OFFERING CIRCULAR

The Royal Bank of Scotland Group

The Royal Bank of Scotland Group plc

(a public limited company incorporated under the laws of Scotland with registered number 45551)

1,250,000 Non-cumulative Euro Preferred Securities of €0.01 each, Series 1

Issue price: €1,000 per Series 1 Euro Preferred Security

The Royal Bank of Scotland Group plc (the "**Company**") is issuing 1,250,000 Non-cumulative Euro Preferred Securities, Series 1 ("**Series 1 Euro Preferred Securities**").

Dividends on the Series 1 Euro Preferred Securities will accrue from the date of issue. The Company will (subject as provided herein) pay dividends out of its distributable profits in Euro annually in arrear on 31 December in each year beginning on 31 December 2005 at an annual rate of 5.50 per cent. of the liquidation preference of €1,000 per Series 1 Euro Preferred Security. Provided that the United Kingdom ("**UK**") Financial Services Authority does not object, the Company may redeem the Series 1 Euro Preferred Securities in whole on 31 March, 30 June, 30 September or 31 December in each year commencing on or after 31 December 2009 at €1,000 per Series 1 Euro Preferred Security plus accrued dividends for the then current dividend period.

If the Company is liquidated, each holder of Series 1 Euro Preferred Securities will be entitled to receive a liquidation preference of €1,000 per Series 1 Euro Preferred Security plus accrued dividends for the then current dividend period, but only after the Company has paid all of its debts and other liabilities to its creditors and to holders of other securities that expressly are senior to the Series 1 Euro Preferred Securities.

Application has been made for all the Series 1 Euro Preferred Securities to be admitted to the Official Segment of the Stock Market of Euronext Amsterdam N.V. ("**Euronext, Amsterdam**"). This Offering Circular constitutes a prospectus for the purposes of the application for listing on Euronext, Amsterdam.

Investing in the Series 1 Euro Preferred Securities involves certain risks. See "Investment Considerations" beginning on page 13. Investors should note, without limitation, that the Series 1 Euro Preferred Securities have no fixed date for repayment, being perpetual in nature.

The Series 1 Euro Preferred Securities will be issued in bearer form and will be represented by a single global certificate. It is expected that the Series 1 Euro Preferred Securities will be delivered against payment through the facilities of Euroclear Bank S.A./N.V. as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**", together with Euroclear, the "**Clearing Systems**") on or about 29 November 2004 (the "**Closing Date**").

ABN AMRO BNP PARIBAS The Royal Bank of Scotland UBS Investment Bank

22 November 2004

The Company accepts responsibility for the information contained in this Offering Circular. To the best of the knowledge and belief of the Company (which has taken all reasonable care to ensure that such is the case), the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

No person has been authorised to give any information or to make any representation other than as contained in this Offering Circular and, if given or made, such information or representation must not be relied upon as having been authorised by the Company or the Managers (as defined under "Subscription and Sale" below). Neither the delivery of this Offering Circular nor any subscription, sale or purchase made in connection herewith shall, in any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof. This Offering Circular is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see "Documents Incorporated by Reference" below). This Offering Circular shall be read and construed on the basis that such documents are incorporated and form part of this Offering Circular.

Prospective investors should inform themselves as to the legal requirements and tax consequences within the countries of their residence and domicile for the acquisition, holding or disposal of Series 1 Euro Preferred Securities and any foreign exchange restrictions that might be relevant to them. This Offering Circular does not constitute an offer of, or an invitation by or on behalf of, the Company or the Managers to subscribe for or purchase any of the Series 1 Euro Preferred Securities.

Investors should satisfy themselves that they understand all the risks associated with making investments in the Series 1 Euro Preferred Securities. If a prospective investor is in any doubt whatsoever as to the risks involved in investing in the Series 1 Euro Preferred Securities, he or she should consult his or her professional advisers. See "Investment Considerations" for further details of such risks. The Managers have not separately verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Managers or any of them as to the accuracy or completeness of the information contained in this Offering Circular or any other information provided by the Company in connection with the Series 1 Euro Preferred Securities or their distribution.

The distribution of this Offering Circular and the offering of the Series 1 Euro Preferred Securities in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Company and the Managers to inform themselves of, and to observe, any such restrictions.

No action has been taken in any jurisdiction (other than The Netherlands) to permit a public offering of the Series 1 Euro Preferred Securities. Accordingly, the Series 1 Euro Preferred Securities may not be offered or sold, directly or indirectly and this Offering Circular may not be distributed in any jurisdiction, except in accordance with the legal requirements applicable in that jurisdiction. In particular, the Series 1 Euro Preferred Securities have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "**Securities Act**") and may not be offered or sold within the United States or to, or for the account or benefit of, US persons (as defined in Regulation S under the Securities Act), except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. A further description of certain restrictions on the offering and sale of the Series 1 Euro Preferred Securities and on the distribution of this Offering Circular is given under "Subscription and Sale" below.

In connection with the issue of the Series 1 Euro Preferred Securities, UBS Limited (the "**Stabilising Manager**") (or any person acting for the Stabilising Manager) may over-allot or effect transactions with a view to supporting the market price of the Series 1 Euro Preferred Securities at a level higher than that which might otherwise prevail for a limited period. However, there may be no obligation on the Stabilising Manager (or any agent of the Stabilising Manager) to do this. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period. Such stabilising shall be in compliance with all applicable laws, regulations and rules. When conducted by Dutch persons or entities anywhere in the world or by non-Dutch persons or entities in The Netherlands, such stabilising will be conducted in accordance with the rules of the Further Conduct of Business Regulation to the Dutch Securities Market Supervision Act (*Nadere Regeling gedragstoezicht effectenverkeer 2002*) and will in any event be discontinued within 30 days after the Closing Date. Stabilisation transactions conducted on the stock market of Euronext, Amsterdam must be conducted by a member of Euronext, Amsterdam.

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DOCUMENTS INCORPORATED BY REFERENCE

The following documents shall be deemed to be incorporated in, and to form part of, the Offering Circular:

(1) the published annual audited financial statements (on both a consolidated basis and a non-consolidated basis) of the Company for the years ended 31 December 2003 and 31 December 2002;

(2) the published semi-annual interim unaudited financial statements of the Company (on a consolidated basis) for the six month period ended 30 June 2004; and

(3) the articles of association of the Company.

The Company will, at the specified offices of The Bank of New York (the "**Paying and Settlement Agent**"), provide, free of charge, upon oral or written request, a copy of this Offering Circular (or any document incorporated by reference in this Offering Circular). Written or oral requests for such documents should be directed to the Company or The Bank of New York at their principal offices set out at the end of this Offering Circular. In addition, such documents will be available from the offices of ABN AMRO Bank N.V., in its capacity as paying agent (the "**Paying Agent**") (together with the Paying and Settlement Agent, the "**Paying Agents**").

SUMMARY

*The following summary should be read together with the more detailed information regarding the Company and its subsidiaries (the "**RBS Group**" or the "**Group**"), the Series 1 Euro Preferred Securities being sold in this offering and the financial information included elsewhere in this Offering Circular.*

The Group

The Royal Bank of Scotland Group plc is a public limited company incorporated on 25 March 1968 in Scotland under the Companies Act 1985 and 1989 with registration number 45551. The Group is a diversified financial services group engaged in a wide range of banking, financial and finance-related activities in the UK and internationally. The Group's operations are principally centred in the UK.

The Issue

Issuer	The Royal Bank of Scotland Group plc.
Issue size	1,250,000 Non-cumulative Euro Preferred Securities of liquidation preference €1,000 each.
Issue price	€1,000 per Series 1 Euro Preferred Security, payable only in cash.
Use of proceeds	The proceeds of the offering will be used for general corporate purposes and to strengthen the Group's regulatory capital base. See "Use of Proceeds".
Dividends	Non-cumulative preferential dividends will accrue on the Series 1 Euro Preferred Securities from the date they are issued at an annual rate of 5.50 per cent. of the liquidation preference of €1,000 per Series 1 Euro Preferred Security. Dividends will be payable (subject as provided herein) annually in arrear on 31 December in each year to The Bank of New York as common depositary ("**Common Depositary**") for Euroclear and Clearstream, Luxembourg for the benefit of holders through Euroclear and Clearstream, Luxembourg. Payments of less than €0.01 will be rounded upwards. The effective yield per Series 1 Euro Preferred Security is 5.50 per cent. per annum. The Company expects to pay the first dividend on 31 December 2005 which shall amount to €59.89 per Series 1 Euro Preferred Security in respect of the period from (and including) the Closing Date to (but excluding) 31 December 2005. The dividend payable on each other scheduled dividend payment date will be €55 per Series 1 Euro Preferred Security. The Company's obligation to pay dividends is subject to (i) the sole and absolute discretion of the board of directors of the Company (the "**Board of Directors**") and/or (ii) the requirements of applicable law, sufficiency of distributable profits and payment of dividends not causing a breach of the UK Financial Services Authority's capital adequacy provisions. The Series 1 Euro Preferred Securities will rank junior as to dividends to the Company's cumulative preference shares and equally as to dividends with the Company's other non-cumulative preference shares. See "Description of the Series 1 Euro Preferred Securities — Dividends".
Dividend stopper	If dividends are not paid on the Series 1 Euro Preferred Securities as a consequence of the exercise by the Directors of their discretion not to pay the relevant dividend, then the right of the holders of the Series 1 Euro Preferred Securities to receive a dividend will be lost. In such a case the Company shall not pay dividends or any other distributions on its ordinary shares or on any other class of share capital or securities issued by it and expressed to rank junior to the Series 1 Euro Preferred Securities until such time as dividends on the Series 1 Euro Preferred Securities in respect of

	successive dividend periods together aggregating no less than 12 months shall have been declared and paid in full. If dividends are not paid on the Series 1 Euro Preferred Securities as a result of insufficiency of distributable funds or restrictions imposed by capital adequacy requirements, then the right of the holders of the Series 1 Euro Preferred Securities to receive a dividend from the Company will be lost. In such a case the Company will not pay dividends or other distributions on its ordinary shares or any other class of share capital or securities issued by it and expressed to rank junior to or equal with the Series 1 Euro Preferred Securities until such time as dividends on the Series 1 Euro Preferred Securities in respect of successive dividend periods together aggregating no less than 12 months shall have been declared and paid in full.
Capital stopper	If dividends are not paid on the Series 1 Euro Preferred Securities as a consequence of the exercise by the Directors of their discretion not to pay the relevant dividend, then the Company may not redeem, purchase or otherwise acquire for any consideration any of its shares expressed to rank junior to the Series 1 Euro Preferred Securities, and may not set aside any sum nor establish any sinking fund for the redemption, purchase or other acquisition thereof, until such time as dividends on the Series 1 Euro Preferred Securities in respect of successive dividend periods together aggregating no less than 12 months shall have been declared and paid in full. If dividends are not paid on the Series 1 Euro Preferred Securities as a result of insufficiency of distributable funds or restrictions imposed by capital adequacy requirements, then the Company may not redeem, purchase or otherwise acquire for any consideration any of its other shares, and the Company may not set aside any sum or establish any sinking fund for the redemption, purchase or other acquisition of such other shares, until such time as dividends on the Series 1 Euro Preferred Securities in respect of successive dividend periods together aggregating no less than 12 months shall have been declared and paid in full.
Rights upon liquidation	If the Company is wound up or liquidated, holders of the Series 1 Euro Preferred Securities will be entitled to receive €1,000 per Series 1 Euro Preferred Security, payable by the Company out of surplus assets available for distribution to its shareholders. The Series 1 Euro Preferred Securities have liquidation rights which rank junior to the Company's cumulative preference shares but equally with the Company's other non-cumulative preference shares as to entitlement to dividends due for payment after the date of commencement of liquidation and any other dividend payable in respect of the period from the preceding dividend payment date to the date of payment. Subject to the foregoing, the Series 1 Euro Preferred Securities rank equally with the Company's cumulative preference shares, as regards entitlement to a sum equal to the amount paid up or credited as paid up on the Series 1 Euro Preferred Securities. See "Description of the Series 1 Euro Preferred Securities — Rights Upon Liquidation".
Optional redemption	Provided that the UK Financial Services Authority does not object, the Company may redeem the Series 1 Euro Preferred Securities, at its option, in whole on 31 March, 30 June, 30 September or 31 December in each year commencing on or after 31 December 2009, provided in each case that the Company gives at least 30 days' but not more than 60 days' notice. If the Company were to exercise this option, it would redeem each Series 1 Euro Preferred Security at a redemption price of €1,000 plus the dividends

accrued and payable for the then-current dividend period. See "Description of the Series 1 Euro Preferred Securities — Redemption".

Voting rights	Holders of Series 1 Euro Preferred Securities will only be entitled to vote at general meetings of the Company's shareholders in certain limited circumstances, including (1) where the rights of holders of the Series 1 Euro Preferred Securities may be varied or abrogated, (2) where a resolution has been proposed for a winding-up or liquidation and (3) where the Company has failed to pay in full the dividend on the Series 1 Euro Preferred Securities for the most recent period. See "Description of the Series 1 Euro Preferred Securities — Voting Rights".
Form of the Series 1 Euro Preferred Securities	The Series 1 Euro Preferred Securities will constitute a class of preference share capital in the Company, will be represented by a share warrant to bearer and will be in the form of a single global certificate (the "**Global Certificate**"), which will be deposited with the Common Depositary. Beneficial interests in the Global Certificate will be evidenced by, and transfers thereof will be effected only through, records maintained by the participants in Euroclear and Clearstream, Luxembourg. If either or both of Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays), or announces an intention permanently to cease business, each holder of a beneficial interest in the Global Certificate shall have transferred to it a number of Series 1 Euro Preferred Securities corresponding to its book-entry interest in the Series 1 Euro Preferred Securities represented by the Global Certificate, in the form of share warrants to bearer within 30 days of such closure or announcement. Definitive share certificates will not be available to holders of Series 1 Euro Preferred Securities unless share warrants to bearer are presented to the Company's registrar at its office in the UK for exchange — see "Description of the Series 1 Euro Preferred Securities — Form and Denomination". Transfers, or agreements to transfer, Series 1 Euro Preferred Securities in registered form will be subject to UK stamp duty or stamp duty reserve tax — see "Taxation".
Rating	The Series 1 Euro Preferred Securities are expected, on issue, to be rated "A1" by Moody's Investors Service, Inc., "A" by Standard & Poor's Rating Services, a division of the McGraw-Hill Companies, Inc. and "AA–" by Fitch Ratings Inc. A security rating is not a recommendation to buy, sell or hold securities and may be subject to supervision, reduction or withdrawal at any time by the assigning rating agency.
Listing	Application has been made to the Official Segment of the Stock Market of Euronext Amsterdam N.V. for admission to listing of the Series 1 Euro Preferred Securities. It is expected that admission to listing will become effective and dealings are expected to commence on 29 November 2004.
Settlement	The Series 1 Euro Preferred Securities will be cleared through Euroclear and Clearstream, Luxembourg. Series 1 Euro Preferred Securities deposited with the Common Depositary for Euroclear and Clearstream, Luxembourg and credited to the respective securities accounts of purchasers in Euroclear or Clearstream, Luxembourg against payment to Euroclear or Clearstream, Luxembourg will be held in accordance with the terms and conditions governing use of Euroclear and Clearstream, Luxembourg, the operating procedures of the Euroclear system, as amended from time to time, and the management regulations of Clearstream, Luxembourg and the instructions to participants of Clearstream, Luxembourg, as amended from time to time, as applicable. Cash dividends received in respect of the Series 1 Euro Preferred Securities that are deposited with the depositaries for Euroclear and Clearstream,

	Luxembourg will be credited to the cash accounts maintained at Euroclear and Clearstream, Luxembourg on behalf of the investors having accounts at Euroclear and Clearstream, Luxembourg, as the case may be, after deduction for applicable withholding taxes (if any), in accordance with the applicable regulations and procedures of Euroclear and Clearstream, Luxembourg. Each of Euroclear and Clearstream, Luxembourg may, at its discretion, take such action as it shall deem appropriate in order to assist investors having accounts at Euroclear or Clearstream, Luxembourg in the exercise of voting rights in respect of the Series 1 Euro Preferred Securities. Such actions may include (i) acceptance of instructions from investors having accounts at Euroclear or Clearstream, Luxembourg to execute, or to arrange for the execution of, proxies, powers of attorney or other similar certificates for delivery to the Company or its agent; or (ii) voting of such Series 1 Euro Preferred Securities by Euroclear or its nominees and Clearstream, Luxembourg or its nominees in accordance with the instructions of investors having accounts at Euroclear or Clearstream, Luxembourg.
Governing law	The creation and issuance of the Series 1 Euro Preferred Securities and the rights attached to them will be governed by, and construed in accordance with, the laws of Scotland.

DESCRIPTION OF THE SERIES 1 EURO PREFERRED SECURITIES

General

The Series 1 Euro Preferred Securities constitute a class of preference share capital in the Company and will be represented by a share warrant to bearer in the form of the Global Certificate. The Global Certificate will be deposited with the Common Depositary for Euroclear and Clearstream, Luxembourg. Beneficial interests in the Global Certificate will be evidenced by and transfers thereof will be effected only through, records maintained by the participants in Euroclear and Clearstream, Luxembourg. Beneficial interests in the Global Certificate will be transferable only in accordance with the rules and procedures of Euroclear or Clearstream, Luxembourg, as the case may be.

Pre-emptive Rights

Holders of Series 1 Euro Preferred Securities will have no pre-emptive rights.

Dividends

Non-cumulative preferential dividends on the Series 1 Euro Preferred Securities will accrue from the date the Company issues the Series 1 Euro Preferred Securities. Subject to the limitations set forth below, the Company will pay these dividends annually in arrear on, and to the holders of record 15 days prior to 31 December of each year ("**Dividend Payment Date**"), beginning on 31 December 2005. The Company will pay dividends when, as and if declared by the Board of Directors or an authorised committee of the Board of Directors (the "**Committee**"). If any date on which dividends are payable on the Series 1 Euro Preferred Securities is not a day on which TARGET is operating and on which banks in London are open for business, and on which foreign exchange dealings may be conducted in Euro (a "**Euro Business Day**"), then payment of the dividend payable on such date will be made on the succeeding Euro Business Day and without any interest or other payment in respect of such delay unless such day shall fall within the next calendar month whereupon such payment will be made on the preceding Euro Business Day; for these purposes "TARGET" means the Trans-European Real-Time Gross Settlement Express Transfer (TARGET) system.

Declaration of Dividends

The Board of Directors or the Committee (i) may in its sole and absolute discretion resolve prior to any Dividend Payment Date that such dividend shall not be paid or (ii) may declare and pay in full dividends on Series 1 Euro Preferred Securities on each Dividend Payment Date if, in the opinion of the Board of Directors or the Committee, the distributable profits of the Company are sufficient to cover the payment in full of dividends on the Series 1 Euro Preferred Securities and also the payment in full of all other dividends stated to be payable on such date on any other equally ranking preference shares, after payment in full, or the setting aside of a sum to cover the payment in full, of all dividends stated to be payable on or before such date on any of the Company's cumulative preference shares (and any arrears of dividends thereon). If, in the opinion of the Board of Directors or the Committee, the payment of any dividend on any Series 1 Euro Preferred Securities would breach or cause a breach of the capital adequacy requirements of the UK Financial Services Authority that apply at that time to the Company and/or any of the Company's subsidiaries, then no dividend shall be declared or paid.

The Companies Act 1985 (the "**Act**") defines "distributable profits" as, in general terms, and subject to adjustment, accumulated realised profits less accumulated realised losses.

If any dividend on the Series 1 Euro Preferred Securities is not payable for the reasons described in para (ii) above, then the Board of Directors or the Committee may, if applicable law permits, pay a special non-cumulative preferential dividend on the Series 1 Euro Preferred Securities at a rate not exceeding €0.01 per share. However, under the Company's articles of association, no dividend shall be payable in contravention of the special rights attaching to any of the Company's other shares.

Dividends on the cumulative preference shares issued by the Company, including any arrears, are payable in priority to any dividends on the Series 1 Euro Preferred Securities, and as a result, the Company may not pay any dividend on the Series 1 Euro Preferred Securities unless the Company has declared and paid in full dividends on such cumulative preference shares, including any arrears.

Payment of Dividends

The Company will pay dividends on Series 1 Euro Preferred Securities out of its distributable profits in Euros, at the rate per annum of 5.50 per cent. of the liquidation preference of €1,000 per Series 1 Euro Preferred

Security. The dividend on each Series 1 Euro Preferred Security will therefore amount to €55 per annum, and will amount to €59.89 per Series 1 Euro Preferred Security in respect of the period from (and including) the Closing Date to (but excluding) the first Dividend Payment Date, being 31 December 2005. Payments of dividends with respect to the Series 1 Euro Preferred Securities will be made to each of Euroclear and Clearstream, Luxembourg with respect to that portion of the Global Certificate held for its account.

The holder of the Global Certificate shall be the only person entitled to receive payments of dividends in respect of the Series 1 Euro Preferred Securities represented by that Global Certificate. The Global Certificate will initially be held by the Common Depositary. The Company will be discharged by payment to, or to the order of, the holder of the Global Certificate with respect to the amount so paid. Each of the persons on the records of Euroclear or Clearstream, Luxembourg as the holder of a beneficial interest must look solely to Euroclear and/or Clearstream, Luxembourg, as the case may be, for its share of such payment made by the Company to, or to the order of, the holder of the Global Certificate. No person other than the holder of the Global Certificate shall have any claim against the Company with respect to payments due on that Global Certificate.

Dividends on the Series 1 Euro Preferred Securities will be non-cumulative. If the Company's Board of Directors or the Committee does not pay a dividend payable on a Dividend Payment Date in respect of the Series 1 Euro Preferred Securities, then holders of Series 1 Euro Preferred Securities will have no claim in respect of the non-payment. Except as described in this Offering Circular, the holders of the Series 1 Euro Preferred Securities will have no right to participate in the Company's profits.

If any dividend stated to be payable on the Series 1 Euro Preferred Securities on the most recent Dividend Payment Date has not been declared and paid in full, or if the Company has not set aside a sum to provide for payment in full of such dividend, other than by reason of the exercise of its Directors' or the Committee's discretion referred to in para (i) under "Declaration of Dividends" above, then the Company may not declare or pay dividends upon any other shares ranking equally with or after the Series 1 Euro Preferred Securities as to dividends and the Company may not set aside any sum for the payment of these dividends, unless, on the date of declaration of any such dividends, the Company sets aside an amount equal to the dividend for the then-current annual dividend period payable on the Series 1 Euro Preferred Securities to provide for the payment in full of such dividend on the Series 1 Euro Preferred Securities on the next Dividend Payment Date.

If the Company has not declared and paid in full any annual dividend payable on the Series 1 Euro Preferred Securities or if the Company has not set aside a sum to provide for its payment in full, other than by reason of the exercise of its Directors' or the Committee's discretion referred to in para (i) under "Declaration of Dividends" above, then the Company may not redeem, purchase or otherwise acquire for any consideration any of its other shares, and the Company may not set aside any sum or establish any sinking fund for the redemption, purchase or other acquisition of such other shares, until such time as dividends on the Series 1 Euro Preferred Securities in respect of successive dividend periods together aggregating no less than 12 months shall have been declared and paid in full.

In addition, if the Company has not declared and paid in full, or if it has not set aside an amount to provide for the payment in full of, the dividend stated to be payable on any other equally ranking non-cumulative preference shares which are then outstanding other than by reason of the exercise by its Directors or the Committee of a discretion analogous to the discretion referred to in para (i) under "Declaration of Dividends" above, then:

- the Company may not declare or pay any dividends on the Series 1 Euro Preferred Securities, and the Company may not set aside any sum to pay such dividends, unless, on the date of declaration, the Company sets aside an amount equal to the dividend on such other series of non-cumulative preference shares for the then-current dividend period to provide for the payment in full of such dividend on the next applicable Dividend Payment Date; and
- the Company may not redeem, repurchase or otherwise acquire any Series 1 Euro Preferred Securities until such time as it has declared and paid in full dividends on such other series of non-cumulative preference shares in respect of successive dividend periods together aggregating no less than 12 months.

To the extent that any dividend on the Series 1 Euro Preferred Securities is, on any occasion, not declared and paid by the Company by reason of the exercise of its Directors' or the Committee's discretion referred to in para (i) under "Declaration of Dividends" above, holders of the Series 1 Euro Preferred Securities shall have no claim in respect of such non-payment. In addition, such non-payment shall not prevent or restrict (a) the declaration and payment of dividends on any other series of non-cumulative preference shares (including, but not limited to, any series of non-cumulative preference shares outstanding as of the date of this Offering Circular) expressed to rank *pari passu* with the Series 1 Euro Preferred Securities, (b) the setting aside of sums for the payment of dividends referred to in (a), (c) except as set forth in the following paragraph, the redemption, purchase or other acquisition of its shares by the Company, or (d) except as set forth in the following paragraph, the setting aside of sums, or the establishment of sinking funds, for any such redemption, purchase or other acquisition by the Company.

If the Company has not declared and paid in full the dividend stated to be payable on Series 1 Euro Preferred Securities as a result of the exercise of its Directors' or the Committee's discretion referred to in para (i) under "Declaration of Dividends", then the Company may not redeem, purchase or otherwise acquire for any consideration any of its shares ranking after the Series 1 Euro Preferred Securities, and may not set aside any sum nor establish any sinking fund for the redemption, purchase or other acquisition thereof, until such time as the Company has declared and paid in full dividends on the Series 1 Euro Preferred Securities in respect of successive dividend periods singly or together aggregating no less than 12 months. In addition, no dividend may be declared or paid on any of the Company's shares ranking after the Series 1 Euro Preferred Securities as to dividends until such time, after the non-payment, as the dividend stated to be payable on the Series 1 Euro Preferred Securities in respect of a dividend period has been declared and paid in full.

The Company's articles of association provide that the Series 1 Euro Preferred Securities shall not be treated as ranking after any other series of preference shares with which it is expressed to rank *pari passu* as regards participation in profits, by reason only of the exercise of the Directors' discretion referred to in para (i) under "Declaration of Dividends" above, or any dividend on the Series 1 Euro Preferred Securities not being paid by virtue of the exercise of such discretion.

The amount of dividends payable for any period shorter than a full dividend period will be computed on the basis of twelve 30-day months and a 360-day year with respect to full months, and, for those periods shorter than one month, the actual number of days elapsed in such period calculated on a 360-day year. Payments of less than €0.01 will be rounded upwards.

Any dividend which has remained unclaimed for 12 years from the date when it became due for payment shall, if the Board of Directors so resolves, be forfeited and shall revert to the Company.

Rights upon Liquidation

If the Company is wound up or liquidated, whether or not voluntarily, the holders of the Series 1 Euro Preferred Securities will be entitled to receive in Euros out of the Company's surplus assets available for distribution to shareholders, after payment of arrears of dividends on the cumulative preference shares, up to the date of payment, equally with the Company's cumulative preference shares, any other series of non-cumulative preference shares then outstanding, and all of the Company's other shares ranking equally with the Series 1 Euro Preferred Securities as regards participation in the Company's profits, a distribution of €1,000 per Series 1 Euro Preferred Security, 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 Company's Ordinary Shares or any other class of the Company's shares ranking after the Series 1 Euro Preferred Securities.

If the assets available for distribution are insufficient to pay in full the amounts payable with respect to the Series 1 Euro Preferred Securities and any of the Company's other preference shares ranking equally as to any such distribution with the Series 1 Euro Preferred Securities, the holders of the Series 1 Euro Preferred Securities and such other preference shares will share rateably in any distribution of the Company's surplus assets in proportion to the full respective preferential amounts to which they are entitled.

After payment of the full amount of the liquidation distribution to which they are entitled, the holders of the Series 1 Euro Preferred Securities will have no right or claim to any of the Company's surplus assets and will not be entitled to any further participation in surplus assets.

Redemption

The Company may redeem the Series 1 Euro Preferred Securities, at its option, in whole on 31 March, 30 June, 30 September and 31 December in each year commencing on or after 31 December 2009, upon not less than 30 nor more than 60 days' notice, at a redemption price of €1,000 per Series 1 Euro Preferred Security plus the dividends otherwise payable for the then-current dividend period accrued to the redemption date. If the due date for the payment of the redemption monies on any Series 1 Euro Preferred Securities is not a Euro Business Day then payment of such monies will be made on the next succeeding day which is a Euro Business Day and without any interest or other payment in respect of such delay unless such day shall fall within the next calendar month whereupon such payment will be made on the preceding Euro Business Day.

The Company's articles of association provide that no defect in the notice of redemption or in the giving of the notice will affect the validity of the redemption proceedings.

Under existing UK Financial Services Authority requirements, the Company may only redeem or purchase any Series 1 Euro Preferred Securities if the UK Financial Services Authority does not object. The Financial Services Authority may impose conditions on any redemption or purchase.

If certain limitations contained in the Company's articles of association, the special rights of any of the Company's shares and the provisions of applicable law permit, the Company may, at any time or from time to time, purchase outstanding Series 1 Euro Preferred Securities by tender, available alike to all holders of Series 1 Euro Preferred Securities, in the open market or by private agreement, in each case upon the terms and conditions that the Board of Directors or the Committee shall determine. Any Series 1 Euro Preferred Securities that the Company purchases for its own account will, pursuant to applicable law, be treated as cancelled and will no longer be issued and outstanding.

In each year in which a repurchase is made, the aggregate nominal amount of the Series 1 Euro Preferred Securities repurchased shall be announced in accordance with the Listing and Issuing Rules (*Fondsenreglement*) of Euronext Amsterdam with mention of remaining Series 1 Euro Preferred Securities.

Voting Rights

The holders of the Series 1 Euro Preferred Securities will not be entitled to receive notice of, attend or vote at any general meeting of the Company's shareholders except as provided by applicable law or as described below.

If any resolution is proposed for adoption by the Company's shareholders varying or abrogating any of the rights attaching to the Series 1 Euro Preferred Securities or proposing that the Company would be wound up or liquidated, the holders of the Series 1 Euro Preferred Securities or, in the case of the proposal of a resolution for a winding-up or liquidation, the holders of the outstanding preference shares generally will be entitled to receive notice of and to attend the general meeting of shareholders at which the resolution is to be proposed and will be entitled to speak and vote on such resolution, but not on any other resolution.

In addition, if before any general meeting of shareholders the Company has failed to pay in full the dividend payable on the Series 1 Euro Preferred Securities for the most recent annual dividend period, the holders of the Series 1 Euro Preferred Securities shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters. In these circumstances only, the right of the holders of Series 1 Euro Preferred Securities to vote shall continue until the Company has made payment in full of dividends on the Series 1 Euro Preferred Securities for the most recent dividend period.

Whenever entitled to vote at a general meeting of shareholders on a show of hands, each holder of Series 1 Euro Preferred Securities present in person shall have one vote and, on a poll, each holder of Series 1 Euro Preferred Securities present in person or by proxy will be entitled to one vote for each Series 1 Euro Preferred Security held (subject to adjustment to reflect any capitalisation issue, consolidations, sub-divisions or any other re-classification of the Company's Ordinary Shares as a result of any distribution to the holders of Ordinary Shares of the Company's assets and certain issues of Ordinary Shares or of rights or options to subscribe for Ordinary Shares at a market discount (subject to certain exceptions)).

The holders, including holders of Series 1 Euro Preferred Securities at a time when they have voting rights as a result of the Company having failed to pay dividends as described above, of not less than 10 per cent. of its paid-up capital that at the relevant date carries the right to vote at the Company's general meetings, are entitled to require the Board of Directors to convene an extraordinary general meeting. In addition, the holders of Series 1 Euro Preferred Securities may have the right to vote separately as a class in certain circumstances as described below under the heading "Variation of Rights".

Form and Denomination

The Series 1 Euro Preferred Securities will, when issued, be fully paid and, as such, will not be subject to a call for any additional payment. For each Series 1 Euro Preferred Security issued, an amount equal to its nominal value will be credited to the Company's issued share capital account and an amount of €999.99, being the difference between its issue price and its nominal value, will be credited to the Company's share premium account.

The Series 1 Euro Preferred Securities will be represented by a single share warrant to bearer and will be in the form of the Global Certificate. The Global Certificate will be deposited with the Common Depositary on or before the issue date of the Series 1 Euro Preferred Securities. The Company may consider the Common Depositary one holder of the Series 1 Euro Preferred Securities so deposited for all purposes. If either or both of Euroclear and Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays), or announces an intention permanently to cease business, a number of Series 1 Euro Preferred Securities corresponding to its book-entry interest in the Series 1 Euro Preferred Securities represented by the Global Certificate will be transferred to each holder of Series 1 Euro Preferred Securities, in the form of share warrants to bearer within 30 days of such closure or announcement. Upon presentation to the Company's registrar at its office in the UK, a share warrant to bearer may be exchanged for the relevant Series 1 Euro Preferred Securities in registered form, in which event the holder of the share warrant to bearer will be registered as a holder of the Series 1 Euro Preferred Securities in the register of members the Company maintains and will receive a certificate made in such holder's name. Other than in the circumstances referred to in this paragraph, definitive share certificates will not be available to holders of Series 1 Euro Preferred Securities. Temporary documents of title will not be issued.

Title to Series 1 Euro Preferred Securities in registered form will pass by transfer and registration on the register for the Series 1 Euro Preferred Securities. Title to Series 1 Euro Preferred Securities represented by a share warrant to bearer, or to any dividend coupons appertaining to them, will pass by delivery of the relevant bearer share warrants or dividend coupons. Series 1 Euro Preferred Securities in registered form will not be exchangeable, in whole or in part, for Series 1 Euro Preferred Securities represented by a share warrant to bearer.

Each exchange or registration of transfer of Series 1 Euro Preferred Securities in registered form will be effected by entry on the register for the Series 1 Euro Preferred Securities kept by the Company's registrar at its office in the UK. See "Registrar and Paying and Settlement Agent" below. Any exchange or registration of transfer will be effected without charge to the person requesting the exchange or registration, but the requesting person will be required to pay any related taxes, stamp duties or other governmental charges.

The exchange of Series 1 Euro Preferred Securities represented by a share warrant to bearer for definitive Series 1 Euro Preferred Securities in registered form will also be subject to applicable UK tax laws and regulations in effect at the time of the exchange. No exchange will be made unless any resulting taxes, stamp duties or other governmental charges have been paid to the Company.

Variation of Rights

The rights attached to Series 1 Euro Preferred Securities may be varied or abrogated only with the written consent of the holders of 75 per cent. in nominal value of the outstanding Series 1 Euro Preferred Securities or with the sanction of an extraordinary resolution passed at a separate class meeting of the holders of the outstanding Series 1 Euro Preferred Securities. An extraordinary resolution will be adopted if passed by a majority of 75 per cent. of those holders voting in person or by proxy at the meeting. The quorum required for any such class meeting will be two persons at least holding or representing by proxy one-third in nominal amount of the outstanding Series 1 Euro Preferred Securities affected, except at any adjourned meeting, where any two holders present in person or by proxy will constitute a quorum.

The written consent of the holders of 75 per cent. in nominal value of the outstanding Series 1 Euro Preferred Securities or the sanction of an extraordinary resolution passed at a separate class meeting of holders of the outstanding Series 1 Euro Preferred Securities will be required if the Board of Directors propose to authorise, create or increase the amount of any shares of any class or any security convertible into shares of any class ranking as regards rights to participate in the Company's profits or assets, other than if the Company redeems or purchases such shares, in priority to the Series 1 Euro Preferred Securities.

If the Company has paid the most recent dividend payable on the Series 1 Euro Preferred Securities in full, the rights attached to the Series 1 Euro Preferred Securities will not be deemed to be varied by the creation or issue of any further non-cumulative preference shares or of any other further shares ranking equally as regards participation in the Company's profits or assets with, or junior to, the Series 1 Euro Preferred Securities, whether carrying identical rights or different rights in any respect, including as to dividend, premium on a return of capital, redemption or conversion or denominated in Euro or any other currency.

Notice of Meetings

The Company will cause a notice of any meeting at which holders of Series 1 Euro Preferred Securities are entitled to attend and vote to be mailed to each holder of Series 1 Euro Preferred Securities. Each such notice will state:

- the date of the meeting;
- a description of any resolution to be proposed for adoption at the meeting on which those holders are entitled to vote; and
- instructions for delivery of proxies.

A holder of Series 1 Euro Preferred Securities in registered form who is not registered with an address in the UK and who has not supplied an address within the UK to the Company for the purpose of notices is not entitled to receive notices of meetings. In addition, notices to holders of the Series 1 Euro Preferred Securities, including notices for general meetings of holders of the Series 1 Euro Preferred Securities, will be published in accordance with the operating procedures for the time being of Euroclear and Clearstream, Luxembourg and in English in a leading newspaper (which is expected to be the *Financial Times*) having general circulation in Europe that is published on each business day in morning editions, whether or not it is published on Saturday, Sunday or holiday editions.

In addition, for so long as the Series 1 Euro Preferred Securities are listed on the Official Segment of the Stock Market of Euronext Amsterdam N.V., and the rules of such exchange so require, notices will be published in the Euronext Daily Official List (*Officiële Prijscourant*) of the Amsterdam securities exchanges and in a newspaper having general circulation in The Netherlands.

All such notices shall be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers.

Governing Law

The creation and issuance of the Series 1 Euro Preferred Securities and the rights attached to them shall be governed by and construed in accordance with the laws of Scotland.

Registrar and Paying and Settlement Agent

The Company has appointed Computershare Investor Services PLC as registrar. Computershare's current address is PO Box 82, The Pavilions, Bridgewater Road, Bristol BS99 7NH. The Company has appointed The Bank of New York as Paying and Settlement Agent and ABN AMRO Bank N.V. as Paying Agent pursuant to an agency agreement to be dated 29 November 2004 for the Series 1 Euro Preferred Securities ("**Agency Agreement**"). The Paying and Settlement Agent's current address is 1 Canada Square, London E14 5AL, England and the Paying Agent's current address is Kemelstede 2, 4817 ST Breda, The Netherlands.

The Company reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor principal paying and settlement agent and additional or successor paying agent; provided, however, that if, and for so long as, the Series 1 Euro Preferred Securities are listed on Euronext Amsterdam and the rules of such exchanges so require, the Company shall maintain a paying agent having its specified office in Amsterdam. Notice of any change of registrar or agent will be given to holders of the Series 1 Euro Preferred Securities as described in "General Information — Notices".

USE OF PROCEEDS

The net proceeds of this offering of Series 1 Euro Preferred Securities are estimated to be €1,225,000,000 after payment of commissions and expenses.

The proceeds of the offering will be used for general corporate purposes and to strengthen the Group's regulatory capital base.

INVESTMENT CONSIDERATIONS

Investing in the securities offered using this Offering Circular involves risk. Investors should carefully consider the following factors and the other information in this Offering Circular, the Group's financial statements for the year ended 31 December 2003 and the Group's unaudited interim financial statements for the six months ended 30 June 2004 (which are set out at the end of the Offering Circular at pages F-2 to F-78), before deciding to invest in the Series 1 Euro Preferred Securities. If any of these risks occurs, the Group's business, financial condition, and results of operations could suffer, and the trading price and liquidity of the Series 1 Euro Preferred Securities could decline, in which case investors could lose part or all of their investment.

Risks Related to the Group's Business

Set out below are certain risk factors which could affect the 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 below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties the Group's businesses face.

The Group's financial performance is affected by borrower credit quality and general economic conditions, in particular in the UK and in 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 the UK, US or global economic conditions, or arising from systemic risks in the financial systems, could affect the recoverability and value of its assets and require an increase in the Group's 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 businesses 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 that it has assumed.

Operational risks are inherent in the Group's businesses.

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, those of 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.

Each of the Group's businesses is subject to regulation and regulatory oversight. Any significant regulatory developments could have an effect on how the Group conducts the Group's 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 it offers or the value of its 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.

Risks Related to the Series 1 Euro Preferred Securities

Dividends on the Series 1 Euro Preferred Securities are discretionary and may not be declared and paid in full if the Board of Directors or the Committee resolves not to pay dividends in respect of any Dividend Payment Date.

The Board of Directors or the Committee thereof (in either case referred to herein as the Board of Directors) may resolve, in its sole and absolute discretion, prior to the relevant Dividend Payment Date not to pay in full dividends on the Series 1 Euro Preferred Securities. To the extent that any dividend or part thereof is on any occasion not declared and paid by reason of the exercise of such discretion, holders of Series 1 Euro Preferred Securities shall have no claim in respect of such non-payment.

In addition, such non-payment shall not prevent or restrict (a) the declaration and payment of dividends on any other series of the Company's non-cumulative preference shares or on any of the Company's preference shares expressed to rank *pari passu* with the Series 1 Euro Preferred Securities, (b) the setting aside of sums for the payment of dividends referred to in (a), (c) except with respect to share capital ranking after the Series 1 Euro Preferred Securities, the redemption, purchase or other acquisition of the Company's shares by the Company, or (d) except with respect to share capital ranking after Series 1 Euro Preferred Securities, the setting aside of sums, or the establishment of sinking funds, for any such redemption, purchase or other acquisition.

Dividends on the Series 1 Euro Preferred Securities are non-cumulative and will not be declared and paid in full if certain requirements relating to the Company's capital levels and other conditions are not satisfied. If the Company's financial condition were to deteriorate, investors could lose all or a part of their investment.

In addition to the discretion not to declare a dividend for any reason as described above, the Board of Directors will not declare and pay in full the dividends on any series of preference shares or preferred securities if, in the opinion of the Directors, payment of the dividend would cause a breach of applicable capital adequacy requirements of the UK Financial Services Authority or if the Company does not have sufficient distributable profits.

If the Board of Directors does not pay a dividend or any part of a dividend when due on a Dividend Payment Date in respect of any Series 1 Euro Preferred Securities because it is not required to do so, then holders of such preference shares or Series 1 Euro Preferred Securities will have no claim in respect of the non-payment and the Company will have no obligation to pay the dividend accrued for the dividend period or to pay any interest on the dividend, whether or not dividends on the Series 1 Euro Preferred Securities are declared for any future dividend period. Holders of Series 1 Euro Preferred Securities will have no right to participate in the Company's profits.

If the Company's financial condition were to deteriorate, investors might not receive dividends on the Series 1 Euro Preferred Securities. If the Company liquidates, dissolves or is wound up, investors could lose all or part of their investment.

An active market for the Series 1 Euro Preferred Securities may fail to develop or may not be sustainable.

Prior to the offering, there has been no trading market for this series of preferred securities. The Company cannot assure investors that an active or liquid market will develop or be sustainable for the Series 1 Euro Preferred Securities.

The Series 1 Preferred Securities are perpetual and therefore have no fixed date for repayment.

THE RBS GROUP

The Company is a public limited company incorporated in Scotland with registration number 45551. The Group is a diversified financial services group engaged in a wide range of banking, financial and finance-related activities in the UK and internationally. The Group's operations are principally centred in the UK.

The Company's principal operating subsidiary is The Royal Bank of Scotland plc ("**RBS**"). As of 31 January 2003, the entire issued ordinary share capital of National Westminster Bank Plc ("**NatWest**") was transferred from the Company to RBS. Both RBS and NatWest are major UK clearing banks engaging principally in providing a comprehensive range of banking, insurance and other financial services and each controls, directs and promotes the operations of various subsidiary companies.

RBS was created by the merger in 1985 of the former The Royal Bank of Scotland plc, the largest of the Scottish clearing banks, and Williams & Glyn's Bank plc, the Company's wholly-owned English clearing bank subsidiary. At 31 December 2003, RBS had over 600 retail branches in the UK.

NatWest was incorporated in England in 1968 and was formed from the merger of National Provincial Bank Limited and Westminster Bank Limited, which had themselves been formed through a series of mergers involving banks with origins dating back as far as the seventeenth century. At 31 December 2003, NatWest had over 1,600 retail branches in the UK.

Business Overview

At and for the year ended 31 December 2003, based on domicile of the customer, no country outside the UK or the United States accounted for more than 10% of total assets or profit before tax or net assets of the Group. At 30 June 2004, the Group had total assets of £519 billion and total deposits of £338 billion. Shareholders' funds at 30 June 2004 were £32,408 million.

As at 30 June 2004, the Group employed 125,100 staff on a full-time equivalent basis.

Organisation Structure

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 the activities of each of the divisions is given below.

Corporate Banking and Financial Markets

Corporate Banking and Financial Markets provides an integrated range of products and services to mid-sized and large corporate and institutional customers in the UK and overseas, including 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 and futures brokerage. In addition, it provides foreign exchange, money market, currency derivative and rate risk management services. It also engages in similar activities for its own account, and provides treasury services support to the Group. RBS Greenwich Capital, headquartered in Connecticut, delivers debt market solutions tailored to meet the needs of companies and institutions around the world.

Retail Banking

Retail Banking provides a wide range of banking, insurance and related financial services to individuals and small businesses. These services are delivered from a network of RBS and NatWest branches throughout Great Britain and through ATMs, the internet and the telephone. It also has complementary subsidiary businesses covering life assurance and pensions.

In the personal banking market, Retail Banking offers money transmission, savings and loan facilities, mortgages and insurance. In the small business banking market, Retail Banking provides a range of services which includes money transmission and cash management, short, medium and long-term finance and retail and wholesale deposit-taking products.

Retail Direct

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

Manufacturing

Manufacturing supports the customer facing businesses, principally Corporate Banking and Financial Markets, 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.

Wealth Management

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 of Scotland 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 and 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.

RBS Insurance

RBS Insurance was established following the acquisition by the Group of Churchill Insurance Group on 1 September 2003. RBS Insurance is comprised of the companies from the previous 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 Limited operates as a specialist travel insurance broker administrator.

Ulster Bank

Ulster Bank Limited ("**Ulster Bank**") provides a comprehensive range of retail and wholesale financial services in Northern Ireland and the Republic of Ireland. Ulster Bank retail banking has a network of branches throughout Ireland and operates in the personal, commercial and wealth management sectors. Ulster Bank corporate banking and financial markets provides a wide range of services in the corporate and institutional markets.

Since Ulster Bank's acquisition of First Active plc, First Active and Ulster Bank have retained their own distinctive brands, branch networks and customer offerings.

Citizens

Citizens Financial Group, Inc. ("**Citizens**") is engaged in retail and corporate banking activities carried out through its branch network in the states of Rhode Island, Connecticut, Massachusetts, New Hampshire, Pennsylvania, Delaware and New Jersey. Citizens is the second largest bank in New England and the thirteenth largest commercial banking organisation in the United States 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 loan and commercial real estate activities, consumer lending, credit card services, trust services and retail investment services. Citizens also operates subsidiaries primarily engaged in equipment lease financing.

Recent Developments

The Group completed a number of acquisitions during the first half of 2004. These included:

In January 2004, Ulster Bank completed the acquisition of First Active plc, for a cash consideration of €887 million.

In March 2004, RBS completed the purchase of the credit card portfolio and certain associated assets of People's Bank of Connecticut in the US.

The acquisition of Charter One Financial, Inc. by Citizens was completed on 31 August 2004.

The acquisition of Lynk Systems Inc., by the Group was completed on 8 September 2004.

For further information in respect of the business and operations of the Group for the six months ended 30 June 2004 see the Company's interim financial statements which are included in this Offering Circular at pages F-70 to F-78.

Terms of Office of the Directors

At each annual general meeting of the Company's shareholders, the terms of office of Directors appointed since the previous annual general meeting, together with the terms of one-third by rotation of the Company's remaining Directors expire. There is an overriding requirement that each Director must stand for re-election at least once every three years. Directors may be appointed by an Ordinary Resolution of the Company. For further details regarding Directors' appointments see Articles 100-108 of the articles of association of the Company available as described in "General Information" below.

The Directors and the Secretary of the Company, their functions within the Group and their principal outside activities (if any) of significance are:

Name	Functions within the Group	Principal outside activity (if any) of significance to the Group
Chairman		
Sir George Ross Mathewson	Chairman	—
Vice Chairman		
The Lord Vallance of Tummel	Vice-Chairman	Formerly Chairman, British Telecommunications plc
Sir Angus McFarlane McLeod Grossart	Vice-Chairman	Chairman and Managing Director, Noble Grossart Limited
Executive Directors		
Sir Frederick Anderson Goodwin	Group Chief Executive	—
Lawrence Kingsbaker Fish	Chairman, President and Chief Executive Officer, Citizens Financial Group, Inc.	—
Gordon Francis Pell	Chairman, Retail Banking and Wealth Management	—
Frederick Inglis Watt	Group Finance Director	—
Non-executive Directors		
Colin Alexander Mason Buchan	—	Formerly Head of Global Equities, UBS Warburg
James McGill Currie	—	Formerly a Director General at the European Commission
Archibald Hunter	—	Chairman, MacFarlane Group plc
Charles John Koch	—	Formerly Chairman, President and Chief Executive Officer of Charter One Financial, Inc.
Eileen Alison Mackay	—	Formerly Principal Finance Officer, The Scottish Office
Joseph Patrick MacHale	—	Formerly Chief Executive, J P Morgan Europe, Middle East and Africa Region

Name	Functions within the Group	Principal outside activity (if any) of significance to the Group
Iain Samuel Robertson..........	Chairman, Corporate Banking and Financial Markets	—
Sir Steve Arthur Robson	—	Formerly Second Permanent Secretary, HM Treasury
Robert Avisson Scott	—	Formerly Chief Executive, CGNU plc
Peter Denis Sutherland	—	Chairman and Managing Director, Goldman Sachs International
Company Secretary		
Miller Roy McLean	Group Secretary and General Counsel	

The business address for all the Directors and the Secretary is:

42 St. Andrew Square
Edinburgh EH2 2YE
Scotland.

CAPITALISATION

The following table, which is prepared on a consolidated basis, shows the authorised, issued and fully paid share capital of the Group and the shareholders' funds and indebtedness as at 30 June 2004, derived from the unaudited consolidated interim accounts of the Company for the six months ended 30 June 2004.

	As at 30 June 2004
	£m
Share capital — authorised	
Ordinary shares — shares of £0.25 each	1,020
Non-voting deferred shares — shares of £0.01 each	323
Preference shares(1)	555
	1,898
Share capital — allotted, called up and fully paid	
Ordinary shares	784
Non-voting deferred shares	27
Preference shares(2)	2
	813
Retained income and other reserves	31,595
Total shareholders' funds	32,408
Group indebtedness	
Dated loan capital	9,658
Undated loan capital	8,174
	17,832
Debt securities in issue	51,721
Total indebtedness	69,553
Total capitalisation and indebtedness	101,961

(1) The authorised preference share capital of the Group as at 30 June 2004 was £528 million, consisting of 348.5 million non-cumulative preference shares of US$0.01 each, 3.9 million non-cumulative convertible preference shares of US$0.01 each, 66 million non-cumulative preference shares of €0.01 each, 3.0 million non-cumulative convertible preference shares of €0.01 each, 900 million non-cumulative convertible preference shares of £0.25 each, 1.0 million non-cumulative convertible preference shares of £0.01 each, 0.9 million cumulative preference shares of £1 each and 300 million non-cumulative preference shares of £1 each. Preference shares includes Additional Value Shares of £0.01 each amounting to £27 million.

(2) The allotted, called up and fully paid preference share capital of the Group as at 30 June 2004 was £2 million, consisting of 82 million non-cumulative preference shares of US$0.01 each, 1.9 million non-cumulative convertible preference shares of US$0.01 each, 0.75 million non-cumulative convertible preference shares of €0.01 each, 0.2 million non-cumulative convertible preference shares of £0.01 each and 0.9 million cumulative preference shares of £1 each.

On 2 July 2004, the Group issued €1,000 million floating rate and €500 million fixed/floating rate undated subordinated notes.

On 5 July 2004, the National Westminster Bank Plc, a subsidiary of the Group, redeemed £100 million 12.5% subordinated unsecured loan stock.

On 24 August 2004, the Group issued US$950 million fixed rate non-cumulative trust preferred securities and US$550 million floating rate non-cumulative trust preferred securities, accounted for as non-equity minority interests in the consolidated accounts of the Group.

On 26 August 2004, the Group issued 37 million non-cumulative dollar preference shares, Series M, each with a US$25 principal.

On 22 September 2004, the Group issued €1,000 million fixed rate dated subordinated notes.

On 27 September 2004, the Group issued US$450 million floating rate non-cumulative trust preferred securities, accounted for as non-equity minority interests in the consolidated accounts of the Group.

On 30 September 2004, the Group exchanged its US$850 million exchangeable capital securities, Series B into 34 million non-cumulative dollar preference shares, Series L, each with a US$25 principal.

On 14 October 2004, the Group issued US$500 million floating rate dated subordinated notes and National Westminster Bank Plc redeemed US$650 million floating rate subordinated notes.

On 27 October 2004, the Group issued A$590 million fixed rate dated subordinated notes and A$410 million floating rate dated subordinated notes.

All of the above indebtedness is unsecured. None of the above indebtedness is guaranteed.

As at 30 June 2004, the Group had total liabilities, including shareholders' funds, of £519 billion, including deposits by banks of £84 billion and customer accounts of £254 billion.

As at 30 June 2004, the Group had contingent liabilities, including guarantees, arising in the normal course of business totalling £15,048 million, consisting of acceptances and endorsements of £349 million, guarantees and assets pledged as collateral security of £8,872 million and other contingent liabilities of £5,827 million.

Save as disclosed above, there has been no material change in the contingent liabilities, total capitalisation and indebtedness of the Group since 30 June 2004.

SUMMARY FINANCIAL INFORMATION RELATING TO THE GROUP

The financial information contained in this section is text extracted, without material adjustment, from the annual report and accounts of the Group for the year ended 31 December 2003. The unaudited consolidated interim financial statements of the Company for the six months ended 30 June 2004 are also included in summary form, and are attached in full at the end of this Offering Circular together with the financial statements and notes for the year ended 31 December 2003.

The non-consolidated and consolidated financial information of the Company for the years ended 31 December 2002 and 2003 contained in this Offering Circular do not constitute statutory accounts within the meaning of Section 240 of the Act. Statutory accounts for such years have been delivered to the Registrar of Companies in Scotland. The Company's auditors have made reports under Section 235 of the Act on such statutory accounts which were not qualified within the meaning of Section 262 of the Act and did not contain any statements made under Section 237(2) or (3) of the Act.

Summary Consolidated Profit and Loss Account

	Year ended 31 December	
	2003	2002
	£m	£m
Net interest income	8,301	7,849
Non-interest income	10,928	8,966
Total income	19,229	16,815
Operating expenses	9,381	9,357
General insurance claims (net)	2,195	1,350
Profit before provisions	7,653	6,108
Provisions	1,494	1,345
Profit on ordinary activities before tax	6,159	4,763
Tax on profit on ordinary activities	1,910	1,556
Profit on ordinary activities after tax	4,249	3,207
Minority interests (including non-equity)	210	133
Preference dividends — non-equity	261	305
	3,778	2,769
Additional Value Shares dividend	1,463	798
Profit attributable to ordinary shareholders	2,315	1,971
Ordinary dividends	1,490	1,267
Retained profit	825	704

	Six months ended 30 June	
	2004	2003
	£m	£m
Net interest income	4,378	4,025
Non-interest income	6,562	5,055
Total income	10,940	9,080
Operating expenses	5,085	4,606
General insurance claims (net)	1,723	836
Profit before provisions	4,132	3,638
Provisions	751	742
Profit on ordinary activities before tax	3,381	2,896
Tax on profit on ordinary activities	1,048	927
Profit on ordinary activities after tax	2,333	1,969
Minority interests (including non-equity)	111	87
Preference dividends — non-equity	116	137
	2,106	1,745
Additional Value Shares dividend	—	—
Profit attributable to ordinary shareholders	2,106	1,745
Ordinary dividends	529	431
Retained profit	1,577	1,314

Summary consolidated balance sheet

	30 June 2004	31 December 2003	30 June 2003	31 December 2002
	£m	£m	£m	£m
Loans and advances to banks	60,152	51,891	44,923	44,296
Loans and advances to customers	290,154	252,531	248,726	223,324
Debt securities and equity shares	92,128	82,249	75,478	68,928
Intangible fixed assets	13,589	13,131	12,514	12,697
Other assets	63,055	55,473	67,504	62,755
Total assets	519,078	455,275	449,145	412,000
Called up share capital	813	769	764	754
Share premium account	10,904	8,175	8,141	7,608
Other reserves	11,037	11,307	11,645	11,922
Profit and loss account	9,654	7,848	8,064	6,768
Shareholders' funds	32,408	28,099	28,614	27,052
Minority interests	2,685	2,713	2,421	1,839
Subordinated liabilities	17,832	16,998	15,696	13,965
Total capital resources	52,925	47,810	46,731	42,856
Deposits by banks	84,120	67,323	62,039	54,720
Customer accounts	253,949	236,963	225,697	219,161
Debt securities in issue	51,721	41,016	40,156	33,938
Other liabilities	76,363	62,163	74,522	61,325
Total liabilities	519,078	455,275	449,145	412,000

Summary consolidated cash flow statement

	31 December 2003	31 December 2002	31 December 2001
	£m	£m	£m
Net cash inflow from operating activities	19,708	13,737	7,287
Dividend received from associated undertakings	9	1	1
Net cash outflow from returns on investments and servicing of finance	(2,419)	(1,901)	(1,447)
Net cash outflow from Taxation	(1,454)	(1,107)	(1,209)
Net cash outflow from capital expenditure and financial investment	(6,965)	(9,185)	(10,337)
Net cash outflow from acquisitions and disposals	(1,571)	(281)	(1,653)
Ordinary equity dividends paid	(772)	(729)	(653)
Net cash inflow from financing	4,128	2,711	4,411
Increase/(decrease) in cash	10,664	3,246	(3,600)

TAXATION

The comments set out below are intended only as a general guide to certain limited aspects of, primarily, current UK tax law and practice that may be relevant to holders of Series 1 Euro Preferred Securities. The comments only address the tax consequences for certain holders of receiving dividends and the UK stamp duty and stamp duty reserve tax issues relevant to the issue of and dealings in Series 1 Euro Preferred Securities. Otherwise they do not address the tax consequences in any jurisdiction arising from the acquisition, ownership, conversion or disposal of the Series 1 Euro Preferred Securities. The comments do not apply to certain classes of holders, such as dealers. Further, they do not constitute tax or legal advice. Any holders who are in doubt as to their personal tax position should consult their professional advisers.

UNITED KINGDOM

General

The following summarises certain UK tax consequences of the acquisition, holding and disposition of Series 1 Euro Preferred Securities by a beneficial owner of Series 1 Euro Preferred Securities.

The statements regarding UK tax laws and practices set forth below are based on those laws and practices as in force and as applied in practice on the date of this and are subject to changes to those laws and practices and any relevant judicial decision, subsequent to the date of this Offering Circular. This summary is not exhaustive of all possible tax considerations that may be relevant in the particular circumstances of each prospective investor. Each prospective investor should seek professional advice as to the tax consequences of the acquisition, ownership and disposition of Series 1 Euro Preferred Securities.

UK Withholding Tax on Dividends

There is no UK withholding tax on dividends. Accordingly, the Company is not required to withhold UK tax at source from dividend payments on the Series 1 Euro Preferred Securities or from any amount (including any amounts in respect of accrued dividends) distributed on a redemption or winding up.

Stamp Duty and Stamp Duty Reserve Tax

Based on a current understanding of UK Inland Revenue practice, it is expected that no UK stamp duty or stamp duty reserve tax ("**SDRT**") will be payable on the delivery of Series 1 Euro Preferred Securities to Euroclear or Clearstream, Luxembourg. However, if this understanding proves to be incorrect, the Company will pay or procure payment of any such UK stamp duty or SDRT which becomes payable on the delivery of the Series 1 Euro Preferred Securities.

Neither UK stamp duty nor SDRT will generally be payable on the transfer of a beneficial interest in the Series 1 Euro Preferred Securities so long as the Global Certificate is held in Euroclear or Clearstream, Luxembourg.

UK stamp duty will, subject to certain exceptions, be payable at the rate of 1.5% (rounded up, if necessary, to the nearest £5) of the value of the Series 1 Euro Preferred Securities in registered form on any instrument pursuant to which Series 1 Euro Preferred Securities are transferred (i) to, or to a nominee for, a person whose business is or includes the provision of clearance services or (ii) to, or to a nominee or agent for, a person whose business is or includes issuing depositary receipts.

Subject to certain exceptions, a transfer of Series 1 Euro Preferred Securities in registered form will attract ad valorem UK stamp duty, and an unconditional agreement to transfer would attract SDRT provided that SDRT will not be payable if UK stamp duty has been paid, generally at the rate of 0.5% (rounded up, if necessary, to the nearest £5) on the amount or value of the consideration for the transfer. Generally, ad valorem stamp duty applies neither to gifts nor on a transfer from a nominee to the beneficial owner, although in cases of transfers where no ad valorem stamp duty arises, a fixed UK stamp duty of £5 may be payable.

No UK stamp duty is payable on the transfer by delivery of the Series 1 Euro Preferred Securities in bearer form so long as no written transfer of such securities will be executed in or brought into the UK. No SDRT will be payable on an agreement to transfer such securities provided that the agreement is not made in contemplation of, or as part of an arrangement for, a takeover of the Group.

NETHERLANDS

General

The following describes the principal Netherlands tax consequences of the acquisition, holding and disposal of the Series 1 Euro Preferred Securities. This summary does not purport to be a comprehensive description of all Netherlands tax considerations that may be relevant to a decision to acquire, to hold, to redeem, to convert and to dispose of the Series 1 Euro Preferred Securities. Each prospective investor should consult a professional tax adviser with respect to the tax consequences of an investment in the Series 1 Euro Preferred Securities. The discussion of certain Netherlands taxes set forth below is included for general information only.

This summary is based on the tax legislation, published case law, treaties, rules, regulations and similar documentation, in force as of the date of this Offering Circular, without prejudice to any amendments introduced at a later date and implemented with retroactive effect.

For the purpose of the principal Netherlands tax consequences described herein, it is assumed that Company is not a resident nor deemed to be a resident of The Netherlands for Netherlands tax purposes.

Dutch Resident Holders

Holders of the Series 1 Euro Preferred Securities who are individuals and are resident or deemed to be resident in The Netherlands ("**Holders**"), or who have elected to be treated as a Dutch resident Holder for Dutch tax purposes, are subject to Dutch income tax on a deemed return regardless of the actual income derived from the Series 1 Euro Preferred Securities or gain or loss realised upon disposal or redemption of the Series 1 Euro Preferred Securities, provided that the Series 1 Euro Preferred Securities are held as a portfolio investment and are not held in the context of any business or substantial interest. The deemed return amounts to 4% of the average value of the Holder's net assets in the relevant fiscal year (including the Series 1 Euro Preferred Securities) and is taxed at a flat rate of 30%.

Corporate Holders that are resident or deemed to be resident in The Netherlands, without being exempt from Dutch corporate tax, will be subject to Dutch corporate tax on all income and gains realised in connection with the Series 1 Euro Preferred Securities, unless such Corporate Holders benefit from the participation exemption.

SUBSCRIPTION AND SALE

Under a subscription agreement (the "**Subscription Agreement**") dated 22 November 2004, the Company and UBS Limited, ABN AMRO Bank N.V., BNP Paribas and The Royal Bank of Scotland plc (the "**Managers**"), have agreed jointly and severally to subscribe or procure subscribers for the Series 1 Euro Preferred Securities at an issue price of €1,000 per Series 1 Euro Preferred Security. The Managers are entitled to terminate the Subscription Agreement in certain circumstances before the issue of the Series 1 Euro Preferred Securities. The Subscription Agreement contains customary warranties and indemnities given by the Company to the Managers. In addition, the Company has agreed to reimburse the Managers for certain of their expenses.

Selling Restrictions

United States

The Series 1 Euro Preferred Securities have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, US persons except in certain transactions exempt from the registration requirements of the Securities Act. Each Manager has represented and agreed that it has not offered or sold, and will not offer or sell any Series 1 Euro Preferred Securities except in accordance with Rule 903 or Rule 904 of Regulation S. Terms used above have the meanings given to them by Regulation S under the Securities Act.

Each Manager has acknowledged and agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver any Series 1 Euro Preferred Securities (i) as part of its distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering or the original issue date of the Series 1 Euro Preferred Securities (the "**Distribution Compliance Period**") except in accordance with Rule 903 of Regulation S under the Securities Act, and that it will send to each dealer to which it sells Series 1 Euro Preferred Securities during the Distribution Compliance Period a confirmation or other notice setting forth the restrictions on offers and sales of the Series 1 Euro Preferred Securities within the United States or to, or for the account or benefit of, US persons.

Until 40 days after the commencement of this offering, an offer or sale of Series 1 Euro Preferred Securities within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than pursuant to an exemption from registration under the Securities Act.

United Kingdom

Each Manager has represented, warranted and undertaken that:

(a) *No offer to public:* it has not offered or sold and, prior to the expiry of six months from the issue date of the Series 1 Euro Preferred Securities, will not offer or sell any Series 1 Euro Preferred Securities to persons in the UK except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the UK within the meaning of the Public Offers of Securities Regulations 1995;

(b) *Financial promotion:* it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "**FSMA**") received by it in connection with the issue or sale of any Series 1 Euro Preferred Securities in circumstances in which section 21(1) of the FSMA does not apply to the Company; and

(c) *General compliance:* it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Series 1 Euro Preferred Securities in, from or otherwise involving the UK.

Federal Republic of Germany

No German sales prospectus (*Verkaufsprospekt*) has been or will be published with respect to the Series 1 Euro Preferred Securities and the offer of the Series 1 Euro Preferred Securities in the Federal Republic of Germany must comply with the Securities Sales Prospectus Act (*Wertpapier-Verkaufsprospektgesetz*, the "**Prospectus Act**") of the Federal Republic of Germany and all other applicable legal and regulatory requirements. No public offering (*Öffentliches Angebot*) within the meaning of the Prospectus Act with respect to any Series 1 Euro Preferred Securities can be made otherwise than in accordance with the Prospectus Act.

Belgium

This Offering Circular will not be submitted to the Belgian Banking, Finance and Insurance Commission and, accordingly, the Series 1 Euro Preferred Securities may not be distributed by way of public offering in Belgium.

Switzerland

This Offering Circular does not constitute an offer to buy or to subscribe to securities of the Company or any of its affiliates and it does not constitute an offering circular within the meaning of Art. 1156 of the Swiss Code of Obligations or Art. 652a of the Swiss Code of Obligations or a listing prospectus within the meaning of the listing rules of the SWX Swiss Exchange. Potential investors are furthermore advised to consult their bank and financial advisor.

Italy

Each Manager has represented and agreed that the offering of the Series 1 Euro Preferred Securities has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Series 1 Euro Preferred Securities may be offered, sold or delivered, nor may copies of this Offering Circular or of any other document relating to the Series 1 Euro Preferred Securities be distributed in the Republic of Italy ("**Italy**"), except:

(i) to professional investors ("*operatori qualificati*"), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1 July 1998 (the "**CONSOB Regulation No. 11522**"), as amended; or

(ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24 February 1998 (the "**Financial Services Act**") and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14 May 1999, as amended.

Any offer, sale or delivery of the Series 1 Euro Preferred Securities or distribution of copies of this Offering Circular or any other document relating to the Series 1 Euro Preferred Securities in Italy under (i) or (ii) above must be:

(a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in Italy in accordance with the Financial Services Act, the CONSOB Regulation No. 11522 and Legislative Decree No. 385 of 1 September 1993 (the "**Banking Act**"), as amended;

(b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, pursuant to which the issue or the offer of securities in Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in Italy and their characteristics; and

(c) in accordance with all relevant Italian securities, tax and exchange control and other applicable laws and regulations and in compliance with any other applicable requirement or limitation which may be imposed from time to time by CONSOB or the Bank of Italy.

General

No action has been or will be taken in any jurisdiction by the Company or the Managers (other than in The Netherlands) that would permit a public offering of the Series 1 Euro Preferred Securities, or the possession or distribution of this Offering Circular, or any amendment or supplement thereto, or any other offering material relating to the Series 1 Euro Preferred Securities, in any country or jurisdiction where action for that purpose is required. Accordingly, the Series 1 Euro Preferred Securities may not be offered or sold, directly or indirectly, and neither this Offering Circular nor any other offering material may be distributed or published, in or from any other country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

GENERAL INFORMATION

Significant Undertakings

The Royal Bank of Scotland plc is a company incorporated in the UK engaged in banking activities. Its registered office is 36 St Andrew Square, Edinburgh, Scotland and the Company holds 100% of its ordinary share capital.

National Westminster Bank Plc is a company incorporated in the UK engaged in banking activities. Its registered office is 135 Bishopsgate, London, England and the Company indirectly holds 100% of its ordinary share capital.

Citizens Financial Group, Inc. is a company incorporated in the United States of America engaged in banking activities. Its registered office is One Citizens Plaza, Providence, United States and the Company indirectly holds 100% of its ordinary share capital.

Greenwich Capital Markets, Inc. is a company incorporated in the United States of America engaged in banking activities. Its registered office is 600 Steamboat Road, Greenwich, United States and the Company indirectly holds 100% of its ordinary share capital.

Listing

Application has been made to list the Series 1 Euro Preferred Securities on the Official Segment of the Stock Market of Euronext Amsterdam N.V.

So long as the Series 1 Euro Preferred Securities are listed on the Official Segment of the Stock Market of Euronext Amsterdam N.V., the Company will comply with the provisions set forth in Schedule B of the Listing and Issuing Rules (*Fondsenreglement*) of Euronext Amsterdam N.V. (to the extent applicable) as amended from time to time. In particular, the Company will comply with the provisions set forth in Article 2.1.20, section a-g of Schedule B of the Listing and Issuing Rules (*Fondsenreglement*) of Euronext Amsterdam N.V. (to the extent applicable).

Consents

The issue of the Series 1 Euro Preferred Securities has been authorised pursuant to resolutions passed at a meeting of the Board of Directors held on 11 February 2004 and a meeting of a committee of the Board of Directors held on 22 November 2004.

Significant or Material Change

Save as disclosed herein, there has been no significant change in the financial or trading position of the Company and its subsidiaries taken as a whole and no material adverse change in the financial position or prospects of the Company and its subsidiaries taken as a whole since 31 December 2003, being the date of the latest audited published financial statements of the Company.

Litigation

In December 2003, members of the Group were joined as defendants in a number of legal actions in the United States following the collapse of Enron. Collectively, the claims are, to a substantial degree, unqualified and in each case they are made against large numbers of defendants. The Group intends to defend these claims vigorously. The US courts dealing with the main Enron actions have ordered that the Group join the non-binding, multi-party mediation which commenced in late 2003. Based on current knowledge including applicable defences and given the unqualified nature of these claims, the Directors of the Group are unable at this stage to predict with certainty the eventual loss, if any, in these matters. In addition, pursuant to requests received from the US Securities and Exchange Commission and the US Department of Justice, the Group has been providing copies of Enron-related materials to these authorities and the Group continues to co-operate fully with them.

The Group is engaged in other litigation in the UK and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The Directors of the Group have reviewed the actual, threatened and known potential claims and proceedings and, after consulting with the Group's legal advisers, are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Group's consolidated net assets, results of operations or cash flows.

Save as disclosed herein, neither the Company nor any of its subsidiaries is or has been involved in any legal or arbitration proceedings which may have or have had during the twelve months prior to the date hereof a significant effect on the financial position of the Company and its subsidiaries, taken as a whole, nor, so far as the Company is aware, are any such proceedings pending or threatened.

Auditors

The consolidated financial statements of the Company for the year ended 31 December 2003 have been audited by Deloitte & Touche LLP, Chartered Accountants. The consolidated financial statements of the Company for the year ended 31 December 2002 have been audited by Deloitte & Touche, Chartered Accountants.

The financial information contained in this Offering Circular in relation to the Company does not constitute the Company's statutory accounts. Statutory accounts for the year ended 31 December 2003 and 31 December 2002 to which certain of the financial information in this Offering Circular relates, have been delivered to the Registrar of Companies in Scotland.

Deloitte & Touche LLP and Deloitte & Touche, respectively, have reported on such statutory accounts and such reports were unqualified and did not contain a statement under Section 237 of the Act.

The audit report of Deloitte & Touche LLP for the year ended 31 December 2003 states that the report, including the opinion, has been prepared for and only for the members of the Company, as a body in accordance with section 235 of the Act and for no other purpose, and that Deloitte & Touche LLP did not, in giving their audit opinion, accept or assume responsibility for any other purpose or to any other person to whom the report is shown or into whose hands the report may come.

Available documents

Copies of the following documents are available free of charge at the office of the registrar, the Paying and Settlement Agent and the Paying Agent at the addresses shown on the back cover of this Offering Circular during normal business hours:

- the memorandum and articles of association of the Company;
- the consolidated accounts and the annual reports of the Group for the financial years ended 31 December 2003 and 31 December 2002;
- the unaudited consolidated interim financial statements of the Company for the six months ended on 30 June 2004;
- the written consents (if any) of the holders of the Series 1 Euro Preferred Securities referred to on page 10 of this Offering Circular;
- the Subscription Agreement; and
- the Agency Agreement.

The most recently published consolidated and non-consolidated audited financial statements and the Company's unaudited consolidated interim financial statements will also be available free of charge at the offices of the Paying and Settlement Agent and the registrar and the Paying Agent at the addresses shown on the back cover of this Offering Circular and from the Company's registered office.

Clearing and Settlement Systems

The Series 1 Euro Preferred Securities have been accepted for clearance through the facilities of Euroclear and Clearstream, Luxembourg. The ISIN for the Series 1 Euro Preferred Securities is XS0205935470 and the Common Code for the Series 1 Euro Preferred Securities is 020593547. The fondscode for the Series 1 Euro Preferred Securities is 15045.

Notices

Notices to holders of the Series 1 Euro Preferred Securities, including notices for general meetings of holders of Series 1 Euro Preferred Securities, will be published in accordance with operating procedures for the time being of Euroclear and Clearstream, Luxembourg and in English in a leading newspaper (which is expected to be the *Financial Times*) having general circulation in Europe that is published on each business day in morning editions, whether or not it is published on Saturday, Sunday or public holidays.

In addition, for so long as the Series 1 Euro Preferred Securities are listed on the Official Segment of the Stock Market of Euronext Amsterdam N.V., and the rules of such exchange so require, notices will be published in the Euronext Daily Official List (*Officiële Prijscourant*) of the Amsterdam securities exchanges and in a newspaper having general circulation in The Netherlands.

Articles of Association

The objects of the Company contained in its memorandum of association are to carry on banking business in any part of the world and associated businesses and services. The memorandum and articles of association can only be amended by a resolution of the shareholders of the Company in accordance with the Act. The articles of association of the Company were last amended on 29 April 2004.

FINANCIAL STATEMENTS

The full text of the following documents is reproduced on the following pages:

1. The financial statements and notes thereto of the Company for the year ended 31 December 2003; and
2. The statutory consolidated financial statements and notes thereto of the Company for the six months ended 30 June 2004 (unaudited).

THE ROYAL BANK OF SCOTLAND GROUP plc

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2003

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.

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 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.

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.

Consolidated profit and loss account

for the year ended 31 December 2003

	Note	2003	2002	2001
		£m	£m	£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)

Consolidated balance sheet

at 31 December 2003

	Note	2003	2002
		£m	£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

Statement of consolidated total recognised gains and losses

for the year ended 31 December 2003

	2003	2002	2001
	£m	£m	£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	2002	2001
	£m	£m	£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

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

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.

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.

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%
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	2002
	£m	£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		2001	
	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

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		2001	
	Main UK scheme	Other Group schemes	Main UK scheme	Other Group schemes	Main UK schemes	Other Group schemes
	£m	£m	£m	£m	£m	£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	Other schemes	2003 Total	2002 Total
	£m	£m	£m	£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	2002 Total
	£m	£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	2002 Total
	£m	£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	2002
	£m	£m
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	2002	2001
	£m	£m	£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
* 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	2002
	£m	£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).

5 Tax on profit on ordinary activities

	2003	2002	2001
	£m	£m	£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	2002	2001
	£m	£m	£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

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).

2003	Year in which the residual value will be recovered				
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total
	£m	£m	£m	£m	£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

2002	Year in which the residual value will be recovered				
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total
	£m	£m	£m	£m	£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

13 Provisions for bad and doubtful debts

	2003			2002		
	Specific	General	Total	Specific	General	Total
	£m	£m	£m	£m	£m	£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	2002
	£m	£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	Gross unrecognised gains	Gross unrecognised losses	2003 Valuation	2002 Book value	Gross unrecognised gains	Gross unrecognised losses	2002 Valuation
	£m	£m	£m	£m	£m	£m	£m	£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	Discounts and premiums	Provisions	Book value
	£m	£m	£m	£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

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	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	£m	%	£m	%	£m	%	£m	%	£m	%
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	Gross unrecognised gains	Gross unrecognised losses	2003 Valuation	2002 Book value	Gross unrecognised gains	Gross unrecognised losses	2002 Valuation
	£m	£m	£m	£m	£m	£m	£m	£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	Provisions	Book value
	£m	£m	£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.

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 0QS

(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

20 Tangible fixed assets

	Freehold premises	Long leasehold premises	Short leasehold premises	Computers and other equipment	Assets on operating leases	Total
	£m	£m	£m	£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.

	2003	2002
	£m	£m
Net book value:		
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	2002
	£m	£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	2002
	£m	£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 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 increase in the shareholders' interest in the long-term assurance business included in the profit and loss account is calculated as follows:

	2003	2002
	£m	£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 key assumptions used are:

	2003	2002
	%	%
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

23 Deposits by banks

	2003	2002
	£m	£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	2002
	£m	£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
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

	2003 £m	2002 £m
Analysis of obligations under finance leases:		
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	2002
	£m	£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	2002
	£m	£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

	£m
Movements during the year:	
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]	Pensions and other similar obligations[2]	Other[3]	Total
	£m	£m	£m	£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.

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

	2003 £m	2002 £m
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 UK Financial 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.

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	Issued during the year	Other movement during the year	31 December 2003	31 December 2003	31 December 2002
	£m	£m	£m	£m	£m	£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.

Number of shares — thousands	Allotted, called up and fully paid 2003	2002	Authorised 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.

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.

	2003 £m	2002 £m
Non-equity shareholders' funds:		
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	2002 £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 were 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.

38 Assets charged as security for liabilities

Assets charged as security for liabilities	2003	2002
	£m	£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	2002
	£m	£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.

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	One to two years	Two to five years	Over five years	2003 Total	Within one year	One to two years	Two to five years	Over five years	2002 Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£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	Liabilities	Assets	Liabilities
	£m	£m	£m	£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.

The following table analyses, by maturity and contract type, the notional principal amounts of the Group's trading derivatives:

	Within one year	One to two years	Two to five years	Over five years	2003 Total	Within one year	One to two years	Two to five years	Over five years	2002 Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£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	Negative	Positive	Negative	Positive	Negative	Positive	Negative
	£m	£m	£m	£m	£m	£m	£m	£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	One to two years	Two to five years	Over five years	2003 Total	Within one year	One to two years	Two to five years	Over five years	2002 Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£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	After 3 months but within 6 months	After 6 months but within 1 year	After 1 year but within 5 years	After 5 years	Non-interest bearing funds	Banking book total	Trading book total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£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				

2002	Within 3 months	After 3 months but within 6 months	After 6 months but within 1 year	After 1 year but within 5 years	After 5 years	Non-interest bearing funds	Banking book total	Trading book total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Loans and advances to banks	14,208	4,572	2,569	2	26	482	21,859	22,437	44,296
Loans and advances to customers	139,822	12,547	9,134	25,023	10,228	1,064	197,818	25,506	223,324
Treasury bills and debt securities	23,498	4,529	3,693	6,639	5,130	—	43,489	35,012	78,501
Other assets	—	—	—	—	—	48,322	48,322	17,557	65,879
Total assets	177,528	21,648	15,396	31,664	15,384	49,868	311,488	100,512	412,000
Liabilities									
Deposits by banks	31,189	731	623	177	459	1,295	34,474	20,246	54,720
Customer accounts	158,253	3,747	2,146	3,232	373	27,919	195,670	23,491	219,161
Debt securities in issue	27,462	1,030	1,307	3,615	513	—	33,927	11	33,938
Subordinated liabilities	2,688	528	623	1,446	8,615	—	13,900	65	13,965
Other liabilities	3	11	15	14	128	27,418	27,589	35,575	63,164
Shareholders' funds	—	—	—	—	—	26,182	26,182	870	27,052
Internal funding of trading business	(19,634)	—	(620)	—	—	—	(20,254)	20,254	—
Total liabilities	199,961	6,047	4,094	8,484	10,088	82,814	311,488	100,512	412,000
Off-balance sheet items	(1,762)	(3,141)	(1,946)	3,708	3,141	—			
Interest rate sensitivity gap	(24,195)	12,460	9,356	26,888	8,437	(32,946)			
Cumulative interest rate sensitivity gap	(24,195)	(11,735)	(2,379)	24,509	32,946				

Currency risk

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investment in overseas subsidiary and associated undertakings and their related funding.

The Group's structural currency exposures were as follows:

Functional currency of net investment	Net investments in overseas operations	Foreign currency borrowings hedging net investments	2003 Structural foreign currency exposures	Net investments in overseas operations	Foreign currency borrowings hedging net investments	2002 Structural foreign currency exposures
	£m	£m	£m	£m	£m	£m
US dollar	5,329	5,198	131	5,190	5,107	83
Euro	1,422	826	596	1,019	558	461
Swiss franc	357	357	—	306	295	11
Other non-sterling	118	114	4	35	30	5
Total	7,226	6,495	731	6,550	5,990	560

Trading book market risk

An explanation of the value-at-risk ("VaR") methodology of estimating potential losses arising from the Group's exposure to market risk in its trading book and the main assumptions and parameters underlying it is given in "Risk management — market risk" in the Operating and financial review.

The following table analyses the VaR for the Group's trading portfolios by type of market risk exposure at the period end and as an average for the period and the maximum and minimum for the period:

	31 December 2003	Year ended 31 December 2003			31 December 2002	Year ended 31 December 2002		
		Maximum	Minimum	Average		Maximum	Minimum	Average
Interest rate	7.4	14.5	5.7	9.4	8.4	11.6	6.0	9.0
Currency	0.8	2.5	0.7	1.3	1.2	2.5	0.4	1.2
Equity	0.4	1.4	0.2	0.5	0.6	1.0	0.2	0.5
Diversification effects	(1.2)				(1.8)			
Total	7.4	14.2	5.6	9.4	8.4	11.8	5.6	9.1

Fair values of financial instruments

The following tables set out the fair values of the Group's financial instruments. Fair value is the amount at which an instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgements covering prepayments, credit risk and discount rates. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale; nor are there plans to settle liabilities prior to contractual maturity. As there is a wide range of valuation techniques, it may be inappropriate to compare the Group's fair value information to independent markets or other financial institutions' fair value.

Trading business	Note	2003 Carrying amount	2003 Fair value	2002 Carrying amount	2002 Fair value
		£m	£m	£m	£m
Assets					
Treasury bills and other eligible bills	(1)	1,869	1,869	6,890	6,890
Loans and advances to banks and customers	(1)	59,608	59,608	47,943	47,943
Debt securities	(1)	37,575	37,575	28,122	28,122
Equity shares	(1)	428	428	37	37
Derivatives	(2)	14,087	14,087	13,210	13,210
Liabilities					
Deposits by banks and customer accounts	(3)	52,300	52,300	43,737	43,737
Debt securities in issue	(1)	1,117	1,117	11	11
Short positions in securities	(1)	19,128	19,128	16,381	16,381
Subordinated loan capital	(1)	59	59	65	65
Derivatives	(2)	15,173	15,173	14,729	14,729

Banking business	Note	2003 Carrying amount	2003 Fair value	2002 Carrying amount	2002 Fair value
		£m	£m	£m	£m
Assets					
Cash and balances at central banks	(1)	3,822	3,822	3,481	3,481
Items in the course of collection from other banks	(1)	2,501	2,501	2,741	2,741
Treasury bills and other eligible bills	(1)	2,977	2,977	4,569	4,569
Loans and advances to banks and customers	(4)	244,814	246,244	219,677	221,883
Debt securities	(5)	42,374	42,195	38,920	39,288
Equity shares	(5)	1,872	2,289	1,849	1,765
Derivatives — net	(2)			82	342
Liabilities					
Items in the course of transmission to other banks	(1)	958	958	1,258	1,258
Deposits by banks and customer accounts	(3)	251,986	252,360	230,144	230,266
Debt securities in issue	(6)	39,899	39,897	33,927	33,941
Subordinated loan capital	(7)	16,939	17,522	13,900	14,890
Non-equity minority interests	(7)	2,724	2,867	1,850	1,984
Non-equity shareholders' funds	(7)	2,923	3,245	3,507	5,277
Derivatives — net	(7)	297	266		

Notes:

(1) Financial assets and financial liabilities carried at fair value or where carrying value approximates to fair value because they are of short maturity or repricing date.

(2) Fair values of derivatives are determined by market prices where available. Otherwise fair value is based on current market information using appropriate valuation models.

(3) The fair value of deposits repayable on demand is equal to their carrying value. The fair values of term deposits and time certificates of deposit are estimated by discounting expected future cash flows using rates currently offered for deposits of similar remaining maturities.

(4) For loans which reprice frequently or are linked to the Group's base rate, and for which there has been no significant change in credit risk since inception, carrying value represents a reasonable estimate of fair value. For other loans, fair values are estimated by discounting expected future cash flows, using current interest rates appropriate to the type of loan, and making adjustments for credit risk.

(5) Fair values of marketable securities are based on quoted market prices. Where these are unavailable, fair value is estimated using other valuation techniques.

(6) The fair value of short-term debt securities in issue is approximately equal to their carrying value. The fair value of other debt securities in issue is based on quoted market prices where available, or where these are unavailable, is estimated using other valuation techniques.

(7) The fair value of loan capital, non-equity minority interests and preference shares is based on quoted market prices where available. For unquoted loan capital, fair value has been estimated using other valuation techniques.

(8) Fair values are not given for financial commitments and contingent liabilities. The diversity of the fee structures, the lack of an established market and the difficulty of separating the value of the instruments from the value of the overall relationship involve such uncertainty that it is not meaningful to provide an estimate of their fair value. (The principal amounts of these instruments are given in Note 41).

Hedges

Derivatives and debt securities held for hedging purposes are accounted for in accordance with the treatment of the hedged transaction. As a result, any gains or losses on the hedging instrument arising from changes in fair values are not recognised in the profit and loss account immediately but are accounted for in the same manner as the hedged item.

	2003 Unrecognised gains and losses	2003 Deferred gains and losses	2002 Unrecognised gains and losses	2002 Deferred gains and losses
	£m	£m	£m	£m
At 1 January				
gains	2,535	285	1,201	148
losses	(2,275)	(44)	(1,329)	(64)
	260	241	(128)	84
Recognised gains that arose in previous periods	(659)	(72)	(307)	(35)
Recognised losses that arose in previous periods	636	12	322	22
Unrecognised gains and losses arising in the year	(208)	—	585	—
Unrecognised gains and losses deferred in the year	2	(2)	(212)	212
Unrecognised gains and losses deferred and taken to profit and loss in the year	—	—	—	(42)
At 31 December	31	179	260	241
Of which				
gains	2,236	213	2,535	285
losses	(2,205)	(34)	(2,275)	(44)
	31	179	260	241
Gains expected to be recognised in the year to 31 December 2004 (year to 31 December 2003)	532	66	601	72
Gains expected to be recognised in the year to 31 December 2005 or later (year to 31 December 2004 or later)	1,704	147	1,934	213
	2,236	213	2,535	285
Losses expected to be recognised in the year to 31 December 2004 (year to 31 December 2003)	(371)	(5)	(541)	(12)
Losses expected to be recognised in the year to 31 December 2005 or later (year to 31 December 2004 or later)	(1,834)	(29)	(1,734)	(32)
	(2,205)	(34)	(2,275)	(44)

During the year to 31 December 2003, gains of £58 million (2002 — £33 million) and losses of £95 million (2002 — £16 million) arising in previous periods were taken directly to the profit and loss account on financial instruments no longer accounted for as hedges.

41 Memorandum items

Contingent liabilities and commitments

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

	2003	2002
	£m	£m
Contingent liabilities:		
Acceptances and endorsements	595	2,407
Guarantees and assets pledged as collateral security	8,787	5,200
Other contingent liabilities	5,482	7,981
	14,864	15,588
Commitments:		
Documentary credits and other short-term trade related transactions	605	655
Undrawn formal standby facilities, credit lines and other commitments to lend		
less than one year	85,424	87,645
one year and over	51,827	39,784
Other commitments	1,837	508
	139,693	128,592

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

Contingent liabilities

Acceptances — in accepting a bill of exchange drawn on it by a customer a bank undertakes to pay the holder of the bill at maturity. Most acceptances are presented for payment and reimbursement by the customer is usually immediate. In the UK, bills accepted by certain banks designated by the Bank of England are eligible for rediscount at the Bank of England.

Endorsements — in endorsing a bill of exchange a bank accepts liability for payment of any shortfall on the bill at maturity. Unlike acceptances, the endorsing bank receives value for the bill, which is then rediscounted.

Guarantees — the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities — these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments

Documentary credits and other short-term trade related transactions — documentary letters are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents.

Commitments to lend — under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived.

Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments — these include forward asset purchases, forward forward deposits placed and undrawn note issuance and revolving underwriting facilities.

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

Litigation

In December 2003, members of the Group were joined as defendants in a number of legal actions in the United States following the collapse of Enron. Collectively, the claims are, to a substantial degree, unquantified and in each case they are made against large numbers of defendants. The Group intends to defend these claims vigorously. The US Courts dealing with the main Enron actions have ordered that the Group join the non-binding, multi-party mediation which commenced in late 2003. Based on current knowledge including applicable defences and given the unquantified nature of these claims, the directors are unable at this stage to predict with certainty the eventual loss, if any, in these matters. The Group continues to co-operate fully with the appropriate authorities.

Members of the Group are engaged in other litigation in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The directors of the company have reviewed the actual, threatened and known potential claims and proceedings and, after consulting with the Group's legal advisers are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Group's consolidated net assets, results of operations or cash flows.

42 Acquisitions

The Group made a number of acquisitions during the year, all of which were accounted for using acquisition accounting principles. The most significant of these was Churchill Insurance Group PLC which was acquired by the company in September 2003 for a consideration of £1.1 billion.

The provisional fair values of the assets and liabilities of all acquisitions made during the year and the consideration paid are shown in the table below:

At respective dates of acquisition	Book value of net assets acquired	Fair value adjustments	Fair value to the Group
	£m	£m	£m
Cash and balances at central banks	153	4	157
Treasury and other eligible bills	13	—	13
Loans and advances to banks	622	—	622
Loans and advances to customers	3,326	(11)	3,315
Debt securities	1,921	(3)	1,918
Equity shares	5	(3)	2
Interest in associates	21	—	21
Intangible fixed assets	52	(52)	—
Tangible fixed assets	603	(7)	596
Other assets	1,144	(61)	1,083
Prepayments and accrued income	616	(35)	581
Deposits by banks	(1,416)	—	(1,416)
Customer accounts	(2,446)	(7)	(2,453)
Other liabilities	(537)	80	(457)
Accruals and deferred income	(2,801)	(300)	(3,101)
Deferred tax provisions	(34)	—	(34)
Other provisions	(9)	—	(9)
Minority interest — non-equity	(16)	—	(16)
Net assets acquired	1,217	(395)	822
Goodwill			1,456
Total consideration			2,278
Satisfied by:			
Payment of cash			2,228
Loan notes			26
Fees and expenses relating to the acquisition			24
			2,278

Fair value adjustments reflect the restatement of balances to their estimated fair values at the date of acquisition, and the related tax effect.

43 Reconciliation of operating profit to net cash inflow from operating activities

	2003 £m	2002 £m	2001 £m
Operating profit	6,159	4,763	4,252
(Increase)/decrease in prepayments and accrued income	(490)	(657)	486
Interest on subordinated liabilities	551	659	674
Increase in accruals and deferred income	1,456	856	490
Amortisation of and provisions against investment securities	60	99	39
Provisions for bad and doubtful debts	1,461	1,286	984
Loans and advances written off net of recoveries	(1,447)	(973)	(755)
Profit on sale of tangible fixed assets	(30)	(32)	(55)
Profit on sale of subsidiaries and associates	(63)	(13)	—
(Profit)/loss from associated undertakings	(12)	(2)	6
Profit on sale of investment securities	(172)	(85)	(48)
Provisions for liabilities and charges	47	50	67
Provisions utilised	(101)	(57)	(37)
Depreciation and amortisation of tangible and intangible fixed assets	1,682	1,626	1,532
Increase in value of long-term assurance business	(73)	(61)	(55)
Net cash inflow from trading activities	9,028	7,459	7,580
Decrease/(increase) in items in the course of collection	240	547	(327)
Decrease/(increase) in treasury and other eligible bills	6,626	(1,323)	(6,796)
Decrease/(increase) in loans and advances to banks	2,797	(2,756)	(4,785)
Increase in loans and advances to customers	(26,140)	(32,670)	(18,038)
(Increase)/decrease in securities	(9,871)	1,799	760
(Increase)/decrease in other assets	(886)	(1,087)	860
(Decrease)/increase in items in the course of transmission	(300)	(851)	402
Increase in deposits by banks	11,188	14,512	4,604
Increase in customer accounts	15,669	19,383	11,584
Increase in debt securities in issue	7,078	3,269	11,262
(Decrease)/increase in other liabilities	(168)	3,817	(3,560)
Increase in settlement balances and short positions	3,202	482	3,644
Effect of other accruals/deferrals and other non-cash movements	1,245	1,156	97
Net cash inflow from operating activities	19,708	13,737	7,287

44 Analysis of the net outflow of cash in respect of the purchase of businesses and subsidiary undertakings

	2003 £m	2002 £m	2001 £m
Cash consideration paid	(2,252)	(415)	(1,770)
Cash acquired	504	107	156
Net outflow of cash	(1,748)	(308)	(1,614)

45 Sale of subsidiary and associated undertakings

	2003 £m	2002 £m	2001 £m
Net assets disposed of	66	13	8
Goodwill written back	40	—	—
Goodwill sold	10	3	—
Profit on disposal	63	13	—
Net inflow of cash in respect of disposals (net of expenses)	179	29	8

46 Analysis of changes in financing during the year

	Share capital (including share premium)			Loan capital		
	2003	2002	2001	2003	2002	2001
	£m	£m	£m	£m	£m	£m
At 1 January	8,362	8,358	7,378	13,965	12,530	10,436
Currency translation adjustments	(203)	(283)	58	(448)	(520)	82
Net cash (outflow)/inflow from financing	(180)	(515)	2,412	3,481	1,955	2,012
Amount credited to merger reserve	—	—	(2,007)	—	—	—
Other non-cash movements	965	802	517	—	—	—
At 31 December	8,944	8,362	8,358	16,998	13,965	12,530

47 Analysis of cash

	2003	2002	2001
	£m	£m	£m
Cash and balances at central banks	3,822	3,481	3,093
Loans and advances to banks repayable on demand	17,115	6,792	3,934
Cash	20,937	10,273	7,027

Certain subsidiary undertakings are required to maintain balances with the Bank of England which, at 31 December 2003, amounted to £231 million (2002 — £211 million). Certain subsidiary undertakings are required by law to maintain reserve balances with the Federal Reserve Bank in the US. Such reserve balances amounted to US$190 million at 31 December 2003 (2002 — US$205 million).

48 Analysis of changes in cash during the year

	2003	2002	2001
	£m	£m	£m
At 1 January	10,273	7,027	10,627
Net cash inflow/(outflow)	10,664	3,246	(3,600)
At 31 December	20,937	10,273	7,027

49 Segmental analysis

In the tables below, the analyses of net assets are included in compliance with Statement of Standard Accounting Practice 25 "Segmental Reporting". The fungible nature of liabilities within the banking industry results in allocations of liabilities which, in some cases, are necessarily subjective. The directors believe that it is more meaningful to analyse total assets and the result of this analysis is therefore also included in the tables.

The prior year data in the tables below have been restated to reflect the transfer in 2003 of certain activities from Corporate Banking and Financial Markets and Wealth Management to Manufacturing.

(a) Classes of business

	Net interest income	Non-interest income	Total income	Operating expenses and other operating charges	Provisions*	Profit/(loss) on ordinary activities before tax
	£m	£m	£m	£m	£m	£m
2003						
Corporate Banking and Financial Markets	2,324	4,373	6,697	(2,322)	(755)	3,620
Retail Banking	2,951	1,452	4,403	(1,004)	(273)	3,126
Retail Direct	849	986	1,835	(665)	(297)	873
Manufacturing	—	—	—	(1,875)	—	(1,875)
Wealth Management	465	414	879	(432)	(9)	438
RBS Insurance	232	3,013	3,245	(2,777)	—	468
Ulster Bank	396	185	581	(276)	(32)	273
Citizens	1,310	514	1,824	(879)	(88)	857
Central items	(226)	(9)	(235)	(354)	(40)	(629)
Profit before goodwill amortisation and integration costs	8,301	10,928	19,229	(10,584)	(1,494)	7,151
Goodwill amortisation	—	—	—	(763)	—	(763)
Integration costs	—	—	—	(229)	—	(229)
Profit on ordinary activities before tax	8,301	10,928	19,229	(11,576)	(1,494)	6,159
2002						
Corporate Banking and Financial Markets	2,349	3,703	6,052	(2,066)	(725)	3,261
Retail Banking	2,840	1,353	4,193	(961)	(213)	3,019
Retail Direct	749	841	1,590	(608)	(281)	701
Manufacturing	—	—	—	(1,762)	—	(1,762)
Wealth Management	460	447	907	(464)	11	454
RBS Insurance	158	1,981	2,139	(1,784)	—	355
Ulster Bank	339	181	520	(254)	(22)	244
Citizens	1,248	468	1,716	(855)	(95)	766
Central items	(294)	(8)	(302)	(265)	(20)	(587)
Profit before goodwill amortisation and integration costs	7,849	8,966	16,815	(9,019)	(1,345)	6,451
Goodwill amortisation	—	—	—	(731)	—	(731)
Integration costs	—	—	—	(957)	—	(957)
Profit on ordinary activities before tax	7,849	8,966	16,815	(10,707)	(1,345)	4,763
2001						
Corporate Banking and Financial Markets	2,138	3,319	5,457	(1,875)	(502)	3,080
Retail Banking	2,622	1,277	3,899	(928)	(164)	2,807
Retail Direct	674	696	1,370	(564)	(255)	551
Manufacturing	—	—	—	(1,646)	—	(1,646)
Wealth Management	464	469	933	(457)	5	481
RBS Insurance	129	1,414	1,543	(1,282)	—	261
Ulster Bank	313	170	483	(239)	(15)	229
Citizens	814	306	1,120	(550)	(69)	501
Central items	(308)	61	(247)	(248)	9	(486)
Profit before goodwill amortisation and integration costs	6,846	7,712	14,558	(7,789)	(991)	5,778
Goodwill amortisation	—	—	—	(651)	—	(651)
Integration costs	—	—	—	(875)	—	(875)
Profit on ordinary activities before tax	6,846	7,712	14,558	(9,315)	(991)	4,252

* Comprises provisions for bad and doubtful debts and amounts written off fixed asset investments.

	Total assets		Net assets	
	2003	2002	2003	2002
	£m	£m	£m	£m
Corporate Banking and Financial Markets	268,523	245,225	11,728	10,434
Retail Banking	67,340	66,501	3,745	3,418
Retail Direct	21,905	19,440	1,236	1,072
Manufacturing	4,259	3,929	194	193
Wealth Management	15,231	13,441	671	615
RBS Insurance	10,124	4,410	1,373	912
Ulster Bank	15,560	12,713	1,078	976
Citizens	42,976	37,858	4,417	3,510
Central items	9,357	8,483	3,657	5,922
	455,275	412,000	28,099	27,052

Segmental analysis of goodwill is as follows:

	CBFM	Retail Direct	Wealth Management	RBS Insurance	Citizens	Centre	Total
	£m	£m	£m	£m	£m	£m	£m
Cost:							
At 1 January 2003	130	60	8	221	2,547	11,629	14,595
Currency translation and other adjustments	—	—	1	—	(284)	—	(283)
Arising on acquisitions during the year	61	54	144	792	405	—	1,456
Disposals	—	—	—	(2)	—	(8)	(10)
At 31 December 2003	191	114	153	1,011	2,668	11,621	15,758
Amortisation:							
At 1 January 2003	4	2	—	41	226	1,625	1,898
Currency translation and other adjustments	—	—	—	—	(34)	—	(34)
Charge for the year	10	4	1	28	139	581	763
At 31 December 2003	14	6	1	69	331	2,206	2,627
Net book value:							
At 31 December 2003	177	108	152	942	2,337	9,415	13,131
At 31 December 2002	126	58	8	180	2,321	10,004	12,697

(b) *Geographical segments*

The geographical analyses in the tables below have been compiled on the basis of location of office where the transactions are recorded.

	UK	USA	Europe	Rest of the World	Total
	£m	£m	£m	£m	£m
2003					
Interest receivable	10,780	2,142	942	134	13,998
Dividend income	33	7	18	—	58
Fees and commissions receivable	4,725	622	323	85	5,755
Dealing profits	1,004	717	39	33	1,793
Other operating income	1,384	82	132	—	1,598
General insurance premium income (net of reinsurance)	2,919	—	142	—	3,061
Gross income	20,845	3,570	1,596	252	26,263
Profit on ordinary activities before tax	4,529	1,157	327	146	6,159
Total assets	315,426	102,448	27,411	9,990	455,275
Net assets	20,595	5,389	2,110	5	28,099

	UK	USA	Europe	Rest of the World	Total
	£m	£m	£m	£m	£m
2002					
Interest receivable	10,372	2,240	837	112	13,561
Dividend income	32	10	16	—	58
Fees and commissions receivable	4,434	601	251	22	5,308
Dealing profits	736	649	42	35	1,462
Other operating income	1,156	28	33	(8)	1,209
General insurance premium income (net of reinsurance)	1,815	—	79	—	1,894
Gross income	18,545	3,528	1,258	161	23,492
Profit/(loss) on ordinary activities before tax	3,840	620	337	(34)	4,763
Total assets	280,390	102,582	25,354	3,674	412,000
Net assets	21,038	4,086	1,928	—	27,052
2001					
Interest receivable	11,360	1,816	973	272	14,421
Dividend income	28	9	17	—	54
Fees and commissions receivable	4,079	412	238	6	4,735
Dealing profits	816	532	45	33	1,426
Other operating income	1,039	6	14	(7)	1,052
General insurance premium income (net of reinsurance)	1,364	—	11	—	1,375
Gross income	18,686	2,775	1,298	304	23,063
Profit/(loss) on ordinary activities before tax	3,270	628	426	(72)	4,252
Total assets	243,382	99,082	19,226	7,169	368,859
Net assets	21,392	4,170	1,106	—	26,668

50 Directors' remuneration

	2003	2002
	£000	£000
Non-executive directors — emoluments	759	716
Chairman and executive directors		
emoluments	7,945	12,286
contributions and allowances in respect of defined contribution pension schemes	164	153
	8,868	13,155
amounts receivable under long-term incentive plans	6,056	546
gains on exercise of share options	2	16
	14,926	13,717

Retirement benefits are accruing to six directors (2002 — six) under defined benefit schemes, two (2002 — two) of whom also accrued benefits under defined contribution schemes.

The executive directors may also participate in the company's executive share option, sharesave and option 2000 schemes and details of their interests in the company's shares arising from their participation are contained on page 129. Details of the remuneration received by each director during the year and each directors' pension arrangements are given on pages 128 to 131.

51 Transactions with directors, officers and others

(a) At 31 December 2003, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group were £343,298 in respect of loans to eight persons who were directors of the company (or persons connected with them) at any time during the financial period and £31,783 to one person who was an officer of the company at any time during the financial period.

(b) There were no contracts of significance to the business of the company and its subsidiaries which subsisted at 31 December 2003, or during the year then ended, in which any director of the company had a material interest.

52 Related party transactions

Subsidiary undertakings

In accordance with Financial Reporting Standard 8 "Related Party Disclosures" ("FRS 8"), transactions or balances between Group entities that have been eliminated on consolidation are not reported.

Investments

Group members provide development and other types of capital support to businesses in their roles as providers of finance. These investments are made in the normal course of business and on arm's-length terms depending on their nature. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under FRS 8.

Pension Fund

The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

Santander Central Hispano ("SCH")

Details of the Group's cross-holding with SCH are given on page 55. It is not a related party as defined in FRS 8.

53 Significant differences between UK and US generally accepted accounting principles

The consolidated financial statements of the Group are prepared in accordance with UK generally accepted accounting principles ("GAAP") that differ in certain material respects from US GAAP. The significant differences are summarised as follows:

(a) Acquisition accounting

Under UK GAAP, all integration costs relating to acquisitions are expensed as post-acquisition expenses. Under US GAAP, certain restructuring and exit costs incurred in the acquired business are treated as liabilities assumed on acquisition and taken into account in the calculation of goodwill.

Under UK GAAP, provisional fair value adjustments made in the accounting year in which the acquisition occurs may be amended in the subsequent accounting year. Under US GAAP, the allocation of the cost of acquisition to the fair values of assets and liabilities is generally completed within 12 months of the date of acquisition.

(b) Goodwill

Under the Group's UK GAAP accounting policy, goodwill arising on acquisitions after 1 October 1998 is recognised as an asset and amortised on a straight-line basis over its estimated useful economic life. Impairment tests on goodwill are carried out at the end of the first full accounting period after its acquisition, and whenever there are indications of impairment. Goodwill arising on acquisitions before 1 October 1998 was deducted from reserves immediately. Under US GAAP, goodwill is recognised as an asset, and is not amortised. Under the transition rules of SFAS 142 "Goodwill and Other Intangible Assets", no amortisation is charged on acquisitions made after 30 June 2001; amortisation is charged up to 31 December 2001 for other goodwill. All goodwill is tested for impairment at least annually. Certain amounts included in goodwill under UK GAAP are classified as intangible assets under US GAAP and amortised over their useful economic life.

(c) Property revaluation and depreciation

The Group's freehold and leasehold properties are carried at original cost or subsequent valuation. The surplus or deficit on revaluation is included in the Group's reserves. Under US GAAP, revaluations of property are not permitted to be reflected in the financial statements.

Depreciation charged and gains or losses on disposal under UK GAAP are based on the revalued amount of freehold and long leasehold properties; no depreciation is charged on investment properties which are revalued annually. Under US GAAP, the depreciation charge and gains or losses on disposal are based on the historical cost of all properties.

(d) Leasehold property provisions

Under UK GAAP, provisions are raised on leasehold properties when there is a commitment to vacate the property. US GAAP requires provisions to be recognised at the time the property is vacated.

(e) Dividends

Under UK GAAP, dividends are recorded in the period to which they relate, whereas under US GAAP dividends are recorded in the period in which they are declared.

(f) Loan origination fees

Under UK GAAP, certain loan fees are recognised when received. Under US GAAP, all non-refundable loan fees and certain direct costs are deferred and recognised as an adjustment to the yield on the related loan or facility.

(g) Pension costs

Pension costs, based on actuarial assumptions and methods, are charged in the consolidated accounts so as to allocate the cost of providing benefits over the service lives of employees in a consistent manner approved by the actuary. US GAAP prescribes the method of actuarial valuation and also requires assets to be assessed at fair value and the assessment of liabilities to be based on current interest rates. Additionally, under US GAAP a minimum additional liability must be recognised if the accumulated benefit obligation exceeds the fair value of plan assets and the Group has recorded a prepaid pension cost or has an accrued liability that is less than the unfunded accumulated benefit. This minimum additional liability represents the underfunding of the scheme on an accumulated benefit obligation basis, together with an amount equal to the pension prepayment. Movements in the minimum additional liability, together with the related deferred tax, are recognised through other comprehensive income as a deduction from equity.

(h) Long-term assurance business

The shareholders' interest in the long-term assurance fund is valued as the discounted value of the cash flows expected to be generated from in-force policies together with net assets in excess of the statutory liabilities. Under US GAAP, for traditional business, premiums are recognised as revenue when due from the policyholders. Costs of claims are recognised when insured events occur. A liability for future policy benefits is established based upon the present value of future benefits less the present value of future net premiums. Acquisition costs for traditional business contracts are charged to the profit and loss account in proportion to premium revenue recognised. For unit-linked business, premiums and front-end load-type charges receivable from customers and acquisition costs relating to the acquisition of new contracts are capitalised and depreciated in proportion to the present value of estimated gross profits. Costs of claims are recognised when insured events occur.

(i) Extinguishment of liabilities

Under UK GAAP, recognition of a financial liability ceases once any transfer of economic benefits to the creditor is no longer likely. Under US GAAP, a financial liability is derecognised only when the creditor is paid or the debtor is legally released from being the primary obligator under the liability, either judicially or by the creditor.

(j) Leasing

In accordance with UK GAAP, the Group's accounting policy for finance lease income receivable is to allocate total gross earnings to accounting periods so as to give a constant periodic rate of return on the net cash investment, and certain operating lease assets are depreciated on a reverse-annuity basis. Under US GAAP, finance lease income is recognised so as to give a level rate of return on the investment in the lease but without taking into account the associated tax flows, and all operating lease assets are depreciated on a straight-line basis.

(k) *Securities*

Under UK GAAP, the Group's debt securities and equity shares are classified as being held as investment securities or for dealing purposes. Investment securities are stated at cost less provision for any permanent diminution in value. Premiums and discounts on dated debt securities are amortised to interest income over the period to maturity. Securities held for dealing purposes are carried at fair value with changes in fair value recognised in the profit and loss account. Under US GAAP, securities held by the Group's private equity business are considered to be held by investment companies and are carried at fair value, with changes in fair value being reflected in net income. The Group's other investment debt securities and marketable investment equity shares are classified as available-for-sale securities with unrealised gains and losses reported in a separate component of equity.

(l) *Derivatives and hedging activities*

SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" was effective for the Group's US GAAP information from 1 January 2001. The Group has not made changes in its use of non-trading derivatives to meet the hedge criteria of SFAS 133. As a result, from 1 January 2001, for US GAAP purposes, the Group's portfolio of non-trading derivatives has been remeasured to fair value and changes in fair value reflected in net income. Under UK GAAP, these derivatives continue to be classified as non-trading and accounted for in accordance with the underlying transaction or transactions being hedged. SFAS 133 does not permit a non-derivative financial instrument to be designated as the hedging instrument in a fair value hedge of the foreign exchange exposure of available-for-sale securities. The Group's UK and US GAAP reconciliations also reflect transition adjustments on initial application of SFAS 133. These adjustments were: a cumulative-effect-type adjustment increasing net income by £45 million (£65 million less tax of £20 million); and a cumulative-effect-type adjustment decreasing other comprehensive income by £51 million (£73 million less tax of £22 million). SFAS 133 also requires derivatives embedded in other financial instruments to be accounted for on a stand-alone basis if they have economic characteristics and risks that differ from those of the host instrument.

US GAAP does not permit a profit or loss to be recognised on transacting a derivative unless its valuation is based on observable market data. There is no similar requirement under UK GAAP. Inception profits and losses reflecting the application of the Group's usual pricing methodologies are recognised as they arise.

(m) *Software development costs*

Under UK GAAP, most software development costs are written off as incurred. Under US GAAP, certain costs relating to software developed for own use that are incurred after 1 January 1999 are capitalised and depreciated over the estimated useful life of the software.

(n) *Stock-based compensation*

Under UK GAAP, no compensation expense is recognised for the Group's executive share option schemes, under which options are granted at the higher of nominal value and market value on the date of grant and for the Group's Sharesave schemes, under which employees are granted options at a 20% discount to market value at date of grant. Under US GAAP, the compensation is based on the estimated fair value which is charged to the profit and loss account over the period to their average vesting date.

(o) *Variable interest entities*

UK GAAP requires consolidation of entities controlled by an enterprise where control means the enterprise's ability to direct the financial and operating policies of an entity with a view to gaining economic benefits. US GAAP requires consolidation by the primary beneficiary of a variable interest entity ("VIE"). An enterprise is the primary beneficiary of a VIE if it will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

(p) *Perpetual regulatory securities*

Under UK GAAP, the Group's perpetual regulatory securities are classified as liabilities. Under US GAAP, they are classified as equity instruments.

(q) Acceptances

Acceptances outstanding and the matching customers' liabilities are not reflected in the consolidated balance sheet, but are disclosed as memorandum items. Under US GAAP, acceptances outstanding and the matching customers' liabilities are reflected in the consolidated balance sheet.

(r) Offset of repurchase and reverse repurchase agreements

Under UK GAAP, debit and credit balances with the same counterparty are aggregated into a single item where there is a right to insist on net settlement and the debit balance matures no later than the credit balance. Under US GAAP, repurchase and reverse repurchase agreements with the same counterparty may be offset only where they have the same settlement date specified at inception.

(s) Deferred taxation

Accounting for deferred tax under UK GAAP is consistent with US GAAP except that deferred tax is not recognised under UK GAAP on certain timing differences resulting from the roll-over of gains on disposal of properties, but is provided under US GAAP on such differences.

Recent developments in US GAAP

In April 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". It amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities under SFAS 133. The statement is effective for contracts entered into or modified after 30 June 2003, and for hedging relationships designated after 30 June 2003. Implementation of SFAS 149 has had no effect on the Group's US financial information.

The FASB issued SFAS 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" in May 2003. This statement addresses classification and measurement by an issuer of certain financial instruments with characteristics of both liabilities and equity. SFAS 150 also addresses the classification of certain financial instruments that embody obligations to issue equity shares. The statement is effective for financial instruments entered into or modified after 31 May 2003 and is otherwise effective on or after 15 June 2003. SFAS 150 has not affected the classification of any of the capital instruments issued by the Group.

The FASB issued SFAS 132 (revised) "Employers' Disclosures about Pensions and Other Postretirement Benefits — an amendment of FASB Statements No. 87, 88 and 106" in December 2003. This statement retains the disclosures required by SFAS 132 and requires additional information on changes in pension and other post-retirement benefit obligations and fair value of assets. SFAS 132R is effective for the Group's 2003 financial statements.

In December 2003, the FASB issued FASB Interpretation ("FIN") No. 46 (revised) "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." FIN 46R clarifies some of the provisions of FIN 46, issued in January 2003, and exempts certain entities from its requirements. FIN 46R replaces FIN 46 but as FIN 46R contains deferral provisions, FIN 46 is extant until FIN 46R is applied. FIN 46 and FIN 46R address accounting for VIEs. Expected losses and expected residual returns of a VIE have been clarified in FIN 46R as the expected negative variability and positive variability, respectively, in the fair value of its net assets excluding variable interests and include expected variability resulting from the operating results of the entity.

The Group elected to adopt the provisions of FIN 46R as at 31 December 2003, except in relation to certain investments made by its private equity business which is involved with entities that may be deemed to be VIEs. The FASB has deferred non-registered investment companies (entities that invest for capital appreciation and income) from the application of FIN 46R until the scope of investment company accounting has been clarified by the American Institute of Certified Public Accountants.

The FASB continues to provide additional guidance on implementation of FIN 46. As further guidance is provided, the Group will continue to review the status of the VIEs with which it is involved.

Selected figures in accordance with US GAAP

The following tables summarise the significant adjustments to consolidated net income available for ordinary shareholders and shareholders' equity which would result from the application of US GAAP instead of UK GAAP. Where applicable, the adjustments are stated gross of tax with the tax effect shown separately in total.

	2003 £m	2002 £m	2001 £m
Consolidated statement of income			
Profit attributable to ordinary shareholders — UK GAAP	2,315	1,971	1,868
Adjustments in respect of:			
Acquisition accounting	33	—	(113)
Amortisation of goodwill	721	681	(48)
Property revaluation and depreciation	(41)	(18)	(12)
Leasehold property provisions	83	—	—
Loan origination	(47)	(72)	(95)
Pension costs	(369)	(58)	242
Long-term assurance business	(57)	(37)	(25)
Extinguishment of liabilities	(84)	—	—
Leasing	(53)	(71)	(68)
Securities	49	—	—
Derivatives and hedging	232	770	(125)
Software development costs	(300)	283	442
Stock-based compensation	(32)	—	—
Variable interest entities	(60)	—	—
Tax effect on the above adjustments	187	(261)	(44)
Deferred taxation	(13)	(80)	40
Net income available for ordinary shareholders — US GAAP	2,564	3,108	2,062

	2003 £m	2002 £m
Consolidated shareholders' equity		
Shareholders' funds — UK GAAP	28,099	27,052
Adjustments in respect of:		
Acquisition accounting	451	418
Goodwill	2,222	1,541
Property revaluation and depreciation	(249)	(277)
Leasehold property provisions	83	—
Proposed dividend	1,059	899
Loan origination	(288)	(241)
Pension costs	(27)	342
Recognition of pension scheme minimum liability	—	(3,568)
Long-term assurance business	(178)	(121)
Extinguishment of liabilities	(84)	—
Leasing	(218)	(165)
Securities	232	284
Derivatives and hedging	161	535
Software development costs	660	960
Stock-based compensation	(32)	—
Variable interest entities	(60)	—
Perpetual regulatory tier one securities	678	751
Tax effect on cumulative UK/US GAAP adjustments	(274)	(461)
Tax effect on other comprehensive income	155	1,013
Deferred tax	(47)	(34)
Shareholders' equity — US GAAP	32,343	28,928

Total assets under US GAAP, adjusted to reflect the inclusion of acceptances, provisions for contingent liabilities and commitments, the fair value of financial guarantees and the grossing-up of certain repurchase agreements offset under UK GAAP, together with the effect of adjustments made to net income and shareholders' funds, were £488 billion (2002 — £431 billion).

Earnings per share

Basic and diluted earnings per share ("EPS") under US GAAP differs from UK GAAP only to the extent that the income calculated under US GAAP differs from that under UK GAAP.

	2003			2002			2001		
	Income*	No. of shares	Per share amount	Income*	No. of shares	Per share amount	Income*	No. of shares	Per share amount
	£m	million	pence	£m	million	pence	£m	million	pence
Basic EPS	2,564	2,931	87.5	3,108	2,881	107.9	2,062	2,762	74.7
Dilutive effect of share options outstanding	—	22	(0.7)	—	43	(1.6)	—	55	(1.5)
Diluted EPS	2,564	2,953	86.8	3,108	2,924	106.3	2,062	2,817	73.2

* US GAAP net income available to ordinary shareholders, see page 189.

Convertible preference shares totalling £200 million (2002 — £200 million, 2001 — £800 million), €750 million (2002 and 2001 — €750 million) and $1,900 million (2002 and 2001 — $1,900 million) have not been included in the computation of diluted earnings per share as their effect is anti-dilutive. Interest payments on the $1,200 million (2002 and 2001 — $1,200 million) perpetual regulatory securities may be settled by the issue of ordinary shares at the option of the company and have not been included in the computation of diluted earnings per share as their effect is also anti-dilutive.

Outstanding options to purchase shares are excluded from the computation of diluted EPS where the exercise prices of the options are greater than the average market price of the ordinary shares during the relevant period. At 31 December 2003, there were 5.2 million such options outstanding (2002 — 3.8 million; 2001 — 0.6 million).

Pensions

On 1 April 2002, the Group's main pension schemes, The Royal Bank of Scotland Staff Pension Scheme and the National Westminster Bank Pension Fund, were merged to form The Royal Bank of Scotland Group Pension Fund ("the plan"). The provisions of SFAS 87 "Employers' Accounting for Pensions" have been applied to the plan, which covers most of the Group's UK employees; the impact of US GAAP on the other Group schemes is considered to be immaterial.

A trust fund has been established under the plan, to which payments are made, determined on an actuarial basis, designed to build up reserves during the working life of full-time employees to pay such employees or dependants a pension after retirement. Such pensions are based on final pensionable salaries and are related to the length of service prior to retirement. Pensions are limited to a maximum of two-thirds of final salary for 40 years service or more. Staff do not make contributions for basic pensions but may make voluntary contributions on a regular basis to purchase additional service qualification where less than 40 years service will have been completed by normal retirement age.

The assets of the plan are held under separate trusts and, in the long-term, the funding policy is to maintain assets sufficient to cover the benefits in respect of service to date, with due allowance for future earnings increases. The plan assets consist mainly of fixed-income securities and listed securities. The investment policy followed for the plan seeks to deploy the plan assets primarily in UK and overseas equity shares and UK government securities.

Pension scheme disclosures required by SFAS 132R are set out below.

Obligations and funded status

	2003 £m	2002 £m	2001 £m
Change in benefit obligation:			
Projected benefit obligation at beginning of year	12,526	12,198	10,573
Service cost	340	303	236
Interest cost	706	715	647
Amendments	—	—	14
Net actuarial loss/(gain)	902	(217)	1,257
Benefits paid	(511)	(473)	(529)
Projected benefit obligation at year end	13,963	12,526	12,198

	2003 £m	2002 £m	2001 £m
Change in plan assets:			
Fair value of plan assets at beginning of year	10,682	12,567	13,846
Actual return on plan assets	1,559	(1,521)	(833)
Employer contribution	92	109	83
Benefits and expenses paid	(511)	(473)	(529)
Market value of plan assets at year end	11,822	10,682	12,567

	2003 £m	2002 £m	2001 £m
Prepaid pension cost:			
Funded status	(2,141)	(1,844)	369
Unrecognised net actuarial loss	5,078	5,266	3,199
Unrecognised prior service cost	13	14	15
Unrecognised transition amount	(14)	(22)	(30)
Prepaid pension cost at year end	2,936	3,414	3,553

	2003 £m	2002 £m	2001 £m
Components of net periodic pension cost:			
Service cost	340	303	236
Interest cost	706	715	647
Expected return on plan assets	(757)	(901)	(956)
Amortisation of prior service cost	1	1	—
Amortisation of loss/(gain)	287	138	(6)
Amortisation of net transition asset	(8)	(8)	(8)
Net periodic pension cost/(credit)	569	248	(87)

Assumptions

	2003 % per annum	2002 % per annum	2001 % per annum
Weighted average assumptions used at 31 December:			
Discount rate for liabilities	5.60	5.75	6.00
Salary increases	3.95	3.50	4.25
Pension increases	2.70	2.25	2.50
Long-term rate of return on assets	7.20	7.20	7.30

	2003	2002	2001
	%	%	%
Weighted-average allocations of market value of plan assets at 31 December:			
Equity shares	65	67	63
Debt securities	32	31	33
Other	3	2	4
Total	100	100	100

At 31 December 2003 and 2001, the fund had a surplus of assets over its accumulated benefit obligation and no minimum liability was recognised. At 31 December 2002, the fund's accumulated benefit obligation was underfunded by £168 million. This resulted in a reduction in the accumulated other comprehensive income component of US GAAP shareholders' equity of £3,568 million, comprising the excess of the accumulated benefit obligation over the market value of assets of £168 million, prepaid pension cost of £3,414 million less unrecognised prior service cost of £14 million. This was reduced by deferred tax of £1,070 million.

Cash flows

The Group's contribution to its main UK pension scheme in 2004 will be determined by the actuarial valuation to be completed as at 31 March 2004. The following pension payments under the main scheme, which reflect expected future service, as appropriate, are expected to be paid:

	£m
2004	445
2005	454
2006	462
2007	474
2008	489
After 2008	2,802

Loan impairment

At 31 December 2003 and 2002, the Group estimated that the difference between the carrying value of its loan portfolio under US GAAP and its value in the Group's UK GAAP financial statements was such that no adjustment to net income or consolidated shareholders' equity was required. At 31 December 2003, the Group's non-accrual loans, loans past due 90 days and troubled debt restructurings amounted to £5,157 million (2002 — £4,871 million). Specific provisions of £2,782 million (2002 — £2,435 million) were held against these loans. Average non-accrual loans, loans past due 90 days and troubled debt restructurings for the year to 31 December 2003 were £5,166 million (2002 — £4,762 million).

Gross interest income not recognised, but which would have been recognised under the original terms of non-accrual and restructured loans, amounted to £237 million for the year ended 31 December 2003 (2002 — £234 million; 2001 — £173 million) from domestic loans and £55 million for the year ended 31 December 2003 (2002 — £73 million; 2001 — £60 million) from foreign loans. Interest on non-accrual and restructured loans included in net income was £60 million for the year ended 31 December 2003 (2002 — £47 million; 2001 — £42 million) from domestic loans and £3 million for the year ended 31 December 2003 (2001 — £7 million; 2000 — £14 million) from foreign loans.

Securities

During 2003, there were no gross gains or gross losses included in US GAAP net income from transfers of securities from the available-for-sale category into the trading category. For 2003, net unrealised losses of £652 million on available-for-sale securities were included in US GAAP other comprehensive income and £164 million was reclassified from accumulated other comprehensive income into US GAAP net income.

Cash flow statements

There are many similarities between SFAS 95, "Statement of Cash Flows" as amended by SFAS 104 "Statement of Cash Flows — Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions", and FRS 1 "Cash Flow Statements" (Revised). The principal differences are the classifications of certain transactions.

	Classification under FRS 1	Classification under SFAS 95
Equity dividends paid	Equity dividends paid	Financing activities
Dividends paid on non-equity shares	Returns on investments and servicing of finance	Financing activities
Tax paid	Taxation	Operating activities
Purchase and sale of associated and subsidiary undertakings	Acquisitions and disposals	Investing activities
Purchase and sale of investment securities and fixed assets	Capital expenditure and financial investment	Investing activities
Net change in loans and advances, including finance lease receivables	Operating activities	Investing activities
Net change in deposits	Operating activities	Financing activities
Net change in debt securities in issue	Operating activities	Financing activities
Short-term funding not included in cash	Operating activities	Financing activities

Summary consolidated statements of cash flows presented on a US GAAP basis for each of the three years ended 31 December 2003 are set out below:

	2003	2002	2001
	£m	£m	£m
Cash flows from operating activities	8,534	11,008	1,413
Cash flows from investing activities	(31,879)	(44,892)	(34,813)
Cash flows from financing activities	34,872	37,245	29,761
Effect of exchange rate changes on cash and cash equivalents	(863)	(115)	39
Change in cash and cash equivalents	10,664	3,246	(3,600)
Cash and cash equivalents at beginning of the year	10,273	7,027	10,627
Cash and cash equivalents at end of the year	20,937	10,273	7,027

The composition of cash at 31 December 2003, 2002 and 2001 and the movement in cash for the years then ended are shown in Note 47 and Note 48 on the accounts respectively.

Stock-based compensation costs

The Group grants share options to executive officers under an executive share option scheme (the "executive scheme") and to employees under a savings-related sharesave scheme (the "savings scheme") and the option 2000 scheme.

Executive scheme

Under the terms of the executive scheme, senior management employees and executive directors of Group companies may participate in the executive scheme at the discretion of the Board of directors of the company. The executive scheme involves a participant being granted an option to subscribe for ordinary shares of the company at the higher of nominal value and market value of ordinary shares on the date of grant. Normally, options may be granted only within six weeks after the announcement of final or interim results of the Group for any particular year. Options may not be transferred or assigned. A participant may not be granted options over new shares to the extent that the aggregate subscription price would exceed four times his compensation. Options granted under the executive scheme are issued on a UK Inland Revenue approved or unapproved basis. Options are exercisable between the third and tenth anniversaries of the grant date, only if performance criteria are met.

For options granted from 1996 to 1998, the criterion is the average growth in adjusted earnings per ordinary share to exceed the average increase in the UK Retail Prices Index by 2% per annum over a three year period. For options granted since 1999, the relevant percentage has been increased to 3% per annum.

Savings scheme

Under the Inland Revenue rules, a participant in a savings scheme is permitted to make a maximum monthly saving of £250 under approved savings schemes. Employees of Group companies in the UK and Ireland and certain offshore jurisdictions are offered participation in the savings scheme. Participants can make monthly savings for a period of three, five or seven years. Options may be granted at not less than 80% of the average market value of ordinary shares of the company by reference to dealings in the ordinary shares over the last three trading days of the week immediately preceding the date of an invitation to participate, or, if higher, at par. Options comprise, as nearly as possible, such number of ordinary shares as may be purchased at the option price with the proceeds on maturity after either three, five or seven years of the savings contract, and options may normally be exercised only within six months after the third, fifth or seventh anniversary of the savings contract. Options may not be transferred or assigned.

Option 2000 scheme

On 9 August 2000 and again on 4 April 2001, every qualifying permanent member of staff in the Group received an option over 150 shares in the company. The executive directors of the company waived their entitlement to the option granted on 4 April 2001. On 21 March 2002, options over 150 shares were granted to all employees of Mellon who transferred to Citizens Financial Group, and 1 September 2003 further options over 150 shares were granted to all employees of Churchill Insurance Group, as a result of the acquisition by the Group.

Under the scheme, options are granted at the market value of ordinary shares at the date of grant and may normally be exercised only between the third and sixth anniversary of the date of grant.

Limitations of the option schemes:

(i) During a ten year period, no more than 10% in aggregate of the issued ordinary share capital of the company from time to time may be issued pursuant to all of the employee share schemes operated by the company.

(ii) During a five year period, no more than 5% in aggregate of the issued ordinary share capital of the company from time to time may be issued pursuant to all of the employee share schemes operated by the company.

(iii) During a ten year period, no more than 5% in aggregate of the issued ordinary share capital of the company from time to time may be issued pursuant to the executive scheme.

(iv) During a four year period, no more than 2½% in aggregate of the issued ordinary share capital of the company from time to time may be issued pursuant to the executive scheme.

(v) During a three year period, no more than 3% in aggregate of the issued ordinary share capital of the company from time to time may be issued pursuant to the executive scheme.

The following is a summary of outstanding options under the various schemes:

	Savings scheme		Executive scheme		Option 2000 scheme		Total	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	000's	pence	000's	pence	000's	pence	000's	pence
At 1 January 2001 ...	58,841	666	15,797	768	14,876	1240	89,514	779
Granted	9,581	1364	1,941	1714	13,412	1563	24,934	1498
Exercised	(13,465)	427	(5,217)	599	(1)	1240	(18,683)	475
Forfeited	(3,353)	1112	(488)	715	(1,703)	1302	(5,544)	1135
At 31 December 2001	51,604	829	12,033	996	26,584	1399	90,221	1019
Granted	12,419	1235	2,096	1810	620	1841	15,135	1339
Exercised	(12,112)	493	(3,160)	729	(5)	1380	(15,277)	542
Forfeited	(2,271)	1025	(145)	940	(1,313)	1419	(3,729)	1160
At 31 December 2002	49,640	1003	10,824	1232	25,886	1409	86,350	1153
Granted	9,100	1307	4,073	1347	1,363	1590	14,536	1345
Exercised	(11,902)	747	(1,299)	798	(6,380)	1240	(19,581)	911
Forfeited	(2,715)	1117	(76)	1251	(1,603)	1459	(4,394)	1244
At 31 December 2003	44,123	1128	13,522	1308	19,266	1474	76,911	1246

In 2003, awards totalling 341,269 options (2002 — 59,869; 2001 — 91,742) with negligible exercise prices and 59,525 shares (2002 and 2001 — nil) were made under the Group's medium-term performance plan. Under the plan, the amount of shares or options that vest ranges from nil to 200% of the award depending on the annual growth in the Group's earnings per share and its performance relative to that of a comparator group of companies principally from the UK financial services sector.

The following table shows options outstanding by normal exercise date. An option life of 5 years, being the midpoint on the 10 year option, has been assumed for options granted under Group and former NatWest executive plans.

	2003		2002		2001	
Year exercisable	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	000's	pence	000's	pence	000's	pence
2002	—	—	—	—	14,500	475
2003	—	—	27,769	963	28,238	987
2004	31,817	1188	25,553	1226	28,498	1215
2005	14,081	1112	15,473	1118	10,320	1012
2006	11,822	1421	6,924	1447	7,237	1443
2007	8,785	1351	9,265	1343	874	985
2008	9,110	1328	494	1364	554	1364
2009	809	1235	872	1235	—	—
2010	487	1307	—	—	—	—
Total	76,911	1246	86,350	1153	90,221	1019

If the compensation cost for the schemes had been determined based on the fair value at the grant dates consistent with the fair value method of SFAS 123, net income and earnings per share as adjusted to include stock compensation would have been as shown below:

	2003	2002	2001
	£m	£m	£m
Net income under US GAAP:			
As reported	2,564	3,108	2,062
Adjusted to include stock compensation	2,503	2,978	1,942
Basic earnings per share under US GAAP:			
As reported	87.5p	107.9p	74.7p
Adjusted to include stock compensation	85.4p	103.4p	70.3p
Diluted earnings per share under US GAAP:			
As reported	86.8p	106.3p	73.2p
Adjusted to include stock compensation	84.8p	101.8p	68.9p

The fair value of each option has been estimated as at the grant date using a Black-Scholes option pricing model using the following assumptions:

	2003	2002	2001
Risk free interest rate	3.6%-4.6%	4.7%-4.9%	5.0%
Volatility based on historical data	29%	43%	42%
Dividend yield	2.9%-4.1%	2.4%-2.9%	1.9%-2.2%
Expected lives of options granted under:			
Employee savings scheme	3, 5 and 7 years	3, 5 and 7 years	3, 5 and 7 years
Executive scheme	3 to 10 years	3 to 10 years	3 to 10 years
Option 2000 scheme	3 years	3 years	3 years

The following table summarises fair values of options issued in each year:

	2003			2002			2001		
	Exercise price	Fair value	Life Years	Exercise price	Fair value	Life Years	Exercise price	Fair value	Life Years
	£	£		£	£		£	£	
Executive scheme[1]	13.48	2.91	3-10	18.10	6.54	3-10	17.14	6.40	3-10
Savings scheme									
3 year	13.07	4.64	3	12.35	5.58	3	13.64	6.47	3
5 year	13.07	5.15	5	12.35	6.33	5	13.64	7.48	5
7 year	13.07	5.48	7	12.35	6.76	7	13.64	8.15	7
Option 2000 scheme	15.90	2.91	3	18.41	5.44	3	15.63	4.63	3

Note:

(1) For the purposes of calculating a fair value on executive scheme options, an option life of 5 years, being the mid-point on the 10 year option, has been assumed. Historical exercise trends have not been used as these are not felt to be indicative of future trends given changes to the scheme rules and participants in the scheme.

Goodwill

The Group has fully implemented SFAS 142 "Goodwill and Other Intangible Assets", with effect from 1 January 2002. Under this standard, goodwill and intangible assets deemed to have indefinite lives are not amortised and are subject to annual impairment tests. Other intangible assets continue to be amortised over their useful lives. The Group has completed the impairment tests required under SFAS 142 and no impairment has been recognised as a result.

The table below sets out reported net income reconciled to net income adjusted to comply with SFAS 142.

	2003	2002	2001
	£m	£m	£m
Net income under US GAAP	2,564	3,108	2,062
Goodwill amortisation	—	—	657
Adjusted net income	2,564	3,108	2,719
Basic earnings per share under US GAAP	87.5p	107.9p	74.7p
Goodwill amortisation	—	—	23.7p
Adjusted basic earnings per share	87.5p	107.9p	98.4p
Diluted earnings per share under US GAAP	86.8p	106.3p	73.2p
Goodwill amortisation	—	—	23.3p
Adjusted diluted earnings per share	86.8p	106.3p	96.5p

Intangible assets other than goodwill

A summary of the carrying value of intangible assets other than goodwill is as follows:

	2003			2002			2001		
	Gross carrying amount	Accumulated amortisation	Net carrying amount	Gross carrying amount	Accumulated amortisation	Net carrying amount	Gross carrying amount	Accumulated amortisation	Net carrying amount
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Core deposit intangibles	459	(149)	310	461	(108)	353	487	(66)	421
Brands	338	—	338	—	—	—	—	—	—
Customer relationships	128	(6)	122	—	—	—	—	—	—
Total amortising intangible assets	925	(155)	770	461	(108)	353	487	(66)	421

The weighted average amortisation period of intangible assets other than goodwill are:

	Years
Core deposit intangibles	7
Brands	—
Customer relationships	9

Amortisation charge on intangibles during 2003 was £62 million (2002 — £50 million; 2001 — £699 million). The Group estimates amortisation expense for the next five years will be:

	£m
2004	73
2005	73
2006	73
2007	73
2008	71

Securitisations

The Group engages in securitisation activities pertaining to certain of its assets including US commercial and residential mortgage loans, commercial and residential mortgage related securities, US Government agency collateralised mortgage obligations, and other types of financial assets. Additionally, the Group acts as an underwriter and depositor in securitisation transactions involving both client and proprietary transactions. The Group has classified these activities into three broad securitisation categories, US Agency based, consumer based, and commercial based securitisations.

During 2003, the Group received proceeds of approximately £37.5 billion (2002 — £26.2 million) from securitisation trusts in connection with new securitisations.

The Group recognised net pre-tax gains of approximately £58.8 million (2002 — £83.0 million) relating to these securitisations. Net pre-tax gains are based on the difference between the sales prices and previous carrying values of assets prior to date of sale, are net of transaction specific expenses, and exclude any results attributable to hedging activities, interest income, funding costs, changes in asset values prior to securitisation date, and retained interest values subsequent to securitisation date.

In some instances, the Group retained certain interests. The Group typically does not retain a significant portion of the loans or securities that it securitises. This reduces the impact that changes to fair values of retained interests might have on the Group's financial results.

The Group's retained interests may be subordinated to other investors' interests. The investors and securitisation trusts have no recourse to the Group's other assets for failure of debtors to perform on the securitised loans. The value of the retained interests varies and is subject to prepayment, credit and interest rate risks on the transferred assets.

At 31 December 2003, the fair value of the Group's retained interests was approximately £1.5 billion (2002 — £1.7 billion). Cash flows received in 2003 from retained interests held at 31 December 2003 in connection with securitisations that took place in current and prior years amounted to approximately £368 million (2002 — £157 million).

These retained interests comprises approximately £907 million in US Agency based retained interests, £540 million in consumer based retained interests and £47 million in commercial based retained interests. These retained interests primarily relate to mortgage loans and securities and arose from securitisations that have taken place in current and prior years.

Key economic assumptions used in measuring the value of retained interests at the date of securitisation resulting from securitisations completed during the year were as follows:

Assumptions	U.S. Agency retained interests	Consumer retained interests	Commercial retained interests
Prepayment speed	143-651 PSA	4-40% CPR(1)	0% CPY(2)
Weighted average life	1-18 years	1-16 years	1-10 years
Cash flow discount rate	2-53%	1-53%	3-6%
Credit losses	N/A(3)	0-6% CDR(4)	N/A(5)

Key economic assumptions and the sensitivity of the current fair value of retained interests at 31 December 2003 to immediate adverse changes, as indicated below, in those assumptions are as follows:

Assumptions/impact on fair value	U.S. Agency retained interests	Consumer retained interests	Commercial retained interests
Fair value of retained interests at 31 December 2003	£907m	£540m	£47m
Prepayment speed(6)	2-50% CPR(1)	4-66% CPR(1)	0-50% CPY(2)
Impact on fair value of 10% adverse change	£1.4m	£11.8m	—
Impact on fair value of 20% adverse change	£2.8m	£22.9m	—
Weighted average life	1-18 years	1-16 years	1-10 years
Cash flow discount rate	3-43%	1-56%	3-11%
Impact on fair value of 10% adverse change	£25.6m	£11.8m	£1.3m
Impact on fair value of 20% adverse change	£51.4m	£23.2m	£2.5m
Credit losses	N/A(3)	0-3% CDR(4)	0-1% CDR(4)
Impact on fair value of 10% adverse change	N/A	£8.7m	£0.1m
Impact on fair value of 20% adverse change	N/A	£19.0m	£0.2m

Notes:

(1) Constant prepayment rate — The CPR range represents the low and high points of a dynamic CPR curve

(2) CPR with yield maintenance provision

(3) Population consists of securities whose collateral is guaranteed by US Government Sponsored Entities and therefore, no credit loss has been assumed.

(4) Constant default rate

(5) Population consists of only investment grade senior tranches; therefore, no credit losses are included in the assumptions at deal settlement.

(6) Prepayment speed has been stressed on an overall portfolio basis for US Agency retained interests due to the overall homogeneous nature of the collateral. Consumer and Commercial retained interests have been stressed on a security level basis.

The sensitivities depicted in the preceding table are hypothetical and should be used with caution. The likelihood of those percent variations selected for sensitivity testing is not necessarily indicative of expected market movements because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of a retained interest is calculated without changing any other assumptions. This might not be the case in actual market conditions since changes in one factor might result in changes to other factors. Further, the sensitivities depicted above do not consider any corrective actions that the Group might take to mitigate the effect of any adverse changes in one or more key assumptions.

Variable interest entities

Special purpose entities ("SPEs")

The Group has elected to apply the provisions of FIN 46R in its 2003 accounts. The Group reviewed its SPEs in light of FIN 46R and has concluded that it is the primary beneficiary of a number of commercial paper conduits and other asset securitisation vehicles that meet FIN 46R's definition of a variable interest entity. These entities, with total assets of £6.9 billion at 31 December 2003, acquire financial assets from third parties or from the Group funded by the issue of commercial paper or other debt instruments. The Group supplies certain administrative services and provides credit enhancement, liquidity facilities and derivative transactions to some or all of these entities on an arm's length basis. In the case of commercial paper conduits, the Group provides programme-wide credit enhancement by letters of credit or loan facilities across all tranches of assets funded by conduits.

Trust preferred securities

The trust preferred securities referred to in Note 32 (3) and (4) on page 167, represent undivided beneficial interests in the assets of trusts, which consist of partnership preferred securities representing non-cumulative perpetual preferred limited partnership interests issued by Delaware limited partnerships. The Group has provided subordinated guarantees for the benefit of the holders of the trust preferred securities and the partnership preferred securities. Under the terms of the guarantees, the Group has fully and unconditionally guaranteed on a subordinated basis, payments on such trust preferred securities and partnership preferred securities, to the extent they are due to be paid and have not been paid by, or on behalf of the trusts and the partnerships, as the case may be:

- any due and payable distributions on the trust preferred securities or partnership preferred securities
- the redemption price required to be paid for each trust preferred security or partnership preferred security called for redemption; and
- upon a dissolution, winding up or liquidation of the trust or partnership, any amounts due in respect of the trust preferred securities or partnership preferred securities, through to the date of payment.

The application of FIN 46 (and FIN 46R) has resulted in the deconsolidation of trust preferred securities and partnership preferred securities issued by the Group's subsidiaries. The deconsolidation of these securities has resulted in a balance sheet reclassification from minority interests to subordinated liabilities. The effect on US GAAP net income and equity is negligible.

54 Post balance sheet events

There have been no significant events between the year end and the date of approval of these accounts which would require a change to our disclosures in the accounts.

STATUTORY CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE HALF YEAR ENDED 30 JUNE 2004 (unaudited)

In the consolidated profit and loss account set out below, goodwill amortisation and integration costs are included in the captions prescribed by the Companies Act 1985.

	First half 2004	First half 2003	Full year 2003
			(Audited)
	£m	£m	£m
Net interest income	4,378	4,025	8,301
Non-interest income (excluding general insurance)	4,146	3,878	7,805
General insurance net premium income	2,416	1,177	3,123
Non-interest income	6,562	5,055	10,928
Total income	10,940	9,080	19,229
Administrative expenses	4,163	3,784	7,699
Depreciation and amortisation			
tangible fixed assets	509	449	919
goodwill	413	373	763
Operating expenses*	5,085	4,606	9,381
Profit before other operating charges	5,855	4,474	9,848
General insurance net claims	1,723	836	2,195
Operating profit before provisions	4,132	3,638	7,653
Provisions	751	742	1,494
Profit on ordinary activities before tax	3,381	2,896	6,159
Tax on profit on ordinary activities	1,048	927	1,910
Profit on ordinary activities after tax	2,333	1,969	4,249
Minority interests (including non-equity)	111	87	210
Profit after minority interests	2,222	1,882	4,039
Preference dividends	116	137	261
	2,106	1,745	3,778
Additional Value Shares dividend	—	—	1,463
Profit attributable to ordinary shareholders	2,106	1,745	2,315
Ordinary dividends	529	431	1,490
Retained profit	1,577	1,314	825
Basic earnings per ordinary share (Note 4)	69.9p	60.0p	79.0p
Adjusted earnings per ordinary share (Note 4)	84.4p	76.5p	159.3p
Diluted earnings per ordinary share (Note 4)	69.5p	59.5p	78.4p

* Integration costs included in operating expenses comprise:

	£m	£m	£m
Administrative expenses	55	181	229
Depreciation	2	1	—
	57	182	229

THE ROYAL BANK OF SCOTLAND GROUP plc

CONSOLIDATED BALANCE SHEET
AT 30 JUNE 2004 (unaudited)

	30 June 2004	31 December 2003	30 June 2003
		(Audited)	
	£m	£m	£m
Assets			
Cash and balances at central banks	3,140	3,822	3,268
Items in the course of collection from other banks	3,149	2,501	3,729
Treasury bills and other eligible bills	6,902	4,846	7,047
Loans and advances to banks	60,152	51,891	44,923
Loans and advances to customers	290,154	252,531	248,726
Debt securities	89,813	79,949	73,328
Equity shares	2,315	2,300	2,150
Interests in associated undertakings	122	106	91
Intangible fixed assets	13,589	13,131	12,514
Tangible fixed assets	14,866	13,927	11,638
Settlement balances	10,288	2,857	15,169
Other assets	14,997	18,436	19,026
Prepayments and accrued income	6,060	5,421	4,074
	515,547	451,718	445,683
Long-term assurance assets attributable to policyholders	3,531	3,557	3,462
Total assets	519,078	455,275	449,145
Liabilities			
Deposits by banks	84,120	67,323	62,039
Items in the course of transmission to other banks	996	958	1,367
Customer accounts	253,949	236,963	225,697
Debt securities in issue	51,721	41,016	40,156
Settlement balances and short positions	38,058	21,369	36,749
Other liabilities	17,301	20,584	22,343
Accruals and deferred income	13,945	13,173	8,399
Provisions for liabilities and charges	2,532	2,522	2,202
Subordinated liabilities	17,832	16,998	15,696
Minority interests			
equity	27	(11)	(23)
non-equity	2,658	2,724	2,444
Shareholders' funds			
equity	29,541	25,176	25,496
non-equity	2,867	2,923	3,118
	515,547	451,718	445,683
Long-term assurance liabilities attributable to policyholders	3,531	3,557	3,462
Total liabilities	519,078	455,275	449,145
Memorandum items			
Contingent liabilities and commitments	173,316	154,557	138,933

THE ROYAL BANK OF SCOTLAND GROUP plc

STATEMENT OF CONSOLIDATED TOTAL RECOGNISED GAINS AND LOSSES FOR THE HALF YEAR ENDED 30 JUNE 2004 (unaudited)

	First half 2004	First half 2003	Full year 2003
			(Audited)
	£m	£m	£m
Profit attributable to ordinary shareholders	2,106	1,745	2,315
Currency translation adjustments and other movements	(30)	47	43
Revaluation of premises	—	—	(69)
Total recognised gains in the period	2,076	1,792	2,289

RECONCILIATION OF MOVEMENTS IN CONSOLIDATED SHAREHOLDERS' FUNDS FOR THE HALF YEAR ENDED 30 JUNE 2004 (unaudited)

	First half 2004	First half 2003	Full year 2003
			(Audited)
	£m	£m	£m
Profit attributable to ordinary shareholders	2,106	1,745	2,315
Ordinary dividends	(529)	(431)	(1,490)
Retained profit for the period	1,577	1,314	825
Issue of ordinary shares	2,829	555	775
Redemption of preference shares	—	(364)	(364)
Own shares held in relation to employee share schemes	(7)	—	—
Goodwill previously written off to reserves	—	40	40
Other recognised gains and losses	(30)	47	(26)
Currency translation adjustment on share premium account	(60)	(30)	(203)
Net increase in shareholders' funds	4,309	1,562	1,047
Opening shareholders' funds	28,099	27,052	27,052
Closing shareholders' funds	32,408	28,614	28,099

THE ROYAL BANK OF SCOTLAND GROUP plc

CONSOLIDATED CASH FLOW STATEMENT
FOR THE HALF YEAR ENDED 30 JUNE 2004 (unaudited)

	First half 2004	First half 2003	Full year 2003 (Audited)
	£m	£m	£m
Net cash inflow from operating activities (note 10)	3,689	14,428	19,708
Dividends received from associated undertakings	8	1	9
Returns on investments and servicing of finance			
Preference dividends paid	(136)	(140)	(269)
Additional Value Shares dividend paid	—	—	(1,463)
Dividends paid to minority shareholders in subsidiary undertakings	(72)	(60)	(130)
Interest paid on subordinated liabilities	(340)	(322)	(557)
Net cash outflow from returns on investments and servicing of finance	(548)	(522)	(2,419)
Taxation			
UK tax paid	(212)	(359)	(933)
Overseas tax paid	(237)	(233)	(521)
Net cash outflow from taxation	(449)	(592)	(1,454)
Capital expenditure and financial investment			
Purchase of investment securities	(22,068)	(24,343)	(44,861)
Sale and maturity of investment securities	22,485	20,775	41,805
Purchase of tangible fixed assets	(2,330)	(1,533)	(5,017)
Sale of tangible fixed assets	853	395	1,108
Net cash outflow from capital expenditure and financial investment	(1,060)	(4,706)	(6,965)
Acquisitions and disposals			
Purchases of businesses and subsidiary undertakings (net of cash acquired)	(2,098)	(318)	(1,748)
Investment in associated undertakings	(25)	(3)	(2)
Sale of subsidiary and associated undertakings (net of cash sold)	3	105	179
Net cash outflow from acquisitions and disposals	(2,120)	(216)	(1,571)
Ordinary equity dividends paid	(999)	(396)	(772)
Net cash (outflow)/inflow before financing	(1,479)	7,997	6,536
Financing			
Proceeds from issue of ordinary share capital	2,769	9	184
Proceeds from issue of trust preferred securities	—	512	883
Redemption of preference share capital	—	(364)	(364)
Issue of subordinated liabilities	1,193	1,731	3,817
Repayment of subordinated liabilities	(174)	(40)	(336)
(Decrease)/increase in minority interests	(1)	19	(56)
Net cash inflow from financing	3,787	1,867	4,128
Increase in cash	2,308	9,864	10,664

THE ROYAL BANK OF SCOTLAND GROUP plc

NOTES

1. Accounting policies

There have been no changes to the Group's principal accounting policies as set out on pages 137 to 140 of the 2003 Report and Accounts.

2. Provisions for bad and doubtful debts

Operating profit is stated after charging provisions for bad and doubtful debts of £719 million (30 June 2003 — £746 million) and amounts written off fixed asset investments of £32 million (30 June 2003 — recovery of £4 million). The balance sheet provisions for bad and doubtful debts increased in the six months to 30 June 2004 from £3,929 million to £4,038 million, and the movements thereon were:

	Specific	General	First half 2004	First half 2003
	£m	£m	£m	£m
At 1 January	3,363	566	3,929	3,927
Currency translation and other adjustments	29	(71)	(42)	(6)
Acquisitions	72	28	100	10
Amounts written off	(712)	—	(712)	(740)
Recoveries of amounts previously written off	44	—	44	34
Charge to profit and loss account	691	28	719	746
At 30 June	3,487	551	4,038	3,971

The provision at 30 June 2004 includes provision against loans and advances to banks of £6 million (31 December 2003 — £7 million; 30 June 2003 — £7 million).

3. Taxation

The charge for taxation is based on a UK corporation tax rate of 30% and comprises:

	First half 2004	First half 2003	Full year 2003
	£m	£m	£m
Tax on profit before goodwill amortisation and integration costs	1,081	1,001	2,012
Tax relief on goodwill amortisation and integration costs	(33)	(74)	(102)
	1,048	927	1,910

The actual tax charge differs from the expected tax charge computed by applying the standard UK corporation tax rate of 30% as follows:

	First half 2004	First half 2003	Full year 2003
	£m	£m	£m
Expected tax charge	1,014	869	1,848
Goodwill amortisation	109	95	203
Non-deductible items	27	3	106
Non-taxable items	(8)	(34)	(111)
Other	(14)	(1)	(24)
Adjustments in respect of prior periods	(80)	(5)	(112)
Actual tax charge	1,048	927	1,910

4. Earnings per share

Earnings per share have been calculated based on the following:

	First half 2004	First half 2003	Full year 2003
	£m	£m	£m
Earnings			
Profit attributable to ordinary shareholders	2,106	1,745	2,315
	Number of shares — millions		
Weighted average number of ordinary shares			
In issue during the period	3,013	2,908	2,931
Effect of dilutive share options and convertible non-equity shares	18	26	22
Diluted weighted average number of ordinary shares during the period	3,031	2,934	2,953
Basic earnings per share	69.9p	60.0p	79.0p
AVS dividend	—	—	49.9p
	69.9p	60.0p	128.9p
Goodwill amortisation	13.2p	12.2p	25.0p
Integration costs	1.3p	4.3p	5.4p
Adjusted earnings per share	84.4p	76.5p	159.3p
Diluted earnings per share	69.5p	59.5p	78.4p

5. Interim dividend

The directors have declared an interim dividend of 16.8p per ordinary share which will be paid on 8 October 2004 to shareholders registered on 13 August 2004. As an alternative to cash, a scrip dividend election is to be offered and shareholders will receive details of this by letter.

6. Analysis of repurchase agreements

	30 June 2004	31 December 2003	30 June 2003
	£m	£m	£m
Reverse repurchase agreements and stock borrowing			
Loans and advances to banks	29,659	26,522	15,140
Loans and advances to customers	34,892	24,069	30,443
Repurchase agreements and stock lending			
Deposits by banks	33,067	27,044	20,644
Customer accounts	33,343	27,021	19,595

7. Contingent liabilities and commitments

	30 June 2004	31 December 2003	30 June 2003
	£m	£m	£m
Contingent liabilities			
Acceptances and endorsements	349	595	2,268
Guarantees and assets pledged as collateral security	8,872	8,787	5,683
Other contingent liabilities	5,827	5,482	8,232
	15,048	14,864	16,183
Commitments			
Documentary credits and other short-term trade related transactions	618	605	244
Undrawn formal standby facilities, credit lines and other commitments to lend	155,726	137,251	121,515
Other commitments	1,924	1,837	991
	158,268	139,693	122,750
Total contingent liabilities and commitments	173,316	154,557	138,933

8. Derivatives

Replacement cost of over-the-counter contracts (trading and non-trading)

The following table shows the gross replacement cost, which is the sum of the fair values, of all over-the-counter contracts with third parties (trading and non-trading) with positive value. This measure makes no allowance for netting arrangements.

	30 June 2004	31 December 2003	30 June 2003
	£m	£m	£m
Exchange rate contracts	16,269	28,163	20,941
Interest rate contracts	48,686	54,974	76,548
Credit derivatives	185	272	335
Equity and commodity contracts	1,437	1,020	924
	66,577	84,429	98,748

Derivatives held for trading purposes

The table below shows the notional principal amounts of trading instruments entered into with third parties.

	30 June 2004	31 December 2003	30 June 2003
	£bn	£bn	£bn
Exchange rate contracts	1,542.7	1,144.7	1,241.8
Interest rate contracts	6,441.7	5,307.8	5,046.6
Credit derivatives	32.3	28.5	25.6
Equity and commodity contracts	47.8	34.1	28.3

The table below shows the fair values (which, after netting, are the balance sheet values) of trading instruments entered into with third parties.

	30 June 2004 Fair value		31 December 2003 Fair value		30 June 2003 Fair value	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Exchange rate contracts	16,219	17,066	28,102	29,564	20,905	22,392
Interest rate contracts	48,006	48,757	54,266	54,212	76,030	76,418
Credit derivatives	185	114	273	155	334	138
Equity and commodity contracts	1,315	917	924	720	867	599
	65,725	66,854	83,565	84,651	98,136	99,547
Netting	(55,319)	(55,319)	(69,478)	(69,478)	(83,374)	(83,374)
	10,406	11,535	14,087	15,173	14,762	16,173

Derivatives held for purposes other than trading

The Group uses derivatives to manage specific interest rate positions relating to assets and liabilities and to hedge foreign currency exposures. The Group establishes non-trading derivative positions with third parties and through intra-company and intra-Group transactions with the Group's independent trading operations. The table below shows the notional principal amounts of the Group's non-trading derivatives (third party and internal).

	30 June 2004	31 December 2003	30 June 2003
	£bn	£bn	£bn
Exchange rate contracts	22.4	26.5	16.3
Interest rate contracts	158.6	135.1	126.1
Credit derivatives	1.2	1.0	1.5
Equity and commodity contracts	2.1	1.7	1.7

9. Analysis of consolidated shareholders' funds

	First half 2004 £m	First half 2003 £m	Full year 2003 £m
Called-up share capital			
At beginning of period	769	754	754
Shares issued during the period	44	10	15
At end of period	813	764	769
Share premium account			
At beginning of period	8,175	7,608	7,608
Currency translation adjustments	(60)	(30)	(203)
Shares issued during the period	2,785	557	760
Other movements	4	6	10
At end of period	10,904	8,141	8,175
Merger reserve			
At beginning of period	10,881	11,455	11,455
Transfer to profit and loss account	(287)	(287)	(574)
At end of period	10,594	11,168	10,881
Revaluation reserve			
At beginning of period	7	80	80
Revaluation of premises	—	—	(69)
Transfer to profit and loss account	—	—	(4)
At end of period	7	80	7
Other reserves			
At beginning of period	419	387	387
Transfer of increase in value of long-term assurance business	17	10	32
At end of period	436	397	419
Profit and loss account			
At beginning of period	7,848	6,768	6,768
Currency translation adjustments and other movements	(34)	29	33
Retention for the period	1,577	1,314	825
Own shares held in relation to employee share schemes	(7)	—	—
Redemption of preference shares	—	(364)	(364)
Goodwill previously written off	—	40	40
Transfer from merger reserve	287	287	574
Transfer from revaluation reserve	—	—	4
Transfer of increase in value of long-term assurance business	(17)	(10)	(32)
At end of period	9,654	8,064	7,848
Closing shareholders' funds	32,408	28,614	28,099

10. Analysis of net cash inflow from operating activities

	First half 2004 £m	First half 2003 £m	Full year 2003 £m
Net cash inflow from trading activities	4,674	3,920	9,028
Increase in loans and advances to banks and customers	(37,416)	(14,452)	(23,343)
Increase in deposits by banks and customers	28,754	11,677	26,857
Increase in securities	(9,322)	(2,901)	(9,871)
Increase in debt securities in issue	10,014	6,218	7,078
Increase in settlement balances and short positions	9,258	6,270	3,202
(Decrease)/increase in other assets and liabilities	(2,273)	3,696	6,757
Net cash inflow from operating activities	3,689	14,428	19,708

11. Litigation

In December 2003, members of the Group were joined as defendants in a number of legal actions in the United States following the collapse of Enron. Collectively the claims are, to a substantial degree, unquantified and in each case they are made against large numbers of defendants. The Group intends to defend these claims vigorously. The US Courts dealing with the main Enron actions have ordered that the Group join the non-binding, multi-party mediation which commenced in late 2003. Based on current knowledge including applicable defences and given the unquantified nature of these claims, the directors are unable at this stage to predict with certainty the eventual loss, if any, in these matters. In addition, pursuant to requests received from the US Securities and Exchange Commission and the US Department of Justice, the Group has been providing copies of Enron-related materials to these authorities and the Group continues to co-operate fully with them.

Members of the Group are engaged in other litigation in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The directors of the company have reviewed these other actual, threatened and known potential claims and proceedings and, after consulting with the Group's legal advisers are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Group's consolidated net assets, results of operations or cash flows.

12. International Financial Reporting Standards

The Group's 2005 interim and annual accounts will be prepared in accordance with International Reporting Financial Standards (IFRS). In the first half of 2004 IFRS implementation activities have included building IT solutions, revising processes and reporting structures, Group-wide IFRS training and analysis of new standards and amendments to existing standards. The Group remains on track to produce IFRS compliant accounts in 2005. A summary of the key differences between the Group's current accounting policies and IFRS is included in the Group's 2003 Annual Report and Accounts.

13. Statutory accounts

Financial information contained in this document does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985 ("the Act"). The statutory accounts for the year ended 31 December 2003 have been filed with the Registrar of Companies and have been reported on by the auditors under section 235 of the Act. The report of the auditors was unqualified and did not contain a statement under section 237(2) or (3) of the Act.

14. Auditors' review

The interim results have been reviewed by the Group's auditors, Deloitte & Touche LLP, and their review report is set out on page 49.

15. Form 6-K

A report on Form 6-K will be filed with the Securities and Exchange Commission in the United States.

The profit and loss account presented in the Form 6-K will be the statutory profit and loss account as set out on page 27 of this announcement, which includes goodwill amortisation and integration costs in the captions prescribed by the Companies Act 1985. The Financial Review included in the Form 6-K will be based on the statutory profit and loss account.

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