The Royal Bank of Scotland Group plc

Report & Accounts 1997

Contents

Report of the directors

The directors have pleasure in presenting their report together with the audited accounts for the year ended 30th September 1997.

Profit and dividends The profit attributable to the ordinary shareholders of the company amounted to £457 million (after preference dividends of £53 million – see Note 8 on page 43) as set out in the consolidated profit and loss account on pages 34 and 35.

An interim dividend of 6.2p per ordinary share was paid on 18th July 1997 at a cost of £48 million. The directors now recommend that a final dividend of 15.2p per ordinary share be paid on 19th February 1998 to members on the register at the close of business on 12th December 1997, absorbing £131 million. If this recommendation is approved by the shareholders at the annual general meeting on 15th January 1998, the retained profit for the year will amount to £278 million.

Subject to the approval of shareholders at the annual general meeting, shareholders will be offered the choice of taking ordinary shares in lieu of cash in respect of the final dividend.

Turnover For details of turnover attributable to non-banking business see Note 48 on the accounts on page 68.

Activities and business review The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc (the "Bank"), the direct operating subsidiary undertaking of the company. The "Group" comprises the company, the Bank and its subsidiary and associated undertakings. The Bank and its subsidiary undertakings are engaged principally in providing a comprehensive range of banking, insurance and other financial services. A review of the business for the year ended 30th September 1997, of recent events, and of likely future developments is contained in the Annual Review and Summary Financial Statement.

Annual report on Form 20-F An annual report on Form 20-F is being filed with the Securities and Exchange Commission (the "SEC") in the USA and copies will be available in February 1998 on request from the secretary (telephone: 0131 523 4431). Much of the detailed financial information therein is shown in the accounts and subsequent financial analyses.

Corporate structure Details of the principal subsidiary undertakings of the company are shown on page 49.

On 6th November 1996, Citizens Financial Group, Inc. ("Citizens") completed the acquisition of Farmers and Mechanics Bank for US$53 million cash.

On 19th December 1996, Citizens sold US$5.0 billion of its third party mortgage servicing business, held by its wholly owned subsidiary Citizens Mortgage Corporation, for US$89 million cash and on 27th January 1997 it sold the remaining US$3.8 billion for US$58 million cash. The pre-tax gain on sale of US$45 million (£28 million) has been credited to the consolidated profit and loss account as an exceptional item.

On 13th February 1997, the Group announced its agreement to establish a joint venture in financial services with Tesco PLC, the UK's leading supermarket group. The new venture, Tesco Personal Finance Group Limited, allies the strengths of the Bank, Direct Line Insurance plc and Scottish Widows Fund and Life Assurance Society ("Scottish Widows") with Tesco's excellent relationship with its customers.

On 4th March 1997, Citizens completed the acquisition of Grove Bank for US$87 million cash.

On 24th March 1997, the Group confirmed the acquisition of the Custody and Investor Services Division together with the related treasury and banking business of S.G.Warburg & Co. Ltd. and certain assets used in that business owned by Mercury Asset Management Group plc.

On 31st March 1997, the Group completed the disposal of its 100% interest in The Royal Bank of Scotland AG to Banque de Depots of Switzerland.

On 8th April 1997, Citizens agreed to acquire BNH Bancshares, Inc., based in Connecticut, for US$57 million cash and this acquisition was completed on 28th August 1997.

On 6th May 1997, the Group completed the acquisition of 9,800,000 ordinary shares of £1 each, representing the minority interest of 20% in the issued ordinary share capital of Royal Scottish Assurance plc, from Scottish Equitable plc.

On 12th May 1997, the Group completed the sale of 14,700,000 ordinary shares of £1 each in the ordinary share capital of Royal Scottish Assurance plc, representing 30% of its issued ordinary share capital, to Scottish Widows. As a result, the Group holds 70% of the ordinary share capital of Royal Scottish Assurance plc.

On 1st July 1997, the Group completed the sale of 7,500,000 ordinary shares of £1 each in Direct Line Life Holdings Limited, representing 50% of its issued ordinary share capital, to Scottish Widows.

On 12th August 1997, the Group and Birmingham Midshires Building Society ("Birmingham Midshires") agreed terms under which the Bank will acquire the business of Birmingham Midshires, subject to the completion of due diligence, member and regulatory approvals and certain other conditions.

Ordinary share capital During the year, the ordinary share capital was increased by the issue as follows of:

(a) 7,156,504 ordinary shares allotted as a result of the exercise of options under the company's executive and sharesave schemes;

(b) 3,389,797 ordinary shares in lieu of cash dividends; and

(c) on 13th August 1997, the Group announced that it had agreed to place 33,359,810 new ordinary shares of 25p each for cash with Scottish Widows at a net price of 601.1725p per share.

The proceeds from the above issues of shares amounted to £264 million. Details of the current authorised and issued ordinary share capital are shown on page 57.

Preference share capital On 16th October 1996, the company completed the redemption of all of the 8 million Series A non-cumulative dollar preference shares issued on 14th September 1989 at a redemption price of US$25.84 per share, plus accrued and unpaid dividends to the redemption date. A substantial portion of the redemption cost was financed by the contemporaneous issue of 8 million Series E non-cumulative dollar preference shares of US$0.01 each at US$25.00 per share, the net proceeds being US$194 million.

On 26th March 1997, the company issued 8 million Series F non-cumulative dollar preference shares of US$0.01 each at US$25.00 per share, the net proceeds being US$194 million. Details of the authorised and issued non-cumulative dollar preference share capital as at 30th September 1997 are shown on page 57.

Subordinated liabilities On 29th January 1997, the Bank issued £150 million 8⅜% subordinated notes due 2007 at an issue price of 99.21%, the net proceeds being £148 million.

On 26th March 1997, the Bank issued £150 million undated subordinated floating rate step-up notes at an issue price of 99.39%, the net proceeds being £148 million.

On 23rd April 1997, the fourth US$40 million tranche of US$200 million guaranteed floating rate notes 1994/98 were repaid by Royscot International Finance B.V.

On 10th July 1997, the company issued US$75 million undated capital securities at an issue price of 100%, the net proceeds being US$75 million.

Details of the current subordinated liabilities are shown on pages 54, 55 and 56.

Shareholdings The company has been notified of the following interests in its shares as at 27th November 1997.

	% held		% held
Ordinary shares:		Preference shares 5½% *cumulative*:	
Banco Santander, S.A.	9.89	Provincial Group PLC	22.83
Tiger Management L.L.C.	5.00	Guardian Royal Exchange plc	20.25
Scottish Widows Fund and Life Assurance Society	4.98	Bassett-Patrick Securities Limited*	11.56
Preference shares 11% *cumulative:*		Mr P. S. and Mrs J. Allen	7.25
Guardian Royal Exchange plc	25.97	Mrs Gina Wild	4.95
Windsor Life Assurance Company Limited	10.30	Miss Elizabeth Hill	4.03
The Investment Company plc	6.81	Mr W. T. Hardison Jr.	3.38
Mr S. J. and Mrs J. A. Cockburn	6.16	Trustees of The Stephen Cockburn	
Cleaning Tokens Limited	5.10	Limited Pension Scheme	3.07
Mr P. S. and Mrs J. Allen	5.04		

*Notification has been received on behalf of Mr A. W. R. Medlock and Mrs H. M. Medlock that they each have an interest in the holding of 5½% cumulative preference shares registered in the name of Bassett-Patrick Securities Limited noted above and that there are further holdings of 5,300 and 5,000 shares, respectively, of that class registered in each of their names.

Directors The names, brief biographical details and a photograph of the directors are contained in the Annual Review and Summary Financial Statement. Mr J. A. Barclay, Mr P. J. Wood, Dr E. H. Nelson and Sir Ian Wood retired from the board of directors on 16th January 1997, 25th June 1997, 1st October 1997 and 22nd October 1997, respectively. The directors retiring by rotation are Mr L. K. Fish, Dr G. R. Mathewson, Mr I. S. Robertson, Sir Iain Vallance and Viscount Younger of Leckie, all of whom, being eligible, offer themselves for re-appointment. The unexpired term of the service contracts of Mr Fish, Dr Mathewson and Mr Robertson are shown on page 9. There are no service contracts in respect of the other directors seeking re-appointment.

Directors' interests The interests of the directors in the shares of the company at 30th September 1997 are shown on page 12.

None of the directors held an interest in the loan capital of the company or its subsidiary undertakings, or in the shares of any of the subsidiary undertakings of the company, during the period between 1st October 1996 and 27th November 1997.

Audit Committee The Audit Committee comprises Sir Robin Duthie (chairman), Sir Angus Grossart, Miss E. A. Mackay and Mr W. M. Wilson, all of whom are non-executive directors of the company.

Remuneration Committee The Remuneration Committee comprises Viscount Younger of Leckie (chairman), Sir Robin Duthie, Sir Angus Grossart and Sir Iain Vallance.

Staff The weekly average number of persons employed by the company and its subsidiary undertakings in the UK was 26,699 (1996 – 23,382) and their aggregate remuneration for the year amounted to £544 million (1996 – £490 million). For the purposes of this report, aggregate remuneration comprises salaries, bonus payments, directors' fees, staff profit sharing payments and redundancy costs.

Staff involvement The company and its subsidiary undertakings encourage staff involvement by a process of communication and consultation. This takes the form of the provision of information through normal management channels, internal publications, video communication and regular dialogue with staff representatives.

Profit sharing schemes have existed since 1980 and these have included the opportunity to acquire shares in the company. Included in expenses for the year ended 30th September 1997 are sums totalling £36 million for payments to staff eligible to participate in the Group profit sharing schemes (1996 – £31 million).

Share option schemes were introduced in 1986. On 6th June 1997, options were granted over 5,254,759 ordinary shares, at a price of 497p per share, under the company's sharesave scheme. On 14th August 1997, options were granted over 1,462,000 ordinary shares, at a price of 601p per share, under the company's executive share option scheme.

Equal opportunities The company is committed to equality of opportunity. The company and its subsidiary undertakings' employment practices follow the best practice of each country in which they operate. In the recruitment of staff and their subsequent career development, individuals are considered solely on the basis of their aptitude and ability, irrespective of sex, marital status, race, age, sexual orientation, religion or disability.

In the Bank, progress continues to be made in redressing the imbalance in the number of women in management positions, with women now making up 17% of middle management and almost 9% of senior management. For serving employees who become disabled, every help is given to ensure their continued employment and to arrange rehabilitative training. The Bank is a member of the Employers' Forum on Disability, and is committed to action to improve the position of disabled people both as valued employees and as customers of the Bank.

Charitable contributions The total amount given for charitable purposes by the company and its subsidiary undertakings during the year was £2,081,352.

Close company provisions The close company provisions of the Income and Corporation Taxes Act 1988, as amended, do not apply to the company and there has been no change in this respect since 30th September 1997.

Corporate governance The company complies with the provisions of the Cadbury Committee's Code of Best Practice which are currently applicable and for which formal guidance is in force. Details are given on pages 5 and 6.

Policy and practice on payment of creditors In the year ending 30th September 1998, the company will adhere to the following payment policy in respect of all suppliers. The company is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the company's policy to negotiate and agree terms and conditions with its suppliers, either directly or through its operating subsidiaries, which includes the giving of an undertaking to pay suppliers within 30 days of the date of invoice or other agreed payment period.

The proportion which the amount owed to trade creditors at 30th September 1997 bears to the amounts invoiced by suppliers during the year then ended equated to a 21 days proportion of 365 days.

Auditors The auditors, Coopers & Lybrand, have indicated their willingness to continue in office. Resolutions to re-appoint them and to authorise the directors to fix their remuneration will be proposed at the annual general meeting.

By order of the board.
M. R. McLean
Secretary
Edinburgh
27th November 1997

The Royal Bank of Scotland Group plc is registered in Scotland No. 45551.

Corporate governance

In accordance with the recommendations of the Cadbury Committee on the Financial Aspects of Corporate Governance, the company has complied with the relevant provisions of the Code of Best Practice throughout the financial year. The preliminary report of the Hampel Committee on Corporate Governance was published on 5th August 1997 and the final report is expected to be published in December 1997. The company supports the preliminary conclusions arising from the Hampel Committee's review of the implementation of Cadbury and Greenbury recommendations.

In terms of the Listing Rules of the London Stock Exchange, the company has applied the following procedures:

Board of directors

- the board of directors meets regularly and has adopted a formal Schedule of Matters detailing key aspects of the company's affairs which must be referred to it for decision;
- there is a clearly accepted division of responsibilities at the head of the company, through the separation of the positions of chairman and chief executive;
- there are currently nine non-executive directors of varied backgrounds and experience and of independent judgement on the board;
- all directors have access to the advice and services of the secretary who is responsible for ensuring that the board procedures and applicable rules and regulations are observed. In addition, the directors are able, if necessary, to take independent professional advice at the company's expense; and
- new non-executive directors will be appointed for a specific term and re-appointment will not be as a matter of course. The position of current non-executive directors is reviewed as each director approaches re-appointment.

Board committees The Audit Committee of non-executive directors is responsible for assisting the board to discharge its responsibilities for accounting policies, internal control and financial reporting.

The Remuneration Committee is composed principally of non-executive directors and is responsible for considering and making recommendations to the board, within agreed terms of reference, on the company's remuneration policies, the remuneration arrangements of directors and senior executives and the operation of the company's employee share schemes. In line with the Listing Rules of the London Stock Exchange, which implement the recommendations of the Greenbury Committee on Directors' Remuneration and adopt the Greenbury Committee Code of Best Practice, the Remuneration Committee's annual report to shareholders is contained on pages 8 to 11.

The Personnel Committee provides advice to the board of directors on matters affecting staff.

All members of the board are involved in the formal selection and appointment of directors. The board is assisted in this process by the Chairman's Advisory Group, which comprises executive and non-executive directors, and also acts as a nomination committee. The directors' biographies contained in the Annual Review and Summary Financial Statement on pages 18 and 19 identify the members of the Audit Committee, the Remuneration Committee, the Chairman's Advisory Group and the Personnel Committee.

Going concern The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the "going concern" basis for preparing the accounts.

Internal financial control The board of directors is responsible for the Group's system of internal financial control and for monitoring its effectiveness. In establishing this system, the directors consider the nature of the Group's business, which involves the acceptance and management of risk, the materiality of the financial risk being run, the likelihood of a loss being incurred and the cost of implementing control. The system of internal financial control can, therefore, only provide reasonable, and not absolute, assurance:

- as to the reliability and integrity of financial information;
- that assets are safeguarded and only authorised transactions are entered into; and
- that fraud and other irregularities are prevented or detected.

The main features of the Group's internal financial control framework are:

- **Control environment** The Group is committed to the maintenance and development of a control-conscious culture appropriate to the financial services sector. This is achieved through a formally defined organisational structure with clear reporting lines, endorsement and promulgation of policies and procedures at board level and the commitment to recruitment and training of quality staff governed by appropriate codes of conduct.

- **Risk management** The board has delegated its authority for day to day risk management to the executive via the Group Risk Strategy and Group Risk Management Committees which are supported by a dedicated Group function.

- **Information and communication** The Group operates well-established budgetary and strategic planning cycles. The board reviews financial performance of all principal business units against budget and prior year on a monthly basis.

- **Control procedures** The Group operates a number of procedures manuals, tailored to meet the requirements of individual business units, which detail the procedures to control physical and logical access, segregation of duties and credit, trading, expenditure and other authorisation limits.

- **Monitoring and corrective action** The operation of the system of internal financial controls is the responsibility of line management and is subjected to independent review by Group Internal Audit and, where appropriate, by the Group's external auditors and external regulators. The reports of all of these bodies on internal control are received on behalf of the board by the Audit Committee, which ensures that, where necessary, appropriate corrective action is being taken. The effectiveness of the Group's internal financial control system for the period from 1st October 1996 to 27th November 1997 has been reviewed on behalf of the board by the Audit Committee having regard to the "criteria for assessing effectiveness" promulgated by the Cadbury Committee.

Report by the auditors to The Royal Bank of Scotland Group plc on corporate governance matters

In addition to our audit of the financial statements, we have reviewed the directors' statement on pages 5 and 6 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

Basis of opinion We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or its corporate governance procedures nor on the ability of the Group and the company to continue in operational existence.

Opinion With respect to the directors' statement on internal financial control on pages 5 and 6, and going concern on page 5, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statement on pages 5 and 6 appropriately reflects the company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Coopers & Lybrand
Chartered Accountants
Edinburgh
27th November 1997

Remuneration Committee report

The following report by the Remuneration Committee has been prepared in accordance with the Listing Rules of the London Stock Exchange which implemented and adopted the recommendations of the Greenbury Committee on Directors' Remuneration and adopted the Greenbury Committee Code of Best Practice. Except as otherwise stated in this report, the company has complied throughout the year with Section A, and the Remuneration Committee has given full consideration to Section B, of the best practice provisions contained in the Listing Rules.

Remuneration Committee It is the view of the board of directors that, as the board has ultimate responsibility for the proper stewardship of the Group, it is appropriate that the remuneration of executive directors of the company is determined by the board of directors of the company on the recommendation of the Remuneration Committee, rather than by the Remuneration Committee alone. In this regard, the company's remuneration policy is technically at variance with the recommendations of the Greenbury Committee Code of Best Practice, which states that the company's policy on executive remuneration and the specific remuneration packages of each executive director should be determined by the Remuneration Committee on behalf of the board. The Remuneration Committee is composed principally of non-executive directors of the company namely Viscount Younger, Sir Iain Vallance, Sir Angus Grossart and Sir Robin Duthie. The chairman of the Remuneration Committee is Viscount Younger. Mr C. M. Stuart and Mr W. M. Wilson have been appointed to the Remuneration Committee with effect from 1st December 1997. The board and the Remuneration Committee are satisfied that, as Viscount Younger has no involvement in the day to day running of the business, there is no conflict of interest in his position as chairman of the company and Bank boards and as chairman of the Remuneration Committee.

The terms of reference of the Remuneration Committee, in summary, are as follows:

Principal function To consider and make recommendations to the board of directors of the company and on behalf of shareholders with regard to the policies of the company and the Bank on remuneration. Particular attention is paid to the remuneration arrangements of directors and senior executives including pension rights, service contracts, bonus arrangements and compensation payments.

Policies In accordance with authority delegated by the board of directors:

- to monitor the remuneration policy of the company and its subsidiaries having regard to relevant market comparisons and practice;
- to consider and make recommendations to the board of directors on the remuneration arrangements including bonuses, share options, pension rights, service contracts and compensation payments of executive directors of the company;
- to decide whether, and in what amount, grants of options should be made under the executive share option scheme and the sharesave scheme;
- to determine annually, where appropriate, the staff profit share under the company's profit sharing schemes;
- to review employee share schemes in light of legislative and market developments and overall remuneration policy; and
- to consider, determine and, where appropriate, approve the remuneration arrangements including bonuses, share options, pension rights, service contracts and compensation payments of senior executives of the Bank.

Remuneration, salaries and fees The remuneration of the board of directors and the salaries of the executive directors of the company and the Bank are set by the board based on the recommendations of the Remuneration Committee. Executive directors' remuneration is determined after a review of the performance of each individual director.

It is the aim of the Committee to reward directors competitively having regard to the remuneration paid to the senior management of comparable public companies. For guidance, the Remuneration Committee seeks advice from external consultants and uses published specific job-matched surveys of similar companies. Further surveys are also commissioned as necessary. It has been the practice to review executive directors' salaries annually in April and non-executive directors' fees in October, with such reviews taking account of individual performance and responsibilities, as appropriate.

As a result of the additional responsibilities required of non-executive directors to enable the Group to comply with its corporate governance responsibilities, the board has reviewed the fees paid to non-executive directors. Following this review, the board has agreed to recommend to shareholders at the company's annual general meeting that fees for non-executive directors of the company be increased by £3,000 to £13,000 with effect from 1st October 1997 and that discretion be given to the board in the company's revised articles of association to amend the annual fees payable to directors up to an aggregate sum of £250,000 without prior shareholder approval. In addition, the board has agreed that the vice-chairmen should receive additional fees in respect of their committee membership with effect from 1st October 1997.

Share option schemes The executive directors participate in the company's executive and sharesave schemes and details of their interests in the company's shares arising from their participation are contained in the directors' interests in shares note on page 12. It is the company's policy that executive share options be awarded only to those executives who can genuinely influence the company's performance over the medium term. Executive share options are normally granted on a regular, phased basis. The exercise of options granted under the executive share option scheme in 1996 and in subsequent years is subject to a performance condition whereby options may not normally be exercised unless the growth in the company's adjusted earnings per share has exceeded the growth in the Retail Prices Index over a three year period by an average of at least 2% per annum. In respect of the years ended 30th September 1996 and 30th September 1997, the company's adjusted earnings per share has exceeded the growth in the Retail Prices Index by more than 2%. The condition is reviewed annually.

Profit sharing schemes Since 1980, the company has provided profit sharing for employees. Two schemes are in force which provide that a total of up to 5% of available profits may be distributed to eligible employees, including executive directors, either in shares or in cash after deduction of income tax.

Benefits in kind Executive directors receive benefits in kind, which include the provision of a company car for their use, medical health insurance, death in service benefits and beneficial loans, on similar terms to other senior executives.

Service agreements The service agreement of Dr G. R. Mathewson will terminate on his retirement on 14th May 2000. Consequently, as at 30th September 1997, the notice period required to be given by the Bank to Dr Mathewson was 31 months and it will continue to reduce as he approaches retirement. Dr Mathewson is required to give the Bank six months' notice.

The service agreement of Mr I. S. Robertson is terminable on 24 months' notice by the Bank and six months' notice by Mr Robertson.

The service agreement of Mr R. Speirs is terminable on 12 months' notice by the Bank and on three months' notice by Mr Speirs.

Mr L. K. Fish's employment agreement with Citizens is terminable on 24 months' notice by Citizens and 12 months' notice by Mr Fish.

The board of directors and the Remuneration Committee consider the relevant notice periods noted above to be in the best interests of the company and its shareholders. These enable the company to retain executive directors of the highest calibre and maintain management continuity.

Incentive schemes The Bank's UK executive directors participate in a discretionary performance-related incentive scheme for senior executives, payments under which are determined by the Remuneration Committee. The scheme provides for payments to be made by reference to the achievement of financial and other targets which are set for each participant by the Remuneration Committee at the beginning of each financial year. The maximum payment is 60% of salary for Dr G. R. Mathewson and Mr I. S. Robertson, 50% of salary for Mr R. Speirs and 40% of salary for Mr N. C. McLuskie and Mr G. A. Schofield. One half of each payment is applied to purchase ordinary shares in the company which are held in a restricted share trust for three years.

In terms of his service contract with Citizens, Mr L. K. Fish participates in its annual and long-term cash incentive plans which apply to the senior executives of Citizens. Awards under the plans require the achievement of pre-determined financial and other performance targets. Under the long-term plan, awards are linked to three year performance targets based on Citizens' budgets. A separate three year cycle commences each financial year. Mr Fish also participates in a shadow equity plan in terms of which senior executives of Citizens participate in the appreciation above a specific target in the capital value of Citizens over a period of years. The plan commenced on 1st October 1993 and will terminate on 30th September 2000. The units granted to Mr Fish vested two years after the date of grant. In the year ended 30th September 1997, the value of the units held by Mr Fish increased by US$1,538,460 and as at 30th September 1997 the value of units held by Mr Fish was US$4,323,060. These amounts are included in the remuneration table shown on page 11 in the year in which they were earned. To date no cash withdrawals have been made by Mr Fish.

Directors' pension arrangements Viscount Younger, Dr G. R. Mathewson, Mr I. S. Robertson, Mr N. C. McLuskie and Mr G. A. Schofield participate in The Royal Bank of Scotland Staff Pension Scheme (the "Scheme"). The Scheme is a defined benefit scheme which provides pensions and other benefits within Inland Revenue limits. Viscount Younger is provided with life assurance benefits only under the Scheme; these are restricted by Inland Revenue limits as set out in the Finance Act 1989. Additional life assurance cover in excess of that provided by the Scheme is secured under separate arrangements. Provision for his pension entitlement is made under a personal pension contract which is a defined contribution arrangement and an unfunded defined benefit arrangement. In the case of Mr Robertson, his pension entitlement in the Scheme is restricted by Inland Revenue limits as set out in the Finance Act 1989; additional life assurance cover in excess of these limits is provided by a separate arrangement. Mr Speirs is provided with pension benefits under a defined contribution personal pension. Mr Wood is a member of the Direct Line Insurance pension scheme which is a defined contribution arrangement and he has a separate individual defined contribution pension scheme. In recognition of his contribution to Direct Line Insurance, payments were made during the year of £350,000 to his individual pension and £536,061 to his Direct Line pension. Mr Fish accrues pension benefits under a number of arrangements in the USA. Defined benefits are built up under the Citizens' Qualified Plan, Excess Plan and Employee Arrangement. In addition, he is a member of two defined contribution arrangements – a Qualified 401(K) Plan and Executive Supplemental Benefit Plan. The London Stock Exchange has recently made rule changes on, inter alia, disclosure of directors' pension entitlement following the Institute and Faculty of Actuaries' recommendations. The tables below provide information on both defined benefit and defined contribution arrangements in line with the revised rules.

Defined benefit arrangements	Age nearest at 30th September 1997	Additional pension earned during the year ended 30th September 1997 £000 p.a.	Accrued entitlement at 30th September 1997 £000 p.a.	Transfer value for the additional pension earned during the year ended 30th September 1997 £000
Viscount Younger	66	18	62	200
Dr G. R. Mathewson	57	32	180	425
Mr N. C. McLuskie	53	8	63	94
Mr I. S. Robertson	52	2	11	24
Mr G. A. Schofield	57	14	147	179
Mr L. K. Fish – Qualified Plan	53	1	9	5
– Excess Plan		10	44	43
– Employee Arrangement		2	48	8

Contributions paid in the year ended 30th September 1997 under defined contribution arrangements were:

	£000		£000
Viscount Younger	33	Mr P. J. Wood	941
Mr R. Speirs	17	Mr L. K. Fish	87

The undernoted tables report the remuneration received by each director during the year:

	Salary £000	Performance related bonuses £000	Profit sharing £000	Pension contributions £000	Benefits £000	**Total 1997 £000**	Total 1996 £000
Chairman							
Viscount Younger	235	—	—	33	9	**277**	255
Executive directors							
Dr G. R. Mathewson	392	229	30	58	16	**725**	557
R. Speirs	227	107	18	17	11	**380**	316
L. K. Fish	455	1,694	—	87	13	**2,249**	2,570
N. C. McLuskie	215	78	18	32	13	**356**	316
I. S. Robertson	263	144	20	40	12	**479**	359
G. A. Schofield	215	78	18	32	12	**355**	339
P. J. Wood	290	—	—	941	17	**1,248**	500
1997	**2,292**	**2,330**	**104**	**1,240**	**103**	**6,069**	
1996	2,185	2,431	126	361	109		5,212

Non-executive directors	Board fees £000	Board committee fees £000	Fees from subsidiary companies £000	**Total 1997 £000**	Total 1996 £000
Vice-chairmen					
Sir Iain Vallance	25	—	25	**50**	50
A. M. Hamilton (retired 18th January 1996)	—	—	—	**—**	14
Sir Angus Grossart (from 1st May 1996)	25	—	25	**50**	36
J. A. Barclay (retired 16th January 1997)	3	—	35	**38**	60
E. Botin	10	—	10	**20**	20
J. Botin	10	—	10	**20**	20
Sir Robin Duthie	15	5	23	**43**	35
I. F. H. Grant	10	—	15	**25**	23
E. A. Mackay	10	—	13	**23**	8
Dr E. H. Nelson (retired 1st October 1997)	10	—	12	**22**	20
C. M. Stuart	10	—	12	**22**	14
W. M. Wilson	10	—	17	**27**	21
Sir Ian Wood (retired 22nd October 1997)	10	—	10	**20**	20
1997	**148**	**5**	**207**	**360**	
1996	141	13	187		341
Aggregate emoluments of directors who served during the year				**6,429**	5,553

Details of the potential pre-tax gains made by directors on the excerise of share options are contained in directors' interests in shares on page 12.

Directors' interests in shares

Ordinary shares The following directors held a beneficial interest in the company's ordinary shares:

	30th September 1997	1st October 1996 or date of appointment if later		**30th September 1997**	1st October 1996 or date of appointment if later
Sir Robin Duthie	**20,946**	40,573	G. A. Schofield	**267,474**	25,183
I. F. H. Grant	**4,398**	4,247	R. Speirs	**25,276**	18,212
Dr G. R. Mathewson	**65,918**	44,098	C. M. Stuart	**3,137**	3,030
N. C. McLuskie	**132,283**	121,161	Sir Iain Vallance	**2,500**	2,500
E. A. Mackay	**3,000**	—	W. M. Wilson	**7,610**	7,409
Dr E. H. Nelson	**5,810**	5,810	Viscount Younger	**15,751**	15,578
I. S. Robertson	**88,047**	78,283			

Options to subscribe for ordinary shares of 25p each in the company granted to, and exercised by, directors during the year to 30th September 1997 are included in the table below. Some prices in the table have been rounded to two decimal places.

	Options at 1st October 1996 or date of appointment if later	Average exercise price £	Options granted		Options exercised		Market price at date of exercise £	Potential pre-tax gain at date of exercise £	**Options at 30th September 1997**	Average exercise price £
			Number	Price £	Number	Price £				
L. K. Fish	23,000	4.29	—	—	—	—	—	—	**23,000**	4.29
Dr G.R. Mathewson	345,000	4.58	84,000	6.01	—	—	—	—	**430,961**	4.86
			1,961	4.97						
N. C. McLuskie	175,301	5.00	46,000	6.01	3,387	1.55	5.82	14,462	**218,885**	5.26
			971	4.97						
I. S. Robertson	254,417	4.05	47,000	6.01	—	—	—	—	**302,554**	4.36
			1,137	4.97						
G. A. Schofield	331,455	2.82	125,000	6.01	25,000	1.89	5.98	951,777	**213,875**	5.55
					46,000	2.65	5.98			
					165,000	1.93	5.98			
					6,580	1.55	5.82			
R. Speirs	146,000	4.51	—	—	25,000	4.53	5.72	29,750	**121,000**	4.50
Viscount Younger	250,000	3.28	26,000	6.01	—	—	—	—	**276,000**	3.54

The market price of the company's ordinary shares at 30th September 1997 was 690.5p and the range during the year to 30th September 1997 was 482.5p to 719.0p. Outstanding options under the executive share option scheme and the sharesave scheme are exercisable between now and 14th August 2007 and between now and 31st December 2002, respectively. Mr E. Botin, Mr J. Botin, Sir Angus Grossart and Sir Ian Wood did not have an interest in the company's ordinary shares during the year.

Preference shares Dr E. H. Nelson held a beneficial interest in 1,378 Series C non-cumulative dollar preference shares of US$0.01 each of the company at 30th September 1997 and at 1st October 1996.

Except as disclosed above, there has been no change in the directors' interests in the shares of the company shown above between 30th September 1997 and 27th November 1997. No director held a non-beneficial interest in the shares of the company at 30th September 1997, at 1st October 1996 or date of appointment if later.

Operating and financial review

The following review is based on the financial statements on pages 31 to 71 of this report and accounts. It discusses and analyses the Group's performance for the year to 30th September 1997 and it addresses the factors underlying the results of operations and financial condition in order to assist users in their assessment of the future prospects of the Group.

I Operating review

Overview of results The Group's profit before tax and before write-down of finance leases was, at £801 million, 15% higher than the prior year. The write-down of finance leases reflects one-off charges resulting from the Government's budget in July 1997. Profit before exceptional items rose by 19% to a record level of £768 million (1996 – £644 million). Profit before tax increased by 9% to £760 million (1996 – £695 million).

Net interest income increased by 18% to £1,414 million (1996 – £1,202 million). This increase was due to the growth in average advances and deposits in the UK Bank and the acquisitions by Citizens over the past 18 months. Compared with the year ended 30th September 1996, average interest earning assets grew by 17%. Within this, average loans and advances to customers including leasing were up by £4.5 billion or 15%, with lending to corporate customers by the UK Bank accounting for £1.7 billion of this growth. Average debt securities held and wholesale lending to banks increased by £3.9 billion or 22%. Customer deposits also grew strongly, up by £6.0 billion or 19%, as a result of the launch of new products together with the acquisitions by Citizens and customer balances from the acquisition of the Custody and Investor Services Division of S.G. Warburg & Co. Ltd. in March 1997. The Group's net interest margin was unchanged at 2.5%.

Non-interest income, excluding general insurance, also grew strongly and was up 21% to £1,003 million. The acquisitions by RBS Trust Bank and Citizens accounted for £51 million of this growth. Fees and commissions receivable grew by 18% to £809 million reflecting the acquisitions and good growth in banking related fees. The increase of £50 million in other operating income was due principally to a combination of increased profits on the sale of investments and increased property revenues. There was a reduction in the Group's share of income from associated undertakings following the disposal of CC Bank in the prior year. General insurance earned premium income was little changed at £658 million. During the year, Direct Line Insurance extended its reinsurance arrangement on the motor account. Non-interest income, after deducting general insurance claims, increased by 20% to £1,051 million. This represented 43% of total income after deducting general insurance claims.

Operating expenses, before exceptional items, were 17% up on the prior year. More than half of this increase was accounted for by acquisitions and new businesses. In the established businesses, more was spent on staff resources and technology investment to support the growth in business volumes.

Staff numbers increased by 3,700 as a result of the acquisitions, the launch of new businesses and the growth in business volumes.

The cost:income ratio for the UK Bank continued to improve to 56.6% compared with 58.1% for the year ended 30th September 1996. The Group cost:income ratio increased from 50.0% to 52.5%. This was due to the increase in reinsurance, the acquisition of the S.G. Warburg & Co. Ltd. custody business and the start-up costs of the new businesses.

General insurance claims, before reinsurance, decreased to £582 million from £593 million in the prior year which was affected by severe winter weather.

Provisions for bad and doubtful debts were £33 million higher than the prior year which had benefited from releases of provisions of £17 million at Citizens. Provisions in the UK Bank increased by £4 million to £117 million, mainly as a result of provisions in the credit card business reflecting a substantial growth in volumes. There was also the expected reduction in recoveries and releases. Excluding the credit card business, provisions for the UK Bank lending were similar to the prior year.

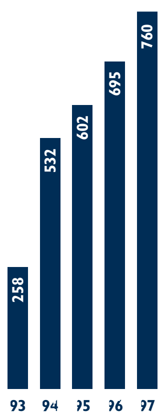
Exceptional gains of £28 million and £34 million were realised from the disposals of the Citizens' third party mortgage servicing business and the Group's shareholding in Banco Espanol de Credito ("Banesto") respectively. The Government's July budget changes affected tax variation clauses in finance lease contracts written by the Group and this resulted in an exceptional charge of £41 million to the Group's consolidated profit and loss account compensated in part by a reduction of £28 million in tax on ordinary activities. An amount of £29 million has also been charged as an exceptional item for the total expected costs of amending the Bank's computer systems to ensure that they will be Year 2000 compatible.

The tax charge of £247 million on profits before exceptional items of £768 million is an effective rate of 32%. There is also an overall tax credit on the exceptional items. The tax payable on the gain on sale of the investment in Banesto has been offset by capital losses brought forward and the write-down of finance leases results in a large tax credit.

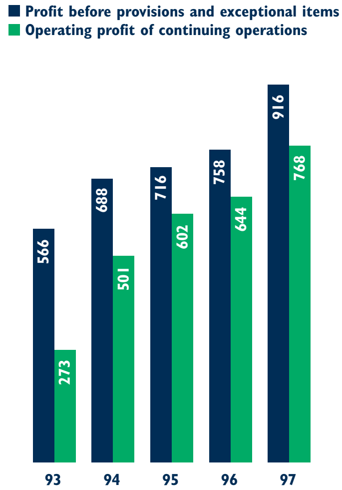
Total assets of the Group increased by 19% to £72.6 billion at 30th September 1997. In the UK Bank, total assets increased by 13% to £56.5 billion and this growth arose mainly from higher volumes of corporate lending, credit cards and treasury operations. The growth was funded by increased retail deposits and wholesale funds. Total assets at Citizens grew by 8% to £9.6 billion (US$15.5 billion). Investor Services grew as a result of the acquisition by RBS Trust Bank in March 1997. There was also good growth in the balance sheet of Direct Line Financial Services.

Capital adequacy ratios of 6.8% (tier 1) and 11.6% (total) remain comfortably ahead of the minimum required by the banking industry's regulators. Compared with the prior year, the Group's capital base increased by £1.2 billion to £5.3 billion as a result of the retained profit of £278 million, the placing of ordinary shares with Scottish Widows for £201 million, the issue of US$200 million preference shares and the issue of £300 million and US$75 million loan capital during the year and a fall of £323 million in deductions from the capital base. Weighted risk assets increased by 22% reflecting the growth of the Group's balance sheet.

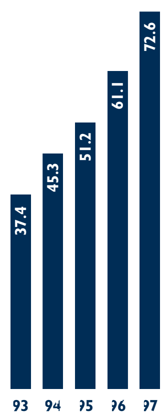
Profit before taxation (£m)



Profit (£m)



Total assets (£bn)



Divisional performances
The UK Bank

	1997			1996		
	Retail & Corporate Banking £m	**Offshore (RBSI) £m**	**Total £m**	Retail & Corporate Banking £m	Offshore (RBSI) £m	Total £m
Net interest income	**921**	**56**	**977**	838	43	881
Non-interest income	**733**	**30**	**763**	640	25	665
Total income	**1,654**	**86**	**1,740**	1,478	68	1,546
Total expenses	**945**	**40**	**985**	868	30	898
Profit before provisions	**709**	**46**	**755**	610	38	648
Bad debt provisions and investment write-offs	**118**	**1**	**119**	113	—	113
Profit before exceptional items	**591**	**45**	**636**	497	38	535
Cost:income ratio (%)	**57.1**	**46.5**	**56.6**	58.7	44.1	58.1

Five-year financial summary	**1997 £m**	1996 £m	1995 £m	1994 £m	1993 £m
Profit before provisions	**755**	648	515	498	480
Provisions	**(119)**	(113)	(96)	(159)	(270)
Profit before exceptional items	**636**	535	419	339	210
Cost:income ratio (%)	**56.6**	58.1	63.1	62.7	60.8
Pre-tax return on ordinary equity (%)	**40.0**	37.0	35.0	33.0	20.0
Post-tax return on ordinary equity (%)	**26.0**	23.0	21.0	20.0	12.0
Total assets (£bn)	**56.5**	50.0	43.7	38.5	33.3
Shareholders' funds – ordinary (£m)	**1,738**	1,419	1,320	1,150	960
– preference (£m)	**581**	469	440	380	320
Employees at 30th September	**19,060**	17,950	18,420	19,350	18,530

The UK Bank performed strongly with profit before exceptional items ahead by 19% to £636 million compared with £535 million for the prior year.

Net interest income was up 11% to £977 million as a result of the growth in average advances and deposits. Average advances were up 12% or £4.9 billion. Within this, average loans and advances to personal customers increased by 8% or £0.6 billion while lending to corporate customers increased by 13% or £1.7 billion and leasing balances grew by 20% or £0.5 billion. Both average debt securities and wholesale lending to banks grew strongly by 22% and 10% respectively. There was good growth over the range of personal and business deposits. Non-interest income grew strongly mainly as a result of banking related fees, income from specialist businesses and increased property revenues. Non-interest income accounts for 44% (1996 – 43%) of total income.

Total expenses increased by 10% to £985 million as a result of business growth and systems development costs.

The cost:income ratio continued to improve and fell by 1.5% to 56.6%.

Provisions for bad and doubtful debts increased by £4 million as a result of provisions on the credit card business, reflecting the growth in volumes.

In addition to the growth in the retail and commercial banking business, the other main contributors to the £101 million increase in profits were the specialist finance businesses (i.e. Development Capital, Acquisition Finance and Structured Finance – up £40 million), Treasury and Capital Markets (up £14 million) and credit cards (up £7 million). The offshore business (Royal Bank of Scotland International) achieved strong profit growth of 18% or £7 million, despite investing heavily to cater for its growing business.

Note: the figures for the UK Bank assume that it had a total risk asset ratio of 10% and that the tier 1 element was 6%, split between ordinary equity and preference shares in the same 3:1 ratio as the Group. Certain expenses previously shown as Group central costs have been reallocated to the UK Bank.

Investor Services

	1997 £m	1996 £m
Net interest income	**20**	5
Non-interest income	**94**	45
Total income	**114**	50
Total expenses	**126**	67
Deficit before tax	**(12)**	(17)
Analysis:		
RBS Trust Bank	**5**	—
RBS Global Custody	**(20)**	(16)
Registrars	**3**	(1)
	(12)	(17)

Five-year financial summary	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
(Loss)/Profit before exceptional items	**(12)**	(17)	(13)	1	(1)
Cost:income ratio (%)	**110.5**	134.0	127.0	110.0	134.0
Shareholders' funds (£m)	**48**	5	3	2	2
Employees at 30th September	**2,020**	1,240	1,170	880	800

The acquisition of the custody and related banking businesses of S.G. Warburg & Co. Ltd. and Mercury Asset Management was completed in March 1997 and the new custody subsidiary, RBS Trust Bank, commenced trading at the end of March.

RBS Trust Bank has made a very promising start and its six month profit of £5 million is in line with expectations. Income from high volumes has been offset by additional systems development expenditure required to facilitate customer service and establish strong controls over risk.

RBS Global Custody represents that part of the custody business which has not yet transferred to RBS Trust Bank. It is expected that the transfer will be substantially completed by September 1998. In addition to operating losses, the 1997 figures include the cost of preparing the business for transfer to RBS Trust Bank.

Registrars benefited from increased business volumes including the Halifax and Northern Rock flotations.

Note: Investor Services comprises RBS Trust Bank, the RBS Global Custody business and the Registrars business. Although sharing certain customers with Corporate and Institutional Banking it is a distinct and separate business unit. It is different from the UK Bank in terms of capital employed, cost:income ratio, profit per employee etc.

Direct Line Insurance

	1997 £m	1996 £m
Earned premiums	**644**	656
Reinsurers' share	**(118)**	(45)
Insurance premium income	**526**	611
Net interest income	**66**	57
Non-interest income	**47**	43
Total income	**639**	711
Expenses	**124**	123
Gross claims	**571**	593
Reinsurers' share	**(92)**	(31)
Profit before tax	**36**	26
In-force policies (000)		
Motor	**2,063**	2,162
Home	**833**	796
Travel	**65**	19
Total	**2,961**	2,977
Gross written premium (£m)		
Motor	**472**	480
Home	**157**	144
Creditor	**39**	20
Travel	**3**	1
Total	**671**	645

Five-year financial summary	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Profit before exceptional items	**36**	26	112	110	50
Operating ratio (%)	**106.0**	106.8	89.0	80.0	80.0
Pre-tax return on equity (%)	**11.0**	8.0	39.0	52.0	41.0
Total assets (£m)	**1,124**	1,042	911	781	531
Insurance reserves – net (£m)	**773**	720	620	507	357
Shareholders' funds (£m)	**343**	326	311	258	178
Employees at 30th September	**3,020**	2,690	2,850	2,610	1,790

Profits in Direct Line Insurance grew by 37% to £36 million, mainly due to the reduced level of claims over 1996 which suffered from severe winter weather.

On the motor account, the number of in-force policies remained above 2.0 million striking a balance between volume and profit. Although average earned premiums are unchanged on prior year, written premium rates have improved by 4% in the year. The impact of this increase should be seen in 1997/98.

On the home account, in-force policies increased by 37,000 (5%) to 833,000. Average earned premiums are unchanged on prior year. Written premium rates increased by 2%.

Expenses have been maintained at the level of the prior year underlining Direct Line Insurance's position as the lowest cost operator in the sector.

Direct Line Insurance has extended its reinsurance arrangement on the motor account resulting in an increase in the reinsurers' share of earned premiums and gross claims.

New Retail Financial Services Businesses

	1997 £m	1996 £m
Net interest income	**36**	13
Non-interest income – associated companies	**(7)**	(10)
– other	**23**	(4)
Insurance premium income	**9**	—
Total income	**61**	(1)
Expenses	**75**	38
General insurance claims	**8**	—
Losses before provisions	**(22)**	(39)
Provisions	**13**	4
Net investment cost	**(35)**	(43)

Analysis of net investment cost:	% owned	1997 £m	1996 £m
Direct Line Financial Services	100	**(10)**	(15)
Direct Line Life and Unit Trusts	50	**3**	(10)
Privilege Insurance	60	**(2)**	(4)
Linea Directa	50	**(5)**	(7)
RBS Advanta	51	**(2)**	(5)
Tesco Personal Finance	50	**(11)**	—
		(27)	(41)
Direct Line Accident Management	100	**(8)**	(2)
		(35)	(43)

Five-year financial summary	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Loss before provisions	**(22)**	(39)	(15)	(7)	(1)
Provisions	**(13)**	(4)	(1)	—	—
Net investment cost	**(35)**	(43)	(16)	(7)	(1)
Ordinary Shareholders' funds – Group's share (£m)	**55**	42	23	25	9
Total assets (£m)	**1,984**	837	273	61	3
Employees at 30th September	**1,840**	690	220	110	30

The improvement at Direct Line Financial Services results principally from increased balances. Mortgage balances have increased to £1.2 billion (1996 – £0.6 billion) and deposit balances have increased to £0.5 billion (1996 – £0.3 billion).

The profits of £3 million at Direct Line Life and Unit Trusts were £13 million ahead of prior year. Included in 1997 is a gain of £5 million on the disposal of a 50% shareholding as part of the Group's link up with Scottish Widows. Increased volumes and reduced expenses also contributed to the improvement. These companies were accounted for as subsidiaries until 1st July when they became associated companies on the sale of 50% to Scottish Widows.

Privilege Insurance and Linea Directa reported improved performances during the year. Privilege was accounted for as an associated company until 1st July 1997 when it became a subsidiary.

RBS Advanta has shown strong growth during the year and at 30th September 1997 had balances exceeding £500 million.

Tesco Personal Finance commenced trading in July 1997 and is accounted for as a subsidiary. As a consequence, the start-up costs for the period to 30th September 1997 have been fully consolidated.

The loss at Direct Line Accident Management increased by £6 million during the year, reflecting the increasing investment in establishing this operation. Four repair centres have been opened in the year (1996 – two).

Citizens

	1997 £m	1996 £m
Net interest income	**352**	280
Non-interest income	**98**	88
Total income	**450**	368
Expenses	**245**	202
Profit before provisions	**205**	166
Provisions/(net releases)	**16**	(2)
Profit before exceptional items	**189**	168

Five-year financial summary	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Profit before provisions	**205**	166	125	88	56
(Provisions)/net releases	**(16)**	2	(18)	(20)	(20)
Profit before exceptional items	**189**	168	107	68	36
US$/£ rate of exchange – average	**1.63**	1.54	1.58	1.51	1.52
Cost:income ratio (%)	**54.4**	54.9	56.6	63.4	63.2
Pre-tax return on equity – before exceptional items (%)	**36.7**	41.3	32.3	25.2	15.9
– after exceptional items (%)	**42.2**	36.1	32.3	25.2	15.9
Total assets (£m)	**9,565**	8,854	6,148	5,752	3,435
Shareholders' funds (£m)	**575**	522	337	314	203
Employees at 30th September	**4,910**	4,580	3,160	3,150	2,100

The record profit of £189 million at Citizens was 12% or £21 million up on the prior year, reflecting an excellent underlying performance and the impact of recent acquisitions. In dollar terms, Citizens' profit increased by 19% to US$308 million.

During the year, Citizens completed the acquisitions of Farmers and Mechanics Bank (Connecticut) for US$53 million in November 1996, Grove Bank (Massachusetts) for US$87 million in March 1997 and Bank of New Haven (Connecticut) for US$57 million in August 1997. Citizens also completed the sale of its third party mortgage servicing business and realised an exceptional gain of US$45 million (£28 million) in January 1997.

Citizens' results in 1996 benefited by £32 million from one-time investment gains of £15 million and releases from provisions of £17 million. In comparing 1996 and 1997, these items, together with the 6% exchange rate movement, offset, to a major extent, the benefit to 1997 of the first full year of Citizens Bank New Hampshire ("CBNH").

The acquisition of CBNH in April 1996 was accounted for by the acquisition method of accounting and the contribution to Group operating profit made by CBNH in the year to 30th September 1997 was approximately £55 million (US$90 million) and in the year to 30th September 1996 it was approximately £13 million (US$20 million), excluding restructuring costs.

Net interest income grew by 26% to £352 million. Improved volumes and margins contributed £21 million to the increase whilst £55 million was due to CBNH and £8 million due to new acquisitions made in the year.

Other operating income increased by 11% to £98 million. Acquisitions and CBNH contributed £2 million and £19 million respectively to the increase. Other operating income in the existing Citizens' business grew by £6 million which included the impact of a reduction of £12 million due to the sale of the mortgage servicing business.

Expenses were 21% or £43 million higher than the prior year. This was due to the new acquisitions (£18 million) and the full year impact of CBNH (£37 million), offset by other cost savings.

Central items

The Centre's deficit for the year ended 30th September 1997 was as follows:

	1997 £m	1996 £m
Central expenses	**(16)**	(7)
Funding costs	**(30)**	(27)
Associated company – CC-Holding GmbH	**—**	9
Deficit before exceptional items	**(46)**	(25)

The Centre's balance sheet at 30th September was as follows:

	1997	1996
Book value of investments in the ordinary equity of business units:		
UK Bank	**1,738**	1,419
Investor Services	**48**	5
New Retail Financial Services Businesses	**55**	42
Direct Line Insurance	**343**	326
Citizens (net of minority interests and goodwill)	**440**	399
Banco Santander	**180**	180
	2,804	2,371
Funded by:		
Subordinated liabilities	**2,550**	2,250
Less: lent to the UK Bank	**(2,207)**	(1,920)
	343	330
Preference shares	**734**	639
Less: invested in the UK Bank	**(581)**	(469)
	153	170
Net borrowing	**496**	500
Ordinary shareholders' funds	**2,308**	1,871
	2,804	2,371

Five-year financial summary	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Deficit before provisions	**(46)**	(27)	(8)	(2)	(18)
Net releases/(provisions)	**—**	2	1	(8)	(3)
Deficit before exceptional items	**(46)**	(25)	(7)	(10)	(21)
Investments in the equity of business units	**2,804**	2,371	2,117	1,846	1,651
Funding – subordinated liabilities*	**343**	330	394	333	215
– preference shares*	**153**	170	185	133	141
– ordinary shareholders' funds	**2,308**	1,871	1,538	1,380	1,295
Employees at 30th September	**50**	50	50	50	50

(*net of lending to the UK Bank)

Investment in Banco Santander As at 30th September 1997, the total cost of the Group's 4.9% shareholding in Banco Santander was £180 million and the market value was £480 million, giving an unrealised pre-tax gain of £300 million (1996 – £46 million).

Future development of the business The Group's principal objective is to create value for shareholders. It seeks to achieve this by allocating capital to develop established businesses and to create new businesses and through acquisitions, disposals and joint ventures.

In the UK Bank, there is a clear separation between corporate and retail banking, and activities are divided into customer facing businesses. Corporate and Institutional Banking covers all corporate and commercial customers throughout the UK and Retail Banking focuses entirely on small businesses and personal customers. Jobs have been re-defined throughout the UK Bank and each area now has the appropriate structure, products, people and skills, culture and incentives to enable it to meet the needs of its customers. This provides a solid base for further growth. It also provides the UK Bank with opportunities for broader product growth across the UK population and through different brands using low cost distribution channels.

Retail Banking has a wide product range and an excellent reputation for customer service. It will expand its business both through its branch network and, where the network is limited, by other distribution channels such as telephone, mail and, as demand grows, the Internet. Having completed a comprehensive programme for change, Retail Banking is in a position to extend its customer base and to develop opportunities to cross-sell products such as mortgages, credit cards and life insurance. The joint ventures, RBS Advanta, Tesco Personal Finance and Virgin Direct Personal Financial Services will also extend the Bank's multi-brand, multiple channel strategy. When completed, the proposed acquisition of Birmingham Midshires will provide yet another retail brand and channel. Offshore, The Royal Bank of Scotland International will continue to develop new added-value products and services by working closely with the onshore businesses within the Group.

To develop its business, Corporate and Institutional Banking will build on its relationship management culture. It will seek to continue to grow customer numbers and to deepen its relationships with them by offering a product range and infrastructure expected from a successful corporate bank. The Bank has already achieved lead or important bank status with many corporate customers. Opportunities exist for growing the Bank's existing businesses and expanding its franchise in the mid-corporate and commercial sectors. Europe and new product development will also provide growth opportunities.

Although Investor Services is outside the core of the Bank's operations it has strong links with Corporate and Institutional Banking through common customers. RBS Trust Bank is merging the Bank's Global Custody business with that of S.G. Warburg and this will achieve significant cost savings and provide further development opportunities to create value for shareholders.

The Group remains confident about the prospects for Direct Line Insurance. It is cost efficient and has an expense ratio of 18% (expenses divided by gross written premiums) which is half that of many of its competitors and over time it will benefit as motor insurance premiums rise. New repair centres opened by Direct Line Accident Management will further reduce claims costs and improve customer service. The Group's growing customer base will also provide opportunities to expand the home insurance business. Direct Line Financial Services and Direct Line Life and Unit Trusts have already demonstrated their ability to sell a wider product range by telephone. They will seek to develop the brand name, to build loyalty and to establish Direct Line as a supplier of a broad range of financial services.

In five years, Citizens has completed 12 acquisitions and has grown from total assets of US$4 billion to US$16 billion. The customer base has increased from 0.4 million to 1.1 million. It has a strong local franchise in the New England states and it will build on its community bank status and focus on personal and small business customers. It will also continue to participate in the rationalisation that is taking place in US banking as this process provides further opportunities for acquisitions.

Investment for the future The Group allocates capital to its various businesses to create value for shareholders. Investment is made to grow the customer base and to improve the product range available through multiple distribution channels. In assessing the extent to which this investment has been successful in creating value, the Group uses a variety of performance indicators. The Group evaluates performance by various measures such as economic value added, discounted cash flows, return on equity, cost:income ratios and return on risk weighted assets.

Before investing in new businesses the Group considers strategic issues, competitive advantage and the availability of the necessary skills and resources. In the year ended 30th September 1997, the Group invested £43 million of capital in new businesses such as RBS Advanta, Direct Line Financial Services, Direct Line Life Insurance, Direct Line Unit Trusts,Tesco Personal Finance and RBS Scottish Widows Cards. In addition, there were start-up costs of £35 million (1996 – £43 million) but the Group expects these losses to be followed by increasing profits. To estimate the value created, standard discounted cash flow models are used and the results are checked by comparing them with current market values of comparable businesses.

Capital expenditure on premises, computers and other equipment for the year ended 30th September 1997 was £240 million (1996 – £161 million). This investment in the infrastructure will continue as the refurbishment of premises progresses and new technology systems and new businesses are put in place. Contracts entered into for future capital expenditure but not provided for in the accounts for the year ended 30th September 1997 amounted to £19 million (1996 – £17 million) and the directors have authorised a further £88 million (1996 – £69 million) for future capital expenditure which is not yet subject to agreed contracts.

Shareholder value The Group's profits have again improved to record levels and the increased dividend is comfortably covered at 2.6 times.

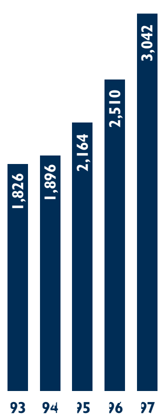
Shareholders' funds at 30th September 1997 were £3,042 million (1996 – £2,510 million). The principal elements in the movement on shareholders' funds during the year were the retained profit of £278 million and the net proceeds of £361 million from the issues and redemptions of ordinary and preference share capital.

Earnings per share increased by 3% to 55.4p. The adjusted earnings per share, which excludes exceptional items, increased by 15% from 46.4p to 53.5p. The return on ordinary shareholders' equity (excluding the share premium account for dollar preference shares) continues to be high at 33.2% pre-tax and 22.6% post-tax.

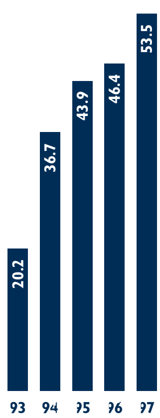
The Group will endeavour to maintain its dividend and to seek to increase it annually, taking into account the annual increase in adjusted earnings per share and the future needs of, and prospects for, the business. Normally, it will seek to pay an interim dividend equal to one third of the preceding year's total dividend.

Market perception of the Group's performance is reflected in the higher share price of 690p at 30th September 1997 (1996 – 489p).

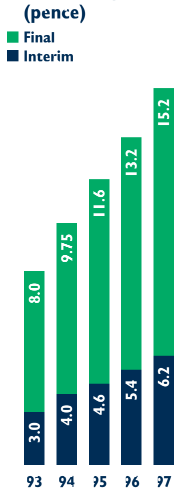
Shareholders' funds (£m)



Adjusted earnings per share (before exceptional items) (pence)



Dividends per ordinary share (pence)

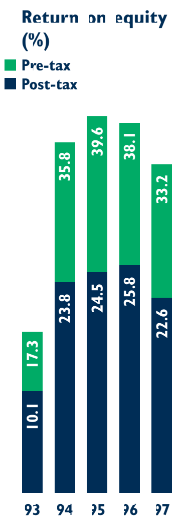


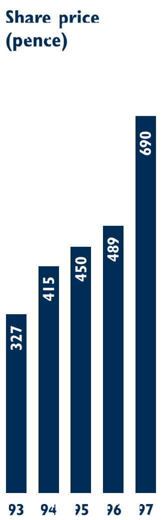
2 Financial Review

Capital resources The following table analyses the Group's capital resources at 30th September for each of the last five years, in accordance with supervisory requirements:

	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Capital base					
Tier 1 capital	**3,107**	2,539	2,092	1,857	1,791
Tier 2 capital	**2,699**	2,388	1,929	1,757	1,576
Total capital	**5,806**	4,927	4,021	3,614	3,367
Less investments in insurance subsidiaries, associated undertakings and other supervisory deductions	**(489)**	(812)	(596)	(534)	(203)
Capital base	**5,317**	4,115	3,425	3,080	3,164
Weighted risk assets					
On-balance sheet	**41,750**	34,367	30,082	25,909	23,167
Off-balance sheet	**4,066**	3,114	3,230	3,011	2,744
	45,816	37,481	33,312	28,920	25,911
Risk asset ratio	%	%	%	%	%
– Tier 1	**6.8**	6.8	6.3	6.4	6.9
– Total	**11.6**	11.0	10.3	10.6	12.2

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, a guiding factor is the supervisory requirements of the Bank of England which applies a risk asset ratio as the principal measure of capital adequacy in the UK banking sector. This ratio compares a bank's capital, which is divided into tiers, with its assets and off-balance sheet exposures weighted according to broad categories of relative credit risk. An internationally agreed minimum risk asset ratio of 8% and a minimum tier 1 ratio of 4% are the base standards from which the Bank of England sets individual ratios reflecting each bank's particular circumstances and in most cases it requires a minimum risk asset ratio in excess of 8%. At 30th September 1997, the Group's risk asset ratio was 11.6% (1996 – 11.0%) and the tier 1 ratio was 6.8% (1996 – 6.8%).





Risk management Through its normal operations, the Group is exposed to a number of risks, the most significant of which are liquidity, market (interest rate and currency risk) and credit risk. Ultimate responsibility for the control of risk within the Group is vested in the Group Risk Strategy Committee (GRSC), a sub committee of the board of directors. The GRSC establishes the overall risk limits to which the Group adheres. The implementation of policy decisions and operational management of strategic decisions is delegated to the Group Risk Management Committee (GRMC) which is composed of the Group's senior executives. The GRSC's responsibilities also include authorising risk measurement methodology.

The principal risks and the manner in which they are managed by the Group are discussed in more detail below.

Liquidity risk Liquidity risk is the risk that the Group is unable to meet payment obligations and potential payment obligations as and when they fall due without incurring unacceptable losses and that term asset commitments cannot be funded on an economic basis over their life. To manage that risk, the Group maintains at all times a diversified stock of high quality liquid assets in the world's principal currencies that can be quickly and discreetly mobilised in extraordinary circumstances.

Group sterling liquidity policy encompasses benchmarks for the components of the liquid asset portfolio. These are subject to regulatory supervision by the Bank of England. The Bank of England requires that the Group should be able to meet its obligations without recourse to the wholesale money market for a period of at least five business days. Sufficient liquid assets must therefore be held in amount equal to at least 100% of the potential net outflows of wholesale funds maturing within five working days, plus 5% of the gross retail deposit base. The Bank of England requires the Group to measure and manage this on a daily basis in addition to maintaining monthly reporting on liquidity. For currencies other than sterling, the Bank of England monitors the Group's liquidity position through a series of periodic returns covering non-sterling balances and their maturities.

The Group's banking businesses require a stable flow of funds both to replace existing deposits as they mature and to satisfy demands of customers for additional borrowing. Undrawn borrowing facility commitments and the level of outstanding contingent obligations arising from financial instruments with off-balance sheet risk are taken into consideration in monitoring the Group's liquidity position. The overall objective is to raise deposits at the lowest possible cost while ensuring that maturity mismatches between lending and funding are managed within prudent risk policy limits set by the GRSC. These limits are designed to provide a balance between the risk of reliance solely on short-term deposits to fund longer term assets versus the additional cost of raising long-term funds. In addition to long-term liabilities arising from the Group's capital issues and the significant long-term stability provided by the Group's retail deposit bases, the Group raises longer term funds through its euro medium term note (EMTN) programme. At 30th September 1997, the Group had raised £1.3 billion of term funds through EMTN issue. Close control is exercised over the pricing, volume and quality of short-term deposits with sources and maturities being managed to avoid concentration of funding requirements at any one time from any one source. Of crucial importance is the maintenance of depositors' confidence in the Group, in both the wholesale and retail markets, to ensure the ready availability of funds at competitive market rates. The widespread customer base of the Group, together with the geographic spread of its branches in the UK, have ensured that its retail deposit base has a core stability and is widely dispersed.

In the wholesale markets, the Group has a significant involvement in both the London and New York markets. This involvement and the underlying strength of the Group's earnings and balance sheet are important factors in ensuring the continued availability of wholesale deposits to the Group at competitive market rates.

All cash flows resulting from derivative transactions (netted where appropriate) are incorporated into the daily liquidity management process which ensures that the Group can meet its cash flow obligations as they arise.

During the year ended 30th September 1997, there was an increase in cash of £1,066 million. The major contributory factors to this increase were net cash inflows of £2,338 million from operating activities and £716 million from financing activities. These inflows were offset by net cash outflows of £1,461 million arising from capital expenditure and investment activities, £255 million from servicing of finance and £150 million taxation paid. At 30th September 1997, the ratio of cash to total assets was 7.1% (1996 – 6.7%).

Market risk Market risk is the risk of adverse movements in the level of interest rates, in the rate of exchange between currencies, the price of securities and other financial contracts including derivatives. Accordingly, these movements may affect the Group's profitability. Market risk is actively managed at an individual business unit level and is monitored and reviewed at an individual business and Group level by an independent Group Risk Management (GRM) function to ensure compliance with market risk limits. The market risk exposure arising within the trading function is reported daily. Excesses arising over the Group's approved market risk limit structure are referred to senior management and if material to the Director, Group Risk Management. The main elements of the Group's market risk are interest rate risk and currency risk and they are described in greater detail below.

Interest rate risk Interest rate risk is the Group's exposure to adverse movements in interest rates. It arises as a result of timing differences on the repricing of assets and liabilities, unexpected changes in the slope and shape of yield curves and changes in correlation of interest rates between different financial instruments (often referred to as basis risk). In addition to interest rate risk positions managed within controlled risk limits in the authorised trading units within the Group, structural interest rate risk arises in the Group's consolidated balance sheet, particularly in relation to the deployment and funding of non-interest bearing, fixed rate and managed variable rate assets and liabilities. Exposure to interest rate movements arises when there is a mismatch between rate sensitive assets and liabilities.

The Group closely monitors interest rate movements, the interest rate and repricing maturity structure of its interest bearing assets and liabilities and the level of non-interest bearing assets and liabilities. In order to reduce the effect of fluctuating interest rates on net interest income, the composition of interest rate risk in each Group company and division is assessed and hedged via interest rate swaps or other derivative transactions either through local treasury units or via the central Group Treasury function.

Currency risk Currency risk is the risk of adverse movements in the rate of exchange between currencies. The Group is an active participant in global foreign exchange markets. The most significant currencies in which the Group has transactions are US Dollars and major European currencies. Exposure to exchange rate movements is managed by ensuring that mismatches are monitored constantly by treasury officials and dealers in relation to established limits (except where deviations from limits are expressly sanctioned by senior management). Each dealing operation has established open position limits. Within these constraints, profit opportunities are exploited wherever possible.

Structural currency risk exposure arises primarily out of the Group's investments in overseas branches, subsidiaries and other foreign currency investments. Where appropriate, these investments are hedged to minimise exposure.

Commodity and equity risk Commodity and equity risk is the risk of adverse movements in the value of commodities and equities or related indices. The Group does not have any material exposure to either of these risks other than its holdings of equity shares as shown in Note 19 on the accounts. At 30th September 1997, equity shares held as investment securities had a book value of £407 million (1996 – £398 million) and a valuation of £826 million (1996 – £512 million).

Measuring market risk A variety of techniques are used to measure market risk including value at risk methodology (VAR), analysis of interest rate sensitivity and the application of multipliers to the nominal amounts of instruments according to the nature of the instrument.

Value at risk The Group has developed a VAR methodology for quantifying exposure, expressed in sterling. The instruments covered by the VAR include all money market products, foreign exchange products, securities and derivatives within the Group's trading units. The VAR methodology uses one year's underlying data to estimate the effect of adverse movements in market rates on the Group's trading portfolios over a one day holding period. The methodology assumes a normal distribution of changes in market rates and a confidence level of 97.5%. Correlations between movements in market rates are taken into account with the exception of volatility inputs for option positions. Optionality is dealt with using scenario analysis by identifying the greatest loss arising on varying both the price and volatility of the underlying instrument. Risk of changes in credit spreads for positions in corporate securities is controlled using limits on the sensitivity of the fair value of the positions to changes in the credit spreads. In common with other VAR methodologies, known limitations include the fact that changes in market rates may not tend to a normal distribution, especially over short periods and ultimately the models are based on past movements and may not be indicative of future market conditions, irrespective of the historical time period selected. Consequently, the Group has a research and development programme to refine the techniques used to quantify market risk. This includes the use of historical simulations and stress testing with specified scenarios.

The following table shows details of the VAR and daily revenues analysed into market risk related (including trading) and trading activities:

VAR	**As at 30th September 1997 £m**	As at 30th September 1996 £m	**Average for the period to 30th September 1997 £m**	Average for the period to 30th September 1996 £m
Market risk related	**3.0**	2.3	**2.4**	2.2
Trading	**1.5**	1.1	**1.5**	1.0

Daily revenues	**Average for the period to 30th September 1997 £m**	Average for the period to 30th September 1996 £m	**Standard deviation for the period to 30th September 1997 £m**	Standard deviation for the period to 30th September 1996 £m
Market risk related	**0.4**	0.2	**0.3**	0.2
Trading	**0.1**	0.1	**0.2**	0.2

Over the year, there was no significant change in the VAR and in the primary market risks to which the Group is exposed.

Interest rate sensitivity Management of interest rate sensitivity is carried out individually by the treasury units of the Bank, Citizens and other Group companies. The following table shows management's estimate of the interest rate sensitivity gap for the Group as at 30th September 1997, for both the trading and non-trading portfolios. Contractual repricing terms are shown. This does not reflect the potential impact of early repayment or withdrawal. Transactions without defined contractual repricing terms are shown according to management's expectations. The table is a consolidated view of trading and non-trading, it therefore includes positions that are included in the VAR disclosures above. Positions may not be reflective of those in subsequent periods. Major changes in position can be, and are, made promptly as market outlook changes. In addition, significant variations in interest rate sensitivity may exist within the repricing periods presented and among the currencies in which the Group has interest rate positions.

	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non-interest bearing funds £m	Total £m
Assets							
Loans to banks	11,168	1,175	780	663	—	305	14,091
Loans to customers	26,259	2,109	1,807	3,370	4,208	853	38,606
Treasury bills and other eligible bills	594	32	3	—	—	—	629
Debt securities	4,061	477	353	2,574	2,459	1	9,925
Interest earning assets	42,082	3,793	2,943	6,607	6,667	1,159	63,251
Non-interest earning assets	—	—	—	—	—	9,350	9,350
Total assets	42,082	3,793	2,943	6,607	6,667	10,509	72,601
Liabilities							
Deposits by banks	4,168	865	307	2	—	53	5,395
Customer accounts	33,591	1,612	1,647	4,517	92	6,123	47,582
Debt securities in issue	4,156	258	138	83	28	334	4,997
Loan capital	688	266	25	—	1,571	—	2,550
Interest bearing liabilities	42,603	3,001	2,117	4,602	1,691	6,510	60,524
Interest free liabilities	—	—	—	—	—	9,035	9,035
Shareholders' equity	—	—	—	—	—	3,042	3,042
Total liabilities	42,603	3,001	2,117	4,602	1,691	18,587	72,601
Off-balance sheet items affecting interest rate sensitivity	(602)	1,456	(942)	(15)	103	—	—
	42,001	4,457	1,175	4,587	1,794	18,587	72,601
Interest rate sensitivity gap	81	(664)	1,768	2,020	4,873	(8,078)	—
Cumulative interest rate sensitivity gap	81	(583)	1,185	3,205	8,078	—	—
Cumulative interest rate sensitivity gap as a percentage of interest earning assets	0.1%	(0.9%)	1.9%	5.1%	12.8%	—	—

As at 30th September 1997, the change in projected non-trading annual net interest income of a uniform plus or minus 1% change in market rates along the yield curves was considered to be immaterial.

Credit risk Credit risk is the risk of default by counterparties to transactions. The management of specific credit risk is devolved to individual business units. GRM checks that appropriate policies are established and ensures compliance with the related credit sanction monitoring procedures and controls at the business unit level. Credit exposures are also aggregated from individual business units and are monitored on a regular basis by the GRM function. Portfolio monitoring is carried out by asset quality (credit grade), sector and country (for significant country concentrations – the UK and USA – by region). As in other parts of the Group's businesses, a programme of regular audits is followed by Group Internal Audit staff complemented by the risk review unit within GRM. In order to monitor and manage the credit risk arising from foreign exchange and interest rate derivative activities more accurately, the Group has adopted and implemented a "mark to market plus add-on" approach to calculating credit exposure amounts for such activities. While the positive mark to market value represents the current credit risk, the add-on amount resulting from the product of the nominal amount and the appropriate percentage, weighted according to the period to maturity, allows for the effect of potentially increased exposure due to future rate movements.

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 hedge or modify risk exposure arising on the balance sheet from a variety of activities including lending and securities investment. They are also used to actively take, hedge and modify positions as part of trading activities and to provide financial services to customers. The majority of the counterparties in the Group's derivative transactions are banks and other financial institutions. The risks involved in derivatives include market, credit and liquidity risk. These are discussed within the Risk management section above. Analyses of the derivatives entered into by the Group both for trading and non-trading purposes are provided in Note 38 on the accounts. The principal types of derivative contracts into which the Group enters are described below.

Swaps Swaps 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, equity 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. 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 swaps exchange interest for the return on an equity or equity index.

Options Options confer the right on the buyer, but not the obligation, 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 A future or forward is an agreement 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 currency as forward foreign exchange contracts.

Five-year financial summary

	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
Profit from continuing businesses before provisions	**916**	758	716	688	566
Provisions	**(146)**	(113)	(112)	(182)	(293)
Investment write-offs	**(2)**	(1)	(2)	(5)	—
Profit from continuing businesses before exceptional items	**768**	644	602	501	273
Year 2000 costs	**(29)**	—	—	—	—
Write-down of finance leases	**(41)**	—	—	—	—
Director's contract variation payment	**—**	—	—	(21)	—
Restructuring costs – Citizens Bank New Hampshire	**—**	(21)	—	—	—
Profit from discontinued businesses	**—**	—	—	—	20
Group operating profit	**698**	623	602	480	293
Profit on sale of mortgage servicing business	**28**	—	—	—	—
Profit on sale of fixed asset investment	**34**	—	—	—	—
Profit on sales of investments in associated undertakings	**—**	72	—	52	—
Loss on sale of Charterhouse	**—**	—	—	—	(35)
Profit on ordinary activities before taxation	**760***	695	602	532	258
Tax on profit on ordinary activities	**(219)**	(191)	(202)	(146)	(80)
Profit on ordinary activities after taxation	**541**	504	400	386	178

(*£801 million before write-down of finance leases)

	1997	1996	1995	1994	1993
Earnings per 25p ordinary share					
before exceptional items	**53.5p**	46.4p	43.9p	36.7p	20.2p
after exceptional items	**55.4p**	54.0p	43.9p	41.4p	15.8p
Dividends per 25p ordinary share	**21.4p**	18.6p	16.2p	13.75p	11.0p
Dividend cover (times)	**2.6**	2.9	2.7	3.0	1.4
Cost: income ratio – Group	**52.5%**	50.0%	51.7%	53.2%	55.8%
– UK Bank	**56.6%**	58.1%	63.1%	62.7%	60.8%
Return on ordinary shareholders' equity – pre-tax	**33.2%**	38.1%	39.6%	35.8%	17.3%
(including exceptional items) – post-tax	**22.6%**	25.8%	24.5%	23.8%	10.1%
Net asset value per 25p ordinary share	**268p**	229p	192p	174p	170p
Share price at 30th September	**690p**	489p	450p	415p	327p
Average base rate	**6.3%**	6.2%	6.5%	5.4%	6.5%
Interest spread	**2.0%**	2.0%	2.1%	2.2%	2.1%
Interest margin	**2.5%**	2.5%	2.6%	2.7%	2.6%

	£m	£m	£m	£m	£m
Shareholders' funds	**3,042**	2,510	2,164	1,896	1,826
Minority interests	**190**	150	19	16	19
Dated loan capital	**1,383**	1,241	1,075	929	867
Undated loan capital	**1,167**	1,009	714	729	638
Capital resources	**5,782**	4,910	3,972	3,570	3,350

	£bn	£bn	£bn	£bn	£bn
Customer accounts – deposits	**47.6**	38.1	32.7	29.5	25.9
Loans and advances to customers	**38.6**	33.4	29.2	25.9	22.7
Total assets	**72.6**	61.1	51.2	45.3	37.4

Bank branches	**959**	930	849	891	845
Other branches	**67**	53	69	112	112
Number of employees at 30th September – Group	**30,900**	27,200	25,870	26,150	23,299
– UK Bank	**19,060**	17,950	18,420	19,350	18,530

Statement of directors' responsibilities

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that these financial statements comply with the aforementioned requirements.

By order of the board.

M. R. McLean
Secretary
Edinburgh
27th November 1997

Report of the auditors

To the members of The Royal Bank of Scotland Group plc We have audited the financial statements on pages 31 to 71.

Respective responsibilities of directors and auditors As described above the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

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

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

Opinion In our opinion the financial statements give a true and fair view of the state of affairs of the company and the Group at 30th September 1997 and of the profit, total recognised gains and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
Edinburgh
27th November 1997

Accounting policies

The accounts have been prepared in accordance with applicable Accounting Standards in the UK and the Statements of Recommended Accounting Practice issued jointly by the British Bankers' Association and the Irish Bankers' Federation. 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 relating to banking groups. The accounts of the company are prepared in accordance with section 226 of, and Schedule 4 to, the Companies Act 1985. As provided by section 230(3) of the Companies Act 1985, no profit and loss account is presented for the company.

1 **Accounting convention and bases of consolidation** The accounts are prepared under the historical cost convention modified by the periodic valuations of premises and certain investments. The consolidated accounts deal with the accounts of the Group made up to 30th September. In accounting for subsidiaries, the Group consolidates fully their assets, liabilities and results for the year and shows separately the interests of minority shareholders therein. All inter-company balances and transactions are eliminated from the consolidated statements.

2 **Goodwill** Goodwill arising on acquisitions of subsidiaries and associates, being the excess of cost over fair value of the Group's share of net tangible assets acquired, is charged against profit and loss account reserves in the year of acquisition and is written back and included in the calculation of the profit or loss on any disposal.

3 **Rates of exchange** The balance sheets of overseas branches and subsidiaries are translated into sterling at the rates of exchange ruling at 30th September and their profit and loss accounts are translated at the average rates of exchange for the year to 30th September. Exchange differences relating to trading are dealt with in the profit and loss account; those arising from the application of closing rates of exchange to the opening net assets are taken to profit and loss account reserves. At 30th September 1997, the principal rate of exchange for foreign currency translations was US$1.6148=£1 (1996 – US$1.5649=£1). The principal average rate of exchange for foreign currency translations for the year to 30th September 1997 was US$1.6327=£1 (1996 – US$1.5426=£1).

4 **Pensions and other post-retirement benefits** In arriving at the operating profit, the costs of providing pensions are assessed and charged on a regular basis in accordance with the advice of independent professionally qualified actuaries. The Group provides post-retirement benefits in the form of health care plans to eligible employees and the cost of providing these benefits is assessed by independent professionally qualified actuaries and is recognised on a systematic basis over employees' service lives.

5 **Lease income receivable** Total gross earnings under finance leases are recognised according to the actuarial after tax method whereby pre-tax and post-tax profits are allocated to accounting periods 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. Progress payments made prior to the commencement of the lease are included at cost.

6 **Insurance business** In calculating operating profit from general insurance activities, premiums are recognised in the accounting period in which they begin. Unearned premiums represent the proportion of the premiums which relate to periods of insurance after the balance sheet date and are calculated on a daily or 24th's basis. Provision is made where necessary for the estimated amount required over and above unearned premiums to meet future claims and related expenses and is calculated by class 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 motor and household policies are deferred over the period during which the premiums are earned, generally twelve months. The principal acquisition costs so deferred are direct advertising expenditure and costs associated with the telesales and underwriting staff. Claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost 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.

7 Value of long-term life assurance business A value is placed on the Group's long-term life assurance and in-force pensions policies written by Royal Scottish Assurance plc. The value is a prudent estimate of the net present value of the profits inherent in such policies and is determined annually in consultation with an independent actuary. Changes in the value are included in operating profit, grossed up at the underlying rate of taxation.

8 Taxation Provision is made for taxation at current rates on the taxable profits and relief for overseas taxation is taken where appropriate. Certain items of income and expenditure are accounted for in different periods for financial reporting purposes and for taxation purposes. Deferred taxation is provided on the liability method in respect of timing differences to the extent that they are likely to crystallise in the foreseeable future.

9 Provisions for bad and doubtful debts Specific provisions are made against loans and advances when, as a result of a detailed appraisal of the portfolio, it is considered that recovery is doubtful. A general provision is made against loans and advances to cover bad and doubtful debts which have not been separately identified but are known from experience to be present in any portfolio of bank advances. The specific and general provisions are deducted from loans and advances. Provisions made during the year (less amounts released and recoveries of amounts written off in previous years) are charged against profits. Interest receivable on doubtful loans and advances is brought into the profit and loss account as it accrues provided that its collectibility is not subject to significant doubt. Interest debited to borrowers' accounts, the collectibility of which is subject to significant doubt, is credited to an interest in suspense account. Loans and advances classified as bad debts are written off in part or in whole when there is no realistic prospect of recovery.

10 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 any such amortisation is included in interest receivable. Debt securities held for the purpose of hedging are carried at a value which reflects the accounting treatment of the items hedged. Debt securities and equity shares held for dealing purposes are included in the consolidated balance sheet at market value.

11 Shares in subsidiary undertaking The company's shares in the Bank are stated in the balance sheet of the company at a directors' valuation which reflects the Bank's net asset value.

12 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 investing company's share of their net tangible assets. The investing company'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.

13 Tangible fixed assets Freehold and long leasehold premises are maintained in a state of good repair with regular maintenance expenditure being charged against operating profit. Depreciation is not charged on freehold and long leasehold premises as any such charge is considered to be insignificant in view of their useful economic lives and estimated residual values. The costs of adapting premises for the use of the Group are separately identified and depreciated on a straight-line basis over fifteen years. Short leasehold premises are amortised by equal annual instalments over the unexpired term of the lease. Valuations of premises are carried out annually by the Bank's internal professional surveyors and in some instances by independent valuers. Any increase or deficit on revaluation is reflected in the carrying value of premises at that time. Any permanent diminution in the value of premises is charged to the profit and loss account after eliminating previous revaluation surpluses arising on the premises. Any profit from the sale of revalued premises is calculated by deducting the revalued amount from the net proceeds. Computers are depreciated on a straight-line basis over five years and other equipment over periods between four and fifteen years.

14 Derivatives A description of the derivatives into which the Group enters for both trading and non-trading purposes is given on page 28 in the Operating and Financial Review. The accounting treatment for these instruments is dependent upon whether they are entered into for trading or non-trading (hedging) purposes.

Trading Trading derivatives are those actively traded or held under constant review of both their realisable value and potential future return. Trading transactions are recognised in the financial statements at fair value. The resultant gains or losses arising from changes in the fair value are shown under dealing profits in the consolidated profit and loss account and are included within net cash inflow from operating activities in the cash flow statement. Assets, including the gains arising from transactions in these instruments, are shown under other assets in the consolidated balance sheet. Liabilities, including losses arising from transactions in these instruments, are shown under other liabilities in the consolidated balance sheet. For many derivative instruments, fair value is determined by market prices. Where representative market prices are not available, the fair value is calculated by applying current market information to pricing or valuation models. Fair value includes, where appropriate, adjustments or income deferrals for items such as credit risk, liquidity risk and future operational costs.

Non-trading Non-trading derivatives are entered into by the Group to close out or reduce (hedge) the market risk arising on the transactions entered into in the normal course of banking activities.

Non-trading transactions entered into for hedging purposes are recognised in the financial statements in accordance with the accounting treatment of the underlying transaction or transactions being hedged. They are therefore recognised as adjustments to the income and expenditure, balance or cash flow of the transaction or transactions being hedged. To the extent necessary to achieve a common timing of income recognition on the transaction or transactions being hedged, deferred gains and losses are included in the consolidated balance sheet under accruals and deferred income and prepayments and accrued income respectively.

A non-trading derivative hedge transaction must significantly reduce the market risk arising on the underlying transaction, transactions, or part thereof, to be classified as a hedge. Also, in order for a non-trading derivative transaction to be accounted for as a hedge, it must have a demonstrable link to an individual underlying transaction, pool of underlying transactions or specific future transactions. Specified future transactions must have a reasonable degree of certainty of arising in order 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 fair valued and the resulting profit or loss is amortised over the remaining life of the underlying transaction or transactions being hedged. If the accumulation of the fair valuation of the derivative and the expected future revenues of the underlying transaction result in a net loss, that loss will be recognised immediately. In the case of hedges of specific future transactions, if it is determined that the anticipated transactions are no longer likely to occur, the hedge is fair valued and any resultant profits or losses recognised immediately. Where the underlying item being hedged is removed, any profits or losses arising on the hedge will be recognised on the same basis as the profits or losses arising on the removed underlying transaction.

Material deferred gains or losses arising on hedges of specific future transactions or as a result of the termination of hedges are disclosed in Note 38 on the accounts.

15 Restatement of prior year figures Changes in the presentation of the cash flow statement and related Notes on the accounts have been made as a result of adopting Financial Reporting Standard No.1 (Revised 1996) "Cash Flow Statements". Comparative figures for the year ended 30th September 1996 have been restated where appropriate.

Consolidated profit and loss account

for the year ended 30th September 1997

	Note	1997 Before exceptional items £m	1997 Exceptional items £m	1997 Total £m	1996 Total £m
Interest receivable	1				
– interest receivable and similar income arising from debt securities		**558**	**—**	**558**	438
– other interest receivable and similar income		**3,567**	**—**	**3,567**	3,089
Interest payable	2	**(2,711)**	**—**	**(2,711)**	(2,325)
Net interest income		**1,414**	**—**	**1,414**	1,202
Dividend income from equity shares		**24**	**—**	**24**	22
Fees and commissions receivable		**809**	**—**	**809**	686
Fees and commissions payable		**(76)**	**—**	**(76)**	(70)
Dealing profits (see note below)		**117**	**—**	**117**	110
Other income		**129**	**—**	**129**	79
		1,003	**—**	**1,003**	827
General insurance – earned premiums		**658**	**—**	**658**	656
– reinsurance		**(123)**	**—**	**(123)**	(45)
Non-interest income		**1,538**	**—**	**1,538**	1,438
Total income		**2,952**	**—**	**2,952**	2,640
Administrative expenses					
– staff costs	3	**794**	**—**	**794**	678
– staff profit share		**36**	**—**	**36**	31
– premises and equipment		**227**	**—**	**227**	197
– other		**385**	**—**	**385**	319
Depreciation and amortisation	24	**107**	**—**	**107**	95
Year 2000 costs	6	**—**	**29**	**29**	—
Restructuring costs – Citizens Bank New Hampshire*		**—**	**—**	**—**	21
Operating expenses		**1,549**	**29**	**1,578**	1,341
Profit before other operating charges		**1,403**	**(29)**	**1,374**	1,299
General insurance – gross claims		**582**	**—**	**582**	593
– reinsurance		**(95)**	**—**	**(95)**	(31)
Profit before provisions for bad and doubtful debts		**916**	**(29)**	**887**	737
Provisions for bad and doubtful debts	15	**146**	**—**	**146**	113
Amounts written off fixed asset investments		**2**	**—**	**2**	1
Write-down of finance leases	6	**—**	**41**	**41**	—
Group operating profit *(carried forward)*		**768**	**(70)**	**698**	623

Note: dealing profits comprise foreign exchange and arbitrage trading income, profits/losses on sales of debt securities and mark to market adjustments on debt securities held, before charging funding costs and operating expenses of these activities.

*Exceptional item in 1996

	Note	1997 Before exceptional items £m	1997 Exceptional items £m	1997 Total £m	1996 Total £m
Group operating profit *(brought forward)*		**768**	**(70)**	**698**	623
Profit on sale of mortgage servicing business	6	**—**	**28**	**28**	—
Profit on sale of fixed asset investment	6	**—**	**34**	**34**	—
Profit on sale of associated undertaking		**—**	**—**	**—**	72
Profit on ordinary activities before tax	5	**768**	**(8)**	**760**	695
Tax on ordinary activities	7	**(247)**	**28**	**(219)**	(191)
Profit on ordinary activities after tax		**521**	**20**	**541**	504
Minority interests		**(27)**	**(4)**	**(31)**	(8)
Profit after minority interests		**494**	**16**	**510**	496
Preference dividends	8	**53**	**—**	**53**	57
Profit attributable to ordinary shareholders		**441**	**16**	**457**	439
Ordinary dividends	9	**179**	**—**	**179**	154
Retained profit	35	**262**	**16**	**278**	285

	Note	1997	1996
Earnings per 25p ordinary share	11	**55.4p**	54.0p
Adjustments:			
Year 2000 costs		**2.3p**	—
Write-down of finance leases		**1.5p**	—
Profit on sale of mortgage servicing business		**(1.7p)**	—
Profit on sale of fixed asset investment		**(4.0p)**	—
Restructuring costs – Citizens Bank New Hampshire		**—**	1.2p
Profit on sale of associated undertaking		**—**	(8.8p)
Adjusted earnings per 25p ordinary share (see note below)		**53.5p**	46.4p

Note: the adjusted earnings per share figures have been calculated to show the effect of excluding exceptional items.

With the exception of the Group's share of profits of CC-Holding GmbH of £9 million in 1996, all items dealt with in arriving at Group operating profit for 1997 and 1996 relate to continuing operations. The effect of the acquisitions and disposals of subsidiary undertakings during the year ended 30th September 1997 was not material.

The acquisition of First NH Bank (now Citizens Bank New Hampshire) by Citizens in April 1996 was accounted for by the acquisition method of accounting and the contribution to Group operating profit made by Citizens Bank New Hampshire in the year to 30th September 1997 was approximately £55 million (US$90 million) and in the year to 30th September 1996 it was approximately £13 million (US$20 million) before deducting restructuring costs of £21 million (US$32 million).

Consolidated balance sheet

at 30th September 1997

	Note	**1997 £m**	1996 £m
Assets			
Cash and balances at central banks		**1,213**	1,211
Treasury bills and other eligible bills	12	**629**	561
Loans and advances to banks	13	**14,091**	11,981
Items in course of collection due from other banks		**1,070**	1,028
Loans and advances to customers	14	**38,606**	33,446
Debt securities	18	**9,925**	7,392
Equity shares	19	**463**	428
Interests in associated undertakings	20	**52**	63
Tangible fixed assets	24	**1,078**	955
Other assets	25	**4,566**	3,274
Prepayments and accrued income		**908**	777
Total assets		**72,601**	61,116

	Note	1997 £m	1996 £m
Liabilities			
Deposits by banks	26	**5,395**	5,323
Items in course of collection due to other banks		**636**	775
Customer accounts	27	**47,582**	38,087
Debt securities in issue	28	**4,997**	5,553
Other liabilities	29	**6,147**	4,681
Accruals and deferred income		**1,807**	1,547
Provisions for liabilities and charges			
– deferred taxation	30	**190**	195
– pensions and other similar obligations	31	**42**	45
– other provisions	6	**23**	—
Subordinated liabilities			
– dated loan capital	32	**1,383**	1,241
– undated loan capital including convertible debt	33	**1,167**	1,009
Minority interests			
– equity		**178**	150
– non-equity		**12**	—
Called up share capital	34	**216**	205
Share premium account	35	**1,229**	881
Reserves	35	**103**	94
Revaluation reserve	35	**(19)**	(19)
Profit and loss account	35	**1,513**	1,349
Shareholders' funds			
– equity		**2,308**	1,871
– non-equity		**734**	639
Total liabilities		**72,601**	61,116
Memorandum items:			
Contingent liabilities	39		
– acceptances and endorsements		**863**	934
– guarantees and assets pledged as collateral security		**951**	914
– other contingent liabilities		**827**	511
		2,641	2,359
Commitments	39		
– commitments arising out of sale and option to resell transactions		**—**	32
– other commitments (standby facilities, credit lines and other)		**17,133**	14,186
		17,133	14,218

Viscount Younger of Leckie
Chairman

George Mathewson
Group Chief Executive

Robert Speirs
Group Finance Director

Balance sheet – the company

at 30th September 1997

	Note	1997 £m	1996 £m
Fixed assets			
Investments:			
Shares in subsidiary undertaking	22	**3,205**	2,836
Loans to subsidiary undertaking	23	**1,252**	1,077
		4,457	3,913
Current assets			
Debtors:			
Due by subsidiary undertaking		**372**	143
Creditors			
Amounts falling due within one year:			
Deposits by banks		**71**	—
Due to subsidiary undertaking		**2**	—
Creditors		**13**	13
Current taxation		**33**	27
Proposed final dividend	9	**131**	110
		250	150
Net current assets/(liabilities)		**122**	(7)
Assets less liabilities		**4,579**	3,906
Creditors			
Amounts falling due beyond one year:			
Loan from subsidiary undertaking		**80**	—
Dated loan capital	32	**381**	387
Undated loan capital including convertible debt	33	**700**	690
		1,161	1,077
Capital and reserves			
Called up share capital	34	**216**	205
Share premium account	35	**1,229**	881
Reserves	35	**20**	20
Revaluation reserve	35	**1,922**	1,648
Profit and loss account	35	**31**	75
Shareholders' funds			
– equity		**2,684**	2,190
– non-equity		**734**	639
		4,579	3,906

Viscount Younger of Leckie
Chairman

George Mathewson
Group Chief Executive

Robert Speirs
Group Finance Director

Statement of total recognised gains and losses

for the year ended 30th September 1997

	1997 £m	1996 £m
Profit attributable to ordinary shareholders	**457**	439
Currency translation adjustments on foreign currency net investments	**(1)**	(1)
Movements in revaluations of premises	**3**	(8)
Movements in net unrealised gains and losses on debt securities and equity shares	**(3)**	(1)
Total recognised gains and losses	**456**	429

Note of historical cost profits and losses

for the year ended 30th September 1997

	1997 £m	1996 £m
Profit on ordinary activities before tax	**760**	695
Realisation of premises revaluation gains of previous years	**1**	1
Historical cost profit on ordinary activities before tax	**761**	696
Historical cost profit for the year retained after tax, minority interests and dividends	**279**	286

Reconciliation of movements in shareholders' funds

for the year ended 30th September 1997

	1997 £m	1996 £m
Profit attributable to ordinary shareholders	**457**	439
Ordinary dividends	**(179)**	(154)
Retained profit	**278**	285
Other recognised net gains and losses relating to the year	**(1)**	(10)
Currency translation adjustment on share premium account	**(17)**	7
Increase in share capital	**11**	2
Premium arising on issues of shares	**493**	18
Premium arising on redemption of shares	**(132)**	—
Elimination of goodwill on acquisitions	**(58)**	—
Negative goodwill on acquisitions	**—**	17
Write-back of goodwill on disposals	**—**	18
Employee share option payments	**(23)**	—
Tax on unrealised currency translation gains	**(14)**	—
Other movements	**(5)**	9
Net increase in shareholders' funds	**532**	346
Shareholders' funds at 1st October	**2,510**	2,164
Shareholders' funds at 30th September	**3,042**	2,510

Cash flow statement

for the year ended 30th September 1997

	Note	1997 £m	1997 £m	1996 Restated* £m	1996 Restated* £m
Net cash inflow from operating activities	40		**2,338**		3,035
Returns on investments and servicing of finance					
Dividends received from associated undertakings		**1**		4	
Preference dividends paid		**(50)**		(51)	
Interest paid on subordinated liabilities		**(206)**		(177)	
Net cash outflow from returns on investments and servicing of finance			**(255)**		(224)
Taxation			**(150)**		(58)
Capital expenditure and financial investment					
Purchase of investment securities		**(11,594)**		(9,411)	
Sale of investment securities		**10,247**		8,237	
Purchase of tangible fixed assets		**(240)**		(161)	
Sale of tangible fixed assets		**51**		16	
Sale of fixed asset investment	6	**75**		—	
Net cash outflow from capital expenditure and financial investment			**(1,461)**		(1,319)
Acquisitions and disposals					
Purchase of subsidiary undertakings (net of cash acquired)	42	**(127)**		102	
Investment in associated undertakings	20	**(3)**		—	
Sale of subsidiary and associated undertakings	43	**78**		129	
Sale of mortgage servicing business	6	**88**		—	
Net cash inflow from acquisitions and disposals			**36**		231
Ordinary (equity) dividends paid			**(158)**		(137)
Net cash inflow before financing			**350**		1,528
Financing					
Issue of subordinated liabilities (net of expenses)		**368**		503	
Repayments of subordinated liabilities		**(25)**		(27)	
Issue of preference and ordinary share capital (net of expenses)		**505**		20	
Redemption of preference share capital		**(132)**		—	
Net cash inflow from financing	44		**716**		496
Increase in cash	46		**1,066**		2,024

*Prior year figures have been restated – see Accounting policy Note 15 on page 33.

1 Interest receivable

	1997 £m	1996 £m
Treasury bills and other eligible bills	**41**	42
Loans and advances to banks	**722**	560
Loans and advances to customers	**2,534**	2,233
Leasing and hire purchase income	**270**	254
Debt securities	**558**	438
	4,125	3,527

2 Interest payable

	1997 £m	1996 £m
Deposits by banks	**315**	281
Customer accounts		
– demand deposits	**766**	613
– savings deposits	**405**	375
– other time deposits	**671**	576
Debt securities in issue	**344**	294
Subordinated liabilities	**210**	186
	2,711	2,325

3 Administrative expenses – staff costs

	1997 £m	1996 £m
Wages and salaries	**589**	515
Social security costs	**50**	44
Pension costs (see Note 4)	**64**	43
Other staff costs	**91**	76
	794	678

4 Pension costs

The Group operates a number of pension schemes covering the majority of employees. The principal scheme is The Royal Bank of Scotland Staff Pension Scheme (the "Scheme") which is a non-contributory defined benefit scheme. The Scheme is a funded scheme under which future liabilities for benefits are provided for by the accumulation of assets which are held independently from those of the Bank under a separately administered trust. A formal valuation of the Scheme as at 31st December 1996 was carried out by independent professionally qualified actuaries using the projected unit method to determine the level of contributions to be made by the Bank. Following the UK government's budget in July 1997, pension schemes are no longer able to obtain repayment of tax credits attached to UK dividends received by them. As a result, the actuaries have reviewed the methods and assumptions underlying the actuarial valuation of the Scheme and a valuation basis linked to market values has been used to value investments. In previous valuations, the actuaries valued investments as the discounted cash flow value of the expected future income. The principal actuarial assumptions used at 31st December 1996 were as follows:

Valuation rate of interest	8¼%
Salary growth (in addition, allowance is made for promotional salary increases)	6%
Pension increases	4%

At the valuation date, the market value of the assets of the Scheme was £1,350 million and this was sufficient to cover 98% of the value of the benefits that had accrued to members after making allowance for expected future increases in salaries. To eliminate the shortfall of assets over the expected average remaining working lifetimes of the members, the Bank has increased its level of contributions to the Scheme with effect from 1st January 1997. The next formal valuation of the Scheme is due to take place as at 31st December 1999.

4 Pension costs *(continued)*

The pension scheme operated within Direct Line Insurance plc is similarly constituted and an actuarial valuation as at 1st October 1995 showed that the market value of the assets, which are invested in a managed fund, was £7 million. The actuarial value of those assets represented 91% of the benefits that had accrued to members, after allowing for expected future increases in salaries. The deficit is being removed by increased contributions over the average remaining working lifetimes of the members.

The principal overseas schemes, which are sponsored by Citizens, are defined benefit plans and are funded on a current basis in compliance with the requirements of the Employee Retirement Income Security Act in the USA. A pension cost of £2 million in respect of these overseas schemes has been included in expenses for the year to 30th September 1997.

The Group also operates schemes which provide post-retirement benefits, principally contributions to subscriptions for private health care schemes in the UK and the USA. Provision for the costs of these benefits is being charged to the profit and loss account over the average remaining future service lives of the employees eligible for the benefits.

5 Profit on ordinary activities before tax

Group profit on ordinary activities before tax is stated after taking account of the following:		**1997 £m**	1996 £m
Income	Aggregate amounts receivable, including capital repayments, under finance leases, hire purchase and conditional sale contracts	**302**	275
	Increase in value of long-term life assurance business	**18**	20
	Income from listed investments	**369**	298
	Profits less losses on disposals of investment securities	**71**	53
Expenses	Hire of equipment	**57**	42
	Operating lease rentals of premises	**43**	34
	Operating lease rentals of computers and other equipment	**4**	6
	Finance charges on leased assets	**13**	2

Auditors' remuneration

The auditors' remuneration for statutory audit work was £56,500 for the company (1996 – £55,275) and £1.7 million for the Group (1996 – £1.6 million). The auditors' remuneration for non-audit work in the year ended 30th September 1997 was £1.2 million for the Group (1996 – £1.5 million).

6 Exceptional items

On 19th December 1996, Citizens sold US$5.0 billion of its third party mortgage servicing business held by its wholly owned subsidiary Citizens Mortgage Corporation for US$89 million cash and on 27th January 1997 it sold the remaining US$3.8 billion for US$58 million cash. The pre-tax gain of US$45 million (£28 million) has been credited to the consolidated profit and loss account as an exceptional item.

A change in the UK corporation tax rate enacted in the Finance (No 2) Act 1997 affected tax variation clauses in finance lease contracts written by leasing subsidiaries in the Group. This resulted in an exceptional charge of £41 million to Group operating profit compensated in part by a reduction of £28 million in the charge for taxation.

On 15th September 1997, the Group sold its 2% holding in Banco Espanol de Credito, S.A. ("Banesto") for a cash consideration of approximately Ptas 17.9 billion (£75 million) realising an exceptional gain of £34 million.

During the year ended 30th September 1997, the Group has made progress in amending its computer systems to ensure that they are Year 2000 compatible and an exceptional amount of £29 million has been charged to the consolidated profit and loss account for the costs of completing this work. The Group has expended £6 million during the year ended 30th September 1997 and the remaining amount of £23 million is disclosed within provisions for liabilities and charges.

7 Tax on ordinary activities

	1997 £m	1996 £m
Based on the profit for the year:		
UK corporation tax at 32% (1996 – 33%)	**113**	72
Relief for overseas taxation	**(2)**	(27)
Deferred taxation	**19**	109
	130	154
Overseas taxation	**83**	33
	213	187
Prior year items	**5**	(3)
Share of associated undertakings	**1**	7
	219	191

The tax charge of £247 million on profit before exceptional items of £768 million is an effective rate of 32%. There is an overall net credit to tax arising on the exceptional items since the tax payable on the gain on sale of the investment in Banesto has been offset by capital losses brought forward and there is a credit to tax on the write-down of finance lease contracts resulting from the reduction in the corporation tax rate. Tax has been charged on the profit on sale of the Citizens' mortgage servicing business and a credit to tax has been recognised on the Year 2000 costs.

8 Preference dividends

Dividends were paid on the non-cumulative dollar preference shares of 1 cent each on 31st December 1996, 31st March, 30th June and 30th September 1997 as follows:

	1997 £m	1996 £m
Series A at US$0.703125 per share totalling US$1 million (1996 – US$18 million)	**1**	11
Series B at US$0.70 per share totalling US$18 million (1996 – US$18 million)	**11**	11
Series C at US$0.59375 per share totalling US$30 million (1996 – US$30 million)	**18**	20
Series D at US$0.5703125 per share totalling US$13 million (1996 – US$13 million)	**8**	9
Series E at US$0.5625 per share totalling US$14 million	**8**	—
Series F at US$0.53125 per share totalling US$7 million	**4**	—
Appropriation for premium payable on redemption and issue costs	**3**	6
Total dividends on non-equity shares	**53**	57

Cumulative preference shares of £1 each are also in issue and consist of £0.5 million 11% and £0.4 million 5½%. As a result of the introduction of the imputation system of company taxation in the UK in 1973, the rates of dividend on the cumulative preference shares are now 7.7% plus tax credit and 3.85% plus tax credit, respectively. Half-yearly dividends on the cumulative preference shares were paid on 30th May 1997 at a cost of £27,000. The directors have declared the dividends for the half-year ended 30th September 1997 on the cumulative preference shares which will also cost £27,000.

9 Ordinary dividends

	1997 p per share	1996 p per share	1997 £m	1996 £m
Interim	**6.2**	5.4	**48**	44
Proposed final	**15.2**	13.2	**131**	110
Total dividends on equity shares	**21.4**	18.6	**179**	154

10 Profit dealt with in the accounts of the company

Of the profit attributable to ordinary shareholders, £168 million (1996 – £127 million) has been dealt with in the accounts of the company.

11 Earnings per ordinary share

Earnings per ordinary share have been calculated by reference to the weighted average of 824.6 million (1996 – 812.4 million) ordinary shares in issue during the year, profit attributable to ordinary shareholders of £441 million (1996 – £377 million) before the exceptional items, net of taxation and minority interests relating thereto, and profit attributable to ordinary shareholders of £457 million (1996 – £439 million) after the exceptional items. Fully diluted earnings per share are not given as the dilution arising from options granted is not material.

12 Treasury bills and other eligible bills

	1997 £m	1996 £m
Treasury bills and similar securities	**19**	16
Other eligible bills	**610**	545
	629	561

13 Loans and advances to banks

	1997 £m	1996 £m
Repayable on demand	**3,963**	2,899
Remaining maturity		
– three months or less	**8,019**	5,654
– one year or less but over three months	**1,838**	2,752
– five years or less but over one year	**12**	422
– over five years	**259**	254
	14,091	11,981
Amounts above include due from associated undertakings – unsubordinated	**7**	3

Certain subsidiary undertakings are required to maintain balances with the Bank of England which, at 30th September 1997, amounted to £87 million (1996 – £77 million). Certain subsidiary undertakings are required by law to maintain average reserve balances with the Federal Reserve Bank in the USA. Such reserve balances amounted to US$158 million at 30th September 1997 (1996 – US$148 million).

14 Loans and advances to customers

	1997 £m	1996 £m
On demand or short notice	**7,038**	6,413
Remaining maturity		
– three months or less	**3,927**	3,753
– one year or less but over three months	**4,179**	3,293
– five years or less but over one year	**7,076**	7,113
– over five years	**16,845**	13,348
	39,065	33,920
General and specific bad and doubtful debt provisions	**(459)**	(474)
	38,606	33,446
Amounts above include:		
Due from associated undertakings – unsubordinated	**3**	9
Amounts receivable under finance leases	**2,627**	2,374

The cost of assets acquired during the year for the purpose of letting under finance leases and hire purchase agreements was £644 million (1996 – £919 million).

15 Provisions for bad and doubtful debts

	1997 Specific £m	1997 General £m	1996 Specific £m	1996 General £m
At 1st October	**379**	**95**	436	104
Currency translation adjustments	**(3)**	**(1)**	1	1
Amounts written off	**(211)**	**—**	(228)	—
Additions on acquisitions	**—**	**21**	25	—
Recoveries of amounts written off in previous years	**33**	**—**	22	—
Transfers between provisions	**11**	**(11)**	10	(10)
Charge to profit and loss account	**145**	**1**	113	—
At 30th September	**354**	**105**	379	95

All of the provisions for bad and doubtful debts relate to loans and advances to customers.

16 Interest in suspense

In certain cases, interest may be charged to a customer's account but, because its recoverability is in doubt, it is not recognised in the Group's consolidated profit and loss account but is held in a suspense account and netted off against loans and advances to customers in the consolidated balance sheet. Movements in interest in suspense accounts were as follows:

	1997 £m	1996 £m
At 1st October	**13**	3
Amounts written off	**(3)**	(1)
Interest suspended in the year	**26**	17
Suspended interest recovered and credited to the profit and loss account	**(9)**	(6)
At 30th September	**27**	13
Loans and advances on which interest is being placed in suspense:		
Loans and advances before specific provisions	**342**	411
Loans and advances after specific provisions	**257**	295

In addition, loans and advances at 30th September 1997 on which interest is not being applied amounted to approximately £779 million (1996 – £822 million) and unapplied interest on them was approximately £64 million (1996 – £72 million).

17 Concentration of exposure to risk

The Group's exposure to risk from its lending activities is widely diversified both geographically and industrially. With the exception of lending to the service industry sector and for house mortgage loans in the UK, there were no loan concentrations in any individual sector or industry which exceeded 10% of total loans and advances to customers (before provisions). An analysis of loans and advances to customers is contained on page 74. Details of financial instruments with off-balance sheet risk are contained in Notes 38 and 39.

18 Debt securities

	1997 Book value £m	1997 Valuation £m	1996 Book value £m	1996 Valuation £m
Investment securities:				
British government	**105**	**105**	14	14
Other government	**2,583**	**2,595**	2,508	2,483
Other public sector bodies	**195**	**199**	62	62
Bank and building society certificates of deposit	**1,424**	**1,441**	1,248	1,285
Other issuers	**1,970**	**1,971**	1,259	1,254
	6,277	**6,311**	5,091	5,098
Other debt securities:				
British government	**1,169**	**1,270**	1,355	1,359
Other government	**444**	**460**	400	400
Other public sector bodies	**3**	**3**	—	—
Bank and building society certificates of deposit	**1,238**	**1,238**	80	80
Other issuers	**794**	**800**	466	467
	9,925	**10,082**	7,392	7,404
Due within one year	**2,927**		1,387	
Due one year and over	**6,998**		6,005	
	9,925		7,392	
Investment securities:				
Listed on a recognised UK exchange	**540**	**542**	444	444
Listed elsewhere	**3,669**	**3,687**	3,223	3,193
Unlisted	**2,068**	**2,082**	1,424	1,461
	6,277	**6,311**	5,091	5,098
Other debt securities:				
Listed on a recognised UK exchange	**1,812**	**1,913**	1,747	1,751
Listed elsewhere	**717**	**740**	548	549
Unlisted	**1,119**	**1,118**	6	6
	9,925	**10,082**	7,392	7,404
Amounts above include:				
Subordinated debt securities	**9**		—	
Unamortised discounts/(premiums) on investment securities	**1**		(1)	

The cost of securities carried at market value is not disclosed because it cannot be determined without unreasonable expense. Other debt securities include securities held for the purpose of hedging borrowings.

Movements in debt securities which are held as investment securities were as follows:

	Cost £m	Discounts and premiums £m	Provisions £m	Book value £m
At 1st October 1996	5,058	33	—	5,091
Currency translation adjustments	(143)	—	—	(143)
Additions	11,480	—	—	11,480
Disposals	(10,101)	(39)	—	(10,140)
Transfers	(14)	—	—	(14)
Amortisation of discounts and premiums	—	3	—	3
At 30th September 1997	**6,280**	**(3)**	**—**	**6,277**

19 Equity shares

	1997 Book value £m	1997 Valuation £m	1996 Book value £m	1996 Valuation £m
Investment securities:				
Listed on a recognised UK exchange	**1**	**1**	1	3
Listed elsewhere	**223**	**541**	274	323
Unlisted	**183**	**284**	123	186
	407	**826**	398	512
Other securities:				
Listed on a recognised UK exchange	**15**	**15**	8	8
Listed elsewhere	**18**	**18**	22	22
Unlisted	**23**	**23**	—	—
	463	**882**	428	542

The cost of securities carried at market value is not disclosed because it cannot be determined without unreasonable expense.

Movements in equity shares which are held as investment securities were as follows:

	Cost £m	Provisions £m	Book value £m
At 1st October 1996	402	(4)	398
Currency translation adjustments	(41)	—	(41)
Additions	114	—	114
Disposals	(70)	—	(70)
Provisions made	—	(2)	(2)
Transfers	8	—	8
At 30th September 1997	**413**	**(6)**	**407**

20 Interests in associated undertakings

Movements in interests in associated undertakings were as follows:

	Share of net assets £m
At 1st October 1996	63
Acquisitions	3
Transfers	(14)
Share of losses	(7)
Other movements	7
At 30th September 1997	**52**

20 Interests in associated undertakings *(continued)*

On the historical cost basis, the Group's interests in associated undertakings would have been included as follows:

	1997 £m	1996 £m
Cost	**129**	143
Provisions	**—**	(2)
Net book value at 30th September	**129**	141

An analysis of interests in associated undertakings is as follows:	1997 £m	1996 £m
Banks		
– listed elsewhere	**16**	19
– unlisted	**6**	5
Others	**30**	39
	52	63

The principal associated undertakings are:	Total issued share and loan capital at 30th September 1997	% held	Share of results based on accounts made up to	Nature of business
Banco de Comercio e Industria, S.A.				
(incorporated in Portugal)	31.1m ordinary shares of Es 1,000	12.8	30th September*	Banking
	Es 17.5m loan capital	—		
Linea Directa Aseguradora S.A. (registered in Spain)	2,400.0m 5 Ptas ordinary shares	50.0	30th September*	Insurance
Direct Line Life Holdings Limited (registered in England)	15m £1 ordinary shares	50.0	30th September	Insurance
ICCH Limited (registered in England)	6.75m £1 ordinary shares	10.0	31st July*	Clearing house holding company
Inter-Bank On Line System Limited (registered in Scotland)	6.1m £1 ordinary shares	33.3	30th September*	Technology
Newton Management Limited	5.9m 10p ordinary shares	—	30th September*	Fund management
(registered in England)	18.3m 50p A ordinary shares	33.1		
P.T. Bank Multicor	1.2m shares of Rp 50,000	24.0	30th September*	Banking
(incorporated in Indonesia)	Rp 32,750.0m loan capital	—		
The Scottish Agricultural Securities Corporation p.l.c. (registered in Scotland)	2.0m £1 ordinary shares	33.3	31st March	Agricultural lending
Travellers Cheque Associates Limited (registered in England)	0.5m £1 ordinary shares	10.0	30th June*	Issuing sterling travellers' cheques

*Incorporating unaudited interim accounts.

Banco de Comercio e Industria, S.A. operates in Portugal, Linea Directa Aseguradora S.A. operates in Spain and P.T. Bank Multicor operates in Indonesia. The UK is the principal area of operation for the other associated undertakings. Dividends receivable from the associated undertakings (excluding related tax credits) totalled £1 million (1996 – £4 million).

Where the equity shareholdings are less than 20%, associated undertakings are accounted for as such due to significant influence being exercised through representation on the board of directors and participation in financial and operating policy decisions.

21 Principal subsidiary undertakings

The principal subsidiary undertakings at 30th September 1997, the capital of which consists of ordinary and preference shares, are shown below. Except for the Bank, which is owned by the company, all of the subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, by the Bank and they are all wholly-owned except where otherwise indicated. The undertakings marked with an asterisk operate in the country of incorporation or registration; the others operate mainly in the UK.

	Nature of business	Country of incorporation or registration
The Royal Bank of Scotland plc	Banking	Scotland
Adam & Company Group PLC	Banking	Scotland
*Citizens Bank of Rhode Island (76.5%)	Banking	USA
*Citizens Bank of Connecticut (76.5%)	Banking	USA
*Citizens Bank of Massachusetts (76.5%)	Banking	USA
*Citizens Bank New Hampshire (76.5%)	Banking	USA
Direct Line Insurance plc	Insurance	England
Direct Line Financial Services Limited	Banking	England
Privilege Insurance Company Limited (60%)	Insurance	England
RBS Advanta (51%)	Credit card company	Scotland
RBS Mezzanine Limited	Provision of mezzanine finance	Scotland
RBS Scottish Widows Cards Limited (51%)	Credit card company	Scotland
RBS Trade Services Limited	Confirming house	England
RBS Trust Bank Ltd.	Custody	England
Royal Bank Development Capital Limited	Provision of development capital	Scotland
Royal Bank Insurance Services Limited	Insurance broking	England
Royal Bank Insurance Services (Independent Financial Advisers) Limited	Insurance broking	Scotland
Royal Bank Invoice Finance Limited	Factoring and invoice discounting	England
Royal Bank Leasing Limited	Leasing and hire purchase	Scotland
Royal Scottish Assurance plc (70%)	Life assurance	Scotland
*Royscot International Finance B.V.	Finance raising company	The Netherlands
RoyScot Trust plc	Instalment financing and leasing	England
Style Financial Services Limited	Credit card company	Scotland
Tesco Personal Finance Limited (50%)	Banking	Scotland
*The Royal Bank of Scotland (Gibraltar) Limited (50%)	Banking	Gibraltar
*The Royal Bank of Scotland International Limited	Banking	Jersey
*The Royal Bank of Scotland Trust Company (Guernsey) Limited	Banking	Guernsey
*The Royal Bank of Scotland Trust Company (I.O.M.) Limited	Banking	Isle of Man
*The Royal Bank of Scotland (Nassau) Limited	Banking	Bahamas

22 Shares in subsidiary undertaking

Movements during the year:	£m
At 1st October 1996	2,836
Currency translation adjustment	(14)
Dollar preference shares issued by the Bank	241
Dollar preference shares redeemed by the Bank	(132)
Increase in net assets of the Bank	274
At 30th September 1997	**3,205**

On the historical cost basis, shares in the subsidiary undertaking at 30th September 1997 would have been included at a cost of £1,283 million (1996 – £995 million).

23 Loans to subsidiary undertaking

Movements during the year:	£m
At 1st October 1996	1,077
Currency translation adjustment	(25)
Additions and other movements	200
At 30th September 1997	**1,252**

24 Tangible fixed assets

	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
Cost or valuation:					
At 1st October 1996	460	8	98	879	1,445
Currency translation adjustments	(3)	—	(1)	(2)	(6)
Additions	58	—	13	169	240
Additions on acquisitions	6	—	3	22	31
Disposals	(14)	—	(2)	(35)	(51)
Transfers	(17)	7	1	9	—
Revaluation adjustments	5	(1)	—	—	4
At 30th September 1997	**495**	**14**	**112**	**1,042**	**1,663**
Consisting of:					
At valuation	**291**	**13**	**—**	**—**	**304**
At cost	**204**	**1**	**112**	**1,042**	**1,359**
	495	**14**	**112**	**1,042**	**1,663**
Accumulated depreciation and amortisation:					
At 1st October 1996	—	—	29	461	490
Currency translation adjustments	—	—	—	(2)	(2)
Additions on acquisitions	—	—	3	5	8
Disposals	—	—	(1)	(17)	(18)
Depreciation and amortisation charge for year	—	—	6	101	107
At 30th September 1997	**—**	**—**	**37**	**548**	**585**
Net book value at 30th September 1997	**495**	**14**	**75**	**494**	**1,078**
Net book value at 30th September 1996	460	8	69	418	955

The Group's principal freehold and long leasehold premises have been valued during the year principally on the basis of open market value for existing use. The valuations were carried out mainly by the Bank's internal professional surveyors who are members of The Royal Institution of Chartered Surveyors. Certain of the Group's larger premises were valued by independent professionally qualified valuers to support the work completed by the Bank's surveyors.

On the historical cost basis, the Group's freehold and long leasehold premises would have been included at £378 million (1996 – £362 million).

Land and buildings occupied for own activities:	1997 £m	1996 £m
Net book value (including plant and works of adaptation) at 30th September	**554**	504

Future expenditure:	1997 £m	1996 £m
Contracts not provided for in the accounts	**19**	17
Authorised by the directors but not contracted for	**88**	69
	107	86

25 Other assets

	1997 £m	1996 £m
Long-term assurance fund assets attributable to policyholders (see note below)	**1,464**	981
Foreign exchange and interest rate contracts	**1,910**	1,304
Other	**1,192**	989
	4,566	3,274

Note: the long-term assurance fund assets are extracted from the balance sheet of Royal Scottish Assurance plc and were as follows:

	1997 £m	1996 £m
Investments	**143**	21
Assets held to cover linked liabilities	**1,158**	809
Debtors and prepayments	**12**	12
Other assets	**151**	139
	1,464	981

26 Deposits by banks

	1997 £m	1996 £m
Repayable on demand	**1,155**	991
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**3,099**	2,785
– one year or less but over three months	**1,018**	1,486
– five years or less but over one year	**27**	25
– over five years	**96**	36
	5,395	5,323
Amounts above include due to associated undertakings	**5**	—

27 Customer accounts

	1997 £m	1996 £m
Repayable on demand	**29,896**	24,740
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**13,417**	9,667
– one year or less but over three months	**2,713**	2,412
– five years or less but over one year	**1,252**	1,044
– over five years	**304**	224
	47,582	38,087
Amounts above include due to associated undertakings	**—**	1

28 Debt securities in issue

	1997 £m	1996 £m
Bonds and medium term notes, by remaining maturity		
– three months or less	**586**	723
– one year or less but over three months	**181**	223
– two years or less but over one year	**81**	290
– five years or less but over two years	**324**	207
– over five years	**1,007**	929
	2,179	2,372
Other debt securities in issue, by remaining maturity		
– three months or less	**2,616**	2,844
– one year or less but over three months	**181**	311
– two years or less but over one year	**21**	10
– five years or less but over two years	**—**	16
	2,818	3,181
	4,997	5,553

Issues under the Bank's £2.5 billion euro medium term note programme, for the issue from time to time of notes with a minimum maturity of six months from the date of issue, are included in the above amounts.

29 Other liabilities

	1997 £m	1996 £m
Notes in circulation	**900**	870
Long-term assurance fund liabilities to policyholders (see note below)	**1,464**	981
Foreign exchange and interest rate contracts	**2,173**	1,637
Current taxation	**127**	96
Proposed final dividend	**131**	110
Other liabilities	**1,352**	987
	6,147	4,681

Note: an analysis of the long-term assurance fund liabilities to policyholders is as follows:

	1997 £m	1996 £m
Technical provisions	**81**	76
Technical provisions for linked liabilities	**1,258**	822
Other creditors	**125**	83
	1,464	981

30 Deferred taxation

Provision has been made in the consolidated accounts for the amounts of deferred taxation shown below:

	1997 £m	1996 £m
Short-term timing differences	**(93)**	(68)
Capital allowances on computers and other equipment	**57**	57
Capital allowances on finance lease receivables	**238**	236
Advance corporation tax recoverable	**(35)**	(30)
Deferred gains	**23**	—
	190	195

Movements during the year:	£m
At 1st October 1996	195
Charge to profit and loss account	
– current year	19
– prior year	11
Arising on acquisitions	(25)
Other movements	(10)
At 30th September 1997	**190**

No provision has been made for the following potential amounts of deferred taxation:	**1997 £m**	1996 £m
Capital allowances on finance lease receivables	**101**	101

Additionally, no provision has been made for the potential taxation liability which might arise in the event of any of the investments in subsidiaries and associated undertakings or of freehold and long leasehold premises being realised at their balance sheet values, as it is intended that all of the material investments and premises will be retained on a long-term basis; it is also expected that tax on any chargeable gain which might arise on sales of premises would be covered by roll-over relief.

31 Provisions for pensions and other similar obligations

	£m
At 1st October 1996	45
Charge to profit and loss account	67
Provisions utilised	(69)
Other movements	(1)
At 30th September 1997	**42**

An analysis of provisions for pensions and other similar obligations is as follows:

	£m
– The Royal Bank of Scotland Staff Pension Scheme	35
– Citizens Financial Group	7
	42

32 Dated loan capital

	1997 £m	1996 £m
Dated loan capital, all of which has been raised for the development and expansion of the Group's businesses and to strengthen its capital base, comprises:		
The company		
£200 million floating rate (minimum 5¼%) notes 2005	**199**	199
US$300 million 6⅜% subordinated notes 2011	**182**	188
The Royal Bank of Scotland plc		
£125 million 10⅝% subordinated bonds 1998*	**125**	125
£150 million 10½% subordinated bonds 2013*	**149**	149
£250 million 9⅝% subordinated bonds 2015	**246**	246
£125 million subordinated floating rate notes 2005	**124**	124
£150 million 8⅜% subordinated notes 2007	**148**	—
Royscot International Finance B.V.		
US$40 million (1996 – US$80 million) guaranteed floating rate notes 1994/1998*	**25**	51
RBSG Capital Corporation		
US$250 million 10⅛% guaranteed capital notes 2004*	**155**	159
RBSTB (Holdings) Limited		
£30 million convertible unsecured loan stock 2016	**30**	—
	1,383	1,241
Dated loan capital in issue, by remaining maturity		
– repayable within one year or less, or on demand	**150**	26
– repayable between one and two years	**—**	150
– repayable between two and five years	**80**	—
– repayable in five years or more	**1,153**	1,065
	1,383	1,241

*Loans unconditionally guaranteed by the company.

Interest on dated loan capital wholly repayable within five years was £16 million (1996 – £17 million) and after five years was £99 million (1996 – £86 million).

The proceeds of the dated loan capital issued by the company, Royscot International Finance B.V. and RBSG Capital Corporation have been on-lent to the Bank on a subordinated basis. Subordination provisions in the terms and conditions of loan capital issues are designed to ensure that claims against the issuer in respect of the principal of, and interest on, the issue will be subordinated, in the event of the winding-up of the issuer, to the claims of unsubordinated creditors, principally depositors in the case of a bank.

With the exception of the US$300 million 6⅜% subordinated notes 2011 and the US$250 million 10⅛% guaranteed capital notes 2004, all of the dated loan capital is repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the respective debt obligations. In the event of certain changes in the tax laws of the UK, the US$300 million 6⅜% subordinated notes 2011 and the US$250 million 10⅛% guaranteed capital notes 2004 are redeemable in whole, but not in part, at the principal amount thereof plus accrued interest.

The £200 million floating rate (minimum 5¼%) notes 2005 are repayable in five equal annual instalments on each of the interest payment dates falling in May in each of the years 2001 to 2005. Noteholders cannot demand early repayment except in the event of a winding-up of the company.

The US$40 million guaranteed floating rate notes 1994/1998 are repayable on the interest payment date falling in April 1998.

On 22nd March 1997, RBSTB (Holdings) Limited, a wholly-owned subsidiary undertaking of the Bank and the parent of RBS Trust Bank Ltd., issued £30 million of convertible unsecured loan stock (the "loan stock") maturing in 2016 to Mercury Asset Management Group plc ("MAM"). The stock is convertible at the option of MAM from 2004 to 2012 into fully paid ordinary shares of RBSTB (Holdings) Limited. If the conversion rights are fully exercised, shares equal to 30% of the total issued ordinary share capital of RBSTB (Holdings) Limited would be paid to MAM. In addition, MAM has the right in both 2002 and 2007 to require £15 million of the loan stock to be purchased by the Bank: the price of such transaction will be determined by an agreed earnings valuation for RBS Trust Bank Ltd. By virtue of an agreement between the Bank, RBSTB (Holdings) Limited, RBSI Security Services (Holdings) Limited and MAM, on conversion of the loan stock, MAM will also be entitled to one special non-voting share in the capital of RBSI Security Services (Holdings) Limited, a subsidiary undertaking of The Royal Bank of Scotland International Limited, for each £1 million of loan stock converted. If the conversion rights are exercised in full, 30 special shares would be issued to MAM and these confer rights to receive a share of up to 30% (if all special shares are issued) of any dividends declared by RBSI Security Services (Holdings) Limited. The special shares will not permit MAM to attend or vote at any general meeting of the shareholders of RBSI Security Services (Holdings) Limited.

33 Undated loan capital

	Note	1997 £m	1996 £m
Undated loan capital, all of which has been raised for the development and expansion of the Group's businesses and to strengthen its capital base, comprises:			
The company			
US$350 million undated floating rate primary capital notes	(a)	**217**	223
US$400 million undated floating rate primary capital notes	(b)	**141**	162
US$200 million exchangeable capital securities, Series A	(c)	**121**	125
US$50 million undated 7.993% capital securities	(d)	**31**	32
US$35 million undated 7.755% capital securities	(d)	**21**	22
US$75 million floating rate perpetual capital securities	(d)	**46**	—
US$200 million undated 7.375% reset capital securities	(e)	**123**	126
The Royal Bank of Scotland plc			
£200 million 9½% undated subordinated bonds	(f)	**196**	196
£125 million 9¼ % undated subordinated step-up notes	(g)	**123**	123
£150 million undated subordinated floating rate step-up notes	(h)	**148**	—
		1,167	1,009

The proceeds of the undated loan capital issued by the company have been on-lent to the Bank on a subordinated basis.

Notes:

(a) The US$350 million undated floating rate primary capital notes may be redeemed, in whole or in part, at the option of the company at par on any interest payment date. Interest is payable at a rate of ¼% per annum over an average calculated by reference to six-month eurodollar deposits in London for each interest period. The payment of interest is dependent upon a dividend having been declared or paid on the ordinary share capital of the company in the relevant interest period. Noteholders cannot demand repayment of the notes except in the event of a winding-up of the company.

33 Undated loan capital *(continued)*

(b) The US$400 million undated floating rate primary capital notes bear interest at a variable margin above a rate determined by reference to six-month eurodollar deposits in London for each interest period until March 2004 ("the primary period"). Thereafter, the notes bear interest at a rate determined by reference to six-month eurodollar deposits in London for each interest period with no additional margin. Like any other perpetual bond, the repayment of principal and payment of interest are conditional to the extent that, after such payments, the company would remain solvent. Also, the payment of interest is dependent upon a dividend having been declared or paid on the ordinary share capital of the company in the relevant interest period. Noteholders cannot demand repayment of the notes except in the event of a winding-up of the company. When the notes were first issued, they were sold with a warrant entitling investors to put the notes on to a repackaging vehicle (not owned or controlled by the Group) at the end of an initial 15 year investment period. Under arrangements between the company and the repackaging vehicle, any profits accruing to the vehicle from holding or repackaging the notes following exercise of the warrants are to be paid over to the company. Thus, the profit and loss account reflects both the finance charge for each financial year and the increasing year by year value of the repackaging rights as the warrant exercise date approaches. The value of the repackaging rights has also been taken into account in setting the balance sheet value of the notes. In certain circumstances, the company may purchase or designate one of its affiliates or any other person to purchase the notes.

(c) The US$200 million exchangeable capital securities, Series A, are redeemable, at the option of the company, in whole or in part, on any interest payment date on or after 30th June 2004 or, 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. They are 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, at the option of the company on any interest payment date, into the company's non-cumulative dollar preference shares of US$0.01 each. The exchangeable capital securities bear interest at a rate of 8½%.

(d) The US$50 million undated 7.993%, the US$35 million undated 7.755% and the US$75 million floating rate perpetual capital securities were issued by way of private placements and are callable on the first interest payment date following the tenth anniversary of issuance at par.

(e) The US$200 million undated 7.375% reset capital securities were issued at pricing resulting in an annual yield of 7.552% to noteholders up to 1st April 2006. The rate of interest on the capital securities will be reset at that date and on every fifth anniversary thereafter unless they have been redeemed. The capital securities have no maturity date but the company may repay all of them at par on 1st April 2006 or on each fifth anniversary thereafter.

(f) The £200 million 9½% undated subordinated bonds may be redeemed at the option of the Bank in whole, but not in part, on 12th August 2018 or on any fifth anniversary thereafter. The bonds bear interest at 9½% until 12th August 2018 at which time and at each fifth anniversary thereafter the interest rate is reset for a further five years by reference to a defined then current rate of interest applying on those dates. Bondholders cannot demand repayment of the bonds except in the event of a winding-up of the Bank. The bonds are guaranteed by the company.

(g) The £125 million 9¼% undated subordinated step-up notes were issued at pricing resulting in an annual yield of 9.368% to noteholders up to 3rd April 2006. As from that date and on each fifth anniversary thereafter, unless the notes have been redeemed, the interest rate will be reset. The notes have no maturity date but the Bank may repay all of the notes at par on 3rd April 2006 or on any fifth anniversary thereafter.

(h) The £150 million undated subordinated floating rate step-up notes are callable on 26th March 2007 at the option of the Bank.

34 Share capital

	Ordinary shares of 25p each £m	Cumulative preference shares of £1 each £m	Non-cumulative dollar preference shares of 1 cent each £m	Non-cumulative sterling preference shares of £1 each £m	Total £m
Authorised	260	1	1	200	462
Allotted, called up and fully paid:					
At 1st October 1996	203	1	1	—	205
Issued during the year	11	—	—	—	11
At 30th September 1997	**214**	**1**	**1**	**—**	**216**

Ordinary shares During the year to 30th September 1997, the following ordinary shares were issued:

(a) 7,156,504 ordinary shares were allotted following the exercise of options under the company's executive and sharesave schemes;

(b) 3,389,797 ordinary shares were allotted in lieu of cash in respect of the final dividend for the year ended 30th September 1996 and the interim dividend for the year ended 30th September 1997; and

(c) in August 1997, 33,359,810 new ordinary shares were placed with Scottish Widows for cash at a net price of 601.1725p per share giving total proceeds of £201 million.

Also, during the year to 30th September 1997, options were granted over 6,716,759 ordinary shares under the company's executive and sharesave schemes. At 30th September 1997, options under the schemes exercisable between 1997 and 2007 at prices ranging from 150p to 601p per share were outstanding in respect of 30,487,807 ordinary shares.

The non-equity shareholders' funds represent £1 million (1996 – £1 million) of nominal non-cumulative dollar preference shares and £733 million (1996 – £638 million) of share premium relating thereto.

Non-cumulative dollar preference shares Non-cumulative dollar preference shares entitle the holders thereof to receive quarterly non-cumulative preferential cash dividends at specified fixed rates set for each Series payable out of distributable profits of the company.

On or after 23rd August 1996, the 8.0 million Series B non-cumulative dollar preference shares are redeemable, at the option of the company, in whole or in part from time to time, at US$26.40 per share on or after 23rd August 1996 and prior to 23rd August 1997, and at decreasing prices thereafter declining to US$25.00 per share on 23rd August 2001 and thereafter, plus an amount equal to dividends otherwise payable for the then current quarterly dividend period accrued to the date fixed for redemption.

On or after 27th August 1997, the 16.0 million Series C non-cumulative dollar preference shares are redeemable, at the option of the company, in whole or in part from time to time, at US$26.18 per share on or after 27th August 1997 and prior to 27th August 1998, and at decreasing prices thereafter declining to US$25.00 per share on 27th August 2002 and thereafter, plus an amount equal to dividends otherwise payable for the then current quarterly dividend period accrued to the date fixed for redemption.

The 7.0 million Series D non-cumulative dollar preference shares are redeemable at the option of the company, in whole or in part from time to time, on any date that falls on or after 14th September 2005 at US$25.00 per share plus an amount equal to dividends otherwise payable for the then current quarterly dividend period accrued to the date fixed for redemption.

The 8.0 million Series E non-cumulative dollar preference shares are redeemable at the option of the company, in whole or in part from time to time, on any date that falls on or after 17th October 2006 at US$25.00 per share plus the dividends otherwise payable for the then current quarterly dividend period accrued to the date fixed for redemption.

The 8.0 million Series F non-cumulative dollar preference shares are redeemable at the option of the company, in whole or in part from time to time, on any date that falls on or after 31st March 2007 at US$25.00 per share plus the dividends otherwise payable for the then current quarterly dividend period accrued to the date fixed for redemption.

Under existing requirements, no redemption or purchase of any non-cumulative dollar preference shares may be made by the company without the prior consent of the Bank of England.

On a winding-up or liquidation of the company, the holders of the non-cumulative dollar preference shares will be entitled to receive, out of the 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 dollar preference shares as regards participation in the surplus assets of the company, a liquidation distribution of US$25.00 per share together with an amount equal to dividends for the then current quarterly 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 dollar preference shares will have no right to participate in the surplus assets of the company.

Holders of the non-cumulative dollar 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 dollar 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 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 dollar preference shares so to vote shall continue until the company shall have resumed the payment in full of dividends for three consecutive quarterly dividend periods.

35 Reserves

	The Group £m	The company £m	Associated undertakings £m
Share premium account:			
At 1st October 1996	881	881	—
Currency translation adjustment	(17)	(17)	—
Shares issued during the year	493	493	—
Shares redeemed during the year	(132)	(132)	—
Other movements	4	4	—
At 30th September 1997	**1,229**	**1,229**	**—**
Reserves:			
At 1st October 1996	94	20	—
Increase in value of long-term life assurance business	9	—	—
At 30th September 1997	**103**	**20**	**—**
Revaluation reserves:			
At 1st October 1996	(19)	1,648	—
Revaluation of interest in subsidiary undertaking	—	274	—
Movements in revaluations of premises	3	—	—
Movements in net unrealised gains and losses on debt securities and equity shares	(3)	—	—
At 30th September 1997	**(19)**	**1,922**	**—**
Profit and loss account:			
At 1st October 1996	1,349	75	(17)
Currency translation adjustment	(1)	—	(3)
Goodwill on acquisitions	(58)	—	—
Employee share option payments	(23)	(23)	—
Tax on unrealised currency translation gains	(14)	—	—
Transfer to subsidiary undertakings	—	—	15
Retentions for the year	278	(12)	(7)
Transfer to reserves	(9)	—	—
Other movements	(9)	(9)	—
At 30th September 1997	**1,513**	**31**	**(12)**

The cumulative goodwill arising on acquisitions of subsidiary and associated undertakings which are still part of the Group and charged against profit and loss account reserves of the Group amounted to £464 million at 30th September 1997 (1996 – £406 million).

36 Lease commitments

At 30th September, the annual rental commitments under non-cancellable operating leases were:

	1997 Premises £m	1997 Equipment £m	1996 Premises £m	1996 Equipment £m
Expiring within one year	**2**	**1**	1	1
Expiring between one and five years	**10**	**6**	9	3
Expiring after five years	**36**	**—**	31	—
	48	**7**	41	4

37 Analysis of total assets and liabilities

	1997 £m	1996 £m
Assets:		
Denominated in sterling	**47,684**	38,168
Denominated in currencies other than sterling	**24,917**	22,948
	72,601	61,116
Liabilities:		
Denominated in sterling	**48,294**	39,098
Denominated in currencies other than sterling	**24,307**	22,018
	72,601	61,116

38 Derivatives

At 30th September 1997, the net replacement cost, by maturity, of all the Group's derivatives were as follows:

	Within one year £m	One to five years £m	Over five years £m	Total £m
Exchange rate contracts:				
Forward foreign exchange	**1,333**	**32**	**—**	**1,365**
Cross currency swaps	**—**	**15**	**21**	**36**
Currency options	**74**	**10**	**—**	**84**
	1,407	**57**	**21**	**1,485**
Interest rate contracts:				
Forward rate agreements	**3**	**2**	**—**	**5**
Interest rate swaps	**100**	**162**	**188**	**450**
Interest rate options	**1**	**11**	**—**	**12**
	104	**175**	**188**	**467**
Equity and commodity contracts:				
Swaps	**7**	**24**	**—**	**31**
Options	**—**	**1**	**—**	**1**
	7	**25**	**—**	**32**

In addition to the amounts in the above table, the Group had entered into financial futures contracts with an outstanding aggregate notional principal amount of £17,436 million at 30th September 1997 (1996 – £27,522 million). Such contracts generally involve lower credit risk than over-the-counter contracts because trades in such contracts are cleared through exchanges that subject their participants to margining requirements and require daily settlement of gains and losses.

38 Derivatives *(continued)*

The following tables analyse the net replacement cost of the Group's derivatives as at 30th September 1997 into financial and non-financial counterparty and also into OECD and non-OECD counterparty:

	Financial £m	Non-financial £m	OECD £m	Non-OECD £m
Exchange rate contracts:				
Forward foreign exchange	**1,268**	**97**	**1,257**	**108**
Cross currency swaps	**35**	**1**	**36**	**—**
Currency options	**64**	**20**	**83**	**1**
	1,367	**118**	**1,376**	**109**
Interest rate contracts:				
Forward rate agreements	**4**	**1**	**5**	**—**
Interest rate swaps	**367**	**83**	**445**	**5**
Interest rate options	**10**	**2**	**12**	**—**
	381	**86**	**462**	**5**
Equity and commodity contracts:				
Swaps	**25**	**6**	**31**	**—**
Options	**1**	**—**	**1**	**—**
	26	**6**	**32**	**—**

Note: the net replacement cost shown in the above tables represents the gross positive fair values, without giving effect to offsetting positions with the same counterparty.

Trading derivatives The following table shows for each type of instrument in the trading derivatives portfolio the average fair value, the end of period fair value and the net trading gains or losses for the year ending 30th September 1997:

	Average fair value		End of period fair value		Net trading gains or (losses)
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m
Exchange rate contracts:					
Forward foreign exchange	**1,487**	**1,474**	**1,364**	**1,340**	**89**
Cross currency swaps	**18**	**37**	**26**	**45**	**—**
Currency options	**62**	**54**	**84**	**67**	**(14)**
	1,567	**1,565**	**1,474**	**1,452**	**75**
Interest rate contracts:					
Forward rate agreements	**8**	**8**	**5**	**6**	**(2)**
Interest rate swaps	**369**	**646**	**413**	**686**	**1**
Interest rate options	**9**	**22**	**9**	**21**	**5**
Interest rate futures	**68**	**39**	**13**	**15**	**(7)**
	454	**715**	**440**	**728**	**(3)**
Equity and commodity contracts:					
Swaps	**6**	**5**	**9**	**8**	**—**
Futures	**—**	**—**	**—**	**—**	**—**
	6	**5**	**9**	**8**	**—**
Cash	**222**	**6**	**273**	**5**	**16**
	2,249	**2,291**	**2,196**	**2,193**	**88**

The Group may require collateral in respect of the credit risk in derivative transactions which is principally the positive fair value. Collateral may be in the form of cash or more commonly is in the form of a lien over a customer's assets entitling the Group to make a claim for current and future liabilities.

The following table analyses by maturity and contract the notional principal amount of the Group's trading derivatives at 30th September 1997:

	Within one year £m	One to five years £m	Over five years £m	Total £m
Exchange rate contracts:				
Forward foreign exchange	**86,026**	**1,905**	**13**	**87,944**
Cross currency swaps	**67**	**229**	**108**	**404**
Currency options purchased	**3,241**	**52**	**—**	**3,293**
Currency options written	**3,538**	**31**	**—**	**3,569**
	92,872	**2,217**	**121**	**95,210**
Interest rate contracts:				
Forward rate agreements	**9,144**	**2,424**	**—**	**11,568**
Interest rate swaps	**16,960**	**18,845**	**4,756**	**40,561**
Interest rate options purchased	**2,079**	**1,903**	**15**	**3,997**
Interest rate options written	**647**	**1,752**	**89**	**2,488**
Interest rate futures	**6,333**	**10,789**	**15**	**17,137**
	35,163	**35,713**	**4,875**	**75,751**
Equity and commodity contracts:				
Swaps	**154**	**14**	**—**	**168**
Futures	**2**	**—**	**—**	**2**
	156	**14**	**—**	**170**

Non-trading derivatives The Group establishes non-trading derivatives positions externally with third parties and also internally through intra-company or intra-group transactions. 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 Bank or to external third party participants in the derivative markets.

The following table summarises the fair values and book values of derivatives held for non-trading activities as at 30th September 1997:

	Positive fair value £m	Negative fair value £m	Positive book value £m	Negative book value £m
Exchange rate contracts:				
Forward foreign exchange	**16**	**16**	**16**	**15**
Currency swaps	**11**	**20**	**—**	**—**
	27	**36**	**16**	**15**
Interest rate contracts:				
Forward rate agreements	**—**	**—**	**—**	**—**
Interest rate swaps	**101**	**180**	**66**	**98**
Interest rate options purchased	**7**	**—**	**3**	**—**
Interest rate options written	**—**	**3**	**—**	**—**
Interest rate futures	**—**	**1**	**—**	**—**
	108	**184**	**69**	**98**
Equity and commodity contracts:				
Swaps	**23**	**3**	**23**	**3**
Options	**1**	**1**	**1**	**1**
	24	**4**	**24**	**4**

38 Derivatives *(continued)*

At 30th September 1997, the notional principal amounts, by maturity, of the Group's non-trading derivatives (third party, intra-company and intra-group) by contract amount were as follows:

	Within one year £m	One to five years £m	Over five years £m	Total £m
Exchange rate contracts:				
Forward foreign exchange	**1,548**	**—**	**—**	**1,548**
Cross currency swaps	**19**	**200**	**99**	**318**
	1,567	**200**	**99**	**1,866**
Interest rate contracts:				
Forward rate agreements	**141**	**2**	**—**	**143**
Interest rate swaps	**3,223**	**4,832**	**1,535**	**9,590**
Interest rate options purchased	**25**	**682**	**50**	**757**
Interest rate options written	**—**	**61**	**50**	**111**
Interest rate futures	**274**	**14**	**12**	**300**
	3,663	**5,591**	**1,647**	**10,901**
Equity and commodity contracts:				
Swaps	**—**	**455**	**—**	**455**
Options	**—**	**24**	**—**	**24**
	—	**479**	**—**	**479**

For non-trading interest rate swaps, the weighted average fixed pay rates, weighted average variable receive rates and related contract amounts by maturity at 30th September 1997 (consolidated across currencies) were as follows:

	Pay fixed		Receive variable	
	Notional principal £m	Average rate %	Notional principal £m	Average rate %
Contracts maturing:				
Within one year	**2,459**	**7.3**	**2,396**	**7.0**
One to five years	**3,378**	**7.7**	**3,415**	**6.9**
Over five years	**1,055**	**7.5**	**1,009**	**7.1**
	6,892	**7.5**	**6,820**	**7.0**

For non-trading interest rate swaps, the weighted average fixed receive rates, weighted average variable pay rates and related notional principal amounts by maturity at 30th September 1997 (consolidated across currencies) were as follows:

	Receive fixed		Pay variable	
	Notional principal £m	Average rate %	Notional principal £m	Average rate %
Contracts maturing:				
Within one year	**846**	**8.1**	**783**	**7.0**
One to five years	**1,637**	**8.8**	**1,674**	**6.9**
Over five years	**605**	**7.6**	**559**	**6.7**
	3,088	**8.4**	**3,016**	**6.9**

Included in the above tables, as receive variable and pay variable interest rate swaps, are basis swaps with an aggregate contract amount of £346 million. These are interest rate swaps where interest receivable and payable are both calculated by reference to variable interest rates; the swap contains no fixed interest receivable or payable leg. At 30th September 1997, there were gross deferred losses of £6 million relating to terminated non-trading contracts (1996 – net gain £6 million). The amortisation profile of the £6 million loss was £1 million in under one year, £4 million in the period one to five years and £1 million in the period over five years. As at 30th September 1997, there were no hedges of anticipated transactions in place. The effect of non-trading activities on the consolidated profit and loss account for the year ended 30th September 1997 was to decrease net interest by £11 million.

39 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 30th September. 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.

	1997			1996		
	Contract amount £m	**Credit equivalent amount £m**	**Risk weighted amount £m**	Contract amount £m	Credit equivalent amount £m	Risk weighted amount £m
Contingent liabilities:						
Acceptances and endorsements	**863**	**863**	**691**	934	934	699
Guarantees and irrevocable letters of credit	**946**	**946**	**703**	909	909	761
Assets pledged as collateral security	**5**	**—**	**—**	5	—	—
Other contingent liabilities	**827**	**414**	**406**	511	256	246
	2,641	**2,223**	**1,800**	2,359	2,099	1,706
Commitments:						
Sale and option to resell transactions	**—**	**—**	**—**	32	32	16
Documentary credits and trade related transactions	**1,184**	**237**	**118**	800	160	108
Forward asset purchases and forward deposits placed	**137**	**137**	**88**	267	267	153
Undrawn note issuance and revolving underwriting facilities	**20**	**10**	**4**	26	13	7
Undrawn formal standby facilities, credit lines and other commitments to lend						
– less than one year (a)	**13,592**	**—**	**—**	10,954	—	—
– one year and over	**2,200**	**1,098**	**972**	2,139	1,070	916
	17,133	**1,482**	**1,182**	14,218	1,542	1,200

Notes:

(a) Included in this category are facilities of £6,684 million at 30th September 1997 (1996 – £4,168 million) which are cancellable unconditionally at the discretion of the Group. Undrawn loan commitments which are cancellable unconditionally at any time or which have a maturity of less than one year have a risk weighting of zero.

(b) Under the European Community Solvency Ratio Directive, credit equivalent amounts obtained by applying credit conversion factors are risk weighted according to the nature of the counterparties. Using the minimum 8% BIS ratio indicates that £239 million of total capital would be required to support the total risk weighted amount of £2,982 million.

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

	1997 £m	1996 Restated* £m
Operating profit – the company and its subsidiary undertakings	**690**	621
(Increase)/decrease in interest receivable and prepaid expenses	**(132)**	24
Increase in interest payable and accrued expenses	**256**	162
Increase in other provisions	**23**	—
Decrease in provisions for bad and doubtful debts	**(11)**	(68)
Interest payable on subordinated liabilities	**210**	186
Depreciation and diminution in value of fixed assets	**107**	95
(Profit)/loss on sales of tangible fixed assets	**(18)**	2
Profit on sales of investment securities	**(71)**	(37)
Profit on sale of mortgage servicing business	**(28)**	—
Profit on sale of fixed asset investment	**(34)**	—
Other non-cash movements	**23**	(94)
Net cash inflow from trading activities	**1,015**	891
Net decrease in deposits by banks	**(46)**	(82)
Net increase in customer accounts	**6,311**	3,527
Net (decrease)/increase in debt securities in issue	**(556)**	2,160
Net increase in loans to customers	**(4,432)**	(2,587)
Net increase in loans to banks	**(536)**	(965)
Increase in items in course of collection due from other banks	**(42)**	(111)
(Decrease)/increase in items in course of collection due to other banks	**(139)**	295
(Increase)/decrease in treasury bills and other eligible bills	**(69)**	62
Decrease/(increase) in debt securities and equity shares (other than investment securities)	**777**	(435)
(Increase)/decrease in other assets	**(737)**	117
Increase in other liabilities	**792**	163
Net cash inflow from operating activities	**2,338**	3,035

*Prior year figures have been restated – see Accounting policy Note 15 on page 33.

41 Purchase of subsidiary undertakings

The following table shows the aggregate fair values of net assets acquired in connection with the acquisitions of subsidiary undertakings during the years ended 30th September 1997 and 30th September 1996. No significant adjustments were required to the book values of the net assets as recorded in the acquired companies' books at the dates of acquisitions.

	1997 £m	1996 £m
Net assets acquired:		
Cash	**86**	102
Debt securities	**2,118**	780
Loans and advances to customers and banks	**1,292**	1,574
Prepayments and accrued income	**—**	55
Other assets	**112**	—
Tangible fixed assets	**23**	31
Deposits by banks and customer accounts	**(3,355)**	(2,395)
Other liabilities	**(139)**	(15)
Minority shareholder's interest	**18**	(115)
	155	17
Goodwill written off/negative goodwill (credited) to Group reserves	**58**	(17)
Satisfied by net cash paid (see Note 42)	**213**	—

42 Analysis of the net (outflow)/inflow of cash in respect of the purchase of subsidiary undertakings

	1997 £m	1996 £m
Cash consideration paid	**(213)**	—
Cash acquired	**86**	102
Net (outflow)/inflow of cash	**(127)**	102

43 Sale of subsidiary and associated undertakings

	1997 £m	1996 £m
Net assets disposed of	**65**	39
Goodwill written back	**—**	18
Profit on disposal	**13**	72
Net inflow of cash in respect of the sales	**78**	129

44 Analysis of changes in financing during the year

	Share capital (including premium)		Loan capital	
	1997 £m	1996 £m	1997 £m	1996 £m
At 1st October	**1,086**	1,059	**2,250**	1,789
Effect of foreign exchange differences	**(17)**	7	**(26)**	(1)
Cash inflow from financing	**373**	20	**343**	476
Other non-cash movements	**3**	—	**(17)**	(14)
At 30th September	**1,445**	1,086	**2,550**	2,250

45 Analysis of cash

	1997 £m	1996 £m	Change in year £m
Cash and balances at central banks	**1,213**	1,211	**2**
Loans and advances to banks repayable on demand	**3,963**	2,899	**1,064**
Cash	**5,176**	4,110	**1,066**

46 Analysis of changes in cash during the year

	1997 £m	1996 £m
At 1st October	**4,110**	2,086
Net cash inflow	**1,066**	2,024
At 30th September	**5,176**	4,110

47 Segmental analysis

In the tables below, the analyses of net assets are included in compliance with Statement of Standard Accounting Practice No. 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.

(a) Classes of business

1997	UK banking £m	Direct Line Insurance £m	Citizens Bank £m	Other* £m	Group total £m
Net interest income	**977**	**66**	**352**	**19**	**1,414**
Non-interest income	**763**	**47**	**98**	**95**	**1,003**
General insurance premium income (net of reinsurance)	**—**	**526**	**—**	**9**	**535**
Total income	**1,740**	**639**	**450**	**123**	**2,952**
Operating expenses	**985**	**124**	**245**	**195**	**1,549**
General insurance claims (net of reinsurance)	**—**	**479**	**—**	**8**	**487**
Profit before provisions	**755**	**36**	**205**	**(80)**	**916**
Provisions for bad and doubtful debts	**117**	**—**	**16**	**13**	**146**
Investment write downs	**2**	**—**	**—**	**—**	**2**
Segment result	**636**	**36**	**189**	**(93)**	**768**
Exceptional items	**(60)**	**—**	**28**	**24**	**(8)**
Profit on ordinary activities before tax	**576**	**36**	**217**	**(69)**	**760**
Total assets	**56,515**	**1,124**	**9,565**	**5,397**	**72,601**
Net assets	**2,319**	**343**	**575**	**(195)**	**3,042**

1996	£m	£m	£m	£m	£m
Net interest income	881	57	280	(16)	1,202
Non-interest income	665	43	88	31	827
General insurance premium income (net of reinsurance)	—	611	—	—	611
Total income	1,546	711	368	15	2,640
Operating expenses	898	123	202	97	1,320
General insurance claims (net of reinsurance)	—	562	—	—	562
Profit before provisions	648	26	166	(82)	758
Provisions for bad and doubtful debts/(net releases)	113	—	(2)	2	113
Investment write downs	—	—	—	1	1
Segment result	535	26	168	(85)	644
Exceptional items	—	—	(21)	72	51
Profit on ordinary activities before tax	535	26	147	(13)	695
Total assets	50,050	1,042	8,854	1,170	61,116
Net assets	1,888	326	522	(226)	2,510

**Note:* Other comprises net central financing costs, central expenses, the results of Investor Services and new retail financial services businesses and these segmental results can be analysed as follows:

	1997 £m	1996 £m
Central costs	**(46)**	(25)
Investor Services	**(12)**	(17)
New retail businesses	**(35)**	(43)
	(93)	(85)

Investor Services comprises the Bank's Global Custody business, RBS Trust Bank and the Registrars business.

47 Segmental analysis *(continued)*

(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. In addition to Citizens Bank, USA includes the Bank's New York branch.

1997	UK £m	Continental Europe £m	USA £m	Rest of the World £m	Group total £m
Interest receivable	**3,176**	**45**	**703**	**201**	**4,125**
Dividend income	**11**	**11**	**2**	**—**	**24**
Fees and commissions receivable	**707**	**5**	**93**	**4**	**809**
Dealing profits	**110**	**1**	**3**	**3**	**117**
General insurance premium income (net of reinsurance)	**535**	**—**	**—**	**—**	**535**
Income from associated undertakings	**—**	**(6)**	**—**	**1**	**(5)**
Other income	**121**	**—**	**13**	**—**	**134**
Gross income	**4,660**	**56**	**814**	**209**	**5,739**
Profit on ordinary activities before tax	**503**	**21**	**224**	**12**	**760**
Total assets	**58,863**	**716**	**9,979**	**3,043**	**72,601**
Net assets	**2,208**	**203**	**568**	**63**	**3,042**

1996	£m	£m	£m	£m	£m
Interest receivable	2,787	32	551	157	3,527
Dividend income	11	8	3	—	22
Fees and commissions receivable	587	10	85	4	686
Dealing profits	106	1	2	1	110
General insurance premium income (net of reinsurance)	611	—	—	—	611
Income from associated undertakings	1	—	—	1	2
Other income	63	—	14	—	77
Gross income	4,166	51	655	163	5,035
Profit on ordinary activities before tax	439	92	151	13	695
Total assets	48,508	798	9,081	2,729	61,116
Net assets	1,692	254	510	54	2,510

As permitted by the Companies Act 1985, a segmental analysis of turnover has not been disclosed.

48 Turnover

Turnover attributable to the business of banking is not shown. Non-banking turnover, all of which arose in the UK, was:

	1997 £m	1996 £m
Capital cost of assets financed	**644**	919
General insurance business	**720**	650
Credit card business and other non-banking activities	**273**	162
	1,637	1,731

49 Directors' emoluments

	1997 £000	1996 £000
Non-executive directors – emoluments	**360**	341
Executive directors – emoluments	**4,829**	4,851
– pension contributions	**1,240**	361
	6,429	5,553
– gains on exercise of share options	**996**	167
	7,425	5,720

Retirement benefits are accruing to six directors under defined benefit schemes.

The emoluments of the highest paid UK director, Mr G. A. Schofield (1996 – Dr G. R. Mathewson), were as follows:

	1997 £000	1996 £000
Aggregate emoluments	**323**	502
Gains on exercise of share options	**952**	—
	1,275	502
Pension contributions	**32**	55
Defined benefit pension scheme – accrued pension at end of year	**147**	145

The emoluments of the highest paid director, Mr L. K. Fish, were as follows:

	1997		1996	
	£000	US$000	£000	US$000
Aggregate emoluments and gains on exercise of share options	**2,162**	**3,530**	2,487	3,836
Pension contributions	**87**	**142**	83	128
Defined benefit pension scheme – accrued pension at end of year	**101**	**165**	91	140

The executive directors may also participate in the company's executive and sharesave schemes and details of their interests in the company's shares arising from their participation are contained in the directors' interests in shares note on page 12. Details of the remuneration received by each director during the year and directors' pension arrangements are given on pages 10 and 11.

50 Transactions with directors, officers and others

(a) At 30th September 1997, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group were £11,330,320 in respect of loans to 14 persons who were directors of the company (or persons connected with them) at any time during the financial year and £242,771 to one person who was an officer of the company at any time during the financial year. As at the same date, there was in existence one guarantee of £41,500 in respect of certain obligations of one connected person.

(b) Dr G. R. Mathewson, a director and chief executive of the company and the Bank, has a right to repurchase from the Bank his former dwellinghouse which the Bank purchased from him and his wife in May 1988 at a price of £125,000. The right will become exercisable (1) in the event that Dr Mathewson ceases to be an executive director of the company or its subsidiaries; or (2) on 31st May 2008 in the event that he remains an executive director at that date; or (3) on such earlier date as the directors of the company may allow. Any repurchase is to be at the higher of the purchase price paid by the Bank or a price determined by independent professional valuation at the time of repurchase. The dwellinghouse is at present let by the Bank on a commercial basis, with any rental payments being received wholly by the Bank.

(c) There were no contracts of significance to the business of the company and its subsidiaries which subsisted during or at the end of the company's financial year to 30th September 1997 in which any director of the company had a material interest.

51 Related party transactions

Subsidiary undertakings Details of the principal subsidiary undertakings are shown in Note 21. In accordance with Financial Reporting Standard No. 8 "Related Party Disclosures", transactions or balances between Group entities that have been eliminated on consolidation are not reported.

Associated undertakings Details of the Group's principal associated undertakings are shown in Note 20. The amounts of loans and advances due from associated undertakings at 30th September 1997 are shown in Notes 13 and 14 and the amounts of deposits received from associated undertakings as at 30th September 1997 are shown in Notes 26 and 27. These transactions are conducted on similar terms to third party transactions and are not material to the Group's results or financial condition. Certain subsidiary undertakings in the Group 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 arms-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.

Joint ventures Tesco PLC has a 50% minority shareholding in Tesco Personal Finance Group Limited ("TPFG"). Under the terms of an agreement with Tesco PLC, Tesco Personal Finance Limited ("TPFL"), which is a 100% owned subsidiary of TPFG, receives fees for managing certain financial products and is charged costs incurred by Tesco PLC on its behalf. Tesco PLC has charged TPFL an amount totalling £2.9 million, of which £2.4 million is in respect of services provided and £0.5 million relates to the transfer of fixed assets. Both amounts were outstanding at 30th September 1997. In addition, TPFL has entered into a licensing agreement with Tesco Stores Limited, a 100% owned subsidiary of Tesco PLC, which will enable TPFL to operate within Tesco stores. At 30th September 1997, TPFL had commitments under the licensing agreement totalling £5.8 million, of which £0.5 million expires within one year and £5.3 million expires between two and five years inclusive. TPFL also receive fees from Tesco PLC for managing certain financial products and during the year ended 30th September 1997 fees totalled £2.9 million, of which £1.8 million was outstanding at 30th September 1997.

Scottish Widows has a 30% minority shareholding in Royal Scottish Assurance plc ("RSA"). Under the terms of a service agreement with Scottish Widows, RSA will pay fees for administration services. Nothing was paid in the year ended 30th September 1997. Prior to 6th May 1997, Scottish Equitable plc had a 20% minority shareholding in RSA and, under the terms of a service agreement, RSA paid administration fees of £1.8 million in the year ended 30th September 1997.

51 Related party transactions *(continued)*

Under the terms of a joint venture agreement, the Advanta Corporation of Pennsylvania ("Advanta") has a 49% minority shareholding in RBS Advanta. Also, Advanta has subscribed for loan capital of £12.2 million issued by RBS Advanta. A market related rate of interest applies to this loan capital and during the year ended 30th September 1997 RBS Advanta paid interest of £0.3 million to Advanta.

Bank of Ireland has a 23.5% minority shareholding in Citizens and it also holds US$35.25 million of trust preferred loan capital issued by Citizens. A market related rate of interest applies to this loan capital and during the year ended 30th September 1997, interest of US$1.5 million (£0.9 million) was payable to Bank of Ireland.

The Royal Bank of Scotland Staff Pension Scheme (the "Scheme") The Bank recharges the Scheme with the cost of administration services incurred by it and the total amount recharged in the year ended 30th September 1997 was £0.6 million.

Banco Santander Under the terms of an alliance agreement, the Group and Banco Santander ("Santander") co-operate in certain banking and financial activities in Europe. The Group holds 4.9% of Santander's capital stock and Santander holds 9.89% of the company's ordinary shares and in addition Santander has a 50% minority shareholding in The Royal Bank of Scotland (Gibraltar) Limited. On 15th September 1997, the Group sold its 2% holding in Banco Espanol de Credito S.A. to Santander. Details of the sale are shown in Note 6.

Directors, officers and others Details of directors' emoluments are set out in Note 49 and the Remuneration Committee report on pages 8 to 11. Details of transactions with directors, officers and others connected to them are shown in Note 50.

On 25th June 1997, the company entered into an agreement with, amongst others, Mr P. J. Wood, pursuant to which Royal Bank Development Limited ("RBD") agreed to subscribe for 22,500,000 (and subsequently subscribed for the first tranche of 5,000,000) "B" Cumulative Redeemable Preference Shares of £1 each of Privilege Insurance Holdings Limited ("PIHL"). Mr Wood was a related party at that time, being a director of the company, the Bank and a number of the company's other subsidiary and associated undertakings. Mr Wood resigned these directorships (other than his chairmanship of PIHL and Privilege Insurance Company Limited (together the "Privilege Group") and his vice-chairmanship of Linea Directa Aseguradora) on 25th June 1997.

The terms of the shareholders' agreement (which governs the arrangements between the company, RBD, Mr Wood and his associates in relation to the Privilege Group) were also amended on 25th June 1997. The principal changes were:

- Further equity or debt funding (in addition to the new preference shares) to PIHL will be provided on a pro rata basis to the then current shareholdings. Any party who fails, or declines, to subscribe for further capital will be correspondingly diluted. If one party's shareholding is diluted, the number of directors that the party is entitled to appoint may also be reduced.
- RBD now has a majority of shareholder votes (except in relation to the appointment of new directors).
- An increase in the number of matters which require the consent of the directors appointed by the company.
- The Direct Line Group and the Privilege Group are no longer prevented from competing with each other to the extent that each can write non-standard motor and non-standard household business through affinity schemes and joint venture arrangements.

52 Approval of accounts The accounts were approved by the board of directors on 27th November 1997.

Financial analyses

Average balance sheet and related interest

	1997 Average Balance* £m	Rate %	1997 Interest £m	1996 Restated Average Balance* £m	Rate %	1996 Restated Interest £m
Assets						
Treasury and other eligible bills						
UK	**633**	**6.2**	**39**	688	6.1	42
overseas	**38**	**4.8**	**2**	5	5.8	—
Loans and advances to banks						
UK	**11,262**	**5.5**	**621**	9,739	5.6	548
overseas	**1,769**	**5.7**	**101**	1,373	5.8	79
Loans and advances to customers						
UK	**24,927**	**7.9**	**1,980**	21,867	7.8	1,701
overseas	**6,667**	**8.3**	**554**	5,630	8.3	465
Lease and HP receivables						
UK	**3,207**	**8.2**	**264**	2,831	8.8	250
overseas	**78**	**7.5**	**6**	55	7.7	4
Debt securities						
UK	**5,076**	**6.7**	**342**	3,685	7.1	265
overseas	**3,370**	**6.4**	**216**	2,805	6.2	173
Interest earning assets	**57,027**	**7.2**	**4,125**	48,678	7.3	3,527
Non-interest earning assets	**8,895**	**—**	**—**	7,395	—	—
Total average assets	**65,922**	**6.3**	**4,125**	56,073	6.3	3,527
Liabilities						
Deposits by banks						
UK	**3,935**	**5.8**	**229**	3,498	5.7	198
overseas	**1,583**	**5.4**	**86**	1,504	5.5	83
Customer demand deposits						
UK	**16,156**	**4.3**	**697**	12,355	4.5	557
overseas	**1,840**	**3.8**	**69**	1,284	4.4	56
Customer savings deposits						
UK	**2,819**	**5.0**	**142**	2,928	5.3	154
overseas	**5,963**	**4.4**	**263**	5,080	4.3	221
Customer other time deposits						
UK	**10,769**	**6.1**	**655**	9,894	5.6	558
overseas	**327**	**4.9**	**16**	322	5.5	18
Debt securities in issue						
UK	**5,132**	**6.1**	**313**	4,426	6.1	268
overseas	**621**	**5.0**	**31**	502	5.3	26
Loan capital	**2,386**	**8.8**	**210**	2,161	8.6	186
Interest bearing liabilities	**51,531**	**5.2**	**2,711**	43,954	5.3	2,325
Interest free liabilities						
demand deposits	**2,716**	**—**	**—**	2,454	—	—
other liabilities	**8,760**	**—**	**—**	7,339	—	—
Shareholders' funds	**2,915**	**—**	**—**	2,326	—	—
Total average liabilities	**65,922**	**4.1**	**2,711**	56,073	4.1	2,325

*Average balances have been calculated on a daily basis using customers' cleared balances, netted where interest set-off arrangements exist. The analysis into UK and overseas in the above table has been compiled on the basis of location of office. For the purposes of the average balance sheet and related interest, the prior year figures have been restated to reflect a reclassification of lending to members of the London Discount Market Association as follows:

	1996 Restated £m	1996 Original £m
Loans and advances to banks (UK)	9,739	8,654
Loans and advances to customers (UK)	21,867	22,952

The prior year figures for non-interest earnings assets and other liabilities have been restated to include £2,349 million related to the grossing up of derivative transactions.

Interest rates, yields, spreads and margins

	1997 Average rate %	1996 Average rate %
UK		
The Royal Bank of Scotland plc base rate	**6.3**	6.2
London inter-bank offered rate		
three month sterling	**6.6**	6.2
three month eurodollar	**5.6**	5.5
USA		
Prime rate	**8.4**	8.4
Yields, spreads and margins:		
Gross yield[1]		
total	**7.2**	7.3
UK	**7.2**	7.2
overseas	**7.4**	7.3
Interest spread[2]		
total	**2.0**	2.0
UK	**1.7**	1.8
overseas	**2.9**	2.6
Interest margin[3]		
total	**2.5**	2.5
UK	**2.2**	2.3
overseas	**3.5**	3.0

[1]Gross yield is the average interest rate earned on average interest earning assets.

[2]Interest spread is the difference between the gross yield and the average interest rate paid on average interest bearing liabilities.

[3]Interest margin is net interest income as a percentage of average interest earning assets.

Cross border outstandings in excess of 1% of total assets The following table identifies countries to which the Group's cross border outstandings exceeded 1% of total assets at 30th September 1997.

	Commercial, industrial and other private sector £m	Governments and official institutions £m	Banks and other financial institutions £m	Total £m	As % of total assets* £m
USA	**1,366**	**410**	**1,363**	**3,139**	**4.3**
France	**97**	**—**	**1,766**	**1,863**	**2.5**
Japan	**35**	**—**	**1,100**	**1,135**	**1.5**
Belgium	**6**	**—**	**1,050**	**1,056**	**1.4**
Germany	**79**	**—**	**717**	**796**	**1.1**

*Assets comprise total assets as reported in the consolidated balance sheet and acceptances and endorsements as reported in the memorandum items below the consolidated balance sheet, which together totalled £73,464 million at 30th September 1997.

Analysis of loans and advances to customers The following table analyses, for UK and overseas offices, loans and advances to customers (before provisions) by type of customer and geographical area:

At 30th September	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
UK					
ECGD and government	**116**	90	112	116	161
Manufacturing	**1,739**	1,732	1,682	1,289	1,203
Construction	**404**	530	471	501	594
Finance	**3,100**	3,173	3,231	2,722	2,142
Service industries	**4,660**	3,374	3,296	2,706	2,508
Agriculture, forestry and fishing	**613**	493	473	490	526
Property	**2,617**	1,525	1,263	1,200	1,201
Business and other services	**2,140**	2,715	2,384	2,108	2,250
Persons					
– home mortgages (including staff)	**7,371**	6,532	6,201	5,601	4,560
– other	**3,530**	2,713	2,319	2,360	2,468
Instalment credit and other loans	**856**	630	660	597	557
Finance leases	**2,569**	2,333	1,623	1,559	1,412
Overseas residents	**1,880**	1,403	1,178	819	726
Total UK	**31,595**	27,243	24,893	22,068	20,308
Overseas					
Continental Europe	**426**	408	350	294	263
USA	**6,063**	5,416	3,942	3,743	2,341
Rest of the World	**981**	853	572	391	436
Total overseas	**7,470**	6,677	4,864	4,428	3,040
Total loans and advances to customers	**39,065**	33,920	29,757	26,496	23,348

Note: in 1997 the Bank of England introduced new industrial classifications which are based on the Central Statistical Office's Standard Industrial Classifications of Economic Activities – SIC(92). Previous classifications have been based on SIC(80). During the year, the Bank reclassified all its non-personal customer accounts and it took the opportunity to review and update industrial codes on all business customer accounts. As a result of this exercise there have been movements between some of the categories compared with prior years.

Analysis of deposits The following table shows the distribution of the Group's deposits by type and geographical area:

At 30th September	1997 £m	1996 £m	1995 £m	1994 £m	1993 £m
UK					
Demand deposits					
– interest free	**5,741**	3,437	2,944	2,320	2,536
– interest bearing	**19,444**	14,725	13,470	12,755	10,851
Time deposits					
– savings	**3,354**	3,987	2,957	2,693	2,578
– other	**12,355**	10,659	10,417	8,179	7,910
Total UK	**40,894**	32,808	29,788	25,947	23,875
Overseas					
Demand deposits					
– interest free	**1,014**	696	543	467	400
– interest bearing	**1,560**	1,246	698	657	661
Time deposits					
– savings	**6,522**	5,664	4,501	4,279	2,425
– other	**2,987**	2,996	2,040	1,995	1,357
Total overseas (see below)	**12,083**	10,602	7,782	7,398	4,843
Total deposits	**52,977**	43,410	37,570	33,345	28,718
Overseas					
Continental Europe	**496**	417	445	696	557
USA	**8,651**	7,633	6,121	5,454	3,131
Rest of the World	**2,936**	2,552	1,216	1,248	1,155
Total overseas	**12,083**	10,602	7,782	7,398	4,843

Significant differences between UK and US generally accepted accounting principles Pursuant to securities legislation in the USA, the company has a reporting obligation under the Securities Exchange Act of 1934. This arises in respect of the issues of dollar preference shares and loan capital in the USA. An annual report on Form 20-F is being filed with the SEC in the USA and, although much of the detailed financial analyses therein is also shown in this report and accounts, the additional disclosures on this and the following three pages have been extracted from the Form 20-F as they contain important information which may be of interest to shareholders of the company, particularly those resident in the USA.

The Group's consolidated financial statements are prepared in accordance with UK generally accepted accounting principles (UK GAAP). These differ in certain significant respects from generally accepted accounting principles followed in the USA (US GAAP) and, in the case of the Group, these differences are summarised as follows:

(a) The Group's premises are carried in the accounts at original cost or subsequent valuation. Revaluation reserves are reflected in the consolidated balance sheet. Under US GAAP, revaluations of property are not permitted to be reflected in the financial statements.

(b) Freehold and long leasehold premises are maintained in a state of good repair with regular maintenance expenditure being charged against operating profit. Based on an assessment of useful life and estimated residual value, no depreciation is charged. US GAAP requires that such properties be depreciated. The Group applies depreciation for US GAAP purposes at a rate of 2% per annum on original cost.

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

(d) Deferred tax is provided on the liability method in respect of timing differences which are expected to result in a taxation liability in the foreseeable future. Under the liability method, deferred tax is calculated at the rate of tax that it is estimated will be applicable when the temporary differences crystallise. Under US GAAP, provision for deferred tax under the liability method is required in full for all timing differences. Deferred tax assets recognised are subject to adjustment for valuation allowances.

(e) Goodwill arising on acquisition of subsidiaries and associates is charged against reserves in the year of acquisition. Under US GAAP, goodwill is capitalised and amortised through the profit and loss account over the period estimated to benefit which, in the Group's case, is 25 years.

(f) Under UK GAAP, dividends declared after the year end are recorded in the period to which they relate, whereas US practice is to record dividends in the period in which they are declared.

(g) Certain loan origination fees in the Group are recognised immediately as income whereas under US GAAP fee income from originating a loan is spread over the life of the loan in accordance with US FASB Statement No. 91, "Accounting for Non Refundable Fees and Costs".

(h) In arriving at operating profit, the Group assesses and charges the cost of providing pensions on a regular basis in accordance with the advice of independent professionally qualified actuaries. Contributions to UK pension funds are made at rates calculated by the actuaries to provide, over the average remaining service of eligible employees, for all retirement benefits related to projected final salaries. For the purposes of US GAAP, the Group complies with US FASB Statement No. 87, "Employers' Accounting for Pensions", which prescribes the method of actuarial valuation and also requires pension fund assets to be assessed at fair value and the assessment of liabilities to be based on current interest rates.

(i) Under UK GAAP, long-term assurance policies are valued at the net present value of the profits inherent in such policies, whereas under US GAAP this is not permitted to be reflected in the financial statements.

(j) Under UK GAAP, the Group's investments in debt securities and equity shares are classified as being held as investment securities, held for the purpose of hedging or held for dealing purposes. The accounting treatment of these assets is detailed in Accounting policies Note 10 on page 32. For the purposes of US GAAP, the Group complies with US FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities" under which debt securities and equity shares are required to be classified between trading securities, available for sale securities and held to maturity securities. Held to maturity securities are accounted for in the same way as securities held for investment purposes under UK GAAP. Trading securities are accounted for in the same way as securities not held for investment purposes under UK GAAP. Available for sale securities are reported at market value with unrealised gains and losses excluded from earnings but reported in a separate component of shareholders' funds.

(k) Under UK GAAP, the Group establishes specific provisions against loans and advances when, as a result of a detailed appraisal of the portfolio, it is considered that recovery is doubtful. Under US GAAP, the Group complies with US FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan", ("SFAS 114"), which requires that impaired loans be determined on the basis of the present value of expected future cash flows discounted at the loans' effective interest rates or at the loans' observable market values or the fair values of collateral if the loans are collateral dependent. Having compared the carrying value of its loan portfolio calculated under SFAS 114 with the carrying value (net of bad debt provisions) calculated under UK GAAP, the Group has determined that there is no material effect on the reconciliation between UK GAAP and US GAAP net income, shareholders' funds and total assets.

(l) In accordance with UK GAAP, the Group's accounting policy for finance lease income receivable is to allocate total gross earnings to accounting periods using the actuarial after tax method to give a constant periodic rate of return on the net cash investment. Application of US FASB Statement No. 13, "Accounting for Leases" gives rise to a level rate of return on the investment in the lease but without taking into account tax payments and receipts. This results in income being recognised in different periods than under UK GAAP.

(m) In accordance with UK GAAP, the Group has charged a total of £29 million to the consolidated profit and loss account for the costs of completing work on its computer systems to ensure that they are Year 2000 compatible. Under US GAAP, the Group complies with a pronouncement that such costs should be charged to the net income statement as incurred.

Selected figures in accordance with US GAAP The tables below summarise the significant adjustments to profit attributable to ordinary shareholders (net income), shareholders' funds and total assets which would result from the application of US GAAP instead of UK GAAP. Where applicable, the adjustments are stated gross of tax.

Net income	**1997 £m**	1996 £m
Net income as reported under UK GAAP	**510**	496
Property depreciation	**—**	(1)
Disposal of revalued property	**1**	1
Deferred tax	**(22)**	(3)
Amortisation of goodwill	**(4)**	(6)
Loan origination fees	**15**	14
Pension costs	**28**	13
Long-term assurance policies	**2**	(16)
Leasing	**6**	(8)
Year 2000 costs	**23**	—
Approximate net income under US GAAP	**559**	490
Preference dividends	**(53)**	(57)
Approximate net income available for ordinary shareholders under US GAAP	**506**	433

Shareholders' funds	**1997 £m**	1996 £m
Shareholders' funds as reported under UK GAAP	**3,042**	2,510
Revaluation of property less depreciation	**(138)**	(136)
Deferred tax	**(213)**	(93)
Goodwill	**392**	340
Loan origination fees	**(24)**	(39)
Proposed dividend	**131**	110
Pension costs	**1**	(27)
Leasing	**(2)**	(8)
Long-term assurance policies	**(104)**	(106)
Debt securities and equity shares	**453**	121
Year 2000 costs	**23**	—
Approximate shareholders' funds under US GAAP	**3,561**	2,672

Total assets	**1997 £m**	1996 £m
Total assets as reported under UK GAAP	**72,601**	61,116
Revaluation of property less depreciation	**(138)**	(136)
Goodwill	**396**	343
Acceptances	**862**	933
Long-term assurance policies	**(101)**	(90)
Loans and advances to customers	**(1)**	(5)
Debt securities and equity shares	**453**	121
Approximate total assets under US GAAP	**74,072**	62,282

Risk elements in lending The Group's provisioning policy for bad and doubtful debts is described under Accounting policies Note 9 on page 32. There are differences between the provisioning policies of banks in the UK and the USA. In common with other UK banking groups, interest receivable on doubtful loans and advances is brought into the profit and loss account as income as it accrues provided that its collectibility is not subject to significant doubt. Interest debited to borrowers' accounts, the collectibility of which is subject to significant doubt, is credited to an interest in suspense account. Loans and related accrued interest are charged off only when, as a matter of banking judgement, the extent of the loss is confirmed. When management determines that a charge off is appropriate, the principal amount and accrued interest on the obligation are written down to estimated net realisable value. In contrast, banks in the USA typically stop accruing interest when loans become overdue by 90 days or more, or recovery is doubtful, and charge off loans more rapidly.

The cumulative effect of these policies is to increase the relative size of the Group's gross loan portfolio and the specific provision for bad and doubtful debts, compared with those of US banks. This also has the effect of increasing the Group's bad debt provisioning ratios compared with those which result from the adoption of US bank accounting practices. However, management believe that this effect is not material and the policies do not result in a significant adjustment to the Group's net income, shareholders' funds and total assets for restatement under US GAAP.

Generally, the Group's advances control and review procedures do not include the classification of loans as non-accrual, accruing past due, restructured and potential problem loans, as defined by the SEC. The following table shows the estimated amount of loans which would be reported using the SEC's classifications:

At 30th September	**1997 £m**	1996 £m	1995 £m	1994 £m	1993 £m
Loans accounted for on a non-accrual basis:					
domestic	**462**	534	591	755	860
foreign	**75**	86	99	76	64
Accruing loans which are contractually overdue 90 days or more as to principal or interest*:					
domestic	**217**	236	207	176	182
foreign	**14**	3	13	20	6
Loans not included above which are classified as "troubled debt restructurings" by the SEC:					
domestic	**13**	34	87	94	116
foreign	**—**	—	6	5	1
Total	**781**	893	1,003	1,126	1,229
Total provisions as a % of risk elements in lending	**59%**	53%	54%	56%	52%

*Generally, lending by way of overdraft has no fixed repayment schedule and consequently is not included in this category.

Loans that are current as to payment of principal and interest and not reflected in the above table, but as to which the Group has serious doubts as to the ability of the borrower to comply with loan repayment terms, totalled approximately £116 million at 30th September 1997 (1996 – £97 million). In accordance with the Group's provisioning policy for bad and doubtful debts, it is considered that adequate provisions for the above risk elements in lending have been made in the accounts.

Gross interest income not recognised but which would have been recognised in the year ended 30th September 1997 under the original terms of non-accrual and restructured loans amounted to £42 million from domestic loans (1996 – £60 million) and £12 million from foreign loans (1996 – £7 million). Interest on non-accrual and restructured loans included in the consolidated profit and loss account in the year ended 30th September 1997, totalled £2 million from domestic loans (1996 – £14 million) and £4 million from foreign loans (1996 – £2 million).

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