ROYAL BANK OF SCOTLAND GROUP PLC
Form 6-K
April 01, 2004

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

For April 1, 2004

Commission File Number: 001-10306

The Royal Bank of Scotland Group plc

42 St Andrew Square
Edinburgh EH2 2YE
Scotland
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F _X_ Form 40-F ___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ________

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ________

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ___ No _X_

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-________

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Make it happen

Contents

Make it happen

Financial highlights

Ø Profit before tax up 29%

Ø Final dividend of 35.7p giving a total for the year of 50.3p per share, up 15%

Ø Total shareholder return exceeding 100% over the last five years

Chairman s statement

The highlight of 2003, the successful completion of the integration of NatWest, seems a long time ago. Our focus is now on maintaining our income growth, using the experience gained in integration to improve our efficiency further, and delivering the benefits of the various acquisitions which we made during 2003.

By the time of completing the NatWest integration in 2003, the annualised transaction benefits amounted to £2,030 million, against the promised amount of £1,420 million in our bid for NatWest, in December 1999.

Financial performance

In 2003, the Group profit before tax, goodwill amortisation and integration costs increased by 11% to £7,151 million (2002 £6,451 million). Total income grew by 14% to £19,229 million (2002 £16,815 million), while operating expenses grew by only 9% to £8,389 million (2002 £7,669 million).

Dividends

The Board has recommended a final dividend for the year of 35.7p per share which, with the interim dividend of 14.6p per share, makes a total for the year of 50.3p per share, an increase of 15%. Our third and final Additional Value Share dividend of 55.0p per share was paid on 1 December 2003. The total amount payable to shareholders in the form of ordinary and AVS dividends in respect of 2003 was £2,953 million, against £2,065 million for 2002.

Staff profit sharing

The staff profit share for the year has been set at 10% of basic salaries, reflecting the strong financial performance of the Group.

Business developments

During 2003 we completed seven acquisitions and announced two others which were completed in January 2004. These acquisitions strengthened the international capabilities of the Group. Four were in the United States, three were in Continental Europe and one each in Ireland and the United Kingdom. The total amount paid for these acquisitions was £3 billion.

In February 2004 we announced the acquisition of the credit card portfolio of People s Bank of Connecticut with 1.1 million customers and £1.3 billion of receivables.

Board of directors

The Board is committed to high standards of corporate governance and business integrity in all its activities. The Board is also conscious of the Group s impact on social issues and during 2003 ratified the Group s Corporate Responsibility Policy.

We were deeply saddened by the death of Bill Wilson on 25 December 2003. Bill had been a member of the Board since 1993, and his wise counsel in Board discussions and contribution as Chairman of the Audit Committee will be greatly missed. We are grateful to Colin Buchan for taking over as interim Chairman of the Audit Committee.

Outlook

During 2003 there were signs of improving economic conditions in the United States and Continental Europe, while the United Kingdom economy maintained its positive trend. In the United States, monetary and fiscal policies remain expansive. Overall, while uncertainties remain, the economic outlook seems brighter than it has for several years.

A key aspect of our strategy is to build and retain strategic options. As a result, the future progress of the Group is not dependent on any particular economic scenario, or market development. We remain confident that the strength, diversity and flexibility of the Group will enable us to continue to deliver value for our customers, employees and shareholders.

Sir George Mathewson, Chairman

Group Chief Executive s review

In 2003 we continued our focus on delivering strong growth organically and through acquisitions. Customer numbers rose across all our divisions. Our cost:income ratio, a key measure of our efficiency, improved to 42%. Our profit before tax, goodwill amortisation and integration costs increased by 11%, and our adjusted earnings per share increased by 11%.

These are pleasing figures, the more so since they demonstrate a consistently strong performance over the last decade. The strength and diversity of the Group we are building gives us continued scope for growth and creates many strategic options.

Good organic growth last year is indicative of the focus and commitment to building our existing businesses. All our divisions, with the exception of Wealth Management, increased their contribution to the Group, with particularly strong performances from RBS Insurance and Retail Direct which achieved growth of 32% and 25% respectively.

We announced eight acquisitions during 2003. Some of these were concentrated on product areas where we saw considerable scope for both growth and efficiency improvement. The acquisition of Churchill Insurance Group, completed in September 2003, positions RBS Insurance as the UK s second largest general insurer. The purchase of First Active plc by Ulster Bank, completed in January 2004, has greatly strengthened our presence in financial services in Ireland.

Other acquisitions reinforced the geographic reach of the Group in Europe and the US. Citizens made three more bank acquisitions and is now the 13th largest commercial banking organisation in the US by deposits. The purchase of the credit card and personal loans portfolios of Santander Direkt in Germany expanded our European consumer finance operation. Coutts enhanced its position in international wealth management with the acquisition of Bank von Ernst in Switzerland.

We have kept in place many of the successful cross-business teams established during the NatWest integration. With the skills built up during that process, they have now turned their attention to further improving our service to customers and our efficiency.

Our customers

It has been particularly pleasing to see again good growth in customer numbers across all our businesses. We are proud of the large numbers of awards our businesses have won this year for products and services.

We are the only bank in the UK to give our customers the option to call their local branch. We believe that what matters is that customers have choice; some prefer to use telephone or internet banking while others prefer to speak to one of our customer service advisers who are all based in the UK, Europe or the US, close to the customers they serve.

Our people

Our people have delivered everything that has been asked of them and more, particularly during the integration of NatWest. We are committed to retaining their trust and loyalty, meeting their development needs and are complementing our extensive range of training with new and enhanced leadership programmes. We believe our staff are the key to our growth and that they should share in the success they have helped to create. We have again set the staff profit share at 10% of basic salaries. As a result of growing volumes across our businesses, we have increased our staff numbers again this year.

Our shareholders

We made the final Additional Value Share payment of £1.5 billion, meaning that a total of £2.7 billion has been returned to shareholders by this means, following the acquisition of NatWest.

Our underlying capital generation continues to be good. We have the capital strength to grow our existing businesses and take advantage of acquisition opportunities when they arise and when we see value for our shareholders.

By maintaining our focus on the fundamentals of growing income, improving efficiency and maintaining credit quality, we are confident that we can continue to deliver superior sustainable value to our shareholders.

Fred Goodwin, Group Chief Executive

Group profile

RBS has built one of the strongest portfolios of brands in the financial services sector growing both organically and by acquisition.

Corporate Banking and Financial Markets

Chief Executive
Johnny Cameron

Geographic spread
Ø UK, Europe, US, Asia

Employees
Ø 15,900

The largest provider of banking services and structured financing to medium and large businesses in the UK and a growing provider of debt financing and risk management solutions to large businesses in Europe and North America. It also provides an integrated range of products and services to mid-sized and large corporate and institutional customers in the UK and overseas.

Treasury and capital markets products are provided through Financial Markets, which is a leading provider of debt, foreign exchange and derivatives products.

RBS Greenwich Capital (US)

Tailors debt capital market solutions to institutions worldwide and has a leading position in US treasuries and asset-backed securities.

Market data

Ø lead corporate bank in the UK
Ø serves over 90% of the FTSE 100
Ø serves over 75% of the FTSE 250
Ø serves 50% of Fortune 100 companies in the US
Ø banking relationships with 70% of the top 100 Continental European companies
Ø No.1 agent globally for traditional cross border US$ private placement transactions
Ø No.1 Project Finance Global mandated lead arranger
Ø No. 2 European leveraged loans mandated arranger

Retail Banking

Chief Executive
Benny Higgins

Geographic spread
Ø UK

Employees
Ø 30,700

Two of the UK s best known banking brands, NatWest and The Royal Bank of Scotland, offer a wide range of products and services to over 13.7 million individual and 1.1 million small business customers. Retail Banking offers the choice of banking at over 2,270 local branches, via the UK s largest network of over 5,900 ATMs, or via the internet, to access a wide range of banking, financial, insurance, life assurance and pension products.

For small business customers Retail Banking offers:-

money transmission
cash management
short, medium and long term finance
deposit taking

Market data

Ø largest retail network in the UK
Ø over 2,270 branches
Ø over 5,900 ATMs
Ø over 13.7 million personal customers
Ø largest provider of banking services to small to medium sized enterprises (SMEs) in the UK
Ø over 1.1 million business customers

Retail Direct

Chief Executive
Chris Sullivan

Geographic spread
Ø UK, US and Europe

Employees
Ø 7,300

Retail Direct offers financial services and banking products direct to consumers through a range of channels and includes well known brands such as Tesco Personal Finance, The One account, Direct Line Financial Services, Lombard Direct and in Europe, Comfort Cards.

It offers a comprehensive range of credit and charge cards through The Royal Bank of Scotland, NatWest and a range of brands, such as MINT.

It also provides a global infrastructure of merchant acquiring and processing facilities via Streamline for retailers in the UK. For retailers who are internet based it provides a similar infrastructure via WorldPay.

Market data

Ø over 16 million customer accounts
Ø 2nd largest credit card issuer in the UK
Ø over 13 million credit and storecard accounts
Ø over 2 million customer accounts in Europe
Ø most successful supermarket bank in the UK
Ø over 4 million Tesco Personal Finance customer accounts
Ø over 1 million Tesco Personal Finance motor insurance customers

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Manufacturing

Chief Executive
Mark Fisher

Geographic spread
Ø UK, US and Europe

Employees

Ø 21,800

Manufacturing provides a diverse range of services to support the customer facing operations of the Group s multiple brands. It provides customer support via telephony, account management, lending, mortgage processing and money transmission.

Group Technology

Group Technology continually develops and maintains the infrastructure and technology that supports the branches, ATMs and internet banking for customers of CBFM, Retail Banking, Retail Direct and Wealth Management.

Purchasing

Manufacturing is responsible for the vast majority of purchasing undertaken by the Group, leveraging its purchasing power to maximise cost efficiencies.

Property

The Group s property portfolio is managed, maintained and refurbished by Manufacturing who also oversee the property investment programme.

Market data

Ø No.1 in UK for cheque payments

Ø No.1 in UK for Banks Automated Clearing System (BACS)

Ø No.1 in UK for Clearing House Automated Payment System (CHAPS)

Ø runs the UK s largest ATM network

Wealth Management

Chief Executive

Gordon Pell

Geographic spread

Ø UK, Europe, Asia, offshore locations

Employees

Ø 5,600

Private Banking

Coutts Group and Adam & Company offer private, corporate and expatriate client services including:-

- banking
- wealth management
- investment management

financial planning
trust and fiduciary services

Offshore Banking

The offshore banking business offers retail banking services to local and expatriate customers and corporate banking and treasury services to corporate, intermediary and institutional clients.

Market data

Ø No.1 for private banking in the UK
Ø a leading player in offshore banking in the UK
Ø over 90,000 UK and international clients
Ø over 168,000 offshore clients

RBS Insurance

Chief Executive
Annette Court

Geographic spread
Ø UK, Ireland, Spain, Germany, Italy and Japan

Employees
Ø 19,400

RBS Insurance sells and underwrites retail and wholesale general insurance via the telephone, the internet and a network of brokers.

It includes some of the best known insurance brands including Direct Line, Churchill Insurance, NIG, Devitt, Green Flag, UKI Partnerships and Inter Group.

Market data

Ø 2nd largest general insurer in the UK
Ø No.1 for UK motor insurance
Ø No.2 for UK household insurance
Ø over 19 million UK insurance policies in-force
Ø over 8 million UK motor policies
Ø over 5 million UK home policies
Ø largest direct insurer in Spain
Ø largest direct insurer in Italy
Ø over 1.5 million international motor policies

Ulster Bank

Chief Executive
Cormac McCarthy

Geographic spread
Ø across Ireland

Employees
Ø 5,100

On 5 January 2004 Ulster Bank was significantly enlarged with the completion of the acquisition of First Active plc. Ulster Bank provides banking and financial products and services via its branch network, telephone and the internet to customers throughout Ireland:-

- retail
- wholesale
- mortgage
- savings
- investment

First Active offers mortgage and savings products to customers in the Republic of Ireland.

Corporate and institutional customers benefit from the scale and experience of the Corporate Banking and Financial Markets division.

Market data

Ø 3rd largest clearing bank in the Republic of Ireland
Ø largest bank in Northern Ireland
Ø now has 1.4 million customers
Ø over 120,000 mortgage customers
Ø No. 2 for mortgages in the Republic of Ireland

Citizens

Chairman, President and Chief Executive Officer
Larry Fish

Geographic spread
Ø New England and Mid Atlantic regions of US

Employees
Ø 14,200

Citizens is engaged in retail and commercial banking through a growing network of city centre, local and supermarket branches in the US states of :

- Connecticut
- Delaware
- Massachusetts
- New Hampshire
- New Jersey
- Pennsylvania
- Rhode Island

It offers personal banking, residential mortgages and home equity loans. It also provides a wide variety of commercial loans and services including; real estate lending, equipment leasing, credit card merchant services, trust and investment services, cash management and international banking.

Market data

Ø 13th largest commercial banking organisation in the US ranked by deposits
Ø 4th largest supermarket bank in the US
Ø 2.4 million personal customers

Group profile continued

As one of the world s largest banks we continue to seek new opportunities to build every aspect of the Group s business in the UK, Europe and America.

Global ranking

The Forbes Global 2000 for 2003 is a comprehensive listing of the world s biggest and most important companies, as measured by sales, profit, assets and market value. Those that make the list have the best composite ranking based on all four of these measures.

Rank	Company	Country
1	Citigroup	US
2	General Electric	US
3	American International Group	US
4	ExxonMobil	US
5	Bank of America	US
6	Royal Dutch/Shell group	NL
7	BP	UK
8	Fannie Mae	US
9	HSBC	UK
10	Toyota Motor	Japan
11	Verizon Communications	US
12	Wal-Mart Stores	US
13	ING Group	NL
14	**The Royal Bank of Scotland Group**	**UK**
15	Berkshire Hathaway	US
15	BNP Paribas	France
17	International Business Machines	US
18	Altria Group	US
19	General Motors	US
20	Total	France

At the end of 2003 The Royal Bank of Scotland Group was the world s fifth largest banking group, with a market capitalisation of £49 billion.

Our three key areas of operation are the UK, US and Continental Europe. In each of these the scale of our businesses has significantly grown over the past five years through strong organic growth and acquisitions. We are increasingly serving the needs of our existing customers in Asia and Australia.

The bulk of both our income and assets continue to be in the UK, although the US and Europe are making a growing contribution.

The number of people we employ and the number of customers buying banking products and financial services from the Group is also growing in each of these three main territories. We now employ over 120,000 people worldwide.

09

Divisional review

Group profit before tax, goodwill amortisation and integration costs up 11% to £7,151 million (2002 £6,451 million).

Make it happen

10

11

Corporate Banking and Financial Markets

Ø Profit contribution £3,620 million (2002 £3,261 million)

Ø Profit increase 11%

Ø Total income up 11%

12

In 2003 we maintained our position as the UK s leading Corporate Bank and grew both our corporate banking and financial markets businesses in Europe, the US and Asia. Our total income increased by £645 million or 11% to £6,697 million.

ØAverage loans and advances to customers increased by 9% or £7.5 billion to £94.3 billion. Average customer deposits within the banking business increased by 7% or £4.1 billion to £61.0 billion.

ØGrowth in income reflected our commitment to supporting our customers through a broad range of transactions tailored to their individual requirements.

UK Corporate Banking

ØWe played a major role in a £600 million refinancing of EMI s credit facilities which included the launch of the company s first high yield capital markets issue.

ØWe created a unique back-to-back solution that met the coin requirements of Arriva s UK Bus division and Sainsbury s.

ØWe provided a tailored cash and treasury management solution to support Element 6 (formerly De Beers Industrial Diamonds).

ØWhen Vue Cinemas acquired 36 Warner Village premises, they sought a bank partner who could rapidly create a cash and card processing solution to meet their very demanding acquisition timeframe. We structured a solution which met this.

ØOur £22 million financing for Petrofac helped to support their acquisition plans.

ØWe structured a multi jurisdictional financing package to support Dorchester Hotels further expansion of their international hotels, including new prime assets in Milan and Paris.

ØWe co-wrote and syndicated the £148 million re-financing debt package for Anglian Windows allowing Alchemy Partners to return a proportion of capital to investors.

ØWe enabled Peel Holdings to acquire Clydeport by solely arranging and underwriting a £165 million bridging facility.

ØWe have supported award winning Innocent Drinks since its launch in 1999, enabling the company to grow and expand despite significant international competition.

ØCarillion (previously Tarmac) celebrated its centenary and a 100 year relationship with RBS.

Structured Finance

ØWe were mandated lead arranger for the £2.5 billion Spirit Group and S&N retail pub group transaction. This was the largest sterling leveraged buyout in the UK and the 2nd largest in Europe in 2003.

ØWe led the US$6.1 billion acquisition facility for Cadbury Schweppes, to enable their purchase of the US confectioner Adams. The deal was awarded Loan of the Year by Corporate Finance magazine.

Asset Finance

ØBoth Angel Trains, our rolling stock leasing company, and Lombard our small and mid-ticket asset finance brand in the UK and Ireland, maintained their leading market positions in 2003.

ØA new car division comprising the Dixon Motors retail business, jamjar and the Lombard full service contract hire and leasing operation was formed. It supplied more than 100,000 new and used vehicles to its customers in 2003.

We are constantly exploring opportunities to develop new markets, leveraging our reputation and financial strength to broker bigger and better deals for our UK and international customers.

Financial Markets

ØWe improved our ranking in the Sterling Bond league table moving from No.11 in 2000 to No.2 in 2003.

ØWe rose from 8th in 2002 to 3rd best FX bank in London in the 2003 Euromoney FX survey.

ØFinancial Markets is the leading arranger for cross-border issues into the US private placement market, with a market share of 26%.

ØOur money market funds, Global Treasury Funds, continue to grow strongly with client investments up 38% in the year to £5 billion.

ØWe executed the three largest sterling securitisations in the market: Southern Water, Mitchells & Butlers and Punch Taverns.

ØRBS Agency Treasury Services, the premier UK based provider of treasury outsourcing services won the mandate for Acambis plc, techMARK Mediscience Company of the Year and a world leader in the development of vaccines to prevent and treat infectious disease.

Europe

ØWe have invested significantly in growing our presence in Europe. We now have offices in France, Italy, Spain, Germany and Sweden, offering lending, capital markets and risk management products to major corporate customers.

ØWe acted as bookrunner and joint mandated lead arranger in the €3.0 billion deal for Energie Baden-Wurttemberg AG which was one of the largest loan transactions in the German utility sector.

ØIn Italy we acted as a lead arranger for the Olivetti/Telecom Italia €15.5 billion syndicated term loan and revolving credit facilities the largest bank financing in Europe for three years. This won European Loan of the Year in International Financing Review Review of the Year.

ØRBS co-led the largest ever European leveraged buy out for SEAT Pagine Gialle, the dominant Italian classified directories business, providing debt facilities of €4.4 billion.

ØWe were lead arranger and bookrunner in the €2.5 billion term loan and revolving credit facility for Vivendi Universal and joint lead and bookrunner in the company s €1.2 billion bond issue. Institutional investors voted this transaction High Yield Deal of the Year in Credit magazine s annual deals of the year poll.

ØWe were awarded SVT (primary dealership) status by the Agence France Tresor, enabling Financial Markets to provide French Government securities to our global customers. This status complements the primary dealerships we already hold in the UK, US and Germany.

ØIn 2003, RBS became a participant on TradeWeb, the leading electronic platform for institutional investors in government and corporate bonds. By volume, we already rank 8th out of 25 participants.

ØWe purchased Nordisk Renting AB, a Swedish leasing company in June 2003.

15

Corporate Banking and Financial Markets continued

Our commitment to innovation, customer focus and expertise makes RBS the corporate bank of choice for businesses of all sizes in the UK.

16

US

ØWe continue to expand our US business and now have a presence in New York, Houston, Chicago and Greenwich.

ØRBS Greenwich Capital continued to grow its institutional fixed income franchise. Its US Treasury primary dealership and mortgage backed securities trading businesses are recognised as among the industries leading liquidity providers, with its US Government sales and trading operations ranked No.1 and No. 2 respectively.

ØCorporate Banking and Financial Markets, in partnership with Citizens Bank, provided £24 million of financing to Aberdeen-based Sparrows Offshore to support their international expansion.

Asia

ØWe have expanded our presence in Asia. We now have offices in Hong Kong, Singapore, Tokyo, Beijing and Shanghai.

ØRBS performed strongly this year in the Euromoney Tokyo FX Survey, being ranked 3rd overall provider, No.1 for sterling and No. 2 for Euro/Japanese Yen by Banks.

ØIn 2003 we established a securitisation business in Asia, signalling a step change in the development of our franchise there and complementing existing operations in the UK, US and Europe.

ØThe RBS and National Australia Bank (NAB) joint venture offers customers of NAB in Australia and New Zealand private placements in the US market. We completed three financings for Lion Nathan, Iluka Resources and Smorgon Steel making us the No.1 Agent for Australian issuers.

Awards

Ø Best Loan Cadbury Schweppes
Corporate Finance

Ø Best Buyout Seat
Corporate Finance

ØRanked No.2 by UK institutional investors as the best provider of secondary market liquidity for Sterling deals brought to market Credit Magazine

Ø Sterling Bond House of the Year
International Financing Review

Ø Sterling Bond of the Year BBC
International Financing Review

Ø European Leveraged Loan SEAT
International Financing Review

Ø Loan of the Year Six Continents
The Treasurer

Ø Securitisation Deal of the Year BBC Broadcasting House
The Treasurer

Ø Securitisation House of the Year BUPA
The Banker

Ø Best Bank FX in London by banks
FX Week Survey

ØRBS Greenwich Capital Best Overall Government Sales Team
Institutional Investor

17

Retail Banking

ØProfit contribution £3,126 million (2002 £3,019 million)

ØProfit increase 4%

ØTotal income up 5%

18

The Royal Bank of Scotland and NatWest operate the largest retail banking network in the UK serving over 13.7 million personal customers and 1.1 million small business customers. In 2003 we increased our income by 5%, to £4,403 million and increased our customer numbers by 3%.

ØOur average loans to customers, excluding mortgages, grew by 9% to £23.7 billion, average mortgage lending by 12% to £33.7 billion and average customer deposits by 6% to £60.9 billion.

Customer service

ØWe continued to combine traditional banking values and innovation to give our customers the freedom to choose how they wish to do business with us, in their branch, by phone or over the internet.

ØWe have the largest retail banking network in the UK with over 2,270 branches, over 5,900 ATMs and more relationship managers than any other bank.

ØWe are the only UK bank that has made an unequivocal commitment to our branch network and this includes branch openings where appropriate. In 2003 we re-opened the NatWest branch, in Roman Road, Bethnal Green, London.

ØWe also increased the number of staff in our branch network to improve the speed and quality of service.

ØIn NatWest we made a significant investment, enabling customers to telephone their branches direct, for the first time for many years.

ØOnLine Banking has seen another excellent year of growth. Average daily volume of payments was up 59% in 2003 and average daily value of payments up 85%. We have also made a significant investment to improve the enrolment process, and have seen a 70% increase in applications.

ØTo meet the needs of customers buying pensions and investments we introduced a telephone advice centre enabling customers to speak to advisers during office hours and in the evening.

ØIn response to customer feedback, Saturday banking has been extended in Royal Bank branches in our busiest locations and now includes a full banking service. We have also increased 12-2pm weekday cover in branches to make banking at lunchtime easier.

ØThe introduction of Royal Bank of Scotland Mortgages Direct Service, provides customers with further choice in how they obtain finance for their home, either face to face through our extensive branch network, over the telephone or via the internet.

ØThe Premium Banking Service continues to attract new customers who benefit from relationship banking.

ØRoyal Bank of Scotland Customer Service Reviews offer customers the opportunity to review their finances with the purpose of making or saving them money. In 2003 we were able to make or save money for the vast majority of our customers for whom a review was undertaken.

ØIn NatWest branches we launched Quick Deposit units to save customers time and allow them to make deposits without queuing. We also continued our branch refurbishment programme.

Retail Banking continued

Our branches lie at the heart of the communities they serve. We study customer feedback to ensure that our branch network meets local needs and expectations.

20

ØWe run a fleet of 12 mobile banks which cover thousands of miles every year taking banking services to over 250 remote rural communities. In the Orkney islands some of Scotland s most northerly residents are served by a branch aboard an aeroplane.

ØWe began piloting a new generation of intelligent pay-in machines in both Royal Bank of Scotland and NatWest branches.

Products

ØNatWest launched three new savings products: the 90-day Bonus Reserve Account is for savers who want to limit withdrawals to earn an interest bonus; the Private Banking Savings Account helps customers to plan by balancing their assets between accessible short-term savings and longer term investments; Advantage Reserve, for packaged account holders, gives instant access to competitively priced savings.

ØNatWest launched a new mortgage product. Flexible Choice offers customers the flexibility to vary monthly payments and save by paying off their mortgage earlier.

ØThe NatWest Advantage Gold Account was relaunched including a range of new benefits.

ØRoyal Bank of Scotland launched the Instant Savings Tracker Account, which offers competitive interest rates with instant access. We enhanced our Royalties, and Royalties Gold packaged accounts and launched Royalties Premier.

ØTo meet customer demand we launched a new Permanent Life Assurance Plan for the over 50s.

Business customers

ØWe strengthened our position as the UK market leader in banking for small and medium sized businesses, increasing our number of business customers by over 3%.

ØBusiness customers have seen the introduction of our new Telephone Business Service Review complementing our existing face to face Business Service Review. This provides customers with a review of their financial needs without having to leave their workplace.

ØWe continued to help more of our business customers fulfil their growth aspirations by providing the finance they need. Our business term lending grew by 16% in 2003.

ØRoyal Bank of Scotland and NatWest launched new business deposit accounts, Bonus Reserve in Royal Bank and Bonus Saver in NatWest. Both accounts are aimed at encouraging business customers to set aside funds as a provision for specific bills such as: tax, national insurance and VAT; to cope with seasonal cash flow fluctuations; or prepare for unexpected opportunities or difficulties.

ØLast year NatWest and Royal Bank of Scotland lent £500 million to small businesses based in the 5% most deprived postcodes in the UK. Our share of lending in these areas is nearly double the amount provided by our nearest competitor. According to a recent Bank of England study into access to finance for small firms in deprived areas, our lending represents almost half of the total £1.2 billion lending to this sector.

21

Retail Banking continued

Award winning products and record levels of customer satisfaction mean more consumers than ever are choosing to bank with us.

ØNatWest and Royal Bank of Scotland offer specialist advice to small business customers in a number of sectors including agriculture, healthcare, franchising and social enterprise. After a difficult two years in agriculture we were pleased to see strong growth in this sector with deposits increasing.

ØNatWest and Royal Bank of Scotland sponsored the DTI s National Social Enterprise Award Enterprising Solutions to help raise awareness about what social enterprises can achieve.

ØRecycle IT! This award winning social enterprise which provides computers to the long term unemployed and low income families, as well as voluntary organisations, schools, start-up s and people with disabilities, benefited from specialist finance and support from our Community Development Banking Unit.

ØAlmost all business areas within Retail have achieved the Investors in People standard, with the remaining areas working towards this recognition. This is testimony to the investment we have made in our people and enables us to prioritise their development to better serve our customers.

Awards

Ø Best Retail Bank in Europe
Lafferty International Retail Banking Awards

Royal Bank of Scotland

Ø Best Current Account Provider
Personal Finance Readership Awards

Ø Best 100% Mortgage Provider
Money£acts

Ø Customer Service Leader of the Year Anita Hunt, Regional Managing Director, East and North Scotland for The Royal Bank of Scotland
National Customer Service Awards

NatWest

Ø Best Bank for Mortgages in 10 out of the last 14 years
Your Mortgage Magazine

Ø Best Banking and Financial Services Award natwest.com
British Interactive Media Awards

Ø Best Direct Mortgage Provider , 4th win in five years
Your Money

Ø Highly Commended Current Account Mortgage Provider
Mortgage Awards

ØFinalist Best Online Advertising NatWest Student Online Campaign
Revolution Awards

Retail Direct

ØProfit contribution £873 million (2002 £701 million)

ØProfit increase 25%

ØTotal income up 15%

Retail Direct is responsible for the Group s cards and non-branch based retail businesses. We continued to expand by organic growth and acquisition. During 2003 the total number of customer accounts grew by 12% or 1.7 million. Our income showed strong growth, up 15% to £1,835 million.

ØAverage lending rose by 15% to £20.3 billion of which average mortgage lending was up 20% at £7.6 billion. Average customer deposits were up 5% to £4.4 billion.

Cards

ØOur cards business remains the second largest issuer in the UK and continued to grow customer numbers and balances in 2003.

ØThe acquisition of the credit card and personal loans portfolios of Santander Direkt Bank in Germany added over 460,000 customer accounts and balances of around €350 million, bringing our total number of customer accounts in Continental Europe to over 2 million.

ØWe are at the forefront of tackling fraud through the implementation of Chip and PIN technology giving our customers the security they expect and deserve when using their credit card. Despite the size of our operations, we have the lowest experience of fraud in the UK, and we intend to improve on this by issuing new, more secure cards to all our customers.

ØIn December we launched our new direct brand 'MINT'. The brand stands out from its competitors by offering customers an exceptional combination of benefits.

ØThe MC^2 card, the new credit card with a curved edge, was launched in December. This innovative new style marked the first change to credit card shape in Europe since credit cards were first introduced 37 years ago.

ØOur business customers also benefited from innovation with the launch of a new product which combines the features of a corporate credit card and a purchasing card. It enables businesses to track expenditure by card holders on key elements of purchasing such as travel.

Ø2003 was another record year for Streamline, our merchant acquiring business, which handled over 2 billion transactions during the year, retaining its position as No.1 in the UK market.

ØWorldPay, our internet merchant acquirer, occupies a significant position in the SME internet segment of the UK market.

Tesco Personal Finance

ØTesco Personal Finance is the UK s most successful supermarket bank. It now has over 4 million customer accounts, and over 1 million of these are motor insurance policies.

ØIn Tesco Personal Finance average personal loans rose by 25% and average customer deposits by 16%.

ØMore than 100 million transactions were carried out during 2003 from over 1,000 Tesco Personal Finance ATMs.

25

Retail Direct continued

As direct banking becomes a modern reality our culture of product innovation puts us in prime position to maximise exciting market potential.

26

ØTesco Personal Finance confirmed its reputation for the development of innovative products and services, launching the first 'off the shelf' vehicle recovery insurance, Instant Breakdown Cover. This follows the success of Instant Travel Insurance, which scooped a prestigious award from the Institute of Financial Services for 'most innovative use of traditional channels'.

ØTesco Personal Finance has extended its reach in international markets supporting the Tesco supermarket brand in Hungary through the supply of financial services products there.

Consumer finance

ØDirect Line Financial Services, which celebrated its tenth anniversary in 2003, offers a range of financial services products including loans, mortgages and savings.

ØAverage lending in Direct Line Financial Services and Lombard Direct increased by 20%.

ØComfort, our European consumer finance business operating in Germany, the Netherlands, Belgium, Austria and Luxembourg, has grown balances by 37%. It has signed up several major new retail distribution partners in each of its countries of operation, and has launched a direct loans business in Germany.

The One account

ØThe One account continues to grow its share of the mortgage market through intermediary and direct channels. Customer numbers increased by 21%.

ØIn 2003 we introduced an additional innovative flexible mortgage product to complement our market leading current account mortgage.

Awards

Ø Best Gold/Platinum Card Provider RBS Advanta
Money£acts Awards

Ø Best Direct Lender Direct Line Financial Services
Mortgage Magazine

Ø Best Direct Life Insurance Provider Tesco Personal Finance
Your Money Savings & Investments

Ø Best Current Account Mortgage Lender The One account
Your Mortgage Awards

Ø Best Current Account and Offset Mortgage Provider The One account
Money£acts Awards

Ø Loans Website of the Year Lombard Direct
find.co.uk

Manufacturing

ØCosts increased by 6% to £1,875 million (2002 £1,762 million)

ØStaff costs £625 million

ØOther costs £1,250 million

Manufacturing provides the Group s back office processing, technology and services. In 2003 we introduced a range of improvements which enhanced customer service, increased efficiency and helped the Group expand its business. Our costs increased by 6% to £1,875 million against a backdrop of double digit volume and income growth across the Group.

ØOur single technology platform is capable of processing around 16 billion instructions every second. The flexible system has capacity to cater for further organic growth and future acquisitions.

ØWe improved service and reliability to our customers. Availability from our key systems was better than ever, available 99.90% of the time, and reaching an all time high of 99.99% in November.

ØWe are continuing to invest in new technologies to simplify our processes and improve the customer experience. This includes an investment to convert customer letters to electronic images and remove a massive 40 million pieces of paper from our centres.

ØThrough a programme of structured improvement initiatives, our staff will have saved and reinvested 600,000 working hours.

ØWithin our call centres we answered over 70 million telephone calls. We now offer our customers more choice in how they contact us. They can choose to speak to their local branch, a customer service adviser or use our automated service.

ØWe counted over £96.5 billion of cash and coins in our centres.

ØWe processed almost 17 million CHAPS Sterling payments valued at £28 trillion.

ØThe value of new loans opened through our network of lending centres in the UK during 2003 was up nearly 16%.

ØWe run the largest ATM network in the UK. We dispensed over £31.5 billion in cash in 2003 and December was a record breaking month with over £3 billion leaving ATMs in the run up to Christmas.

ØWe installed the 1,000th Tesco Personal Finance ATM.

ØWe were one of the first banks in Britain to provide an ATM offering customers euros, at Bishopsgate in London.

ØOur aim is to provide our disabled customers with equal access to the Group s servicesImprovement work is already underway at around 600 locations across the NatWest and Royal Bank of Scotland branch networks, including installing automatic entry doors, audio induction loops and low level writing units.

29

Manufacturing continued

The engine room of RBS, Manufacturing enables the Group to function 24 hours a day, 365 days a year.

30

ØOur reverse auction programme for procurement is the largest of any financial organisation in the world. It has allowed us to deliver significant cost savings while purchasing £1.2 billion of goods and services for the Group from paper clips to computers.

ØConstruction of the Group s world headquarters in Edinburgh continued ahead of schedule. It has an exemplary health & safety record.

ØWith some of our businesses open around the clock for our customers, around 5,000 people have adopted flexible working patterns, including working part time, having term-time or compressed hours contracts and job sharing.

ØWe are helping the fight against criminal activity. Last year, we were the first in the world to introduce coded DNA smoke and dye packs, designed to deter bank robberies.

Awards

Ø Systems Integration Project of the Year
Financial Services Technology magazine

ØFlagship Award for Business Achievement Excellence in IT Management
British Computer Society (BCS) Professional Awards

Ø IT Excellence in Investment Banking Best Systems Integration Project
Financial News Award

ØTwo million man-hours without reportable injury Gogarburn HQ Project
Prestigious award from British Safety Council

ØCertificate of Excellence in the category of Call Centre People Manager of the Year
European Call Centre of the Year Awards

Ø Best Call Centre Recruitment Practice Southampton customer telephone centre
European Call Centre of the Year Awards

31

Wealth Management

ØProfit contribution £438 million (2002 £454 million)

ØProfit decrease 4%

ØTotal income down 3%

32

Wealth Management comprises the Group s private and offshore banking businesses. We expanded in the UK and completed the acquisition of Bank von Ernst in Switzerland. Low interest rates and uncertain equity markets, contributed to a small decline in income of 3% to £879 million, but customer numbers increased.

ØTotal investment assets under management continued to increase. In 2003 they rose by 33% to £27.3 billion.

ØWith a global network of 50 offices, Coutts grew its client base by 29%.

ØDespite volatile markets, Coutts investment programmes have grown by 25% to £5.2 billion and continue to perform well against industry benchmarks. Coutts is also one of Europe s largest fund of hedge fund managers, with more than £2.8 billion invested in its range of alternative investments.

ØCoutts consolidated its position as the UK s leading private bank with significant investment in the regional office network. We increased the number of regional private bankers by 18% and opened a new office in Liverpool, bringing the number of regional offices in the UK to 16.

ØCoutts Asia has achieved rapid growth in profits and a 36% increase in assets under management.

ØAdam & Company completed ten years in the Group as well as ten years of unbroken profit growth. Client numbers grew by 9% in 2003.

ØThe Offshore Banking Group is one of the leading players in the UK Offshore market and has offices in Jersey, Guernsey, Isle of Man and Gibraltar.

ØWe were selected by British Airways as their preferred partner for the provision of banking services to their Executive Club members. The members can now enjoy the benefit of NatWest Advantage International , an innovative multi-currency transactional account, which fulfils their international banking requirements.

Awards

Ø Best Private Bank in the UK Coutts
Euromoney Magazine

Ø Best Private Bank in Western Europe Coutts for:
High Net Worth individuals
Super-affluent and wealthy artists
Euromoney Magazine

Ø1st place over one year for our Euro Currency Bond Programme on behalf of our clients
Standard & Poor s 2003

Ø1st place over five years for our Dollar Bond Programme on behalf of our clients
Standard & Poor s 2003

33

RBS Insurance

ØProfit contribution £468 million (2002 £355 million)

ØProfit increase 32%

ØTotal income up 52%

34

RBS Insurance was created on 1 September 2003 by bringing together the Direct Line Group and the newly acquired Churchill Insurance Group. Their combined strength makes RBS Insurance the second largest general insurer, the number one motor insurer and the number two home insurer in the UK. Our total income was up by 52% to £3,245 million.

ØDirect Line and Churchill are two of the best known general insurance brands in the UK and provide general insurance and motor breakdown services to the customer direct, by telephone and the internet, or through independent brokers.

ØMotor insurance policies in-force in the UK increased by over 3.4 million.

ØHome insurance policies in-force grew by almost 3.6 million.

ØTravel insurance policies in the UK increased by 103,000.

ØPet insurance policies in the UK increased by 78,000.

ØDirect Line sells and services eight separate products under the Direct Line, Privilege and Green Flag brands. It has over 6 million in-force policies.

ØChurchill sells and services four separate products under the Churchill brand and has over 1.4 million in-force policies.

ØUKI Partnerships is a leading wholesale provider of insurance and motoring related services and provides insurance for, amongst others, Tesco Personal Finance and seven out of the top ten motor manufacturers.

ØSales of motor insurance through Tesco Personal Finance have topped one million policies.

ØOur International Division sells insurance in Spain, Germany, Italy and Japan. We maintained our position as the largest direct private motor insurer in Spain and Italy. Internationally we now have over 1.5 million policies in-force.

ØThrough NIG we sell personal and commercial insurance products through a network of 5,000 independent brokers. Devitt is our specialist broker for motor cycles. Inter provides travel insurance and claims administration for several well-known retail brands.

35

RBS Insurance continued

RBS is the strength behind some of the UK s biggest and best-known insurance brands, offering customers more choice and better products.

36

ØGreen Flag Motoring Assistance responds to over 1.1 million breakdown incidents each year.

ØMore than 60,000 vehicles were repaired in our Accident Repair Centres during 2003.

ØOur customers like to choose the way in which they contact us and our internet motor quotes increased by 50% in 2003 making us the leading online provider of motor insurance.

ØNIG launched Insurancexpert.co.uk a website designed to offer customers general information and advice on personal and commercial insurance as well as help in finding a broker.

Awards

Ø Best Direct Motor Insurance Provider and Best Internet Motor Insurance Provider Churchill
Your Money Direct

Ø Best Internet Travel Insurance Provider Direct Line
Your Money Direct

Ø Best Household Insurer Direct Line
Mortgage Magazine 2003

Ø First prize for Motor Insurance for second year running Direct Line
Personal Finance Magazine

Ø Best Companies To Work For Churchill
Sunday Times

Ø Best Product in the Services Category Dealercover
Motorcycle News Dealer Awards Devitt

Ø Best Claims and Assistance Handler Inter
International Travel Insurance Conference

37

Ulster Bank

ØProfit contribution £273 million (2002 £244 million)

ØProfit increase 12%

Ø Total income up 12%

38

Ulster Bank is the largest bank in Northern Ireland. The acquisition of First Active plc by Ulster Bank was announced in October 2003 and completed in January 2004 and greatly strengthens our position in the Republic of Ireland, particularly in mortgages. Our total income increased by 12% to £581 million.

Ø Average loans to customers grew by 26% and customer deposits increased by 13%.

Ø We now have 1.4 million personal and business customers, 265 branches and employ 5,100 staff.

Ø The enlarged Ulster Bank Group is the third largest clearing bank and second largest mortgage provider in the Republic of Ireland.

Ø We continued our success in the residential mortgage market. Advances were 43% up on 2002.

Ø Our Base Rate Tracker Mortgage gave customers one of the most competitive and innovative products in the Republic of Ireland, where mortgage advances grew by 58%. Continued growth in Northern Ireland led to an increase in mortgage advances of 20%.

Ø More than 45,000 credit cards were issued in 2003, in part due to the introduction of our market-leading Zinc credit card and innovative €40 loyalty incentive within the Republic of Ireland.

Ø A partnership entered into with EasyCash will see an expansion of our ATM network in the Republic of Ireland from 200 to over 600.

Ø Ulster Bank made successful introductions to the RBS private placement team, for the Kerry Group ($650m), Bord Gais Eireann ($250m) and ESB International Spanish Power Project Amorebiata (€685m).

Ø With a significant proportion of US investment in Europe going to Ireland this is an important area of financing for Ulster Bank. During the year we achieved notable success by winning the majority of all new Government sponsored inward investment.

Ø The inward investment team won a total of 149 new business accounts in 2003. These included biotechnology companies like Genzyme in partnership with Citizens, Affiliated Computer Services in partnership with RBS in Dallas and Lidl, the German supermarket group.

Awards

Ulster Bank

Ø Best Credit Card
Irish Independent Your Money Honours List

Ø Best Tracker Mortgage
Irish Independent Your Money Honours List

First Active

Ø Most Innovative Product Current Account Mortgage
Irish Independent Your Money Honours List

39

Citizens

ØProfit contribution £857 million (2002 £766 million)

ØProfit increase 22% to US$1,401 million

ØTotal income up 16% to US$2,984 million

40

Citizens now ranks as the 13th largest commercial banking organisation in the US by deposits. Last year was the 11th consecutive year of record profits, fuelled by organic growth and a further three bank acquisitions. Our total income grew by 16% to $2,984 million.

ØLoans increased by $12.1 billion or 39% and deposits grew $11.7 billion or 23%.

ØWe are now the No. 2 commercial banking organisation in New England and No.3 in Pennsylvania, based on deposit share.

ØIn 2003, we increased our personal customer base by 376,000 (18%) and our business customers by 36,000 (18%) due to growth through both traditional and supermarket branches and our three bank acquisitions.

ØCitizens Bank announced a further three bank acquisitions in 2003, Port Financial Corporation and Community Bancorp Inc. both in Massachusetts and Roxborough Manayunk Bank in Pennsylvania.

ØWe made a record 379,000 consumer loans and lines of credit totalling $20.4 billion during the year.

ØWe continued to grow our supermarket banking programme in the Mid Atlantic region, adding 26 branches, an increase of 34%.

ØWe expanded our successful in-store supermarket banking franchise into a large part of the affluent Cape Cod area.

ØDuring 2003, the number of Citizens' on-line banking customers and on-line banking transactions both grew by more than 70%.

ØWe brought seven-day banking to our entire four-county Greater Philadelphia retail region.

ØCitizens received the highest rating, outstanding, this year in each of its state bank Community Reinvestment Act reviews in New England. The Delaware and Pennsylvania banks are being evaluated for the first time in 2004.

ØWe were named the No.1 Small Business Administration (SBA) lender in both the Mid Atlantic and New England regions for the second consecutive year, making 5,800 SBA-backed loans totalling more than $167 million.

ØThe US Small Business Administration honoured four Citizens executives in 2003 for their efforts on behalf of small business entrepreneurs throughout our franchise.

41

Citizens continued

Strategic acquisitions, organic growth and innovations in customer service have taken Citizens to top 20 rankings among US banks.

42

ØOur new Neighbourhood Investment Programmes in Philadelphia and Pittsburgh channelled more than $61 million for neighbourhood improvement initiatives through grants, loans and investments.

ØCitizens Community Champions programme flourished during its first full year in 2003. Each quarter, the Group s resources are offered to help a non-profit agency in each state fulfil its mission and raise its public awareness. It underscores our belief that strong communities and strong companies go hand in hand.

ØDuring 2003, nine more Citizens colleagues went into the community on paid leave of absence to work with agencies and people in need. Thirty five employees have used their skills on the Community Service Sabbatical Program over the past 10 years and the programme continues to expand as our company grows.

ØAn award-winning Home Buyers Assistance Program has helped more than 700 employees achieve their dream of home ownership since September 2002. It offers five-year loans of $5,000 or $8,000 towards the down payment on a mortgage.

ØCitizens asset quality is ranked among the top 20 commercial bank holding companies in the US.

Awards

Ø Export Lender Award
US Small Business Administration for Export Express loan programmes

ØCitizens Bank New In-branch Customer Experience has won two awards
Chain Store Age magazine's "Retail Store of the Year"
Visual Merchandising and Store Design

Ø Corporate Partner of the Year
American Red Cross of Rhode Island

Ø Top Ten Family Friendly Companies
New Hampshire Magazine

43

Corporate responsibility

To deliver superior sustainable value we run our business with integrity, openness and clearly defined business principles.

44

45

Corporate responsibility

We spent £40.1 million (2002 £33.7 million) making a difference in our local communities.

46

We have built our business on the principles of honesty, openness and integrity and they are the foundations of our Corporate Responsibility strategy. Last year the Group made significant progress in governance and management of this increasingly important area and will continue to give it a high priority.

Governance and reporting

The Group Chief Executive is the designated Board member for Corporate Responsibility and reports twice yearly to the Board and the Group Executive Management Committee. In 2003 the Board ratified our Corporate Responsibility Policy, which embraces the principles of the Association of British Insurers. Our Corporate Responsibility team, is responsible for ensuring that this policy becomes an integral part of the day to day management of our business.

We recognise the importance of reporting fully on Corporate Responsibility matters, and our 2003 report provides a more detailed analysis of the past year for each of our key stakeholders our customers, people, shareholders, suppliers and the communities in which we operate. We also report on matters of Corporate Governance, our position in key indices and what we do to manage the direct and indirect environmental impact of our activities.

Economic impact

The economic impact of the Group s activities goes beyond our financial performance. In 2003 our total income was £19.2 billion. The table below shows the way in which this was distributed amongst our key stakeholders including shareholders, staff, suppliers and Governments in the form of taxes. This brings significant benefits to the communities and the economies in which we operate.

International indices and guidelines

We have continued to participate in the most well established Corporate Responsibility indices. We have once again met the socially responsible investment criteria required for inclusion in the FTSE4Good Index, and been selected as an index component for the Dow Jones Sustainability World Index and the Dow Jones STOXX Sustainability Index. Our Dow Jones overall score was 58% in 2003, 10% above the financial services industry average. We improved our rating by 9% in Business in the Community s annual Business in the Environment survey, and have participated in the Business in the Community Corporate Responsibility Index.

The Group has signed up to the UN Global Compact and was one of the first banks to adopt the Equator Principles in June 2003. We have continued to be active members of the FORGE Group, which is currently focusing on developing guidance for Corporate Responsibility reporting within the financial services sector.

Our people

We recognise that our success depends on the abilities of our people, how we reward them and the way in which we train and develop them. To attract and retain the highest calibre of staff, our overall reward package is among the best in the financial services sector, with a combination of remuneration, a final salary pension scheme, a selection of benefits, access to profit share and sharesave schemes for most of our staff.

In 2003 the Group awarded staff a 10% profit share bonus in recognition of their contribution to our success. Nearly £190 million was shared between 105,000 of our people. Non-financial benefits are equally important, such as flexible working arrangements to suit our employees personal circumstances.

47

Corporate responsibility continued

Our community programme is one of the largest in Europe and in 2003 the Group invested £40.1 million in the communities it serves.

48

We have an extensive suite of policies covering issues such as diversity, work-life balance and whistleblowing. Our recently revised Code of Conduct sets exacting standards of behaviour.

Our annual employee opinion survey, carried out by International Survey Research (ISR) has repeatedly reported a strong performance by the Group compared to the UK financial services sector and a group of the world s top performing companies. As a result of this consistently high standard, we have now been included in the ISR Global High Performing Norm.

Environment

RBS continues to actively manage the impact on the environment of its own operations with demanding targets for reducing emissions, increasing the amount of energy we use from renewable sources and reducing travel and waste. We report extensively on this in our Corporate Responsibility Report.

Suppliers

We place increasing importance on ensuring that we work with suppliers committed to the same high standards of environmental and corporate responsibility (CR) as ourselves. Our key supplier management programme embraces an increasing range of CR issues including equal opportunities, social accountability, health, safety and environment.

Community investment

The Group s community investment programme is one of the largest in Europe. Last year we contributed £40.1 million into the communities in which we operate.*

The programme is clearly focused on social inclusion and education. In long-term partnerships with charities and government we are working in areas of financial education, inclusion, money advice, widening access to higher education and helping excluded young people realise their potential.

We measure our community impact by the difference we make to people s lives.

In 2003 in the UK:

ØWe helped Fairbridge and The Prince s Trust improve the prospects of over 40,000 of the UK s hardest to reach young people.

ØWe worked with the Inner City 100 to demonstrate the role that enterprise can play in revitalising inner city economies.

ØWe helped 135,000 pupils from our most deprived communities to consider going on to higher education and Face 2 Face With Finance passed the milestone of helping 300,000 pupils to learn about managing their money.

ØWe are the largest corporate supporter of the money advice sector. Our current partnership will see an investment of £1.8 million in the quality of face to face money advice given through organisations such as Citizens Advice Bureau.

Staff giving

At a community level, we believe our staff are better placed than we are to identify the needs of the community in which they live and work:

ØFor each £1 a member of staff donates to a charity or community project, we will donate £2 and we are the only UK based organisation which double matches Give As You Earn on this basis.

ØWe also provide Community Cashback Awards of between £100 and £1,000 to the good causes which our staff are involved in as volunteers or as fundraisers.

ØIn total £8.5 million was generated for over 6,000 good causes through our staff giving and double matching programme.

Awards

Ø Volunteer of the Year
The National Association for the Advancement of Coloured People for Citizens

Ø Can do Award
Goodwill Industries for Citizens

Ø Most Innovative Working Practice
Institute of Financial Services for RBS Workout programme

ØThe Giving Campaign recognised the achievement of our Give As You Earn scheme
Pay Magazine s Payroll Giving Award for 2003

* Some examples of our community programme in the US have been included in the Citizens section of this report (pages 40 to 43).

49

Make it happen

50

Operating and financial review

Contents

Presentation of information

In the Report and Accounts, and unless specified otherwise, the term company means The Royal Bank of Scotland Group plc, RBS or the Group means the company and its subsidiary undertakings, the Royal Bank means The Royal Bank of Scotland plc and NatWest means National Westminster Bank Plc.

The company publishes its financial statements in pounds sterling (£ or sterling). The abbreviations £m and £bn represent millions and thousands of millions of pounds sterling, respectively, and references to pence represent pence in the United Kingdom (UK). Reference to dollars or $ are to United States of America (US) dollars. The abbreviations $m and $bn represent million and thousands of millions of dollars, respectively, and references to cents represent cents in the US. The abbreviation € represents the euro , the European single currency and the abbreviations €m and €bn represent millions and thousands of millions of euros, respectively.

Certain information in this report is presented separately for domestic and foreign activities. Domestic activities primarily consist of UK domestic transactions of the Group. Foreign activities comprise the Group s transactions conducted through those offices in the UK specifically organised to service international banking transactions and transactions conducted through offices outside the UK.

The geographic analysis in the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have been compiled on the basis of location of office UK and Overseas. Management believe that presentation on this basis provides more useful information on the yields, spreads and margins of the Group s activities than would be provided by presentation on the basis of the domestic and foreign activities analysis used elsewhere in this report as it more closely reflects the basis on which the Group is managed. UK in this context includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

The Group distinguishes its trading from non-trading activities by determining whether a business unit s principal activity is trading or non-trading and then attributing all of that unit s activities to one portfolio or the other. Although this method may result in some non-trading activity being classified as trading, and vice versa, the Group believes that any resulting misclassification is not material.

In this report, the terms UK GAAP and US GAAP refer to generally accepted accounting principles (GAAP) in the UK and the US respectively.

Forward-looking statements

Certain sections in this document contain forward-looking statements as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words expect , estimate , project , anticipate , should , intend , probability , risk , Value-at-Risk (VaR) , target , goal , objective , will , endeavour , outlook , optimistic , prospects a expressions or variations on such expressions and sections such as Chairman s statement and Group Chief Executive s review .

In particular, this document includes forward-looking statements relating, but not limited, to the Group s potential exposures to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. Such statements are subject to risks and uncertainties. For example, certain of the market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: general economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G-7 central banks; inflation; deflation; unanticipated turbulence in interest rates, foreign currency exchange rates, commodity prices and equity prices; changes in UK and foreign laws, regulations and taxes; changes in competition and pricing environments; natural and other disasters; the inability to hedge certain risks economically; the adequacy of loss reserves; acquisitions or restructurings; technological changes; changes in consumer spending and saving habits; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this report, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

For a further discussion of certain risks faced by the Group, see Risk factors on page 56.

Operating and financial review

Description of business

Introduction

The Royal Bank of Scotland Group plc is the holding company of one of the world s largest banking and financial services groups, with a market capitalisation of £49 billion at the end of 2003. Headquartered in Edinburgh, the Group operates in the UK and internationally through its two principal subsidiaries, The Royal Bank of Scotland plc (the Royal Bank), and National Westminster Bank Plc (NatWest). Both the Royal Bank and NatWest are major UK clearing banks whose origins go back over 275 years. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

The Group had total assets of £455 billion and ordinary shareholders equity of £25.2 billion at 31 December 2003. It is strongly capitalised with a total capital ratio of 11.8% and tier 1 capital ratio of 7.4% as at 31 December 2003.

Organisational structure and business overview

The Group s activities are organised in the following business divisions: Corporate Banking and Financial Markets, Retail Banking, Retail Direct, Manufacturing, Wealth Management, RBS Insurance, Ulster Bank and Citizens. A description of each of the divisions is given below.

Corporate Banking and Financial Markets (CBFM) is the largest provider of banking services to medium and large businesses in the UK and the leader in the UK in asset finance. It provides an integrated range of products and services to mid-sized and large corporate and institutional customers in the UK and overseas. These services include corporate and commercial banking, treasury and capital markets products, structured and leveraged finance, trade finance, leasing and factoring.

Financial Markets provides corporate and institutional customers with treasury services, including global interest rate derivatives trading, bond origination and trading, sovereign debt trading, futures brokerage, foreign exchange, money market, currency derivative and rate risk management services. RBS Greenwich Capital, with headquarters in Connecticut, US, delivers debt market solutions tailored to meet the needs of companies and institutions around the world.

During 2003, CBFM acquired Nordisk Renting AB, a Swedish leasing company.

Retail Banking comprises both the Royal Bank and NatWest retail brands. It offers a full range of banking products and related financial services to the personal, premium and small business markets.

To meet its customers needs in the personal banking market, Retail Banking offers a variety of products: money transmission, savings, loans, mortgages and insurance. In the small business market, Retail Banking provides a full range of services which include money transmission and cash management, short, medium and long-term financial and deposit products and insurance. Customer choice and flexibility is at the heart of the Retail Banking proposition and a number of options are available to customers for carrying out their day to day banking transactions through branches, ATMs, the internet, and the telephone.

Retail Direct issues a comprehensive range of credit, charge and debit cards to personal and corporate customers and engages in merchant acquisition and processing facilities for retail businesses. It also includes Tesco Personal Finance (TPF), The One account (formerly Virgin One), Direct Line Financial Services (DLFS), Lombard Direct, WorldPay Limited, the Group s internet banking platform, the Primeline brand and in Europe, the Comfort Card businesses, all of which offer products to customers through direct channels.

During 2003, Retail Direct acquired the credit card and personal loans portfolios of Santander Direkt Bank in Germany.

Manufacturing supports the customer facing businesses, mainly CBFM, Retail Banking, Retail Direct and Wealth Management, and provides operational technology, customer support in telephony, account management and money transmission, global purchasing, property and other services.

Manufacturing drives optimum efficiencies in high volume processing activities, leverages the Group s purchasing power and has become a centre of excellence for managing large scale and complex change programmes such as integration.

Wealth Management comprises various private banking subsidiaries and offshore banking businesses. The Coutts Group brings together businesses that focus on private banking through the Coutts, the Royal Bank and the NatWest private banking brands. Adam & Company is a private bank operating primarily in Scotland. The offshore banking businesses The Royal Bank of Scotland International and NatWest Offshore deliver retail banking services to local expatriate customers, and corporate banking and treasury services to corporate, intermediary and institutional clients, principally in the Channel Islands, the Isle of Man and Gibraltar.

During 2003, the Miami-based Latin American operations of Coutts were sold and the acquisition of Bank von Ernst & Cie AG, a private bank based in Switzerland, was completed.

RBS Insurance was established following the acquisition of Churchill Insurance Group on 1 September 2003. RBS Insurance comprises all companies from the Direct Line and Churchill Groups. Direct Line and Churchill sell and underwrite retail and wholesale insurance on the telephone and the internet in the UK and overseas. UKI Partnerships is a leading wholesale provider of insurance and motoring related services. The National Insurance and Guarantee Corporation sells personal and commercial insurance products through a network of independent financial advisers, while Intergroup acts as a travel insurance intermediary and Devitt Insurance Services operates as a specialist travel broker administrator.

The combined strength of Direct Line and Churchill makes RBS Insurance the second largest general insurer in the UK, by gross earned premiums.

Ulster Bank provides a comprehensive range of retail and wholesale financial services in Northern Ireland and the Republic of Ireland. Retail Banking has a network of branches throughout Ireland and operates in the personal, commercial and wealth management sectors. Corporate Banking and Financial Markets provides a wide range of services in the corporate and institutional markets.

On 6 October 2003, the Group announced that it had agreed the terms of a recommended acquisition for cash of First Active plc. The acquisition was completed in January 2004.

First Active and Ulster Bank have retained their own distinctive brands, branch networks and customer propositions. The acquisition enables the Group to sell First Active s competitive range of mortgage and savings products to Ulster Bank customers, and Ulster Bank s wide range of banking products, to First Active customers.

Citizens is engaged in retail and corporate banking activities through its branch network in the states of Rhode Island, Connecticut, Massachusetts, New Hampshire, Pennsylvania, Delaware and New Jersey. Citizens is the second largest commercial banking organisation in New England and the 13th largest commercial banking organisation in the US measured by deposits. Citizens provides a full range of retail and corporate banking services, including personal banking, residential mortgages and home equity loans. In addition, Citizens engages in a wide variety of commercial loans (including real estate), consumer lending, credit card services, trust services and retail investment services. Citizens also operates subsidiaries primarily engaged in equipment lease financing.

During 2003, Citizens completed the acquisitions of Commonwealth Bancorp, Inc., Port Financial Corp. (the holding company of CambridgePort Bank) and Community Bancorp, Inc. (the holding company of Community National Bank). It also announced the acquisition of Thistle Group Holdings, Co., the holding company of Roxborough Manayunk Bank, which was completed in January 2004.

Santander Central Hispano, S.A.

In October 1988, the Group and Banco Santander entered into an agreement whereby the Group and Banco Santander and its subsidiaries agreed to co-operate in certain banking and financial services activities in Europe, including representation in each other s bank branches to service their respective customers, offshore and investment banking, technology development, operational co-operation and the development of representation in Europe and the Far East. In April 1999, Banco Santander merged with Banco Central Hispanoamericano, another Spanish banking group and the merged entity is now called Santander Central Hispano, S.A. (SCH).

The Group holds 2.83% of SCH s capital stock and SCH holds 5.15% of the company s ordinary shares.

Competition

The Group faces intense competition in the markets it serves. In the UK, the Group s principal competitors are the other UK retail and commercial banks, building societies (which are similar to savings and loans associations in the US) and the other major international banks represented in London.

Competition for corporate and institutional customers in the UK remains strong. In addition to the UK banks, large foreign financial institutions are also active and offer combined investment and commercial banking capabilities. In asset finance, Lombard competes with banks and specialised asset finance providers, both captive and non-captive.

In the small business banking market, where competition remains strong, the Group competes with other UK clearing banks, with specialist finance providers and building societies.

In the personal banking segment, competition remains intense. In addition to UK banks and building societies, major retailers, life assurance companies and internet-only players are active participants. The mortgage market has remained highly competitive, with re-mortgaging activity by customers at a high level. NatWest Life and Royal Scottish Assurance compete with Independent

Financial Advisors and life assurance companies. The competitive situation in the long term savings market is dynamic due to regulatory change and the impact of volatile securities markets on consumer confidence.

The UK credit card market is highly competitive. Large retailers and specialist card issuers, including major US operators, are active in the market in addition to the UK banks and building societies. There has been some consolidation in the market as larger players have acquired smaller portfolios, but non-bank new entrants are continuing to grow in importance in the marketplace. Competition is across a range of dimensions, including aggressive pricing, loyalty and reward schemes, and packaged benefits. In addition to physical distribution channels, providers compete through direct marketing activity and, increasingly, the internet.

In Wealth Management, The Royal Bank of Scotland International and NatWest Offshore compete with other UK and international banks to offer offshore banking services. Coutts Group and Adam & Co. compete as private banks with UK clearing and private banks, and with international private banks. Difficult market conditions have seen some retrenchment of competitive activity, particularly in the mass-affluent segment.

RBS Insurance competes in personal lines insurance. The market is highly competitive. There is competition from a range of insurance companies which now operate telephone and internet direct sales businesses. RBS Insurance also competes in the direct motor insurance markets in Spain, Italy and Germany with the local insurance companies.

In Northern Ireland and the Republic of Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and

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Operating and financial review continued

international banks and building societies active in the market. Competition is intensifying as both UK and Irish institutions seek to expand their businesses.

In the United States, Citizens competes in the New England and Mid-Atlantic retail and mid-corporate banking markets with local and regional banks and other financial institutions. The Group also competes in the US in large corporate lending and specialised finance markets, and in fixed-income trading and sales. Competition is principally with the large US commercial and investment banks and international banks active in the US.

In other international markets, principally in continental Europe, the Group faces competition from the leading domestic and international institutions active in the relevant national markets.

Risk factors

Set out below are certain risk factors which could affect the Group s future results and cause them to be materially different from expected results. The Group s results could also be affected by competition and other factors. The factors discussed in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

The financial performance of the Group is affected by borrower credit quality and general economic conditions, in particular in the UK and the US

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of the Group s businesses. Adverse changes in the credit quality of the Group s borrowers and counterparties or a general deterioration in UK, US or global economic conditions, or arising from systemic risks in the financial systems, could affect the recoverability and value of the Group s assets and require an increase in the provision for bad and doubtful debts and other provisions.

Changes in interest rates, foreign exchange rates, equity prices and other market factors affect the Group s business

The most significant market risks the Group faces are interest rate, foreign exchange and bond and equity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Changes in currency rates, particularly in the sterling-dollar and sterling-euro exchange rates, affect the value of assets and liabilities denominated in foreign currencies and affect earnings reported by the Group s non-UK subsidiaries, mainly Citizens, RBS Greenwich Capital and Ulster Bank, and may affect income from foreign exchange dealing. The performance of financial markets may cause changes in the value of the Group s investment and trading portfolios. The Group has implemented risk management methods to mitigate and control these and other market risks to which the Group is exposed. However, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group s financial performance and business operations.

The Group s insurance businesses are subject to inherent risks involving claims provisions

Future claims in the Group s general and life assurance business may be higher than expected as a result of changing trends in claims experience resulting from catastrophic weather conditions, demographic developments, changes in mortality and other causes outside the Group s control. Such changes would affect the profitability of current and future insurance products and services. The Group re-insures some of the risks it has assumed.

Operational risks are inherent in the Group s business

The Group s businesses are dependent on the ability to process a very large number of transactions efficiently and accurately. Operational risk and losses can result from fraud, errors by employees, failure to document transactions properly or to obtain proper internal authorisation, failure to comply with regulatory requirements and Conduct of Business rules, equipment failures, natural disasters or the failure of external systems, for example, the Group s suppliers or counterparties. Although the Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training, it is only possible to be reasonably, but not absolutely, certain that such procedures will be effective in controlling each of the operational risks faced by the Group.

Each of the Group s businesses is subject to substantial regulation and regulatory oversight. Any significant regulatory developments could have an effect on how the Group conducts its business and on the Group s results of operations

The Group is subject to financial services laws, regulations, administrative actions and policies in each location in which the Group operates. This supervision and regulation, in particular in the UK, if changed could materially affect the Group s business, the products and services offered or the value of assets.

The Group s future growth in earnings and shareholder value depends on strategic decisions regarding organic growth and potential acquisitions

The Group devotes substantial management and planning resources to the development of strategic plans for organic growth and identification of possible acquisitions, supported by substantial expenditure to generate growth in customer business. If these strategic plans do not meet with success, the Group s earnings could grow more slowly or decline.

Critical accounting policies

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Group s principal accounting policies are set out on pages 137 to 140. UK company law and accounting standards require the directors, in preparing the Group s financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. Where UK GAAP allows a choice of policy, Financial Reporting Standard (FRS) 18 Accounting Policies requires an entity to adopt those policies judged to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.

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

Provisions for bad and doubtful debts

The Group provides for losses existing in its lending book so as to state its impaired loan portfolio at its expected ultimate net realisable value. Specific provisions are established against individual exposures and the general provision covers advances impaired at the balance sheet date but which have not been identified as such. Bad and doubtful debt provisions made during the year less amounts released and recoveries of amounts written-off in previous years are charged to the profit and loss account. Loans and advances are reported on the balance sheet net of specific and general provisions.

For certain homogeneous portfolios, including credit card receivables and other personal advances including mortgages, specific provisions are established on a portfolio basis, taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These factors are kept under constant review by the Group.

For loans and advances that are individually assessed, the specific provision is determined from a review of the financial condition of the borrower and any guarantor and takes into account the customer s debt capacity and financial flexibility; the level and quality of earnings; the amount and sources of cash flows; the industry in which the customer operates; and the realisable value of any security held. The most significant estimates that affect the quantum of a specific provision are the amounts and timing of receipts from the borrower and the amount that will be recovered from any security held.

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

The general provision covers bad and doubtful debts that have not been separately identified at the balance sheet date but are known to be present in any portfolio of advances. The level of general provision is assessed in the light of past experience and reflects the size and diversity of the Group s loan portfolio, the current state of the economies in which the Group operates, other factors affecting the business environment, recent trends in companies going into administration, receivership and bankruptcy and the Group s monitoring and control procedures, including the scope of specific provisioning procedures.

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

Loans and advances recognition of interest income

Where the collectibility of interest is in doubt it is excluded from the profit and loss account but is credited to an interest in suspense account. As interest charged to overdraft accounts loses its identity, the determination of the collectibility is generally achieved through individual file reviews. However, for some products, such as personal loans and credit cards, suspension of interest is automated based on the number of payments in arrears. Such automated suspension of interest may be accelerated in the event of death, bankruptcy, legal proceedings or financial hardship. Notwithstanding any arrears, where it is established that the customer is able to cover interest, it is credited to the profit and loss account. Loans classified as impaired and any related suspended interest are written-down to their estimated net realisable value when it is determined that there is no realistic prospect of recovery of all or part of the loan.

Operating and financial review continued

Fair value

Securities and derivatives held for trading purposes are recognised in the financial statements at fair value. In the balance sheet, trading securities are included within Treasury and other eligible bills, Debt securities and Equity shares as appropriate. Positive fair values (assets) of trading derivatives are included in Other assets and negative fair values (liabilities) in Other liabilities. Positive and negative fair values of trading derivatives are offset where the contracts have been entered into under master netting agreements or other agreements that give a legally enforceable right of set-off. Gains or losses arising from changes in fair value are included in Dealing profits in the profit and loss account.

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

Securities carried at fair value include government, asset-backed and corporate debt obligations and corporate equity shares. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Determining fair value for such instruments does not involve significant judgement. Where observable prices are not available or if a position could be liquidated only at an unfavourable price or over an extended period, fair value is based on appropriate valuation techniques or management estimates.

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

The table below analyses the Group s assets and liabilities carried at fair value according to the basis on which fair value is determined.

	Assets carried at fair value		Liabilities carried at fair value	
Fair value at 31 December 2003 is based on:	Securities purchased %	Derivatives %	Securities sold %	Derivatives %
Quoted market prices	99	1	99	1
Internal models	1	99	1	99
	100	100	100	100

General insurance claims

The Group makes provision for the full cost of settling outstanding claims arising from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling expenses. Claims are recognised in the accounting period in which the loss occurs.

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims at the balance sheet date. Also included in the estimation of outstanding claims are other assumptions such as the inflationary factor used for bodily injury claims which is based on historical trends and, therefore, allows for some increase due to changes in common law and statute. Costs for both direct and indirect claims handling expenses are also included. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

The outstanding claims provision is based on information available to management and the eventual outcome may vary from the original assessment. Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of settling individual claims may exceed that assumed.

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as disclosed in the Accounting policies. Under UK GAAP goodwill is amortised and there is a rebuttable presumption that the useful economic life of purchased goodwill does not exceed 20 years from the date of acquisition. The useful economic life of acquired goodwill is assessed on the basis of the type and diversity of the business, its location and the markets in which it operates. Under US GAAP goodwill is not amortised but is subject to annual review for impairment.

An impairment test is designed to assess the recoverable amount of an asset or, in the case of goodwill, an operating segment, by comparing its carrying value with the discounted value of future cash flows that it will generate. Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting, the valuation of the separable assets of each business whose goodwill is being reviewed and an assessment of the discount rate appropriate to the business. Under UK GAAP, impairment tests are only undertaken in the year following an acquisition or when there is evidence that impairment might have occurred. US GAAP requires annual impairment tests that are different from any UK tests and accordingly they may support a different carrying value for the asset being tested.

58

Accounting developments

UK GAAP

The Accounting Standards Board published FRS 5 Application Note G *Revenue recognition* that is applicable to the Group for the year ended 31 December 2003. No changes to the Group s revenue recognition policies were required.

UITF Abstract 37 Purchases and sales of own shares had no impact on the Group because no own shares are deemed to be under the control of Group companies.

UITF Abstract 38 Accounting for ESOP trusts and the consequential amendment to UITF Abstract 17 Employee shares schemes which are mandatory for accounting periods ending on or after 23 June 2004 are not expected to have a material effect on the Group.

International Financial Reporting Standards

In June 2002, the European Union adopted a regulation that requires, from 1 January 2005, listed companies to prepare their financial statements in accordance with international accounting standards. The Group s 2005 financial statements will therefore be prepared in accordance with International Financial Reporting Standards (IFRS). These comprise not only IFRS but also International Accounting Standards (IAS).

In the light of the European Union decision, the International Accounting Standards Board (IASB) announced its commitment to have a platform of high quality, improved standards in place by the end of March 2004 and its intention to avoid mandatory accounting changes between 2004 and 2006. Adoption of new standards issued in that period would be discretionary. A number of new or revised standards that will be effective for 2004 have only recently, or not yet, been finalised. These include standards of major significance for the Group, in particular IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement . Revised versions of IAS 32 and IAS 39 were published on 18 December 2003 and the IASB s proposals on macro-hedging are expected to be completed by the end of March 2004.

During 2003, the Group initiated a programme to change its accounting policies and practices to be IFRS compliant by 2005. A dedicated project team has been assembled and separate work streams established for each difference in accounting that will require significant effort to implement. Activities during 2003 included documenting differences between the Group s current accounting policies and IFRS, detailed planning for the move to IFRS, identification of implementation methodologies, the specification of IT requirements and raising awareness of IFRS throughout the Group.

IFRS differ in certain significant respects from the Group s accounting policies under UK GAAP. The summary below outlines the important differences for the Group in respect of recognition and measurement on the basis of extant IFRS that will be effective for 2005, including revised IAS 32 and IAS 39:

Dividends IFRS require dividends payable to be recorded in the period in which they are declared whereas under UK GAAP dividends are recorded in the period to which they relate.

Computer software under UK GAAP, most software development costs are written off as incurred. Under IFRS, such costs are capitalised if certain conditions are met and amortised over the estimated useful life of the software.

Pensions under UK GAAP, the cost of defined benefit pension schemes and healthcare plans is determined by independent professionally qualified actuaries using the projected unit method and recognised on a systematic basis over employees service lives. Scheme liabilities are discounted at a long-term stable rate. Under IFRS, scheme liabilities are discounted at the market rate on high quality corporate bonds. Actuarial gains and losses must be amortised, on a straight-line basis over the expected average remaining working lives of employees, to income or expense if they amount cumulatively to more than 10% of the present value of scheme liabilities or 10% of the fair value of scheme assets.

Financial instruments: financial assets under UK GAAP, loans are measured at cost less provisions for bad and doubtful debts, derivatives held for trading are carried at fair value and hedging derivatives are accounted for in accordance with the treatment of the item being hedged (see Derivatives and hedging below), and securities are classified as being held as investment securities, or held for dealing purposes. Investment debt securities are stated at cost less provision for any permanent diminution in value. Premiums and discounts on dated securities are amortised to interest income over the period to maturity. Other securities are carried at fair value. Under IFRS, financial assets are classified into held-to-maturity; available-for-sale; held for trading; designated as fair value through profit or loss; and loans and receivables. Financial assets classified as held-to-maturity or as loans and receivables are carried at amortised cost. Other financial assets are measured at fair value. Changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders equity. Changes in the fair value of financial assets held for trading or designated as fair value are taken to the profit and loss account. Financial assets can be classified as held-to-maturity only if they have a fixed maturity and the reporting entity has the positive intention

Operating and financial review continued

and ability to hold to maturity. Trading financial assets are held for the purpose of selling in the near term. IFRS allows any financial asset to be designated as fair value through profit and loss on initial recognition. Unquoted debt financial assets that are not classified as held-to-maturity, held for trading or designated as fair value through profit or loss are categorised as loans and receivables. All other financial assets are classified as available-for-sale.

Effective interest rate and lending fees under UK GAAP, loan origination fees are recognised when receivable unless they are charged in lieu of interest. IFRS requires origination fees to be deferred and recognised as an adjustment to the effective interest rate on the related financial asset. The effective interest rate is the rate that discounts estimated future cash flows over an instrument s expected life to its net carrying value. It takes into account all fees and points paid that are an integral part of the yield, transaction costs and all other premiums and discounts. Under IFRS, the carrying value of a financial instrument held at amortised cost is calculated using the effective interest method.

Loan impairment under UK GAAP, provisions for bad and doubtful debts are made so as to record impaired loans at their ultimate net realisable value. IFRS require impairment losses on financial assets carried at amortised cost to be measured as the difference between the asset s carrying amount and the present value of estimated future cash flows discounted at the asset s original effective interest rate. Impairment must be assessed individually for individually significant assets but can be assessed collectively for other assets.

Financial instruments: financial liabilities IFRS require all financial liabilities to be measured at amortised cost except those held for trading and those that were designated as fair value through profit and loss on initial recognition. Under UK GAAP, short positions in securities and trading derivatives are carried at fair value, all other financial liabilities are recorded at amortised cost.

Liabilities and equity under UK GAAP, all issued shares are classified as shareholders funds, and analysed between equity and non-equity interests. There is no concept of non-equity shares in IFRS. Instruments are classified between equity and liabilities in accordance with the substance of the contractual arrangements. A non-derivative instrument is classified as equity if it does not include a contractual obligation either to deliver cash or to exchange financial instruments with another entity under potentially unfavourable conditions, and if the instrument will or may be settled by the issue of equity, settlement does not involve the issue of a variable number of shares.

Derivatives and hedging under UK GAAP, non-trading derivatives are accounted for on an accruals basis in accordance with the accounting treatment of the underlying transaction or transactions being hedged. If a non-trading derivative transaction is terminated or ceases to be an effective hedge, it is re-measured at fair value and any gain or loss amortised over the remaining life of the underlying transaction or transactions being hedged. If a hedged item is derecognised the related non-trading derivative is remeasured at fair value and any gain or loss taken to the profit and loss account. Under IFRS, all derivatives are measured at fair value. Hedge accounting is permitted for three types of hedge relationship: fair value hedge the hedge of changes in the fair value of a recognised asset or liability or firm commitment; cash flow hedge - the hedge of variability in cash flows from a recognised asset or liability or a forecast transaction; and the hedge of a net investment in a foreign entity. In a fair value hedge the gain or loss on the derivative is recognised in the profit and loss account as it arises offset by the corresponding gain or loss on the hedged item attributable to the risk hedged. In a cash flow hedge and in the hedge of a net investment in a foreign entity, the element of the derivative s gain or loss that is an effective hedge is recognised directly in equity. The ineffective element is taken to the profit and loss account. Certain conditions must be met for a relationship to qualify for hedge accounting. These include designation, documentation and prospective and actual hedge effectiveness.

Offset for a financial asset and financial liability to be offset, IFRS require that an entity must intend to settle on a net basis or to realise the asset and settle the liability simultaneously. However, under UK GAAP an intention to settle net is not a requirement for set off, although the entity must have the ability to insist on net settlement and that ability is assured beyond doubt.

Leasing under UK GAAP, finance lease income is recognised so as to give a level rate of return on the net cash investment in the lease. IFRS require a level rate of return on the net investment in the lease. This means that under UK GAAP tax cash flows are taken into account in allocating income but they are not under IFRS.

US GAAP

For a discussion of recent developments in US GAAP relevant to the Group, see Note 53 on the accounts.

Financial highlights

for the year ended 31 December	2003 £m	2002 £m	2001 £m
Total income	19,229	16,815	14,558
Profit before tax, goodwill amortisation and integration costs	7,151	6,451	5,778
Profit before tax	6,159	4,763	4,252
Profit attributable to ordinary shareholders	2,315	1,971	1,868
Cost:income ratio (%) (1)	42.0	44.0	45.3
Basic earnings per share (pence)	79.0	68.4	67.6
Adjusted earnings per share (pence) (2)	159.3	144.1	127.9
Dividend cover (times) (3)	3.1	3.3	3.3
Adjusted after-tax return on equity (%) (4)	18.7	17.6	16.8

at 31 December	2003 £m	2002 £m	2001 £m
Total assets	455,275	412,000	368,859
Loans and advances to customers	252,531	223,324	190,492
Deposits	304,286	273,881	239,033
Shareholders funds	28,099	27,052	26,668
Risk asset ratio			
tier 1 (%)	7.4	7.3	7.1
total (%)	11.8	11.7	11.5

Notes:

(1) Cost:income ratio represents operating expenses excluding goodwill amortisation and integration costs, and after netting operating lease depreciation against rental income, expressed as a percentage of total income.

(2) Adjusted earnings per share is based on earnings per share adjusted for goodwill amortisation, integration costs and the Additional Value Shares dividend.

(3) Dividend cover represents the total ordinary dividend expressed as a multiple of profit attributable to ordinary shareholders adjusted for goodwill amortisation, integration costs and the Additional Value Shares dividend.

(4) Adjusted after-tax return on equity is based on profit attributable to ordinary shareholders before goodwill amortisation, integration costs and the AVS dividend, and average equity shareholders funds.

61

Operating and financial review continued

Summary consolidated profit and loss account for the year ended 31 December 2003

The profit and loss account set out below shows goodwill amortisation and integration costs separately. In the statutory profit and loss account on page 141, these items are included in the captions prescribed by the Companies Act.

	2003 £m	2002 £m	2001 £m
Net interest income	8,301	7,849	6,846
Dividend income	58	58	54
Fees and commissions receivable	5,755	5,308	4,735
Fees and commissions payable	(1,337)	(965)	(930)
Dealing profits	1,793	1,462	1,426
Other operating income	1,598	1,209	1,052
	7,867	7,072	6,337
General insurance net premium income	3,061	1,894	1,375
Non-interest income	10,928	8,966	7,712
TOTAL INCOME	19,229	16,815	14,558
Staff costs	4,393	3,942	3,461
Other operating expenses	3,996	3,727	3,380

OPERATING EXPENSES	8,389	7,669	6,841
Profit before other operating charges	10,840	9,146	7,717
General insurance net claims	2,195	1,350	948
Operating profit before provisions	8,645	7,796	6,769
Provisions for bad and doubtful debts	1,461	1,286	984
Amounts written off fixed asset investments	33	59	7
PROFIT BEFORE TAX, GOODWILL AMORTISATION AND INTEGRATION COSTS	7,151	6,451	5,778
Goodwill amortisation	763	731	651
Integration costs	229	957	875
PROFIT BEFORE TAX	6,159	4,763	4,252
Tax	1,910	1,556	1,537
Profit after tax	4,249	3,207	2,715
Minority interests (including non-equity)	210	133	90
Preference dividends non-equity	261	305	358
	3,778	2,769	2,267
Additional Value Shares dividend non-equity	1,463	798	399
Profit attributable to ordinary shareholders	2,315	1,971	1,868
Basic earnings per ordinary share	79.0p	68.4p	67.6p
Additional Value Shares dividend	49.9p	27.7p	14.5p
	128.9p	96.1p	82.1p
Goodwill amortisation	25.0p	24.2p	23.2p
Integration costs	5.4p	23.8p	22.6p
Adjusted earnings per ordinary share	159.3p	144.1p	127.9p

62

2003 compared with 2002

Profit

Profit before tax, goodwill amortisation and integration costs increased by 11% or £700 million, from £6,451 million to £7,151 million.

Profit before tax was up 29%, from £4,763 million to £6,159 million.

Total income

The Group achieved strong growth in income during 2003. Total income was up 14% or £2,414 million to £19,229 million. Non-interest income now accounts for 57% of total income. Excluding acquisitions, total income rose by 10%.

Net interest income increased by 6% to £8,301 million and represents 43% of total income (2002 47%). Average loans and advances to customers and average customer deposits grew by 12% and 8% respectively. The benefit of this growth has more than offset the impact on net interest income of the Competition Commission inquiry into SME banking in the UK and the lower interest rate environment in the UK and the US which have reduced income earned from deposits and investments.

Non-interest income increased by 22% to £10,928 million and represents 57% of total income (2002 53%). Fees receivable were up 8% with good growth in lending, transmission and card related fees reflecting higher volumes. General insurance premium income grew strongly, reflecting volume growth in both motor and home insurance products, and the acquisition of Churchill. In addition, volumes in financial markets were up strongly in both the UK and the US reflecting growth in customer-driven activity in interest rate protection, mortgage securitisation and foreign exchange. Income from rental assets grew by 17% to £1,088 million, reflecting the growth in operating leases and investment properties.

Net interest margin

The Group s net interest margin at 3.0% was, in line with the first half, down from 3.1% in 2002 due to a reduced benefit from interest-free funds arising from the lower interest rate environment, and the outcome of the Competition Commission inquiry into SME banking.

Operating expenses

Operating expenses, excluding goodwill amortisation and integration costs, rose by 9% to £8,389 million. Excluding acquisitions, operating expenses were up 7% or £521 million in support of higher business volumes and 10% income growth.

Cost:income ratio

The strong growth in income together with tight cost management resulted in a further improvement in the Group s ratio of operating expenses (excluding goodwill amortisation and integration costs and after netting operating lease depreciation against rental income) to total income, to 42.0% from 44.0%. Excluding the effect of acquisitions, the cost:income ratio improved to 42.5%.

Net insurance claims

General insurance claims, after reinsurance, increased by 63% to £2,195 million. Excluding Churchill, the increase was 29%, consistent with volume growth in the component parts of the insurance division.

Provisions

The profit and loss charge for bad debts and amounts written off fixed asset investments was £1,494 million compared with £1,345 million in 2002. The profit and loss charge is in line with the growth in loans and advances.

Credit quality

There has been no material change during the year in the distribution by grade of the Group s total risk assets.

The ratio of risk elements in lending to gross loans and advances to customers at 2.01% at 31 December 2003 showed an improving trend (31 December 2002 2.14%).

Risk elements in lending and potential problem loans represented 2.24% of gross loans and advances to customers compared with 2.66% at 31 December 2002.

Integration

Integration costs in the year were £229 million, of which, £143 million related to the final elements of the NatWest integration and £86 million related to other acquisitions, including Citizens acquisitions and Churchill.

All integration initiatives in relation to NatWest have been implemented. The programme benefits, comprising £890 million annual revenue benefits and £1,440 million annual cost savings, were fully implemented less than three years after the acquisition of NatWest. Total costs for the integration programme were £2.3 billion. Since 6 March 2000 the integration initiatives have contributed a cumulative £5.6 billion to the Group.

Earnings and dividends

Basic earnings per ordinary share increased by 15%, from 68.4p to 79.0p. Earnings per ordinary share, adjusted for goodwill amortisation, integration costs and the dividend on Additional Value Shares (AVS), increased by 11%, from 144.1p to 159.3p.

The final dividend of 55p per share amounting to £1.5 billion was paid on 1 December 2003 to the holders of the AVS issued in connection with the acquisition of NatWest. A total of £1 per AVS amounting to £2.7 billion in aggregate has been paid over three years to shareholders in accordance with the original schedule.

A final dividend of 35.7p per ordinary share is recommended, making a total for the year of 50.3p per share, an increase of 15%. If approved, the final dividend will be paid on 4 June 2004 to shareholders registered on 12 March 2004. The total dividend is covered 3.1 times by earnings before goodwill amortisation, integration costs and the AVS dividend.

Operating and financial review continued

Balance sheet

Total assets were £455 billion at 31 December 2003, 11% higher than total assets of £412 billion at 31 December 2002.

Lending to customers, excluding repurchase agreements and stock borrowing (reverse repos), increased by 13% or £27 billion to £228 billion. Customer deposits, excluding repurchase agreements and stock lending (repos), grew by 8% or £16 billion to £210 billion.

Capital ratios at 31 December 2003 were 7.4% (tier 1) and 11.8% (total), against 7.3% (tier 1) and 11.7% (total) at 31 December 2002.

Profitability

The adjusted after-tax return on ordinary equity was 18.7% compared with 17.6% for 2002. This is based on profit attributable to ordinary shareholders before goodwill amortisation, integration costs and the AVS dividend, and average equity shareholders funds.

Acquisitions

In January 2003, Citizens completed the acquisition of Pennsylvania-based commercial bank, Commonwealth Bancorp, Inc. for a cash consideration of US$450 million.

In April 2003, Citizens announced the acquisition of Port Financial Corp., the holding company of the Massachusetts savings bank, CambridgePort Bank for a cash consideration of US$285 million. This transaction was completed on 31 July 2003.

In May 2003, RBS announced the acquisition of Nordisk Renting AB, a Swedish leasing company, for a cash consideration of €104 million. This transaction was completed on 2 June 2003.

In May 2003, RBS announced the acquisition of the credit card and personal loans portfolios of Frankfurt-based Santander Direkt Bank for a cash consideration of €486 million. This transaction was completed on 31 July 2003.

In June 2003, RBS announced the acquisition of Churchill Insurance Group PLC for a cash consideration of £1.1 billion. This transaction was completed on 1 September 2003.

In July 2003, Citizens announced the acquisition of Community Bancorp, Inc., the holding company for Community National Bank, for a cash consideration of US$116 million. This transaction was completed on 31 October 2003.

In September 2003, Citizens announced the acquisition of Thistle Group Holdings, Co., the holding company for Roxborough Manayunk Bank, for a cash consideration of US$136 million. This transaction was completed on 5 January 2004.

In October 2003, Coutts Bank (Switzerland) Limited announced the acquisition of a Swiss private bank, Bank von Ernst & Cie AG, for a cash consideration of Swiss Francs 500 million. This transaction was completed on 28 November 2003.

In October 2003, RBS announced that it had agreed terms for a recommended acquisition of First Active plc, for a cash consideration of €887 million. This transaction was completed on 5 January 2004.

On 3 February 2004, RBS announced that it had agreed terms with People s Bank of Connecticut to purchase their credit card portfolio. This transaction is subject to regulatory approval and is expected to complete by the end of March 2004.

Disposals

In May 2003, RBS announced the sale of the Miami-based Latin American private banking operations of Coutts Group to Santander Central Hispano. The cash consideration was US$81 million. This transaction was completed on 31 July 2003.

2002 compared with 2001

Profit

RBS increased its profit before tax, goodwill amortisation and integration costs by 12%, or £673 million, from £5,778 million to £6,451 million.

After goodwill amortisation and integration costs, profit before tax was up 12%, from £4,252 million to £4,763 million. Integration costs relating to NatWest, the Mellon Regional Franchise and Medford Bancorp Inc. (Medford) were £957 million against £875 million in 2001.

Total income

RBS continued to achieve strong growth in income. Total income at £16,815 million was up by 16%, or £2,257 million. Excluding acquisitions, total income rose by 12%.

Citizens increased its income by 53% (15% underlying growth, excluding the effect of acquisitions and exchange rate fluctuations), Direct Line Group by 39% (34% excluding acquisitions) and Retail Direct by 16%.

Corporate Banking and Financial Markets income was up by 11%, notwithstanding Financial Markets strong performance in 2001 when it benefited from market volatility and falling interest rates.

Retail Banking grew its income by 8% and Ulster Bank by 8%. Income in Wealth Management declined 3% as the effect of lower stock market values on activity levels and fees more than offset the benefit from increased customer numbers and volumes.

Net interest income

Net interest income increased by 15%, or £1,003 million, to £7,849 million. Net interest income accounted for 47% of total income. Average interest-earning assets of the banking business increased by 14%.

Net interest margin

The Group s net interest margin remained stable at 3.1%. Improved lending margins offset the downward pressure on deposit margins arising from lower interest rates.

Non-interest income

Non-interest income increased by 16%, or £1,254 million, to £8,966 million. Non-interest income accounted for 53% of total income.

Fees and commissions receivable were up 12%, or £573 million. Volume driven increases in lending fees and continued strong growth in fee paying current accounts contributed to the increase. Dealing profits at £1,462 million were up £36 million, 3%, on the strong performance in 2001. The increase in dealing profits resulted from customer led business growth and higher revenues from trading in interest rate instruments. Other operating income was £157 million, 15% higher mainly due to the expansion of CBFM s operating lease business. General insurance premium income, after reinsurance, rose by 38%, or £519 million reflecting Direct Line Group s organic growth and acquisitions in Continental Europe.

Operating expenses

Operating expenses, excluding goodwill amortisation and integration costs, rose by 12%, or £828 million, to £7,669 million. Excluding acquisitions, operating expenses were up 7%, £469 million in support of strong growth in business volumes.

Cost:income ratio

Strong income growth coupled with tight cost management resulted in a further improvement in the Group s cost:income ratio, to 44.0% from 45.3%. Excluding the effect of acquisitions, the cost:income ratio improved to 43.7%.

Net insurance claims

General insurance claims, after reinsurance, increased by 42%, or £402 million, to £1,350 million reflecting significant volume growth and acquisitions at Direct Line.

Provisions

The profit and loss charge for provisions was £1,345 million compared with £991 million in 2001. The charge for the two halves of the year was consistent with the second half of 2001.

Bad debt provisions amounted to £1,286 million compared with £984 million in 2001. The charge reflects overall growth in lending and, as in the second half of 2001, is particularly influenced by provisions required against a number of specific corporate situations. Amounts written off fixed asset investments, largely in the first half of the year, were £59 million against £7 million in 2001.

Total balance sheet provisions for bad debts amounted to £3,927 million at 31 December 2002, up 8% from £3,653 million at 31 December 2001.

Credit quality

Overall credit quality remains strong with no material change in the distribution by grade of the Group s total risk assets compared with the position at the previous year end.

Risk elements in lending amounted to £4,871 million at 31 December 2002, up 8% from £4,493 million at 31 December 2001, and up 2% from £4,791 million at 30 June 2002.

Total provision coverage (the ratio of total balance sheet provisions to risk elements in lending) at 31 December 2002 was maintained at 81%.

Risk elements in lending and potential problem loans in aggregate amounted to £6,054 million, an increase of 9% over 31 December 2001 and 1% over 30 June 2002.

Integration

The Group successfully completed the conversion of NatWest IT systems on to the RBS technology platform in October 2002. This programme ran for 30 months and involved more than 4,000 staff, culminating in the migration of a customer base three times the size of the Royal Bank of Scotland on to a single technology platform. The scale and complexity of this project are without precedent.

Annualised revenue benefits of £805 million and annualised cost savings of £1,350 million were delivered by December 2002. In addition, by February 2003 all integration initiatives had been completed. As a result the full programme annualised benefits, comprising £890 million revenue benefits and £1,440 million cost savings, have been achieved less than three years after the acquisition of NatWest.

Cumulative combined revenue and cost benefits to the profits for the period 2000 to 2002 amounted to £3.6 billion, which was £1.1 billion ahead of the original plan.

In the US, Citizens completed the IT integration of the Mellon Regional Franchise in August 2002, earlier than planned. Benefits from this transaction were delivered more quickly than was envisaged.

Earnings and dividends

Earnings per ordinary share, adjusted for goodwill amortisation, integration costs and the dividend on Additional Value Shares (AVS), increased by 13% from 127.9p to 144.1p. Basic earnings per ordinary share increased by 1% from 67.6p to 68.4p, reflecting the increase in the AVS dividend paid during the year.

A second dividend of 30.0p per share was paid on 2 December 2002 to the holders of AVS issued in connection with the acquisition of NatWest. By the end of 2002, a total of 45.0p per AVS had been paid, in accordance with the original payment schedule.

The total ordinary dividend for the year was 43.7p per ordinary share, an increase of 15%. The total dividend was covered 3.3 times by earnings before goodwill amortisation, integration costs and the AVS dividend.

65

Operating and financial review continued

Balance sheet

Total assets were £412 billion at 31 December 2002, 12% higher than total assets of £369 billion at 31 December 2001. Of the total assets, £311 billion (76%) related to banking business and £101 billion (24%) to trading business (31 December 2001: £285 billion (77%) banking business and £84 billion (23%) trading business).

Lending to customers excluding repurchase agreements and stock borrowing (reverse repos) increased by 13%, £22 billion. Including reverse repos, loans and advances to customers were up 17%. Customer deposits increased by 10%, from £199 billion at 31 December 2001 to £219 billion at 31 December 2002. Excluding repurchase agreements and stock lending (repos), customer deposits grew by 7%, £13 billion.

Capital ratios at 31 December 2002 were 7.3% (tier 1) and 11.7% (total), against 7.1% (tier 1) and 11.5% (total) at 31 December 2001.

Profitability

The adjusted after-tax return on ordinary equity was 17.6% compared with 16.8% for 2001. This is based on profit attributable to ordinary shareholders before integration costs, goodwill amortisation and the AVS dividend, and average equity shareholders funds.

Acquisitions

In May 2002, Lombard, the leasing arm of CBFM, completed the acquisition of Dixon Motors PLC for a consideration of £118 million.

In July 2002, Citizens announced the acquisition of Medford Bancorp Inc., a Massachusetts savings bank for a cash consideration of US$273 million and in September 2002 announced the acquisition of Pennsylvania-based commercial bank, Commonwealth Bancorp, Inc for a cash consideration of US$450 million. These acquisitions were completed in October 2002 and January 2003, respectively.

66

Analysis of results
Net interest income

	2003 £m	2002 £m	2001 £m
Interest receivable	13,998	13,561	14,421
Interest payable	(5,697)	(5,712)	(7,575)
Net interest income	8,301	7,849	6,846

	%	%	%
Gross yield on interest-earning assets of the banking business	5.0	5.4	6.6
Cost of interest-bearing liabilities of the banking business	(2.3)	(2.7)	(4.0)
Interest spread of the banking business	2.7	2.7	2.6
Benefit from interest-free funds	0.3	0.4	0.5
Net interest margin of the banking business	3.0	3.1	3.1

Yields, spreads and margins of the banking business	%	%	%
Gross yield			
Group	5.0	5.4	6.6
UK	5.2	5.6	6.6
Overseas	4.4	5.0	6.4
Interest spread			
Group	2.7	2.7	2.6
UK	2.7	2.7	2.6
Overseas	2.7	2.7	2.5

Net interest margin			
Group	3.0	3.1	3.1
UK	3.0	3.1	3.2
Overseas	3.0	3.1	3.0
The Royal Bank of Scotland plc base rate	3.7	4.0	5.1
London inter-bank three month offered rates:			
Sterling	3.7	4.1	5.0
Eurodollar	1.2	1.8	3.8
Euro	2.3	3.3	4.3

Notes:

(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.
(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

2003 compared with 2002

Net interest income increased by 6%, £452 million, to £8,301 million. Average interest-earning assets of the Group s banking business increased by 12%, £29.1 billion, to £279.7 billion. Within this, average loans and advances to customers were up 12%, £23.3 billion, to £213.3 billion due to growth in both corporate and personal lending.

Interest spread for the Group as a whole was unchanged at 2.7%. Interest-free balances fell partly due to the outcome of the Competition Commission inquiry into SME banking. This, together with the lower interest rate environment contributed to the reduction in the benefit of interest-free funds from 0.4% to 0.3% giving a decline in net interest margin from 3.1% to 3.0%.

UK Interest spread remained unchanged at 2.7% with product margins remaining stable despite growth in the relatively lower margin mortgage business. The reduced benefit of interest-free funds due to the rate and volume impact described above resulted in the decrease in net interest margin from 3.1% to 3.0%.

Overseas Interest spread was unchanged at 2.7%. Asset spreads tightened in the US due to lower interest rates; however, this was offset by overall mix and volume improvements elsewhere. Lower interest rates led to a reduction in the benefit from interest-free funds, resulting in the decline in net interest margin from 3.1% to 3.0%.

2002 compared with 2001

Net interest income increased by 15%, £1,003 million, to £7,849 million. Average interest-earning assets of the Group s banking business increased by 14%, £30.3 billion, to £250.6 billion. Within this, average loans and advances to customers were up 14%, £23.9 billion, to £190.0 billion due to growth in both corporate and personal lending.

Interest spread rose 0.1% to 2.7% with growth in higher-yielding customer lending offsetting the effects of the low interest rate environment.

Despite the increase in net interest-free funds of the banking business, up 28%, £8.6 billion, to £38.9 billion, the decline in interest rates led to a lower benefit from interest-free funds offsetting the rise in interest spread, leaving net interest margin of the banking business unchanged at 3.1%.

Average balance sheet and related interest

		2003			2002		
		Average balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets							
Treasury and other eligible bills	UK	1,378	48	3.5	910	24	2.6
	Overseas	64	1	1.6	351	6	1.7
Loans and advances to banks	UK	13,724	459	3.3	13,439	532	4.0
	Overseas	9,559	212	2.2	9,811	304	3.1
Loans and advances to customers	UK	168,390	9,519	5.7	154,202	9,141	5.9
	Overseas	44,862	2,240	5.0	35,759	1,963	5.5
Debt securities	UK	23,810	754	3.2	17,950	675	3.8
	Overseas	17,927	765	4.3	18,188	916	5.0
Total interest-earning assets	**banking business**	279,714	13,998	5.0	250,610	13,561	5.4
	trading business (3)	96,648			78,380		
Total interest-earning assets		376,362			328,990		
Non-interest-earning assets		67,026			65,898		
Total assets		443,388			394,888		
Percentage of assets applicable to overseas operations		32.4%			32.0%		
Liabilities and shareholders equity							
Deposits by banks	UK	28,220	703	2.5	21,090	544	2.6
	Overseas	9,565	218	2.3	9,058	215	2.4
Customer accounts: demand deposits	UK	64,469	1,028	1.6	58,618	1,062	1.8
	Overseas	9,166	70	0.8	8,275	99	1.2
Customer accounts: savings deposits	UK	18,653	503	2.7	16,002	463	2.9
	Overseas	16,310	260	1.6	11,742	229	2.0
Customer accounts: other time deposits	UK	49,880	1,478	3.0	45,902	1,542	3.4
	Overseas	16,642	374	2.2	16,264	462	2.8
Debt securities in issue	UK	29,977	914	3.0	24,154	965	4.0
	Overseas	9,630	119	1.2	8,693	209	2.4
Loan capital	UK	15,342	534	3.5	13,154	640	4.9
	Overseas	154	16	10.4	166	17	10.2
Internal funding of trading business	UK	(21,258)	(497)	2.3	(20,129)	(709)	3.5
	Overseas	(1,651)	(23)	1.4	(1,301)	(26)	2.0
Total interest-bearing liabilities	**banking business**	245,099	5,697	2.3	211,688	5,712	2.7
	trading business(3)	93,466			75,059		
Total interest-bearing liabilities		338,565			286,747		
Non-interest-bearing liabilities							
Demand deposits	UK	17,589			21,848		
	Overseas	7,330			6,401		

Other liabilities	51,793	52,600
Shareholders funds equity	24,956	23,553
non-equity	3,155	3,739
Total liabilities and shareholders equity	443,388	394,888
Percentage of liabilities applicable to overseas operations	30.7%	30.4%

Notes:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.
(2) Loans and advances to customers include non-accrual loans. Interest income includes income on non-accruing loans only to the extent cash payments have been received.
(3) Interest receivable and interest payable on trading assets and liabilities are included in dealing profits.

		2001		
		Average balance £m	Interest £m	Rate %
Assets				
Treasury and other eligible bills	UK	231	11	4.8
	Overseas	277	8	2.9
Loans and advances to banks	UK	18,214	834	4.6
	Overseas	7,467	421	5.6
Loans and advances to customers	UK	137,232	9,584	7.0
	Overseas	28,847	1,981	6.9
Debt securities	UK	16,632	931	5.6
	Overseas	11,427	651	5.7
Total interest-earning assets	**banking business**	220,327	14,421	6.6
	trading business(3)	66,545		
Total interest-earning assets		286,872		
Non-interest-earning assets		63,385		
Total assets		350,257		
Percentage of assets applicable to overseas operations		27.1%		
Liabilities and shareholders equity				
Deposits by banks	UK	18,360	760	4.1
	Overseas	8,779	382	4.4
Customer accounts: demand deposits	UK	54,237	1,576	2.9
	Overseas	6,422	154	2.4

Customer accounts: savings deposits	UK	15,892	594	3.7
	Overseas	11,690	435	3.7
Customer accounts: other time deposits	UK	43,161	1,967	4.6
	Overseas	8,127	338	4.2
Debt securities in issue	UK	20,140	1,031	5.1
	Overseas	8,407	384	4.6
Loan capital	UK	10,779	657	6.1
	Overseas	171	14	8.2
Internal funding of trading business	UK	(14,626)	(654)	4.5
	Overseas	(1,576)	(63)	4.0
Total interest-bearing liabilities	**banking business**	189,963	7,575	4.0
	trading business (3)	63,159		
Total interest-bearing liabilities		253,122		
Non-interest-bearing liabilities				
Demand deposits	UK	21,025		
	Overseas	4,513		
Other liabilities		46,249		
Shareholders funds	equity	21,073		
	non-equity	4,275		
Total liabilities and shareholders equity		350,257		
Percentage of liabilities applicable to overseas operations		27.5%		

Notes:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.
(2) Loans and advances to customers include non-accrual loans. Interest income includes income on non-accruing loans only to the extent cash payments have been received.
(3) Interest receivable and interest payable on trading assets and liabilities are included in dealing profits.

Operating and financial review continued

Analysis of change in net interest income volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

2003 over 2002	2002 over 2001

	Increase/(decrease) due to changes in:			Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m
Interest-earning assets						
Treasury and other eligible bills						
UK	15	9	24	20	(7)	13
Overseas	(5)		(5)	2	(4)	(2)
Loans and advances to banks						
UK	11	(84)	(73)	(199)	(103)	(302)
Overseas	(8)	(84)	(92)	108	(225)	(117)
Loans and advances to customers						
UK	820	(442)	378	1,105	(1,548)	(443)
Overseas	467	(190)	277	423	(441)	(18)
Debt securities						
UK	196	(117)	79	69	(325)	(256)
Overseas	(13)	(138)	(151)	348	(83)	265
Total interest receivable of the banking business						
UK	1,042	(634)	408	995	(1,983)	(988)
Overseas	441	(412)	29	881	(753)	128
	1,483	(1,046)	437	1,876	(2,736)	(860)
Interest-bearing liabilities						
Deposits by banks						
UK	(179)	20	(159)	(101)	317	216
Overseas	(12)	9	(3)	(12)	179	167
Customer accounts: demand deposits						
UK	(101)	135	34	(119)	633	514
Overseas	(10)	39	29	(36)	91	55
Customer accounts: savings deposits						
UK	(72)	32	(40)	(4)	135	131
Overseas	(78)	47	(31)	(2)	208	206
Customer accounts: other time deposits						
UK	(128)	192	64	(119)	544	425
Overseas	(10)	98	88	(257)	133	(124)
Debt securities in issue						
UK	(205)	256	51	(184)	250	66
Overseas	(20)	110	90	(13)	188	175
Loan capital						
UK	(96)	202	106	(130)	147	17
Overseas	1		1		(3)	(3)
Internal funding of trading business						
UK	38	(250)	(212)	213	(158)	55
Overseas	6	(9)	(3)	(10)	(27)	(37)
Total interest payable of the banking business						
UK	(743)	587	(156)	(444)	1,868	1,424
Overseas	(123)	294	171	(330)	769	439

	(866)	881	15	(774)	2,637	1,863
Movement in net interest income						
UK	299	(47)	252	551	(115)	436
Overseas	318	(118)	200	551	16	567
	617	(165)	452	1,102	(99)	1,003

Non-interest income

	2003 £m	2002 £m	2001 £m
Dividend income	58	58	54
Fees and commissions receivable	5,755	5,308	4,735
Fees and commissions payable	(1,337)	(965)	(930)
Dealing profits	1,793	1,462	1,426
Other operating income	1,598	1,209	1,052
	7,867	7,072	6,337
General insurance premium income			
Earned premiums	3,565	2,383	1,804
Reinsurance	(504)	(489)	(429)
	3,061	1,894	1,375
	10,928	8,966	7,712

2003 compared with 2002

Non-interest income increased by 22%, or £1,962 million, to £10,928 million. Non-interest income now represents 57% of total income. Excluding general insurance premium income, non-interest income rose by 11% or £795 million to £7,867 million reflecting strong performances in CBFM, up 18% or £670 million and Retail Direct, up 17%, or £145 million.

Within non-interest income, fees and commissions receivable increased by 8% or £447 million, to £5,755 million. This reflected an increase in lending and transmission fees, and good growth in insurance brokerage, cards related fees and ATM income.

Fees and commissions payable increased by £372 million to £1,337 million reflecting higher brokerage costs in CBFM, fees paid in Retail Direct in support of higher volumes and commissions payable to brokers and intermediaries following the acquisition of Churchill.

Dealing profits at £1,793 million were up £331 million, 23% on 2002. This reflects strong growth in volumes in all product areas. The performance in the first half of the year benefited from the unusually high levels of demand for mortgage backed securities in the US.

Other operating income increased by 32% to £1,598 million. This was due to growth in income from rental assets (comprising operating lease assets and investment properties) and higher investment securities gains.

General insurance premium income, after reinsurance, rose by 62%, or £1,167 million to £3,061 million. Excluding the acquisition of Churchill Insurance the growth was 26% or £487 million reflecting volume growth in motor and home insurance products.

2002 compared with 2001

Non-interest income increased by 16%, or £1,254 million, to £8,966 million. Non-interest income accounted for 53% of total income. Excluding general insurance premium income, non-interest income rose by 12% or £735 million to £7,072 million reflecting strong performances in CBFM, up 12% or £384 million, Retail Direct, up 21%, or £145 million and Citizens, up £162 million of which £121 million related to acquisitions.

Within non-interest income, net fees and commissions increased by £538 million, 14% to £4,343 million. This reflected higher transmission fees in Retail Banking due to the growth in packaged accounts and in Citizens which benefited from acquisitions, increase in lending fees, particularly in CBFM and higher insurance income. Strong growth in Cards business and TPF also contributed to this increase.

Dealing profits at £1,462 million were up £36 million, 3% on the strong performance in 2001. The increase in dealing profits resulted from customer led business growth and higher revenues from trading in interest rate instruments.

Other operating income increased by 15% to £1,209 million. This was due to the significant growth in CBFM s operating lease business, where income rose by 16%, £112 million, and higher profits from sale of investment securities.

General insurance premium income, after reinsurance, rose by 38%, or £519 million reflecting RBS Insurance s organic growth and acquisitions in Continental Europe.

Operating and financial review continued

Operating expenses (excluding goodwill amortisation and integration costs)

	2003 £m	2002 £m	2001 £m
Administrative expenses:			
Staff costs	4,393	3,942	3,461
Premises and equipment	1,042	879	809
Other administrative	2,035	1,955	1,715
Total administrative expenses	7,470	6,776	5,985
Depreciation of tangible fixed assets	919	893	856
	8,389	7,669	6,841

2003 compared with 2002

Operating expenses excluding goodwill amortisation and integration costs rose by 9% or £720 million to £8,389 million. This increased expenditure was in support of strong organic growth and customer service improvements. Excluding acquisitions, operating expenses were up 7%, £521 million in support of higher business volumes and 10% income growth.

Staff costs were up £451 million, 11% to £4,393 million reflecting acquisitions and business growth. The number of staff increased by 9,100, 8% to 120,900. Acquisitions in the year added 9,700 staff of which 8,500 related to Churchill.

Premises and equipment expenses increased by £163 million, 19% to £1,042 million reflecting the continuing upgrade of the property portfolio in major UK centres to support the core business.

The increase in other administrative expenses reflected higher business volumes and included expenditure in support of Group wide projects.

Continued income growth coupled with a rigorous approach to cost management further improved the Group s cost:income ratio, to 42.0% from 44.0%. Excluding the effect of acquisitions the cost:income ratio improved to 42.5%.

2002 compared with 2001

Operating expenses excluding goodwill amortisation and integration costs rose by 12% or £828 million to £7,669 million. This reflected the effect of acquisitions and expenditure to support strong organic growth and customer service improvements. Excluding acquisitions, operating expenses were up 7%, £469 million in support of strong growth in business volumes.

Staff costs were up £481 million, 14% to £3,942 million reflecting acquisitions and business growth. The number of staff employed increased by 6,100, 6% to 111,800. Excluding acquisitions since 1 January 2001, staff numbers increased by 500.

Premises and equipment expenses increased by £70 million, 9% to £879 million reflecting higher operating lease rentals and higher utility costs supporting business expansion.

The increase in other administrative expenses reflected higher marketing expenditure, outsourcing costs and legal and professional fees.

Strong income growth coupled with tight cost management resulted in a further improvement in the Group s cost income ratio, to 44.0% from 45.3%. Excluding the effect of acquisitions the cost:income ratio improved to 43.7%.

72

Integration costs

	2003 £m	2002 £m	2001 £m
Staff costs	125	530	598
Premises and equipment	31	127	64
Other administrative expenses	73	298	188
Depreciation of tangible fixed assets		2	25
	229	957	875

All integration initiatives in relation to NatWest have been implemented. The programme s annualised benefits, comprising £890 million revenue benefits and £1,440 million cost savings, were fully implemented less than three years after the acquisition of NatWest. Total costs for the integration programme were £2.3 billion.

Integration costs in relation to NatWest were £143 million in 2003, £810 million in 2002 and £847 million in 2001.

Citizens incurred £63 million of integration costs in 2003 in respect of completed acquisitions.

Expenditure of £134 million and £13 million was incurred in 2002 relating to the integration of Mellon Regional Franchise and Medford respectively compared with £28 million in respect of Mellon Regional Franchise in 2001. The transaction benefits are being delivered more quickly than was planned.

Integration costs in 2003 relating to other acquisitions were £23 million.

During 2002 and 2003, the Group committed to various integration initiatives following the acquisition of Churchill Insurance and various acquisitions by Citizens. Accruals in relation to these integration costs, together with NatWest related integration costs, are set out below.

	At 31 December 2002 £m	Currency translation adjustments £m	Charge to profit and loss account £m	Utilised during the year £m	At 31 December 2003 £m
Staff costs redundancy	71		58	(110)	19
Staff costs other	15	1	67	(56)	27
Premises and equipment			31	(29)	2
Other	66	(2)	73	(104)	33
	152	(1)	229	(299)	81

Operating and financial review continued

Provisions

	2003 £m	2002 £m	2001 £m
Gross new provisions	1,566	1,408	1,071
less: recoveries	(72)	(63)	(80)
Charge to profit and loss account	1,494	1,345	991
Comprising:			
Provisions for bad and doubtful debts	1,461	1,286	984
Amounts written off fixed asset investments	33	59	7
Charge to profit and loss account	1,494	1,345	991

2003 compared with 2002

Gross new provisions were up 11%, £158 million to £1,566 million. Recoveries of amounts previously written off were up £9 million, 14%, to £72 million. Consequently the net charge to the profit and loss account was up £149 million, 11% to £1,494 million.

Bad debt provisions amounted to £1,461 million compared with £1,286 million in 2002, an increase of 14%. The increased charge was in line with the growth in lending during 2003. Amounts written off fixed asset investments, largely in the second half of the year, were down £26 million to £33 million compared with £59 million in 2002.

Total balance sheet provisions for bad and doubtful debts amounted to £3,929 million compared with £3,927 million at 31 December 2002. Total provision coverage (the ratio of total balance sheet provisions to total risk elements in lending) was 76% compared with 81% at 31 December 2002.

The ratio of total balance sheet provisions to total risk elements in lending and potential problem loans increased to 68% compared with 65% at 31 December 2002.

2002 compared with 2001

Gross new provisions were up 31%, £337 million to £1,408 million. The increase reflects growth in overall lending and as in the second half of 2001, provisions required in a number of specific corporate situations. Recoveries of amounts previously written off were down £17 million, 21%, to £63 million. Consequently the net charge to the profit and loss account was up £354 million, 36% to £1,345 million.

Bad debt provisions amounted to £1,286 million compared with £984 million in 2001. The charge reflects overall growth in lending and is particularly influenced by provisions required against a number of specific corporate situations. Amounts written off fixed asset investments, largely in the first half of the year, were £59 million against £7 million in 2001.

Total balance sheet provisions for bad and doubtful debts amounted to £3,927 million, up 8% from £3,653 million at 31 December 2001. Total provision coverage (the ratio of total balance sheet provisions to risk elements in lending) at 31 December 2002 was maintained at 81%.

Taxation

	2003 £m	2002 £m	2001 £m
Tax on profit on ordinary activities	1,910	1,556	1,537

	%	%	%
UK corporation tax rate	30.0	30.0	30.0
Effective tax rate	31.0	32.7	36.1

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax as follows:

	2003 £m	2002 £m	2001 £m
Expected tax charge	1,848	1,429	1,276
Goodwill amortisation	200	183	169
Contributions to employee share schemes	(35)	(40)	(48)
Non-deductible items	231	179	251
Non-taxable items	(207)	(163)	(92)
Capital allowances in excess of depreciation	(626)	(340)	(280)
Other	13	7	(7)
Adjustments in respect of prior periods	(77)	(15)	15
Current tax charge for year	1,347	1,240	1,284
Deferred taxation:			
Origination and reversal of timing differences	598	372	255
Adjustments in respect of prior periods	(35)	(56)	(2)
Actual tax charge	1,910	1,556	1,537

Divisional performance

The contribution of each division before goodwill amortisation and integration costs and, where appropriate, Manufacturing costs is detailed below.

	2003 £m	2002 £m	2001 £m
Corporate Banking and Financial Markets*	3,620	3,261	3,080
Retail Banking	3,126	3,019	2,807
Retail Direct	873	701	551
Manufacturing*	(1,875)	(1,762)	(1,646)
Wealth Management*	438	454	481
RBS Insurance	468	355	261
Ulster Bank	273	244	229
Citizens	857	766	501
Central items	(629)	(587)	(486)
Profit before goodwill amortisation and integration costs	7,151	6,451	5,778

* Prior periods have been restated to reflect the transfer in 2003 of certain activities from Corporate Banking and Financial Markets and Wealth Management to Manufacturing. The performance of each of the divisions is reviewed on pages 76 to 87.

Operating and financial review continued

Corporate Banking and Financial Markets

	2003 £m	2002* £m	2001* £m
Net interest income excluding funding cost of rental assets	2,653	2,631	2,338
Funding cost of rental assets	(329)	(282)	(200)
Net interest income	2,324	2,349	2,138
Fees and commissions receivable	1,537	1,394	1,250
Fees and commissions payable	(220)	(157)	(165)
Dealing profits (before associated direct costs)	1,661	1,338	1,349
Income on rental assets	1,088	931	748
Other operating income	307	197	137
Non-interest income	4,373	3,703	3,319
Total income	6,697	6,052	5,457
Direct expenses			
staff costs	1,410	1,230	1,091
other	394	375	350
operating lease depreciation	518	461	434

	2,322	2,066	1,875
Contribution before provisions	4,375	3,986	3,582
Provisions	755	725	502
Contribution	3,620	3,261	3,080

* prior periods have been restated following the transfer of certain activities to Manufacturing

	£bn	£bn	£bn
Total assets**	219.0	203.4	187.7
Loans and advances to customers** gross			
banking book	99.3	92.1	82.7
trading book	5.0	3.6	1.0
Rental assets	10.1	7.0	5.5
Customer deposits**	68.6	62.2	56.4
Weighted risk assets banking	140.0	125.2	105.8
Weighted risk assets trading	12.6	11.3	12.5

** excluding repos and reverse repos

2003 compared with 2002

Contribution increased by 11% or £359 million to £3,620 million. As well as in the UK, the division also achieved good growth in Europe and North America.

Total income was up 11% or £645 million to £6,697 million with strong growth across all business areas.

Average loans and advances to customers of the banking business increased by 9% or £7.5 billion to £94.3 billion. Lending margin was maintained. Average customer deposits within the banking businesses increased by 7% or £4.1 billion to £61.0 billion; however, the lower interest rate environment adversely affected deposit margins as it reduced the benefit of interest free funds. Net interest income was further impacted by the effect of implementing from 1 January 2003 the pricing remedies agreed following the Competition Commission inquiry into SME banking and by lower money market income, due to less favourable market conditions.

The asset rental business comprising operating leases and investment properties, grew strongly. Average rental assets increased to £8.1 billion and net income after deducting funding costs and operating lease depreciation increased by 28%, £53 million to £241 million.

Fees receivable rose by £143 million, 10% to £1,537 million due to growth in fees related to lending and from the expansion and success of capital markets activities. Fees payable including brokerage were up £63 million to £220 million due to higher volumes in Financial Markets.

Dealing profits which is income before associated direct costs from our role in servicing customer demand for interest and currency rate protection and mortgage backed securitisation rose by 24% to £1,661 million providing incremental profit contribution of some £170 million. There has been steady growth in underlying customer volumes in all product areas. While first half performance was particularly strong given the unusually high levels of demand for mortgage backed securities in the United States, dealing revenues in the second half were up 10% on the prior year period, in line with the growth in income for the division as a whole.

Other operating income was up £110 million, 56% to £307 million partially due to the full year effect of the inclusion of Dixon Motors gross profit.

Direct expenses increased by 12% or £256 million to £2,322 million. Excluding the effect of the acquisition of Nordisk Renting and Dixon Motors and operating lease depreciation, operating expenses were up 10%, £161 million. This was due to performance related costs associated with the strong growth in trading revenues, expansion in all business areas and continued investment in capital market activities and in the growing overseas franchise.

The charge for provisions for bad debts and amounts written off fixed asset investments amounted to £755 million, an increase of £30 million. The charge in the second half of the year was £351 million, 13% lower than the first half. The increase in provisions of 4% over last year was less than the growth in lending of 9%, reflecting an improvement in credit quality and the economic environment during 2003.

2002 compared with 2001

Contribution increased by 6% or £181 million to £3,261 million. Contribution before provisions was up by 11%, £404 million to £3,986 million.

Total income was up 11% or £595 million to £6,052 million. Excluding acquisitions, which added £67 million, total income increased 10%.

Net interest income rose by 10% or £211 million to £2,349 million, reflecting customer lending growth in Corporate Banking and continued good performance by Financial Markets from strong wholesale money market activity. Average loans and advances to customers of the banking business increased by 12%, £9.3 billion to £86.9 billion.

Non-interest income rose by 12% or £384 million to £3,703 million, mainly as a result of increased fees, reflecting growth in lending and in payment and electronic banking activities. Dealing profits benefited from continued customer led business growth and higher revenues from trading in interest rate instruments and matched the strong performance of 2001. Operating lease business expanded significantly during 2002 with average assets increasing by 23% from £3.5 billion to £4.3 billion resulting in higher income, up 16%, £112 million.

Direct expenses increased by 10% or £191 million to £2,066 million. Excluding acquisitions, expenses were up £131 million or 7%, of which £104 million was higher staff costs reflecting business growth and £27 million was higher operating lease depreciation.

Provisions amounted to £725 million compared with £502 million in 2001. The increase reflected growth in lending and, as in the second half of 2001, provisions required against a number of specific corporate situations, and higher investment provisions.

Operating and financial review continued

Retail Banking

	2003 £m	2002 £m	2001 £m
Net interest income	2,951	2,840	2,622
Non-interest income	1,452	1,353	1,277
Total income	4,403	4,193	3,899
Direct expenses			

staff costs	777	707	702
other	227	254	226
	1,004	961	928
Contribution before provisions	3,399	3,232	2,971
Provisions	273	213	164
Contribution	3,126	3,019	2,807
	£bn	£bn	£bn
Total banking assets	63.8	57.4	50.9
Loans and advances to customers gross			
mortgages	36.6	32.1	28.5
other	25.2	23.5	20.5
Customer deposits	66.3	61.7	56.8
Weighted risk assets	42.9	38.8	35.2

2003 compared with 2002

The division achieved strong volume growth across all personal product areas - current accounts, mortgages and loans and savings. Despite lower interest rates and the adverse effect of the pricing remedies agreed following the Competition Commission inquiry into SME banking which were implemented from 1 January 2003, income increased by 5% or £210 million to £4,403 million, and contribution by 4% or £107 million to £3,126 million.

Net interest income rose by 4% or £111 million to £2,951 million, reflecting the continued strong growth in customer advances and deposits which was partially offset by the implementation of the Competition Commission pricing remedies and the impact of a lower interest rate environment. Excluding the effect of the Competition Commission the increase was 8%. Average loans to customers, excluding mortgages, grew by 9% or £1.9 billion to £23.7 billion. Average mortgage lending grew by 12% or £3.6 billion to £33.7 billion. Average customer deposits increased by 6% or £3.7 billion to £60.9 billion.

Non-interest income rose by 7% or £99 million to £1,452 million. This reflected further growth in the customer base and a 15% growth in general insurance income to £301 million. Embedded value profits of the life assurance business increased by 14%, or £7 million to £57 million.

Direct expenses increased by 4% or £43 million to £1,004 million. Staff expenses increased 10% or £70 million to £777 million reflecting further investment in customer facing staff.

Other expenses decreased 11% or £27 million to £227 million, as a result of our rigorous approach to management of non-staff costs.

The charge for provisions for bad debts increased by £60 million to £273 million. The overall quality of the loan portfolio remains stable and the increased charge reflects growth in lending over recent years particularly in NatWest since its acquisition.

2002 compared with 2001

Contribution increased by 8% or £212 million to £3,019 million.

Total income was up 8% or £294 million to £4,193 million. The increase in income reflected continued growth in customer numbers. The number of personal current accounts increased by 4% to 10.63 million. Retail Banking is the leading provider of services to small businesses and has 1.10 million customers.

Net interest income rose by 8% or £218 million to £2,840 million, reflecting strong growth in customer loans and deposits. Average loans to customers, excluding mortgages, grew by 14% or £2.7 billion to £21.8 billion. Average mortgage lending was up 10% or £2.7 billion to £29.8 billion. Average customer deposits increased by 6% or £3.1 billion to £57.2 billion.

Non-interest income rose by 6% or £76 million to £1,353 million, reflecting growth in packaged current accounts, transmission income and higher volumes of general insurance products sold through the Royal Bank and NatWest networks. Strong sales performance was seen in Bancassurance with new business up 30% although the sharp fall in equity markets depressed Bancassurance income.

Direct expenses increased by 4% or £33 million to £961 million. Staff costs were up £5 million, 1% to £707 million. Other costs rose £28 million, 12% to £254 million partly due to increased incidence of fraud losses.

Provisions increased by £49 million to £213 million, reflecting recent growth in lending.

79

Operating and financial review continued

Retail Direct

	2003 £m	2002 £m	2001 £m
Net interest income	849	749	674
Non-interest income	986	841	696
Total income	1,835	1,590	1,370
Direct expenses			
staff costs	211	190	164
other	454	418	400
	665	608	564
Contribution before provisions	1,170	982	806
Provisions	297	281	255
Contribution	873	701	551
	£bn	£bn	£bn
Total assets	21.9	19.4	17.1
Loans and advances to customers gross			
mortgages	8.2	7.0	5.9
other	13.8	12.4	11.2
Customer deposits	4.4	4.4	4.3

Weighted risk assets	16.8	14.4	12.5

2003 compared with 2002

Contribution increased by 25% or £172 million to £873 million.

Total income was up 15% or £245 million to £1,835 million, reflecting continued strong growth in supermarket banking (TPF), mortgages and cards. Net interest income was up 13% or £100 million to £849 million. Average lending rose by 15% to £20.3 billion of which average mortgage lending was 20% higher at £7.6 billion mainly in The One account. Average customer deposits were up 5% to £4.4 billion. During 2003, the total number of customer accounts increased by 1.7 million.

Non-interest income was up 17% or £145 million to £986 million. There was good growth in insurance and ATM income resulting from increased volumes, particularly in TPF and in the Cards Business.

Direct expenses increased by 9% or 7% excluding acquisitions, and other expenses increased by £36 million, 9% (7% excluding acquisitions), with increased processing and operational costs in support of the higher business levels.

The charge for provisions for bad debts increased by £16 million or 6% to £297 million, reflecting growth in lending volumes offset by higher recoveries. The indicators of credit quality remain stable.

2002 compared with 2001

Contribution increased by 27% or £150 million to £701 million.

Total income was up 16% or £220 million to £1,590 million, reflecting continued strong growth in the Cards business and in TPF. The number of active credit card accounts increased during the year to 9.5 million. TPF continued its strong growth, increasing customer accounts across all products to 3.4 million.

Net interest income was up 11% or £75 million to £749 million. Average customer lending increased by 16% to £17.9 billion. In TPF, average personal loans rose by 29% to £1.1 billion and average customer deposits rose by 26% to £1.9 billion.

Average mortgage lending in The One account was 36% higher at £4.3 billion and in DLFS was up 10% to £2.3 billion. Average personal lending in DLFS and Lombard Direct increased by 20% to £2.0 billion.

Non-interest income was up 21% or £145 million to £841 million mainly as a result of higher fee income reflecting growth in volumes, especially in TPF, where the total number of general insurance policies increased during the year to 1.3 million.

Direct expenses increased by 8% or £44 million to £608 million reflecting increased volumes and higher marketing activity to support strong business expansion.

Provisions increased by £26 million to £281 million due to the growth in lending volumes.

Manufacturing

	2003 £m	2002* £m	2001* £m
Staff costs	625	536	484
Other costs	1,250	1,226	1,162
Total manufacturing costs	1,875	1,762	1,646

Analysis:			
Group Technology**	651	613	572
Group Purchasing and Property Operations**	636	585	535
Customer Support and other operations	588	564	539
Total manufacturing costs	1,875	1,762	1,646

* prior periods have been restated following the transfer of certain activities from Corporate Banking and Financial Markets and Wealth Management

** prior periods have also been restated to reflect the transfer of certain business units within Manufacturing

2003 compared with 2002

Manufacturing s costs increased by 6% or £113 million, to £1,875 million.

Group Technology costs have increased by 6% or £38 million to £651 million. This reflects business as usual cost growth and a specific improvement programme, the majority of the cost of which will be borne by Group Technology. This is already providing benefits across the Group and further investment opportunities have been identified which will lead to further efficiency benefits across the Group in 2004 and again in 2005.

The cost base of Group Purchasing and Property Operations rose by 9% or £51 million to £636 million, largely as a result of the continuing upgrade of the property portfolio in major UK centres to support the Group s core business.

Customer Support and other operations costs were £588 million, 4% or £24 million higher than the previous year. This reflects further expansion of business operations with increased expenditure in customer support areas of Lending, Telephony, Payments and Security. In telephony, the Royal Bank of Scotland customer service proposition has been introduced to NatWest customers who can now choose between speaking to their local branch, to a customer service officer or using the automated telephone service.

2002 compared with 2001

Total manufacturing costs at £1,762 million were 7% or £116 million higher than 2001.

The increase in costs reflected growth in business volumes arising from customer accounts, mortgage applications, personal loans and ATM transactions, and initiatives to enhance customer service, particularly in NatWest telephony.

Manufacturing successfully completed the integration of NatWest on to the RBS technology platform in October 2002, ahead of schedule.

Operating and financial review continued

Wealth Management

	2003 £m	2002* £m	2001* £m
Net interest income	465	460	464
Non-interest income	414	447	469
Total income	879	907	933
Expenses			

staff costs	275	301	282
other	157	163	175
	432	464	457
Contribution before provisions	447	443	476
Provisions for bad and doubtful debts charge/(release)	9	(11)	(5)
Contribution	438	454	481
	£bn	£bn	£bn
Total assets	15.2	13.4	12.5
Investment management assets excluding deposits	27.3	20.5	21.4
Customer deposits	29.3	29.1	29.1
Weighted risk assets	9.1	8.4	7.8

* Prior periods have been restated following the transfer of certain activities to Manufacturing.

2003 compared with 2002

Contribution was £438 million, £16 million or 4% lower than 2002. Excluding the acquisition and disposals, income was up 1%, with contribution before provisions up 4%. The charge for provisions for bad and doubtful debts was £9 million compared with a net release of £11 million in 2002.

Total income was down by 3% or £28 million to £879 million.

Net interest income increased by 1% or £5 million to £465 million. The benefit from growth in lending volumes was partly negated by the effect of lower interest rates which also caused a tightening of deposit margins.

Non-interest income declined by 7% or £33 million to £414 million. Excluding the acquisition and disposals the decrease was 1%. This reflects the impact of lower equity markets adversely affecting fees and commissions.

Investment management assets increased by £6.8 billion or 33% to £27.3 billion principally due to the acquisition of Bank von Ernst in the year.

Expenses were down by 7% or £32 million to £432 million reflecting tight cost control in difficult market conditions and the 7% reduction in staff numbers since 31 December 2002.

Provisions for bad and doubtful debts were £9 million compared with a net release of £11 million in 2002.

2002 compared with 2001

Contribution at £454 million was £27 million, 6% lower primarily due to the effect of the fall in equity markets on the level of activity and ad valorem fee income.

Total income was down 3% or £26 million to £907 million.

Net interest income declined by 1% or £4 million to £460 million, as a result of a slight contraction in deposit margins due to lower interest rates. Average customer deposits increased from £28.5 billion to £28.7 billion.

Non-interest income was £22 million, 5% lower at £447 million. This reflected lower equity markets which continued adversely to affect fees and commissions. Investment management assets at £20.5 billion were £0.9 billion, 4% lower as new business inflow was more than offset by the significant decline in equity markets.

Expenses were up 2% or £7 million to £464 million.

Releases and recoveries of provisions exceeded gross new provisions required. As a result, there was a net release of provisions of £11 million, against a net release of £5 million in 2001.

RBS Insurance (formerly Direct Line)

	2003 £m	2002 £m	2001 £m
Earned premiums	3,565	2,383	1,804
Reinsurers share	(504)	(489)	(429)
Insurance premium income	3,061	1,894	1,375
Net fees and commissions	(99)	65	26
Other income	283	180	142
Total income	3,245	2,139	1,543
Expenses			
staff costs	241	178	152
other	341	256	182
	582	434	334
Gross claims	2,644	1,693	1,263
Reinsurers share	(449)	(343)	(315)
Net claims	2,195	1,350	948
Contribution	468	355	261
In-force policies (000 s)			
Motor: UK	8,086	4,668	4,017
: International	1,541	1,224	601
Home: UK	5,154	1,587	1,360
Combined operating ratio UK (%)	91.6	89.4	88.0
Gross insurance reserves total (£m)	6,582	3,002	2,370

2003 compared with 2002

Contribution increased by 32% or £113 million to £468 million. Excluding Churchill, contribution increased by 26% or £92 million.

Total income was up 52% or £1,106 million to £3,245 million. Excluding Churchill, total income grew by 25% or £525 million.

After reinsurance, insurance premium income was up 62% or £1,167 million to £3,061 million. Excluding Churchill, insurance premium income (net of reinsurance) grew by 26% or £487 million. The number of UK in-force motor insurance policies increased by 3.4 million of which 3.1 million was from Churchill, while the number of UK in-force home insurance policies increased by 3.6 million including 3.4 million from Churchill. The number of international in-force motor policies increased by 317,000 during the year.

Other income net of commissions payable was down from £245 million to £184 million. Excluding Churchill, which included £148 million commissions payable to brokers and intermediaries, other income was up 16% or £38 million due to higher investment income, embedded value profits and share of associates profits.

Expenses increased by 34% or £148 million to £582 million. Excluding Churchill, expenses increased by 9% or £40 million. Staff numbers, excluding Churchill, increased by 4% (400) to support growth in business volumes, particularly in the partnership business.

Net claims, after reinsurance, increased by 63% or £845 million to £2,195 million. Excluding Churchill, net claims increased by 29% or £393 million.

UK combined operating ratio was 91.6%. Excluding Churchill, the UK ratio improved from 89.4% to 89.2%.

2002 compared with 2001

Contribution increased by 36% or £94 million to £355 million.

Total income was up 39% or £596 million to £2,139 million. Excluding acquisitions, which added £73 million, total income was up 34% or £523 million.

After reinsurance, insurance premium income was up 38% or £519 million to £1,894 million, reflecting strong growth in customer numbers. The leading position in the UK direct motor insurance market was maintained with motor insurance policies increasing 16%, or 651,000 to 4.67 million. The number of UK in-force home insurance policies increased by 17% or 227,000 to 1.59 million. The number of international in-force motor policies more than doubled to 1.22 million, including 280,000 from acquisitions.

Other income increased by 46% or £77 million to £245 million. Higher investment income and profit commissions contributed to this increase.

Expenses increased by 30% or £100 million to £434 million. Excluding acquisitions, which added £35 million, expenses were up by 20% or £65 million reflecting business expansion.

Net claims, after reinsurance, increased by 42% or £402 million to £1,350 million reflecting increased volumes.

Operating and financial review continued

Ulster Bank

	2003 £m	2002 £m	2001 £m
Net interest income	396	339	313
Non-interest income	185	181	170
Total income	581	520	483
Expenses			
staff costs	164	145	135

other	112	109	104
	276	254	239
Contribution before provisions	305	266	244
Provisions	32	22	15
Contribution	273	244	229
	£bn	£bn	£bn
Total assets	15.6	12.7	10.8
Loans and advances to customers gross	11.6	9.1	7.6
Customer deposits	9.7	8.8	7.7
Weighted risk assets	11.0	9.0	7.7
Average exchange rate €/£	1.445	1.591	1.609
Spot exchange rate €/£	1.416	1.536	1.637

2003 compared with 2002

Contribution increased by 12% or £29 million to £273 million driven by strong volume growth in both loan and deposit products. The number of customers increased in 2003 by 36,000.

Total income increased by 12% or £61 million to £581 million reflecting the strong volume growth, in particular residential mortgages.

Net interest income rose by 17% or £57 million to £396 million, reflecting strong growth in both average customer lending and deposits which increased by 26% or £2.1 billion, to £10.1 billion and by 13% or £1.0 billion, to £8.9 billion respectively.

Non-interest income increased by £4 million to £185 million. Strong growth in lending, transmission and card fee income was partially offset by lower dealing profits. Uncertainty in equity markets adversely affected brokerage fees in the stockbroking business which was sold in October 2003.

Expenses increased by 9% or £22 million to £276 million. This reflected the annual pay award and the additional costs to support increased business volumes.

The charge for provisions for bad debts was up £10 million to £32 million reflecting growth in lending.

2002 compared with 2001

Contribution increased by 7%, or £15 million to £244 million.

Total income increased by 8%, £37 million to £520 million.

Net interest income rose by 8% or £26 million to £339 million, reflecting good growth in loans and deposits despite a less buoyant economic environment in the Republic of Ireland. Average customer lending and deposits of the banking business increased by 10%, £0.7 billion, to £8.0 billion, and by 7%, £0.5 billion, to £7.9 billion respectively. Average mortgage lending grew by 23% to £1.5 billion and the number of current accounts increased by 5%.

Non-interest income rose by 6% or £11 million to £181 million. Increases of £7 million in net fees and commissions and £6 million in other operating income were partially offset by a £2 million reduction in dealing profits.

Expenses increased by 6% or £15 million to £254 million to support higher business volumes and pay awards.

Provisions were up by £7 million to £22 million reflecting a small number of specific situations.

Citizens

	2003 £m	2002 £m	2001 £m
Net interest income	1,310	1,248	814
Non-interest income	514	468	306
Total income	1,824	1,716	1,120
Expenses			
staff costs	505	485	305
other	374	370	245
	879	855	550
Contribution before provisions	945	861	570
Provisions	88	95	69
Contribution	857	766	501
	$bn	$bn	$bn
Total assets	76.8	61.1	52.4
Loans and advances to customers gross	43.5	31.4	26.3
Customer deposits	62.8	51.1	42.8
Weighted risk assets	50.8	38.8	35.8
Average exchange rate $/£	1.635	1.503	1.440
Spot exchange rate $/£	1.786	1.613	1.450

2003 compared with 2002

Contribution which increased by 12% or £91 million to £857 million was diminished by the weakening of the US dollar in relation to sterling. In US dollar terms, contribution increased by 22% or $250 million to $1,401 million.

Total income was up 16% or $406 million to $2,984 million.

Net interest income increased by 14% or $268 million to $2,143 million. Excluding the acquisitions, net interest income was up 9% or $164 million (£100 million), reflecting strong organic growth in personal loans and deposits. Excluding the acquisitions, average loans were up 29% or $8.0 billion and average deposits were up 20% or $9.1 billion. The benefit of this growth was reduced by a narrowing interest margin due to reductions in US interest rates.

Non-interest income rose by 20% or $138 million to $841 million. Excluding the acquisitions, non-interest income was up 16% or $115 million (£70 million).

Expenses increased by 12% or $153 million to $1,438 million. Excluding the acquisitions, expenses increased by 8% or $102 million (£62 million), to support higher business volumes and expansion of Citizens supermarket banking programme.

Provisions were up $3 million from $142 million to $145 million. Excluding the acquisitions, provisions were $2 million (£1 million), or 1%, lower than 2002. Credit quality metrics remain strong and total non-performing loans were 0.40% of total loans and advances at 31 December 2003 compared with 0.57% at the end of 2002.

In 2003, Citizens increased its personal customer base by 376,000 accounts and its business customers by 36,000 due to growth through both traditional and supermarket branches, and the acquisition of Commonwealth Bancorp, Inc., Port Financial Corp. and Community Bancorp, Inc.

2002 compared with 2001

Contribution increased by 53% or £265 million to £766 million. In US dollar terms, contribution increased by 60% or $431 million to $1,151 million. Excluding the incremental contribution of $331 million from the Mellon Regional Franchise and Medford (the acquisitions), the contribution increased by 14% or $100 million (£67 million).

Total income was up 60% or $966 million to $2,578 million. Excluding acquisitions, organic income growth was up 15% or $238 million.

Net interest income rose by 60% or $703 million to $1,875 million. Excluding acquisitions, which added $546 million, net interest income was up 14% or $157 million (£104 million), as a result of strong organic growth in customer loans and deposits.

Non-interest income rose by 60% or $263 million to $703 million. Excluding acquisitions, which added $183 million, non-interest income was up 19% or $80 million (£53 million), as a result of growth in deposit service charges and mortgage banking.

Expenses increased by 62% or $492 million to $1,285 million. Excluding acquisitions, which added $385 million, expenses increased by 14% or $107 million (£71 million), to support higher business volumes. Citizens increased its in-store banking activities by opening new branches in 58 Stop&Shop supermarkets. The cost of establishing presence in these stores contributed to the increase in operating expenses.

Provisions were up from $99 million to $142 million. Excluding the Mellon Regional Franchise which added $15 million, provisions were broadly consistent with the second half of 2001.

Operating and financial review continued

Central items

	2003 £m	2002 £m	2001 £m
Funding costs	215	215	211
Departmental and corporate costs	414	372	275
Total Central items	629	587	486

2003 compared with 2002

Total Central items increased by £42 million to £629 million.

Funding costs at £215 million, were unchanged. Increased income from higher shareholders funds was offset by the funding costs associated with the acquisition of Churchill in September 2003 and the £1.5 billion AVS dividend paid in December 2003.

Central departmental costs and other corporate items at £414 million were £42 million or 11% higher than 2002. This is partly due to staff costs and other costs relating to certain departments such as Customer Relations which have been centralised and additional resources devoted to Group wide projects such as preparations for the implementation of Basel II and International Accounting Standards.

2002 compared with 2001

Total Central items increased by £101 million to £587 million.

Funding costs, which include interest on the perpetual regulatory tier one securities issued in August 2001 of £60 million (2001 £23 million) were similar to the previous year. This reflected the benefit of retained earnings and lower interest rates.

Central departmental costs and other corporate items increased to £372 million compared with £275 million in 2001, which benefited from certain one off items.

Employee numbers at 31 December

	2003	2002	2001
Corporate Banking and Financial Markets*	15,900	16,900	12,800
Retail Banking	30,700	30,100	30,500
Retail Direct	7,300	7,000	6,200
Manufacturing*	21,800	21,900	22,800
Wealth Management*	5,600	6,000	6,600
RBS Insurance	19,400	10,500	9,200
Ulster Bank	4,400	4,400	4,500
Citizens	14,100	13,300	11,500
Centre	1,700	1,700	1,600
Group total	120,900	111,800	105,700
Acquisitions in the year	9,700	5,600	5,000
Underlying	111,200	106,200	100,700

* Prior periods have been restated to reflect the transfer in 2003 of certain activities from Corporate Banking and Financial Markets and Wealth Management to Manufacturing.

2003 compared with 2002

The number of employees increased by 9,100, 8% to 120,900. The acquisition of Churchill added 8,500 staff in RBS Insurance.

2002 compared with 2001

The number of employees increased by 6,100, 6% to 111,800 reflecting business growth and 5,600 from acquisitions, offset by staff reductions from integration.

Operating and financial review continued

Consolidated balance sheet
at 31 December 2003

	2003 £m	2002 £m
Assets		
Cash and balances at central banks	3,822	3,481

Items in the course of collection from other banks	2,501	2,741
Treasury bills and other eligible bills	4,846	11,459
Loans and advances to banks	51,891	44,296
Loans and advances to customers	252,531	223,324
Debt securities	79,949	67,042
Equity shares	2,300	1,886
Interests in associated undertakings	106	94
Intangible fixed assets	13,131	12,697
Tangible fixed assets	13,927	10,485
Settlement balances	2,857	4,102
Other assets	18,436	16,929
Prepayments and accrued income	5,421	4,353
	451,718	402,889
Long-term assurance assets attributable to policyholders	3,557	9,111
Total assets	455,275	412,000
Liabilities		
Deposits by banks	67,323	54,720
Items in the course of transmission to other banks	958	1,258
Customer accounts	236,963	219,161
Debt securities in issue	41,016	33,938
Settlement balances and short positions	21,369	19,412
Other liabilities	20,584	20,754
Accruals and deferred income	13,173	8,626
Provisions for liabilities and charges	2,522	2,164
Subordinated liabilities	16,998	13,965
Minority interests		
equity	(11)	(11)
non-equity	2,724	1,850
Shareholders funds		
equity	25,176	23,545
non-equity	2,923	3,507
	451,718	402,889
Long-term assurance liabilities attributable to policyholders	3,557	9,111
Total liabilities	455,275	412,000

Analysis of repurchase agreements included above

Reverse repurchase agreements and stock borrowing		
Loans and advances to banks	26,522	20,578
Loans and advances to customers	24,069	21,941
	50,591	42,519

Repurchase agreements and stock lending		
Deposits by banks	27,044	20,097
Customer accounts	27,021	25,060
	54,065	45,157

88

Overview of consolidated balance sheet

Total assets of £455.3 billion at 31 December 2003 were up £43.3 billion, 11%, compared with 31 December 2002, reflecting business growth.

Treasury bills and other eligible bills decreased by £6.6 billion, 58%, to £4.8 billion, reflecting liquidity management.

Loans and advances to banks rose £7.6 billion, 17%, to £51.9 billion. Growth in bank placings, up £1.7 billion, 7% to £25.4 billion, and reverse repurchase agreements and stock borrowing (reverse repos), up £5.9 billion, 29%, to £26.5 billion, were due in part to a switch from treasury bills and other eligible bills.

Loans and advances to customers were up £29.2 billion, 13%, to £252.5 billion. Within this, reverse repos increased by 10%, £2.1 billion to £24.1 billion. Excluding reverse repos, lending increased by £27.1 billion, 13% to £228.4 billion with growth in all divisions.

Debt securities increased by £12.9 billion, 19%, to £79.9 billion, principally due to increased holdings in Financial Markets together with growth in Wealth Management s investment portfolio of investment grade asset-backed securities, Citizens portfolio of US government and agency securities and the acquisition of Churchill.

Equity shares rose £0.4 billion, 22% to £2.3 billion largely to support an increase in Financial Markets equity derivatives business.

Intangible fixed assets increased by £0.4 billion, 3% to £13.1 billion. Goodwill arising on the acquisitions made during the year amounted to £1.5 billion, principally in respect of Churchill, £0.8 billion and Citizens acquisitions, £0.4 billion. This was partially offset by goodwill amortisation, £0.8 billion and the adverse effect of exchange rate movements, £0.3 billion.

Tangible fixed assets were up £3.4 billion, 33% to £13.9 billion, primarily due to growth in operating lease assets, up £1.1 billion, 20% to £6.4 billion, and the acquisition of various investment properties.

Other assets rose by £1.5 billion, 9% to £18.4 billion, mainly due to growth in the mark-to-market value of trading derivatives.

Long-term assurance assets and liabilities declined £5.6 billion, 61% to £3.6 billion, resulting from the transfer of the pension managed fund business of NatWest Life to another third party life company.

Deposits by banks increased by £12.6 billion, 23% to £67.3 billion to fund business growth, with repurchase agreements and stock lending (repos) up £6.9 billion, 35%, to £27.0 billion and inter-bank deposits up £5.7 billion, 16% to £40.3 billion.

Customer accounts were up £17.8 billion, 8% at £237.0 billion. Within this, repos were up £2.0 billion, 8% to £27.0 billion. Excluding repos, deposits rose by £15.8 billion, 8%, to £210.0 billion with growth mainly in CBFM, £6.4 billion, Retail Banking, £4.6 billion, Citizens, £3.2 billion and Ulster Bank £0.9 billion. In $ terms, Citizens grew US$11.7 billion, 23%, of which, US$3.2 billion related to acquisitions.

Debt securities in issue were up £7.1 billion, 21%, at £41.0 billion primarily to meet the Group s funding requirements.

Subordinated liabilities were up £3.0 billion, 22% to £17.0 billion. This reflected the issue of £1.6 billion (€2,250 million) euro denominated and £0.7 billion (US$1,100 million) US$ denominated dated loan capital, and £1.1 billion sterling denominated and £0.5 billion (US$850 million) US$ denominated, undated loan capital. This was partially offset by the £0.4 billion (US$500 million and £40 million) redemption of dated loan capital and the effect of exchange rate movements, £0.5 billion.

Minority interests increased by £0.9 billion, 48%, to £2.7 billion, mainly reflecting the issues by subsidiaries of the Group of US$850 million (£0.5 billion) Series I non-cumulative trust preferred securities in May 2003 and US$650 million (£0.4 billion) Series II non-cumulative trust preferred securities in December 2003.

Shareholders funds rose £1.0 billion, 4% to £28.1 billion principally due to retentions of £0.8 billion and the issue of £0.8 billion of equity shares in respect of scrip dividends and the exercise of share options, partly offset by the redemption of £0.4 billion non-equity preference shares in January 2003 and the adverse effect of exchange rate movements on share premium account, £0.2 billion.

89

Operating and financial review continued

Cash flow

	2003 £m	2002 £m	2001 £m
Net cash inflow from operating activities	19,708	13,737	7,287
Dividends received from associated undertakings	9	1	1
Returns on investments and servicing of finance	(956)	(1,103)	(1,048)
Taxation	(1,454)	(1,107)	(1,209)
Capital expenditure and financial investment	(6,965)	(9,185)	(10,337)
Acquisitions and disposals	(1,571)	(281)	(1,653)
Equity and AVS dividends paid	(2,235)	(1,527)	(1,052)
Financing	4,128	2,711	4,411
Increase/(decrease) in cash	10,664	3,246	(3,600)

2003

The major factors contributing to the net cash inflow of £19,708 million from operating activities in 2003 were the profit before tax of £6,159 million, increases in deposits and debt securities in issue of £33,935 million, increases in short positions and settlement balances of £3,202 million and decreases in treasury and other eligible bills of £6,626 million, partially offset by the net increase in loans and advances of £23,343 million and increases in securities of £9,871 million.

Interest on subordinated liabilities of £557 million and dividends of £399 million to preference and minority shareholders were paid during the year.

Net purchases of investment securities of £3,056 million and fixed assets of £3,909 million, including operating lease assets and investment properties, comprised the net cash outflow from capital expenditure and financial investment.

Equity and Additional Value Shares (AVS) dividends paid includes the final dividend on the AVS of £1,463 million.

The issue of £883 million trust preferred securities and £3,817 million subordinated debt, partially offset by the redemption of preference shares of £364 million and repayment of £336 million of subordinated debt were the main contributors to the net cash inflow from financing of £4,128 million.

2002

The major factors contributing to the net cash inflow of £13,737 million from operating activities in 2002 were the profit before tax of £4,763 million and an increase in deposits, debt securities in issue and other liabilities of £40,981 million, which were partially offset by the increase in loans and advances of £35,426 million.

Interest on subordinated liabilities of £674 million and dividends of £429 million to preference and minority shareholders were paid during the year.

Net purchases of investment securities of £6,629 million and fixed assets of £2,556 million, including operating lease assets, comprised the net cash outflow from capital expenditure and financial investment.

Equity and AVS dividends paid includes the second dividend on the AVS of £798 million.

The issue of £1,242 million trust preferred securities and £2,157 million subordinated debt, partially offset by the redemption of preference shares of £600 million and repayment of £202 million of subordinated debt were the main contributors to the net cash inflow from financing of £2,711 million.

2001

Profit before tax of £4,252 million and an increase of £27,450 million in deposits and debt securities in issue together with an increase in short positions and settlement balances of £3,644 million, partially offset by increases in loans and advances of £22,823 million and in treasury and other eligible bills of £6,796 million, were the major factors in the net cash inflow from operating activities of £7,287 million.

Interest on subordinated liabilities of £652 million and dividends of £396 million to preference and minority shareholders were paid during the year.

Net cash outflow from capital expenditure and financial investment consisted of net purchases of investment securities of £6,959 million and fixed assets, including operating lease assets, of £3,378 million.

Equity and AVS dividends paid includes the first dividend on the AVS of £399 million.

The issue of £2,705 million of subordinated debt and £2,131 million proceeds from the issue of shares, including a market placing of £2,007 million, in July 2001, to fund the acquisition of the Mellon Regional Franchise, were the main contributors to the net cash inflow from financing of £4,411 million.

UK GAAP compared with US GAAP

The Group s financial statements are prepared in accordance with UK GAAP, which differs in certain material respects from US GAAP as described on pages 186 to 198.

The net income available for ordinary shareholders under US GAAP was £2,564 million, £249 million higher than profit attributable to ordinary shareholders under UK GAAP of £2,315 million. The principal reasons for the increase are:

- Goodwill amortisation is charged to the profit and loss under UK GAAP, whereas under US GAAP only intangible assets other than goodwill are amortised, resulting in an increase in net income before tax of £721 million.

- Certain software development costs have been charged to the profit and loss account under UK GAAP; under US GAAP such costs are capitalised and depreciated over the estimated useful life of the software, resulting in a net decrease in net income before tax of £300 million.

Capital resources

The following table analyses the Group s regulatory capital resources at the period end:

	31 December 2003	31 December 2002	31 December 2001	31 December 2000	31 December 1999

	£m	£m	£m	£m	£m
Capital base					
Tier 1 capital	19,399	17,155	15,052	12,071	4,605
Tier 2 capital	16,439	13,271	11,734	10,082	3,256
Tier 3 capital			172	167	
	35,838	30,426	26,958	22,320	7,861
Less: investments in insurance subsidiaries, associated undertakings and other supervisory deductions	(4,618)	(3,146)	(2,698)	(2,228)	(1,011)
Total capital	31,220	27,280	24,260	20,092	6,850
Weighted risk assets					
Banking book:					
On-balance sheet	214,400	193,800	176,000	146,600	51,200
Off-balance sheet	36,400	28,700	22,000	16,200	4,200
Trading book	12,900	11,500	12,500	12,400	1,400
	263,700	234,000	210,500	175,200	56,800
Risk asset ratios	%	%	%	%	%
Tier 1	7.4	7.3	7.1	6.9	8.1
Total	11.8	11.7	11.5	11.5	12.1

It is the Group s policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the Financial Services Authority (FSA). The FSA uses Risk Asset Ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank s capital resources with its weighted risk assets (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a tier 1 component of not less than 4%. At 31 December 2003, the Group s total RAR was 11.8% (2002 11.7%) and the tier 1 RAR was 7.4% (2002 7.3%).

Operating and financial review continued

Risk management

Framework

A number of high-level committees support the Board in the effective measurement and management of risk. Board subcommittees have the following roles and responsibilities for managing risk, capital and liquidity:

- *Group Audit Committee* is a non-executive committee that supports the Board in carrying out its responsibilities for internal control and risk assessment. The Group Audit Committee monitors the ongoing process of the identification, evaluation and management of all significant risks throughout the Group. The Committee provides an independent review of risk management and controls. The Committee is supported by Group Internal Audit which provides an independent assessment of the adequacy and effectiveness of the Group s internal controls.

- *Advances Committee* is an executive committee that deals with all transactions that exceed the Group Credit Committee s delegated authority, which in turn approves facility limits in excess of the authorities delegated to divisional credit committees.

In addition to the responsibilities at Board level outlined above, operational authority and oversight is delegated to the Group Executive Management Committee (GEMC), which is responsible for implementing a risk management framework consistent with the Board's risk appetite. The GEMC, in turn, is supported by:

- *Group Risk Committee* (GRC), which recommends and approves limits, processes and policies in respect of the effective management of all material risks across the Group.

- *Group Asset and Liability Management Committee* (GALCO) which is responsible for reviewing the balance sheet, funding and capital implications of the Group's strategy and operations. In addition, GALCO monitors and reviews legal, regulatory and accounting developments affecting balance sheet risks and capital. It also reviews the effect of external, economic and environmental changes on the Group's balance sheet, risks, margins and capital.

- *Group Risk Management* (GRM) reports to the GEMC through the Group Finance Director and is responsible for credit, market and enterprise risk measurement and controls across the Group. An assessment of the adequacy and effectiveness of each divisional risk management team is undertaken by GRM on a continuous basis to ensure effective control of risks. Each divisional risk function has a direct reporting line to the Director of Group Risk Management, which reinforces these controls and ensures independence of risk management within each division.

- *Group Treasury* (GT) also reports to the GEMC through the Group Finance Director, and is responsible for the management of the Group s balance sheet, capital raising, liquidity and hedging policies. GT assesses and monitors the effectiveness of the divisional asset and liability management teams.

GRM and GT also respond to various regulatory developments affecting risk, capital and liquidity management. This includes working with international and domestic trade associations, being active with various regulators, especially the FSA, and encouraging discussions with the main regulatory and political groups, such as the Basel Committee and the EU Commission.

The principal risks that the Group manages are as follows:

- Credit risk
- Liquidity risk
- Market risk
- Insurance risk
- Enterprise risk

92

Credit risk

Credit risk is the risk arising from the possibility that the Group will incur losses from the failure of customers to meet their obligations.

The credit risk framework

The management of credit risk is undertaken within an agreed and regulated Credit Risk Framework which is defined in the Group s Principles for Managing Credit Risk . These set out minimum standards for managing credit risk including principles for maintaining the credit risk framework, approving credit risk taken by the Group, credit stewardship and reviewing the effectiveness of the credit culture. These standards are used to manage the Group s portfolio of risk assets.

All credit risk exposures require approval by authorised individuals or credit committees, independent of business revenue generation. Existing credit risk exposures are monitored and reviewed periodically against approved risk limits. Review occurs at least annually with the lower quality exposures being subject to greater frequency of analysis and assessment. Exposures below specified thresholds and meeting specific criteria can be approved through authorised largely automated processes.

Different credit approval processes exist for each customer type in order to ensure appropriate skills and resources are employed in credit assessment and approval. Risk exposures are aggregated to determine the appropriate level of credit approval required and to facilitate consolidated credit risk management:

- *Retail and personal* businesses employ market best practice credit scoring techniques to process small scale, large volume credit decisions. Insights from such systems are combined with management judgement to ensure an effective ongoing process of approval, review and enhancement. Credit decisions for loans above specified thresholds, including lending to SMEs, are individually assessed.

- *Corporate businesses* are assessed using the judgement of the relationship managers, supported by an independent internal dedicated analysis team. A range of risk rating models have been developed to facilitate risk assessments for both borrower and transaction risk. Specialist internal credit risk departments independently oversee the credit process and make decisions or recommendations to the appropriate credit committee. Credit authority is not extended to relationship managers.

- *Financial Markets* counterparties are approved by a dedicated credit function, with expertise in traded market product risk and which also specialises in the analysis and assessment of financial market counterparties.

GRM and the GEMC review the reports on the Group s portfolio of credit risks on a monthly basis.

93

Operating and financial review continued

Credit risk (continued)

Risk asset quality

Internal reporting and oversight of risk assets is principally differentiated by credit ratings. Internal ratings are used to assess the credit quality of borrowers. Customers are assigned credit ratings, based on statistical and judgemental rating systems that map to a Group asset quality scale reflecting the probability of default.

Asset quality	S&P equivalent
AQ1	AAA to BBB-
AQ2	BB+ to BB
AQ3	BB- to B+

AQ4	B+ to B
AQ5	B and below

As at December 2003, exposure to investment grade counterparties (AQ1) accounted for over half of risk assets. Over 97% of exposures were to counterparties rated AQ4 or higher.

Loans and advances

The Group s loan portfolio consists of loans (including overdraft facilities), instalment credit and finance lease receivables. The value of loans and advances to customers as at 31 December 2003 was £256,453 million (2002 £227,244 million), representing an increase of £29,209 million (13%) over the year. Including banks, total loans and advances at 31 December 2003 was £308,351 million (2002 £271,547 million), an increase of 14%.

Loans and advances gross	2003 £m	2002 £m	2001 £m
Loans and advances to customers by division gross			
CBFM	128,124	117,365	95,096
Retail	61,809	55,619	49,026
Retail Direct	22,024	19,350	17,081
Wealth Management	7,894	7,267	6,815
Ulster Bank	11,633	9,111	7,608
Citizens	24,384	19,457	18,138
Other	585	(925)	373
Loans and advances to customers gross	256,453	227,244	194,137
Loans and advances to banks gross	51,898	44,303	38,521
Total loans and advances gross	308,351	271,547	232,658

94

Industry analysis

Industry analysis plays an important part in assessing concentrations within the loan portfolio. Particular attention is given to industry sectors where the Group believes there is a higher degree of risk or potential for volatility in the future.

Loans and advances to customers by industry	2003 £m	2002 £m	2001 £m
Central and local government	2,100	2,385	1,419
Finance	38,936	34,079	21,462
Individuals home mortgages	61,960	49,986	41,641
other	35,027	30,021	22,403
Other commercial and industrial comprising:			
Manufacturing	12,769	14,715	15,427

Construction	5,839	5,152	5,199
Service industries and business activities	50,772	48,155	49,118
Agriculture, forestry and fishing	3,081	3,026	2,940
Property	31,629	26,593	22,380
Finance leases and instalment credit	14,340	13,132	12,148
Total loans and advances to customers gross	256,453	227,244	194,137

Together, corporates, financial institutions and sovereigns, account for 62% of loans and advances. The remaining exposures, accounting for 38% of loans and advances, relate to personal and retail customers, especially mortgage lending and other small loans that are intrinsically highly diversified.

Geographic analysis

Although the Group is active in over twenty different countries, its principal focus is on the UK, US and Europe.

Geographically, 92% of loans and advances to customers fall within the UK or US, both of which have experienced stable or improving economic growth. Europe accounts for about 8% of exposures.

Loans and advances to customers by geography	2003 £m	2002 £m	2001 £m
UK	194,545	168,931	151,814
US	40,373	41,008	29,230
Europe	19,842	15,572	11,627
Rest of the World	1,693	1,733	1,466
Total loans and advances to customers gross	256,453	227,244	194,137

Notes:

(1) The geographic analysis is based on location of office. The UK includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

Operating and financial review continued

Credit risk (continued)

Cross border exposures

Cross border exposures are defined as loans to banks and customers (including finance lease and instalment credit receivables) and other monetary assets, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk.

The table below sets out the Group s cross border outstandings in excess of 0.75% of Group total assets (including acceptances), which totalled £455.9 billion (2002 £414.4 billion; 2001 £371.7 billion). None of these countries has experienced repayment difficulties that have required refinancing of outstanding debt.

	2003 £m	2002 £m	2001 £m
Geographical analysis:			
Germany	15,073	10,464	7,969
United States	14,618	11,658	8,901
France	7,524	5,971	4,930
Netherlands	6,830	6,318	4,596
Cayman Islands	6,666	6,897	5,501
Japan	4,141	3,156	*
Spain	3,421	*	*
Italy	*	3,867	*
Switzerland	*	*	3,646

* Less than 0.75% of Group total assets (including acceptances).

Selected country exposures

The Group devotes particular attention to those countries that have been adversely affected by global economic pressure. The table below details exposures to countries that are considered as having a higher credit and foreign exchange risk.

	2003 £m	2002 £m	2001 £m
Argentina			
Bank	26	30	39
Non-bank	4	15	12
Brazil			
Bank	15		158
Non-bank	2	14	22
Turkey			
Bank	5	25	38
Non-bank	65	65	102
Venezuela			
Bank			
Non-bank	87	115	99

96

Risk elements in lending and potential problem loans

The table below sets out the Group s loans that are classified as non-accrual, accruing past due and restructured loans (together risk elements in lending (REIL)) or potential problem loans (PPL) as defined by the SEC in the US. The figures incorporate estimates and are stated before the value of security held or related provisions.

REIL and PPL	2003 £m	2002 £m	2001 £m
Non-accrual loans (2)	4,432	4,175	3,566
Accrual loans past due 90 days (3)	642	492	785

Troubled debt restructurings	83	204	142
Total REIL	5,157	4,871	4,493
PPL (4)	591	1,183	1,080
Total REIL and PPL	5,748	6,054	5,573

Notes:

(1) The classification of a loan as non-accrual, past due 90 days or troubled debt restructuring does not necessarily indicate that the principal of the loan is uncollectable in whole or in part. Collection depends in each case on the individual circumstances of the loan, including the adequacy of any collateral securing the loan and therefore classification of a loan as non-accrual, past due 90 days or troubled debt restructuring does not always require that a provision be made against such a loan. In accordance with the Group s provisioning policy for bad and doubtful debts, it is considered that adequate provisions for the above risk elements in lending have been made.

(2) The Group s UK banking subsidiary undertakings account for loans on a non-accrual basis from the point in time at which the collectability of interest is in significant doubt. Certain subsidiary undertakings of the Group, principally Citizens, generally account for loans on a non-accrual basis when interest or principal is past due 90 days.

(3) Overdrafts generally have no fixed repayment schedule and consequently are not included in this category.

(4) Loans which are current as to the payment of principal and interest but in respect of which management have serious doubts about the ability of the borrowers to comply with contractual repayment terms. Substantial security is held in respect of these loans and appropriate provisions have already been made in accordance with the Group s provisioning policy for bad and doubtful debts.

REIL increased to £5,157 million (a rise of 6% compared with 2002). REIL as a proportion of total loans and advances to customers was 2.01% in 2003 (2002 2.14%; 2001 2.31%), reflecting active risk management and improvements in the economic environment in the Group s key markets.

These factors also contributed to a reduction of 5% in the aggregate amount of PPL and REIL which together account for 2.24% of loans and advances to customers (2002 2.66%; 2001 2.87%).

97

Operating and financial review continued

Credit risk (continued)

Provisions

The Group provides for losses in its loan portfolio so as to record impaired loans and advances at their expected ultimate net realisable value. The objective is to set provisions based on the current understanding of the portfolio. To reach this understanding, retail and corporate loans and advances are treated separately.

The Group s retail portfolios which consist of small value, high volume credits have highly efficient largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery measures.

Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customers requirements. These portfolios do not have an automated provisioning process, relying on individual expert judgement, controls and oversight to identify problems.

Early and proactive management of problem exposures ensures that credit losses are minimised. Specialised units are used for different customer types to ensure that the appropriate risk mitigation is taken in a timely manner.

Specific and general provisions

Provisions fall into one of two categories, specific or general:

- Specific provisions: arise when the creditworthiness of a borrower has undergone a significant deterioration and the recovery of the advance is in significant doubt. The amount of specific provision will reflect the financial condition of the borrower, the realisable value of security and the costs of recovery.

- General provisions: cover losses that have not yet been specifically identified but are known from experience to be present in any portfolio of loans. The level of general provision reflects the size and diversity of the Group s loan portfolio, past experience, the current state of the economies in which the Group operates and the scope of specific provisioning procedures.

Summary of provisions	2003 £m	2002 £m	2001 £m
Specific provision1	3,356	3,323	3,031
General provision	566	597	614
Total bad and doubtful debt provisions	3,922	3,920	3,645
Total loans and advances to customers	256,453	227,244	194,137
Specific provision as a percentage of loans and advances to customers	1.31%	1.46%	1.56%
General provision as a percentage of loans and advances to customers	0.22%	0.26%	0.32%
Total provisions as a percentage of loans and advances to customers	1.53%	1.72%	1.88%
Closing provisions for bad and doubtful debts expressed as a:			
% of REIL	76%	81%	81%
% of REIL and PPL	68%	65%	66%

(1) Excludes specific provisions against loans and advances to banks of £7 million (2002 £7 million; 2001 £8 million)

Provisions for bad and doubtful debts at the end of 2003 were broadly unchanged from the previous year end. The increase in provisions of £1,461 million through the charge to the profit and loss account was substantially offset by the amounts written-off, net of recoveries, of £1,447 million. This, coupled with the growth in the portfolio, led to a reduction in the ratio of provisions to loans and advances to customers from 1.72% at the end of 2002 to 1.53%.

The coverage ratio of closing provisions as a percentage of REIL has reduced to 76% from 81% at the end of 2002. This is due to a slight shift in the composition of REIL away from larger corporate customers, against which the Group typically holds less security and thus requires higher provisions proportionately, and into smaller mid-corporate customers against which the Group tends to hold higher levels of security.

The coverage ratio of total closing provisions as a percentage of PPL and REIL has increased to 68% from 65% and 66% at the end of 2002 and 2001 respectively.

Analysis of specific provisions

The table below shows specific provisions by industry and geographic area.

		2003 £m	2002 £m	2001 £m
Industry:				
Finance		65	125	109
Individuals	home mortgages	37	67	69
	other	1,159	955	924
Other commercial and industrial		2,095	2,176	1,929
		3,356	3,323	3,031
Geography:				
UK		2,507	2,615	2,376
US		609	556	494
Europe		224	110	82
Rest of the World		16	42	79
		3,356	3,323	3,031

Notes:

(1) Excludes specific provisions against loans and advances to banks of £7 million (2002 £7 million; 2001 £8 million).

(2) The geographic analysis is based on location of office. The UK includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

Amounts written off and recovered

The table below shows the amounts written off by industry and geographical area.

		2003 £m	2002 £m	2001 £m
Industry:				
Finance		66	44	10
Individuals	home mortgages	2	2	3
	other	415	391	333
Other commercial and industrial		1,036	598	483
		1,519	1,035	829
Geography:				
UK		1,333	803	669
US		156	164	85
Europe		15	40	20
Rest of the World		15	28	55
Total amounts written off		1,519	1,035	829

Notes:

(1) Excludes amounts written off in respect of banks of nil (2002 £1 million; 2001 £6 million).

(2) The geographic analysis is based on location of office. The UK includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

The following table shows amounts previously written off and subsequently recovered during the year by industry and geographical area.

	2003 £m	2002 £m	2001 £m
Industry:			
Finance	1		1
Individuals other	42	41	52
Other commercial and industrial	29	22	27
	72	63	80
Geography:			
UK	38	37	55
US	25	21	17
Europe	4	4	7
Rest of the World	5	1	1
Total recoveries	72	63	80

Notes:

(1) The geographic analysis is based on location of office. The UK includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

Operating and financial review continued

Liquidity risk

Liquidity management

Liquidity management within the Group focuses on both overall balance sheet structure and the control, within prudent limits, of risk arising from the mismatch of maturities across the balance sheet and from commitments and contingent obligations.

The management of liquidity risk within the Group is undertaken within limits and other policy parameters set by GALCO, who review monthly and receive on an exception basis reports detailing compliance with those policy parameters. A weekly report is also provided to the Group s executive management. Compliance is monitored and co-ordinated daily under the stewardship of the Group Treasury function, both in respect of internal policy and the regulatory requirements of the Financial Services Authority. Detailed liquidity position reports are compiled each day by Group Treasury and reviewed daily and weekly with Financial Markets, who manage day-to-day and intra-day market execution within the policy parameters set.

In addition to their consolidation within the Group s daily liquidity management processes, it is also the responsibility of all Group subsidiaries and branches outside the UK to ensure compliance with any separate local regulatory liquidity requirements where applicable.

The structure of the Group s balance sheet is managed to maintain substantial diversification, to minimise concentration across its various deposit sources, and to contain the level of reliance on total and net short-term wholesale sources of funds within prudent levels.

The short-term maturity structure of the Group s assets and liabilities is also managed on a daily basis to ensure that contractual cash flow obligations, and potential cash flows arising from undrawn commitments and other contingent obligations, can be met as they arise day to day, either from cash inflows from maturing assets, new borrowing or from the sale or repurchase of debt securities held.

Short-term liquidity risk is managed on a consolidated basis for the whole Group excluding the activities of Citizens and insurance businesses in the UK, which are subject to regulatory regimes that necessitate the separate management of liquidity.

Internal liquidity mismatch limits are set for all other subsidiaries and non-UK branches which have material local treasury activities in external markets, to ensure those activities do not compromise daily maintenance of the Group s overall liquidity risk position within the Group s policy parameters.

The level of large deposits taken from banks, corporate customers, non-bank financial institutions and other customers and significant cash outflows are also reviewed to monitor concentrations and identify any adverse trends.

The degree of maturity mismatch within the overall long-term structure of the Group s assets and liabilities is also managed within internal policy limits, to ensure that term asset commitments may be funded on an economic basis over their life. In managing its overall term structure, the Group analyses and takes into account the effect of retail and corporate customer behaviour on actual asset and liability maturities where they differ materially from the underlying contractual maturities.

The Group also periodically evaluates various scenarios and undertakes stress tests to analyse the potential impact on its liquidity risk. Contingency plans are maintained to anticipate and respond to any approaching or actual material deterioration in market conditions.

Sources of funding

Excluding capital and other liabilities, customer accounts continue to provide a substantial majority of the Group s funding and represent a well diversified and stable source of funds from a wide range of retail, corporate and non-bank institutional customers.

	2003		2002		2001	
	£m	%	£m	%	£m	%
Customer accounts (excluding repos):						
Repayable on demand	141,560	39	127,320	39	115,054	41
Time deposits	68,382	19	66,781	21	66,486	23
Total customer accounts (excluding repos)	209,942	58	194,101	60	181,540	64
Repo agreements with customers	27,021	7	25,060	8	17,455	6
Deposits by banks (including repos)	67,323	19	54,720	17	40,038	14
Debt securities in issue	41,016	11	33,938	10	30,669	11
Short positions	19,128	5	16,381	5	14,622	5
Total	364,430	100	324,200	100	284,324	100

Customer accounts, excluding repo agreements, grew by £15,841 million (8%), and represent 58% of the Group s funding excluding capital and other liabilities. In reflection of the higher rate of growth in customer loans and advances excluding reverse repos, up £27,081 million (13%), the proportion of funding from wholesale sources has increased.

Repo agreements with corporate and institutional customers are undertaken primarily by RBS Greenwich Capital in the US and by Financial Markets. Repo activity with customers represented 7% of the Group s funding excluding capital and other liabilities at 31 December 2003.

Deposits by banks increased by £12,603 million to represent 19% of the Group s funding, excluding capital and other liabilities. Deposits by banks are taken from a wide range of counterparties, with the largest single depositor continuing to represent less than 1% of the Group s total funding.

Debt securities in issue increased by £7,078 million to represent 11% of the Group s funding, excluding capital and other liabilities, at 31 December 2003. Total debt securities in issue at 31 December 2003 includes £9,187 million (2002 £6,035 million) with a maturity of over one year, reflecting the activity of the Group in raising term funds through its Euro Medium Term Note programme and other term issues.

The Group remains well placed to access various wholesale funding sources from a wide range of counterparties and markets, and the changing mix evident between customer repos, deposits by banks and debt securities in issue primarily reflects comparative pricing and investor/counterparty demand rather than a material perceived trend.

Net customer activity

Net customer lending rose by £11,240 million as the growth in loans and advances to customers exceeded the growth in customer accounts, thus increasing wholesale market funding to support loan growth. Structural liquidity risk continues to be maintained well within the Group s policy parameters.

	2003 £m	2002 £m	2001 £m
Loans and advances to customers (gross, excluding reverse repos)	232,384	205,303	182,549
Customer accounts (excluding repos)	209,942	194,101	181,540
Customer lending less customer accounts	22,442	11,202	1,009
Customer accounts as % of loans and advances to customers (gross, excluding repos)	90.3%	94.5%	99.4%

In prevailing economic conditions and with interest rates at historically low levels in the UK, US and Europe, the growth in demand for borrowing by customers may in the medium term continue to exceed customer deposits received, thus increasing net customer lending further. The Group has evaluated a range of balance sheet management strategies and has developed plans to increase gradually over time short term and longer term funding from various wholesale market sources, whilst maintaining its overall funding structure within its normal prudent liquidity risk policy parameters.

Operating and financial review continued

Liquidity risk (continued)

Net wholesale market activity

Overall structural liquidity risk remains well within the Group s policy parameters. The Group s net surplus of wholesale assets reduced by £8,372 million to £6,274 million.

	2003 £m	2002 £m	2001 £m
Deposits by banks (excluding repos):			
repayable on demand	10,232	12,703	6,155
less than 3 months maturity	26,689	18,547	17,557
over 3 months maturity	3,358	3,373	5,880

Total deposits by banks (excluding repos)	40,279	34,623	29,592
Repo agreements with banks and customers	54,065	45,157	27,901
Debt securities in issue	41,016	33,938	30,669
Short positions	19,128	16,381	14,622
Total wholesale liabilities	154,488	130,099	102,784
Loans and advances to banks (gross, excluding reverse repos):			
repayable on demand	6,029	6,433	3,895
less than 3 months maturity	11,287	10,485	12,500
over 3 months maturity	8,060	6,807	4,405
Total loans and advances to banks (gross, excluding reverse repos)	25,376	23,725	20,800
Reverse repo agreements with banks and customers	50,591	42,519	29,309
Debt securities, treasury bills and other eligible bills	84,795	78,501	74,176
Total wholesale assets	160,762	144,745	124,285
Net surplus of wholesale assets	6,274	14,646	21,501

Excluding repo and reverse repos, the comparison of the maturity and level of deposits by banks with that of loans and advances to banks shows an increased reliance on inter-bank funding but of slightly longer maturity.

102

Sterling liquidity

Over 51% of the Group s total assets are denominated in Sterling. The FSA requires the Group, on a consolidated basis, to maintain daily a minimum ratio of 100% between:

1. a stock of qualifying high quality liquid assets (primarily UK government securities, treasury bills, eligible bank bills, and cash held in branches) and

2. the sum of:

   - Sterling wholesale net outflows contractually due within 5 working days (offset up to a limit of 50%, by 85% of sterling certificates of deposit held which mature beyond five working days); and
   - 5% of retail deposits with a residual contractual maturity of five working days or less.

The Group has exceeded the minimum ratio requirement throughout 2003.

The FSA also sets an absolute minimum level for the stock of qualifying liquid assets that the Group is required to maintain each day. The Group has exceeded that minimum stock requirement at all times during 2003.

The Group s operational processes are actively managed to ensure that both the minimum Sterling liquidity ratio and the minimum stock requirement are achieved or exceeded at all times.

Liquidity in non-sterling currencies

For non-Sterling currencies, no specific regulatory liquidity requirement is set for the Group by the FSA. However, the importance of managing prudently the liquidity risk in its non-Sterling activities is recognised and the Group manages its non-Sterling liquidity risk daily within net mismatch limits set for the 0-8 calendar day and 0-1 month periods as a percentage of the Group s total deposit liabilities.

In measuring its non-sterling liquidity risk, due account is taken of the marketability within a short period of the wide range of debt securities held. Appropriate adjustments are applied in each case, dependent on various parameters, to determine the Group s ability to realise cash at short notice via the sale or repo of such marketable assets if required to meet unexpected outflows.

The level of contingent risk from the potential drawing of undrawn or partially drawn commitments, back-up lines, standby lines and other similar facilities is also actively monitored and reflected in the measures of the Group s non-Sterling liquidity risk. Particular attention is given to the US$ commercial paper market and the propensity of the Group s corporate counterparties (who are active in raising funds from that market) to switch to take up facilities offered by the Group in the event of either counterparty specific difficulties or a significant widening of interest spreads generally in the commercial paper market.

The Group also provides liquidity back-up facilities to both its own conduits and certain other conduits which take funding from the US$ commercial paper market. Limits sanctioned for such facilities totalled less than £4,000 million at 31 December 2003. The short-term contingent liquidity risk in providing such back-up facilities is also mitigated by the spread of maturity dates, typically over a three-month period of the commercial paper taken by the conduits.

The Group has operated within its non-Sterling liquidity policy mismatch limits at all times during 2003 and operational processes are actively managed to ensure that is the case going forward.

Contingency plans are also maintained to enable the Group to respond effectively to unforeseen market liquidity or major payment systems problems that may emerge from time to time.

Operating and financial review continued

Market risk

The Group is exposed to market risk because of positions held in its trading portfolios and its non-trading business including the Group s treasury operations.

The Group manages the market risk in its trading and treasury portfolios through its Market Risk Management framework, which is based on value-at-risk (VaR) limits, together with, but not limited to, stress testing, scenario analysis, and position and sensitivity limits. Stress testing measures the impact of abnormal changes in market rates and prices on the fair value of the Group s trading portfolios. GEMC approves the high-level VaR and stress limits for the Group. The Group Market Risk function, independent from the Group s trading businesses, is responsible for setting and monitoring the adequacy and effectiveness of the Group s market risk management processes.

Value-at-risk

VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group s VaR assumes a time horizon of one day and a confidence level of 95%. The Group uses historical simulation models in computing VaR. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used. The Group s method, however, does not make any assumption about the nature or type of underlying loss distribution.

The Group typically uses the previous two years of market data. The Group s VaR should be interpreted in light of the limitations of the methodology used. These limitations include:

- Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.

- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.

- VaR using a 95% confidence level does not reflect the extent of potential losses beyond that percentile.

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

These limitations and the nature of the VaR measure mean that the Group cannot guarantee that losses will not exceed the VaR amounts indicated. For a discussion of the Group s accounting policies for, and information with respect to, its exposures to derivative financial instruments, see Accounting policies and Note 39 on the accounts.

104

Trading

The principal focus of the Group s trading activities is client facilitation - providing products to the Group s client base at competitive prices. The Group also undertakes: market making quoting firm bid (buy) and offer (sell) prices with the intention of profiting from the spread between the quotes; arbitrage entering into offsetting positions in different but closely related markets in order to profit from market imperfections; and proprietary activity taking positions in financial instruments as principal in order to take advantage of anticipated market conditions. The main risk factors are interest rates, credit spreads and foreign exchange.

Financial instruments held in the Group s trading portfolios include, but are not limited to, debt securities, loans, deposits, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options).

The VaR for the Group s trading portfolios segregated by type of market risk exposure is presented in the tables below.

Trading VaR	Period end £m	Maximum £m	Minimum £m	Average[1] £m
2003				
Interest rate [2]	7.4	14.5	5.7	9.4
Currency	0.8	2.5	0.7	1.3
Equity	0.4	1.4	0.2	0.5
Diversification effects	(1.2)			
Total	7.4	14.2	5.6	9.4
2002				
Interest rate [2]	8.4	11.6	6.0	9.0
Currency	1.2	2.5	0.4	1.2
Equity	0.6	1.0	0.2	0.5
Diversification effects	(1.8)			
Total	8.4	11.8	5.6	9.1

Notes:

(1) Calculated as the arithmetic average of daily VaR figures.
(2) Includes credit spreads.

Operating and financial review continued

Market risk (continued)

Non-trading

The principal market risks arising from the Group's non-trading activities are interest rate risk, currency risk and equity risk. Treasury activity and mismatches between the repricing of assets and liabilities in its retail and corporate banking operations account for most of the non-trading interest rate risk. Non-trading currency risk derives from the Group's investments in overseas subsidiaries, associates and branches. The Group's venture capital portfolio, investments held by its general insurance business and its strategic equity investments are the principal sources of non-trading equity price risk. The Group's portfolios of non-trading financial instruments mainly comprise loans (including finance leases), debt securities, equity shares, deposits, certificates of deposits and other debt securities issued, loan capital and derivatives. To reflect their distinct nature, the Group's long-term assurance assets and liabilities attributable to policyholders have been excluded from these market risk disclosures.

Interest rate risk

Treasury

The Group s treasury activities include its money market business and the management of internal funds flow within the Group s businesses. Money market portfolios include cash instruments (principally debt securities, loans and deposits) and related hedging derivatives. VaR for the Group s treasury portfolios, which relates mainly to interest rate risk was £8.1 million at 31 December 2003 (2002 £6.5 million). During the year the maximum VaR was £11.0 million (2002 £6.7 million), the minimum £5.6 million (2002 £3.5 million) and the average £8.3 million (2002 £4.4 million).

Retail and corporate banking

Structural interest rate risk arises in these activities where assets and liabilities have different repricing dates. It is the Group s policy to minimise the sensitivity of net interest income to changes in interest rates and where interest rate risk is retained to ensure that appropriate resources, measures and limits are applied.

Structural interest rate risk is calculated in each division on the basis of establishing the repricing behaviour of each asset and liability product. For many products, the actual interest rate repricing characteristics differ from the contractual repricing. In most cases, the repricing maturity is determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are approved by Group Treasury and divisional asset and liability committees at least annually. Key conventions are reviewed annually by GALCO.

A static maturity gap report is produced as at the month-end for each division, in each functional currency based on the behaviouralised repricing for each product. It is Group policy to include in the gap report, non-financial assets and liabilities, mainly tangible fixed assets and the Group s capital and reserves, spread over medium and longer term maturities. This report also includes hedge transactions, principally derivatives.

Any residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the individual balance sheets. Potential exposures to interest rate movements in the medium to long term are measured and controlled using a version of the same VaR methodology that is used for the Group s trading portfolios but without discount factors. Net interest income exposures are measured and controlled in terms of sensitivity over time to movements in interest rates.

Non-trading interest rate VaR

Non-trading interest rate VaR for the Group s treasury and retail and corporate banking activities was £78.1 million at 31 December 2003 (2002 £34.7 million) with the major exposure being to changes in longer term US dollar interest rates. During the year, the maximum VaR was £78.1 million (2002 £34.7 million), the minimum £29.9 million (2002 £9.7 million) and the average £51.7 million (2002 £14.5 million).

Citizens was the main contributor to the Group s non-trading interest rate VaR in 2002 and 2003. It invests its surplus retail deposits in a portfolio of highly rated and liquid investments principally mortgage-backed securities. This balance sheet management approach is common for US retail banks where mortgages are originated and then sold to Federal agencies for funding through the capital markets. The significant increase in VaR during 2003 reflects substantial growth in retail deposits in Citizens and asset growth in home equity loans and mortgage backed securities.

VaR, like all interest rate risk measures, has its limitations when applied to retail banking books and the management of Citizens interest rate exposures involves a number of other interest rate risk measures and related limits. Two measures that are reported both to Citizens ALCO and Board are:

- the sensitivity of their net interest income to a series of parallel movements in interest rates; and
- economic value of equity (EVE) limits.

These limits are set to parallel movements of +/-1% and +/-2%.

The EVE methodology captures deposit re-pricing strategies and the embedded option risks that exists within both the investment portfolio of mortgage-backed securities and the consumer loan portfolio. EVE is the present value of the cash flows generated by the current balance sheet. EVE sensitivity to a 2% parallel movement upwards and downwards in US interest rates is shown below.

	Percent increase/(decrease) in EVE	
2003	2% parallel upward movement in US interest rates %	2% parallel downward movement in US interest rates (no negative rates allowed) %
Period end	(9.4)	(8.8)
Maximum	(11.4)	(14.2)
Minimum	3.2	(0.6)
Average	(4.4)	(6.4)

	Percent increase/(decrease) in EVE	
2002	2% parallel upward movement in US interest rates %	2% parallel downward movement in US interest rates (no negative rates allowed) %
Period end	(5.7)	(7.4)
Maximum	(8.7)	(9.5)
Minimum	8.7	(0.3)
Average	(4.6)	(6.3)

At Group level, the other major structural interest rate risk arises from a low interest rate environment, particularly in sterling, sustained for a number of years. In such a scenario deposit pricing may reach effective floors below which it is not reasonable to reduce rates further whilst variable rate asset pricing continues to decline. A sustained low rate scenario would also generate progressively reduced income from the medium and long term hedging of non-interest bearing liabilities. GALCO regularly reviews the impact of successive declines in rates to ensure that appropriate risk management strategies are employed. This may involve execution of derivatives, product development and tactical pricing changes.

Note 40 includes, on pages 175 to 176, tables that summarise the Group s interest rate sensitivity gap for its non-trading book at 31 December 2003 and 31 December 2002. The tables show the contractual re-pricing for each category of asset liability and for off-balance sheet items and do not reflect the behaviouralised repricing used in the Group s asset and liability management methodology and the non-trading interest rate VaR presented above.

Operating and financial review continued

Market risk (continued)

Non-trading (continued)

Currency risk

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in overseas subsidiaries and associated undertakings and their related currency funding. The Group s policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in overseas subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group s or the subsidiary s regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. Gains or losses on foreign currency investments net of any gains or losses on related foreign currency funding or hedges are recognised in the statement of total recognised gains and losses.

The tables below set out the Group s structural foreign currency exposures.

2003	Net investments in overseas operations £m	Foreign currency borrowings hedging net investments £m	Structural foreign currency exposures £m
US dollar	5,329	5,198	131
Euro	1,422	826	596
Swiss franc	357	357	
Other non-sterling	118	114	4
	7,226	6,495	731

2002			
US dollar	5,190	5,107	83
Euro	1,019	558	461
Swiss franc	306	295	11
Other non-sterling	35	30	5
	6,550	5,990	560

The structural foreign currency exposure in euros is principally due to Ulster Bank running an open structural foreign exchange position to minimise the sensitivity of its capital ratios to possible movements in the Euro exchange rate against Sterling.

Equity risk

Non-trading equity risk arises principally from the Group s strategic investments, its venture capital activities and its general insurance business. The reserves of the Group s general insurance business are invested in cash, debt securities and equity shares. The VaR of the equity element of this portfolio was £9.9 million at 31 December 2003 (2002 £8.6 million). During 2003, the maximum VaR was £11.1 million (2002 £8.6 million), the minimum £8.3 million (2002 £6.8 million) and the average £9.6 million (2002 £7.4 million).

VaR is not an appropriate risk measure for the Group s venture capital investments, comprising a mix of quoted and unquoted investments, or its portfolio of strategic investments. At 31 December 2003, equity shares held as investment securities had a book value of £1,821 million (2002 £1,783 million) and a valuation of £2,238 million (2002 £1,699 million).

108

Insurance risk

The Group is exposed to insurance risk, either directly through its businesses or through using insurance as a tool to reduce other risk exposures:

- Insurance is a source of risk where the Group sells and underwrites general insurance and life assurance. The essence of an insurance contract is the transfer of risk from the policyholder to the insurer.

  The management of insurance risk is overseen by a Pricing Committee that meets weekly to review underwriting factors, e.g. car groups, terms and conditions, claims experience. This is supplemented by a range of system controls and processes including risk acceptance, with regular independent reviews of underwriting across the business. Primary focus is on high volume and relatively straightforward products for example home and motor. This facilitates the generation of comprehensive underwriting and claims data, which is used to monitor and accurately price the risks accepted. This attention to data analysis is reinforced by tight controls on costs and claims handling procedures.

  Underwriting concentrations and catastrophe exposure are reviewed and, where necessary, mitigated by reinsurance which is spread across a number of reinsurers. Reviews of the Group s general insurance reserves by external actuaries are conducted annually.

  Investment strategy reflects the maturity of underwriting liabilities and is governed through Investment Management Committees, with involvement and oversight from Group Treasury. The Group s underwriting experience, the level of retained risk and solvency are monitored at divisional and Group level.

- The Insurance Sourcing Department is responsible for the Group-wide purchase of insurance as a means of reducing other risk exposures. As such, it is a key component of the Group Insurance Risk Management process and reports its activities to the GEMC.

Enterprise risk

In order to adequately identify and manage the full range of Enterprise risk, the Group has separately defined operational and external risk:

Operational risk is defined as the risk arising from within the organisation from:

- People risks arising from an inappropriate level of staff, inadequately skilled or managed people.
- Process risk caused by inadequate or failed internal processes.
- Systems risks of inadequately designed or maintained systems.
- Assets risk of damage, misappropriation or theft of the Group s physical, logical and intangible assets.

External risk is defined as the risk arising from outside of the organisation in three main areas:

- Business   risks arising from product performance, competitor activity, supplier unreliability or customer activity.
- Political   risks caused by political unrest or uncertainty, activity by public interest groups or extremists, and non-compliance with, or changes to, current legislation.
- Environment   risks arising due to demographic, macro economic, technical, cultural or environmental change.

Enterprise risk also includes the potential or actual impact on corporate reputation arising from any of the Group s activities.

Enterprise risk management is achieved through monitoring the Group s exposure to direct or indirect loss using a range of policies, procedures, data, analytical tools and reporting techniques. In particular, Group-wide risk management processes ensure that Enterprise risk issues are quickly escalated and resolved, that the risks inherent in new products are fully evaluated, and that emerging external risks are actively monitored.

Operational risk exposures and loss events for each division are captured through monthly Risk and Control returns, which provide details on the change of risk exposures for each risk category in the light of improving/deteriorating trends and the risk profile of each division.

Make it happen

Governance

Contents

Board of directors and secretary

Chairman
Sir George Mathewson (age 63)
CBE, DUniv, LLD, FRSE, FCIBS
C (Chairman), N (Chairman)

Appointed to the Board in September 1987 and as Chairman in April 2001, Sir George has a wide background in finance, technology and management and spent some of his career in the United States. He became Group Chief Executive in January 1992 and in March 2000, he was appointed Executive Deputy Chairman. He is president of the British Bankers Association and a director of Santander Central Hispano, S.A., The Scottish Investment Trust PLC and the Institute of International Finance, Inc. He was chief executive of the Scottish Development Agency from 1981 to 1987.

Vice-chairmen
Sir Iain Vallance (age 60)
FCIBS
C

Appointed to the Board in January 1993 and as Vice-Chairman in March 1994, Sir Iain is an experienced businessman who is currently chairman of the European Service Forum and a director of the supervisory board of Siemens AG. He is also a member of the European Advisory Council of the Rothschild Group and the European Advisory Committee of the NYSE. He has also held a range of other positions including president of the CBI, chairman of British Telecommunications Plc and deputy chairman of the Financial Reporting Council. He was also a member of the board of directors of the Mobil Corporation.

Sir Angus Grossart (age 66)
CBE, DBA, LLD, FRSE, DL, FCIBS
C

Appointed to the Board in September 1985 and as Vice-Chairman in April 1996, Sir Angus is an advocate and chartered accountant with a career in merchant banking. He is chairman of Noble Grossart Limited, Scottish Daily Record and Sunday Mail Limited and Edinburgh US Tracker Trust plc. His directorships of public companies include Scottish and Newcastle Plc and Trinity Mirror Plc. He is a trustee of the National Heritage Memorial Fund and a former chairman of the trustees of the National Galleries of Scotland. He has also served on the boards of a wide range of other companies in the UK, the USA and Canada.

Executive directors
Fred Goodwin (age 45)
DUniv, FCIBS, FCIB
Group Chief Executive
C

Appointed to the Board in August 1998, Mr Goodwin is a chartered accountant. He was formerly chief executive and director, Clydesdale Bank PLC and Yorkshire Bank PLC. He is chairman of The Prince s Trust and a former president of the Chartered Institute of Bankers in Scotland.

Lawrence Fish (age 59)
Chairman, President and Chief Executive Officer
of Citizens Financial Group, Inc.

Appointed to the Board in January 1993, Mr Fish is an American national. He is a career banker and a director of Textron Inc. and the Federal Reserve Bank of Boston. He is also a director of the Financial Services Roundtable, a trustee of The Brookings Institution and a director of numerous community organisations in the USA.

Norman McLuskie (age 59)
FCIBS
Chairman, Retail Direct

Appointed to the Board in June 1992, Mr McLuskie is a chartered accountant. He is also chairman of MasterCard Europe SPRL and a member of the board of MasterCard International Inc. He was formerly chief executive, Retail Direct.

Gordon Pell (age 53)
FCIBS, FCIB
Chairman, Retail Banking and Wealth Management

Appointed to the Board in March 2000, Mr Pell was formerly group director of Lloyds TSB UK Retail Banking before joining National Westminster Bank Plc as a director in February 2000 and then becoming chief executive, Retail Banking. He is currently also a director of Race for Opportunity and Southampton University Development Trust.

Fred Watt (age 43)
FCIBS
C
Group Finance Director

Appointed to the Board in September 2000, Mr Watt is a chartered accountant. He was formerly finance director of Wassall plc.

Non-executive directors
Emilio Botin (age 69)

Appointed to the Board in February 1989, Mr Botin is a Spanish national. He is chairman of Santander Central Hispano, S.A. and several Santander Central Hispano Group subsidiaries and a director of a number of Spanish companies including BANKINTER S.A. Mr Botin is chairman of Universia.net, an internet venture between Santander Central Hispano and 650 universities in Spain, Portugal and the main countries in Latin America. He is also a director of Shinsei Bank Limited, a Japanese bank.

Colin Buchan* (age 49)
A (Acting Chairman), R

Appointed to the Board in June 2002, Mr Buchan was educated in South Africa and spent the early part of his career in South Africa and the Far East. He has considerable international investment banking experience, as well as experience in very large risk management in the equities business. He was formerly a member of the group management board of UBS AG and head of equities of UBS Warburg. He is a director of Merrill Lynch World Mining Trust Plc, Merrill Lynch Gold Limited, Royal Scottish National Orchestra Society Limited, Standard Life Investments Limited, UBS Securities Canada Inc. and World Mining Investment Company Limited.

Jim Currie* (age 62)
D.Litt
R

Appointed to the Board in November 2001, Dr Currie is a highly experienced senior international civil servant who spent many years working in Brussels and Washington. He was formerly director general at the European Commission with responsibility for the EU s environmental policy and director general for Customs and Excise and Indirect Taxation. He is also a director of British Nuclear Fuels PLC, an international adviser to Eversheds and a consultant to Butera & Andrews UK Limited.

Juan Inciarte (age 51)

Appointed to the Board in February 1998, Mr Inciarte is a Spanish national. He is a general manager of Santander Central Hispano Group in charge of Europe and consumer finance. He is a director of several Santander Central Hispano Group subsidiaries and a number of Spanish and European companies including CC-Bank AG. He was a director of First Wachovia and San Paolo IMI S.P.A.

Eileen Mackay* (age 60)
CB, FCIBS
A, R

Appointed to the Board in May 1996, Miss Mackay is a former senior UK civil servant who held posts in Scotland, HM Treasury and the Cabinet Office and was principal finance officer at The Scottish Office. She is a director of Edinburgh Investment Trust plc, Scottish Financial Enterprise and the British Library. She is also chairman of the trustees of the David Hume Institute and a trustee of the Carnegie Trust for the Universities of Scotland.

Iain Robertson (age 58)
CBE, FCIBS
Chairman, Corporate Banking and Financial Markets

Appointed to the Board in January 1993, Mr Robertson is a chartered accountant. He is chairman of British Empire Securities and General Trust plc.

Sir Steve Robson* (age 60)
A

Appointed to the Board in July 2001, Sir Steve is a former senior UK civil servant, with responsibility for a wide variety of Treasury matters. His early career included the post of Private Secretary to the Chancellor of the Exchequer and secondment to ICFC, (now 3i). He was also a Second Permanent Secretary of HM Treasury, where he was managing director of the Finance and Regulation Directorate. He is a non-executive director of Cazenove Group Plc, Xstrata Plc and Partnerships UK plc.

Bob Scott* (age 62)
CBE
C, N, R (Chairman)

Appointed to the Board in January 2001, Mr Scott is an Australian national. He is the senior independent director. Mr Scott has many years experience in the international insurance business and played a leading role in the consolidation of the UK insurance industry. He is a former group chief executive of CGNU plc and chairman of the board of the Association of British Insurers. He is chairman of Yell Group plc, a non-executive director of Swiss Reinsurance Company (Zurich), Jardine Lloyd Thompson Group plc and Focus Wickes Group Limited, and a trustee of the Crimestoppers Trust.

Peter Sutherland* (age 57)
KCMG
N

Appointed to the Board in January 2001, Mr Sutherland is an Irish national. He is a former attorney general of Ireland and from 1985 to 1989 was the European commissioner responsible for competition policy. He is chairman of BP Plc and Goldman Sachs International and a director of Investor AB and Telefonaktiebolaget LM Ericsson. He was formerly chairman of Allied Irish Bank and a director general of GATT and the World Trade Organisation.

Group Secretary and General Counsel
Miller McLean (age 54)
FCIBS
C

Mr McLean was appointed group secretary in August 1994. He is a trustee of the Industry and Parliament Trust, a non-executive chairman of The Whitehall and Industry Group and a director of The Scottish Parliament and Business Exchange. He is a former vice-chairman of Banco Santander, Portugal S.A.

A member of the Audit Committee
C member of the Chairman s Advisory Group
N member of the Nominations Committee

R member of the Remuneration Committee
* independent non-executive director

113

Report of the directors

The directors have pleasure in presenting their report together with the audited accounts for the year ended 31 December 2003.

Profit and dividends

The profit attributable to the ordinary shareholders of the company for the year ended 31 December 2003 amounted to £2,315 million (after preference dividends of £261 million and the Additional Value Shares dividend of £1,463 million) compared with £1,971 million for the year ended 31 December 2002, as set out in the consolidated profit and loss account on page 141.

An interim dividend of 14.6p per ordinary share was paid on 10 October 2003 totalling £431 million (2002 £368 million). The directors now recommend that a final dividend of 35.7p per ordinary share totalling £1,059 million (2002 £899 million) be paid on 4 June 2004 to members on the register at the close of business on 12 March 2004. If this recommendation is approved by shareholders at the annual general meeting on 29 April 2004, the retained profit for the year will amount to £825 million (2002 £704 million). Subject to the approval of the dividend by shareholders at the annual general meeting, shareholders will be offered the choice of taking ordinary shares in lieu of cash in respect of the final dividend.

The final dividend of 55p per share on the Additional Value Shares issued in connection with the acquisition of NatWest was paid on 1 December 2003, totalling £1.5 billion.

Activities and business review

The company is a holding company owning the entire issued ordinary share capital of the Royal Bank, the principal direct operating subsidiary undertaking of the company. The Group comprises the company and all its subsidiary and associated undertakings, including the Royal Bank and NatWest. The Royal Bank and NatWest and their subsidiary undertakings are engaged principally in providing a comprehensive range of banking, insurance and other financial services. Details of the principal subsidiary undertakings of the company are shown in Note 17. A review of the business for the year to 31 December 2003, of recent events and of likely future developments is contained in the operating and financial review.

Business developments

In January 2003, 49% of the Royal Bank s economic interest in Royal Bank of Scotland Unit Trust Management was sold to Aviva plc.

In January 2003, the entire issued ordinary share capital of NatWest was transferred from the company to the Royal Bank.

In January 2003, Citizens completed the acquisition of Pennsylvania-based commercial bank, Commonwealth Bancorp, Inc.

In June 2003, RBS completed the acquisition of Nordisk Renting AB, a Swedish leasing company.

In July 2003, Citizens completed the acquisition of Port Financial Corp., the holding company of the Massachusetts savings bank, CambridgePort Bank.

In July 2003, RBS completed the purchase of the credit card and personal loans portfolios of Frankfurt-based Santander Direkt Bank.

In July 2003, RBS completed the sale of the Miami-based Latin American private banking operations of Coutts Group.

In September 2003, RBS completed the acquisition of Churchill Insurance Group PLC.

In September 2003, Citizens announced the acquisition of Thistle Group Holdings, Co., the holding company of Pennsylvania-based Roxborough Manayunk Bank. This acquisition was completed in January 2004.

In October 2003, RBS announced that it had agreed terms for a recommended acquisition for cash of First Active plc. This acquisition was completed in January 2004.

In October 2003, Citizens completed the acquisition of Community Bancorp, Inc., the holding company of Massachusetts-based Community National Bank.

In November 2003, Coutts Bank (Switzerland) Limited completed the acquisition of Zurich-based private bank, Bank von Ernst & Cie AG.

Going concern

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis for preparing the accounts.

114

Ordinary share capital

During the year ended 31 December 2003, the ordinary share capital was increased by the following issues:

(a) 13.3 million ordinary shares allotted as a result of the exercise of options under the company s executive, sharesave and option 2000 schemes and a further 6.2 million ordinary shares allotted in respect of the exercise of options under the NatWest executive and sharesave schemes which had been exchanged for options over the company s shares following the acquisition of NatWest in 2000;

(b) 40.1 million ordinary shares allotted in lieu of cash dividends; and

(c) 2.9 million ordinary shares allotted under the company s profit sharing (share ownership) scheme.

The total consideration for ordinary shares issued during the year amounted to £775 million.

Details of the authorised and issued ordinary share capital at 31 December 2003 are shown in Note 33.

Preference share capital

In January 2003, the company redeemed the 8 million Series B and the 16 million Series C, non-cumulative preference shares of US$0.01 each, at a total cost of US$600 million.

Details of the authorised and issued preference share capital at 31 December 2003 are shown in Note 33.

Non-voting deferred shares

Following the payment of the final dividend on the Additional Value Shares on 1 December 2003, they were de-listed from the London Stock Exchange, converted to Non-voting Deferred Shares and transferred to RBS NVDS Nominees Limited.

Trust preferred securities

In May 2003, a subsidiary of the company issued 850,000 Series I non-cumulative trust preferred securities of US$1,000 per security, the net proceeds being US$841 million.

In December 2003, a subsidiary of the company issued 650,000 Series II non-cumulative trust preferred securities of US$1,000 per security, the net proceeds being US$644 million.

Subordinated liabilities

In March 2003, the Royal Bank issued £500 million 5.125% subordinated notes, the net proceeds being £490 million.

In April 2003, the Royal Bank issued €750 million 4.875% subordinated notes, the net proceeds being €749 million.

In June 2003, the company issued US$850 million 5.75% Exchangeable capital securities, the net proceeds being US$827 million, and the Royal Bank issued £200 million 5.625% subordinated notes, the net proceeds being £211 million.

In July 2003, the company issued US$350 million 4.7% subordinated notes, the net proceeds being US$348 million.

In October 2003, the Royal Bank issued €1 billion subordinated floating rate notes, the net proceeds being €998 million and £400 million 5.625% subordinated notes, the net proceeds being £396 million.

In November 2003, the company issued US$750 million 5% subordinated notes, the net proceeds being US$744 million, and NatWest redeemed US$500 million 9.375% guaranteed capital notes.

In December 2003, the Royal Bank issued €500 million 4.5% subordinated notes, the net proceeds being €498 million.

Details of the subordinated liabilities are shown in Notes 30 and 31.

Shareholdings

As at 18 February 2004, the company had been notified of the following interests in its shares, in accordance with section 198 of the Companies Act 1985:

	Number of shares	% held		Number of shares	% held
Ordinary shares:			5 ½% cumulative preference shares:		
Santander Central Hispano S.A.	149,528,735	5.15	Commercial Union Assurance plc	91,429	22.86
Legal & General Group plc	98,761,695	3.40	Axa S.A.	81,000	20.25
Barclays PLC	89,927,387	3.05	Bassett-Patrick Securities Limited*	46,255	11.56
11% cumulative preference shares:			Mr P. S. and Mrs J. Allen	35,999	9.00
Guardian Royal Exchange			E M Behrens Charitable Trust The Stephen Cockburn	20,000	5.00
Assurance plc	129,830	25.97	Mrs Gina Wild	19,800	4.95
Windsor Life Assurance			Trustees of The Stephen Cockburn		
Company Limited	51,510	10.30	Limited Pension Scheme	19,879	4.97
Mr S. J. and Mrs J. A. Cockburn	30,810	6.16	Miss Elizabeth Hill	16,124	4.03
Cleaning Tokens Limited	25,500	5.10	Mr W. T. Hardison Jr.	13,532	3.38

* Notification has been received on behalf of Mr A. W. R. Medlock and Mrs H. M. Medlock that they each have an interest in the holding of 5 ½% cumulative preference shares registered in the name of Bassett-Patrick Securities Limited noted above and that there are further holdings of 5,300 and 5,000 shares, respectively, of that class registered in each of their names.

115

Report of the directors continued

Directors

The names and brief biographical details of the directors are shown on page 113. All directors, except Mr Bill Wilson who died on 25 December 2003, served throughout the year and to the date of signing of the financial statements. Sir George Mathewson, Sir Angus Grossart, Sir Iain Vallance, Mr Emilio Botin, Mr Lawrence Fish, Mr Gordon Pell and Mr Iain Robertson will retire and offer themselves for re-election at the forthcoming annual general meeting. Sir Angus Grossart and Sir Iain Vallance have indicated that they would not wish to submit themselves for re-election in 2005. Details of the service agreements for Mr Fish, Mr Pell and Mr Robertson are set out on page 126. No other director seeking re-election has a service agreement.

Directors interests

The interests of the directors in the shares of the company at 31 December 2003 are shown on page 132. None of the directors held an interest in the loan capital of the company or in the shares and loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2003 to 18 February 2004.

Employee proposition

The company encourages employees to contribute to the Group s performance through Total Reward, one of the most comprehensive remuneration and benefits packages in financial services. The elements of Total Reward include; salary; selectable benefits; bonus and share schemes; and pensions.

RBSelect, the Group s benefits choice programme, attracted some 43,000 employees in 2003, allowing them to increase the overall value of their Total Reward package as well as tailoring it to suit their lifestyle. Employees can choose from a range of options including subsidised childcare, discounted shopping vouchers, private medical insurance, additional pension contributions and telephone legal advice.

Employees can also participate in a bonus scheme or incentive plan specific to their business. Employees are also able to share in the Group s success through profit sharing, Buy As You Earn and Sharesave schemes, aligning their interests with those of shareholders.

In each of the last five years the success of the Group has given eligible employees a further ten percent of their basic salary through Group profit sharing.

In 2003, the Group introduced the Buy As You Earn Plan allowing employees to buy shares in the Group on a monthly basis.

The Group provides pension scheme membership for the majority of staff in the UK and overseas. The largest scheme is The Royal Bank of Scotland Group Pension Fund, which has some 74,000 employee members. This is a non-contributory, defined benefit fund and is open to full-time and part-time employees, including fixed-term contractors.

Development and training are given a high priority in the Group and significant importance is placed on having strong leadership capability across the organisation, proactively developing future leaders and succession plans for senior and executive management roles. A core component of this is the Executive Leadership Programme provided by Harvard Business School. There has also been strong demand for the Group s graduate programme, with 185 participants in 2003.

The Group encourages professional development and lifelong learning. Through Learning Awards it offers a financial incentive to employees who take the banking qualifications offered by The Chartered Institute of Bankers in Scotland and The Institute of Financial Services.

As part of the Group s relationship with the Prince s Trust, UK-based employees are encouraged to become involved in the Trust s work with young people which offers personal development opportunities. This also contributes to the Group s aims in respect of Community Investment and Corporate Responsibility.

Employee communication

The Group encourages employee involvement through a process of communication and consultation. This involves internal communication through a corporate intranet, an in-house magazine, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Group Chief Executive and other senior Group executives regularly communicate directly with employees through Question Time style programmes, broadcast on the Group s internal television network. The Group Chief Executive also meets employees during frequent visits to Group offices.

Short films explaining the Group s annual and interim financial results are broadcast through the internal television network which is also used for staff training and development.

Employee consultation

The importance the Group places on consultation with employees is evidenced by its annual, Group-wide employee opinion survey, which seeks views and feedback on a variety of key topics. The latest survey took place in January 2003 and with an overall response rate of 83%, the Group is confident that staff value the survey as a method of expressing their views and of initiating change in the organisation.

The Group has established an European Employee Communication Council to facilitate dialogue amongst employee representatives in the European Economic Area on employment matters.

Diversity

The Group is committed to recognising diversity in all areas of recruitment, employment, training and promotion. The Group s business model is based on meritocracy and inclusiveness, which allows all employees to develop their full potential, irrespective of their race, gender, marital status, age, disability, religious belief, political opinion or sexual orientation.

In 2003 the Group participated in a number of programmes and activities in support of its approach to diversity and good people management.

The Group s benchmark ratings for age and race diversity improved in 2003 and silver ratings in both Opportunity Now and Race for Opportunity were achieved. The Group sponsored the launch of the Age Audit toolkit by the Employers Forum on Age, which had been piloted earlier in the year. The Group was also a sponsor of the Guardian Diversity in Britain Conference and the Opportunity Now Annual Awards.

Health, Safety & Security

The health, safety and security of employees and customers is of paramount importance to the Group.

The Group has a continuous programme of reviewing its health and safety policies in light of current legislation and best practice, as well as to ensure that they meet the operational needs of the business.

Corporate responsibility

Business excellence requires that the Group meets changing customer, shareholder, investor, employee and supplier expectations and the Group believes that meeting high standards of environmental, social and ethical responsibility is key to the way it does business.

The Board regularly considers corporate responsibility issues and receives a formal report on these matters twice each year. Further details of the Group s corporate responsibility policies will be contained in the 2003 Corporate Responsibility Report.

Code of ethics

The Group has adopted a code of ethics that is applicable to all of the Group s employees and a copy is available upon request.

Charitable contributions

In 2003 the cost of the Group s Community Investment programmes increased to £40.1 million (2002 £33.7 million). The total amount given for charitable purposes by the company and its subsidiary undertakings during the year ended 31 December 2003 was £14.7 million (2002 £14.7 million).

Corporate governance

The company is committed to high standards of Corporate governance. Details are given on pages 118 to 121.

Political donations

No political donations were made during the year.

At the annual general meeting in 2002 shareholders gave authority for the company and certain of its subsidiaries to make political donations and incur political expenditure up to a maximum aggregate sum of £675,000 as a precautionary measure in light of the wide definitions in The Political Parties, Elections and Referendums Act 2000, for a period of four years. These authorities have not been used and it is not proposed that the Group s longstanding policy of not making contributions to any political party be changed.

Policy and practice on payment of creditors

In the year ending 31 December 2004, the Group will continue to adhere to the payment policy set out below in respect of all suppliers. The Group is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Group s policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

At 31 December 2003, the Group s trade creditors represented 27 days (2002 27 days) of amounts invoiced by suppliers. The company does not have any trade creditors.

Auditors

On 1 August 2003, Deloitte & Touche, the company s auditors transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnership Act 2000. The company s consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 1 August 2003 under the provisions of section 26(5) of the Companies Act 1989. A resolution to re-appoint Deloitte & Touche LLP as the company s auditor will be proposed at the forthcoming annual general meeting.

By order of the Board.

Miller McLean
Secretary
18 February 2004

The Royal Bank of Scotland Group plc
is registered in Scotland No. 45551.

Corporate governance

The company is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 December 2003, the company has complied with all of the provisions set out in section 1 of the Combined Code issued by the London Stock Exchange in June 1998. In addition, the company has complied with the provisions set out in the revised Combined Code issued by the Financial Reporting Council in July 2003 (the Code) except in relation to:

- the requirement that at least half of the Board should comprise independent non-executive directors, which is explained below in the paragraph headed Board balance and independence.

- the authority reserved to the Board to make the final determination of the remuneration of the executive directors, which is explained below in the paragraph headed Remuneration Committee .

Under the US Sarbanes-Oxley Act of 2002, enhanced standards of corporate governance and business and financial disclosure apply to companies, including the company, with securities registered in the US. All changes necessary to comply with the new standards have been implemented.

Board of directors

The Board is the principal decision making forum for the company. It has overall responsibility for leading and controlling the company and is accountable to shareholders for financial and operational performance. The Board approves Group strategy and monitors performance. The Board has adopted a formal schedule of matters detailing key aspects of the company s affairs reserved to it for its decision. This schedule is reviewed annually.

The roles of the Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all non-executive and executive directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated from the Board of directors. Responsibility for the development of policy and strategy and operational management is delegated to the Group Chief Executive and other executive directors.

All directors participate in discussing strategy, performance and financial and risk management of the company and meetings of the Board are structured to allow open discussion. The Board meets at least eight times each year. It is supplied with comprehensive papers in advance of each Board meeting including financial and business reports covering the Group s principal business activities. Members of the executive management attend and make regular presentations at meetings of the Board.

Board balance and independence

The Board currently comprises the Chairman, five executive directors and 11 non-executive directors. The Board functions effectively and efficiently and is considered to be of an appropriate size in view of the scale of the company and the diversity of its businesses. The directors provide the Group with the knowledge, mix of skills, experience and networks of contacts required. The Board Committees contain directors with a variety of relevant skills and experience so that no undue reliance is placed on any one individual.

The non-executive directors combine broad business and commercial experience with independent and objective judgement. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership and maintain the highest standards of integrity across the company s business activities. The names and biographies of all Board members are set out on page 113.

The Code requires the Board to determine whether its non-executive members are independent. The Board considers that all non-executive directors are independent for the purposes of the Code, with the following exceptions:

- Mr Emilio Botin and Mr Juan Inciarte, who are representatives of Santander Central Hispano S.A.
- Sir Angus Grossart and Sir Iain Vallance, who have served on the Board for 18 and 11 years, respectively.
- Mr Iain Robertson who was formerly an executive director of the company.

As a result, in terms of the Code, the Board comprises six independent and 10 non-independent directors (including executive directors), in addition to the Chairman.

The composition of the Board is subject to continuing review and the provisions of the Code will be taken into account in respect of the balance of the Board. It is the Board s intention to have a majority of independent directors. Sir Angus Grossart and Sir Iain Vallance have agreed to offer themselves for reelection at the company s annual general meeting on 29 April 2004. However, they have indicated that they would not wish to submit themselves for re-election in April 2005.

Mr Bob Scott has been nominated as the senior independent director and would be consulted when necessary on the concerns of shareholders.

Re-election of directors

At each annual general meeting, one third of the directors will retire and offer themselves for re-election and each director must stand for re-election at least once every three years. Any non-executive directors who have served for more than nine years will also stand for annual re-election. The proposed reelection of directors is subject to prior review by the Board.

The names of directors standing for re-election at the 2004 annual general meeting are contained on page 116 and further information will be given in the Chairman s letter to shareholders in relation to the company s annual general meeting.

Information, induction and professional development

The Chairman ensures that all directors receive accurate, timely and clear information on all relevant matters. Any requests for further information or clarification are dealt with or co-ordinated by the Group Secretary.

The Group Secretary is responsible for advising the Board, through the Chairman, on all governance matters. All directors have access to the advice and services of the Group Secretary who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. In addition, all directors are able, if necessary, to obtain independent professional advice at the company s expense.

Each new director receives a formal induction, including visits to all the Group s major businesses and meetings with senior management. The induction is tailored to the director s specific requirements. Existing directors undertake such professional development as they consider necessary in assisting them to carry out their duties as directors.

Performance evaluation

Building on the internal review conducted in 2001, a performance evaluation of the Board and its Committees was undertaken in the autumn of 2003. The review was conducted by the Group Secretary using a detailed questionnaire and meetings with each of the directors to discuss the performance of the Board and its Committees.

In addition, each director discussed his or her own performance with the Chairman and the senior independent director met individually with the executive directors and with the non-executive directors as a group without the Chairman present, to consider the Chairman s performance. The report on the Board evaluation, which was designed to assist the Board in further improving its performance, was considered and discussed by the Board as a whole and specific actions are currently being implemented. A performance review will be conducted on an annual basis.

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Committees with particular responsibilities. The Committee chairmanship and membership is refreshed on a regular basis.

Audit Committee

The Audit Committee is responsible for assisting the Board in discharging its responsibilities in relation to the financial affairs of the Group, the arrangements for accounting and financial reporting and regulatory compliance, the standards of internal control, and arrangements for internal audit, risk management and the external auditors. The Audit Committee meets executive directors and management and the external and internal auditors privately.

In January 2003, the Audit Committee established its policy on the engagement of the external auditors to supply audit and non-audit services, taking into account relevant legislation regarding the provision of such services by an external audit firm. This policy is reviewed annually by the Audit Committee which also reviews and monitors the independence of the external auditors when it approves non-audit work to be carried out by them, taking into consideration relevant ethical guidance. To safeguard auditor objectivity and independence in the provision of non-audit services, a detailed submission is made by management to the Audit Committee prior to appointment. The submission contains, in particular, details as to why the proposed appointment would not breach auditor independence.

The Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the external auditors and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The Audit Committee will make recommendations in relation to the reappointment, remuneration and terms of engagement of the external auditors at the annual general meeting on 29 April 2004.

All members of the Audit Committee are independent non-executive directors. The Board is satisfied that the Committee members have recent and relevant financial experience. Although the Board has determined that each member of the Audit Committee is an Audit Committee Financial Expert as defined in the SEC rules under the US Securities Exchange Act, the members of the Audit Committee are selected with a view to the expertise and experience of the Audit Committee as a whole, and the Audit Committee reports to the Board as a single entity. The designation of a director or directors as an Audit Committee Financial Expert does not impose on any such director any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such director as a member of the Audit Committee and Board in the absence of such a designation. Nor does the designation of a director as an Audit Committee Financial Expert affect the duties, obligations or liability of any other member of the Board.

Remuneration Committee

The Remuneration Committee is responsible for formulating and reviewing the Group s executive remuneration policy and making recommendations to the Board on the remuneration arrangements for its directors. The Directors Remuneration report is contained on pages 122 to 131. All members of the Remuneration Committee are independent non-executive directors.

Responsibility for determining the remuneration of executive directors has not been delegated to the Remuneration Committee, and in that sense the provisions of the Code have not been complied with. The Board as a whole reserves the authority to make the final determination of the remuneration of directors as it considers that this two stage process allows greater consideration and evaluation and is consistent with the unitary nature of the Board. No director is involved in decisions regarding his or her own remuneration.

Corporate governance continued

Nominations Committee

The Nominations Committee comprises independent non-executive directors, under the chairmanship of the Chairman. The Nominations Committee is responsible for assisting the Board in the formal selection and appointment of directors and considers succession planning for the Board. It also considers potential candidates and recommends appointments of new directors to the Board. The appointments are based on merit and against objective criteria including the time available, and commitment which will be required of, the potential director.

The Board is aware of the other commitments of its directors and is satisfied that these do not conflict with their duties as non-executive directors of the company.

Meetings

The number of meetings of the Board and the Audit, Remuneration and Nominations Committees and individual attendance by members is shown below.

	Board	Audit	Remuneration	Nominations
Total number of meetings in 2003	8	6	3	2
Number of meetings attended in 2003				
Sir George Mathewson	8			2
Sir Iain Vallance	8			2
Sir Angus Grossart	8			2
Mr Fred Goodwin	8			
Mr Emilio Botin	4			
Mr Colin Buchan	7	6	1*	
Mr Jim Currie	7		3	
Mr Lawrence Fish	5			
Mr Juan Inciarte	8			
Miss Eileen Mackay	8	6	3	
Mr Norman McLuskie	8			

Mr Gordon Pell	8				
Mr Iain Robertson	8				
Sir Steve Robson	8	6		-	-
Mr Bob Scott	8			3	1
Mr Peter Sutherland	6				
Mr Fred Watt	8				
Mr Bill Wilson	6	6		2	1

* Mr Buchan was appointed to the Remuneration Committee on 29 October 2003

Relations with shareholders

The company communicates with shareholders through the annual report and by providing information in advance of the annual general meeting. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time. Furthermore, shareholders are given the opportunity to ask questions at the annual general meeting or submit written questions in advance. The chairmen of the Audit, Remuneration and Nominations Committees are available to answer questions at the annual general meeting.

The Board is proactive in obtaining an understanding of shareholder preferences and all directors receive regular reports. Communication with the company s largest institutional shareholders is undertaken as part of the company s investor relations programme. The mechanisms used to communicate with shareholders were considered as part of the Board evaluation and will be reviewed annually.

The Chairman and Group Chief Executive and, if appropriate, the senior independent director communicate shareholder views to the Board as a whole. In addition, the senior independent director will attend the results presentations.

The terms of reference of the Audit, Remuneration and Nominations Committees and the standard terms and conditions of the appointment of non-executive directors are available on the Group s website (www.rbs.co.uk) and copies are available on request.

120

Internal control

The Board of directors is responsible for the Group s system of internal control that is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, the Group has regard to the nature and extent of the risk, the likelihood of it crystallising and the cost of controls. A system of internal control is designed to manage, but not eliminate, the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against the risk of material misstatement, fraud or losses.

The Board has established an ongoing process for the identification, evaluation and management of the significant risks faced by the Group, which operated throughout the year ended 31 December 2003 and to 18 February 2004, the date the directors approved the Report and Accounts. This process is regularly reviewed by the Board and meets the requirements of the guidance Internal Control: Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales in 1999.

The effectiveness of the Group s internal control system is reviewed regularly by the Board and the Audit Committee. Executive management committees or boards of directors in each of the Group s businesses receive quarterly reports on significant risks facing their business and how they are being controlled. These reports are combined and submitted to the Board as quarterly risk and control assessments. Additional details of the Group s approach to risk management are given in the Risk management section of the Operating and financial review on pages 92 to 109. The Audit Committee also receives regular reports from Group Risk Management and Group Internal Audit. In addition, the Group s independent auditors present to the Audit Committee reports that include details of any significant internal control matters which they have identified. The system of internal controls of the authorised institutions and other regulated entities in the Group are also subject to regulatory oversight in the UK and overseas.

Disclosure controls and procedures

The Group Chief Executive and Group Finance Director, after evaluating the effectiveness of the company s disclosure controls and procedures (as defined in the rules under the US Securities Exchange Act) have concluded and been authorised by the Board to certify that as at 31 December 2003, the company s disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the company and its consolidated subsidiaries would be made known to them by others within those entities.

Changes in internal controls

There were no significant changes in the company s internal controls over financial reporting or, to the knowledge of the Group Chief Executive and Group Finance Director, in other factors that could significantly affect those internal controls as at 31 December 2003.

Directors remuneration report

The Remuneration Committee

The following directors, all of whom are independent non-executive directors, were members of the Remuneration Committee during the year ended 31 December 2003.

Bob Scott (Chairman)
Colin Buchan (from 29 October 2003)
Jim Currie
Eileen Mackay
Bill Wilson (deceased 25 December 2003)

During the accounting period, the Remuneration Committee confirmed the appointment of Ernst & Young and appointed Mercer Human Resource Consulting to provide advice on matters relating to directors remuneration in the UK and US respectively. In addition, the Remuneration Committee has taken account of the views of the Chairman and the Group Chief Executive on performance assessment.

In addition to advising the Remuneration Committee, Ernst & Young provided professional services in the ordinary course of business including actuarial and corporate recovery advice. Mercer Human Resource Consulting provided advice in connection with a range of healthcare, actuarial and investment matters.

Remuneration policy

The executive remuneration policy is kept under review by the Remuneration Committee and is set out below. There have been no material changes to the policy which was approved by shareholders at the company s annual general meeting in 2003.

The objective of the executive remuneration policy is to provide, in the context of the company s business strategy, remuneration in form and amount which will attract, motivate and retain high calibre executives. In order to achieve this objective, the policy is framed around the following core principles:

- Total rewards will be set at levels that are competitive within the relevant market, taking each executive director s remuneration package as a whole.
- Total potential rewards will be earned through achievement of demanding performance targets based on measures consistent with shareholder interests over the short, medium and longer-term.

- Remuneration arrangements will strike an appropriate balance between fixed and performance related rewards. Performance related elements will comprise the major part of executive remuneration packages.

- Incentive plans and performance metrics will be structured to be robust through the business cycle.

- Remuneration arrangements will be designed to support the company s business strategy, to promote appropriate teamwork and to conform to best practice standards.

The non-executive directors fees are reviewed annually by the Board, on the recommendation of the Chairman. The level of remuneration reflects the responsibility and time commitment of directors and the level of fees paid to non-executive directors of comparable major UK companies. Non-executive directors do not participate in any incentive or performance plan.

The Remuneration Committee approves the remuneration arrangements of senior executives below Board level who are members of the Group Executive Management Committee, on the recommendation of the Group Chief Executive, and reviews all long-term incentive arrangements which are operated by the Group.

Components of executive remuneration

UK based directors

Salary

Salaries are reviewed annually as part of total remuneration, having regard to remuneration packages received by executives of comparable companies. The Remuneration Committee uses a range of survey data from remuneration consultants and reaches individual salary decisions taking account of the remuneration environment and the performance and responsibilities of the individual director.

Benefits

UK-based executive directors are eligible to participate in The Royal Bank of Scotland Group Pension Fund (the RBS Fund). The RBS Fund is a non-contributory defined benefit fund which provides pensions and other benefits within Inland Revenue limits. Certain directors receive additional pension and life assurance benefits in excess of Inland Revenue limits. Details of pension arrangements of directors are shown on page 131.

Executives directors are eligible to receive a choice of various employee benefits or a cash equivalent, on a similar basis to other employees. In addition, like other employees, executive directors are eligible also to participate in Sharesave, Buy As You Earn and the Group profit sharing scheme, which currently pays up to 10 per cent of salaries, depending on the Group s performance. These schemes are not subject to performance conditions since they are operated on an all-employee basis. Executive directors also receive death in service benefits.

Short-term annual incentives

This typically focuses from year to year on the delivery of a combination of appropriate Group and individual financial and operational targets approved by the Remuneration Committee. Individual UK-based executive directors normally have a maximum annual bonus potential of 100 per cent of salary

(150 per cent in the case of the Group Chief Executive), although for exceptional performance, as measured by the achievement of significant objectives, bonuses up to 200 per cent of salary may be awarded.

Long-term incentives

The company provides long-term incentives in the form of share options and share or share equivalent awards. Their objective is to encourage the creation of value over the long-term and to align the rewards of the executive directors with the returns to shareholders.

Medium-term performance plan

The medium-term performance plan was approved by shareholders in April 2001. Each executive director is eligible for an annual award under the plan in the form of share or share equivalent awards, within the overall limit of one and a half times earnings. The awards made in 2003 were up to one and a half times salary.

The plan is highly geared to the company s relative performance. All awards under the plan are subject to three-year performance targets. First, the annual growth in the company s earnings per share (EPS) must exceed the annualised growth of the Retail Prices Index (RPI) plus three per cent. If this condition is satisfied, the company s total shareholder return (TSR) is compared with the TSR of a comparator group of certain companies in the financial services sector, referred to below. Awards under the plan will not vest if the company s TSR is below the median of the comparator group. Achievement of the EPS target and median TSR performance against the comparator companies will result in the vesting of up to 50 per cent of the award, increasing on a sliding scale up to 100 per cent at upper quartile performance and up to 200 per cent at upper decile performance. This combination of EPS and TSR performance targets measures the underlying financial performance of the company and ensures a direct link between the value delivered to shareholders and the levels of incentive payment.

The companies in the comparator group are Abbey National plc; Aviva plc; Barclays PLC; Citigroup; HBOS plc; HSBC Holdings plc; Legal & General Group plc; Lloyds TSB Group plc; Prudential plc and Standard Chartered PLC. In choosing the comparator group, it was recognised that while the company has significant international business, the bulk of its operations are UK-based. Consequently the comparator group for the award in 2001 focused on the UK financial services sector. In respect of grants made in 2002 and subsequent years, the comparator group was reviewed and, following the merger of Halifax with Bank of Scotland, Citigroup was added to the group.

Options

The executive share option scheme was approved by shareholders in January 1999. Each executive director is eligible for the annual grant of an option, typically equal to 1.25 times salary, over shares at the market value at date of grant. No payment is made by the executive on the grant of an option award.

All executive share options are subject to a performance target, which is currently that the options are not exercisable unless the growth in the company s EPS over three years has exceeded the growth in the RPI plus nine per cent. This EPS performance target, which is consistent with market practice, measures underlying financial performance and represents a stretching long-term test of performance. For awards made in 2004 and in future, there will be no re-testing of the performance condition. The condition is reviewed annually. No previous awards have been subject to re-testing.

Directors remuneration report continued

US based director Mr Lawrence Fish

Salary

Mr Fish s salary is reviewed annually as part of his total remuneration, having regard to levels of remuneration paid to executives of comparable US companies and Mr Fish s performance.

Benefits

Mr Fish accrues pension benefits under a number of arrangements in the US. Details are provided on page 131. In addition, Mr Fish is entitled to receive other benefits on a similar basis to other employees.

Short-term annual incentives

Mr Fish s short-term performance rewards take the form of an annual incentive plan which rewards the achievement of Group, business unit and individual financial and non-financial targets. In line with US market practice, the maximum annual bonus potential is normally 200 per cent of salary, although additional amounts to a maximum of an additional 200 per cent of salary may be awarded, at the discretion of the Board, for exceptional performance as measured by the achievement of significant objectives.

Longer term incentives

Mr Fish currently participates in two long term incentive plans established for executives of Citizens and may be eligible to participate in the company s long tem incentive plans. The Remuneration Committee believes that it is appropriate to include, as part of his total remuneration package, an element of reward which is based on the value created in Citizens. It is also necessary to ensure that Mr Fish s total remuneration package is competitive for the US market.

Citizens Long Term Incentive Plan

Mr Fish is eligible for an annual award under the Citizens Long Term Incentive Plan, a cash compensation plan designed to reward participants for achieving long-term financial results. A separate three-year cycle commences each year. The maximum award payable to him annually is 105 per cent of his average salary over the previous three-year period. These awards are not, in normal circumstances, payable until the relevant three-year performance target has been met. Each three-year performance target is based on the annual pre-tax income target for Citizens. For the maximum award to be paid in respect of each three-year target, Citizens must achieve 130 per cent of the three-year aggregate budgeted profit figure. This performance target has been chosen because it focuses on the profit targets of Citizens, which the Remuneration Committee believes are challenging, and aligns Mr Fish s reward with the performance of Citizens. This performance target is measured by taking the pre-tax income for Citizens, which is a simple and transparent method of measuring a profit figure target.

Citizens Phantom 2000 Plan

Mr Fish has received two annual grants of awards under the Phantom 2000 Plan and, in line with the grant schedule put in place when the plan was approved by shareholders in 2000, no further awards will be made to him. Under this plan, units are awarded which are a cash-based proxy for share options. The value of the units at the time of vesting is performance-linked and depends on a formula, based on the absolute cumulative levels of economic profit generated by Citizens, the trend in economic profit earnings, and on the external market trends in the US banking sector, using the price/earnings ratios of comparator banks. This performance target has been chosen because it establishes a clear link between the level of potential incentive and the performance of Citizens. It is designed to provide competitive executive rewards in the US environment. Mr Fish may, in normal circumstances, exercise the award only between four and five years from the date of grant.

124

The performance graph

The undernoted performance graph illustrates the performance of the company over the past five years in terms of total shareholder return compared with that of the companies comprising the FTSE 100 index. This index has been selected because it represents a cross-section of leading UK companies. The total shareholder return for the company and the FTSE 100 have been rebased to 0 for 1998.

Total shareholder return

Service contracts

The company s policy in relation to the duration of contracts with directors is that executive directors contracts generally continue until termination by either party, subject to the required notice, or until retirement date. The notice period under the service contracts of executive directors will not normally exceed 12 months. However, the notice period may exceed 12 months if existing service contracts have notice periods greater than 12 months and the Remuneration Committee considers it appropriate not to reduce the existing notice period. In relation to newly recruited executive directors, subject to the prior approval of the Remuneration Committee, the notice period from the employing company required to terminate the contract will not normally exceed 12 months unless there is a clear case for this. Where a longer period of notice is initially approved on appointment, it will normally be structured such that it will automatically reduce to 12 months in due course.

All new service contracts for executive directors will be subject to approval by the Remuneration Committee. It will be the norm to include in those contracts standard clauses covering the performance review process, the company s normal disciplinary procedure, and terms for dismissal in the event of failure to perform or in situations involving actions in breach of the Group s policies.

Any compensation payment made in connection with the departure of an executive director will be subject to approval by the Remuneration Committee, having regard to the terms of the service contract and the reasons for termination.

125

Directors remuneration report continued

Information regarding executive directors service contracts is summarised in the table and notes below.

Name	Date of current contract/ Employing company	Normal retirement age	Notice period from company	Notice period from executive
Fred Goodwin	1 August 1998 The Royal Bank of Scotland plc	60	12 months	6 months
Norman McLuskie	9 October 1997 The Royal Bank of Scotland plc	60	3 months	3 months
Gordon Pell	22 May 2002 National Westminster Bank Plc	60	12 months	6 months
Fred Watt	28 September 2000 The Royal Bank of Scotland plc	60	12 months	6 months
Lawrence Fish	18 February 2004 Citizens Financial Group Inc	65	12 months	12 months
Iain Robertson	See note below			

Except as noted below, in the event of severance of contract where any contractual notice period is not worked, the employing company may pay a sum to the executive in lieu of this period of notice. Any such payment would, at maximum, comprise base salary and a cash value in respect of fixed benefits (including pension plan contributions). In the event of failure to perform, or in situations involving breach of the employing company s policies resulting in dismissal, reduced or no compensation will be paid to the executive. Depending on the circumstances of the termination of employment, the executive may be entitled, or the Remuneration Committee may exercise its discretion to allow, the executive to exercise outstanding awards under long-term incentive arrangements. Exceptions to these severance arrangements are as follows:

- If Mr McLuskie s contract is terminated by the Royal Bank before he reaches age 60, he is entitled to a payment of three months base salary, annual bonus and benefits in lieu of notice plus up to 57 weeks pay (subject in some circumstances to mitigation) and an immediate pension without actuarial reduction. If his contract is terminated by the Royal Bank within 12 months of a change of control, he is entitled to a payment equal to twice his annual salary at the time of such notice, and an immediate pension. Mr McLuskie is due to retire in August 2004 when he reaches age 60.

- If Mr Pell s contract is terminated early by NatWest without notice, he is entitled to a compensation payment of base salary relating to the notice period, his annual bonus to the date of termination, a payment equal to the average annual bonus over the previous three years, payment in lieu of contractual benefits and allowances including pension and extra payments by way of funded or unfunded pension and death in service contributions relating to the notice period.

- If Mr Watt s contract is terminated through redundancy, he is entitled to payment in lieu of notice and a cash payment calculated by reference to his age and length of service. Currently this entitlement is equal to nine months salary, and an additional payment of 2.13 weeks pay.

- Under Mr Fish s previous contract dated 1 July 1996, the notice period on termination by the company was 24 months. Following review, during which Mr Fish s normal retirement date was confirmed to be at the age of 65, Mr Fish has entered into a revised contract under which this notice period has been reduced to 12 months. No compensation has been paid or will be payable as a result of this change. The provisions of Mr Fish s previous contract dealing with termination following a change of control of Citizens, the company or the Royal Bank have been eliminated from the contract. If his contract is terminated without cause, or if Mr Fish terminates the contract for good reason (as defined in the contract), he is entitled to a lump sum payment to compensate him for the loss of salary and annual bonus (and, in the case of a termination during 2004, long-term bonus) in relation to the period he would have worked had notice been given by Citizens. Mr Fish would also be entitled to receive for this period health, life insurance and long term disability coverage and any other benefits determined in accordance with the plans, policies and practices of Citizens at the time of termination.

- Mr Robertson ceased his full-time employment with the Royal Bank on 25 June 2003 but continued as a director of the company in a non-executive capacity. Details of his contract as a non-executive director are set out on page 128.

Chairman and non-executive directors

The original date of appointment as a director of the company and the scheduled date for the next re-election is as follows:

	Date first appointed	Next re-election
Sir George Mathewson	1.9.87	29.4.04
Sir Iain Vallance	14.1.93	29.4.04
Sir Angus Grossart	30.9.85	29.4.04
Emilio Botin	4.2.89	29.4.04
Colin Buchan	1.6.02	2006
Jim Currie	28.11.01	2005
Juan Inciarte	25.2.98	2005
Eileen Mackay	16.5.96	2006
Iain Robertson	14.1.93	29.4.04
Sir Steve Robson	25.7.01	2005
Bob Scott	31.1.01	2006
Peter Sutherland	31.1.01	2006

Other than Mr Robertson, the non-executive directors do not have service contracts or notice periods, although under the company s articles of association, all directors must retire by rotation and seek re-election by shareholders at least every three years.

Mr Robertson entered into a new contract to reflect his role as a non-executive director, which took effect on 25 June 2003. Under this contract, Mr Robertson s appointment will terminate at the company s annual general meeting in April 2005, unless terminated earlier by either party on one month s written notice.

No compensation would be paid to the Chairman or to any non-executive director in the event of early termination.

The tables and explanatory notes on pages 128 to 131 report the remuneration of each director for the year ended 31 December 2003 and have been audited by the company s auditors, Deloitte & Touche LLP.

Directors remuneration report continued

Directors remuneration

	Salary/ fees £000	Performance bonus* £000	Benefits £000	2003 Total £000	2002 Total £000
Chairman					
Sir George Mathewson	497		41	538	468
Executive directors					
Fred Goodwin	898	990	28	1,916	2,580
Lawrence Fish	612	1,223	24	1,859	3,352
Norman McLuskie	498	539	11	1,048	1,375
Gordon Pell	626	676	5	1,307	1,725
Iain Robertson (until 25 June 2003)	159		8	167	1,353

Fred Watt	531	578	1	1,110	1,433

* includes 10% profit sharing

Basic salary is the only component of the remuneration package which is pensionable.

Non-executive directors	Board fees £000	Board committee fees £000	2003 Total £000	2002 Total £000
Vice-chairmen				
Sir Iain Vallance	100		100	100
Sir Angus Grossart	100		100	100
Emilio Botin	44		44	44
Colin Buchan	44	12	56	28
Jim Currie	44	10	54	52
Juan Inciarte	44		44	44
Eileen Mackay	44	20	64	63
Iain Robertson (from 25 June 2003)	50		50	
Sir Steve Robson	44	10	54	54
Bob Scott	44	23	67	67
Peter Sutherland	44		44	44
Bill Wilson	44	38	82	82

From 25 June 2003, Mr Robertson has carried out his role as Chairman, Corporate Banking and Financial Markets and as a director in a non-executive capacity. He also provides general advice on business issues to the Board and Board Committees as appropriate, including attendance as required at the Group Audit Committee and the Advances Committee. For these services Mr Robertson receives a fee of £100,000 per annum.

No director received any expense allowances chargeable to UK income tax or compensation for loss of office/termination payment. The non-executive directors did not receive any bonus payments or benefits.

Share options

Options to subscribe for ordinary shares of 25p each in the company granted to, and exercised by, directors during the year to 31 December 2003 are included in the table below:

			Options exercised in 2003			Options held at 31 December 2003		
	Options held at 1 January 2003	Options granted in 2003	Number	Market price at date of exercise £	Option price £	Number	Exercise period	
Sir George Mathewson	69,257				9.33	69,257	11.05.01	10.05.08
	147,247				7.81	147,247	29.03.03	28.03.10
	150				12.40	150	09.08.03	08.08.06*
	20,100				17.18	20,100	14.08.04	13.08.11
	1,347				13.64	1,347	01.10.08	31.03.09*
	19,500				18.18	19,500	14.03.05	13.03.12

		36,400			12.37	36,400	13.03.06	12.03.13
	257,601	36,400				294,001		
Fred Goodwin	164,571				8.75	164,571	07.12.01	06.12.08
	2,963				11.18	2,963	04.03.02	03.03.09
	27,306				11.97	27,306	03.06.02	02.06.09
	153,648				7.81	153,648	29.03.03	28.03.10
	150				12.40	150	09.08.03	08.08.06*
	43,700				17.18	43,700	14.08.04	13.08.11
	1,713				9.85	1,713	01.10.05	31.03.06*
	41,300				18.18	41,300	14.03.05	13.03.12
		72,800			12.37	72,800	13.03.06	12.03.13
	435,351	72,800				508,151		
Lawrence Fish	107,877				9.33	107,877	11.05.01	10.05.08
	150				12.40	150	09.08.03	08.08.06*
	108,027					108,027		
Norman McLuskie	16,613				9.33	16,613	11.05.01	10.05.08
	8,860				11.18	8,860	04.03.02	03.03.09
	11,356				11.97	11,356	03.06.02	02.06.09
	33,291				7.81	33,291	29.03.03	28.03.10
	150				12.40	150	09.08.03	08.08.06*
	90		90	15.92	9.85			
	23,300				17.18	23,300	14.08.04	13.08.11
	335				13.64	335	01.10.04	31.03.05*
	22,100				18.18	22,100	14.03.05	13.03.12
	335				12.35	335	01.10.05	31.03.06*
		39,700			12.37	39,700	13.03.06	12.03.13
	116,430	39,700	90			156,040		
Gordon Pell	51,216				7.81	51,216	29.03.03	28.03.10
	150		150	16.26	12.40			
	29,100				17.18	29,100	14.08.04	13.08.11
	27,600				18.18	27,600	14.03.05	13.03.12
		49,800			12.37	49,800	13.03.06	12.03.13
	108,066	49,800	150			157,716		
Iain Robertson	56,635				9.33	56,635	11.05.01	10.05.08
	82,654				11.18	82,654	04.03.02	03.03.09
	128,040				7.81	128,040	29.03.03	28.03.10
	150		150	16.26	12.40			
	393				9.85	393	01.10.03	31.03.04*
	36,400				17.18	36,400	14.08.04	13.08.11

	304,272		150		304,122		
Fred Watt	70,148			12.83	70,148	04.09.03	03.09.10
	23,300			17.18	23,300	14.08.04	13.08.11
	710			13.64	710	01.10.04	31.03.05*
	22,100			18.18	22,100	14.03.05	13.03.12
		42,500		12.37	42,500	13.03.06	12.03.13
	116,258	42,500			158,758		

* Options held under the sharesave and option 2000 schemes, which are not subject to performance conditions.

Directors remuneration report continued

No options had their terms and conditions varied during the accounting period to 31 December 2003. No payment is required on the award of an option.

The executive share options which are exercisable from March 2002 onwards are subject to the satisfaction of an EPS growth target such that no option is exercisable unless the growth in the company s EPS over three years has exceeded the growth in the RPI plus 9%. In respect of executive share options exercisable before March 2002 the performance condition is that the growth in the company s EPS over three years has exceeded the growth in the RPI plus 6%.

The market price of the company s ordinary shares at 31 December 2003 was £16.46 and the range during the year to 31 December 2003 was £12.37 to £17.80.

In the ten year period to 31 December 2003, awards made using new issue shares under the company s share plans represented 4.2% of the company s issued ordinary share capital, leaving an available dilution headroom of 5.8%.

Medium Term Performance Plan

		Awards granted in 2003			Awards vested in 2003			
	Scheme interests (share equivalents) at 1January 2003	Scheme interests (share equivalents) awarded	Market price on award £	End of the period for qualifying conditions to be fulfilled	No of interests vested*	Market price on vesting £	Value of interests vested £	Interests at 31 December 2003
Fred Goodwin	68,807		16.35	31.12.03	93,040	16.46	1,531,438	93,040
	44,378		18.59	31.12.04				44,378
		78,398	17.22	31.12.05				78,398
	113,185							215,816
Norman McLuskie	36,697		16.35	31.12.03	49,621	16.46	816,762	49,621
	23,399		18.59	31.12.04				23,399
		28,456	17.22	31.12.05				28,456

	60,096							101,476
Gordon Pell	45,871		16.35	31.12.03	62,026	16.46	1,020,948	62,026
	29,585		18.59	31.12.04				29,585
		35,715	17.22	31.12.05				35,715
	75,456							127,326
Iain Robertson	57,339		16.35	31.12.03	77,533	16.46	1,276,193	77,533
Fred Watt	36,697		16.35	31.12.03	49,621	16.46	816,762	49,621
	24,744		18.59	31.12.04				24,744
		30,488	17.22	31.12.05				30,488
	61,441							104,853

*Awards were granted on 17 June 2001 and vested at 135.22% at the end of the performance period on 31 December 2003.
No variation was made to any of the terms of the plan during the year. The performance measures are detailed on page 123.

Phantom 2000 Plan

		Awards granted during year				
	Phantom 2000 units at 1 January 2003	Units awarded during year	Market price on award	End of the period for qualifying conditions to be fulfilled	Benefits received during the year	Phantom 2000 units at 31 December 2003
Lawrence Fish	1,000,000		01.01.04			1,000,000
	1,000,000		01.01.05			1,000,000
	2,000,000					2,000,000

No variation was made to any of the terms of the plan during the year. The performance measures are detailed on page 124.

Citizens Long Term Incentive Plan

	Interests at 1 January 2003	Awards granted during year	Benefits received during the year	Interests at 31 December 2003
Lawrence Fish	LTIP* awards for the 3 year periods: 01.01.00 31.12.02 01.01.01 31.12.03 01.01.02 31.12.04	LTIP award for the 3 year period: 01.01.03 31.12.05	LTIP award for the 3 year period: 01.01.00 31.12.02 was $970,885	LTIP* awards for the 3 year periods: 01.01.01 31.12.03 01.01.02 31.12.04 01.01.03 31.12.05

* Under the cash LTIP, target payment is 60% of average salary over the three year period, maximum payment is 105% of average salary. No variation was made to any of the terms of the plan during the year. The performance measures are detailed on page 124.

Directors pension arrangements

During the year, Mr Goodwin, Mr McLuskie, Mr Pell, Mr Robertson and Mr Watt participated in The Royal Bank of Scotland Group Pension Fund (the RBS Fund). The RBS Fund is a defined benefit fund which provides pensions and other benefits within Inland Revenue limits.

The pension entitlements of Mr Goodwin, Mr Pell, Mr Robertson, and Mr Watt within the RBS Fund are restricted by Inland Revenue limits as set out in the Finance Act 1989. Additional life assurance cover in excess of these limits is provided by a separate arrangement. Arrangements have been made to provide Mr Goodwin and Mr Pell with additional pension benefits on a defined benefit basis outwith the RBS Fund. The figures shown below include the accrual in respect of these arrangements. Mr Watt is provided with additional pension benefits on a defined contribution basis and contributions made in the year are shown below.

Sir George Mathewson receives life insurance cover under an individual arrangement. The non-executive directors do not accrue pension benefits, other than Mr Robertson who continued to accrue benefits in the RBS Fund after his appointment as a non-executive director.

Mr Fish accrues pension benefits under a number of arrangements in the USA. Defined benefits are built up under the Citizens Qualified Plan, Excess Plan and Supplemental Executive Retirement Arrangement. In addition, he is a member of two defined contribution arrangements a Qualified 401(k) Plan and an Excess 401(k) Plan.

As in the 2002 Report and Accounts, disclosure of these benefits has been made in accordance with the Stock Exchange Listing Rules and the Combined Code and with the Directors Remuneration Report Regulations 2002.

Defined benefit arrangements	Age at 31 December 2003	Accrued entitlement at 31 December 2003 000 p.a.	Additional pension earned during the year ended 31 December 2003 000 p.a.	Additional pension earned during the year ended 31 December 2003* 000 p.a.	Transfer value as at 31 December 2003 000	Transfer value as at 31 December 2002 000	Increase in transfer value during year ended 31 December 2003 000	Transfer value for the additional pension earned during the year ended 31 December 2003* 000
Fred Goodwin	45	£325	£49	£44	£2,674	£1,900	£774	£365
Norman McLuskie	59	£194	£28	£25	£3,358	£2,624	£734	£433
Gordon Pell	53	£229	£17	£14	£2,930	£2,366	£564	£178
Iain Robertson	58	£28	£3	£2	£449	£353	£96	£39
Fred Watt	43	£5	£1	£1	£40	£23	£17	£12
Lawrence Fish	59	$883	$240	$240	$9,966	$6,648	$3,318	$2,713

* net of statutory revaluation applying to deferred pensions

Notes:

(1) There is a significant difference in the form of disclosure required by the Combined Code and the Directors Remuneration Report Regulations 2002. The former requires the disclosure of the additional pension earned during the year and the transfer value equivalent to this pension based on stock market conditions at the end of the year. The latter requires the disclosure of the difference between the transfer value at the start and end of the year and is therefore dependent on the change in stock market conditions over the course of the year. The above disclosure has been made in accordance with the Combined Code and the Directors Remuneration Report Regulations 2002.

(2) The figures for Mr Pell include an additional pension secured by a transfer from his previous employer which increases in line with statutory revaluation, not salary inflation.

(3) The transfer values disclosed above do not represent a sum paid or payable to the individual director. Instead they represent a potential liability of the company /pension scheme.

Contributions and allowances paid in the year ended 31 December 2003 under defined contribution arrangements were:

	2003 000	2002 000

Fred Watt	£109	£93
Lawrence Fish	$90	$90

Bob Scott, Chairman of the Remuneration Committee
18 February 2004

131

Directors interests in shares

Ordinary shares

The following directors held a beneficial interest in the company s ordinary shares:

	31 December 2003	1 January 2003 or date of appointment if later		31 December 2003	1 January 2003 or date of appointment if later
Colin Buchan	5,000		Gordon Pell	582	432
Lawrence Fish	11,120	11,120	Iain Robertson	125,139	120,904
Fred Goodwin	64,718	64,703	Bob Scott	1,445	1,445
Eileen Mackay	6,140	6,086	Sir Iain Vallance	2,500	2,500
Sir George Mathewson	247,978	247,948	Fred Watt	7,453	7,223
Norman McLuskie	154,508	150,037			

No other director had an interest in the company s ordinary shares during the year.

Additional Value shares

The following directors held a beneficial interest in the company s Additional Value Shares:

	31 December 2003	1 January 2003 or date of appointment if later		31 December 2003	1 January 2003 or date of appointment if later
Lawrence Fish		10,950	Norman McLuskie		26,584
Fred Goodwin		64,703	Iain Robertson		112,747
Eileen Mackay		6,086	Sir Iain Vallance		2,500
Sir George Mathewson		173,674			

No other director had an interest in the company s Additional Value Shares during the year.

Following the final dividend payment on the Additional Value Shares on 1 December 2003, the Additional Value Shares were de-listed from the London Stock Exchange, converted to Non-voting Deferred Shares and transferred to RBS NVDS Nominees Limited. None of the directors has an interest in the Non-voting Deferred Shares.

Preference shares

Mr Fish held 20,000 non-cumulative preference shares of US$0.01 each at 31 December 2003 (2002 20,000). No other director had an interest in the preference shares during the year.

Loan notes

No director had an interest in loan notes during the year.

The company s Register of Directors Interests, which is open to inspection, contains full details of directors shareholdings and options to subscribe.

On 7 January 2004 and 9 February 2004, eight and seven ordinary shares of 25p each, respectively, were acquired by Mr Goodwin under the Group s Buy As You Earn share scheme.

On 7 January 2004 and 9 February 2004, eight and seven ordinary shares of 25p each, respectively, were acquired by Mr McLuskie under the Group s Buy As You Earn share scheme.

No director held a non-beneficial interest in the shares of the company at 31 December 2003, at 1 January 2003 or date of appointment if later.

Statement of directors responsibilities

United Kingdom company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the Group as at the end of the financial year and of the profit or loss of the Group for that year. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board.

Miller McLean
Secretary
18 February 2004

Make it happen

Financial statements

Contents

Independent auditors report to the members of The Royal Bank of Scotland Group plc

We have audited the financial statements of The Royal Bank of Scotland Group plc (the company) and its subsidiaries (together "the Group") for the year ended 31 December 2003 which comprise the accounting policies, the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, the reconciliation of movements in shareholders funds and the related notes 1 to 54. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors remuneration report that is described as having been audited.

This report is made solely to the company s members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company s members those matters we are required to state to them in an auditors report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company s members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of directors responsibilities , the company s directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the 2003 Annual Report including the directors remuneration report. Our responsibility is to audit the financial statements and the part of the directors remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors remuneration and transactions with the company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the directors report and the other information contained in the 2003 Annual Report as described in the contents section including the unaudited part of the directors remuneration report and consider the implications for oureport if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board and with generally accepted auditing standards in the United States of America. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company and the Group, consistently applied and adequately disclosed.

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

UK opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and the Group as at 31 December 2003 and of the profit and cash flows of the Group for the year then ended and the financial statements and the part of the directors remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

US opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2003 and 2002 and the results of its operations and its cash flows for each of the three years in the period ended 31 December 2003 in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States of America. The application of the latter would have affected the determination of net income for each of the three years in the period ended 31 December 2003 and the determination of shareholders equity as at 31 December 2003 and 2002, to the extent summarised in Note 53 to the financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Edinburgh
18 February 2004

Accounting policies

The accounts have been prepared in accordance with applicable Accounting Standards in the UK and the Statements of Recommended Accounting Practice issued by the British Bankers Association and by the Finance and Leasing Association. The Statement of Recommended Practice issued by the Association of British Insurers (1998) has been followed by the insurance members of the Group; they have been consolidated in the recognised manner for banking groups, in particular, by using the embedded value method for life business. A summary of the more important accounting policies is set out below. The consolidated accounts are prepared in accordance with the special provisions of Part VII of the Companies Act 1985 (the Act) relating to banking groups.

The accounts of the company are prepared in accordance with section 226 of, and Schedule 4 to, the Act and, as permitted by section 230(3) of the Act, no profit and loss account is presented.

1 Accounting convention and bases of consolidation

The accounts are prepared under the historical cost convention modified by the periodic revaluation of premises and certain investments. To avoid undue delay in the presentation of the Group s accounts, the accounts of certain subsidiary undertakings have been made up to 30 November. There have been no changes in respect of these subsidiary undertakings, in the period from their balance sheet dates to 31 December, that materially affect the view given by the Group s accounts.

2 Revenue recognition

Interest is credited to the profit and loss account as it accrues unless there is significant doubt that it can be collected (as described in the accounting policy on loans and advances).

Fees in respect of services are recognised as the right to consideration accrues through performance to customers. Services are in respect of financial services related products, the arrangement is generally contractual, the cost of providing this service is incurred as the service is rendered and the price is usually fixed and always determinable.

The application of the Group s policy to significant fee types is outlined below.

Loan origination fees: up-front lending fees are recognised as income when receivable except where they are charged in lieu of interest or charged to cover the cost of a continuing service to the borrower, in which case they are credited to income over the life of the advance.

Commitment and utilisation fees: these are generally determined as a percentage of the outstanding used or unused facility. They are usually charged to the customer in arrears and recognised when charged.

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

Card related services: fees from credit card business include:

> Commission received from retailers for processing credit and debit card transactions: income is accrued to the profit and loss account as the service is performed.
>
> Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and Automated Teller Machine networks. These fees are accrued once the transaction has taken place.

An annual fee payable by a credit card holder is charged at the beginning of each year but is deferred and taken to income over the period of the service i.e. 12 months.

Insurance brokerage: this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

Securities and derivatives held for trading are recorded at fair value. Changes in fair value are recognised in dealing profits together with dividends from, and interest receivable and payable on, trading business assets and liabilities.

3 Goodwill

Goodwill is the excess of the cost of acquisition of subsidiary and associated undertakings over the fair value of the Group s share of net tangible assets acquired. Goodwill arising on acquisitions of subsidiary and associated undertakings after 1 October 1998 is capitalised on the balance sheet and amortised on a straight-line basis over its estimated useful economic life, currently over periods up to 20 years. Capitalised goodwill is reviewed for impairment at the end of the first full year following an acquisition and subsequently if events or changes in circumstances indicate that its carrying value may not be recoverable in full. Goodwill arising on acquisitions of subsidiary and associated undertakings prior to 1 October 1998, previously charged directly against profit and loss account reserves, was not reinstated under the transitional provisions of FRS 10 Goodwill and Intangible Assets . It will be written back only on disposal and reflected in the calculation of the gains or losses arising.

Accounting policies continued

4 Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Profit and loss accounts of overseas branches and subsidiary undertakings are translated at the average rates of exchange for the period. Exchange differences arising from the application of closing rates of exchange to the opening net assets of overseas branches and subsidiary undertakings and from restating their results from average to period-end rates are taken to profit and loss account reserves, together with exchange differences arising on related foreign currency borrowings. All other exchange differences are included in operating profit.

5 Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees. The cost of defined benefit pension schemes and healthcare plans is assessed by independent professionally qualified actuaries and recognised on a systematic basis over employees service lives. Contributions to defined contribution pension schemes are recognised in the profit and loss account when payable.

6 Leases

Contracts to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer. Other contracts to lease assets are classified as operating leases. Total gross earnings under finance leases are allocated to accounting periods using the actuarial after tax method to give a constant periodic rate of return on the net cash investment. Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease. Rental income from operating leases is credited to the profit and loss account on a receivable basis over the term of the lease. Balance sheet carrying values of finance lease receivables and operating lease assets include amounts in respect of the residual values of the leased assets. Unguaranteed residual values are subject to regular review to identify potential impairments. Provisions are made for impairment arising on specific asset categories.

7 General insurance

General insurance comprises short-duration contracts and include principally property and liability insurance contracts. Due to the nature of the products sold retail based property and casualty, motor, home and personal health insurance contracts the insurance protection is provided on an even basis throughout the term of the policy.

In calculating operating profit from general insurance activities, premiums (net of reinsurance premiums) are recognised in the accounting period in which they begin. Unearned premiums represent the proportion of the net premiums that relate to periods of insurance after the balance sheet date and are calculated over the period of exposure under the policy, on a daily basis, 24th s basis or allowing for the estimated incidence of exposure under policies which are longer than twelve months. Provision is made where necessary for the estimated amount required over and above unearned premiums net of reinsurance, including that in respect of future written business on discontinued lines under the run-off of delegated underwriting authority arrangements. It is designed to meet future claims and related expenses and is calculated across related classes of business on the basis of a separate carry forward of deferred acquisition expenses after making allowance for investment income.

Acquisition expenses relating to new and renewed business for all classes are deferred over the period during which the premiums are unearned. The principal acquisition costs so deferred are commissions payable, direct advertising expenditure, costs associated with the telesales and underwriting staff and prepaid claims handling costs in respect of delegated claims handling arrangements for claims which are expected to occur after the balance sheet date.

Claims (net of reinsurance) are recognised in the accounting period in which the loss occurs. Provision is made for the full cost (net of reinsurance) of settling outstanding claims at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date, and claims handling expenses.

8 Long-term life assurance business

The Group s long-term assurance business includes whole-life, guaranteed renewable term life, endowment, annuity and universal life contracts that are expected to remain in force for an extended period of time, generally five to forty years.

The value placed on the Group s long-term life assurance business comprises the net assets of the Group s life assurance subsidiaries, including its interest in the surpluses retained within the long-term assurance funds, and the present value of profits inherent in in-force policies. In calculating the value of in-force policies, future surpluses expected to emerge are estimated using appropriate assumptions as to future mortality, persistency and levels of expenses, which are then discounted at a risk-adjusted rate. Changes in this value, which is determined on a post-tax basis, are included in operating profit, grossed up at the underlying rate of taxation.

Long-term assurance assets attributable to policyholders are valued on the following bases: equity shares and debt securities at market price; investment properties and loans at valuation. These assets are held in the life funds of the Group s life assurance companies, and although legally owned by them, the Group only benefits from these assets when surpluses are declared. To reflect the distinct nature of the long-term assurance assets, they are shown separately on the consolidated balance sheet, as are liabilities attributable to policyholders.

The Group has reinsured contracts that transfer significant insurance risk. Within net assets, the reinsurance cash flows are recognised when they become payable. For most contracts this effectively spreads the cost of reinsurance over the life of the reinsured contracts. In some cases, the acquisition costs

138

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are financed by the reinsurer offering a nil premium payment period. In these cases, the acquisition costs incurred on the underlying insurance contracts are compared with the benefit arising with respect to the nil premium paying period on the reinsurance contract.

9 Loans and advances

The Group makes provisions for bad and doubtful debts, through charges to the profit and loss account, so as to record impaired loans and advances at their expected ultimate net realisable value.

Specific provisions are made against individual loans and advances that the Group no longer expects to recover in full. For the Group s portfolios of smaller balance homogeneous advances, such as credit card receivables, specific provisions are established on a portfolio basis taking into account the level of arrears, security and past loss experience. For loans and advances that are individually assessed, the specific provision is determined from a review of the financial condition of the borrower and any guarantor and takes into account the nature and value of any security held.

The general provision is made to cover bad and doubtful debts that have not been separately identified at the balance sheet date but are known to be present in any portfolio of advances. The level of general provision is determined in the light of past experience, current economic and other factors affecting the business environment and the Group s monitoring and control procedures, including the scope of specific provisioning procedures.

Specific and general provisions are deducted from loans and advances. When there is significant doubt that interest receivable can be collected, it is excluded from the profit and loss account and credited to an interest suspense account. Loans and advances and suspended interest are written off in part or in whole when there is no realistic prospect of recovery.

10 Taxation

Provision is made for taxation at current enacted rates on taxable profits taking into account relief for overseas taxation where appropriate. Timing differences arise where gains and losses are accounted for in different periods for financial reporting purposes and for taxation purposes. Deferred taxation is accounted for in full for all such timing differences, except in relation to revaluations of fixed assets where there is no commitment to dispose of the asset, taxable gains on sales of fixed assets that are rolled over into the tax cost of replacement assets, and unremitted overseas earnings. Deferred tax assets are only recognised to the extent that it is considered more likely than not that they will be recovered. Deferred tax amounts are not discounted.

11 Debt securities and equity shares

Debt securities and equity shares intended for use on a continuing basis in the Group s activities are classified as investment securities and are stated at cost less provision for any permanent diminution in value. The cost of dated investment securities is adjusted for the amortisation of premiums or discounts over periods to redemption and the amortisation is included in interest receivable. Other debt securities and equity shares are carried at fair value, with changes in fair value recognised in the profit and loss account.

12 Shares in subsidiary undertakings

The company s shares in subsidiary undertakings are stated in the balance sheet of the company at directors valuation that takes account of the subsidiary undertakings net asset values.

13 Interests in associated undertakings

Interests in associated undertakings are accounted for by the equity method and are stated in the consolidated balance sheet at the Group s share of their net tangible assets. The Group s share of the results of associated undertakings is included in the consolidated profit and loss account. For this purpose, the latest available audited accounts are used together with available unaudited interim accounts.

14 Tangible fixed assets

Freehold and long leasehold properties are revalued on a rolling basis, each property being revalued at least every five years. Other tangible fixed assets are stated at cost less depreciation and provisions for impairment. Costs of adapting premises for the use of the Group are separately identified and depreciated.

Tangible fixed assets are depreciated to their residual value over their estimated useful economic lives on a straight-line basis, as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

Assets on operating leases are depreciated over their estimated useful lives on a straight-line or reverse-annuity basis. Land has an unlimited life and is not depreciated.

Investment properties are revalued annually to open market value. No depreciation is charged on freehold investment properties, in accordance with the requirements of Statement of Standard Accounting Practice 19 Accounting for investment properties . This is a departure from the requirements of the Companies Act 1985 which requires all tangible fixed assets to be depreciated. Investment properties are held not for consumption but for investment and the directors consider that to depreciate them would not give a true and fair view. It is not practicable to assess estimated useful lives for investment properties, and accordingly the effect of not depreciating them cannot be reasonably quantified.

139

Accounting policies continued

15 Derivatives

The Group enters into derivative transactions including futures, forwards, swaps and options principally in the interest rate, foreign exchange and equity markets. The accounting treatment for these instruments is dependent upon whether they are entered into for trading or non-trading (hedging) purposes.

Trading

Derivatives held for trading purposes are recognised in the accounts at fair value. Gains or losses arising from changes in fair value are included in dealing profits in the consolidated profit and loss account. Fair value is based on quoted market prices. Where representative market prices are not available, the fair value is determined from current market information using appropriate pricing or valuation models. Adjustments are made to quoted market prices where appropriate to cover credit risk, liquidity risk and future operational costs. In the consolidated balance sheet, positive fair values (assets) of trading derivatives are included in Other assets and negative fair values (liabilities) in Other liabilities. Positive and negative fair values of trading derivatives are offset where the contracts have been entered into under master netting agreements or other arrangements that give a legally enforceable right of set-off.

Non-trading

Non-trading derivatives are entered into by the Group to hedge exposures arising from transactions entered into in the normal course of banking activities. They are recognised in the accounts in accordance with the accounting treatment of the underlying transaction or transactions being hedged. To be classified as non-trading, a derivative must match or eliminate the risk inherent in the hedged item from potential movements in interest rates, exchange rates or market values. In addition, there must be a demonstrable link to an underlying transaction, pool of transactions or specified future transaction or transactions. Specified future transactions must be reasonably certain to arise for the derivative to be accounted for as a hedge. In the event that a non-trading derivative transaction is terminated or ceases to be an effective hedge, the derivative is re-measured at fair value and any resulting profit or loss amortised over the remaining life of the underlying transaction or transactions being hedged. If a hedged item is derecognised, or a specified future transaction is no longer likely to occur, the related non-trading derivative is remeasured at fair value and the resulting profit or loss taken to the profit and loss account.

16 Sale and repurchase transactions

Securities which have been sold with an agreement to repurchase continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in reverse sale and repurchase transactions are not recognised in the balance sheet and the purchase price is treated as a loan. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the profit and loss account as interest payable or receivable.

140

Consolidated profit and loss account for the year ended 31 December 2003

	Note	2003 £m	2002 £m	2001 £m
Interest receivable				
interest receivable and similar income arising from debt securities		1,519	1,591	1,582
other interest receivable and similar income		12,479	11,970	12,839
Interest payable		(5,697)	(5,712)	(7,575)
Net interest income		8,301	7,849	6,846

Dividend income		58	58	54
Fees and commissions receivable		5,755	5,308	4,735
Fees and commissions payable		(1,337)	(965)	(930)
Dealing profits	1	1,793	1,462	1,426
Other operating income		1,598	1,209	1,052
		7,867	7,072	6,337
General insurance				
earned premiums		3,565	2,383	1,804
reinsurance		(504)	(489)	(429)
Non-interest income		10,928	8,966	7,712
Total income		19,229	16,815	14,558
Administrative expenses				
staff costs*	2	4,518	4,472	4,059
premises and equipment*		1,073	1,006	873
other*		2,108	2,253	1,903
Depreciation and amortisation				
tangible fixed assets*	20	919	895	881
goodwill	19	763	731	651
Operating expenses		9,381	9,357	8,367
Profit before other operating charges		9,848	7,458	6,191
General insurance				
gross claims		2,644	1,693	1,263
reinsurance		(449)	(343)	(315)
Profit before provisions for bad and doubtful debts		7,653	6,108	5,243
Provisions for bad and doubtful debts	13	1,461	1,286	984
Amounts written off fixed asset investments		33	59	7
Profit on ordinary activities before tax	4	6,159	4,763	4,252
Tax on profit on ordinary activities	5	1,910	1,556	1,537
Profit on ordinary activities after tax		4,249	3,207	2,715
Minority interests (including non-equity)	32	210	133	90
Profit for the financial year		4,039	3,074	2,625
Preference dividends non-equity	6	261	305	358
		3,778	2,769	2,267
Additional Value Shares dividend non-equity	6	1,463	798	399
Profit attributable to ordinary shareholders		2,315	1,971	1,868
Ordinary dividends	7	1,490	1,267	1,085

Retained profit	34	825	704	783
Per 25p ordinary share:				
Basic earnings	9	79.0p	68.4p	67.6p
Additional Value Shares dividend		49.9p	27.7p	14.5p
		128.9p	96.1p	82.1p
Goodwill amortisation		25.0p	24.2p	23.2p
Integration costs		5.4p	23.8p	22.6p
Adjusted earnings		159.3p	144.1p	127.9p
Diluted earnings	9	78.4p	67.4p	66.3p
Dividends	7	50.3p	43.7p	38.0p

All items dealt with in arriving at profit on ordinary activities before tax relate to continuing operations.

Profit on ordinary activities before taxation and the retained profit for the year on a historical cost basis were not materially different from the reported amounts.

* includes integration expenditure (see Note 4)

141

Consolidated balance sheet at 31 December 2003

	Note	2003 £m	2002 £m
Assets			
Cash and balances at central banks		3,822	3,481
Items in the course of collection from other banks		2,501	2,741
Treasury bills and other eligible bills	10	4,846	11,459
Loans and advances to banks	11	51,891	44,296
Loans and advances to customers	12	252,531	223,324
Debt securities	14	79,949	67,042
Equity shares	15	2,300	1,886
Interests in associated undertakings	16	106	94
Intangible fixed assets	19	13,131	12,697
Tangible fixed assets	20	13,927	10,485
Settlement balances		2,857	4,102
Other assets	21	18,436	16,929
Prepayments and accrued income		5,421	4,353

		451,718	402,889
Long-term assurance assets attributable to policyholders	22	3,557	9,111
Total assets		455,275	412,000
Liabilities			
Deposits by banks	23	67,323	54,720
Items in the course of transmission to other banks		958	1,258
Customer accounts	24	236,963	219,161
Debt securities in issue	25	41,016	33,938
Settlement balances and short positions	26	21,369	19,412
Other liabilities	27	20,584	20,754
Accruals and deferred income		13,173	8,626
Provisions for liabilities and charges			
deferred taxation	28	2,266	1,834
other provisions	29	256	330
Subordinated liabilities			
dated loan capital	30	9,312	7,602
undated loan capital including convertible debt	31	7,686	6,363
Minority interests			
equity		(11)	(11)
non-equity	32	2,724	1,850
Called up share capital	33	769	754
Share premium account	34	8,175	7,608
Merger reserve	34	10,881	11,455
Other reserves	34	419	387
Revaluation reserve	34	7	80
Profit and loss account	34	7,848	6,768
Shareholders funds			
equity		25,176	23,545
non-equity	34	2,923	3,507
		451,718	402,889
Long-term assurance liabilities attributable to policyholders	22	3,557	9,111
Total liabilities		455,275	412,000
Memorandum items			
Contingent liabilities	41	14,864	15,588
Commitments (standby facilities, credit lines and other)	41	139,693	128,592

The accounts were approved by the Board of directors on 18 February 2004 and signed on its behalf by:

Sir George Mathewson	Fred Goodwin	Fred Watt
Chairman	*Group Chief Executive*	*Group Finance Director*

142

Statement of consolidated total recognised gains and losses for the year ended 31 December 2003

	2003 £m	2002 £m	2001 £m
Profit attributable to ordinary shareholders	2,315	1,971	1,868
Currency translation adjustments and other movements	43	36	(3)
Revaluation of premises	(69)	(33)	72
Total recognised gains and losses in the year	2,289	1,974	1,937
Prior year adjustment arising from the implementation of FRS 19		(117)	
Total recognised gains and losses	2,289	1,857	1,937

Reconciliation of movements in consolidated shareholders funds for the year ended 31 December 2003

	2003 £m	2002 £m	2001 £m
Profit attributable to ordinary shareholders	2,315	1,971	1,868
Ordinary dividends	(1,490)	(1,267)	(1,085)
Retained profit for the year	825	704	783
Issue of ordinary and preference shares	775	560	2,759
Redemption of preference shares	(364)	(600)	
Goodwill previously written off to reserves	40		
Other recognised gains and losses	(26)	3	69
Currency translation adjustment on share premium account	(203)	(283)	58
Net increase in shareholders funds	1,047	384	3,669
Opening shareholders funds	27,052	26,668	22,999
Closing shareholders funds	28,099	27,052	26,668

143

Consolidated cash flow statement for the year ended 31 December 2003

	Note	2003 £m	2003 £m	2002 £m	2002 £m	2001 £m	2001 £m
Net cash inflow from operating activities	43		19,708		13,737		7,287
Dividends received from associated undertakings			9		1		1
Returns on investments and servicing of finance							
Preference dividends paid		(269)		(317)		(353)	

Additional Value Shares dividend paid		(1,463)		(798)		(399)	
Dividends paid to minority shareholders in subsidiary undertakings		(130)		(112)		(43)	
Interest paid on subordinated liabilities		(557)		(674)		(652)	
Net cash outflow from returns on investments and servicing of finance			(2,419)		(1,901)		(1,447)
Taxation							
UK tax paid		(933)		(833)		(790)	
Overseas tax paid		(521)		(274)		(419)	
Net cash outflow from taxation			(1,454)		(1,107)		(1,209)
Capital expenditure and financial investment							
Purchase of investment securities		(44,861)		(32,701)		(27,537)	
Sale and maturity of investment securities		41,805		26,072		20,578	
Purchase of tangible fixed assets		(5,017)		(3,367)		(4,245)	
Sale of tangible fixed assets		1,108		811		867	
Net cash outflow from capital expenditure and financial investment			(6,965)		(9,185)		(10,337)
Acquisitions and disposals							
Purchase of businesses and subsidiary undertakings (net of cash acquired)	44	(1,748)		(308)		(1,614)	
Investment in associated undertakings	16	(2)		(2)		(47)	
Sale of subsidiary and associated undertakings (net of cash sold)	45	179		29		8	
Net cash outflow from acquisitions and disposals			(1,571)		(281)		(1,653)
Ordinary equity dividends paid			(772)		(729)		(653)
Net cash inflow/(outflow) before financing			6,536		535		(8,011)
Financing							
Proceeds from issue of ordinary share capital		184		85		2,131	
Proceeds from issue of preference share capital						281	
Proceeds from issue of trust preferred securities		883		1,242			
Redemption of preference share capital		(364)		(600)			
Issue of subordinated liabilities		3,817		2,157		2,705	
Repayment of subordinated liabilities		(336)		(202)		(693)	
(Decrease)/increase in minority interests		(56)		29		(13)	
Net cash inflow from financing			4,128		2,711		4,411
Increase/(decrease) in cash	48		10,664		3,246		(3,600)

Balance sheet the company at 31 December 2003

	Note	2003 £m	2002 £m
Fixed assets			
Investments:			
Shares in Group undertakings	17	32,354	19,862
Loans to Group undertakings	18	4,554	3,354
		36,908	23,216
Current assets			
Debtors:			
Due by subsidiary undertakings		238	958
Debtors and prepayments		202	113
		440	1,071
Creditors			
Amounts falling due within one year:			
Due to banks		71	71
Dated loan capital	30	40	40
Debt securities in issue		1,877	1,199
Other creditors		217	154
Proposed final dividend	7	1,059	899
		3,264	2,363
Net current liabilities		(2,824)	(1,292)
Total assets less current liabilities		34,084	21,924
Creditors			
Amounts falling due beyond one year:			
Loans from subsidiary undertakings		186	155
Dated loan capital	30	3,714	2,402
Undated loan capital including convertible debt	31	1,639	1,301
		5,539	3,858
Capital and reserves			
Called up share capital	33	769	754
Share premium account	34	8,175	7,608
Other reserves	34	156	156
Revaluation reserve	34	16,857	6,001
Profit and loss account	34	2,588	3,547
Shareholders funds			
equity		25,622	14,559
non-equity	34	2,923	3,507
		34,084	21,924

The accounts were approved by the Board of directors on 18 February 2004 and signed on its behalf by:

Sir George Mathewson	Fred Goodwin	Fred Watt
Chairman	*Group Chief Executive*	*Group Finance Director*

Notes on the accounts

1 Dealing profits

	2003 £m	2002 £m	2001 £m
Foreign exchange (1)	540	447	450
Securities			
Equities (2)	24	18	10
Debt (3)	774	644	682
Interest rate derivatives (4)	455	353	284
	1,793	1,462	1,426

Dealing profits include interest income and expense recognised on trading-related interest-earning assets and interest-bearing liabilities and exclude direct costs and administrative expenses.

Notes:

(1) Includes spot and forward foreign exchange contracts and currency swaps, futures and options and related hedges and funding.
(2) Includes equities, equity derivatives, commodity contracts and related hedges and funding.
(3) Includes debt securities and related hedges and funding.
(4) Includes interest rate swaps, forward rate agreements, interest rate options, interest rate futures and credit derivatives and related hedges and funding.

2 Administrative expenses staff costs

	2003 £m	2002 £m	2001 £m
Wages, salaries and other staff costs	3,997	4,001	3,667
Social security costs	248	239	212
Pension costs (see Note 3)	273	232	180
	4,518	4,472	4,059

The average number of persons employed by the Group during the year, excluding temporary staff, was 119,500 (2002 113,500; 2001 99,400).

3 Pension costs

The Group operates a number of pension schemes throughout the world. The main schemes are defined benefit schemes whose assets are independent of the Group s finances. The total pension cost for the Group was as follows:

	2003 £m	2002 £m	2001 £m
Main UK scheme	200	187	150

Other Group schemes	73	45	30
	273	232	180

At 31 December 2003, there was a pension cost prepayment of £112 million and accrual of £18 million (2002 prepayment of £136 million and accrual of £17 million; 2001 prepayment of £115 million and accrual of £33 million).

On the acquisition of NatWest in March 2000, a surplus of £1,070 million on its major schemes was recognised in the consolidated balance sheet, and is being amortised over the average future service life of members of the schemes. The unamortised balance as at 31 December 2003 was £755 million (2002 £838 million) before tax and £529 million (2002 £587 million) after tax. The unamortised balance before tax is included in Other assets .

The Group s two main UK pension schemes, The Royal Bank of Scotland Staff Pension Scheme and the National Westminster Bank Pension Fund, merged on 1 April 2002 to form The Royal Bank of Scotland Group Pension Fund. Scheme valuations are carried out by independent professionally qualified actuaries to determine pension costs, using the projected unit method; any imbalance between assets and liabilities is adjusted over the average future service life of members of the scheme. The assumptions that have the most significant effect on the results of the valuations are those relating to the valuation rate of interest and the rates of increases in salaries and pensions.

The latest formal valuation of The Royal Bank of Scotland Staff Pension Scheme and the National Westminster Bank Pension Fund was carried out as at 31 March 2001 on a basis that assumed the merger of the schemes. The results of this valuation and the principal actuarial assumptions were:

Market value of scheme assets (£m)	13,027
Funding level	108%
Excess of scheme assets over schemes liabilities (£m)	1,058
Valuation rate of interest:	
past service liabilities (per annum) pensioners	5.5%
past service liabilities (per annum) non-pensioners	6.0%
future service liabilities (per annum)	6.75%
Salary growth (per annum) (1)	4.25%
Pension increases (per annum)	2.5%
Price inflation (per annum)	2.5%

Notes:

(1) In addition, allowance is made for promotional salary increases.

(2) Assumptions for rate of dividend increases are not relevant to the bases of valuations adopted.

The pension costs relating to the merged schemes were:

Pension costs for the year	2003 £m	2002 £m
Regular cost	274	263
Amortisation of pension fund surplus	(151)	(153)
Prior year service costs		
Amortisation of surplus recognised on acquisition of NatWest	77	77
Net pension cost	200	187

In addition to the main scheme, the Group operates a number of other UK and overseas pension schemes and also provides other post-retirement benefits, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the profit and loss account over the average remaining future service lives of the eligible employees. The amounts are not material.

In accordance with SSAP 24, the pension costs relating to the main scheme are based on the actuarial valuation as at 31 March 2001. Since that date, stock market equity values and bond yields have declined. The next triennial actuarial valuation will be carried out as at 31 March 2004.

FRS 17

In accordance with the transitional requirements of FRS 17 interim valuations of the Group s schemes were prepared to 31 December 2003 and 31 December 2002 by independent actuaries, using the following assumptions:

	2003		2002		2002	
	Main UK scheme	Other Group schemes*	Main UK scheme	Other Group schemes*	Main UK scheme	Other Group schemes*
Rate of increase in salaries (per annum)	3.95%	3.8%	3.50%	3.2%	4.25%	3.2%
Rate of increase in pensions in payment (per annum)	2.70%	2.3%	2.25%	1.7%	2.50%	2.3%
Discount rate (per annum)	5.60%	5.8%	5.75%	5.8%	6.00%	6.1%
Inflation assumption (per annum)	2.70%	2.1%	2.25%	1.7%	2.50%	2.2%

* weighted average

Notes on the accounts continued

Pension costs *(continued)*

The values of the assets and liabilities of the schemes at 31 December 2003 and 2002 and the effect on the Group s reserves if they were to be incorporated in the balance sheet were as follows:

	2003		2002		2002	
	Main UK scheme £m	Other Group schemes £m	Main UK scheme £m	Other Group schemes £m	Main UK scheme £m	Other Group schemes £m
Equities	7,621	686	7,161	610	7,899	717
Bonds	3,818	276	3,298	260	4,203	176
Other	383	103	223	140	465	167
Total market value of assets	11,822	1,065	10,682	1,010	12,567	1,060
Present value of scheme liabilities	(13,594)	(1,261)	(12,418)	(1,130)	(12,121)	(1,014)
Net (deficit)/surplus in the schemes	(1,772)	(196)	(1,736)	(120)	446	46
Related notional deferred tax asset /(liability)	532	22	521	20	(133)	(10)

Net unrecognised pension (deficit)/surplus	(1,240)	(174)	(1,215)	(100)	313	36
Prepayments less accruals currently recognised, net of deferred tax	(25)	(33)	(52)	(27)	(53)	(5)
Pension assets recognised on the acquisition of NatWest, net of deferred tax and amortisation	(494)	(35)	(548)	(39)	(602)	(42)
Effect on Group profit and loss account reserves	(1,759)	(242)	(1,815)	(166)	(342)	(11)

The assumptions for long-term rates of return on the principal classes of assets at 31 December 2003 were equities 8.4%, gilts 4.8%, other bonds 5.6%, property 6.6% and cash and other assets 4.9% (2002 equities 8.4%, gilts 4.5%, other bonds 5.75%, property 6.5% and cash 4.5%; 2001 equities 8.4%, gilts 5.0%, other bonds 6.0%, property 6.8% and cash 4.5%).

The following amounts would be reflected in the profit and loss account and statement of total recognised gains and losses on implementation of FRS 17:

Amount that would be charged to profit and loss account	Main UK scheme £m	Other schemes £m	2003 Total £m	2002 Total £m
Expected return on pension scheme assets	757	69	826	988
Interest on pension scheme liabilities	(710)	(64)	(774)	(787)
Net return credited to other finance income	47	5	52	201
Current service cost	(325)	(46)	(371)	(322)
Past service cost				(3)
Net pension cost defined benefit schemes	(278)	(41)	(319)	(124)
Defined contribution schemes and other retirement benefits		(37)	(37)	(19)
Total pension costs	(278)	(78)	(356)	(143)

Amount that would be recognised in the statement of total recognised gains and losses	2003 Total £m	2002 Total £m
Actual return less expected return on pension scheme assets	872	(2,645)
Experience gains and losses arising on scheme liabilities	7	(25)
Changes in assumptions underlying the present value of scheme liabilities	(810)	278
Actuarial gain/(loss)	69	(2,392)

Movement in pension scheme (deficits)/surpluses during the year	2003 Total £m	2002 Total £m
(Deficit)/surplus in the pension schemes at 1 January	(1,856)	492
Movement in year:		
Current service cost	(371)	(322)
Past service cost		(3)
Contributions	139	167
Other finance income	52	201
Actuarial gain/(loss)	69	(2,392)

Exchange and other movements	(1)	1
Deficit in schemes at 31 December	(1,968)	(1,856)

The contribution rate for 2003 and 2004 for the main scheme is 6.8% (2002 6.8%) of pensionable salaries.

History of experience gains and losses	2003 £m	2002 £ml
Difference between expected and actual return on scheme assets:		
Amount	872	(2,645)
Percentage of scheme assets	6.8%	(22.6%)
Experience gains and losses on scheme liabilities:		
Amount	7	(25)
Percentage of the present value of scheme liabilities		(0.2%)
Total amount recognised in the statement of total recognised gains and losses:		
Amount	69	(2,392)
Percentage of the present value of scheme liabilities	0.5%	(17.7%)

4 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after taking account of the following:

		2003 £m	2002 £m	2001 £m
Income	Aggregate amounts receivable under finance leases,			
	hire purchase and conditional sale contracts	1,161	1,342	1,575
	Aggregate amounts receivable under operating leases	939	811	707
	Profit on disposal of investment securities	172	85	48
	Share of associated undertakings net profit/(loss)	12	2	(6)
Expenses	Operating lease rentals of premises	321	255	214
	Operating lease rentals of computers and other equipment	13	16	18
	Finance charges on leased assets	8	23	40
	Interest on subordinated liabilities	551	659	674
	Integration expenditure* relating to:			
	acquisition of NatWest	143	810	847
	other acquisitions	86	147	28

	2003 £m	2002 £m	2001 £m
*Integration expenditure comprises:			
Staff costs	125	530	598
Premises and equipment	31	127	64
Other administrative expenses	73	298	188
Depreciation		2	25
	229	957	875

Auditors remuneration

Amounts paid to the auditors for statutory audit and other services were as follows:

	2003 £m	2002 £m
Audit services		
Statutory audit	7.2	5.8
Audit related regulatory reporting	0.6	0.5
	7.8	6.3
Further assurance services	5.7	2.0
Tax services		
Compliance services	0.1	0.3
Advisory services	0.5	0.6
	0.6	0.9
Other services	0.7	3.6
Total	14.8	12.8

The auditors remuneration for statutory audit work for the company was £0.1 million (2002 £0.1 million). Non audit fees paid to the auditors and their associates in the UK was £6.2 million (2002 6.3 million).

149

Notes on the accounts continued

5 Tax on profit on ordinary activities

	2003 £m	2002 £m	2001 £m
Current taxation:			
UK corporation tax charge for the year at 30%	1,095	909	984
Over provision in respect of prior periods	(66)	(13)	(16)
Relief for overseas taxation	(211)	(26)	(98)
	818	870	870
Overseas taxation:			
Current year charge	538	370	381
(Over)/under provision in respect of prior periods	(11)	(2)	31
	1,345	1,238	1,282
Share of associated undertakings	2	2	2
Current tax charge for the year	1,347	1,240	1,284

Deferred taxation:			
Origination and reversal of timing differences	598	372	255
Over provision in respect of prior periods	(35)	(56)	(2)
Tax charge for the year	1,910	1,556	1,537

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 30% as follows:

	2003 £m	2002 £m	2001 £m
Expected tax charge	1,848	1,429	1,276
Goodwill amortisation	200	183	169
Contributions to employee share schemes	(35)	(40)	(48)
Non-deductible items	231	179	251
Non-taxable items	(207)	(163)	(92)
Capital allowances in excess of depreciation	(626)	(340)	(280)
Taxable foreign exchange movements	5	4	16
Foreign profits taxed at other rates	23	3	(13)
Unutilised losses brought forward and carried forward	(15)		(10)
Current taxation adjustments relating to prior periods	(77)	(15)	15
Current tax charge for the year	1,347	1,240	1,284
Deferred taxation:			
Origination and reversal of timing differences	598	372	255
Adjustments in respect of prior periods	(35)	(56)	(2)
Actual tax charge	1,910	1,556	1,537

The following factors may affect future tax charges:

(1) No deferred tax is recognised on the unremitted reserves of overseas subsidiary and associated undertakings. A substantial proportion of such reserves are required to be retained by the overseas undertakings to meet local regulatory requirements.

(2) Deferred tax assets of £127 million (2002 £107 million) resulting from tax losses carried forward have not been recognised as there is insufficient evidence that the asset will be recoverable. These assets may be recoverable if the losses can be offset against suitable future taxable profits arising in the same tax jurisdiction.

(3) The fair values of certain financial assets are disclosed in Note 40. The tax that could be payable if these assets were disposed of at the values shown is estimated at £561 million (2002 £965 million). Because of the nature of these financial assets which are held as part of the banking business, it is not possible to determine the amount that may become payable in the foreseeable future.

(4) Freehold and long leasehold properties are revalued (see Note 20). No provision has been made for deferred tax on gains recognised on revaluing Group properties except where there is a commitment to sell the asset and any taxable gain will not be subject to rollover relief. The tax that could be payable if these assets were disposed of at their revalued amount is estimated at £109 million (2002 £81 million), including tax on rolled over gains (see note (5) below). No such tax is expected to be payable in the foreseeable future.

(5) No provision has been made for deferred tax on certain gains realised on disposals of property and other assets as there is an expectation of rolling over such gains into replacement assets. Expenditure to date on valid replacement assets together with forecasts of future such expenditure indicate that these gains will be available for rollover relief. The tax that could be payable if the conditions for rollover relief were not met is estimated at £68 million (2002 £93 million).

6 Preference and Additional Value Shares dividends

	2003 £m	2002 £m	2001 £m

Non-cumulative preference shares of US$0.01	99	141	140
Non-cumulative convertible preference shares of US$0.01	100	108	115
Non-cumulative convertible preference shares of €0.01	37	32	32
Non-cumulative convertible preference shares of £0.25		1	49
Non-cumulative convertible preference shares of £0.01	15	15	15
11% cumulative preference shares of £1 (1)			
5.5% cumulative preference shares of £1 (2)			
Appropriation for premium payable on redemption and issue costs	10	8	7
Total preference dividends	261	305	358
Additional Value Shares	1,463	798	399
Total non-equity dividends	1,724	1,103	757

Notes:

(1) Dividends for the year ended 31 December 2003 amounted to £55,000 (2002 and 2001 £55,000).
(2) Dividends for the year ended 31 December 2003 amounted to £22,000 (2002 and 2001 £22,000).

7 Ordinary dividends

	2003 p per share	2002 p per share	2001 p per share	2003 £m	2002 £m	2001 £m
Interim	14.6	12.7	11.0	431	368	313
Proposed final	35.7	31.0	27.0	1,059	899	772
Total dividends on equity shares	50.3	43.7	38.0	1,490	1,267	1,085

8 Profit dealt with in the accounts of the company

Of the profit attributable to shareholders, £2,619 million (2002 £1,955 million; 2001 £1,033 million) has been dealt with in the accounts of the company.

9 Earnings per ordinary share

The earnings per share are based on the following:

	2003 £m	2002 £m	2001 £m
Earnings:			
Profit attributable to ordinary shareholders	2,315	1,971	1,868
		Number of shares millions	
Number of ordinary shares:			
Weighted average number of ordinary shares in issue during the year	2,931	2,881	2,762
Effect of dilutive share options and convertible non-equity shares	22	43	55
Diluted weighted average number of ordinary shares during the year	2,953	2,924	2,817

Notes on the accounts continued

10 Treasury bills and other eligible bills

	2003 £m	2002 £m
Treasury bills and similar securities	3,917	8,348
Other eligible bills	929	3,111
	4,846	11,459
Banking business	2,977	4,569
Trading business	1,869	6,890

Treasury and other eligible bills are principally of short-term maturity and their market value is not materially different from carrying value.

11 Loans and advances to banks

	2003 £m	2002 £m
Repayable on demand	17,115	6,792
Remaining maturity		
three months or less	25,525	28,537
one year or less but over three months	8,357	8,482
five years or less but over one year	422	180
over five years	479	312
	51,898	44,303
Specific bad and doubtful debt provisions	(7)	(7)
	51,891	44,296
Banking business	21,358	21,859
Trading business	30,533	22,437

12 Loans and advances to customers

	2003 £m	2002 £m

On demand or short notice	24,847	21,122
Remaining maturity		
three months or less	64,281	65,108
one year or less but over three months	27,465	24,750
five years or less but over one year	40,908	40,364
over five years	98,952	75,900
	256,453	227,244
General and specific bad and doubtful debt provisions	(3,922)	(3,920)
	252,531	223,324
Banking business	223,456	197,818
Trading business	29,075	25,506
Amounts above include:		
Subordinated advances	73	96
Due from associated undertakings unsubordinated	313	289
Amounts receivable under finance leases	8,405	7,496
Amounts receivable under hire purchase and conditional sale agreements	5,935	5,636

The cost of assets acquired during the year for the purpose of letting under finance leases and hire purchase agreements was £6,361 million (2002 £4,684 million).

The Group s exposure to risk from its lending activities is widely diversified both geographically and industrially. Lending to the services sector, house mortgage lending, loans to financial institutions, other personal loans and lending to property companies exceeded 10% of total loans and advances to customers (before provisions).

Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (see above) and operating lease assets (see Note 20).

	Year in which the residual value will be recovered				
2003	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
Operating leases					
Transportation	548	198	481	2,344	3,571
Cars and light commercial vehicles	313	128	120		561
Other	11	21	54	96	182
Finance leases	62	21	85	158	326
At 31 December 2003	934	368	740	2,598	4,640

Year in which the residual value will be recovered

2003	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
Operating leases					
Transportation	59	467	204	1,480	2,210
Cars and light commercial vehicles	328	134	110		572
Other	22	12	60	147	241
Finance leases	43	71	83	352	549
At 31 December 2002	452	684	457	1,979	3,572

Notes on the accounts continued

13 Provisions for bad and doubtful debts

	Specific £m	General £m	2003 Total £m	Specific £m	General £m	2002 Total £m
At 1 January	3,330	597	3,927	3,039	614	3,653
Currency translation and other adjustments	(23)	(39)	(62)	(45)	(17)	(62)
Acquisition of subsidiary	44	6	50	23		23
Amounts written off	(1,519)		(1,519)	(1,036)		(1,036)
Recoveries of amounts written off in previous periods	72		72	63		63
Charge to profit and loss account	1,459	2	1,461	1,286		1,286
At 31 December	3,363	566	3,929	3,330	597	3,927

In certain cases, interest may be charged to a customer s account but, because its recoverability is in doubt, not recognised in the Group s consolidated profit and loss account. Such interest is held in a suspense account and netted off against loans and advances in the consolidated balance sheet.

	2003 £m	2002 £m
Loans and advances on which interest is being placed in suspense:		
before specific provisions	1,938	1,660
after specific provisions	930	724
Loans and advances on which interest is not being applied:		
before specific provisions	2,494	2,515
after specific provisions	980	1,082

14 Debt securities

	2003 Book value £m	Gross unrecognised gains £m	Gross unrecognised losses £m	2003 Valuation £m	2002 Book value £m	Gross unrecognised gains £m	Gross unrecognised losses £m	2002 Valuation £m
Investment securities:								
British government	1,516	1	(5)	1,512	197	3		200
Other government	12,442	101	(105)	12,438	11,994	297	(2)	12,289
Other public sector bodies	422	4		426	708	6		714
Bank and building society	11,690	4	(7)	11,687	8,996	7	(2)	9,001
Other issuers	15,464	130	(302)	15,292	16,296	126	(67)	16,355
	41,534	240	(419)	41,355	38,191	439	(71)	38,559
Other debt securities:								
British government	1,246			1,246	1,209			1,209
Other government	10,819			10,819	5,049			5,049
Other public sector bodies	36			36	41			41
Bank and building society	407			407	2,703			2,703
Other issuers	25,907			25,907	19,849			19,849
	38,415			38,415	28,851			28,851
	79,949			79,770	67,042			67,410
Due within one year	16,943				14,512			
Due one year and over	63,006				52,530			
	79,949				67,042			
Investment securities:								
Listed	33,067			33,001	27,416			27,790
Unlisted	8,467			8,354	10,775			10,769
	41,534			41,355	38,191			38,559
Other debt securities:								
Listed	16,307			16,307	10,507			10,507
Unlisted	22,108			22,108	18,344			18,344
	79,949			79,770	67,042			67,410

Banking business	42,374	38,920
Trading business	37,575	28,122
Amounts above include:		
Subordinated debt securities	890	468
Due from associated undertakings unsubordinated	1	7
Unamortised discounts less premiums on investment securities	3	(2)

The cost of securities carried at market value is not disclosed because it cannot be determined without unreasonable expense.

Movements in debt securities which are held as investment securities were as follows:

	Cost £m	Discounts and premiums £m	Provisions £m	Book value £m
At 1 January 2003	38,162	97	(68)	38,191
Currency translation and other adjustments	(1,642)	(24)	3	(1,663)
Additions	44,561			44,561
Acquisition of subsidiaries	1,918			1,918
Maturities and disposals	(41,504)	170	(1)	(41,335)
Provisions made net of write backs			(19)	(19)
Transfers	(55)		(37)	(92)
Amortisation of discounts and premiums		(27)		(27)
At 31 December 2003	41,440	216	(122)	41,534

155

Notes on the accounts continued

14 Debt securities *(continued)*

The following table categorises the Group s investment debt securities by maturity and yield (based on weighted averages) at 31 December 2003:

	Within 1 year		After 1 but within 5 years		After 5 but within 10 years		After 10 years		Total	
	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %
British government securities	68	5.5	1,107	4.8	218	5.3	123	5.2	1,516	4.9
US treasury and other US government securities	75	2.0	533	1.7	1,219	1.6	9,128	3.3	10,955	3.1
Other government securities	695	3.3	766	5.1	24	6.2	2	5.6	1,487	4.3

Securities issued by the states of the US			2	5.2	10	3.0	11	4.0	23	3.6
Other public sector bodies	36	5.1	142	1.2	165	1.7	57	1.4	400	1.8
Corporate debt securities	2,477	2.3	3,318	2.8	345	4.4	193	3.2	6,333	2.7
Mortgage-backed securities	42	1.2	185	4.5	481	4.2	4,353	2.9	5,061	3.1
Bank and building society	8,543	3.0	3,100	2.8	42	5.2	5	4.6	11,690	2.9
Other securities	850	3.4	1,376	4.3	1,035	1.8	808	2.4	4,069	3.1
Total book value	12,786	2.9	10,529	3.3	3,539	2.6	14,680	3.2	41,534	3.1
Total fair value	12,756		10,456		3,477		14,666		41,355	

Gross gains of £158 million (2002 £70 million) and gross losses of £47 million (2002 £7 million) were realised on the sale and redemption of investment debt securities.

15 Equity shares

	2003 Book value £m	Gross unrecognised gains £m	Gross unrecognised losses £m	2003 Valuation £m	2002 Book value £m	Gross unrecognised gains £m	Gross unrecognised losses £m	2002 Valuation £m
Investment securities:								
Listed	1,157	350	(88)	1,419	1,097	43	(127)	1,013
Unlisted	664	174	(19)	819	686			686
	1,821	524	(107)	2,238	1,783	43	(127)	1,699
Other securities:								
Listed	465			465	52			52
Unlisted	14			14	51			51
	2,300	524	(107)	2,717	1,886	43	(127)	1,802
Banking business	1,872				1,849			
Trading business	428				37			

The cost of securities carried at market value is not disclosed because it cannot be determined without unreasonable expense.

Movements in equity shares which are held as investment securities were as follows:

	Cost £m	Provisions £m	Book value £m
At 1 January 2003	1,864	(81)	1,783
Currency translation and other adjustments	24	4	28
Additions	300		300
Disposals	(314)	16	(298)
Amounts written off	(4)	4	
Provisions made net of write backs		(14)	(14)
Transfers	70	(48)	22

At 31 December 2003	1,940	(119)	1,821

Gross gains of £68 million (2002 £52 million) and gross losses of £7 million (2002 £30 million) were realised on the sale of investment equity shares.

16 Interests in associated undertakings

Movements in interests in associated undertakings during the year were as follows:

	Share of net assets £m
At 1 January 2003	94
Currency translation and other adjustments	1
Change of status	14
Additions	2
Acquisitions	21
Disposals	(27)
Share of profit	1
At 31 December 2003	106

Interests in associated undertakings are analysed as follows:

	2003 £m	2002 £m
Banks unlisted		24
Others	106	70
	106	94

The principal associated undertaking is:

	Total issued share and loan capital at 31 December 2003	% held	Share of results based on accounts made up to	Nature of business
Linea Directa Aseguradora S.A. (incorporated in Spain)	2,400m €0.03 ordinary shares	50.0	31 December*	Insurance

* Incorporating unaudited interim accounts.

Linea Directa Aseguradora S.A. operates in Spain.

Dividends receivable from associated undertakings (excluding related tax credits) totalled £9 million (2002 £1 million).

Transactions with associated undertakings are conducted on similar terms to third party transactions and are not material to the Group s results or financial condition.

Notes on the accounts continued

17 Shares in Group undertakings

Movements in shares in Group undertakings during the year were as follows:

	£m
At 1 January 2003	19,862
Currency translation adjustments	(330)
Additions	2,330
Disposals	(364)
Revaluation	10,856
At 31 December 2003	32,354

On the historical cost basis, shares in Group undertakings at 31 December 2003 would have been included at a cost of £15,499 million (2002 £13,863 million).

The principal subsidiary undertakings of the company are shown below. Their capital consists of ordinary and preference shares which are unlisted with the exception of certain preference shares issued by NatWest. The Royal Bank, Churchill Insurance Group PLC and RBS Life Holdings are directly owned by the company, and all of the other subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, by the Royal Bank and are all wholly-owned. All of these subsidiaries are included in the Group s consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operation
The Royal Bank of Scotland plc	Banking	Great Britain
National Westminster Bank Plc (1,4)	Banking	Great Britain
Churchill Insurance Group PLC	Insurance	Great Britain
Citizens Financial Group, Inc.	Banking	US
Coutts Bank (Switzerland) Limited	Private banking	Switzerland
Coutts & Co (2)	Private banking	Great Britain
Direct Line Insurance plc	Insurance	Great Britain
Greenwich Capital Markets, Inc.	Broker dealer	US
Lombard North Central PLC	Banking, credit finance, leasing and hire purchase	Great Britain
National Westminster Home Loans Limited	Home mortgage finance	Great Britain
The Royal Bank of Scotland International Limited	Banking	Jersey
RBS Life Holdings Limited	Life assurance	Great Britain
Ulster Bank Limited (3)	Banking	Northern Ireland

Notes:

(1) The company does not hold any of the NatWest preference shares in issue.
(2) Coutts & Co is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0Q5
(3) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.
(4) On 31 January 2003, ownership of NatWest was transferred from the company to the Royal Bank.

The above information is provided in relation to the principal subsidiaries as permitted by Section 231(5) of the Companies Act 1985. Full information on all subsidiaries will be included in the Annual Return filed with the UK Companies House.

18 Loans to Group undertakings

Movements during the year:	£m
At 1 January 2003	3,354
Currency translation and other adjustments	(249)
Additions	1,489
Repayments	(40)
At 31 December 2003	4,554

19 Intangible fixed assets

Goodwill	£m
Cost:	
At 1 January 2003	14,595
Currency translation and other adjustments	(283)
Arising on acquisitions during the year	1,456
Disposals	(10)
At 31 December 2003	15,758
Amortisation:	
At 1 January 2003	1,898
Currency translation and other adjustments	(34)
Charge for the year	763
At 31 December 2003	2,627
Net book value at 31 December 2003	13,131
Net book value at 31 December 2002	12,697

Notes on the accounts continued

20 Tangible fixed assets

	Freehold premises £m	Long leasehold	Short leasehold	Computers and other equipment	Assets on operating leases	Total £m

		premises £m	premises £m	£m	£m	
Cost or valuation:						
At 1 January 2003	3,951	367	611	2,754	6,335	14,018
Currency translation and other adjustments	(23)	1	(10)	(24)	(24)	(80)
Reclassifications	(9)	(24)	(1)	34		
Acquisition of subsidiaries	561	8	4	111		684
Additions	1,015	1,034	84	480	2,404	5,017
Disposals and write-off of fully depreciated assets	(227)	(22)	(33)	(444)	(1,167)	(1,893)
Revaluation adjustments	(51)	(18)				(69)
At 31 December 2003	5,217	1,346	655	2,911	7,548	17,677
Consisting of:						
At valuation 2003	2,750	37				2,787
2002 and prior	882	166				1,048
At cost	1,585	1,143	655	2,911	7,548	13,842
	5,217	1,346	655	2,911	7,548	17,677
Accumulated depreciation and amortisation:						
At 1 January 2003	327	85	229	1,854	1,038	3,533
Currency translation and other adjustments		1	(6)	(10)	(4)	(19)
Reclassifications	7	(3)	1	(5)		
Acquisition of subsidiaries	29			59		88
Disposals and write-off of fully depreciated assets	(7)		(7)	(387)	(370)	(771)
Charge for the year	51	11	33	294	530	919
At 31 December 2003	407	94	250	1,805	1,194	3,750
Net book value at 31 December 2003	4,810	1,252	405	1,106	6,354	13,927
Net book value at 31 December 2002	3,624	282	382	900	5,297	10,485

On the historical cost basis, the Group s freehold and long leasehold premises would have been included at £5,886 million (2002 £3,638 million).

Freehold and long leasehold properties are revalued on a rolling basis, each property being valued at least every five years. Interim valuations outwith the five year cycle are carried out on properties where there is an indication that their value has changed significantly, given market conditions. The directors are not aware of any material change in the valuation of the Group s properties and therefore no additional interim valuations were required.

Properties occupied by the Group are valued on the basis of Existing Use Value, except for certain specialised properties which are valued on a Depreciated Replacement Cost basis. Investment properties and properties to be disposed of are valued to reflect Open Market Value. Valuations are carried out by internal and external qualified surveyors who are members of the Royal Institution of Chartered Surveyors or, in the case of some overseas properties, locally qualified valuers.

Net book value:	2003 £m	2002 £m
Land and buildings occupied for own use	2,391	2,230
Investment properties	3,628	1,789
Properties under development	429	258
Properties to be disposed of	19	11
	6,467	4,288

Net book value of assets held under finance leases	90	94
Depreciation for the year of assets held under finance leases	20	34

Contracts for future capital expenditure not provided for in the accounts at the year end		
Premises and equipment	104	68
Assets on operating leases	498	678
	602	746

21 Other assets

	2003 £m	2002 £m
Trading derivatives (see Note 39)	14,087	13,210
Other	4,349	3,719
	18,436	16,929

22 Long-term assurance business

The long-term assurance assets and liabilities attributable to policyholders comprise:

	2003 £m	2002 £m
Investments	4,005	9,536
Value of in-force policies	413	386
	4,418	9,922
Long-term assurance business attributable to shareholders*	(861)	(811)
	3,557	9,111

The increase in the shareholders interest in the long-term assurance business included in the profit and loss account is calculated as follows:

	2003 £m	2002 £m
Increase in value for the year before tax	73	61
Tax	(22)	(18)
Increase in value for the year after tax	51	43

The decline in long-term assurance assets and liabilities results from the transfer of the pension managed fund business of NatWest Life to another third party life company.

* The value of the long-term assurance business is calculated by discounting estimated future flows of statutory profits from in-force business at a discount rate that includes a risk margin. The future flows are based on prudent assumptions about long-term economic and business experience determined with the advice of qualified actuaries. The risk margin is designed to reflect uncertainties in expected future flows.

The key assumptions used are:

	2003 £m	2002 £m
Risk discount rate (net of tax)	8.50	8.50
Growth of unit-linked funds (gross of tax)	6.70	6.75
Growth of non-unit-linked funds (gross of tax)	5.00	5.00
Basic tax rate	20.00	22.00
Shareholder taxation life	30.00	30.00
Expense inflation	3.50	3.50

Notes on the accounts continued

23 Deposits by banks

	2003 £m	2002 £m
Repayable on demand	20,995	15,559
With agreed maturity dates or periods of notice, by remaining maturity		
three months or less	42,300	35,125
one year or less but over three months	2,268	1,923
five years or less but over one year	122	805
over five years	1,638	1,308
	67,323	54,720

Banking business	41,061	34,474
Trading business	26,262	20,246

24 Customer accounts

	2003 £m	2002 £m
Repayable on demand	160,574	127,320
With agreed maturity dates or periods of notice, by remaining maturity		
three months or less	64,797	81,015
one year or less but over three months	7,608	5,923
five years or less but over one year	3,288	4,367
over five years	696	536
	236,963	219,161
Banking business	210,925	195,670
Trading business	26,038	23,491
Amounts above include:		
Due to associated undertakings	5	107

25 Debt securities in issue

	2003 £m	2002 £m
Bonds and medium term notes, by remaining maturity		
one year or less	2,227	2,150
two years or less but over one year	1,063	738
five years or less but over two years	3,614	3,096
over five years	3,525	1,391
	10,429	7,375
Other debt securities in issue, by remaining maturity		
three months or less	23,414	24,387
one year or less but over three months	6,188	1,366
two years or less but over one year	977	810
five years or less but over two years	8	
	30,587	26,563
	41,016	33,938
Banking business	39,899	33,927
Trading business	1,117	11

Issues are made under the Royal Bank s £20 billion euro medium term note programme from time to time. Notes issued, which have a minimum maturity of six months from the date of issue, are included in the above amounts.

26 Settlement balances and short positions

	2003 £m	2002 £m
Settlement balances	2,241	3,031
Short positions:		
Debt securities Government	16,631	14,155
Debt securities Other issuers	2,423	1,660
Treasury bills and other eligible bills	74	566
	21,369	19,412

27 Other liabilities

	2003 £m	2002 £m
Notes in circulation	1,394	1,318
Trading derivatives (see Note 39)	15,173	14,729
Current taxation	700	982
Dividends	1,105	946
Obligations under finance leases (analysed below)	182	171
Other liabilities	2,030	2,608
	20,584	20,754

Analysis of obligations under finance leases:	2003 £m	2002 £m
Amounts falling due within one year	19	29
Amounts falling due between one and five years	37	14
Amounts falling due after more than five years	126	128
	182	171

28 Deferred taxation

Provision for deferred taxation has been made as follows:

	2003 £m	2002 £m
Deferred tax liability	2,266	1,834

Deferred tax asset (included in Note 21, Other assets)	(28)	(39)
Net deferred tax	2,238	1,795

	2003 £m	2002 £m
Short-term timing differences	201	22
Capital allowances	2,440	1,965
Bad and doubtful debt provisions	(441)	(238)
Deferred gains	38	46
Net deferred tax	2,238	1,795

Movements during the year:	£m
At 1 January 2003	1,795
Currency translation and other adjustments	19
Acquisition of subsidiaries	34
Disposal of lease receivables	(173)
Charge to profit and loss account	563
At 31 December 2003	2,238

29 Other provisions

	Property(1) £m	Pensions and other similar obligations(2) £m	Other(3) £m	Total £m
At 1 January 2003	262	36	32	330
Currency translation and other adjustments		(2)		(2)
Acquisition of subsidiaries			9	9
Charge to profit and loss account	35	11	1	47
Provisions utilised	(118)	(2)	(8)	(128)
At 31 December 2003	179	43	34	256

Notes:

(1) The Group has a number of leasehold properties where rents payable and other unavoidable costs exceed the value to the Group. Such costs arise over the period of the lease or to the expected termination date, and the provision has been discounted due to the long-term nature of certain of these obligations.
(2) The Group operates various unfunded post-retirement benefit plans and provision is made for the expected costs that will arise over the periods in which pensions are paid to the members of these plans.
(3) Other provisions arise in the normal course of business.

Notes on the accounts continued

30 Dated loan capital

	2003 £m	2002 £m
The company		
£200 million floating rate (minimum 5.25%) notes 2005 (1,2)	80	120
US$400 million 6.4% subordinated notes 2009 (1)	223	247
US$300 million 6.375% subordinated notes 2011 (1)	166	184
US$750 million 5% subordinated notes 2013 (issued November 2003) (3)	416	
US$750 million 5% subordinated notes 2014 (1)	417	461
US$250 million 5% subordinated notes 2014 (1)	137	151
US$350 million 4.7% subordinated notes 2018 (issued July 2003) (1,4)	195	
	1,634*	1,163*
The Royal Bank of Scotland plc		
£125 million subordinated floating rate notes 2005 (5)	125	125
£150 million 8.375% subordinated notes 2007	149	149
DEM500 million (redesignated €255 million) 5.25% subordinated notes 2008	180	165
€300 million 4.875% subordinated notes 2009	211	194
US$150 million floating rate notes 2009 (5)	84	93
£35 million floating rate step-up subordinated notes 2010	35	35
US$350 million floating rate subordinated notes 2012	196	217
€130 million floating rate subordinated notes 2012	92	85
US$500 million floating rate subordinated notes 2012	280	310
£150 million 10.5% subordinated bonds 2013 (6)	149	149
€1,000 million 6.0% fixed rate subordinated notes 2013	700	644
€500 million 6.0% fixed rate subordinated notes 2013	362	334
US$50 million floating rate subordinated notes 2013	28	31
€1,000 million floating rate subordinated notes 2013 (issued October 2003, callable October 2008) (7)	705	
£250 million 9.625% subordinated bonds 2015	248	247
€750 million 4.875% subordinated notes 2015 (issued April 2003) (8)	529	
€500 million 4.5% subordinated notes 2016 (issued December 2003, callable January 2011) (9)	351	
€100 million floating rate subordinated notes 2017	70	65
US$125.6 million floating rate subordinated notes 2020	70	78
RBSG Capital Corporation		
US$250 million 10.125% guaranteed capital notes 2004 (1,6)	140	155
National Westminster Bank Plc		
US$500 million 9.375% guaranteed capital notes 2003 (10)		315
£100 million 12.5% subordinated unsecured loan stock 2004	104	108
US$400 million guaranteed floating rate capital notes 2005	223	246
US$1,000 million 7.375% fixed rate subordinated notes 2009	553	611
US$650 million floating rate subordinated step-up notes 2009 (callable October 2004)	366	404
€600 million 6.0% subordinated notes 2010	419	386
£300 million 8.125% step-up subordinated notes 2011 (callable December 2006)	303	305

€500 million 5.125% subordinated notes 2011	341	309
£300 million 7.875% subordinated notes 2015	309	316
£300 million 6.5% subordinated notes 2021	297	298
Greenwich Capital Holdings, Inc.		
US$105 million subordinated loan capital 2004 floating rate notes	59	65
	9,312	7,602
Dated loan capital in issue, by remaining maturity is repayable as follows:		
in one year or less	709	355
in two years or less but over one year	388	772
in five years or less but over two years	1,337	865
in more than five years	6,878	5,610
	9,312	7,602

*In addition, the company issued 1.25 million subordinated loan notes of €1,000 each in June 2002, 750,000 subordinated loan notes of US$1,000 each in December 2002, 850,000 subordinated loan notes of US$1,000 each in May 2003 and 650,000 subordinated loan notes of US$1,000 each in December 2003 to subsidiaries of the Group. These loan notes are included in the company balance sheet within loan capital but are reclassified as non-equity minority interests on consolidation (see Note 32).

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis.
(2) Repayable in five equal annual instalments in May in each of the years 2001 to 2005.
(3) Net proceeds received US$744 million, £444 million.
(4) Net proceeds received US$348 million, £208 million.
(5) Repayable in whole, at the option of The Royal Bank of Scotland plc, prior to maturity, on conditions governing the respective debt obligation, including prior approval of the UKFinancial Services Authority.
(6) Unconditionally guaranteed by the company.
(7) Net proceeds received €998 million, £701 million.
(8) Net proceeds received €749 million, £520 million.
(9) Net proceeds received €498 million, £350 million.
(10) Redeemed on maturity in November 2003.
(11) In the event of certain changes in the tax laws of the UK, all of the dated loan capital issues are redeemable in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior approval of the UK Financial Services Authority.
(12) Except as stated above, claims in respect of the Group s dated loan capital are subordinated to the claims of other creditors. None of the Group s dated loan capital is secured.
(13) Interest payable on the Group s floating rate dated issues is at a margin over London interbank rates. Interest on £1,450 million, US$4,000 million and €4,405 million of fixed rate dated issues is swapped into floating rates at a margin over London interbank rates.

Notes on the accounts continued

31 Undated loan capital including convertible debt

	2003 £m	2002 £m
The company		
US$350 million undated floating rate primary capital notes (callable on any interest payment date) (1,2)	196	217
US$200 million 8.5% exchangeable capital securities, Series A (callable June 2004) (1,3)	112	124
US$50 million undated 7.993% capital securities (callable November 2005) (1)	28	31
US$35 million undated 7.755% capital securities (callable December 2005) (1)	19	22
US$200 million undated 7.375% reset capital securities (callable April 2006) (1)	112	124
US$75 million floating rate perpetual capital securities (callable September 2007) (1)	42	46
US$850 million 5.75% exchangeable capital securities, Series B (issued June 2003; callable June 2008) (4,5)	464	
US$1,200 million 7.648% perpetual regulatory tier one securities (callable September 2031) (1,6)	666	737
	1,639	1,301
The Royal Bank of Scotland plc		
£125 million 9.25% undated subordinated step-up notes (callable April 2006)	125	124
£150 million undated subordinated floating rate step-up notes (callable March 2007)	150	149
FRF1,000 million (redesignated €152 million) 5.875% undated subordinated notes (callable October 2008)	107	99
£175 million 7.375% undated subordinated notes (callable August 2010)	173	173
£350 million 6.25% undated subordinated notes (callable December 2012)	348	348
£500 million 5.125% undated subordinated notes (issued March 2003; callable March 2016) (7)	491	
£200 million 9.5% undated subordinated bonds (callable August 2018) (8)	198	197
£500 million 6.2% undated subordinated notes (callable March 2022)	497	497
£300 million 5.625% undated subordinated notes (callable September 2026)	298	298
£200 million 5.625% undated subordinated notes (issued June 2003; callable September 2026) (9)	211	
£400 million 5.625% undated subordinated notes (issued October 2003; callable September 2026) (10)	396	
£350 million 5.625% undated subordinated notes (callable June 2032)	346	346
£150 million 5.625% undated subordinated notes (callable June 2032)	144	144
National Westminster Bank Plc		
US$500 million primary capital floating rate notes, Series A (callable on any interest payment date)	280	310
US$500 million primary capital floating rate notes, Series B (callable on any interest payment date)	280	310
US$500 million primary capital floating rate notes, Series C (callable on any interest payment date)	280	310
US$500 million 7.875% exchangeable capital securities (callable on any interest payment date) (11)	280	308
US$500 million 7.75% reset subordinated notes (callable October 2007)	275	304
€100 million floating rate undated subordinated step-up notes (callable October 2009)	70	65
€400 million 6.625% fixed/floating rate undated subordinated notes (callable October 2009)	280	257
£325 million 7.625% undated subordinated step-up notes (callable January 2010)	330	330
£200 million 7.125% undated subordinated step-up notes (callable October 2022)	203	203
£200 million 11.5% undated subordinated notes (callable December 2022) (12)	285	290
	7,686	6,363

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis.

(2) Interest is payable at a rate of 0.25% per annum over an average calculated by reference to six month euro dollar deposits in London for each interest period.

(3) Redeemable in certain circumstances related to changes in the tax laws of the UK, in whole or in part, at the option of the company on any interest payment date.

Exchangeable, in whole or in part, at the option of the company on any interest payment date, or in certain circumstances related to changes in the tax laws of the UK, in whole but not in part, into the company s non-cumulative preference shares of US$0.01 each.

(4) Net proceeds received US$827 million, £497 million.

(5) Redeemable in certain circumstances related to changes in the tax laws of the UK, in whole but not in part, at the option of the company on any interest payment date.

Exchangeable, in whole or in part, at the option of the company on any interest payment date, or in certain circumstances related to changes in the tax laws of the UK, in whole but not in part, into the company s non-cumulative preferences shares US$0.01 each.

(6) Redeemable by the company on or after 30 September 2031 or on any interest payment date thereafter or at any time on the occurrence of certain events, subject to the prior approval of the UK Financial Services Authority.

Interest on the PROs is payable semi-annually in arrears at a fixed rate of 7.648% per annum until 30 September 2031 and thereafter quarterly in arrears at a variable rate of 2.5% per annum above three month dollar LIBOR. The company can satisfy interest payment obligations by issuing ordinary shares to appointed Trustees sufficient to enable them, on selling these shares, to settle the interest payment.

(7) Net proceeds received £490 million.

(8) Guaranteed by the company.

(9) Net proceeds received £211 million.

(10) Net proceeds received £396 million.

(11) Exchangeable at the option of the issuer into 20 million 8.75% (gross) non-cumulative preference shares of US$25 each of National Westminster Bank Plc at any time.

(12) Exchangeable at the option of the issuer into 200 million 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.

(13) Except as stated above, claims in respect of the Group s undated loan capital are subordinated to the claims of other creditors. None of the Group s undated loan capital is secured.

(14) Except as stated above, interest payable on Group floating rate undated issues is at a margin over London interbank rates. Interest on £3,775 million, US$1,668 million and €552 million of fixed rate undated issues is swapped into floating rates at a margin over London interbank rates.

(15) Where the issuer has the ability to redeem the undated loan capital, this is subject to prior approval of the UK Financial Services Authority.

32 Minority interests non-equity

	2003 £m	2002 £m
Non-equity shares issued by NatWest:		
Non-cumulative preference shares of US$25 (1)	299	325
Non-cumulative preference shares of £1 (2)	166	166
	465	491
Non-equity shares issued by other subsidiaries:		
Non-cumulative trust preferred securities of €1,000 (3)	875	806
Non-cumulative trust preferred securities of US$1,000 (4)	1,245	456
Other non-equity minority interests	139	97
Total	2,724	1,850

Notes:

(1) The US$250 million non-cumulative preference shares, Series B, of US$25 each carry a gross dividend of 8.75% inclusive of associated tax credit. They are redeemable at the option of NatWest at US$25 per share.

The US$300 million non-cumulative preference shares, Series C, of US$25 each carry a gross dividend of 8.625% inclusive of associated tax credit. They are redeemable at the option of NatWest from 9 April 2002 to 8 April 2008 inclusive, at a premium per share of US$0.90 in 2004 reducing by US$0.30 in each successive year. There is no redemption premium if the date of redemption falls after 8 April 2007.

(2) The £140 million 9% non-cumulative preference shares, Series A, of £1 each are non-redeemable.

(3) In June 2002, a wholly-owned subsidiary of the Group, issued 1.25 million Series A non-cumulative trust preferred securities at €1,000 per security. Net proceeds received were €1,237 million, £777 million. These securities have no maturity date and are not redeemable at the option of the holders at any time. The securities may, with the consent of the UK Financial Services Authority (FSA), be redeemed, in whole or in part, by the issuer on 30 June 2012 and on any interest payment date thereafter. They may also be redeemed in whole, but not in part, upon the occurrence of certain tax and regulatory events. Interest on the securities is payable annually in arrears at a fixed annual rate of 6.467% until 30 June 2012, and thereafter quarterly in arrears at a rate of 2.1% above three month EURIBOR for the relevant payment period.

(4) In December 2002, a wholly-owned subsidiary of the Group, issued 750,000 Series B non-cumulative trust preferred securities at US$1,000 per security. Net proceeds received were US$735 million, £465 million. These securities have no maturity date and are not redeemable at the option of the holders at any time. The securities may, with the consent of the FSA, be redeemed, in whole or in part, by the issuer on 31 March 2008 or on any interest payment date thereafter. They may also be redeemed in whole, but not in part, upon the occurrence of certain tax and regulatory events. Interest on the securities is payable quarterly in arrears at a fixed annual rate of 6.8% beginning on 31 March 2003.

In May 2003, a wholly-owned subsidiary of the Group, issued 850,000 Series I non-cumulative trust preferred securities at US$1,000 per security. Net proceeds received were US$841 million, £514 million. These securities have no maturity date and are not redeemable at the option of the holders at any time. The securities may, with the consent of the FSA, be redeemed, in whole or in part, by the issuer on 1 July 2013 or on any interest payment date thereafter. They may also be redeemed in whole, but not in part, upon the occurrence of certain tax and regulatory events. Interest on the securities is payable half yearly in arrears at a fixed annual rate of 4.709% beginning on 31 December 2003.

In December 2003, a wholly-owned subsidiary of the Group, issued 650,000 Series II non-cumulative trust preferred securities at US$1,000 per security. Net proceeds received were US$644 million, £369 million. These securities have no maturity and are not redeemable at the option of the holders at any time. The securities may, with the consent of the FSA, be redeemed, in whole or in part, by the issuer on 3 January 2034 or any interest payment date thereafter. They may also be redeemed in whole, but not in part, upon the occurrence of certain tax and regulatory events. Interest on the securities is paid half yearly in arrears at a fixed annual rate of 6.425% beginning on 31 December 2003.

(5) Minority interests in the consolidated profit and loss account includes £127 million (2002 £67 million; 2001 £50 million) in respect of non-equity interests.

33 Share capital

	Allotted, called up and fully paid				Authorised	
	1 January 2003 £m	Issued during the year £m	Other movement during the year £m	31 December 2003 £m	31 December 2003 £m	31 December 2002 £m
Equity shares						
Ordinary shares of 25p	725	15		740	1,020	1,020
Non-voting deferred shares of £0.01*			27	27	323	323
Total equity share capital	725	15	27	767	1,343	1,343
Preference shares and Additional Value Shares						
Additional Value Shares of £0.01*	27		(27)		27	27
Non-cumulative preference shares of US$0.01	1			1	2	2
Non-cumulative convertible preference shares of US$0.01						
Non-cumulative preference shares of €0.01						
Non-cumulative convertible preference shares of €0.01						
Non-cumulative convertible preference shares of £0.25					225	225
Non-cumulative convertible preference shares of £0.01						
Cumulative preference shares of £1	1			1	1	1

Non-cumulative preference shares of £1					300	300
Total non-equity share capital	29		(27)	2	555	555
Total share capital	754	15		769	1,898	1,898

* In December 2003, the AVS were converted to non-voting deferred shares of £0.01 each.

Notes on the accounts continued

33 Share capital *(continued)*

	Allotted, called up and fully paid		Authorised	
Number of shares thousands	2003	2002	2003	2002
Equity shares				
Ordinary shares of 25p	2,963,335	2,900,861	4,079,375	4,079,375
Non-voting deferred shares of £0.01	2,660,556		32,300,000	32,300,000
Additional Value Shares and preference shares				
Additional Value Shares of £0.01		2,660,556	2,700,000	2,700,000
Non-cumulative preference shares of US$0.01	82,000	106,000	238,500	238,500
Non-cumulative convertible preference shares of US$0.01	1,900	1,900	3,900	3,900
Non-cumulative preference shares of €0.01			66,000	66,000
Non-cumulative convertible preference shares of €0.01	750	750	3,000	3,000
Non-cumulative convertible preference shares of £0.25			900,000	900,000
Non-cumulative convertible preference shares of £0.01	200	200	1,000	1,000
Cumulative preference shares of £1	900	900	900	900
Non-cumulative preference shares of £1			300,000	300,000

Ordinary shares

The following issues of ordinary shares were made during the year to 31 December 2003:

(a) 13.3 million ordinary shares following the exercise of options under the company s executive, sharesave and option 2000 schemes and a further 6.2 million ordinary shares in respect of the exercise of options under the NatWest executive and sharesave schemes which had been exchanged for options over the company s shares following the acquisition of NatWest;

(b) 40.1 million ordinary shares in lieu of cash in respect of the final dividend for the year ended 31 December 2002 and the interim dividend for the year ended 31 December 2003; and

(c) 2.9 million ordinary shares under the company s profit sharing (share ownership) scheme.

The total consideration for ordinary shares issued during the year amounted to £775 million.

During the year to 31 December 2003, options were granted over 14.5 million ordinary shares under the company s executive, sharesave and option 2000 schemes. At 31 December 2003, options granted under the company s various schemes, exercisable up to 2013 at prices ranging from 388p to 1841p per share, were outstanding in respect of 69.6 million ordinary shares. In addition, options granted under the NatWest schemes were outstanding in respect of 7.3 million ordinary shares exercisable up to 2009 at prices ranging from 312p to 924p per share. As permitted by UITF 17 Employee share schemes applicable to SAYE schemes, no cost has been recognised in respect of sharesave options.

Additional Value Shares

Approximately 2.7 billion Additional Value Shares (AVS) with a total nominal value of £27 million were issued to shareholders by way of a bonus issue in July 2000 in connection with the acquisition of NatWest.

A dividend of 15 pence per AVS was paid on 3 December 2001, a second dividend of 30 pence per AVS on 2 December 2002 and a third and final dividend of 55 pence per AVS on 1 December 2003. The AVS were de-listed and in accordance with the terms of issue they were converted to Non-voting deferred shares and transferred to RBS NVDS Nominees Limited.

Preference shares

In January 2003, the company redeemed the 8 million Series B and the 16 million Series C, non-cumulative preference shares of US$0.01 each, at a redemption price of US$25 per share, at a total cost of US$600 million.

Non-cumulative preference shares

Non-cumulative preference shares entitle the holders thereof to receive periodic non-cumulative cash dividends at specified fixed rates for each Series payable out of distributable profits of the company.

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

Class of preference share	Series	Number of shares in issue	Redemption date on or after	Redemption price per share
Non-cumulative preference shares of US$0.01	Series D	7 million	14 September 2005	US$25.00
	Series E	8 million	17 October 2006	US$25.00
	Series F	8 million	31 March 2007	US$25.00
	Series G	10 million	31 March 2003	US$25.00
	Series H	12 million	31 March 2004	US$25.00
	Series I	12 million	30 September 2004	US$25.00
	Series J	9 million	31 December 2004	US$25.00
	Series K	16 million	30 June 2006	US$25.00
Non-cumulative convertible preference shares of US$0.01	Series 1	1 million	31 March 2010	US$1,000
	Series 2	0.5 million	31 March 2005	US$1,000
	Series 3	0.4 million	31 December 2005	US$1,000
Non-cumulative convertible preference shares of €0.01	Series 1	0.75 million	31 March 2005	€1,000
Non-cumulative convertible preference shares of £0.01	Series 1	0.2 million	31 December 2010	£1,000

In the event that the non-cumulative convertible preference shares are not redeemed on or before the redemption date, the holder may convert the non-cumulative convertible preference shares into ordinary shares in the company.

Under existing arrangements, no redemption or purchase of any non-cumulative preference shares may be made by the company without the prior consent of the UK Financial Services Authority.

On a winding-up or liquidation of the company, the holders of the non-cumulative preference shares will be entitled to receive, out of any surplus assets available for distribution to the company s shareholders (after payment of arrears of dividends on the cumulative preference shares up to the date of repayment) pari passu with the cumulative preference shares, the non-cumulative sterling preference shares and all other shares of the company ranking pari passu with the non-cumulative preference shares as regards participation in the surplus assets of the company, a liquidation distribution of US$25 per non-cumulative preference share of US$0.01, US$1,000 per non-cumulative convertible preference share of US$0.01, €1,000 per non-cumulative convertible preference share of €0.01 and £1,000 per non-cumulative convertible preference share of £0.01, together with an amount equal to dividends for the then current dividend period accrued to the date of payment, before any distribution or payment may be made to holders of the ordinary shares as regards participation in the surplus assets of the company.

Except as described above, the holders of the non-cumulative preference shares have no right to participate in the surplus assets of the company.

Holders of the non-cumulative preference shares are not entitled to receive notice of or attend general meetings of the company except if any resolution is proposed for adoption by the shareholders of the company to vary or abrogate any of the rights attaching to the non-cumulative preference shares or proposing the winding-up or liquidation of the company. In any such case, they are entitled to receive notice of and to attend the general meeting of shareholders at which such resolution is to be proposed and will be entitled to speak and vote on such resolution (but not on any other resolution). In addition, in the event that, prior to any general meeting of shareholders, the company has failed to pay in full the three most recent quarterly dividend payments due on the non-cumulative dollar preference shares, the two most recent semi-annual dividend payments due on the non-cumulative convertible dollar preference shares and the most recent annual dividend payments due on the non-cumulative convertible euro preference shares and on the non-cumulative convertible sterling preference shares, the holders shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters together with the holders of the ordinary shares, and in these circumstances only, the rights of the holders of the non-cumulative preference shares so to vote shall continue until the company shall have resumed the payment in full of the dividends in arrears.

169

Notes on the accounts continued

34 Reserves

	2003 The Group £m	2002 The Group £m	2001 The Group £m	2003 The company £m
Share premium account				
At 1 January	7,608	7,465	6,530	7,608
Currency translation adjustments	(203)	(283)	58	(203)
Shares issued during the year	760	685	870	760
Preference shares redeemed during the year		(268)		
Other movements	10	9	7	10
At 31 December	8,175	7,608	7,465	8,175
Merger reserve				
At 1 January	11,455	12,029	12,604	
Shares issued			2,007	
Transfer to profit and loss account	(574)	(574)	(2,582)	
At 31 December	10,881	11,455	12,029	

Other reserves				
At 1 January	387	212	191	156
Redemption of preference shares		150		
Transfer of increase in value of long-term life assurance business	32	25	17	
Other movements			4	
At 31 December	419	387	212	156
Revaluation reserve				
At 1 January	80	113	40	6,001
Revaluation of interests in subsidiary undertakings				10,856
Revaluation of premises	(69)	(33)	72	
Transfer (to)/from profit and loss account	(4)		1	
At 31 December	7	80	113	16,857
Profit and loss account				
At 1 January	6,768	5,956	2,786	3,547
Currency translation adjustments and other movements	33	27	(14)	
Retention for the year	825	704	783	(595)
Employee share option payments		(136)	(163)	
Redemption of preference shares	(364)	(332)		(364)
Goodwill previously written off	40			
Transfer from merger reserve	574	574	2,582	
Transfer of increase in value of long-term life assurance business	(32)	(25)	(17)	
Transfer from/(to) revaluation reserve	4		(1)	
At 31 December	7,848	6,768	5,956	2,588

The cumulative goodwill arising on acquisitions of subsidiary and associated undertakings which are still part of the Group and written off directly against profit and loss account reserves of the Group amounted to £1,133 million at 31 December 2003.

Exchange gains of £604 million (2002 £281 million) arising on foreign currency borrowings have been offset in the Group s profit and loss account reserves against differences on retranslating the net investment in overseas subsidiary and associated undertakings financed by these borrowings.

The tax effect of gains and losses taken directly to reserves was nil (2002 £7 million charge).

Included in the closing balances of the Group s revaluation reserves and profit and loss account at 31 December 2003 are cumulative net gains of £90 million (2002 £55 million) relating to the retranslation of opening net assets of subsidiary and associated undertakings offset by foreign currency borrowing.

At 31 December 2003, 790,019 (2002 919,255) ordinary shares of 25p each of the company were held by the 1992 Employee Share Trust in respect of options under the executive option scheme and awards under the restricted share scheme. Included in Other assets is an amount which reflects the exercise price of the options that the shares are expected to be used to satisfy.

Non-equity shareholders funds:

	2003 £m	2002 £m
Non-cumulative preference shares of US$0.01	1,140	1,628
Non-cumulative convertible preference shares of US$0.01	1,058	1,169
Non-cumulative convertible preference shares of €0.01	528	486
Non-cumulative convertible preference shares of £0.01	196	196
Cumulative preference shares of £1	1	1
Total preference shares	2,923	3,480
Additional Value Shares of £0.01		27
	2,923	3,507

35 Lease commitments

The annual rental commitments of the Group under non-cancellable operating leases were as follows:

	2003		2002	
	Premises £m	Equipment £m	Premises £m	Equipment £m
Expiring within one year	7	6	7	4
Expiring between one and five years	39	9	39	13
Expiring after five years	200	1	184	
	246	16	230	17

36 Analysis of total assets and liabilities

		2003 £m	2003 £m
Assets:	denominated in sterling	233,570	220,259
	denominated in currencies other than sterling	221,705	191,741
		455,275	412,000
Liabilities:	denominated in sterling	234,284	216,013
	denominated in currencies other than sterling	220,991	195,987
		455,275	412,000

37 Collateral given and received under repurchase transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it receives or transfers cash or securities as collateral in accordance with normal market practice. Securities transferred under repurchase transactions included within securities on the balance sheet as follows:

	2003 £m	2002 £m
Treasury and other eligible bills	761	1,820
Debt securities	24,231	23,299
	24,992	25,119

Of the above securities, £25.0 billion (2002 £25.1 billion) could be resold or repledged by the holder. Securities received as collateral under reverse repurchase agreements amounted to £57.7 billion (2002 £46.1 billion), of which £53.6 billion (2002 £39.3 billion) had been resold or repledged as collateral for the Group s own transactions.

Notes on the accounts continued

38 Assets charged as security for liabilities

Assets charged as security for liabilities	2003 £m	2002 £m
Loans and advances to customers	1,196	852
Debt securities	2,628	4,017
Tangible fixed assets	1,162	1,010
Other	126	599
	5,112	6,478

Included above are assets pledged with overseas government agencies and banks, and margin deposits placed with exchanges.

Liabilities secured by charges on assets	2003 £m	2002 £m
Deposits by banks	3,000	2,778
Customer accounts	92	2,233
Debt securities in issue	1,550	591
	4,642	5,602

39 Derivatives

In the normal course of business, the Group enters into a variety of derivative transactions principally in the foreign exchange and interest rate markets. These are used to provide financial services to customers and to take, hedge and modify positions as part of trading activities. Derivatives are also used to hedge or modify risk exposures arising on the balance sheet from a variety of activities including lending and securities investment.

The principal types of derivative contracts into which the Group enters are described below.

Swaps

These are over-the-counter (OTC) agreements between two parties to exchange periodic payments of interest, or payments for the change in value of a commodity, or related index, over a set period based on notional principal amounts. The Group enters into swap transactions in several markets. Interest rate swaps exchange fixed rates for floating rates of interest based on notional amounts. Basis swaps exchange floating or fixed interest calculated using different bases. Cross currency swaps are the exchange of interest based on notional values of different currencies. Equity and commodity swaps exchange interest for the return on an equity or commodity, or equity or commodity index.

Options

Currency and interest rate options confer the right, but not the obligation, on the buyer to receive or pay a specific quantity of an asset or financial instrument for a specified price at or before a specified date. Options may be exchange traded or OTC agreements. The Group principally buys and sells currency and interest rate options.

Futures and forwards

Short-term interest rate futures, bond futures and forward foreign exchange contracts are all agreements to deliver, or take delivery of, a specified amount of an asset or financial instrument based on the specified rate, price or index applied against the underlying asset or financial instrument, at a specified date. Futures are exchange traded at standardised amounts of the underlying asset or financial instrument. Forward contracts are OTC agreements and are principally dealt in by the Group in interest rates as forward rate agreements and in currency as forward foreign exchange contracts.

Collateral

The Group may require collateral in respect of the credit risk in derivative transactions. The amount of credit risk is principally the positive fair value of contracts. Collateral may be in the form of cash or in the form of a lien over a customer s assets entitling the Group to make a claim for current and future liabilities.

172

Maturity of replacement cost of over-the-counter contracts (trading and non-trading)

Replacement cost indicates the Group s derivatives credit exposure. The following table sets forth the gross positive fair values by maturity. The net replacement cost of internal trades is not included as there is no credit risk associated with them.

	Within one year £m	One to two years £m	Two to five years £m	Over five years £m	2003 Total £m	Within one year £m	One to two years £m	Two to five years £m	Over five years £m	2002 Total £m
Before netting:										
Exchange rate contracts	22,315	2,245	2,028	1,575	28,163	14,531	947	1,244	540	17,262
Interest rate contracts	8,440	7,401	17,462	21,671	54,974	9,037	8,590	20,420	26,036	64,083
Credit derivatives	11	7	85	169	272	2	62	76	237	377
Equity and commodity contracts	102	590	319	9	1,020	102	58	635	15	810
	30,868	10,243	19,894	23,424	84,429	23,672	9,657	22,375	26,828	82,532
Banks and investment firms					70,421					69,416
Others					14,008					13,116
					84,429					82,532

At 31 December 2003, the potential credit risk exposure, which is after netting and allowing for collateral received, of the Group s trading and non-trading derivatives, was £5,405 million (2002 £5,428 million) to banks and investment firms and £5,985 million (2002 £5,482 million) to other counterparties.

Exchange traded contracts are excluded from the above table. Such contracts generally involve lower credit risk than OTC contracts as they are cleared through exchanges that require margin from participants and the daily settlement of gains and losses.

Trading derivatives

The following table shows the fair values of instruments in the derivatives trading portfolio:

	2003 End of period fair value		2002 End of period fair value	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Exchange rate contracts:				
Spot, forwards and futures	18,299	20,325	12,102	12,572
Currency swaps	5,183	4,944	2,633	3,596
Options purchased	4,620		2,482	
Options written		4,295		2,457
	28,102	29,564	17,217	18,625
Interest rate contracts:				
Interest rate swaps	50,838	50,744	59,079	59,776
Options purchased	2,799		3,332	
Options written		2,829		3,341
Futures and forwards	629	639	1,284	1,164
	54,266	54,212	63,695	64,281
Credit derivatives	273	155	377	139
Equity and commodity contracts	924	720	733	496
	83,565	84,651	82,022	83,541
Netting	(69,478)	(69,478)	(68,812)	(68,812)
	14,087	15,173	13,210	14,729
Average fair values (before netting):				
Exchange rate contracts	18,967	19,619	13,565	14,581
Interest rate contracts	65,676	65,977	41,982	42,559
Credit derivatives	365	133	273	134
Equity and commodity contracts	877	624	545	483
	85,885	86,353	56,365	57,757

Gains and losses on exchange traded contracts subject to daily margining requirements are settled daily. The fair value of such contracts included above reflects the last day s variation margin.

Notes on the accounts continued

39 Derivatives *(continued)*

The following table analyses, by maturity and contract type, the notional principal amounts of the Group s trading derivatives:

	Within one year £bn	One to two years £bn	Two to five years £bn	Over five years £bn	2003 Total £bn	Within one year £bn	One to two years £bn	Two to five years £bn	Over five years £bn	2002 Total £bn
Exchange rate contracts:										
Spot, forwards and futures	616.8	24.9	7.2	0.2	649.1	504.5	26.8	4.5	0.2	536.0
Currency swaps	43.5	26.0	43.4	33.3	146.2	46.8	19.8	34.2	22.7	123.5
Options purchased	156.1	10.5	4.1	1.0	171.7	114.9	3.5	1.2		119.6
Options written	164.7	8.5	3.4	1.1	177.7	114.0	4.6	1.1	0.2	119.9
	981.1	69.9	58.1	35.6	1,144.7	780.2	54.7	41.0	23.1	899.0
Interest rate contracts:										
Interest rate swaps	1,555.8	675.6	960.8	630.1	3,822.3	1,115.5	537.3	662.3	485.2	2,800.3
Options purchased	91.1	34.2	49.3	50.4	225.0	69.5	21.6	46.9	38.9	176.9
Options written	48.0	36.6	47.0	48.5	180.1	51.9	26.8	43.4	38.8	160.9
Futures and forwards	865.3	159.3	55.3	0.5	1,080.4	606.4	116.0	39.4	0.5	762.3
	2,560.2	905.7	1,112.4	729.5	5,307.8	1,843.3	701.7	792.0	563.4	3,900.4
Credit derivatives	7.1	1.7	11.9	7.8	28.5	3.2	6.0	4.7	8.1	22.0
Equity and commodity contracts	20.4	5.3	8.2	0.2	34.1	12.9	6.7	3.7	0.2	23.5

Non-trading derivatives

The Group establishes non-trading derivatives positions externally with third parties and also internally. It should be noted that the following tables include the components of the internal hedging programme that transfers risks to the trading portfolios in the Group or to external third party participants in the derivatives markets.

The following table summarises the fair values and book values of derivatives held for non-trading activities and includes internal trades:

	2003 Fair value		2003 Book value		2002 Fair value		2002 Book value	
	Positive £m	Negative £m	Positive £m	Negative £m	Positive £m	Negative £m	Positive £m	Negative £m
Exchange rate contracts:								
Spot, forwards and futures	101	464	94	460	25	135	16	125
Currency swaps and options	304	210	224	135	199	107	111	76

	405	674	318	595	224	242	127	201
Interest rate contracts:								
Interest rate swaps	2,541	2,247	608	683	2,983	2,504	675	587
Futures, forwards and options	62	416	1	2	14	74		
	2,603	2,663	609	685	2,997	2,578	675	587
Credit derivatives	3	6				4		
Equity and commodity contracts	118	52	78	22	86	141	77	9
Total	3,129	3,395	1,005	1,302	3,307	2,965	879	797

The following table analyses, by maturity and contract type, the notional principal amounts of the Group s non-trading derivatives (third party and internal):

	Within one year £bn	One to two years £bn	Two to five years £bn	Over five years £bn	2003 Total £bn	Within one year £bn	One to two years £bn	Two to five years £bn	Over five years £bn	2002 Total £bn
Exchange rate contracts:										
Spot, forwards and futures	19.4		0.2	0.1	19.7	8.8				8.8
Currency swaps and options	3.2	1.0	0.7	1.9	6.8	2.1	0.2	1.3	1.7	5.3
	22.6	1.0	0.9	2.0	26.5	10.9	0.2	1.3	1.7	14.1
Interest rate contracts:										
Interest rate swaps	34.4	15.1	33.5	43.7	126.7	32.0	16.6	27.3	33.4	109.3
Futures, forwards and options	0.4	0.1	3.3	4.6	8.4	0.9	0.2	0.7	1.1	2.9
	34.8	15.2	36.8	48.3	135.1	32.9	16.8	28.0	34.5	112.2
Credit derivatives		0.5	0.2	0.3	1.0		0.1	1.4		1.5
Equity and commodity contracts	0.3	0.5	0.7	0.2	1.7	0.6	0.2	1.1	0.3	2.2

40 Financial instruments

The Group s objectives and policies in managing the risks that arise in connection with the use of financial instruments are set out in the Operating and financial review under Market risk , Currency risk and Equity risk .

Interest rate sensitivity gap

The tables below summarise the Group s interest rate sensitivity gap for its non-trading book at 31 December 2003 and 31 December 2002. The tables show the contractual repricing for each category of asset, liability and for off-balance sheet items. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. Contractual repricing terms do not reflect the potential impact of early repayment or withdrawal. Positions may not be reflective of those in subsequent periods. Major changes in positions can be made promptly as market outlooks change. In addition, significant variations in interest rate sensitivity may exist within the re-pricing periods presented and among the currencies in which the Group has interest rate positions.

2003	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non-interest bearing funds £m	Banking book total £m	Trading book total £m	Total £m
Assets									
Loans and advances to banks	11,149	3,780	5,188	122	32	1,087	21,358	30,533	51,891
Loans and advances to customers	155,920	11,832	7,763	27,992	18,463	1,486	223,456	29,075	252,531
Treasury bills and debt securities	18,906	2,594	4,835	5,525	11,175	2,316	45,351	39,444	84,795
Other assets						47,430	47,430	18,628	66,058
Total assets	185,975	18,206	17,786	33,639	29,670	52,319	337,595	117,680	455,275
Liabilities									
Deposits by banks	37,670	1,178	408	308	414	1,083	41,061	26,262	67,323
Customer accounts	172,563	4,110	2,360	3,352	400	28,140	210,925	26,038	236,963
Debt securities in issue	27,254	2,567	4,428	4,804	846		39,899	1,117	41,016
Subordinated liabilities	3,583	601	104	1,762	10,889		16,939	59	16,998
Other liabilities	5	5	9	37	126	26,893	27,075	37,801	64,876
Shareholders funds						27,018	27,018	1,081	28,099
Internal funding of trading book	(22,447)	(1,060)	(1,239)	(379)	(197)		(25,322)	25,322	
Total liabilities	218,628	7,401	6,070	9,884	12,478	83,134	337,595	117,680	455,275
Off-balance sheet items	(7,943)	(1,122)	3,597	964	4,504				
Interest rate sensitivity gap	(40,596)	9,683	15,313	24,719	21,696	(30,815)			
Cumulative interest rate sensitivity gap	(40,596)	(30,913)	(15,600)	9,119	30,815				

175

Notes on the accounts continued

40 Financial instruments *(continued)*

2002	Within 3 months £m	After 3 months but within 6 months £m	After 6 months