently service some of the loans in this portfolio. The SBO portfolio is modeled as a separate class and the reserves for this class are generated by using the delinquency roll rate models as described below.

For student loan and SBO portfolios, we estimate the allowance for loan loss by utilizing a delinquency roll rate model. For such a model, the portfolio is segmented by delinquency category (e.g. 30 days past due, 60 days past due, etc.). The purpose of this segmentation is to evaluate the probability of a loan flowing into the next delinquency stage category, within one month. The projected rate for each delinquency category is the moving average of the previous 12 months' rates, although the number of months used could vary by loan type, with the current month from the previous two years included to adjust for seasonality. For the portfolios utilizing the incurred loss model, roll rate models are also run as challenger models and can be used to support management overlays if deemed necessary. At a macro level, retail losses for all portfolio types may be affected by factors such as collateral values, unemployment rates and local economic conditions.

For retail TDRs that are not collateral-dependent, allowances are developed using the present value of expected future cash flows, compared to the recorded investment in the loans. Expected re-default factors are considered in this analysis. Retail TDRs that are deemed collateral-dependent are written down to the fair market value of the collateral less costs to sell. The fair value of collateral is periodically monitored subsequent to the modification.

Changes in the levels of estimated losses, even if minor, can significantly affect management's determination of an appropriate allowance for loan and lease losses. For consumer loans, losses are affected by such factors as loss severity, collateral values, economic conditions, and other factors. A 1% and 5% increase in the estimated loss rate for consumer loans at December 31, 2013 would have increased the allowance by \$5 million and \$25 million, respectively. The allowance for loan and lease losses for our Commercial Banking segment is sensitive to assigned credit risk ratings and inherent loss rates. If 10% and 20% of the December 31, 2013 period ending loan balances (including unfunded commitments) within each risk rating category of our Commercial Banking segment had experienced downgrades of two risk categories, the allowance for loan and lease losses would have increased by \$32 million and \$64 million, respectively, as of December 31, 2013.

Commercial loans and leases are charged off to the allowance when there is little prospect of collecting either principal or interest. Charge-offs of commercial loans and leases usually involve receipt of borrower-specific adverse

information. For commercial collateral-dependent loans, an appraisal or other valuation is used to quantify a shortfall between the fair value of the collateral less costs to sell and the recorded investment in the commercial loan. Retail loan charge-offs are generally based on established delinquency thresholds rather than borrower-specific adverse information. When a loan is collateral-dependent, any shortfalls between the fair value of the collateral less costs to sell and the recorded investment is promptly charged off. Placing any loan or lease on nonaccrual status does not by itself require a partial or total charge-off; however, any identified losses are charged off at that time.

For additional information regarding the allowance for loan and lease losses and reserve for unfunded lending commitments, see Note 4 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 5 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk,” and Note 1 “Significant Accounting Policies,” to our audited Consolidated Financial Statements.

Nonperforming Loans and Leases

Commercial loans, commercial real estate loans and leases are generally placed on nonaccrual status when contractually past due 90 days or more, or earlier if management believes that the probability of collection is insufficient to warrant further accrual. Some of these loans and leases may remain on accrual status when contractually past due 90 days or more if management considers the loan collectible. A loan may be returned to accrual status if (i) principal and interest payments have been brought current and we expect repayment of the remaining contractual principal and interest, (ii) the loan or lease has otherwise become well-secured and in the process of collection, or (iii) the borrower has been making regularly scheduled payments in full for the prior 6 months and it is reasonably assured that the loan or lease will be brought fully current within a reasonable period. Cash receipts on nonaccruing loans and leases are generally applied to reduce the unpaid principal balance.

Residential mortgages are generally placed on nonaccrual status when past due 120 days, or sooner if determined to be collateral-dependent. Residential mortgages are returned to accrual status when principal and interest payments become less than 120 days past due and when future payments are reasonably assured. Credit card balances (included in the “unsecured” retail class of loans) are placed on nonaccrual status when past due 90 days or more. Credit card balances are restored to accruing status if they subsequently become less than 90 days past due. Government guaranteed student loans (included in the “unsecured” class of loans) are not placed on nonaccrual status.

All other retail loans are generally placed on nonaccrual status when past due 90 days or more, or earlier if management believes the probability of collection is insufficient to warrant further accrual. Loans less than 90 days past due may be placed on nonaccrual status upon the death of the borrower, surrender or repossession of collateral, fraud or bankruptcy. Loans are generally returned to accrual status if the loan becomes less than 15 days past due. Cash receipts on nonaccruing loans and leases are generally applied to reduce the unpaid principal balance. Certain TDRs that are current in payment status are classified as nonaccrual in accordance with regulatory guidance. Income on these loans is generally recognized on a cash basis if management believes the remaining book value of the loan is realizable. Nonaccruing TDRs that meet the guidelines above for accrual status can be returned to accruing if supported by a well-documented evaluation of the borrower’s financial condition, and if they have been current for at least 6 months.

Additional information regarding our nonperforming loans and leases can be found in Note 4 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 5 “Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk,” and Note 1 “Significant Accounting Policies,” to our audited Consolidated Financial Statements.

Impaired Loans

A loan is considered to be impaired when it is probable that we will be unable to collect all of the contractual interest and principal payments as scheduled in the loan agreement. Impaired loans include nonaccruing larger balance (greater than \$3 million carrying value) non-homogenous commercial and commercial real estate loans, and restructured loans that are deemed TDRs. A loan modification is identified as a TDR when we, or a bankruptcy court, grants the borrower a concession that we would not otherwise make in response to the borrower’s financial difficulties. Concessions granted in TDRs for all classes of loans may include lowering the interest rate, forgiving a portion of principal, extending the loan term, lowering scheduled payments for a specified period of time, principal forbearance, or capitalizing past due amounts. A rate increase can be a concession if the increased rate is lower than a market rate for debt with risk similar to that of the restructured loan. Additionally, TDRs for commercial loans may also involve creating a multiple note structure, accepting non-cash assets, accepting an equity interest, or receiving a performance-based fee. In some cases a TDR may involve multiple concessions. The financial effects of TDRs for all loan classes may include lower income (either due to a lower interest rate or a delay in the timing of cash flows), larger loan loss provisions and accelerated charge-offs if the

modification renders the loan collateral-dependent. In some cases, interest income throughout the term of the loan may increase if, for example, the loan is extended or the interest rate is increased as a result of the restructuring.

Impairment evaluations are performed at the individual loan level, and consider expected future cash flows from the loan, including, if appropriate, the realizable value of collateral. Impaired loans that are not TDRs are nonaccruing, and loans involved in TDRs may be accruing or nonaccruing. Retail loans that were discharged in bankruptcy and not reaffirmed by the customer are generally deemed to be collateral-dependent TDRs and are charged off to the fair value of the collateral, less cost to sell, and less amounts recoverable under a government guarantee (if any). Recently issued regulatory guidance on bankruptcy-discharged TDRs permits banks to apply judgment in the evaluation of the probability of loan repayment. As a result of the new guidance (which was issued in February 2014), loans for which we have documented that repayment is likely to occur need not be charged down to collateral value. Cash receipts on nonaccruing impaired loans, including nonaccruing loans involved in TDRs, are generally applied to reduce the unpaid principal balance.

Loans are generally restored to accrual status when principal and interest payments are brought current and when future payments are reasonably assured, following a sustained period of repayment performance by the borrower in accordance with the loan's contractual terms.

For additional information regarding our impaired loans, see Note 4 "Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk" to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 5 "Allowance for Credit Losses, Nonperforming Assets and Concentrations of Credit Risk," and Note 1 "Significant Accounting Policies," to our audited Consolidated Financial Statements.

Fair Value

We measure fair value using the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is based upon quoted market prices in an active market, where available. If quoted prices are not available, observable market-based inputs or independently sourced parameters are used to develop fair value, whenever possible. Such inputs may include prices of similar assets or liabilities, yield curves, interest rates, prepayment speeds and foreign exchange rates.

We classify our assets and liabilities that are carried at fair value in accordance with the three-level valuation hierarchy:

- Level 1. Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by market data for substantially the full term of the asset or liability; and
- Level 3. Unobservable inputs that are supported by little or no market information and that are significant to the fair value measurement.

Classification in the hierarchy is based upon the lowest level input that is significant to the fair value measurement of the asset or liability. For instruments classified in Level 1 and 2 where inputs are primarily based upon observable market data, there is less judgment applied in arriving at the fair value. For instruments classified in Level 3, management judgment is more significant due to the lack of observable market data.

Significant assets measured at fair value on a recurring basis include our mortgage-backed securities available for sale. These instruments are priced using an external pricing service and are classified as Level 2 within the fair value hierarchy. The service's pricing models use predominantly observable valuation inputs to measure the fair value of these securities under both the market and income approaches. The pricing service utilizes a matrix pricing methodology to price our U.S. agency pass-through securities, which involves making adjustments to to-be-announced security prices based on a matrix of various mortgage-backed securities characteristics such as weighted-average maturities, indices and other pool-level information. Other agency and non-agency mortgage-backed securities are priced using a discounted cash flow methodology. This methodology includes estimating the cash flows expected to be received for each security using projected prepayment speeds and default rates based on historical statistics of the underlying collateral and current market conventions. These estimated cash flows are then discounted using market-based discount rates that incorporate characteristics such as average life, volatility, ratings, performance of the underlying collateral, and prevailing market conditions.

We review and update the fair value hierarchy classifications on a quarterly basis. Changes from one quarter to the next related to the observability of inputs in fair value measurements may result in a reclassification between the fair value hierarchy levels and are recognized based on period-end balances. We also verify the accuracy of the pricing provided by

our primary external pricing service on a quarterly basis. This process involves using a secondary external vendor to provide valuations for our securities portfolio for comparison purposes. Any securities with discrepancies beyond a certain threshold are researched and, if necessary, valued by an independent outside broker.

Fair value is also used on a nonrecurring basis to evaluate certain assets for impairment or for disclosure purposes. Examples of nonrecurring uses of fair value include mortgage servicing rights accounted for by the amortization method, loan impairments for certain loans and goodwill.

For additional information regarding our fair value measurements, see Note 2 “Securities,” Note 6 “Mortgage Banking,” and Note 11 “Derivatives” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 “Significant Accounting Policies,” Note 3 “Securities,” Note 9 “Mortgage Banking” and Note 15 “Derivatives” to our audited Consolidated Financial Statements.

Goodwill

Goodwill is an asset that represents the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is not amortized, but is subject to annual impairment tests. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. A reporting unit is a business operating segment or a component of a business operating segment. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit’s fair value to its carrying value including goodwill. If the fair value of a reporting unit exceeds its carrying value, applicable goodwill is deemed to be not impaired. If the carrying value exceeds fair value, there is an indication of impairment and the second step is performed to measure the amount of impairment.

The second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, which is the excess of the fair value of the reporting unit, as determined in the first step, over the aggregate fair values of the individual assets, liabilities and identifiable intangible assets as if the reporting unit were being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss recognized cannot exceed the amount of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

We review goodwill for impairment annually as of October 31 (previously as of September 30) or more often if events or circumstances indicate that it is more likely than not that the fair value of one or more reporting units is below its carrying value. We rely on the income approach (discounted cash flow method) as the primary method for determining fair value. Market-based methods are used as benchmarks to corroborate the value determined by the discounted cash flow method.

We rely on several assumptions when estimating the fair value of our reporting units using the discounted cash flow method. These assumptions include the current discount rate, as well as projected loan losses, income taxes and capital retention rates. Discount rates are estimated based on the Capital Asset Pricing Model, which considers the risk-free interest rate, market risk premium, beta and unsystematic risk and size premium adjustments specific to a particular reporting unit. The discount rates are also calibrated on the assessment of the risks related to the projected cash flows of each reporting unit. Multi-year financial forecasts are developed for each reporting unit by considering several key business drivers such as new business initiatives, customer retention standards, market share changes, anticipated loan and deposit growth, forward interest rates, historical performance and industry and economic trends, among other considerations. The long-term growth rate used in determining the terminal value of each reporting unit was estimated based on management’s assessment of the minimum expected terminal growth rate of each reporting unit, as well as broader economic considerations such as gross domestic product and inflation.

We corroborate the fair value of our reporting units determined by the discounted cash flow method using market-based methods: a comparable company method and a comparable transaction method. The comparable company method measures fair value of a business by comparing it to publicly traded companies in similar lines of business. This involves identifying and selecting the comparable companies based on a number of factors (i.e., size, growth, profitability, risk and return on investment), calculating the market multiples (i.e., price-to-tangible book value, price-to-cash earnings and price-to-net income) of these comparable companies and then applying these multiples to our operating results to estimate the value of the reporting unit’s equity on a marketable, minority basis. A control premium is then applied to this

value to estimate the fair value of the reporting unit on a marketable, controlling basis. The comparable transaction method measures fair value of a business based on exchange prices in actual transactions and on asking prices for controlling interests in public or private companies currently offered for sale. The process involves comparison and correlation of ourselves with other similar companies. Adjustments for differences in factors described earlier (i.e., size, growth, profitability, risk and return on investment) are also considered.

The valuation of goodwill is dependent on forward-looking expectations related to the performance of the U.S. economy and our associated financial performance. The prolonged delay in the full recovery of the U.S. economy, and the impact of that delay on earnings expectations, prompted a goodwill impairment test as of June 30, 2013. Although the U.S. economy has demonstrated signs of recovery, notably improvements in unemployment and housing, the pace and extent of recovery in these indicators, as well as in overall gross domestic product, have lagged previous expectations. The impact of the slow recovery is most evident in our Consumer Banking reporting unit. Accordingly, the percentage by which the estimated fair value of our Consumer Banking reporting unit exceeded its carrying value declined from 7% at December 31, 2011 to 5% at December 31, 2012.

During the first half of 2013, we observed further deceleration of expected growth for our Consumer Banking reporting unit's future profits based on forecasted economic growth for the U.S. economy and the continuing impact of the new regulatory framework in the financial industry. This deceleration was incorporated into our revised earnings forecast in the second quarter of 2013, and we subsequently concluded that there was a likelihood of greater than 50% that goodwill impairment had occurred as of June 30, 2013.

An interim goodwill impairment test was subsequently performed for our Consumer Banking and Commercial Banking reporting units. Step One of these tests indicated that (1) the fair value of our Consumer Banking reporting unit was less than its carrying value by 19% and (2) the fair value of our Commercial Banking reporting unit exceeded its carrying value by 27%. Step Two of the goodwill impairment test was subsequently performed for our Consumer Banking reporting unit, which resulted in the recognition of a pretax \$4.4 billion impairment charge in our Consolidated Statement of Operations for the period ending June 30, 2013. The impairment charge, which was a non-cash item, had minimal impact on our Tier 1 and total capital ratios. The impairment charge had no impact on our liquidity position or tangible common equity.

We performed an annual test for impairment of goodwill for both reporting units as of October 31, 2013. As of this testing date, the percentage by which the fair value of our Consumer Banking reporting unit exceeded its carrying value was 21%, and the percentage by which the fair value of our Commercial Banking reporting unit exceeded its carrying value was 31%.

We based the fair value estimates used in our annual goodwill impairment testing on assumptions we believe to be representative of assumptions that a market participant would use in valuing the reporting units but that are unpredictable and inherently uncertain, including estimates of future growth rates and operating margins and assumptions about the overall economic climate and the competitive environment for our reporting units. There can be no assurances that future estimates and assumptions made for purposes of goodwill testing will prove accurate predictions of the future. If the assumptions regarding business plans, competitive environments or anticipated growth rates are not achieved, we may be required to record goodwill impairment charges in future periods.

For additional information regarding our goodwill impairment testing, see Note 5 "Goodwill" to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 1 "Significant Accounting Policies" and Note 8 "Goodwill" to our audited Consolidated Financial Statements.

Income Taxes

Accrued income taxes are reported as a component of either other assets or other liabilities, as appropriate, in the audited Consolidated Balance Sheets and reflect our estimate of income taxes to be paid or that effectively have been prepaid. Deferred income tax assets and liabilities represent the amount of future income taxes to be paid or that effectively have been prepaid, and the net balance is reported as an asset or liability in the audited Consolidated Balance Sheets. We determine the realization of the deferred tax asset based upon an evaluation of the four possible sources of taxable income: (1) the future reversals of taxable temporary differences; (2) future taxable income exclusive of reversing temporary differences and carryforwards; (3) taxable income in prior carryback years; and (4) tax planning strategies. In projecting future taxable income, we utilize forecasted pretax earnings, adjust for the estimated book-tax differences and incorporate assumptions, including the amount of income allocable to taxing jurisdictions. These assumptions require significant judgment and are consistent with the plans and estimates that we use to manage the underlying businesses. The realization of the deferred tax assets could be reduced in the future if these estimates are significantly different than forecasted.

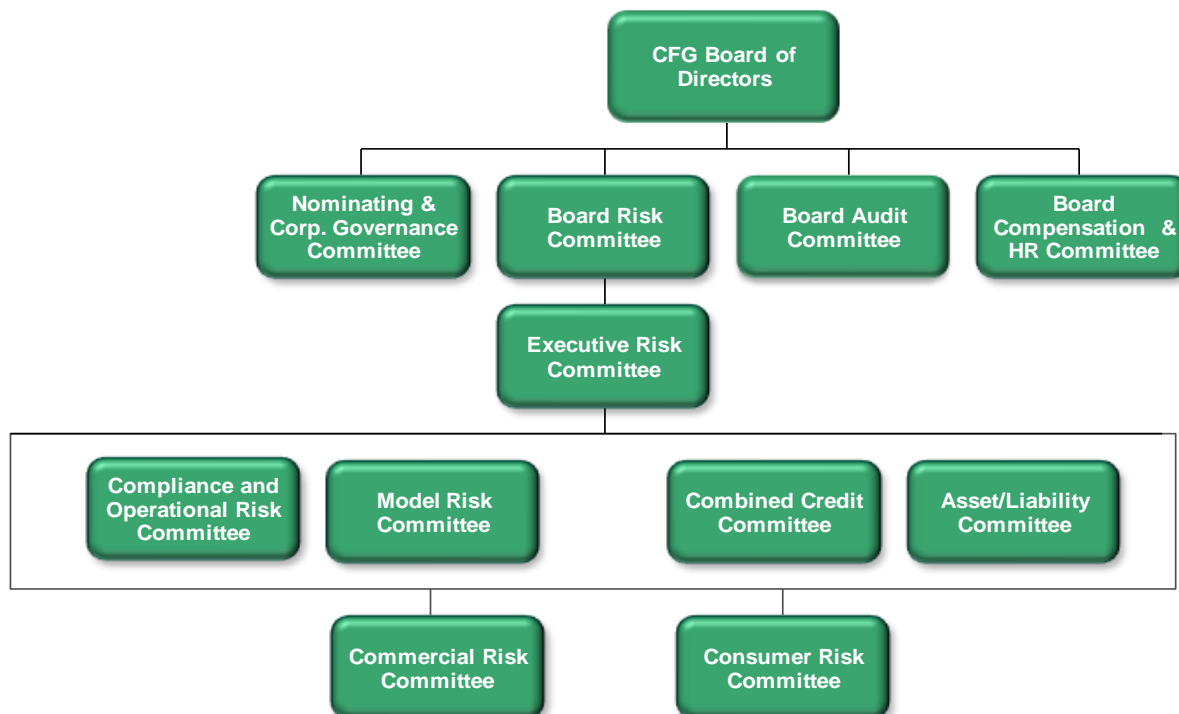
We are subject to income tax in the United States and multiple state and local jurisdictions. The tax laws and regulations in each jurisdiction may be interpreted differently in certain situations, which could result in a range of outcomes. Thus, we are required to exercise judgment regarding the application of these tax laws and regulations. We evaluate and recognize tax liabilities related to any tax uncertainties. Due to the complexity of some of these uncertainties, the ultimate resolution may differ from the current estimate of tax liabilities or refunds.

Our estimate of accrued income taxes, deferred income taxes and income tax expense can also change in any period as a result of new legislative or judicial guidance impacting tax positions, as well as changes in income tax rates. Any changes, if they occur, can be significant to our audited consolidated financial position, results of operations or cash flows.

For additional information regarding income taxes, see Note 10 “Income Taxes” to our unaudited interim Consolidated Financial Statements included elsewhere in this report, as well as Note 14 “Income Taxes” and Note 1 “Significant Accounting Policies” to our audited Consolidated Financial Statements.

Risk Governance and Quantitative and Qualitative Disclosures About Risk

We are committed to maintaining a strong, integrated and proactive approach to the management of all risks to which we are exposed in pursuit of our business objectives. A key aspect of our Board’s responsibility as the main decision making body is setting our risk appetite to ensure that the levels of risk that we are willing to accept in the attainment of our strategic business and financial objectives are clearly understood.



To enable the Board to carry out its objectives, it has delegated authority for risk management activities, as well as governance and oversight of those activities, to a number of Board and executive management level risk committees. The key committees that specifically consider risk across the enterprise are set out in the diagram below.

Chief Risk Officer

The Chief Risk Officer, or CRO, directs our overall risk management function overseeing the compliance, regulatory, operational and credit risk management. In addition, the CRO has oversight of the management of market, liquidity and strategic risks. The CRO reports to our CEO and Board Risk Committee.

Risk Framework

Our risk management framework is embedded in our business through a “Three Lines of Defense” model which defines responsibilities and accountabilities.

First Line of Defense

The business lines (including their associated support functions) are the First Line of Defense and are accountable for owning and managing, within our defined risk appetite, the risks which exist in their respective business areas. The business lines are responsible for performing regular risk assessments to identify and assess the material risks that arise in their area of responsibility, complying with relevant risk policies, testing and certifying the adequacy and effectiveness of their controls on a regular basis, establishing and documenting operating procedures and establishing and owning a governance structure for identifying and managing risk.

Second Line of Defense

The Second Line of Defense includes independent monitoring and control functions accountable for developing and ensuring implementation of risk and control frameworks, oversight of risk, financial management and valuation, and regulatory compliance. This centralized risk function is appropriately independent from the business and is accountable for overseeing and challenging our business lines on the effective management of their risks. This risk function utilizes training, communications and awareness to provide expert support and advice to the business lines. This includes interpreting the risk policy standards and risk management framework, overseeing compliance by the businesses with policies and responsibilities, including providing relevant management information and escalating concerns where appropriate.

The Executive Risk Committee, chaired by the CRO, actively considers our inherent material risks, analyzes our overall risk profile and seeks confirmation that the risks are being appropriately identified, assessed and mitigated.

Third Line of Defense

Our internal audit function is the Third Line of Defense acting as an independent appraisal and assurance function. As an independent assurance function, internal audit ensures the key business risks are being managed to an acceptable level and that the risk management and internal control framework is operating effectively. Independent assessments are provided to our Audit Committee on a monthly basis and to the Board and executive management in the form of quarterly opinions.

Risk Appetite

Risk Appetite is a strategic business and risk management tool. We define our risk appetite as the maximum limit of acceptable risk beyond which we would either be unable to achieve our strategic objectives and capital adequacy obligations or would assume an unacceptable amount of risk to do so. The Board Risk Committee advises our Board of Directors in relation to current and potential future risk strategy, including determination of risk appetite and tolerance.

The principal non-market risks to which we are subject are: credit risk, operational risk, liquidity risk, strategic risk and reputational risk. We are also subject to market risks. Market risk refers to potential losses arising from changes in interest rates, foreign exchange rates, equity prices, commodity prices and/or other relevant market rates or prices. Market risk does not result from proprietary trading, which we prohibit. Rather, modest market risk arises from trading activities that serve customer needs, including hedging of interest rate and foreign exchange risk. As described below, more material market risk arises from our non-trading banking activities, such as loan origination and deposit-gathering. We have established enterprise-wide policies and methodologies to identify, measure, monitor and report market risk. We actively manage both trading and non-trading market risks. We are also subject to liquidity risk, discussed above under “—Liquidity.”

Our risk appetite framework and risk limit structure establishes guidelines to determine the balance between existing and desired levels of risk and supports the implementation, measurement and management of our risk appetite policy.

Credit Risk

Overview

Credit risk represents the potential for loss arising from a customer, counterparty, or issuer failing to perform in accordance with the contractual terms of the obligation. While the majority of our credit risk is associated with lending activities, we do engage with other financial counterparties for a variety of purposes including investing, asset and liability management, and trading activities. Given the financial impact of credit risk on our profit and loss and balance sheet, the

assessment, approval, and management of credit risk represents a major part of our overall risk-management responsibility.

Objective

The credit risk management organization is responsible for approving credit transactions, monitoring portfolio performance, identifying problem loans, and ensuring remedial management.

Organizational Structure

Management and oversight of credit risk is the responsibility of the Chief Credit Officers (“CCO”). Although there is substantial overlap between our consumer and commercial risk management functions and our business segments, Consumer Banking and Commercial Banking, as well as Other, the allocation of a line of business to either Consumer Banking or Commercial Banking for accounting purposes does not necessarily align with our risk management categories. The relevant CCO and their teams oversee the management of credit risk activities, under the guidance of the CRO. There are additional matrix reporting lines for the CCOs and CRO that tie into the segment executive management, as well as the RBS Group Credit Risk Management. From a commercial perspective, it is likely that some matrix reporting lines will continue into the RBS Group Risk functions for as long as we are majority owned by the RBS Group.

The credit risk teams operate independently from the business lines to ensure decisions are not influenced by unbalanced objectives. Each team is comprised of senior credit officers who possess extensive experience structuring and approving loans.

Governance

The primary mechanisms used to govern our credit risk function are our consumer and commercial credit policies. These policies outline the minimum acceptable lending standards that align with our desired risk appetite. Material issues or changes are identified by the individual committees and presented to the Combined Credit Risk Committee, Executive Risk Committee and the Board for approval as required.

Key Management Processes

To ensure credit risks are managed within our risk appetite and business and risk strategies are achieved, we employ a comprehensive and integrated control program. The program’s objective is to proactively (1) identify, (2) measure, (3) monitor, and (4) mitigate existing and emerging credit risks across the lifecycle (origination, account management/portfolio management, and loss mitigation and recovery).

On the consumer banking side of credit risk, our teams use models to evaluate consumer loans across the lifecycle of the loan. Starting at origination, credit scoring models are used to forecast the probability of default of an applicant. These models are embedded in the loan origination system, which allows for real-time scoring and automated decisions for many of our products. Periodic validations are performed on our purchased and proprietary scores to ensure fit for purpose. When approving customers for a new loan or extension of an existing credit line, credit scores are used in conjunction with other credit risk variables such as affordability, length of term, collateral value, collateral type, and lien subordination.

The origination process is supported by dedicated underwriting teams that reside in the business line. The size of each team depends on the intensity of the approval process as the number of handoffs, documentation, and verification requirements differ substantially depending on the loan product.

To ensure proper oversight of the underwriting teams, lending authority is granted by credit risk to each underwriter. The amount of delegated authority depends on the experience of the individual. We periodically evaluate the performance of each underwriter and annually reauthorize their delegated authority. Only senior members of the credit risk team are authorized to grant significant exceptions to credit policies. It is not uncommon to make exceptions to established policies when compensating factors are present. These exceptions are capped at 5% of origination volume and tracked separately to ensure performance expectations are achieved.

Once an account is established, credit scores and collateral values are refreshed at regular intervals to allow for proactive identification of increasing or decreasing levels of credit risk. For accounts with contingent liability (revolving feature), credit policies have been developed that leverage the refreshed customer data to determine if a credit line should be increased, decreased, frozen, or closed. Lastly, behavioral modeling, segmentation, and loan modifications are used to cure delinquency, reduce the severity of loss, and maximize recoveries. Our approach to managing credit risk is highly analytical and, where appropriate, is automated, to ensure consistency and efficiency.

One of the central tools used to manage credit risk is the Consumer and Small Business Credit Risk Dashboard. This dashboard is refreshed monthly and evaluates key dimensions of credit risk against predefined parameters, commonly referred to as triggers and limits. Triggers are designed to alert senior management of unfavorable performance deviations from current risk profile and provide sufficient lead time to address and implement corrective actions before the risk increases in materiality. Where appropriate, triggers are aligned to budget expectations and operational targets. Limits, conversely, are designed to represent the maximum risk tolerance or appetite we are willing to accept in any given year.

The credit risk team is constantly evaluating current and projected economic conditions, internal credit performance in relation to budget and predefined risk tolerances, and current and expected regulatory guidance to determine the optimal balance of expansion and contraction policies. All policy change proposals receive intense scrutiny and syndication prior to approval and implementation. This process ensures decisions are made based on profit based analytics with full consideration to operational and regulatory risks.

On the commercial banking side of credit risk, the structure is broken into Commercial and Industrial (“C&I”) loans and leases and Commercial Real Estate (“CRE”). Within C&I there are separate verticals established for certain specialty products (e.g., asset based lending, leasing, franchise finance, health care, technology, mid-corporate). A “specialty vertical” is a stand-alone team of industry or product specialists. Substantially all activity that falls under the ambit of the defined industry or product is managed through a specialty vertical when one exists. CRE also operates as a specialty vertical.

Commercial credit risk management begins with defined credit products and policies. New credit products and material changes to existing credit products require multiple levels of review and approval. The initial level of review involves the engagement of risk disciplines from across the enterprise for a New Product Risk Assessment. This assessment process reviews the product description, strategic rationale and financial impact and considers the risk impact from multiple perspectives (Reputation, Operational, Regulatory, Market, Legal as well as Credit). Credit risk approval then involves the determination and development of credit policy which includes the approval of the appropriate credit risk acceptance criteria beyond the general credit underwritings standards that already exist.

Commercial transactions are subject to individual analysis and approval at origination and thereafter are subject to formal annual reviews. The underwriting process includes the establishment and approval of Credit Grades that confirm the Probability of Default (“PD”) and Loss Given Default (“LGD”). Approval then requires both a business line approver and an independent Credit Approver. The approval level is determined by the size of the credit relationship as well as the PD with larger relationships and weaker PD’s requiring more senior individuals. The checks and balances in the credit process and the independence of the credit approver function are designed to appropriately assess and sanction the level of credit risk being accepted, facilitate the early recognition of credit problems when they occur, and to provide for effective problem asset management and resolution. All authority to grant credit is delegated through the independent credit administration function and is closely monitored and regularly updated.

The primary factors considered in commercial credit approvals are the financial strength of the borrower, assessment of the borrower’s management capabilities, cash flows from operations, industry sector trends, type and sufficiency of collateral, type of exposure, transaction structure, and the general economic outlook. While these are the primary factors considered, there are a number of other factors that may be considered in the decision process. In addition to the credit analysis conducted during the approval process at origination and annual review, our Credit Quality Assurance group performs testing to provide an independent review and assessment of the quality and/or risk of new loan originations. This group is part of our Risk Management area, and conducts portfolio reviews on a risk-based cycle to evaluate individual loans, validate risk ratings, as well as test the consistency of the credit processes.

The maximum level of credit exposure to individual credit borrowers is limited by policy guidelines based on the perceived risk of each borrower or related group of borrowers. Concentration risk is managed through limits on industry (sector), loan type (asset class), and loan quality factors. We focus predominantly on extending credit to commercial customers with existing or expandable relationships within our primary banking markets, although we will consider lending opportunities outside our primary markets if we believe that the associated risks are acceptable and aligned with strategic initiatives. Geographic considerations occur at both the transactional level as well as the product level, as certain specialties operate on a national basis.

Our management of risk concentrations includes the establishment of Sector and Asset Class limits which track and report correlated risk exposures. We established limits for 29 separate Sectors. These Sector Limits are approved annually by the Concentration Risk Management Committee. Exposure against these limits is tracked on a monthly basis. The two largest sector concentrations are Industrials and CRE.

Apart from Industrials and CRE (which together make up 29% of the commercial utilization as of June 30, 2014), we do not have any major sector concentrations. The Industrial sector includes basic C&I lending focused on general manufacturing. The sector is diversified and not managed as a specialized vertical. Our customers are local to our market and present no significant concentration. We have a smaller concentration in CRE than our peer banks based on industry data obtained from SNL Financial. As of March 31, 2014, our CRE outstandings amounted to 12% of total outstanding loans. According to SNL Financial, the corresponding ratio for peer banks was 18%.

We have also established, through the Concentration Risk Management Committee, Asset Class Limits to further measure and manage concentration risks. Asset classes include Leveraged Lending, Franchise Finance and Loan Underwriting Risk. These asset class limits are expressed as either a percentage of capital or by specific dollar thresholds. Exposure against these limits is tracked quarterly.

Our standardized credit grading system considers many components that directly correlate to loan quality and likelihood of repayment. Our assessment of a borrower's credit strength, or lack thereof, is reflected in our risk ratings for such loans, which are directly tied to, and an integral component of, our allowance for loan and lease losses methodology. When deterioration in credit strength is noted, a loan becomes subject to Watch Review. The Watch Review process evaluates the weaknesses and recommends corrective strategy. The Watch Review process involves senior representatives from the business line portfolio management team, credit and our Global Recovery Group ("GRG"). If a viable corrective action strategy is not achieved, the credit is subject to classification as either Criticized or Classified which triggers a risk rating downgrade. As such, the loan would attract a higher allowance for loan and lease losses requirement, be subject to more frequent review (including continued inclusion in the Watch Review process), and be reported as a "non-pass" credit to our regulators. In addition, all classified assets are transferred to GRG.

Substantially all loans categorized as Classified are managed by GRG. GRG is a specialized group of credit professionals that handles the day-to-day management of workouts, commercial recoveries, and problem loan sales. Its responsibilities include developing and implementing action plans, assessing risk ratings, and determining the appropriateness of the allowance, the accrual status, and the ultimate collectability of the Classified loan portfolio.

Market Risk

Market risk refers to potential losses arising from changes in interest rates, foreign exchange rates, equity prices, commodity prices and/or other relevant market rates or prices. Market risk does not result from proprietary trading, which we prohibit. Rather, modest market risk arises from trading activities that serve customer needs, including hedging of interest rate and foreign exchange risk. As described below, more material market risk arises from our non-trading banking activities, such as loan origination and deposit-gathering. We have established enterprise-wide policies and methodologies to identify, measure, monitor and report market risk. We actively manage both trading and non-trading market risks.

Non-Trading Risk

We are exposed to market risk as a result of non-trading banking activities. This market risk is comprised entirely of interest rate risk, as we have no direct currency, equity or commodity risk. This interest rate risk emerges from the balance sheet after the aggregation of our assets, liabilities and equity. We refer to this non-trading risk embedded in the balance sheet as "structural interest rate risk" or "interest rate risk in the banking book." Our mortgage servicing rights assets also contain interest rate risk as the value of the fee stream is impacted by the level of long-term interest rates.

A major source of structural interest rate risk is a difference in the repricing of assets, on the one hand, and liabilities and equity, on the other. First, there are differences in the timing of rate changes reflecting the maturity and/or repricing of assets and liabilities. For example, the rate earned on a residential mortgage may be fixed for 30 years; the rate paid on a certificate of deposit may be fixed only for a few months. Due to these timing differences, net interest income is sensitive to changes in the level and shape of the yield curve. Second, there are differences in the drivers of rate changes of various assets and liabilities. For example, commercial loans may reprice based on one-month LIBOR or prime; the rate paid on retail money market demand accounts may be only loosely correlated with LIBOR and depend on competitive demand for funds. Due to these basis differences, net interest income is sensitive to changes in spreads between certain indices or repricing rates.

Another important source of structural interest rate risk relates to the potential exercise of explicit or embedded options. For example, most consumer loans can be prepaid without penalty; and most consumer deposits can be withdrawn without penalty. The exercise of such options by customers can exacerbate the timing differences discussed above.

A primary source of our structural interest rate risk relates to faster repricing of floating rate loans relative to the retail deposit funding. This source of asset sensitivity is concentrated at the short end of the yield curve. Given the very low level of short-term interest rates, this risk is asymmetrical with significantly more upside benefit than potential exposure. The secondary source of our interest rate risk is driven by longer term rates comprising the rollover or reinvestment risk on fixed rate loans as well as the prepayment risk on mortgage related loans and securities funded by non-rate sensitive deposits and equity.

The primary goal of interest rate risk management is to control exposure to interest rate risk within policy limits approved by the Board. These limits and guidelines reflect our tolerance for interest rate risk over both short-term and long-term horizons. To ensure that exposure to interest rate risk is managed within this risk appetite, we must both measure the exposure and, as necessary, hedge it. The Treasury Asset and Liability Management team is responsible for measuring, monitoring and reporting on the structural interest rate risk position. These exposures are reported on a monthly basis to the Asset and Liability Committee and at Board meetings.

We measure structural interest rate risk through a variety of metrics intended to quantify both short-term and long-term exposures. The primary method that we use to quantify interest rate risk is simulation analysis in which we model net interest income from assets, liabilities and hedge derivative positions under various interest rate scenarios over a three-year horizon. Exposure to interest rate risk is reflected in the variation of forecasted net interest income across scenarios.

Key assumptions in this simulation analysis relate to the behavior of interest rates and spreads, the changes in product balances and the behavior of loan and deposit clients in different rate environments. The most material of these behavioral assumptions relate to the repricing characteristics and balance fluctuations of deposits with indeterminate (i.e., non-contractual) maturities as well as the pace of mortgage prepayments.

As the future path of interest rates cannot be known in advance, we use simulation analysis to project net interest income under various interest rate scenarios including a “most likely” (implied forward) scenario as well as a variety of deliberately extreme and perhaps unlikely scenarios. These scenarios may assume gradual ramping of the overall level of interest rates, immediate shocks to the level of rates and various yield curve twists in which movements in short- or long-term rates predominate. Generally, projected net interest income in any interest rate scenarios is compared to net interest income in a base case where market forward rates are realized.

The table below reports net interest income exposures against a variety of interest rate scenarios. Exposures are measured as a percentage change in net interest income over the next year due to either instantaneous, or gradual parallel +/- 200 basis point moves in benchmark interest rates. The net interest income simulation analyses do not include possible future actions that management might undertake to mitigate this risk. The current limit is an adverse change of 10% related to an instantaneous +/- 200 basis point move. As the table illustrates, our balance sheet is asset-sensitive: net interest income would benefit from an increase in interest rates. Exposure to a decline in interest rates is well within limit. It should be noted that the magnitude of any possible decline in interest rates is constrained by the low absolute starting levels of rates. While an instantaneous and severe shift in interest rates was used in this analysis, we believe that any actual shift in interest rates would likely be more gradual and would therefore have a more modest impact.

The table below summarizes our positioning in various parallel yield curve shifts:

Basis points

Estimated % Change in Net Interest Income over 12 Months			
	Tolerance Level	June 30, 2014	December 31, 2013
Instantaneous Change in Interest Rates			
+200	(10)%	13.4%	16.1%
+100		6.8%	8.0%
-100		(2.7)%	(3.7)%
-200	(10)%	(3.4)%	(5.7)%
Gradual Change in Interest Rates			
+200		6.6%	6.8%
+100		3.2%	3.2%
-100		(1.4)%	(2.0)%
-200		(2.1)%	(3.0)%

As part of the routine risk management process, a wide variety of similar analyses are reported for each of the next three rolling years.

As recommended by bank regulators, CBPA also uses a valuation measure of exposure to structural interest rate risk, Economic Value of Equity, as a supplement to net interest income simulations. Nevertheless, multi-year net interest income simulation is the main tool for managing structural interest rate risk.

As noted, the balance sheet is asset-sensitive, positioned to benefit from an increase in interest rates. The magnitude of this asset-sensitivity has been reduced from more elevated levels at the end of 2012. At that time, the extremely low levels of medium- to long-term interest rates presented a poor risk-to-reward trade-off for transaction that would add asset duration. As a result, the investment portfolio was reduced in size, increasing asset-sensitivity. Subsequently, intermediate- and long-term interest rates have risen and we resumed portfolio investment, moderating the aggregate asset-sensitivity of the balance sheet.

We also had market risk associated with the value of the mortgage servicing right assets, which are impacted by the level of interest rates. As of June 30, 2014 and December 31, 2013, our mortgage servicing rights had a book value of \$175 million and \$185 million, respectively, and were carried at the lower of cost or fair value. As of June 30, 2014, and December 31, 2013, the fair value of the mortgage servicing rights was \$186 million and \$195 million, respectively. Given low interest rates over recent years, there is a valuation allowance of \$20 million and \$23 million on the asset as of June 30, 2014 and December 31, 2013, respectively. Depending on the interest rate environment, hedges may be used to stabilize the fair value of the mortgage servicing right asset.

Trading Risk

We are exposed to market risk primarily through client facilitation activities including derivatives and foreign exchange products. Exposure is created as a result of the implied volatility and spreads of a select range of interest rates and foreign exchange rates. These trading activities are conducted through our two banking subsidiaries, CBNA and CBPA.

Client facilitation activities consist primarily of interest rate derivatives and foreign exchange contracts where we enter into offsetting trades with a separate counterparty or exchange to manage our exposure to the customer. Historically, the majority of these offsetting trades have been with the RBS Group. We will occasionally execute hedges against the spread that exists across the client facing trade and its offset in the market to maintain a low risk profile. We do not engage in any proprietary trading to benefit from price differences between financial instruments and markets.

We record interest rate derivatives and foreign exchange contracts as derivative assets and liabilities on our Consolidated Balance Sheets. Trading assets and liabilities are carried at fair value with income earned related to these activities included in net interest income. Changes in fair value of trading assets and liabilities are reflected in other net gains (losses), a component of noninterest income on the Consolidated Statements of Operations.

Market Risk Governance. Our market risk function currently leverages the subject matter expertise within the RBS Group to ensure appropriate controls are in place to manage market risk. As part of our separation from the RBS Group, we intend to enter into a Transitional Services Agreement pursuant to which RBS Securities Inc. will continue to provide us with all necessary Value-at-Risk (VaR) and other risk measurements required for regulatory reporting related to trading activities, as well as internal market risk reporting and general consultative services related to our market risk framework until the end of the Transitional Services Agreement. During the term of the Transitional Services Agreement, we intend to build out our own market risk organization and framework in order to gradually migrate away from reliance on services provided by the RBS Group. As part of this process, we hired a new head of market risk management to begin building out our stand-alone capabilities with respect to market risk management.

Given the low level of market risk and substantial market risk expertise at our parent, we have received the support of our U.S. banking regulators for relying on the RBS Group's market risk expertise. In managing our market risk, dealing authorities represent a key control in the management of market risk by setting the scope within which the business is permitted to operate. Dealing authorities are established jointly by designated senior business line and senior risk manager, and are reviewed at least annually. Dealing authorities are structured to accommodate the client facing trades, market offset trades and sets of hedges needed to maintain a low risk profile. Primary responsibility for keeping within established tolerances resides with the business. Key risk indicators, including a combined VaR for interest rate and foreign exchange rate risk, are monitored on a daily basis and reported against tolerances consistent with our risk appetite and business strategy to relevant business line management and risk counterparts.

Market Risk Measurement. We use VaR metrics, complemented with sensitivity analysis and stress testing in measuring market risk. During the term of the Transitional Services Agreement, we will continue to leverage the RBS

Group market risk measurement models, which are described further below, that capture correlation effects and allow for aggregation of market risk across risk types, business lines and legal entities. We measure and monitor market risk for both management and regulatory capital purposes.

Value-at-Risk Overview. The RBS Group's market risk measurement model is based on historical simulation. The VaR measure estimates the extent of any fair value losses on trading positions that may occur due to broad market movements (General VaR) such as changes in the level of interest rates, foreign exchange rates, equity prices and commodity prices. It is calculated on the basis that current positions remain broadly unaltered over the course of a given holding period. It is assumed that markets are sufficiently liquid to allow the business to close its positions, if required, within this holding period. VaR's benefit is that it captures the historic correlations of a portfolio. Based on the composition of our "covered positions," we do not calculate a Specific Risk VaR measure which estimates the extent of any losses that may occur from factors other than broad market movements. The RBS Group's General VaR approach is expressed in terms of a confidence level over the past 500 trading days. The internal VaR measure (used as the basis of the main VaR trading limits) is a 99% confidence level with a one day holding period, meaning that a loss greater than the VaR is expected to occur, on average, on only one day in 100 trading days (i.e., 1% of the time). Theoretically, there should be a loss event greater than VaR two to three times per year. The regulatory measure of VaR is done at a 99% confidence level with a 10-day holding period. The historical market data applied to calculate the VaR is updated on a 10 business day lag. Refer to "—Market Risk Regulatory Capital" below for details of our 10-day VaR metrics for the quarters ended June 30, 2014, March 31, 2014 and December 31, 2013, including high, low, average and period end VaR for interest rate and foreign exchange rate risks, as well as total VaR. We began measuring the high, low, and average VaR for interest rate and foreign exchange currency rate risk during the fourth quarter of 2013, in conjunction with incorporating trade-level detail for foreign exchange risk in our market risk measurement models. Prior to that time, VaR for foreign exchange exposure was calculated using a manual process that did not capture potential interest rate risk from any forward transactions.

Market Risk Regulatory Capital. Effective January 1, 2013, the U.S. banking regulators adopted "Risk-Based Capital Guidelines: Market Risk" as the regulations covering the calculation of market risk capital (the Market Risk Rule). The Market Risk Rule, commonly known as Basel 2.5, substantially modified the determination of market risk-weighted assets and implemented a more risk sensitive methodology for the risk inherent in certain trading positions categorized as "covered positions." For the purposes of the market risk rule, all of our client facing trades, market offset trades and sets of hedges needed to maintain a low risk profile qualify as "covered positions." The internal VaR measure is calculated based on the same population of trades that is utilized for regulatory VaR. The following table shows the results of our modeled measures for regulatory capital calculations:

Market Risk Category	For the Quarter Ended June 30, 2014			
	Period End	Average	High	Low
	(in millions)			
Interest Rate.....	\$ —	\$ —	\$ 1	\$ —
Foreign Exchange Currency Rate	—	—	1	—
Diversification Benefit.....	—	—	NM ⁽¹⁾	NM ⁽¹⁾
General VaR.....	—	—	1	—
Specific Risk VaR.....	—	—	—	—
Total VaR.....	\$ —	\$ —	\$ 1	\$ —
Stressed General VaR.....	\$ —	\$ —	\$ 4	\$ 2
Stressed Specific Risk VaR.....	—	—	—	—
Total Stressed VaR.....	\$ 2	\$ 2	\$ 4	\$ 2
CFG Market Risk Regulatory Capital.....	\$ 9			
CFG Market Risk-Weighted Assets.....	\$ 113			

⁽¹⁾ The high and low for the portfolio may have occurred on different trading days than the high and low for the components. Therefore, there is no diversification benefit shown for the high and low columns.

Market Risk Category	For the Quarter Ended March 31, 2014			
	Period End	Average	High	Low
	(in millions)			
Interest Rate.....	\$ —	\$ —	\$ 1	\$ —
Foreign Exchange Currency Rate	—	—	1	—
Diversification Benefit.....	—	—	NM ⁽¹⁾	NM ⁽¹⁾
General VaR.....	—	—	2	—
Specific Risk VaR.....	—	—	—	—

Market Risk Category	For the Quarter Ended March 31, 2014			
	Period End	Average	High	Low
		(in millions)		
Total VaR.....	\$ —	\$ —	\$ 2	\$ —
Stressed General VaR.....	\$ 2	\$ 2	\$ 7	\$ —
Stressed Specific Risk VaR.....	—	—	—	—
Total Stressed VaR.....	\$ 2	\$ 2	\$ 7	\$ —
CFG Market Risk Regulatory Capital.....	\$ 9			
CFG Market Risk-Weighted Assets.....	\$ 111			

⁽¹⁾ The high and low for the portfolio may have occurred on different trading days than the high and low for the components. Therefore, there is no diversification benefit shown for the high and low columns.

Market Risk Category	For the Quarter Ended December 31, 2013			
	Period End	Average	High	Low
		(in millions)		
Interest Rate.....	\$ 1	\$ —	\$ 1	\$ —
Foreign Exchange Currency Rate	—	1	3	—
Diversification Benefit.....	—	—	NM ⁽¹⁾	NM ⁽¹⁾
General VaR.....	1	1	3	—
Specific Risk VaR.....	—	—	—	—
Total VaR.....	\$ 1	\$ 1	\$ 3	\$ —
Stressed General VaR.....	\$ 2	\$ 3	\$ 7	\$ —
Stressed Specific Risk VaR.....	—	—	—	—
Total Stressed VaR.....	\$ 2	\$ 3	\$ 7	\$ —
CFG Market Risk Regulatory Capital.....	\$ 12			
CFG Market Risk-Weighted Assets.....	\$ 146			

⁽¹⁾ The high and low for the portfolio may have occurred on different trading days than the high and low for the components. Therefore, there is no diversification benefit shown for the high and low columns.

Stress VaR (“SVaR”). Stress VaR is an extension of VaR, but uses a longer historical look back horizon that is fixed from January 1, 2005. This is done not only to identify headline risks from more volatile periods, but also to provide a counter balance to VaR which may be low during periods of low volatility. The holding period for profit and loss determination is 10 days. SVaR is also a component of market risk regulatory capital. SVaR for us is calculated under its own dynamic window regime as compared to the RBS Group’s static SVaR window. In a dynamic window regime, values of the 10-day, 99% VaR are calculated over all possible 260-day periods that can be obtained from the complete historical data set. Refer to “—Market Risk Regulatory Capital” above for details of SVaR metrics, including high, low, average and period end SVaR for the combined portfolio. We began measuring the high, low, and average SVaR for our combined portfolio during the fourth quarter of 2013 in conjunction with the incorporation of trade-level detail for foreign exchange risk, in our market risk measurement models. Prior to that time, our SVaR measure did not include foreign exchange risk given low levels of materiality.

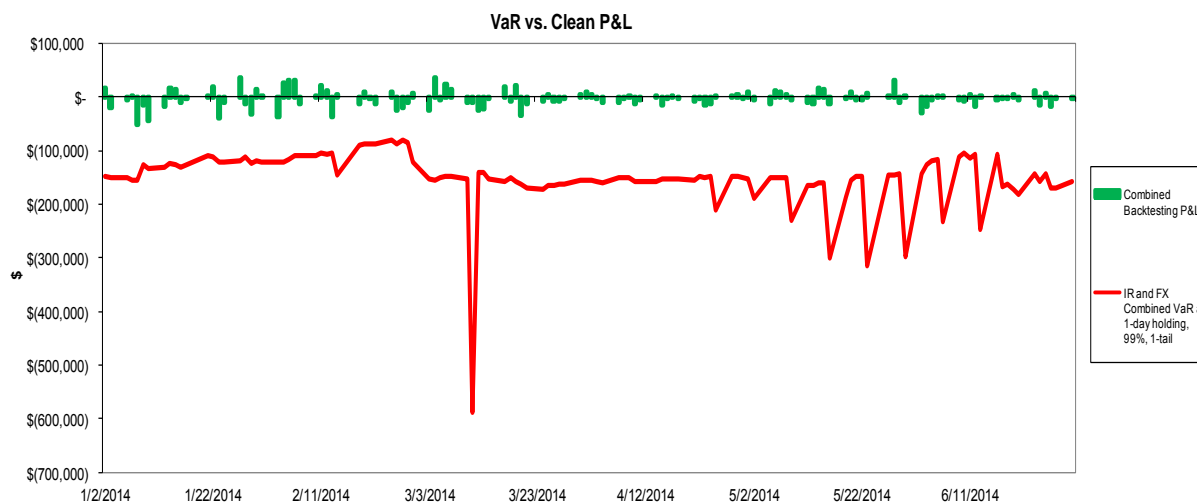
Sensitivity Analysis. Sensitivity analysis is the measure of exposure to a single risk factor, such as a one basis point change in rates or credit spread. We conduct and monitor sensitivity on interest rates, basis spreads, foreign exchange exposures and option prices. Whereas VaR is based on previous moves in market risk factors over recent periods, it may not be an accurate predictor of future market moves. Sensitivity analysis complements VaR as it provides an indication of risk relative to each factor irrespective of historical market moves and is an effective tool in evaluating the appropriateness of hedging strategies.

Stress Testing. Conducting a stress test of a portfolio consists of running risk models with the inclusion of key variables that simulate various historical or hypothetical scenarios. For historical stress tests, profit and loss results are simulated for selected time periods corresponding to the most volatile underlying returns while hypothetical stress tests aim to consider concentration risk, illiquidity under stressed market conditions and risk arising from the bank’s trading activities that may not be fully captured by its other models. Hypothetical scenarios also assume that the market moves happen simultaneously and that no repositioning or hedging activity takes place to mitigate losses as events unfold. We generate stress tests of our trading positions on a regular basis. For example, we currently include a stress test that simulates a Lehman Crisis scenario by taking the worst, 10-day peak to trough moves for the various risk factors that go into VaR from that period, and assuming they occurred simultaneously.

VaR Model Review and Validation. Market risk measurement models used within the RBS Group, including VaR models, are subject to ongoing and independent review and validation that focuses on the model methodology. Independent review of market risk measurement models is the responsibility of RBS Group Risk Analytics (GRA). Aspects covered include challenging the assumptions used, the quantitative techniques employed and the theoretical justification underpinning them, and an assessment of the soundness of the required data over time. Where possible, the quantitative impact of the major underlying modeling assumptions will be estimated (e.g., through developing alternative models). Results of such reviews are shared with U.S. regulators. For the term of the Transitional Services Agreement, we and the RBS Group expect to utilize the same independently validated VaR model for both management and regulatory reporting purposes. The RBS Group market risk teams, including those providing consultative services to us under the Transitional Services Agreement, will conduct internal validation before a new or changed model element is implemented and before a change is made to a market data mapping. For example, the RBS Group market risk teams also perform regular reviews of key risk factors that are used in the market risk measurement models to produce profit and loss vectors used in the VaR calculations. These internal validations are subject to independent re-validation by GRA and, depending on the results of the impact assessment, notification to the appropriate regulatory authorities for the RBS Group and us may be required.

VaR Backtesting. Backtesting is one form of validation of the VaR model. The Market Risk Rule requires a comparison of our internal VaR measure to the actual net trading revenue (excluding fees, commissions, reserves, intra-day trading and net interest income) for each day over the preceding year (the most recent 250 business days). Any observed loss in excess of the VaR number is taken as an exception. The level of exceptions determines the multiplication factor used to derive the VaR and SVaR-based capital requirement for regulatory reporting purposes. We perform sub-portfolio backtesting as required under the Market Risk Rule, and as approved by its U.S. banking regulators, for interest rate and foreign exchange positions. The following table shows our daily net trading revenue and total internal VaR for the quarters ending June 30, 2014 and March 30, 2014. Prior to this time, we did not perform our own portfolio specific backtesting, relying instead on the RBS Group's backtesting results. Until such time as we can accumulate a full 250 business days of backtesting results, we continue to utilize a multiplication factor derived from the RBS Group's backtesting results, as agreed with our banking regulators.

Daily VaR Backtesting: Sub-portfolio Level Backtesting.



UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

CITIZENS FINANCIAL GROUP, INC.

GLOSSARY OF ACRONYMS AND TERMS

GLOSSARY OF ACRONYMS AND TERMS

The following listing provides a comprehensive reference of common acronyms and terms used throughout the document:

AFS	Available For Sale
ALLL	Allowance for Loan and Lease Losses
AOCI	Accumulated Other Comprehensive Income
ATM	Automatic Teller Machine
BHC	Bank Holding Company
bps	Basis Points
Capital Plan Rule	Federal Reserve's Regulation Y Capital Plan Rule
CBNA	Citizens Bank, National Association
CBPA	Citizens Bank of Pennsylvania
CCAR	Comprehensive Capital Analysis and Review
CCB	Capital Conservation Buffer
CEB	Commercial Enterprise Banking
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
Citizens or CFG or the Company	Citizens Financial Group, Inc. and its Subsidiaries
CLTV	Combined Loan-to-Value
CMO	Collateralized Mortgage Obligation
CRA	Community Reinvestment Act of 1977
CSA	Credit Support Annex
Dodd-Frank Act (DFA)	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
EC	Economic Capital
EPS	Earnings Per Share
ESOP	Executive Share Option Plan
ERISA	Employee Retirement Income Security Act of 1974
Fannie Mae (FNMA)	The Federal National Mortgage Association
FASB	The Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991
FFIEC	Federal Financial Institutions Examination Council
FHC	Financial Holding Company
FHLB	Federal Home Loan Bank
FICO	Fair Isaac Corporation (credit rating)
FLSA	Fair Labor Standards Act of 1938, as amended
FRB	Federal Reserve Bank
FRBG	Federal Reserve Board of Governors
Freddie Mac (FHLMC)	The Federal Home Loan Mortgage Corporation
FTP	Funds Transfer Pricing
GAAP	Accounting Principles Generally Accepted in the United States of America
GDP	Gross Domestic Product
Ginnie Mae (GNMA)	The Government National Mortgage Association
GLBA	Gramm-Leach-Bliley Act of 1999
HELOC	Home Equity Line of Credit

CITIZENS FINANCIAL GROUP, INC.

GLOSSARY OF ACRONYMS AND TERMS

HTM	Held To Maturity
ICAR	Internal Capital Adequacy Requirement
IFRS	International Financial Reporting Standards
ILP	Incurred Loss Period
IST	Integrated Stress Testing
IT	Information Technology
LIBOR	London Interbank Offered Rate
LOB	Line of Business
LTV	Loan-to-Value
MBS	Mortgage-Backed Securities
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
MERS	Mortgage Electronic Registration Systems
MSR	Mortgage Servicing Right
NPR	Notice of Proposed Rulemaking
OCC	Office of the Comptroller of the Currency
OCI	Other Comprehensive Income
OIS	Overnight Index Swap
OTC	Over the Counter
PIMCO	Pacific Investment Management Company, LLC
RBS	The Royal Bank of Scotland plc.
RBS CBFM	The Royal Bank of Scotland plc. Corporate Banking and Financial Markets
RBSG or RBS Group	The Royal Bank of Scotland Group plc. and its subsidiaries
REIT	Real Estate Investment Trust
ROTCE	Return on Tangible Common Equity
RPA	Risk Participation Agreement
RV	Recreational Vehicle
SBO	Serviced by Others loan portfolio
SIFI	Systemically Important Financial Institutions
TDR	Troubled Debt Restructuring
UK	United Kingdom

To The Board of Directors and Stockholders of
Citizens Financial Group, Inc.
Providence, Rhode Island

We have reviewed the accompanying consolidated balance sheet of Citizens Financial Group, Inc. and its subsidiaries (the "Company") as of June 30, 2014, and the related consolidated statements of operations and other comprehensive income for the three-month and six-month periods ended June 30, 2014 and 2013, and of cash flows and changes in stockholders' equity for the six-month periods ended June 30, 2014 and 2013 (the "interim financial statements"). The interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial statements consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Citizens Financial Group, Inc. and its subsidiaries as of December 31, 2013 and the related consolidated statement of operations, other comprehensive income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 12, 2014 (except for notes 24, 25, 26, and 27, as to which the date is May 12, 2014) we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2013 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Deloitte & Touche LLP

August 15, 2014

Member of Deloitte Touche Tohmatsu Limited

CITIZENS FINANCIAL GROUP, INC.

CONSOLIDATED BALANCE SHEETS

<i>(in millions, except share data)</i>	June 30, 2014 (unaudited)	December 31, 2013 (unaudited)
ASSETS:		
Cash and due from banks	\$1,038	\$1,406
Interest-bearing cash and due from banks	4,318	1,351
Interest-bearing deposits in banks	309	233
Securities available for sale, at fair value	18,493	15,995
Securities held to maturity (estimated fair value of \$5,398 and \$4,257, respectively)	5,382	4,315
Other investment securities	948	935
Loans held for sale, at fair value	173	176
Other loans held for sale	89	1,078
Loans and leases	88,829	85,859
Less: Allowance for loan and lease losses	1,210	1,221
Net loans and leases	87,619	84,638
Derivative assets	635	650
Premises and equipment, net	560	592
Bank-owned life insurance	1,361	1,339
Goodwill	6,876	6,876
Due from broker	—	446
Other branch assets held for sale	—	46
Other assets (related party balances of (\$45) and \$63, respectively)	2,478	2,078
TOTAL ASSETS	\$130,279	\$122,154
LIABILITIES AND STOCKHOLDERS' EQUITY:		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$26,670	\$24,931
Interest-bearing (related party balances of \$5 and \$5, respectively)	64,986	61,972
Total deposits	91,656	86,903
Deposits held for sale	—	5,277
Federal funds purchased and securities sold under agreements to repurchase	6,807	4,791
Other short-term borrowed funds	7,702	2,251
Derivative liabilities (related party balances of \$643 and \$835, respectively)	747	939
Deferred taxes, net	403	199
Long-term borrowed funds (related party balances of \$1,333 and \$1,000, respectively)	1,732	1,405
Other liabilities (related party balances of \$34 and \$27, respectively)	1,635	1,193
TOTAL LIABILITIES	110,682	102,958
Contingencies (refer to Note 12)		
STOCKHOLDERS' EQUITY:		
Preferred stock:		
\$25.00 par value, 100,000,000 shares authorized, no shares outstanding at June 30, 2014 and \$1.00 par value, 30,000 shares authorized, no shares outstanding at December 31, 2013	—	—
Common stock:		
\$.01 par value, 1,000,000,000 shares authorized, 3,382 shares issued and outstanding at June 30, 2014 and \$.01 par value, 5,000 shares authorized, 3,382 issued and outstanding at December 31, 2013	—	—
Additional paid-in capital	18,609	18,609
Retained earnings	1,346	1,235
Accumulated other comprehensive loss	(358)	(648)
TOTAL STOCKHOLDERS' EQUITY	19,597	19,196
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$130,279	\$122,154

The accompanying Notes to Unaudited Interim Consolidated Financial Statements are an integral part of these statements.

CITIZENS FINANCIAL GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<i>(in millions, except share data)</i>	<i>(unaudited)</i>	<i>(unaudited)</i>	<i>(unaudited)</i>	<i>(unaudited)</i>
INTEREST INCOME:				
Interest and fees on loans and leases (related party balances of \$18, \$16, \$36 and \$21, respectively)	\$751	\$751	\$1,481	\$1,510
Interest and fees on loans held for sale	1	3	2	7
Interest and fees on other loans held for sale	10	—	22	—
Investment securities	154	108	303	228
Interest-bearing deposits in banks	1	4	2	7
Total interest income	917	866	1,810	1,752
INTEREST EXPENSE:				
Deposits (related party balances of \$0, \$1, \$0 and \$3, respectively)	34	57	67	117
Deposits held for sale	2	—	4	—
Federal funds purchased and securities sold under agreement to repurchase (related party balances of \$0, \$54, \$13 and \$110, respectively)	1	56	16	115
Other short-term borrowed funds (related party balances of \$27, \$0, \$44 and \$0, respectively)	30	—	49	1
Long-term borrowed funds (related party balances of \$12, \$1, \$25 and \$2, respectively)	17	4	33	10
Total interest expense	84	117	169	243
Net interest income	833	749	1,641	1,509
Provision for credit losses	49	112	170	202
Net interest income after provision for credit losses	784	637	1,471	1,307
NONINTEREST INCOME:				
Service charges and fees (related party balances of \$1, \$4, \$3 and \$9, respectively)	147	164	286	325
Card fees	61	59	117	114
Trust and investment services fees	42	36	81	72
Foreign exchange and trade finance fees (related party balances of \$(1), \$(11), \$(7) and \$13, respectively)	22	24	44	48
Capital markets fees (related party balances of \$3, \$2, \$5 and \$4, respectively)	26	9	44	23
Mortgage banking fees	14	67	34	112
Bank-owned life insurance income	12	12	23	25
Securities gains, net	—	42	25	94
Other-than-temporary impairment:				
Total other-than-temporary impairment losses	(5)	(11)	(39)	(60)
Portions of loss recognized in other comprehensive income (before taxes)	3	10	33	56
Net impairment losses recognized in earnings	(2)	(1)	(6)	(4)
Other income (related party balances of \$(82), \$154, \$(135) and \$176, respectively)	318	25	350	61
Total noninterest income	640	437	998	870
NONINTEREST EXPENSE:				
Salaries and employee benefits	467	423	872	858
Outside services	125	87	208	171
Occupancy (related party balances of \$0, \$1, \$0 and \$2, respectively)	87	79	168	164
Equipment expense	65	70	129	138
Amortization of software	33	23	64	45
Goodwill impairment	—	4,435	—	4,435
Other operating expense	171	135	317	262
Total noninterest expense	948	5,252	1,758	6,073
Income before income tax expense (benefit)	476	(4,178)	711	(3,896)
Income tax expense (benefit)	163	(273)	232	(174)
NET INCOME (LOSS)	\$313	(\$3,905)	\$479	(\$3,722)
Weighted-average number of shares outstanding:				
Basic	3,382	3,382	3,382	3,382
Diluted	3,382	3,382	3,382	3,382
Per common share information:				
Basic earnings	\$92,601.06	(\$1,154,559.32)	\$141,688.40	(\$1,100,419.53)
Diluted earnings	92,601.06	(1,154,559.32)	141,688.40	(1,100,419.53)
Dividends declared and paid to parent	101,419.28	114,725.01	108,811.35	126,552.34

The accompanying Notes to Unaudited Interim Consolidated Financial Statements are an integral part of these statements.

CITIZENS FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
<i>(in millions)</i>	2014 (unaudited)	2013 (unaudited)	2014 (unaudited)	2013 (unaudited)
Net income (loss)	\$313	(\$3,905)	\$479	(\$3,722)
Other comprehensive income (loss):				
Net unrealized derivative instrument gains (losses) arising during the periods, net of income taxes of \$36, (\$87), \$70 and (\$81), respectively	61	(149)	120	(139)
Reclassification adjustment for net derivative losses included in net income, net of income taxes of \$3, \$23, \$7 and \$45, respectively	6	38	13	77
Net unrealized securities gains (losses) arising during the periods, net of income taxes of \$68, (\$94), \$109 and (\$126), respectively	117	(165)	188	(219)
Other than temporary impairment not recognized in earnings on securities, net of income taxes of (\$1), (\$4), (\$12) and (\$21), respectively	(2)	(6)	(21)	(35)
Reclassification of net securities gains to net income, net of income taxes of \$0, (\$16), (\$7) and (\$34), respectively	2	(25)	(12)	(56)
Defined benefit pension plans:				
Amortization of actuarial loss, net of income taxes of \$0, \$3, \$1 and \$3, respectively	1	3	2	3
Total other comprehensive income (loss), net of income taxes	185	(304)	290	(369)
Total comprehensive income (loss)	\$498	(\$4,209)	\$769	(\$4,091)

The accompanying Notes to Unaudited Interim Consolidated Financial Statements are an integral part of these statements.

CITIZENS FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

<i>(in millions)</i>	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2012	\$—	\$—	\$18,595	\$5,846	(\$312)	\$24,129
Dividend to parent	—	—	—	(95)	—	(95)
Dividends to parent — exchange transactions	—	—	—	(333)	—	(333)
Total comprehensive loss:						
Net loss	—	—	—	(3,722)	—	(3,722)
Other comprehensive loss	—	—	—	—	(369)	(369)
Total comprehensive loss						(4,091)
Balance at June 30, 2013 (unaudited)	\$—	\$—	\$18,595	\$1,696	(\$681)	\$19,610
Balance at December 31, 2013	\$—	\$—	\$18,609	\$1,235	(\$648)	\$19,196
Dividend to parent	—	—	—	(35)	—	(35)
Dividends to parent — exchange transactions	—	—	—	(333)	—	(333)
Total comprehensive income:						
Net income	—	—	—	479	—	479
Other comprehensive income	—	—	—	—	290	290
Total comprehensive income						769
Balance at June 30, 2014 (unaudited)	\$—	\$—	\$18,609	\$1,346	(\$358)	\$19,597

The accompanying Notes to Unaudited Interim Consolidated Financial Statements are an integral part of these statements.

CITIZENS FINANCIAL GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2014	2013
<i>(in millions)</i>	<i>(unaudited)</i>	<i>(unaudited)</i>
OPERATING ACTIVITIES		
Net income (loss)	\$479	(\$3,722)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for credit losses	170	202
Originations of mortgage loans held for sale	(684)	(2,407)
Proceeds from sales of mortgage loans held for sale	688	2,624
Amortization of terminated cash flow hedges (related party balances of \$12 and \$35, respectively)	24	39
Depreciation, amortization and accretion	196	205
Recovery of mortgage servicing rights	(3)	(39)
Securities impairment	6	4
Goodwill impairment	—	4,435
Deferred income taxes	36	(186)
Loss on disposal/impairment of premises and equipment	11	7
Loss on sale of other branch assets held for sale	9	—
Gain on sales of:		
Securities available for sale	(25)	(94)
Other loans held for sale	(11)	—
Deposits held for sale	(286)	—
Decrease in other assets (related party balances of \$47 and \$8, respectively)	57	801
Increase (decrease) in other liabilities (related party balances of (\$147) and (\$412), respectively)	354	(474)
Net cash provided by operating activities	1,021	1,395
INVESTING ACTIVITIES		
Investment securities:		
Purchases of securities available for sale	(4,318)	(3,251)
Proceeds from maturities and paydowns of securities available for sale	1,421	2,822
Proceeds from sales of securities available for sale	711	2,441
Purchases of other investment securities	(68)	—
Proceeds from sales of other investment securities	55	91
Purchases of securities held to maturity	(1,174)	—
Proceeds from maturities and paydowns of securities held to maturity	120	—
Net (increase) decrease in interest-bearing deposits in banks	(76)	1,050
Net (increase) decrease in loans and leases	(2,171)	1,956
Net increase in bank-owned life insurance	(22)	(18)
Premises and equipment:		
Purchases	(37)	(82)
Proceeds from sales	29	—
Capitalization of software	(80)	(75)
Net cash (used in) provided by investing activities	(5,610)	4,934
FINANCING ACTIVITIES		
Net decrease in deposits	(238)	(3,787)
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	2,016	(230)
Net increase (decrease) in other short-term borrowed funds	5,450	(500)
Proceeds from issuance of long-term borrowed funds (related party balances of \$333 and \$333, respectively)	333	333
Repayments of long-term borrowed funds (related party balances of \$0 and \$280, respectively)	(5)	(294)
Dividends declared and paid to parent	(368)	(428)
Net cash provided by (used in) financing activities	7,188	(4,906)
Decrease in cash and cash equivalents	2,599	1,423
Cash and cash equivalents at beginning of period	2,757	3,063
Cash and cash equivalents at end of period	\$5,356	\$4,486

The accompanying Notes to Unaudited Interim Consolidated Financial Statements are an integral part of these statements.

CITIZENS FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

Basis of Presentation

The unaudited Consolidated Financial Statements, including the notes thereto of Citizens Financial Group, Inc. (formerly RBS Citizens Financial Group, Inc., prior to April 16, 2014), have been prepared in accordance with GAAP interim reporting requirements, and therefore do not include all information and notes included in the audited Consolidated Financial Statements in conformity with GAAP. These interim Consolidated Financial Statements and notes thereto should be read in conjunction with the Company's audited Consolidated Financial Statements and accompanying notes. The Company's principal business activity is banking, conducted through its subsidiaries, Citizens Bank, N.A. (formerly RBS Citizens, N.A., prior to April 16, 2014) and Citizens Bank of Pennsylvania.

The unaudited Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods. The results for interim periods are not necessarily indicative of results for a full year.

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications are immaterial and have no effect on net income, total comprehensive income, total assets or total stockholders' equity as previously reported.

Cash and Cash Equivalents

See Note 1, "Significant Accounting Policies" of the Company's audited Consolidated Financial Statements for a detailed discussion of cash and cash equivalents.

New Accounting Pronouncements

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." This update amends the guidance on stock compensation and clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. Accordingly, an entity should not record compensation expense (measured as of the grant date without taking into account the effect of the performance target) related to an award for which a transfer to the employee is contingent on the entity's satisfaction of a performance target until it becomes probable that the performance target will be met. The amendment is effective for annual reporting periods, including interim reporting periods within those periods, beginning after December 15, 2015, and is expected to have an immaterial impact on the Company's Consolidated Financial Statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-11, "Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." which makes limited amendments to the guidance on accounting for certain repurchase agreements. This update requires entities to account for repurchase-to maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements); eliminates accounting guidance on linked repurchase financing transactions; and expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers accounted for as secured borrowings. This update also amends the existing guidance to clarify that repos and securities lending transactions that do not meet all of the derecognition criteria in the existing guidance should be accounted for as secured borrowings. This amendment is effective for annual reporting periods, including interim reporting periods within those periods, beginning after December 15, 2014, and is expected to have an immaterial impact on the Company's Consolidated Financial Statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue From Contracts With Customers." This amendment outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." The new guidance applies to all contracts with customers except those that are within the scope of other topics in GAAP. This amendment is effective for annual reporting periods, including interim reporting periods within those periods, beginning after December 15, 2016, and is expected to have an immaterial impact on the Company's Consolidated Financial Statements.

CITIZENS FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In April 2014, the FASB issued Accounting Standards Update No. 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” This amendment modifies the requirements for reporting a discontinued operation. The amended definition of “discontinued operations” includes only disposals, held-for-sale classifications of components, or groups of components of an entity that represent “strategic shift” that either has or will have a major effect on the entity’s operations and financial results, such as geographic area, line of business, equity method investment or other parts of an entity. This amendment also provides disclosure guidance for situations where an entity has continuing involvement with a discontinued operation or retains an equity method investment in a component after disposal. This amendment is effective for all disposals or classifications as held for sale (including businesses or nonprofit activities that, on acquisition, are classified as held for sale) that occur in annual periods, and in interim periods within those annual periods, beginning after December 15, 2014, and is expected to have an immaterial impact on the Company’s Consolidated Financial Statements.

NOTE 2 - SECURITIES

The following table provides the major components of securities at amortized cost and fair value:

(in millions)	June 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities Available for Sale</u>								
U.S. Treasury	\$15	\$—	\$—	\$15	\$15	\$—	\$—	\$15
State and political subdivisions	10	—	—	10	11	—	(1)	10
Mortgage-backed securities:								
Federal agencies and U.S. government sponsored entities	17,343	289	(47)	17,585	14,970	151	(128)	14,993
Other/non-agency	887	7	(36)	858	992	5	(45)	952
Total mortgage-backed securities	18,230	296	(83)	18,443	15,962	156	(173)	15,945
Total debt securities available for sale	18,255	296	(83)	18,468	15,988	156	(174)	15,970
Marketable equity securities	10	3	—	13	10	3	—	13
Other equity securities	12	—	—	12	12	—	—	12
Total equity securities available for sale	22	3	—	25	22	3	—	25
Total securities available for sale	\$18,277	\$299	(\$83)	\$18,493	\$16,010	\$159	(\$174)	\$15,995
<u>Securities Held to Maturity</u>								
Mortgage-backed securities:								
Federal agencies and U.S. government sponsored entities	\$3,897	\$16	(\$15)	\$3,898	\$2,940	\$—	(\$33)	\$2,907
Other/non-agency	1,485	18	(3)	1,500	1,375	—	(25)	1,350
Total securities held to maturity	\$5,382	\$34	(\$18)	\$5,398	\$4,315	\$—	(\$58)	\$4,257
<u>Other Investment Securities</u>								
Federal Reserve Bank stock	\$470	\$—	\$—	\$470	\$462	\$—	\$—	\$462
Federal Home Loan Bank stock	472	—	—	472	468	—	—	468
Venture capital and other investments	6	—	—	6	5	—	—	5
Total other investment securities	\$948	\$—	\$—	\$948	\$935	\$—	\$—	\$935

CITIZENS FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company has reviewed its securities portfolio for other-than-temporary impairments. The following tables summarize those securities whose fair values are below carrying values, segregated by those that have been in a continuous unrealized loss position for less than twelve months, and those that have been in a continuous unrealized loss position for twelve months or longer:

June 30, 2014									
(dollars in millions)	Less than 12 Months			12 Months or Longer			Total		
	Number of Issues	Fair Value	Gross Unrealized Losses	Number of Issues	Fair Value	Gross Unrealized Losses	Number of Issues	Fair Value	Gross Unrealized Losses
U.S. Treasury	1	\$15	\$—	—	\$—	\$—	1	\$15	\$—
State and political subdivisions	1	10	—	—	—	—	1	10	—
Mortgage-backed securities:									
Federal agencies and U.S. government sponsored entities	77	4,005	(24)	30	916	(38)	107	4,921	(62)
Other/non-agency	10	407	(5)	18	464	(34)	28	871	(39)
Total mortgage-backed securities	87	4,412	(29)	48	1,380	(72)	135	5,792	(101)
Total	89	\$4,437	(\$29)	48	\$1,380	(\$72)	137	\$5,817	(\$101)

December 31, 2013									
(dollars in millions)	Less than 12 Months			12 Months or Longer			Total		
	Number of Issues	Fair Value	Gross Unrealized Losses	Number of Issues	Fair Value	Gross Unrealized Losses	Number of Issues	Fair Value	Gross Unrealized Losses
State and political subdivisions	1	\$10	(\$1)	—	\$—	\$—	1	\$10	(\$1)
Mortgage-backed securities:									
Federal agencies and U.S. government sponsored entities	263	12,067	(158)	7	20	(2)	270	12,087	(160)
Other/non-agency	22	1,452	(34)	19	490	(37)	41	1,942	(71)
Total mortgage-backed securities	285	13,519	(192)	26	510	(39)	311	14,029	(231)
Total	286	\$13,529	(\$193)	26	\$510	(\$39)	312	\$14,039	(\$232)

For each debt security identified with an unrealized loss, the Company reviews the expected cash flows to determine if the impairment in value is temporary or other-than-temporary. If the Company has determined that the present value of the debt security's expected cash flows is less than its amortized cost basis, an other-than-temporary impairment is deemed to have occurred. The amount of impairment loss that is recognized in current period earnings is dependent on the Company's intent to sell (or not sell) the debt security.

If the Company intends to sell the impaired debt security, the impairment loss recognized in current period earnings equals the difference between the debt security's fair value and its amortized cost. If the Company does not intend to sell the impaired debt security, and it is not likely that the Company will be required to sell the impaired security, the credit-related impairment loss is recognized in current period earnings and equals the difference between the amortized cost of the debt security and the present value of the expected cash flows that have currently been projected.

In addition to these cash flow projections, several other characteristics of each debt security are reviewed when determining whether a credit loss exists and the period over which the debt security is expected to recover. These characteristics include: (1) the type of investment, (2) various market factors affecting the fair value of the security (e.g., interest rates, spread levels, liquidity in the sector, etc.), (3) the length and severity of impairment, and (4) the public credit rating of the instrument.

The Company estimates the portion of loss attributable to credit using a cash flow model. The inputs to this model include prepayment, default and loss severity assumptions that are based on industry research and observed data. The loss projections generated by the model are reviewed on a quarterly basis by a cross-functional governance committee. This governance committee determines whether security impairments are other-than-temporary based on this review.

CITIZENS FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the cumulative credit related losses recognized in earnings on debt securities held by the Company as of:

(in millions)	Six Months Ended June 30,	
	2014	2013
Cumulative balance through January 1	\$56	\$55
Credit impairments recognized in earnings on debt securities that have been previously impaired	6	4
Reductions due to increases in cash flow expectations on impaired securities	(2)	(3)
Cumulative balance at end of period	\$60	\$56

Cumulative credit losses recognized in earnings for impaired AFS debt securities held as of June 30, 2014 and 2013 were \$60 million and \$56 million, respectively. There were no credit losses recognized in earnings for the Company's HTM portfolio as of June 30, 2014 and 2013. The Company recognized \$6 million and \$4 million of credit related other-than-temporary impairment losses in earnings for the six months ended June 30, 2014 and 2013, respectively, related to non-agency MBS in the AFS portfolio. No impaired debt securities were sold during June 30, 2014 or 2013. Reductions in credit losses due to increases in cash flow expectations were \$2 million and \$3 million for the six months ended June 30, 2014 and 2013, and are presented in investment securities interest income on the Consolidated Statements of Operations. The Company does not currently have the intent to sell these debt securities, and it is not likely that the Company will be required to sell these debt securities prior to the recovery of their amortized cost bases. As of June 30, 2014 and 2013, \$33 million and \$56 million, respectively, of pretax non-credit related losses were deferred in OCI.

The Company has determined that credit losses are not expected to be incurred on the remaining agency and non-agency MBS identified with unrealized losses as of the current reporting date. The unrealized losses on these debt securities reflect the reduced liquidity in the MBS market and the increased risk spreads due to the uncertainty of the U.S. macroeconomic environment. Therefore, the Company has determined that these debt securities are not other-than-temporarily impaired because the Company does not currently have the intent to sell these debt securities, and it is not likely that the Company will be required to sell these debt securities prior to the recovery of their amortized cost bases. Additionally, any subsequent increases in the valuation of impaired debt securities do not impact their recorded cost bases.

CITIZENS FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The amortized cost and fair value of debt securities at June 30, 2014 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Distribution of Maturities				
(in millions)	1 Year or Less	1-5 Years	5-10 Years	After 10 Years	Total
Amortized Cost:					
<u>Debt securities available for sale</u>					
U.S. Treasury	\$15	\$—	\$—	\$—	\$15
State and political subdivisions	—	—	—	10	10
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	3	35	2,603	14,702	17,343
Other/non-agency	—	61	76	750	887
Total debt securities available for sale	18	96	2,679	15,462	18,255
<u>Debt securities held to maturity</u>					
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	—	—	—	3,897	3,897
Other/non-agency	—	—	—	1,485	1,485
Total debt securities held to maturity	—	—	—	5,382	5,382
Total amortized cost of debt securities	\$18	\$96	\$2,679	\$20,844	\$23,637
Fair Value:					
<u>Debt securities available for sale</u>					
U.S. Treasury	\$15	\$—	\$—	\$—	\$15
State and political subdivisions	—	—	—	10	10
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	4	37	2,626	14,918	17,585
Other/non-agency	—	63	77	718	858
Total debt securities available for sale	19	100	2,703	15,646	18,468
<u>Debt securities held to maturity</u>					
Mortgage-backed securities:					
Federal agencies and U.S. government sponsored entities	—	—	—	3,898	3,898
Other/non-agency	—	—	—	1,500	1,500
Total debt securities held to maturity	—	—	—	5,398	5,398
Total fair value of debt securities	\$19	\$100	\$2,703	\$21,044	\$23,866

The Company recognized \$303 million and \$228 million of interest income from taxable investment securities in earnings for the six months ended June 30, 2014 and 2013, respectively. No interest income was recognized from non-taxable investment securities in earnings for the six months ended June 30, 2014 and 2013.

The Company recognized \$25 million and \$94 million of gains on sale of debt securities in earnings for the six months ended June 30, 2014 and 2013, respectively.

CITIZENS FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The amortized cost and fair value of securities pledged are shown below:

(in millions)	June 30, 2014		December 31, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Pledged against repurchase agreements	\$7,396	\$7,511	\$5,016	\$4,998
Pledged against Federal Home Loan Bank borrowed funds	1	1	1	1
Pledged against derivatives to qualify for fiduciary powers, and to secure public and other deposits as required by law	3,190	3,247	2,818	2,853

The Company regularly enters into security repurchase agreements with unrelated counterparties. Repurchase agreements are financial transactions that involve the transfer of a security from one party to another and a subsequent transfer of the same (or "substantially the same") security back to the original party. The Company's repurchase agreements are typically short-term transactions (e.g., overnight), but they may be extended to longer terms to maturity. Such transactions are accounted for as secured borrowed funds on the Company's financial statements. When permitted by GAAP, the Company offsets the short-term receivables associated with its reverse repurchase agreements with the short-term payables associated with its repurchase agreements.

The effects of this offsetting on the Consolidated Balance Sheets are presented in the following table:

(in millions)	June 30, 2014			December 31, 2013		
	Gross Assets (Liabilities)	Gross Assets (Liabilities) Offset	Net Amounts of Assets (Liabilities)	Gross Assets (Liabilities)	Gross Assets (Liabilities) Offset	Net Amounts of Assets (Liabilities)
Reverse repurchase and similar arrangements	\$—	\$—	\$—	\$—	\$—	\$—
Repurchase and similar arrangements	(5,850)	—	(5,850)	(3,000)	—	(3,000)

Note: The Company also offsets certain derivative assets and derivative liabilities on the Consolidated Balance Sheets. See Note 11, "Derivatives," for further information.

NOTE 3 - LOANS AND LEASES

A summary of the loans and leases portfolio follows:

(in millions)	June 30, 2014	December 31, 2013
Commercial	\$30,076	\$28,667
Commercial real estate	7,158	6,948
Leases	3,740	3,780
Total commercial	40,974	39,395
Residential, including originated home equity products	30,116	29,694
Home equity products serviced by others	1,972	2,171
Other secured retail	12,180	10,700
Unsecured retail	3,587	3,899
Total retail	47,855	46,464
Total loans and leases ^{(1) (2)}	\$88,829	\$85,859

⁽¹⁾ Excluded from the table above are loans held for sale totaling \$262 million as of June 30, 2014 and \$1.3 billion as of December 31, 2013. The December 31, 2013 loans held for sale balance primarily related to the Company's sale of certain assets and liabilities associated with its Chicago-area retail branches. For further discussion, see Note 13, "Divestitures and Branch Assets and Liabilities Held for Sale."

⁽²⁾ Mortgage loans serviced for other by the Company's subsidiaries are not included above, and amounted to \$18.3 billion and \$18.7 billion at June 30, 2014 and December 31, 2013, respectively.

Loans held for sale, excluding the loans related to the sale of the Chicago-area retail branches, totaled \$173 million and \$176 million at June 30, 2014 and December 31, 2013, respectively. Other loans held for sale totaled \$89 million and \$1.1 billion at June 30, 2014 and December 31, 2013, respectively. The other loans held for sale balance at December 31, 2013 primarily related to the Company's sale of certain assets and liabilities associated with its Chicago-area retail branches. See Note 13, "Divestitures and Branch Assets and Liabilities Held for Sale," for further details.

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Loans pledged as collateral for FHLB borrowed funds totaled \$21.0 billion and \$19.0 billion at June 30, 2014 and December 31, 2013, respectively. This collateral consists primarily of residential mortgages and home equity loans. Loans pledged as collateral to support the contingent ability to borrow at the FRB discount window, if necessary, totaled \$13.3 billion and \$13.9 billion at June 30, 2014 and December 31, 2013, respectively.

During the six months ended June 30, 2014 the Company purchased a portfolio of residential loans with an outstanding principal balance of \$878 million, a portfolio of auto loans with an outstanding principal balance of \$759 million and a portfolio of student loans with an outstanding principal balance of \$59 million. In addition to the \$1.1 billion loans sold as part of the Company's sale of its Chicago-area retail branches, the Company sold portfolios of residential mortgage loans with outstanding principal balances of \$126 million and student loans of \$357 million as well as commercial loans with an outstanding principal balance of \$132 million during the six months ended June 30, 2014. The Company had no loan portfolio purchase or sale transactions during the six months ended June 30, 2013.

NOTE 4 - ALLOWANCE FOR CREDIT LOSSES, NONPERFORMING ASSETS, AND CONCENTRATIONS OF CREDIT RISK

The ALLL is increased through a provision for credit losses that is charged to earnings, based on the Company's quarterly evaluation of the loan portfolio, and is reduced by net charge-offs and the ALLL associated with sold loans. See Note 1, "Significant Accounting Policies" of the Company's audited Consolidated Financial Statements, for a detailed discussion of ALLL methodologies and estimation techniques.

On a quarterly basis, the Company reviews and refines its estimate of the allowance for credit losses, taking into consideration changes in portfolio size and composition, historical loss experience, internal risk ratings, current economic conditions, industry performance trends and other pertinent information. As of June 30, 2014, changes in these factors led to an increase in the allowance for credit losses which was offset by a decrease reflecting asset quality improvements and lower charge-offs.

During 2013, the Company modified the way that it establishes the ALLL. The ALLL is reviewed separately for commercial and retail loan portfolios, and the ALLL for each includes an adjustment for qualitative reserves that includes certain risks, factors and events that might not be measured in the statistical analysis. As a result of this change, the unallocated reserve was absorbed into the separately measured commercial and retail qualitative reserves.

There were no other material changes in assumptions or estimation techniques compared with prior periods that impacted the determination of the current period's ALLL and the reserve for unfunded lending commitments.

The following is a summary of changes in the allowance for credit losses:

(in millions)	Six Months Ended June 30, 2014		
	Commercial	Retail	Total
Allowance for loan and lease losses as of January 1, 2014	\$498	\$723	\$1,221
Charge-offs	(14)	(231)	(245)
Recoveries	35	55	90
Net recoveries (charge-offs)	21	(176)	(155)
Provision charged to income	(11)	155	144
Allowance for loan and lease losses as of June 30, 2014	508	702	1,210
Reserve for unfunded lending commitments as of January 1, 2014	39	—	39
Provision for unfunded lending commitments	26	—	26
Reserve for unfunded lending commitments as of June 30, 2014	65	—	65
Total allowance for credit losses as of June 30, 2014	\$573	\$702	\$1,275

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(in millions)	Six Months Ended June 30, 2013			
	Commercial	Retail	Unallocated	Total
Allowance for loan and lease losses as of January 1, 2013	\$509	\$657	\$89	\$1,255
Charge-offs	(49)	(313)	—	(362)
Recoveries	51	56	—	107
Net recoveries (charge-offs)	2	(257)	—	(255)
Provision charged to income	(49)	235	14	200
Allowance for loan and lease losses as of June 30, 2013	462	635	103	1,200
Reserve for unfunded lending commitments as of January 1, 2013	40	—	—	40
Provision for unfunded lending commitments	2	—	—	2
Reserve for unfunded lending commitments as of June 30, 2013	42	—	—	42
Total allowance for credit losses as of June 30, 2013	\$504	\$635	\$103	\$1,242

The recorded investment in loans and leases based on the Company's evaluation methodology is as follows:

(in millions)	June 30, 2014			December 31, 2013		
	Commercial	Retail	Total	Commercial	Retail	Total
Individually evaluated	\$254	\$1,218	\$1,472	\$239	\$1,200	\$1,439
Formula-based evaluation	40,720	46,637	87,357	39,156	45,264	84,420
Total	\$40,974	\$47,855	\$88,829	\$39,395	\$46,464	\$85,859

The following is a summary of the allowance for credit losses by evaluation method:

(in millions)	June 30, 2014			December 31, 2013		
	Commercial	Retail	Total	Commercial	Retail	Total
Individually evaluated	\$23	\$116	\$139	\$23	\$108	\$131
Formula-based evaluation	550	586	1,136	514	615	1,129
Allowance for credit losses	\$573	\$702	\$1,275	\$537	\$723	\$1,260

For commercial loans and leases, the Company utilizes regulatory classification ratings to monitor credit quality. Loans with a "pass" rating are those that the Company believes will be fully repaid in accordance with the contractual loan terms. Commercial loans and leases that are "criticized" are those that have some weakness that indicates an increased probability of future loss. For retail loans, the Company primarily uses the loan's payment and delinquency status to monitor credit quality. The further a loan is past due, the greater the likelihood of future credit loss. These credit quality indicators for both commercial and retail loans are continually updated and monitored.

The recorded investment in classes of commercial loans and leases based on regulatory classification ratings is as follows:

	June 30, 2014				
	Criticized				
(in millions)	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$28,816	\$722	\$406	\$132	\$30,076
Commercial real estate	6,707	229	110	112	7,158
Leases	3,676	13	51	—	3,740
Total	\$39,199	\$964	\$567	\$244	\$40,974

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December 31, 2013					
(in millions)	Criticized				Total
	Pass	Special Mention	Substandard	Doubtful	
Commercial	\$27,433	\$588	\$541	\$105	\$28,667
Commercial real estate	6,366	339	116	127	6,948
Leases	3,679	40	61	—	3,780
Total	\$37,478	\$967	\$718	\$232	\$39,395

The recorded investment in classes of retail loans, categorized by delinquency status is as follows:

June 30, 2014					
(in millions)	Current	1-29 Days Past Due	30-89 Days Past Due	90 Days or More Past Due	Total
Residential, including originated home equity products	\$28,395	\$849	\$208	\$664	\$30,116
Home equity products serviced by others	1,735	143	39	55	1,972
Other secured retail	11,495	608	66	11	12,180
Unsecured retail	3,405	106	45	31	3,587
Total	\$45,030	\$1,706	\$358	\$761	\$47,855

December 31, 2013					
(in millions)	Current	1-29 Days Past Due	30-89 Days Past Due	90 Days or More Past Due	Total
Residential, including originated home equity products	\$27,912	\$861	\$259	\$662	\$29,694
Home equity products serviced by others	1,901	167	43	60	2,171
Other secured retail	10,068	550	66	16	10,700
Unsecured retail	3,593	185	67	54	3,899
Total	\$43,474	\$1,763	\$435	\$792	\$46,464

Nonperforming Assets

A summary of nonperforming loans and leases by class is as follows:

(in millions)	June 30, 2014			December 31, 2013		
	Nonaccruing	Accruing and 90 Days or More Delinquent	Total Nonperforming Loans and Leases	Nonaccruing	Accruing and 90 Days or More Delinquent	Total Nonperforming Loans and Leases
Commercial	\$63	\$—	\$63	\$96	\$—	\$96
Commercial real estate	129	1	130	169	—	169
Leases	—	2	2	—	—	—
Total commercial	192	3	195	265	—	265
Residential, including originated home equity products	876	—	876	981	—	981
Home equity products serviced by others	80	—	80	89	—	89
Other secured retail	18	—	18	26	—	26
Unsecured retail	22	9	31	22	33	55
Total retail	996	9	1,005	1,118	33	1,151
Total	\$1,188	\$12	\$1,200	\$1,383	\$33	\$1,416

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A summary of other nonperforming assets is as follows:

(in millions)	June 30, 2014	December 31, 2013
Nonperforming assets, net of valuation allowance:		
Commercial	\$4	\$10
Retail	37	40
Nonperforming assets, net of valuation allowance	\$41	\$50

Nonperforming assets consists primarily of other real estate owned and is presented in other assets on the Consolidated Balance Sheets.

A summary of key performance indicators is as follows:

	June 30, 2014	December 31, 2013
Nonperforming commercial loans and leases as a percentage of total loans and leases	0.22%	0.31%
Nonperforming retail loans as a percentage of total loans and leases	1.13	1.34
Total nonperforming loans and leases as a percentage of total loans and leases	1.35	1.65
Nonperforming commercial assets as a percentage of total assets	0.15	0.23
Nonperforming retail assets as a percentage of total assets	0.80	0.97
Total nonperforming assets as a percentage of total assets	0.95%	1.20%

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The following is an analysis of the age of the past due amounts (accruing and nonaccruing):

(in millions)	June 30, 2014			December 31, 2013		
	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	30-89 Days Past Due	90 Days or More Past Due	Total Past Due
Commercial	\$24	\$63	\$87	\$61	\$96	\$157
Commercial real estate	57	130	187	34	169	203
Leases	2	2	4	24	—	24
Total commercial	83	195	278	119	265	384
Residential, including originated home equity products	208	664	872	259	662	921
Home equity products serviced by others	39	55	94	43	60	103
Other secured retail	66	11	77	66	16	82
Unsecured retail	45	31	76	67	54	121
Total retail	358	761	1,119	435	792	1,227
Total	\$441	\$956	\$1,397	\$554	\$1,057	\$1,611

Impaired loans include (1) nonaccruing larger balance commercial loans (greater than \$3 million carrying value) and (2) commercial and retail TDRs. The following is a summary of impaired loan information by class:

(in millions)	June 30, 2014				
	Impaired Loans With a Related Allowance	Allowance on Impaired Loans	Impaired Loans Without a Related Allowance	Unpaid Contractual Balance	Total Recorded Investment in Impaired Loans
Commercial	\$124	\$15	\$35	\$163	\$159
Commercial real estate	56	8	39	262	95
Total commercial	180	23	74	425	254
Residential, including originated home equity products	364	57	514	1,123	878
Home equity products serviced by others	86	14	23	122	109
Other secured retail	21	4	10	40	31
Unsecured retail	200	41	—	200	200
Total retail	671	116	547	1,485	1,218
Total	\$851	\$139	\$621	\$1,910	\$1,472

(in millions)	December 31, 2013				
	Impaired Loans With a Related Allowance	Allowance on Impaired Loans	Impaired Loans Without a Related Allowance	Unpaid Contractual Balance	Total Recorded Investment in Impaired Loans
Commercial	\$86	\$15	\$33	\$214	\$119
Commercial real estate	76	8	44	221	120
Total commercial	162	23	77	435	239
Residential, including originated home equity products	355	59	497	1,081	852
Home equity products serviced by others	91	11	21	125	112
Other secured retail	23	3	12	43	35
Unsecured retail	201	35	—	201	201
Total retail	670	108	530	1,450	1,200
Total	\$832	\$131	\$607	\$1,885	\$1,439

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Additional information on impaired loans is as follows:

(in millions)	For the Six Months Ended June 30,			
	2014		2013	
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
Commercial	\$1	\$102	\$1	\$201
Commercial real estate	—	96	1	176
Total commercial	1	198	2	377
Residential, including originated home equity products	13	843	3	733
Home equity products serviced by others	3	108	3	126
Other secured retail	—	31	4	177
Unsecured retail	5	192	2	48
Total retail	21	1,174	12	1,084
Total	\$22	\$1,372	\$14	\$1,461

Troubled Debt Restructurings

A loan modification is identified as a TDR when the Company or a bankruptcy court grants the borrower a concession the Company would not otherwise make in response to the borrower's financial difficulties. TDRs typically result from the Company's loss mitigation efforts and are undertaken in order to improve the likelihood of recovery and continuity of the relationship. Citizen's loan modifications are handled on a case-by-case basis and are negotiated to achieve mutually agreeable terms that maximize loan collectability and meet the borrower's financial needs. Concessions granted in TDRs for all classes of loans may include lowering the interest rate, forgiving a portion of principal, extending the loan term, lowering scheduled payments for a specified period of time, principal forbearance, or capitalizing past due amounts. A rate increase can be a concession if the increased rate is lower than a market rate for debt with risk similar to that of the restructured loan. TDRs for commercial loans and leases may also involve creating a multiple note structure, accepting non-cash assets, accepting an equity interest, or receiving a performance-based fee. In some cases a TDR may involve multiple concessions. The financial effects of TDRs for all loan classes may include lower income (either due to a lower interest rate or a delay in the timing of cash flows), larger loan loss provisions, and accelerated charge-offs if the modification renders the loan collateral-dependent. In some cases interest income throughout the term of the loan may increase if, for example, the loan is extended or the interest rate is increased as a result of the restructuring.

Because TDRs are impaired loans, the Company measures impairment by comparing the present value of expected future cash flows, or, when appropriate, collateral value, to the loan's recorded investment. Any excess of recorded investment over the present value of expected future cash flows or collateral value is recognized by creating a valuation allowance or increasing an existing valuation allowance. Any portion of the loan's recorded investment the Company does not expect to collect as a result of the modification is charged off at the time of modification.

Commercial TDRs were \$194 million and \$167 million on June 30, 2014 and December 31, 2013, respectively. Retail TDRs totaled \$1.2 billion on June 30, 2014 and December 31, 2013. Commitments to lend additional funds to debtors owing receivables which were TDRs were \$46 million and \$52 million on June 30, 2014 and December 31, 2013, respectively.

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The following table summarizes how loans were modified during the six months ended June 30, 2014, the charge-offs related to the modifications, and the impact on the ALLL. The reported balances include loans that became TDRs during 2014, and were paid off in full, charged off, or sold prior to June 30, 2014.

(dollars in millions)	Primary Modification Types					
	Interest Rate Reduction ⁽¹⁾			Maturity Extension ⁽²⁾		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	15	\$7	\$7	28	\$2	\$2
Commercial real estate	2	—	—	2	—	—
Total commercial	17	7	7	30	2	2
Residential, including originated home equity products	136	14	14	266	18	16
Home equity products serviced by others	21	1	1	1	—	—
Other secured retail	58	1	1	7	—	—
Unsecured retail	1,185	6	6	—	—	—
Total retail	1,400	22	22	274	18	16
Total	1,417	\$29	\$29	304	\$20	\$18

(dollars in millions)	Primary Modification Types				
	Other ⁽³⁾			Net Change to ALLL Resulting from Modification	Charge-offs Resulting from Modification
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment		
Commercial	2	\$—	\$—	\$—	\$—
Commercial real estate	—	—	—	—	—
Total commercial	2	—	—	—	—
Residential, including originated home equity products	921	73	69	—	5
Home equity products serviced by others	109	4	4	—	—
Other secured retail	446	7	5	—	2
Unsecured retail	853	16	16	—	—
Total retail	2,329	100	94	—	7
Total	2,331	\$100	\$94	\$—	\$7

⁽¹⁾ Includes modifications that consist of multiple concessions, one of which is an interest rate reduction.

⁽²⁾ Includes modifications that consist of multiple concessions, one of which is a maturity extension (unless one of the other concessions was an interest rate reduction).

⁽³⁾ Includes modifications other than interest rate reductions or maturity extensions, such as lowering scheduled payments for a specified period of time, principal forbearance, capitalizing arrearages, and principal forgiveness. Also included are the following: deferrals, trial modifications, certain bankruptcies, loans in forbearance and prepayment plans. Modifications can include the deferral of accrued interest resulting in post modification balances being higher than pre-modification.

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The following table summarizes how loans were modified during the six months ended June 30, 2013, the charge-offs related to the modifications, and the impact on the ALLL. The reported balances include loans that became TDRs during 2013, and were paid off in full, charged off, or sold prior to June 30, 2013.

(dollars in millions)	Primary Modification Types					
	Interest Rate Reduction ⁽¹⁾			Maturity Extension ⁽²⁾		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	71	\$4	\$4	84	\$4	\$4
Commercial real estate	4	3	3	1	—	—
Total commercial	75	7	7	85	4	4
Residential, including originated home equity products	238	27	29	80	7	7
Home equity products serviced by others	19	1	1	1	—	—
Other secured retail	195	2	2	2	—	—
Unsecured retail	1,342	7	7	—	—	—
Total retail	1,794	37	39	83	7	7
Total	1,869	\$44	\$46	168	\$11	\$11

(dollars in millions)	Primary Modification Types				
	Other ⁽³⁾				
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Net Change to ALLL Resulting from Modification	Charge-offs Resulting from Modification
Commercial	3	\$—	\$—	\$—	\$—
Commercial real estate	—	—	—	(1)	—
Total commercial	3	—	—	(1)	—
Residential, including originated home equity products	1,050	85	80	1	6
Home equity products serviced by others	145	7	5	—	2
Other secured retail	847	8	7	—	1
Unsecured retail	1,536	28	28	—	—
Total retail	3,578	128	120	1	9
Total	3,581	\$128	\$120	\$—	\$9

⁽¹⁾ Includes modifications that consist of multiple concessions, one of which is an interest rate reduction.

⁽²⁾ Includes modifications that consist of multiple concessions, one of which is a maturity extension (unless one of the other concessions was an interest rate reduction).

⁽³⁾ Includes modifications other than interest rate reductions or maturity extensions, such as lowering scheduled payments for a specified period of time, principal forbearance, capitalizing arrearages, and principal forgiveness. Also included are the following: deferrals, trial modifications, certain bankruptcies, loans in forbearance and prepayment plans. Modifications can include the deferral of accrued interest resulting in post modification balances being higher than pre-modification.

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The table below summarizes TDRs that defaulted during the six months ended June 30, 2014 and 2013 within 12 months of their modification date. For purposes of this table, a payment default is defined as being past due 90 days or more under the modified terms. Amounts represent the loan's recorded investment at the time of payment default. Loan data in this table includes loans meeting the criteria that were paid off in full, charged off, or sold prior to June 30, 2014 and 2013. If a TDR of any loan type becomes 90 days past due after being modified, the loan is written down to the fair value of collateral less cost to sell. The amount written off is charged to the ALLL.

(dollars in millions)	June 30, 2014		June 30, 2013	
	Number of Contracts	Balance Defaulted	Number of Contracts	Balance Defaulted
Commercial	17	\$3	1	\$—
Commercial real estate	1	1	1	—
Total commercial	18	4	2	—
Residential, including originated home equity products	429	33	1,124	85
Home equity products serviced by others	46	1	150	4
Other secured retail	67	1	130	1
Unsecured retail	504	5	592	8
Total retail	1,046	40	1,996	98
Total	1,064	\$44	1,998	\$98

Concentrations of Credit Risk

Most of the Company's business activity is with customers located in the New England, Mid-Atlantic and Mid-West regions. Generally, loans are collateralized by assets including real estate, inventory, accounts receivable, other personal property and investment securities. As of June 30, 2014 and December 31, 2013, the Company had a significant amount of loans collateralized by residential and commercial real estate. There are no significant concentrations to particular industries within the commercial loan portfolio. Exposure to credit losses arising from lending transactions may fluctuate with fair values of collateral supporting loans, which fail to perform according to contractual agreements. The Company's policy is to collateralize loans to the extent necessary; however, unsecured loans are also granted on the basis of the financial strength of the applicant and the facts surrounding the transaction.

Certain loan products, including residential mortgages, home equity loans and lines of credit, and credit cards, have contractual features that may increase credit exposure to the Company in the event of an increase in interest rates or a decline in housing values. These products include loans that exceed 90% of the value of the underlying collateral (high LTV loans), interest-only and negative amortization residential mortgages, and loans with low introductory rates. Certain loans have more than one of these characteristics.

The following table presents balances of loans with these characteristics:

(in millions)	June 30, 2014				Total
	Residential Mortgages	Home Equity Loans and Lines of Credit	Home Equity Products serviced by others	Credit Cards	
High loan-to-value	\$1,003	\$2,574	\$1,413	\$—	\$4,990
Interest only/negative amortization	875	—	—	—	875
Low introductory rate	—	—	—	106	106
Multiple characteristics and other	76	—	—	—	76
Total	\$1,954	\$2,574	\$1,413	\$106	\$6,047

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	December 31, 2013				
(in millions)	Residential Mortgages	Home Equity Loans and Lines of Credit	Home Equity Products serviced by others	Credit Cards	Total
High loan-to-value	\$1,054	\$2,798	\$1,581	\$—	\$5,433
Interest only/negative amortization	882	—	—	—	882
Low introductory rate	—	—	—	119	119
Multiple characteristics and other	96	—	—	—	96
Total	\$2,032	\$2,798	\$1,581	\$119	\$6,530

NOTE 5 - GOODWILL

Goodwill represents the excess of fair value of assets purchased over the purchase price. Since 1988, the Company has closed 26 acquisitions of banks or assets of banks. The changes in the carrying value of goodwill for the six months ended June 30, 2014 and 2013 were:

(in millions)	Consumer Banking	Commercial Banking	Total
Balance at December 31, 2012	\$6,393	\$4,918	\$11,311
Impairment losses based on results of interim impairment testing	(4,435)	—	(4,435)
Transfers	178	(178)	—
Balance at June 30, 2013	\$2,136	\$4,740	\$6,876
Balance at December 31, 2013	\$2,136	\$4,740	\$6,876
Adjustments	—	—	—
Balance at June 30, 2014	\$2,136	\$4,740	\$6,876

Accumulated impairment losses related to the Consumer Banking reporting unit totaled \$5.9 billion at June 30, 2014, and 2013. The accumulated impairment losses related to the Commercial Banking unit totaled \$50 million at June 30, 2014 and 2013.

The Company performs an annual test for impairment of goodwill at a level of reporting referred to as a reporting unit. The Company has identified and allocated goodwill to the following reporting units based upon reviews of the structure of the Company's executive team and supporting functions, resource allocations and financial reporting processes:

- Consumer Banking
- Commercial Banking

The Company tested the value of goodwill as of June 30, 2013, and recorded an impairment charge of \$4.4 billion relating to the Consumer Banking reporting unit. The impairment charge, which was a non-cash item, had minimal impact on the Company's regulatory capital ratios and liquidity, and for segment reporting purposes was included in Other. Refer to Note 19, "Business Segments," for information regarding segment reporting.

The valuation of goodwill is dependent on forward-looking expectations related to the performance of the U.S. economy and the associated financial performance of the Company. The prolonged delay in the full recovery of the U.S. economy, and the impact of that delay on earnings expectations, prompted a goodwill impairment test as of June 30, 2013. Although the U.S. economy has demonstrated signs of recovery, notably improvements in unemployment and housing, the pace and extent of these indicators, as well as in overall Gross Domestic Product, have lagged previous expectations. The impact of the slow recovery is most evident in the Company's Consumer Banking reporting unit. Forecasted economic growth for the U.S., coupled with the continuing impact of the new regulatory framework in the financial industry, have resulted in a deceleration of expected growth for the Consumer Banking reporting unit's future profits, and an associated goodwill impairment. Refer to Note 1, "Significant Accounting Policies," in the Company's audited Consolidated Financial Statements for information regarding the impairment test.

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NOTE 6 - MORTGAGE BANKING

In its mortgage banking business, the Company sells residential mortgage loans to government-sponsored entities and other parties, who may issue securities backed by pools of such loans. The Company retains no beneficial interests in these sales, but may retain the servicing rights of the loans sold. The Company is obligated to subsequently repurchase a loan if the purchaser discovers a standard representation or warranty violation such as noncompliance with eligibility requirements, customer fraud, or servicing violations. This primarily occurs during a loan file review.

The Company received \$688 million and \$2.6 billion of proceeds from the sale of residential mortgages in the six months ended June 30, 2014 and 2013, respectively and recognized gains on such sales of \$17 million and \$47 million in the six months then ended, respectively. Pursuant to the standard representations and warranties obligations discussed in the preceding paragraph, the Company repurchased mortgage loans totaling \$17 million and \$26 million for the six months ended June 30, 2014 and 2013, respectively.

Mortgage servicing fees, a component of mortgage banking income, were \$30 million and \$32 million for the six months ended June 30, 2014 and 2013, respectively. The Company recorded a valuation recovery of \$3 million compared to a recovery of \$39 million for its MSRs for the six months ended June 30, 2014 and 2013, respectively.

Changes related to MSRs were as follows:

(in millions)	Six Months Ended June 30,	
	2014	2013
MSRs:		
Balance as of January 1	\$208	\$215
Amount capitalized	8	26
Amortization	(21)	(29)
Carrying amount before valuation allowance	195	212
Valuation allowance for servicing assets:		
Balance as of January 1	23	70
Valuation recovery	(3)	(39)
Balance at end of period	20	31
Net carrying value of MSRs	\$175	\$181

MSRs are presented in other assets on the Consolidated Balance Sheets.

The fair value of MSRs is estimated using a valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. The valuation model uses a static discounted cash flow methodology incorporating current market interest rates. A static model does not attempt to forecast or predict the future direction of interest rates; rather it estimates the amount and timing of future servicing cash flows using current market interest rates. The current mortgage interest rate influences the expected prepayment rate and therefore, the length of the cash flows associated with the servicing asset, while the discount rate determines the present value of those cash flows. Expected mortgage loan prepayment assumptions are obtained using the QRM Multi Component prepayment model. The Company periodically obtains third-party valuations of its MSRs to assess the reasonableness of the fair value calculated by the valuation model.

The key economic assumptions used to estimate the value of MSRs are presented in the following table:

(dollars in millions)	As of June 30,	
	2014	2013
Fair value	\$186	\$188
Weighted average life (in years)	5.2	5.2
Weighted average constant prepayment rate	13.0%	14.1%
Weighted average discount rate	10.3%	10.4%

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The key economic assumptions used in estimating the fair value of MSR capitalizations during the period were as follows:

	Six Months Ended June 30,	
	2014	2013
Weighted average life (in years)	5.4	6.3
Weighted average constant prepayment rate	12.1%	13.3%
Weighted average discount rate	10.3%	10.5%

The sensitivity analysis below as of June 30, 2014 and 2013, presents the impact to current fair value of an immediate 50 basis points and 100 basis points adverse change in the key economic assumptions and presents the decline in fair value that would occur if the adverse change were realized. These sensitivities are hypothetical. The effect of a variation in a particular assumption on the fair value of the mortgage servicing rights is calculated independently without changing any other assumption. In reality, changes in one factor may result in changes in another (for example, changes in interest rates, which drive changes in prepayment speeds, could result in changes in the discount rates), which might amplify or counteract the sensitivities. The primary risk inherent in the Company's MSR is an increase in prepayments of the underlying mortgage loans serviced, which is dependent upon market movements of interest rates.

(in millions)	Six Months Ended June 30,	
	2014	2013
Prepayment rate:		
Decline in fair value from 50 basis points adverse change in interest rates	\$8	\$11
Decline in fair value from 100 basis points adverse change in interest rates	\$14	\$22
Weighted average discount rate:		
Decline in fair value from 50 basis points adverse change	\$3	\$3
Decline in fair value from 100 basis points adverse change	\$6	\$6

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NOTE 7 - BORROWED FUNDS

The following is a summary of the Company's short-term borrowed funds:

<i>(in millions)</i>	As of June 30, 2014	As of December 31, 2013
Federal funds purchased	\$—	\$689
Securities sold under agreements to repurchase	6,807	4,102
Other short-term borrowed funds	7,702	2,251
Total short-term borrowed funds	\$14,509	\$7,042

Key data related to short-term borrowed funds is presented in the following table:

<i>(dollars in millions)</i>	As of and For the Six Months Ended June 30, 2014	As of and For the Year Ended December 31, 2013
Weighted-average interest rate at period end:		
Federal funds purchased and securities sold under agreements to repurchase	0.12%	0.09%
Other short-term borrowed funds	0.27%	0.20%
Maximum amount outstanding at month-end during the period:		
Federal funds purchased and securities sold under agreements to repurchase	\$7,022	\$5,114
Other short-term borrowed funds	7,702	2,251
Average amount outstanding during the period:		
Federal funds purchased and securities sold under agreements to repurchase	\$5,708	\$2,400
Other short-term borrowed funds	4,838	259
Weighted-average interest rate during the period:		
Federal funds purchased and securities sold under agreements to repurchase	0.11%	0.31%
Other short-term borrowed funds	0.26%	0.44%

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The following is a summary of the Company's long-term borrowed funds:

<i>(in millions)</i>	June 30, 2014	December 31, 2013
Citizens Financial Group, Inc.:		
4.150% fixed rate subordinated debt, due 2022	\$350	\$350
5.158% fixed-to-floating rate subordinated debt, (LIBOR + 3.56%) callable, due 2023	333	333
4.771% fixed rate subordinated debt, due 2023	333	333
4.691% fixed rate subordinated debt, due 2024	334	334
4.153% fixed rate subordinated debt due 2024	333	—
Banking Subsidiaries:		
Federal Home Loan advances due through 2033	24	25
Other	25	30
Total long-term borrowed funds	\$1,732	\$1,405

Advances, lines of credit, and letters of credit from the FHLB are collateralized by pledged mortgages and pledged securities at least sufficient to satisfy the collateral maintenance level established by the FHLB. The utilized borrowing capacity for FHLB advances and letters of credit was \$11.1 billion and \$4.2 billion at June 30, 2014 and December 31, 2013, respectively. The Company's available FHLB borrowing capacity was \$1.6 billion and \$8.2 billion at June 30, 2014 and December 31, 2013, respectively. The Company can also borrow from the FRB discount window to meet short-term liquidity requirements. Collateral, such as investment securities and loans, is pledged to provide borrowing capacity at the FRB. At June 30, 2014, the Company's unused secured borrowing capacity was approximately \$22.4 billion, which includes free securities, FHLB borrowing capacity, and FRB discount window capacity.

The following is a summary of maturities for the Company's long-term borrowed funds at June 30, 2014:

Year	(in millions)
2015 or on demand	\$2
2016	6
2017	14
2018	11
2019	1
2020 and thereafter	1,698
Total	\$1,732

NOTE 8 - PREFERRED STOCK

As of June 30, 2014, the Company had authorized 100,000,000 shares of \$25 par value undesignated preferred stock. These undesignated shares were authorized on April 9, 2014, by resolution of the Board of Directors. The Board of Directors or any authorized committee thereof are authorized to provide for the issuance of these shares in one or more series, and by filing a certificate pursuant to applicable law of the State of Delaware, to establish or change from time to time the number of shares of each such series, and to fix the designations, powers, including voting powers, full or limited, or no voting powers, preferences and the relative, participating, optional or other special rights of the shares of each series and any qualifications, limitations and restrictions thereof.

Prior to April 9, 2014, the Company had authorized 30,000 of \$1 par value non-cumulative, non-voting perpetual preferred stock. That preferred stock ranked senior to the common stock of the Company with respect to dividend rights upon liquidation or dissolution of the Company. The stock was not convertible into any other property of the Company, nor was it redeemable by either the Company or the holder thereof. Dividends were non-cumulative and were payable quarterly at LIBOR plus 180 bps, if and when declared by the Company's Board of Directors. In the event of any liquidation, dissolution or winding up of the Company, holders of each share of the preferred stock outstanding were entitled to be paid, out of the assets of the Company available for

CITIZENS FINANCIAL GROUP, INC.

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distribution to stockholders, before any payment was made to the holders of common stock, an amount equal to \$100,000 per share of preferred stock then issued and outstanding.

There were no shares issued and outstanding during 2014 or 2013.

NOTE 9 - EMPLOYEE BENEFITS

The Company maintains a non-contributory pension plan (the "Plan" or "qualified plan") that was closed to new hires and re-hires effective January 1, 2009 and frozen to all participants effective December 31, 2012. Benefits under the Plan are based on employees' years of service and highest 5-year average eligible compensation. The Plan is funded on a current basis, in compliance with the requirements of the ERISA. The Company also provides an unfunded, non-qualified supplemental retirement plan (the "non-qualified plan"), which was closed and frozen consistent with the qualified plan.

The following table presents the components of net periodic (income) cost for the Company's qualified and non-qualified plans:

(in millions)	Six Months Ended June 30,					
	Qualified Plan		Non-Qualified Plan		Total	
	2014	2013	2014	2013	2014	2013
Service cost	\$2	\$2	\$—	\$—	\$2	\$2
Interest cost	22	21	2	2	24	23
Expected return on plan assets	(35)	(34)	—	—	(35)	(34)
Amortization of actuarial loss	4	6	1	1	5	7
Net periodic pension (income) cost	(\$7)	(\$5)	\$3	\$3	(\$4)	(\$2)

NOTE 10 - INCOME TAXES

Income Tax Provision (Benefit)

The provision (benefit) for income taxes was \$232 million and \$(174) million for the six months ended June 30, 2014 and 2013, respectively. The provision represented an effective tax rate of 33% and 4% for the six months ended June 30, 2014 and 2013, respectively. For the six months ended June 30, 2014, the effective tax rate compared favorably to the statutory rate of 35% primarily as a result of tax credits and the permanent benefit of tax-exempt income. For the six months ended June 30, 2013, the effective tax rate compared favorably to the statutory rate of 35% primarily as a result of the tax rate impact of a goodwill impairment charge.

Deferred Tax Liability

At June 30, 2014, the Company reported a net deferred tax liability of \$403 million, compared to a \$199 million liability as of December 31, 2013. The increase in the net deferred tax liability is primarily attributable to the utilization of net operating loss and tax credit carryforwards, in addition to a decrease in the unrealized loss reported on securities available for sale, derivative instruments, and hedging activities.

NOTE 11 - DERIVATIVES

In the normal course of business, the Company enters into a variety of derivative transactions in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates and foreign currency exchange rates. The Company does not use derivatives for speculative purposes.

The Company's derivative instruments are recognized on the Consolidated Balance Sheets at fair value. Information regarding the valuation methodology and inputs used to estimate the fair value of the Company's derivative instruments is described in Note 15, "Fair Value Measurements."

CITIZENS FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table identifies derivative instruments included on the Consolidated Balance Sheets in derivative assets and derivative liabilities:

(in millions)	June 30, 2014			December 31, 2013		
	Notional Amount ¹	Derivative Assets	Derivative Liabilities	Notional Amount ¹	Derivative Assets	Derivative Liabilities
Derivatives designated as hedging instruments:						
Interest rate swaps	\$5,000	\$23	\$223	\$5,500	\$23	\$412
Derivatives <u>not</u> designated as hedging instruments:						
Interest rate swaps	28,381	611	522	29,355	654	558
Foreign exchange contracts	8,395	74	69	7,771	94	87
Other contracts	731	8	14	569	7	10
Total derivatives <u>not</u> designated as hedging instruments		693	605		755	655
Gross derivative fair values		716	828		778	1,067
Less: Gross amounts offset in the Consolidated Balance Sheets ²		(81)	(81)		(128)	(128)
Total net derivative fair values presented in the Consolidated Balance Sheets ³		\$635	\$747		\$650	\$939

¹The notional or contractual amount of interest rate derivatives and foreign exchange contracts is the amount upon which interest and other payments under the contract are based. For interest rate derivatives, the notional amount is typically not exchanged. Therefore, notional amounts should not be taken as the measure of credit or market risk, as they tend to greatly overstate the true economic risk of these contracts.

²Amounts represent the impact of legally enforceable master netting agreements that allow the Company to settle positive and negative positions.

³The Company also offsets assets and liabilities associated with repurchase agreements on the Consolidated Balance Sheets. See Note 2, "Securities," for further information.

The Company's derivative transactions are internally divided into three sub-groups: institutional, customer and residential loan.

Institutional derivatives

The institutional derivatives portfolio primarily consists of interest rate swap agreements that are used to hedge the interest rate risk associated with the Company's investment securities, loans and financing liabilities (i.e., borrowed funds, deposits, etc.). The goal of the Company's interest rate hedging activities is to manage interest rate sensitivity so that movements in interest rates do not significantly adversely affect net interest income.

The Company enters into certain interest rate swap agreements to hedge the risk associated with floating rate loans. By entering into pay-floating/receive-fixed interest rate swaps, the Company was able to minimize the variability in the cash flows of these assets due to changes in interest rates. The Company has outstanding interest rate swap agreements designed to hedge a portion of the Company's borrowed funds and deposits. By entering into a pay-fixed/receive-floating interest rate swap, a portion of these liabilities has been effectively converted to a fixed rate liability for the term of the interest rate swap agreement.

Customer derivatives

The customer derivatives portfolio consists of interest rate swap agreements and option contracts that are transacted to meet the financing needs of the Company's customers. Offsetting swap and cap agreements are simultaneously transacted to effectively eliminate the Company's market risk associated with the customer derivative products. The customer derivatives portfolio also includes foreign exchange contracts that are entered into on behalf of customers for the purpose of hedging exposure related to cash orders and loans and deposits denominated in foreign currency. The primary risks associated with these transactions arise from exposure to changes in foreign currency exchange rates and the ability of the counterparties to meet the terms of the contract. To manage this market risk, the Company simultaneously enters into offsetting foreign exchange contracts.

Residential loan derivatives

The Company enters into residential loan commitments that allow residential mortgage customers to lock in the interest rate on a residential mortgage while the loan undergoes the underwriting process. The Company also uses forward sales contracts to protect the value of residential mortgage loans and loan commitments that are being underwritten for future sale to investors in the secondary market.

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The Company has certain derivative transactions that are designated as hedging instruments described as follows:

Derivatives designated as hedging instruments

The majority of the Company's institutional hedging portfolio qualifies for hedge accounting. This includes interest rate swaps that are designated in highly effective cash flow hedging relationships. The Company formally documents at inception all hedging relationships, as well as risk management objectives and strategies for undertaking various accounting hedges. Additionally, the Company uses dollar offset or regression analysis at the hedge's inception, and at least quarterly thereafter to assess whether the derivatives are expected to be, or have been, highly effective in offsetting changes in the hedged item's expected cash flows. The Company discontinues hedge accounting when it is determined that a derivative is not expected to be or has ceased to be effective as a hedge, and then reflects changes in fair value in earnings after termination of the hedge relationship.

Cash flow hedges

The Company has outstanding interest rate swap agreements designed to hedge a portion of the Company's floating rate assets and financing liabilities (including its borrowed funds and deposits). All of these swaps have been deemed as highly effective cash flow hedges. The effective portion of the hedging gains and losses associated with these hedges are recorded in OCI; the ineffective portion of the hedging gains and losses is recorded in earnings (other income). Hedging gains and losses on derivative contracts reclassified from OCI to current period earnings are included in the line item in the accompanying consolidated statements of operations in which the hedged item is recorded, and in the same period that the hedged item affects earnings. During the next 12 months, approximately \$33 million of net loss (pretax) on derivative instruments included in OCI is expected to be reclassified to net interest expense in the Consolidated Statements of Operations.

Hedging gains and losses associated with the Company's cash flow hedges are immediately reclassified from OCI to current period earnings (other income) if it becomes probable that the hedged forecasted transactions will not occur by the originally specified time period.

The following table summarizes certain information related to the Company's cash flow hedges:

The Effect of Cash Flow Hedges on Net Income and Stockholders' Equity				
(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Effective portion of gain (loss) recognized in OCI ¹	\$97	\$39	\$191	\$55
Amounts reclassified from OCI to interest income ²	18	(17)	36	(22)
Amounts reclassified from OCI to interest expense ²	(27)	(44)	(56)	(98)
Amounts reclassified from OCI to other income ³	—	—	—	(2)

¹The cumulative effective gains and losses on the Company's cash flow hedging activities are included on the accumulated other comprehensive loss line item on the Consolidated Balance Sheets.

²This amount includes both (a) the amortization of effective gains and losses associated with the Company's terminated cash flow hedges and (b) the current reporting period's interest settlements realized on the Company's active cash flow hedges. Both (a) and (b) were previously included on the accumulated other comprehensive loss line item on the Consolidated Balance Sheets and were subsequently recorded as adjustments to the interest expense of the underlying hedged item.

³This amount represents hedging gains and losses that have been immediately reclassified from accumulated other comprehensive loss based on the probability that the hedged forecasted transactions would not occur by the originally specified time period. This amount is reflected in the other income line item on the Consolidated Statements of Operations.

Economic Hedges

The Company's customer derivatives are recorded on the Consolidated Balance Sheets at fair value. These include interest rate and foreign exchange derivative contracts that are transacted to meet the hedging and financing needs of the Company's customers. Mark-to-market adjustments to the fair value of customer related interest rate contracts are included in other income in the accompanying Consolidated Statements of Operations. Mark-to-market adjustments to the fair value of foreign exchange contracts relating to foreign currency loans are included in interest and fees on loans and leases in the accompanying Consolidated Statements of Operations, while all other foreign currency contract fair value changes are included in foreign exchange and trade finance fees. In both cases, the mark-to-market gains and losses associated with the customer derivatives are mitigated by the mark-to-market gains and losses on the offsetting interest rate and foreign exchange derivative contracts transacted.

The Company's residential loan derivatives (including residential loan commitments and forward sales contracts) are recorded on the Consolidated Balance Sheets at fair value. Mark-to-market adjustments to the fair value of residential loan commitments and forward sale contracts are included in noninterest income under mortgage banking fees.

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The following table summarizes certain information related to the Company's economic hedges:

The Effect of Customer Derivatives and Economic Hedges on Net Income				
(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<u>Customer derivative contracts</u>				
Customer interest rate contracts ¹	\$88	(\$142)	\$149	(\$150)
Customer foreign exchange contracts ¹	2	13	6	(10)
Residential loan commitments ³	5	(28)	8	(40)
<u>Economic hedges</u>				
Offsetting derivatives transactions to hedge interest rate risk on customer interest rate contracts ¹	(82)	154	(135)	178
Offsetting derivatives transactions to hedge foreign exchange risk on customer foreign exchange contracts ²	(1)	(10)	(7)	13
Forward sale contracts ³	(3)	40	(4)	40
Total	\$9	\$27	\$17	\$31

¹Reported in other income on the Consolidated Statements of Operations.

²Reported in foreign exchange and trade finance fees on the Consolidated Statements of Operations.

³Reported in mortgage banking fees on the Consolidated Statements of Operations.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Commitments

Commitments to extend credit are agreements to lend to customers in accordance with conditions contractually agreed upon in advance. Generally, the commitments have fixed expiration dates or termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being drawn upon, the contract amounts are not necessarily indicative of future cash requirements.

When-issued securities are agreements to purchase securities that have been authorized for issuance but not yet issued. The fair value of when-issued securities is reflected in the consolidated balance sheets at trade date.

On May 29, 2014, the Company entered into an agreement to purchase auto loans on a quarterly basis in future periods. For the first year, the agreement requires the purchase of a minimum of \$250 million of outstanding balances to a maximum of \$600 million per quarterly period. For quarterly periods after the first year, the minimum and maximum purchases are \$400 million and \$600 million, respectively. The agreement automatically renews until terminated by either party. The Company may cancel the agreement at will with payment of a variable termination fee. After three years, there is no termination fee.

During 2003, the Company entered into a 25-year agreement to acquire the naming and marketing rights of a baseball stadium in Pennsylvania. The Company has not made any payments on this contract for the six months ended June 30, 2014. The Company paid \$3 million for the year ended December 31, 2013, and is obligated to pay \$54 million over the remainder of the contract.

Letters of Credit

Standby letters of credit, both financial and performance, are issued by the Company for its customers. They are used as conditional guarantees of payment to a third party in the event the customer either fails to make specific payments (financial) or fails to complete a specific project (performance). Commercial letters of credit are used to facilitate the import of goods. The commercial letter of credit is used as the method of payment to the Company's customers' suppliers. The Company's exposure to credit loss in the event of counterparty nonperformance in connection with the above instruments is represented by the contractual amount of those instruments, net of the value of collateral held. Standby letters of credit and commercial letters of credit are issued for terms of up to ten years and one year, respectively.

Generally, letters of credit are collateralized by cash, accounts receivable, inventory or investment securities. Credit risk associated with letters of credit is considered in determining the appropriate amounts of reserves for unfunded commitments.

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The Company recognizes a liability on the Consolidated Balance Sheets representing its obligation to stand ready to perform over the term of the standby letters of credit in the event that the specified triggering events occur. The liability for these guarantees at June 30, 2014 and December 31, 2013 is \$3 million.

Risk Participation Agreements

RPAs are guarantees issued by the Company to other parties for a fee, whereby the Company agrees to participate in the credit risk of a derivative customer of the other party. Under the terms of these agreements, the “participating bank” receives a fee from the “lead bank” in exchange for the guarantee of reimbursement if the customer defaults on an interest rate swap. The interest rate swap is transacted such that any and all exchanges of interest payments (favorable and unfavorable) are made between the lead bank and the customer. In the event that an early termination of the swap occurs and the customer is unable to make a required close out payment, the participating bank assumes that obligation and is required to make this payment.

RPAs where the Company acts as the lead bank are referred to as “participations-out,” in reference to the credit risk associated with the customer derivatives being transferred out of the Company. Participations-out generally occur concurrently with the sale of new customer derivatives. RPAs where the Company acts as the participating bank are referred to as “participations-in,” in reference to the credit risk associated with the counterparty’s derivatives being assumed by the Company. The Company’s maximum credit exposure is based on its proportionate share of the settlement amount of the referenced interest rate swap. Settlement amounts are generally calculated based on the fair value of the swap plus outstanding accrued interest receivables from the customer. The Company’s estimate of the credit exposure associated with its risk participations-in as of June 30, 2014 and December 31, 2013 is \$20 million and \$17 million, respectively. The current amount of credit exposure is spread out over 74 counterparties. RPAs generally have terms ranging from 1-5 years; however, certain outstanding agreements have terms as long as 9 years.

Other Guarantees

The Company has issued a guarantee to RBS, for a fee, whereby the Company will absorb credit losses related to the sale of option contracts by RBS to customers of the Company. There were outstanding option contracts with a notional value of \$1 million and \$2 million at June 30, 2014 and December 31, 2013, respectively.

The following is a summary of outstanding off balance sheet arrangements:

(in millions)	June 30, 2014	December 31, 2013
Commitment amount:		
Undrawn commitments to extend credit	\$54,353	\$53,987
Financial standby letters of credit	2,622	2,556
Performance letters of credit	118	149
Commercial letters of credit	56	64
Marketing rights	54	54
Risk participation agreements	20	17
Residential mortgage loans sold with recourse	12	13
Total	\$57,235	\$56,840

Contingencies

The Company operates in a legal and regulatory environment that exposes it to potentially significant risks. A certain amount of litigation ordinarily results from the nature of the Company’s banking and other businesses. The Company is a party to legal proceedings, including class actions. It is also the subject of investigations, reviews, and regulatory matters arising out of its normal business operations, which, in some instances, relate to concerns about unfair and/or deceptive practices and mis-selling of certain products. In addition, the Company engages in discussions with relevant governmental and regulatory authorities on an ongoing and regular basis regarding various issues, and it is possible that any issues discussed or identified may result in investigatory or other action being taken. Litigation and regulatory matters may result in settlements, damages, fines, public or private censure, increased costs, required remediation, restriction on business activities, or other impact on the Company.

In these disputes and proceedings, the Company contests liability and the amount of damages as appropriate. Given their complex nature, it may be years before some of these matters are finally resolved. Moreover, before liability can be reasonably

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estimated for a claim, numerous legal and factual issues may need to be examined, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal issues relevant to the proceedings in question.

The Company cannot predict with certainty if, how, or when such claims will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages. The Company recognizes a provision for a claim when, in the opinion of management after seeking legal advice, it is probable that a liability exists and the amount of loss can reasonably be estimated. In many proceedings, however, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. In each of the matters described below, the Company is unable to estimate the liability in excess of any provision accrued, if any, that might arise or its effects on the Company's Consolidated Statements of Operations or Consolidated Cash Flows in any particular period.

Set out below are descriptions of significant legal matters involving the Company. Based on information currently available, the advice of legal and other counsel, and established reserves, management believes that the aggregate liabilities, if any, arising from these proceedings will not have a materially adverse effect on the Company's Consolidated Financial Statements.

Consumer Products

The activities of the Company's bank subsidiaries are subject to extensive laws and regulations concerning unfair or deceptive acts or practices in connection with customer products. Certain of the bank subsidiaries' practices with respect to overdraft protection and other consumer products have not met applicable standards. The bank subsidiaries have implemented and are continuing to implement changes to bring their practices in conformity with applicable laws and regulations.

In April 2013, the bank subsidiaries consented to the issuance of orders by the OCC and the FDIC (the Consent Orders). In the Consent Orders (which are publicly available and will remain in effect until terminated by the regulators), the bank subsidiaries neither admitted nor denied the regulators' findings that they had engaged in deceptive marketing and implementation of the bank's overdraft protection program, checking rewards programs, and stop-payment process for pre-authorized recurring electronic fund transfers. Under the Consent Orders, the bank subsidiaries paid a total of \$10 million in civil monetary penalties and are required to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately \$8 million) to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders. In addition, Citizens Bank, N.A. agreed to take certain remedial actions to improve its compliance risk management systems and to create a comprehensive action plan designed to achieve compliance with the Consent Orders. Restitution plans have been prepared and submitted for approval and Citizens Bank, N.A. has submitted for approval, and is in the process of implementing, its action plan for compliance with the Consent Order, as well as updated policies, procedures, and programs related to its compliance risk management systems.

The Company's banking subsidiaries have also identified issues regarding, among other things, certain identity theft and debt cancellation products, certain overdraft fees, signature debit card fees, the bank subsidiaries' policies and practices with respect to consumer complaints process, identifying and correcting errors in customer deposits, and the charging of cost-based credit card late payment fees. The banking subsidiaries have paid restitution and expect to pay additional restitution to certain affected customers in connection with certain of these practices. In addition, the banking subsidiaries could face formal administrative enforcement actions from their federal supervisory agencies, including the assessment of civil monetary penalties and restitution, relating to the past practices and policies identified above and other consumer products, and they could face potential civil litigation. The Company does not expect that the aggregate of amounts paid in connection with these matters will have a material adverse effect on the Company's Consolidated Financial Statements.

Fair Labor Standards Act Litigation

The Company was named in several purported class actions brought under the FLSA and equivalent state statutes alleging that certain categories of branch employees were denied overtime for hours worked. These suits were brought by current and former branch employees alleging that either: (1) they were in Assistant Branch Manager positions and were improperly classified as exempt under the FLSA thereby denying them pay for all hours worked, including overtime pay; or (2) they were properly classified as non-exempt tellers, bankers or the like but were told not to record all of their hours, had hours they entered deleted by their managers and/or were otherwise denied pay for hours worked, including overtime pay. These cases cover the Company's entire geographic footprint, and they have been settled with final court approval of the settlements granted on May 5, 2014. The settlement amount (\$12 million), which had been fully covered by an existing reserve, has been paid by the Company and is in the process of being distributed pursuant to the terms of the settlement. Separately, the Company was named in two lawsuits brought by current and former mortgage loan officers and home loan advisors alleging that they were improperly classified as exempt under the FLSA and corresponding state laws and therefore denied pay for all hours worked, including overtime pay. These cases have been settled, and final court approval of the settlements was granted on January 29, 2014. The combined settlement

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amount of these two cases (\$3 million) which had been fully covered by existing reserves, has been paid by the Company and distributed pursuant to the terms of the settlements.

Telephone Consumer Protection Act Litigation

The Company is a defendant in a purported class action complaint filed in December 2013 in the United States District Court for the Southern District of California pursuant to the Telephone Consumer Protection Act. The named plaintiff purports to represent a "national class" of customers who allegedly received automated calls to their cell phones from the bank or its agents, without customer consent, in violation of the Telephone Consumer Protection Act. The Company is vigorously defending this matter.

LIBOR Litigation

The Company is a defendant in lawsuits in which allegations have been made that its parent company, RBS Group, manipulated U.S. dollar LIBOR to the detriment of the Company's customers. The lawsuits include a purported class action on behalf of borrowers of the Company whose interest rates were tied to U.S. dollar LIBOR. The plaintiffs in these cases assert various theories of liability, including fraud, negligent misrepresentation, breach of contract, and unjust enrichment. The Company is vigorously defending these matters.

Foreclosure-Related Expenses

In May 2013, the civil division of the U.S. Attorney's Office for the Southern District of New York served a subpoena pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 seeking information regarding home mortgage foreclosure expenses submitted for reimbursement to the United States Department of Housing and Urban Development, FNMA, or FHLMC. The Company is cooperating with the investigation.

Mortgage Repurchase Demands

The Company is an originator and servicer of residential mortgages and routinely sells such mortgage loans in the secondary market and to government-sponsored entities. In the context of such sales, the Company makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of those representations and warranties. Between the start of January 2009 and the end of June 30, 2014, the Company has received approximately \$146 million in repurchase demands and \$97 million in indemnification payment requests in respect of loans originated, for the most part, since 2003. Of those claims presented, \$81 million was paid to repurchase residential mortgage loans, and \$32 million was incurred for indemnification costs to make investors whole. The Company repurchased mortgage loans totaling \$17 million and \$26 million for the six months ended June 30, 2014 and 2013, respectively. The Company incurred indemnification costs of \$7 million and \$6 million for the six months ended June 30, 2014 and 2013, respectively. The Company cannot estimate what the future level of repurchase demands will be or the Company's ultimate exposure, and cannot give any assurance that the historical experience will continue in the future. It is possible that the volume of repurchase demands will increase. In addition to the above, the Company has since December 2013 been responding to subpoenas issued by the Office of the Inspector General for the Federal Housing Finance Agency seeking information about loans sold to Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation from 2003 through 2011.

NOTE 13 - DIVESTITURES AND BRANCH ASSETS AND LIABILITIES HELD FOR SALE

In June 2014, the Company sold 103 retail branches located in Illinois, including certain customer deposit liabilities of \$4.8 billion and selected loans of \$1.0 billion (primarily middle market, small business, home equity and credit card balances). As a result of this transaction, the Company recorded a gain on sale of \$288 million consisting of, \$286 million related to the deposits, a gain on sale of \$11 million related to the loans and \$9 million loss on sale of other branch assets. For the six months ended June 30, 2014, the corresponding interest and fees on these loans was \$20 million and interest expense on deposits was \$4 million. The Company has agreed to service the credit card accounts sold to the purchaser until September 2014. At such time, the Company is expected to complete all exit activities associated with this transaction. As a result of this transaction, the related assets and liabilities were classified as held for sale as of December 31, 2013. See Note 17, "Divestitures and Branch Assets and Liabilities Held for Sale," in the Company's audited Consolidated Financial Statements for further details.

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NOTE 14 - RELATED PARTY TRANSACTIONS

The following is a summary of inter-company borrowed funds:

(dollars in millions)	Related Party	Interest Rate	Maturity Date	June 30, 2014	December 31, 2013
Subordinated debt	RBSG	4.153%	July 2024	\$333	\$—
	RBSG	4.961%	January 2024	334	334
	RBSG	4.771%	October 2023	333	333
	RBS	5.158%	June 2023	333	333

Total interest expense recorded on inter-company subordinated debt was \$25 million and \$2 million for the six months ended June 30, 2014 and 2013, respectively.

The Company maintained a \$50 million revolving line of credit at December 31, 2013 with RBS. This line of credit was not drawn upon at December 31, 2013, expired on January 31, 2014, and was not renewed. No interest expense was incurred on this revolving line of credit for the six months ended June 30, 2013.

The Company enters into interest rate swap agreements with RBS for the purpose of reducing the Company's exposure to interest rate fluctuations. As of June 30, 2014, the total notional amount of swaps outstanding was \$5 billion which pay fixed rates ranging from 1.78% to 4.3% and receive overnight fed funds rate and one month LIBOR with maturities from 2016 through 2023. As of December 31, 2013, the total notional amount of swaps outstanding was \$5.5 billion, all of which paid fixed rates ranging from 1.78% to 5.47% and received overnight Federal funds rate with maturities from 2014 through 2023. Included in these balances were \$4 billion of receive-fixed swaps that had been executed as of June 30, 2014 and 2013 as part of a new hedging program implemented during the quarter ended March 31, 2013. The Company recorded net interest expense of \$21 million and \$92 million for the six months ended June 30, 2014 and 2013, respectively.

In order to meet the financing needs of its customers, the Company enters into interest rate swap and cap agreements with its customers and simultaneously enters into offsetting swap and cap agreements with RBS. The Company earns a spread equal to the difference between rates charged to the customer and rates charged by RBS. The notional amount of these interest rate swap and cap agreements outstanding with RBS was \$11.7 billion and \$13.4 billion at June 30, 2014 and December 31, 2013, respectively. The Company recorded expense of \$135 million for the six months ended June 30, 2014 and income of \$176 million for the six months ended June 30, 2013 within other income.

Also to meet the financing needs of its customers, the Company enters into a variety of foreign currency denominated products, such as loans, deposits and foreign exchange contracts. To manage the foreign exchange risk associated with these products, the Company simultaneously enters into offsetting foreign exchange contracts with RBS. The Company earns a spread equal to the difference between rates charged to the customer and rates charged by RBS. The notional amount of foreign exchange contracts outstanding with RBS was \$4.9 billion and \$4.6 billion at June 30, 2014 and December 31, 2013, respectively. The Company recorded expense within foreign exchange and trade finance fees of \$7 million for the six months ended June 30, 2014 and income of \$13 million for the six months ended June 30, 2013.

The Company has issued a guarantee to RBS for a fee, whereby the Company will absorb credit losses related to the sale of option contracts by RBS to customers of the Company. There were outstanding option contracts with a notional value of \$1 million and \$2 million at June 30, 2014 and December 31, 2013, respectively.

The Company receives income for providing services and referring customers to RBS. The Company also shares office space with certain RBS entities for which rent expense and/or income is recorded in occupancy expense. The total fee income, net of occupancy expense, for the six months ended June 30, 2014 and 2013 was \$8 million and \$12 million, respectively.

For the six months ended June 30, 2014 and 2013, the Company paid \$333 million of common stock dividends to RBS as part of the exchange transactions described in the "Management's Discussion and Analysis of Financial Condition and Results of Operations - Capital" included elsewhere in this report. Additionally, the Company paid \$35 million and \$95 million of regular dividends to RBS for the six months ended June 30, 2014 and 2013, respectively.

The Company, as a matter of policy and during the ordinary course of business with underwriting terms similar to those offered to the public, has made loans to directors and executive officers and their immediate families, as well as their affiliated companies. Such loans amounted to \$126 million and \$78 million at June 30, 2014 and December 31, 2013, respectively.

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NOTE 15 - FAIR VALUE MEASUREMENTS

As discussed in Note 1, “Significant Accounting Policies” in the Company’s audited Consolidated Financial Statements, the Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for assets and liabilities for which fair value is the required or elected measurement basis of accounting. Additionally, fair value is used on a nonrecurring basis to evaluate assets for impairment or for disclosure purposes. Nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets. The Company also applies the fair value measurement guidance to determine amounts reported for certain disclosures in this note for assets and liabilities not required to be reported at fair value in the financial statements.

Fair Value Option, Residential Mortgage Loans Held for Sale

The Company elected to account for residential mortgage loans held for sale at fair value. Applying fair value accounting to the residential mortgage loans held for sale better aligns the reported results of the economic changes in the value of these loans and their related hedge instruments.

The fair value of residential loans held for sale is derived from observable mortgage security prices and includes adjustments for loan servicing value, agency guarantee fees, and other loan level attributes which are mostly observable in the marketplace. Credit risk does not significantly impact the valuation since loans are sold shortly after origination. Therefore, the Company classifies the residential mortgage loans held for sale in Level 2 of the fair value hierarchy.

The following table summarizes the difference between the aggregate fair value and the aggregate unpaid principal balance for residential mortgage loans held for sale measured at fair value:

(in millions)	June 30, 2014			December 31, 2013		
	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Residential mortgage loans held for sale, at fair value	\$173	\$166	\$7	\$176	\$173	\$3

The loans accounted for under the fair value option are initially measured at fair value when the financial asset is recognized. Subsequent changes in fair value are recognized in current earnings. The Company recognized \$5 million, and (\$36) million in mortgage banking noninterest income for the six months ended June 30, 2014, and 2013, respectively. Interest income on residential mortgage loans held for sale is calculated based on the contractual interest rate of the loan and is recorded in interest income.

Additional information regarding the company’s significant accounting policies for determining fair value is provided in Note 1 “Significant Accounting Policies” in the Company’s audited Consolidated Financial Statements.

Recurring Fair Value Measurements

The Company utilizes a variety of valuation techniques to measure its assets and liabilities at fair value. Following is a description of valuation methodologies used for significant assets and liabilities carried on the balance sheet at fair value on a recurring basis:

Securities AFS: The fair value of securities classified as AFS is based upon quoted prices, if available. Where observable quoted prices are available in an active market, securities are classified as Level 1 in the fair value hierarchy. Classes of instruments that are valued using this market approach include debt securities issued by the U.S. Treasury. If quoted market prices are not available, the fair value for the security is estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. These instruments are classified as Level 2 because they currently trade in active markets and the inputs to the valuations are observable. The pricing models used to value securities generally begin with market prices (or rates) for similar instruments and make adjustments based on the unique characteristics of the instrument being valued. These adjustments reflect assumptions made regarding the sensitivity of each security’s value to changes in interest rates and prepayment speeds. Classes of instruments that are valued using this market approach include residential and commercial CMOs, specified pool mortgage “pass-through” securities and other debt securities issued by U.S. government-sponsored entities and state and political subdivisions.

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A significant majority of the Company's Level 1 and 2 securities are priced using an external pricing service. The Company verifies the accuracy of the pricing provided by its primary outside pricing service on a quarterly basis. This process involves using a secondary external vendor to provide valuations for the Company's securities portfolio for comparison purposes. Any securities with discrepancies beyond a certain threshold are researched and, if necessary, valued by an independent outside broker.

In certain cases where there is limited activity or less transparency around inputs to the valuation model, securities are classified as Level 3.

Residential loans held for sale: See the Fair Value Option discussion above.

Derivatives: The majority of the Company's derivatives portfolio is comprised of "plain vanilla" interest rate swaps, which are traded in over-the-counter markets where quoted market prices are not readily available. For these interest rate derivatives, fair value is determined utilizing models that use primarily market observable inputs, such as swap rates and yield curves. The pricing models used to value interest rate swaps calculate the sum of each instrument's fixed and variable cash flows, which are then discounted using an appropriate yield curve (i.e., LIBOR or OIS curve) to arrive at the fair value of each swap. The pricing models do not contain a high level of subjectivity as the methodologies used do not require significant judgment. The Company also considers certain adjustments to the modeled price which market participants would make when pricing each instrument, including a credit valuation adjustment that reflects the credit quality of the swap counterparty. The Company incorporates the effect of exposure to a particular counterparty's credit by netting its derivative contracts with the collateral available and calculating a credit valuation adjustment on the basis of the net position with the counterparty where permitted. The determination of this adjustment requires judgment on behalf of Company management; however, the total amount of this portfolio-level adjustment is not material to the total fair value of the interest rate swaps in their entirety. Therefore, interest rate swaps are classified as Level 2 in the valuation hierarchy.

The Company's other derivatives include foreign exchange contracts. Fair value of foreign exchange derivatives uses the mid-point of daily quoted currency spot prices. A valuation model estimates fair value based on the quoted spot rates together with interest rate yield curves and forward currency rates. Since all of these inputs are observable in the market, foreign exchange derivatives are classified as Level 2 in the fair value hierarchy.

Venture capital investments: The Company values its venture capital private equity fund investments based on its capital invested in each fund, which is adjusted by management each quarter, if necessary, to arrive at its estimate of fair value. Adjustments for a fund's underlying investments may be based upon comparisons to public companies, industry benchmarks, current financing round pricing, earnings multiples of comparable companies, current operating performance and future expectations, or third-party valuations. Since the inputs to the valuation are difficult to independently corroborate in the marketplace, and involve a significant degree of management judgment, venture capital investments are classified as Level 3 in the fair value hierarchy.

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The following table presents assets and liabilities measured at fair value, including gross derivative assets and liabilities on a recurring basis at June 30, 2014:

(in millions)	Total	Level 1	Level 2	Level 3
Securities available for sale:				
Mortgage-backed securities	\$18,443	\$—	\$18,443	\$—
State and political subdivisions	10	—	10	—
Equity securities	25	8	17	—
U.S. Treasury	15	15	—	—
Residential loans held for sale	173	—	173	—
Derivative assets:				
Interest rate swaps	634	—	634	—
Foreign exchange contracts	74	—	74	—
Other contracts	8	—	8	—
Venture capital investments	6	—	—	6
Total assets	\$19,388	\$23	\$19,359	\$6
Derivative liabilities:				
Interest rate swaps	\$745	\$—	\$745	\$—
Foreign exchange contracts	69	—	69	—
Other contracts	14	—	14	—
Total liabilities	\$828	\$—	\$828	\$—

The following table presents assets and liabilities measured at fair value including gross derivative assets and liabilities on a recurring basis at December 31, 2013:

(in millions)	Total	Level 1	Level 2	Level 3
Securities available for sale:				
Mortgage-backed securities	\$15,945	\$—	\$15,945	\$—
State and political subdivisions	10	—	10	—
Equity securities	25	8	17	—
U.S. Treasury	15	15	—	—
Residential loans held for sale	176	—	176	—
Derivative assets:				
Interest rate swaps	677	—	677	—
Foreign exchange contracts	94	—	94	—
Other contracts	7	—	7	—
Venture capital investments	5	—	—	5
Total assets	\$16,954	\$23	\$16,926	\$5
Derivative liabilities:				
Interest rate swaps	\$970	\$—	\$970	\$—
Foreign exchange contracts	87	—	87	—
Other contracts	10	—	10	—
Total liabilities	\$1,067	\$—	\$1,067	\$—

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The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows:

(in millions)	Six Months Ended June 30,	
	2014	2013
Balance as of January 1,	\$5	\$6
Purchases, issuances, sales and settlements:		
Sales	—	(4)
Settlements	—	3
Other net gains	1	—
Balance as of period end	\$6	\$5
Net unrealized gain (loss) included in net income for the period relating to assets held at period end	\$—	\$—

There were no transfers among Levels 1, 2 or 3 during the six months ended June 30, 2014 and 2013.

Nonrecurring Fair Value Measurements

The following valuation techniques are utilized to measure significant assets for which the Company utilizes fair value on a nonrecurring basis:

Impaired Loans: The carrying amount of collateral-dependent impaired loans is compared to the appraised value of the collateral less costs to dispose and is classified as Level 2. Any excess of carrying amount over the appraised value is charged to the ALLL.

MSRs: MSRs do not trade in an active market with readily observable prices. MSRs are classified as Level 3 since the valuation methodology utilizes significant unobservable inputs. At June 30, 2014 the fair value is calculated using the discounted cash flow model, the model which uses assumptions, including weighted average life of 5.2 years (range of 1.7 - 7 years), weighted average constant prepayment rate of 13.0% (range of 9.8% - 44.5%) and weighted average discount rate of 10.3% (range of 9.6% - 12.6%). At December 31, 2013 the fair value is calculated using the discounted cash flow model, the model which uses assumptions, including weighted average life of 5.4 years (range of 1.8 - 7.4 years), weighted average constant prepayment rate of 13.0% (range of 9.4% - 41.5%) and weighted average discount rate of 10.8% (range of 10.2% - 13.1%). Refer to Note 1, "Significant Accounting Policies," and Note 9, "Mortgage Banking," in the Company's audited Consolidated Financial Statements.

Foreclosed assets: Foreclosed assets consist primarily of residential properties. Foreclosed assets are carried at the lower of carrying value or fair value less costs to dispose. Fair value is based upon independent market prices or appraised values of the collateral and is classified as Level 2.

Goodwill: Goodwill is valued using unobservable inputs and is classified as Level 3. Fair value is calculated using the present value of estimated future earnings (discounted cash flow method). On a quarterly basis, the Company assesses whether or not impairment indicators are present.

The Company monitored events and circumstances during the first half of 2014 and did not observe any factors that would more likely than not reduce the fair value of one or more reporting units below its respective carrying value. Accordingly, goodwill was not tested for impairment during the first half of 2014. For additional information on the Company's goodwill impairment testing and the most recent goodwill impairment test, see Note 1, "Significant Accounting Policies", Note 5 "Goodwill" and Note 19, "Fair Value Measurements" included in the Company's audited Consolidated Financial Statements.

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The following table presents gains (losses) on assets and liabilities measured at fair value on a nonrecurring basis and recorded in earnings:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Impaired collateral-dependent loans	(\$19)	\$2	(\$94)	(\$58)
MSRs	(1)	33	3	39
Foreclosed assets	—	1	1	2
Goodwill impairment	—	(4,435)	—	(4,435)

The following tables present assets and liabilities measured at fair value on a nonrecurring basis:

(in millions)	June 30, 2014			
	Total	Level 1	Level 2	Level 3
Impaired collateral-dependent loans ¹	\$70	\$—	\$70	\$—
MSRs ²	175	—	—	175
Foreclosed assets ³	40	—	40	—
Goodwill ⁴	6,876	—	—	6,876

(in millions)	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Impaired collateral-dependent loans ¹	\$74	\$—	\$74	\$—
MSRs ²	185	—	—	185
Foreclosed assets ³	49	—	49	—
Goodwill ⁴	6,876	—	—	6,876

¹In the first six months of 2014, impaired loans for which collection is dependent on the loan's collateral in the amount of \$121 million were written down to \$70 million, resulting in an impairment charge of \$94 million, which was charged to the ALLL. In the year ended 2013, impaired loans for which collection is dependent on the loan's collateral in the amount of \$161 million were written down to their fair value of \$74 million, resulting in an impairment charge of \$83 million, which was charged to the ALLL.

²In the first six months of 2014, MSRs totaling \$208 million were evaluated for impairment and written down to \$175 million, resulting in an impairment recapture of \$3 million and a total cumulative valuation allowance of \$19 million. In the year ended 2013, MSRs totaling \$215 million were evaluated for impairment and written down to \$185 million, resulting in an impairment (charge) of \$47 million and a total cumulative valuation allowance of \$23 million.

³In the first six months of 2014, foreclosed real estate accounted for at the lower of cost or fair value less costs to sell was written down to fair value of \$40 million, resulting in impairment charges of \$1 million. In the year ended 2013, foreclosed real estate accounted for at the lower of cost or fair value less costs to sell was written down to fair value of \$49 million, resulting in an impairment charge of \$4 million.

⁴In the year ended 2013, Goodwill totaling \$11.3 billion was written down to its implied fair value of \$6.9 billion, resulting in an impairment charge of \$4.4 billion.

Disclosures about Fair Value of Financial Instruments

Following is a description of valuation methodologies used to estimate the fair value of financial instruments for disclosure purposes (these instruments are not recorded in the financial statements at fair value):

Loans and leases: For loans and leases not recorded at fair value on a recurring basis that are not accounted for as collateral-dependent impaired loans, fair value is estimated by using one of two methods: a discounted cash flow method or a securitization method. The discounted cash flow method involves discounting the expected future cash flows using current rates which a market participant would likely use to value similar pools of loans. Inputs used in this method include observable information such as contractual cash flows (net of servicing cost) and unobservable information such as estimated prepayment speeds, credit loss exposures, and discount rates. The securitization method involves utilizing market securitization data to value the assets as if a securitization transaction had been executed. Inputs used include observable market-based MBS data and pricing adjustments based on unobservable data reflecting the liquidity risk, credit loss exposure and other characteristics of the underlying loans. The internal risk-weighted balances of loans are

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grouped by product type for purposes of these estimated valuations. For nonaccruing loans, fair value is estimated by discounting management's estimate of future cash flows with a discount rate commensurate with the risk associated with such assets. Fair value of collateral-dependent loans is primarily based on the appraised value of the collateral.

Loans held for sale: Balances are loans that were transferred to loans held for sale that are reported at book value.

Securities held to maturity: The fair value of securities classified as HTM is estimated using pricing models, quoted prices of securities with similar characteristics or discounted cash flow. The pricing models used to value these securities generally begin with market prices (or rates) for similar instruments and make adjustments based on the unique characteristics of the instrument being valued. These adjustments reflect assumptions made regarding the sensitivity of each security's value to changes in interest rates and prepayment speeds.

Other investment securities: The cost basis carrying value of other investment securities, such as FHLB stock and FRB stock, is assumed to approximate the fair value of the securities. As a member of the FHLB and FRB, the Company is required to hold FHLB and FRB stock. The stock can be sold only to the FHLB and FRB upon termination of membership, or redeemed at the FHLB's or FRB's sole discretion.

Deposits: The fair value of demand deposits, checking with interest accounts, regular savings and money market accounts is the amount payable on demand at the balance sheet date. The fair value of term deposits is estimated by discounting the expected future cash flows using rates currently offered for deposits of similar remaining maturities.

Deposits held for sale: Balances are deposits that were transferred to held for sale that are reported at book value.

Federal funds purchased and securities sold under agreements to repurchase, other short-term borrowed funds, and long-term borrowed funds: Rates currently available to the Company for debt of similar terms and remaining maturities are used to discount the expected cash flows of existing debt.

The following table is a summary of fair value for financial instruments not recorded at fair value in the Consolidated Financial Statements. The carrying amounts in the following table are recorded in the Consolidated Balance Sheets under the indicated captions:

June 30, 2014								
(in millions)	Total		Level 1		Level 2		Level 3	
	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:								
Loans and leases	\$88,829	\$89,580	\$—	\$—	\$70	\$70	\$88,759	\$89,510
Other loans held for sale	89	89	—	—	—	—	89	89
Securities held to maturity	5,382	5,398	—	—	5,382	5,398	—	—
Other investment securities	948	948	—	—	948	948	—	—
Financial Liabilities:								
Deposits	91,656	91,936	—	—	91,656	91,936	—	—
Federal funds purchased and securities sold under agreements to repurchase	6,807	6,830	—	—	6,807	6,830	—	—
Other short-term borrowed funds	7,702	7,705	—	—	7,702	7,705	—	—
Long-term borrowed funds	1,732	1,733	—	—	1,732	1,733	—	—

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(in millions)	December 31, 2013							
	Total		Level 1		Level 2		Level 3	
	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:								
Loans and leases	\$85,859	\$85,724	\$—	\$—	\$74	\$74	\$85,785	\$85,650
Other loans held for sale	1,078	1,078	—	—	—	—	1,078	1,078
Securities held to maturity	4,315	4,257	—	—	4,315	4,257	—	—
Other investment securities	935	935	—	—	935	935	—	—
Financial Liabilities:								
Deposits	86,903	86,907	—	—	86,903	86,907	—	—
Deposits held for sale	5,277	5,277	—	—	5,277	5,277	—	—
Federal funds purchased and securities sold under agreements to repurchase	4,791	4,791	—	—	4,791	4,791	—	—
Other short-term borrowed funds	2,251	2,249	—	—	2,251	2,249	—	—
Long-term borrowed funds	1,405	1,404	—	—	1,405	1,404	—	—

NOTE 16 - REGULATORY MATTERS

As a BHC, the Company is subject to regulation and supervision by the FRB. The primary subsidiaries of Citizens are its two insured depository institutions CBNA, a national banking association whose primary federal regulator is the OCC, and CBPA, a Pennsylvania-chartered savings bank regulated by the Department of Banking of the Commonwealth of Pennsylvania and supervised by the FDIC as its primary federal regulator. Under the regulatory capital adequacy guidelines of the FDICIA, the Company and its banking subsidiaries must meet specific capital requirements. These requirements are expressed in terms of the following ratios: (1) Total Risk-Based Capital (total capital/risk-weighted on- and off-balance sheet assets); (2) Tier 1 Risk-Based Capital (tier 1 capital/risk-weighted on- and off-balance sheet assets); and (3) Tier 1 Leverage (tier 1 capital/adjusted average quarterly assets). To meet the regulatory capital requirements, the Company and its banking subsidiaries must maintain minimum Total Risk-Based Capital, Tier 1 Risk-Based Capital, and Tier 1 Leverage ratios. In addition, the Company must not be subject to a written agreement, order or capital directive with any of its regulators. Failure to meet minimum capital requirements can result in the initiation of certain actions that, if undertaken, could have a material effect on the Company's Consolidated Financial Statements.

The following table presents capital and capital ratio information:

(dollars in millions)	FDIC Requirements					
	Actual		Minimum Capital Adequacy		Classification as Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of June 30, 2014</u>						
Total Capital to Risk-Weighted Assets	\$16,400	16.2%	\$8,112	8.0%	\$10,140	10.0%
Tier 1 Capital to Risk-Weighted Assets	13,448	13.3	4,056	4.0	6,084	6.0
Tier 1 Capital to Average Assets (Leverage)	13,448	11.1	3,638	3.0	6,064	5.0
<u>As of December 31, 2013</u>						
Total Capital to Risk-Weighted Assets	\$15,885	16.1%	\$7,891	8.0%	\$9,863	10.0%
Tier 1 Capital to Risk-Weighted Assets	13,301	13.5	3,945	4.0	5,918	6.0
Tier 1 Capital to Average Assets (Leverage)	13,301	11.6	3,433	3.0	5,721	5.0

In accordance with federal and state banking regulations, dividends paid by the Company's banking subsidiaries to the Company itself are generally limited to the retained earnings of the respective banking subsidiaries unless specifically approved by the appropriate bank regulator. The Company declared and paid RBS total common stock dividends of \$368 million in the six months ended June 30, 2014. There were \$1.2 billion in common stock dividends declared and paid for the year ended December 31, 2013. For the six months ended June 30, 2013, the Company declared and paid RBS total common stock dividends of \$428 million.

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The earnings impact of goodwill impairment recognized by CBNA has put the bank subsidiary in the position of having to request specific approval from the OCC before executing capital distributions to its parent, Citizens. This requirement will be in place through the fourth quarter of 2015. As of June 30, 2014, the unconsolidated BHC had liquid assets in excess of \$399 million compared to an annual interest burden on existing subordinated debt of approximately \$77 million on a non-consolidated basis.

The OCC recently determined that CBNA no longer meets both conditions necessary to own a financial subsidiary. CBNA must be both well capitalized and well managed to own a financial subsidiary. A financial subsidiary is permitted to engage in a broader range of activities, similar to those of a financial holding company, than those permissible for a national bank. CBNA has two financial subsidiaries, Citizens Securities, Inc., a registered broker-dealer, and RBS Citizens Insurance Agency, Inc., a dormant entity, although it continues to collect commissions on certain outstanding policies. CBNA has entered into an agreement with the OCC (the "OCC Agreement") pursuant to which it must develop a remediation plan, which must be submitted to the OCC, setting forth the specific actions it will take to bring itself back into compliance with the conditions to own a financial subsidiary and the schedule for achieving that objective. Until CBNA satisfactorily addresses the deficiencies, CBNA may not consolidate its assets and liabilities with those of the financial subsidiaries for purposes of determining and reporting regulatory capital. In addition, CBNA will be subject to restrictions on its ability to acquire control or hold an interest in any new financial subsidiary and to commence new activities in any existing financial subsidiary, without the prior consent of the OCC. If CBNA fails to remediate the deficiencies within 180 days from March 13, 2014, or such longer period as the OCC may permit, it may have to divest itself of its financial subsidiaries and comply with any additional limitations or conditions on its conduct as the OCC may impose. CBNA has implemented a comprehensive enterprise-wide program that seeks to address these deficiencies.

NOTE 17 - SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

(in millions)	Six Months Ended June 30,	
	2014	2013
Supplemental cash flow information:		
Interest paid	\$163	\$250
Income taxes paid	88	10
Supplemental schedule of non-cash investing and financing activities:		
Due to broker for securities purchased but not settled	\$87	\$524

NOTE 18 - RECLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the changes in the balances, net of taxes, of each component of OCI:

(in millions)	Net Unrealized Gains (Losses) on Derivatives	Net Unrealized Gains (Losses) on Securities	Defined Benefit Pension Plans	Total AOCI
Balance at December 31, 2012	(\$240)	\$306	(\$378)	(\$312)
Other comprehensive loss before reclassifications	(139)	(219)	—	(358)
Other than temporary impairment not recognized in earnings on securities	—	(35)	—	(35)
Amounts reclassified from other comprehensive income	77	(56)	3	24
Net other comprehensive (loss) income	(62)	(310)	3	(369)
Balance at June 30, 2013	(\$302)	(\$4)	(\$375)	(\$681)

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(in millions)	Net Unrealized Gains (Losses) on Derivatives	Net Unrealized Gains (Losses) on Securities	Defined Benefit Pension Plans	Total AOCI
Balance at December 31, 2013	(\$298)	(\$91)	(\$259)	(\$648)
Other comprehensive income before reclassifications	120	188	—	308
Other than temporary impairment not recognized in earnings on securities	—	(21)	—	(21)
Amounts reclassified from other comprehensive income	13	(12)	2	3
Net other comprehensive income	133	155	2	290
Balance at June 30, 2014	(\$165)	\$64	(\$257)	(\$358)

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The following table reports the amounts reclassified out of each component of OCI and into the Consolidated Statement of Operations:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Details about AOCI Components	Amount Reclassified from AOCI				Affected Line Item in the Consolidated Statements of Operations
Reclassification adjustment for net derivative gains (losses) included in net income (loss):	\$18	(\$17)	\$36	(\$22)	Interest income
	(27)	(44)	(56)	(98)	Interest expense
	—	—	—	(2)	Other income
	(9)	(61)	(20)	(122)	Income before income tax expense (benefit)
	(3)	(23)	(7)	(45)	Income tax expense (benefit)
	(\$6)	(\$38)	(\$13)	(\$77)	Net income (loss)
Reclassification of net securities gains (losses) to net income (loss):	\$—	\$42	\$25	\$94	Securities gains, net
	(2)	(1)	(6)	(4)	Net impairment losses recognized in earnings
	(2)	41	19	90	Income before income tax expense (benefit)
	—	16	7	34	Income tax expense (benefit)
	(\$2)	\$25	\$12	\$56	Net income (loss)
Reclassification of changes related to the employee benefit plan:	(\$1)	(\$6)	(\$3)	(\$6)	Salaries and employee benefits
	(1)	(6)	(3)	(6)	Income before income tax expense (benefit)
	—	(3)	(1)	(3)	Income tax expense (benefit)
	(\$1)	(\$3)	(\$2)	(\$3)	Net income (loss)
Total reclassification losses	(\$9)	(\$16)	(\$3)	(\$24)	Net income (loss)

The following table presents the effects to net income of the amounts reclassified out of OCI:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net interest income (includes (\$9), (\$61), (\$20) and (\$120) of AOCI reclassifications, respectively)	\$833	\$749	\$1,641	\$1,509
Provision for credit losses	49	112	170	202
Noninterest income (includes (\$2), \$41, \$19 and \$88 of AOCI reclassifications, respectively)	640	437	998	870
Noninterest expense (includes \$1, \$6, \$3 and \$6 of AOCI reclassifications, respectively)	948	5,252	1,758	6,073
Income before income tax expense (benefit)	476	(4,178)	711	(3,896)
Income tax expense (benefit) (includes (\$3), (\$10), (\$1) and (\$14) income tax net expense and (benefit) from reclassification items, respectively)	163	(273)	232	(174)
Net income (loss)	\$313	(\$3,905)	\$479	(\$3,722)

NOTE 19 - BUSINESS SEGMENTS

The Company is managed by its CEO on a divisional basis. The Company's two business segments are Consumer Banking and Commercial Banking. The business segments are determined based on the products and services provided, or the type of customer served. Each division has a Vice Chairman who reports directly to the CEO. The CEO has final authority over resource allocation decisions and performance assessment. The business segments reflect this management structure and the manner in which financial information is currently evaluated by the CEO. Non-segment operations are classified as Other, which includes corporate functions, the Treasury function, the securities portfolio, wholesale funding activities, intangible assets, Community Development, Non-Core assets, and other unallocated assets, liabilities, revenues and expenses.

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Segment results are determined based upon the Company's management reporting system, which assigns balance sheet and income statement items to each of the business segments. The process is designed around the Company's organizational and management structure and, accordingly, the results derived are not necessarily comparable with similar information published by other financial institutions. A description of each reportable segment and table of financial results is presented below.

- **Consumer Banking** - The Consumer Banking segment focuses on retail customers and small businesses with annual revenues of up to \$25 million. It offers traditional banking products and services, including checking, savings, home loans, student loans, credit cards, business loans and financial management services. It also operates an indirect auto financing business, providing financing for both new and used vehicles through auto dealerships. The segment's distribution channels include a branch network, ATMs and a work force of experienced specialists ranging from financial consultants, mortgage loan officers and business banking officers to private bankers.
- **Commercial Banking** - The Commercial Banking segment primarily targets companies with annual revenues from \$25 million to \$2.5 billion and provides a full complement of financial products and solutions, including loans, leases, trade financing, deposits, cash management, foreign exchange, interest rate risk management, corporate finance and capital markets advisory capabilities. It focuses on small and middle-market companies and has dedicated teams with industry expertise in government banking, not-for-profit, healthcare, technology, asset finance, franchise finance, asset-based lending, commercial real estate, private equity and sponsor finance. While the segment's business development efforts are predominantly focused on the Company's twelve-state core footprint, some of its specialized industry businesses also operate selectively on a national basis (such as healthcare, asset finance and franchise finance). Commercial Banking is organized by teams that target different client segments. A key component of the segment's growth strategy is to expand its loan portfolio by originating high-quality commercial loans, which produce revenues consistent with its financial objectives and complies with its conservative credit policies. Commercial underwriting is driven by cash flow analysis supported by collateral analysis and review. The commercial lending teams offer a wide range of commercial loan products, including commercial real estate loans; working capital loans and lines of credit; demand, term and time loans; and equipment, inventory and accounts receivable financing.

	As of and for the Three Months Ended June 30, 2014			
(in millions)	Consumer Banking	Commercial Banking	Other	Consolidated
Net interest income	\$546	\$264	\$23	\$833
Noninterest income	236	107	297	640
Total revenue	782	371	320	1,473
Noninterest expense	655	157	136	948
Profit before provision for credit losses	127	214	184	525
Provision for credit losses	59	(2)	(8)	49
Income before income tax expense	68	216	192	476
Income tax expense	24	75	64	163
Net income	\$44	\$141	\$128	\$313
Total Average Assets	\$48,556	\$38,022	\$40,570	\$127,148

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As of and for the Three months ended June 30, 2013

(in millions)	Consumer Banking	Commercial Banking	Other	Consolidated
Net interest income	\$542	\$255	(\$48)	\$749
Noninterest income	287	90	60	437
Total revenue	829	345	12	1,186
Noninterest expense	635	160	4,457	5,252
Profit before provision for credit losses	194	185	(4,445)	(4,066)
Provision for credit losses	73	(2)	41	112
Income before income tax expense	121	187	(4,486)	(4,178)
Income tax expense	43	66	(382)	(273)
Net income	\$78	\$121	(\$4,104)	(\$3,905)
Total Average Assets	\$46,306	\$34,826	\$40,894	\$122,026

As of and for the Six Months Ended June 30, 2014

(in millions)	Consumer Banking	Commercial Banking	Other	Consolidated
Net interest income	\$1,083	\$520	\$38	\$1,641
Noninterest income	455	214	329	998
Total revenue	1,538	734	367	2,639
Noninterest expense	1,293	310	155	1,758
Profit before provision for credit losses	245	424	212	881
Provision for credit losses	129	(7)	48	170
Income before income tax expense	116	431	164	711
Income tax expense	40	149	43	232
Net income	\$76	\$282	\$121	\$479
Total Average Assets	\$48,085	\$37,491	\$39,959	\$125,535

As of and for the Six Months Ended June 30, 2013

(in millions)	Consumer Banking	Commercial Banking	Other	Consolidated
Net interest income (expense)	\$1,090	\$508	(\$89)	\$1,509
Noninterest income	544	191	135	870
Total revenue	1,634	699	46	2,379
Noninterest expense	1,262	315	4,496	6,073
Profit (loss) before provision for credit losses	372	384	(4,450)	(3,694)
Provision for credit losses	156	(24)	70	202
Income (loss) before income tax expense (benefit)	216	408	(4,520)	(3,896)
Income tax expense (benefit)	76	144	(394)	(174)
Net income (loss)	\$140	\$264	(\$4,126)	(\$3,722)
Total Average Assets	\$46,737	\$34,897	\$41,241	\$122,875

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In addition to non-segment operations, Other includes certain reconciling items in order to translate the segment results that are based on management accounting practices into consolidated results. For example, Other includes goodwill and the associated \$4.4 billion goodwill impairment charge recorded in 2013. Management accounting practices utilized by the Company as the basis for presentation for segment results include the following:

- *FTP adjustments:* The Company utilizes an FTP system to eliminate the effect of interest rate risk from the segments' net interest income because such risk is centrally managed within the Treasury function. The FTP system credits (or charges) the segments with the economic value of the funds created (or used) by the segments. The FTP system provides a funds credit for sources of funds and a funds charge for the use of funds by each segment. The summation of the interest income/expense and FTP charges/credits for each segment is its designated net interest income. The variance between the Company's cumulative FTP charges and cumulative FTP credits is allocated to the individual business segments.
- *Provision for credit losses allocations:* Provision for credit losses is allocated to each business segment based on actual net charge-offs that have been recognized by the business segment. The difference between the consolidated provision for credit losses and the business segments' net charge-offs is reflected in Other.
- *Income tax allocations:* Income taxes are assessed to each line of business at a standard tax rate with the residual tax expense or benefit to arrive at the consolidated effective tax rate included in Other.
- *Expense allocations:* Noninterest expenses incurred by centrally managed operations or business lines that directly support another business line's operations are charged to the applicable business line based on its utilization of those services.
- *Goodwill:* For impairment testing purposes, the Company allocates goodwill to its Consumer Banking and Commercial Banking reporting units. For management reporting purposes, the Company presents the goodwill balance (and any related impairment charges) in Other.

Substantially all revenues generated and long-lived assets held by the Company's business segments are derived from clients that reside in the United States. Neither segment earns revenue from a single external customer that represents 10 percent or more of the Company's total revenues.

NOTE 20 - SHARE-BASED COMPENSATION

RBS Group grants share-based compensation awards to employees of the Company pursuant to its various long-term incentive plans. These plans are administered by the Group Performance and Remuneration Committee of the RBS Group Board of Directors. All share-based compensation awards granted to employees have been settled in RBS Group shares. For more information, refer to Note 26 "Share Based Compensation," in the Company's audited Consolidated Financial Statements.

In March 2014, the Company granted special IPO awards. The awards were granted half in rights to receive RBS Group shares and half as a fixed convertible bond. These special IPO awards will convert into a right to receive the Company's shares at the closing of the IPO. The special IPO awards are scheduled to vest 50% in March 2016 and 50% in March 2017, subject to certain conditions, including the occurrence of the IPO on or by December 31, 2014.

The Company awarded 9,246,927 and 6,788,959 shares to employees during the periods ended June 30, 2014 and 2013, respectively. The grant date fair value of the shares was \$51 million and \$32 million for the six months ended June 30, 2014 and 2013, respectively. Grant date fair value for all awards is estimated using fair value of RBS Group shares on grant date. Compensation expense related to share based plans was \$19 million and \$15 million for the six months ended June 30, 2014 and 2013, respectively.

The following table summarizes the activity related to share-based plans for the periods presented:

(dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Compensation expense related to share-based plans	(\$1)	\$4	\$19	\$15
Number of shares granted	81,541	145,855	9,246,927	6,788,959
Grant date fair value of shares	\$—	\$1	\$51	\$32

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NOTE 21 - EARNINGS PER SHARE

(dollars in millions, except share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income (loss) from operations	\$313	(\$3,905)	\$479	(\$3,722)
Net income available to common shareholders	\$313	(\$3,905)	\$479	(\$3,722)
Denominator:				
Weighted-average common shares outstanding - basic	3,382	3,382	3,382	3,382
Weighted-average common shares outstanding - diluted	3,382	3,382	3,382	3,382
Earnings per common share:				
Basic	\$92,601.06	(\$1,154,559.32)	\$141,688.40	(\$1,100,419.53)
Diluted	92,601.06	(1,154,559.32)	141,688.40	(1,100,419.53)

NOTE 22 - OTHER OPERATING EXPENSE

The following table presents the details of other operating expense:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Deposit insurance	\$26	\$24	\$46	\$49
Promotional expense	21	19	41	38
Settlements and operating losses	35	11	64	23
Postage and delivery	12	14	25	26
Other	77	67	141	126
Total other operating expense	\$171	\$135	\$317	\$262

NOTE 23 - EXIT COSTS AND RESTRUCTURING RESERVES

In 2014, the Company began the implementation of a restructuring initiative designed to achieve operating efficiencies and reduce expense growth. As a result of this program, the Company expects to incur total restructuring costs of approximately \$121 million through December 31, 2015, consisting of \$41 million of employee compensation, \$40 million of facilities costs and \$40 million of other costs, primarily consulting and technology services. For the six months ended June 30, 2014, the Company incurred \$87 million of restructuring costs, consisting of \$41 million of employee compensation reported in salaries and employee benefits, \$9 million of facilities costs (including \$6 million of building impairment) reported in occupancy, \$26 million reported in outside services, and \$11 million in other operating expenses.

In 2014, as a result of the sale of retail branches located in Illinois (see Note 13, "Divestitures and Branch Assets and Liabilities Held for Sale" for further information), the Company incurred total costs of approximately \$17 million for the six months ended June 30, 2014, consisting of \$3 million of employee compensation reported in salaries and employee benefits, \$3 million of fixed assets expenses reported in equipment, \$4 million reported in outside services and \$7 million reported in other operating expenses.

For segment reporting all of these restructuring costs are reported within Other. See Note 19 "Business Segments" for further information.

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The following table includes the activity in the exit costs and restructuring reserves:

(in millions)	Salaries & Employee Benefits	Occupancy & Equipment	Other	Total
Reserve balance as of December 31, 2012	\$3	\$27	\$—	\$30
Additions	6	22	3	31
Reversals	(1)	(4)	—	(5)
Utilization	(6)	(21)	(3)	(30)
Reserve balance as of December 31, 2013	2	24	—	26
Additions	44	12	48	104
Reversals	(1)	—	—	(1)
Utilization	(7)	(15)	(8)	(30)
Reserve balance as of June 30, 2014	\$38	\$21	\$40	\$99

NOTE 24 - SUBSEQUENT EVENTS

The Company has evaluated the impacts of events that have occurred subsequent to June 30, 2014 through August 15, 2014, the date the Consolidated Financial Statements were issued. Based on this evaluation, the Company has determined none of these events were required to be recognized or disclosed in the Consolidated Financial Statements and related Notes, other than that on August 1, 2014, we declared and paid a special common dividend of \$333 million to RBS and issued \$333 million of 10-year subordinated debt (4.023% fixed rate subordinated debt, due 2024) to RBS Group. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations-Capital" included elsewhere in this report for further details.