The Royal Bank of Scotland Group plc

Report & Accounts 1998

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Corporate statement

The Royal Bank of Scotland Group, headquartered in Edinburgh, provides high quality, competitively priced banking, insurance and related financial services.

Our core market is the United Kingdom. We are active in Europe to serve and develop our UK banking customer base, and in the north-east USA to diversify our earnings.

We aim to be recognised as the best performing financial services group in the United Kingdom. In striving towards that aim we are mindful of the responsibilities to shareholders, customers, employees and the communities in which we operate.

Achieving our aim while successfully balancing these responsibilities is the primary challenge. We believe that we can best respond to this challenge by remaining independent.

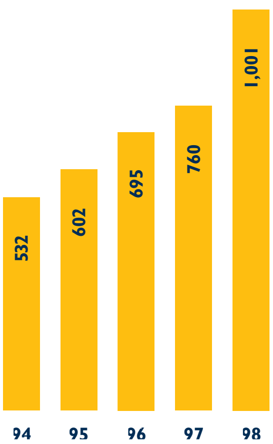
Financial highlights

Profit before tax £1,001m (1997 – £760m)

for the year ended 30th September	**1998 £m**	1997 £m
Profit before provisions and exceptional items	**1,217**	916
Profit before tax and exceptional items	**1,007**	768
Profit before taxation	**1,001**	760
Profit attributable to ordinary shareholders	**637**	457
Cost:income ratio – Group	**52.0%**	52.5%
– UK Bank	**54.6%**	57.1%
Return on ordinary shareholders' equity – pre-tax*	**41%**	33%
– post-tax*	**28%**	23%
Earnings per share – unadjusted	**73.4p**	55.4p
– adjusted	**72.3p**	53.5p
Dividends per ordinary share	**24.6p**	21.4p
Dividend cover (times)	**3.0**	2.6
Total assets	**79,676**	72,601
Total shareholders' funds – ordinary	**2,115**	2,308
– preference	**838**	734
Risk asset ratio – tier 1	**6.6%**	6.8%
Risk asset ratio – total	**11.2%**	11.6%

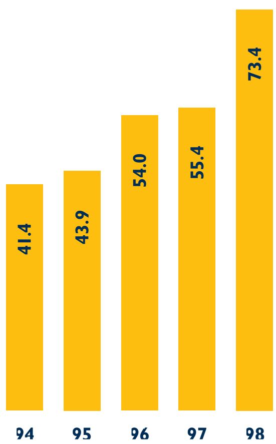
*Including exceptional items

Profit before tax (£m)



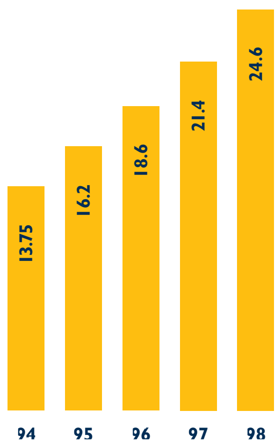
The Group's profit before tax was, at £1,001 million, 32% higher than the prior year. Profit before tax and exceptional items rose by 31% to a record level of £1,007 million (1997 – £768 million).

Earnings per share (pence)



Earnings per share increased to 73.4p. Adjusted earnings per share, which shows the effect of excluding exceptional items, increased by 35% to 72.3p (1997 – 53.5p).

Dividends per ordinary share (pence)



The directors have recommended a final dividend of 17.47p which, when added to the interim dividend of 7.13p, will produce a total for the year of 24.6p, an increase of 15%. The dividend is covered 3.0 times.

Chairman's statement

A further year of record profit and continued growth reflects the strength of our diverse range of businesses in the UK and US and the flexibility which they afford us in responding to new opportunities in financial services. In the UK we have improved market share across a wide range of our retail and corporate banking businesses, and two of our new businesses moved into profit. Direct Line again improved its profitability, and Citizens, now once again 100% owned, continued to expand its market position and its profit.

Financial performance Profit before tax rose by 32% to £1,001 million (1997 – £760 million). Profit before tax and exceptional items rose by 31% to £1,007 million. Provisions for bad and doubtful debts, excluding exceptional provisions for bad debts in the Far East, increased by £54 million, most of it being formula-driven, reflecting mainly growth of credit cards and personal loans. Exceptional provisions of £146 million have been made against the Group's exposure in the Far East. At 30th September provisions in Indonesia amounted to £118 million, or 50% of the outstanding balances.

Dividend The directors have recommended a final dividend of 17.47p which, when added to the interim dividend of 7.13p, will produce a total for the year of 24.6p, an increase of 15%. The dividend is covered 3.0 times.

Staff profit sharing Staff throughout the Group are the key contributors who have made possible our continuing success. Staff entitled to participate in the Group's profit sharing schemes will receive a profit share of 10% (1997 – 9.5%) of basic salaries as at 30th September 1998. The total payment to be made will be £43 million (1997 – £36 million).

Business developments In October 1997 we announced a joint venture with Virgin Direct to launch a personal bank account, the Virgin *One* Account, which breaks down the barrier between savings and borrowings.

In December 1997 we completed the acquisition of the holding company of the rolling stock leasing company, Angel Train Contracts Limited.

In March 1998 we completed the disposal of the Registrars business to a UK subsidiary of the Australian company, Computershare Limited, in exchange for shares in Computershare.

We reached agreement with Birmingham Midshires Building Society in June 1998 to cancel the framework agreement with them which would have led to the acquisition of the business of the Society. This agreement followed our decision not to increase the offer we had made for the business of the Society following receipt by the Society's board of a higher offer from Halifax plc.

In July 1998 we completed the acquisition from Fleet Financial Group, Inc. of Boston of the 49% of our UK credit cards joint venture, RBS Advanta, which we did not already own.

In September 1998 we completed the acquisition from the Bank of Ireland of the 23.5% of Citizens Financial Group not then owned by the Royal Bank Group.

In September 1998 we reached agreement to purchase the minority shareholding in the holding company of Privilege Insurance.

In October 1998 we sold our 33.12% holding in Newton Management Limited to Mellon Bank Corporation of the US.

Our outright ownership of RBS Advanta, Privilege and Citizens considerably increases our operational and strategic flexibility.

Board of directors Fred Goodwin was appointed to the board on 1st August 1998 on taking up his appointment as deputy group chief executive. Fred joined us from National Australia Group, where he was chief executive of Clydesdale and Yorkshire Banks.

Our group finance director, Bob Speirs, retired from the board in October 1998 after five years during which he played a central role in achieving the Group's record of delivering substantial profit increases. Bob will continue his involvement with the Group as chairman of Direct Line Insurance and Privilege Insurance and as a director of Citizens Financial Group.

Tony Schofield retired in March 1998 after a career with the Bank lasting more than 40 years. Tony joined the board in 1992 as managing director, retail banking, and led the successful transformation of our retail banking operations. Tony remains chairman of The Royal Bank of Scotland International Limited and Virgin Direct Personal Finance Limited.

Jaime Botin, vice-chairman of Banco Santander Group, resigned from the board in February 1998 after seven years during which his international banking experience made an important contribution to the Group.

Also in February 1998, Juan Inciarte, executive vice president of Banco Santander, was appointed to the board.

Cameron McLatchie, chairman and chief executive of British Polythene Industries PLC, joined the board on 1st October 1998.

Economic situation During most of 1998 the UK economy continued to show divergent trends with a strong exchange rate hitting exporters and manufacturers, while the service sector continued to grow. The higher interest rates adopted to reduce inflationary pressures supported the exchange rate, squeezing manufacturers further.

More recently inflation has moved back to target. However, continuing problems in international markets, primarily in the Far East, were exacerbated by the difficulties in Russia. These developments increased the risk that domestic deceleration will be sharper than had been expected; recent interest rate reductions have gone some way to offset this.

Prospects It is difficult to predict the extent to which recent difficulties in various global economies may lead to economic slowdown in the United Kingdom. However, a period of greater uncertainty lies ahead.

The Group is well equipped to face this challenge. Our strength, diversity and flexibility will enable us to respond positively, but prudently, to the many opportunities arising from rapidly changing market conditions.

Chief Executive's review

As a result of excellent performances by each of our main businesses, we increased both our Group profit before tax and our earnings per share by 32%.

UK Bank In the largest part of our business, the UK Bank, we increased our profit before exceptional items by 15% to £680 million (1997 – £591 million) while the cost:income ratio improved to 54.6% (1997 – 57.1%).

In Retail Banking, we achieved strong growth in credit cards and personal loans and increased our income from mortgages, deposits and money transmission products. In small business banking, we expanded our activities and were highly rated for good customer service.

In Corporate and Institutional Banking, we increased our income from lending, payments and treasury. In our various specialist areas, we maintained our leading positions in the Private Finance Initiative and in acquisition finance, and were highly rated in development capital.

The Royal Bank of Scotland International In offshore banking, we increased our profit by 22% to £55 million (1997 – £45 million).

The Royal Bank of Scotland International made good progress in each of its four main activities: offshore personal banking, global custody, treasury and corporate banking.

Angel Trains In the nine months following our acquisition of Angel Trains it fully met our expectations with a profit of £46 million. A combination of technical and financial skills has enabled Angel Trains to be very successful in winning new business.

Investor Services In Investor Services, we moved from a loss of £12 million in 1997 to a profit of £5 million in 1998. RBS Trust Bank recorded a profit of £30 million. By October 1998, we completed the transfer of all our global custody business to RBS Trust Bank.

Direct Line Insurance The profit before tax of Direct Line Insurance increased to £64 million (1997 – £36 million). The number of our in-force motor insurance policies was maintained at just over 2 million and motor premium rates maintained the improving trend which became established around July 1997. The number of our in-force home insurance policies increased to 0.86 million (1997 – 0.83 million).

New Retail Financial Services Businesses During the year, Tesco Personal Finance launched a number of products. By the end of the year, it had acquired over 600,000 customers. Virgin Direct Personal Finance launched its innovative *One* account to Virgin's own customers in October 1997, and more widely in May 1998. Losses in these two new businesses reflect significant start-up and customer acquisition costs.

The number of cards issued by RBS Advanta increased to 640,000 (1997 – 400,000). During the year, RBS Advanta moved into profit, as did Direct Line Financial Services, which continued to expand in mortgages and personal loans.

Citizens Citizens maintained its track record with a 31% increase in its profit before tax and exceptional items to £247 million (1997 – £189 million). Citizens' cost:income ratio improved to 50.2% (1997 – 54.4%).

Citizens achieved strong growth in loans, deposits and mutual funds. During the year, Citizens made a profit of £33 million on the sale of its consumer credit card portfolio.

Exceptional items Our results for 1998 include a number of exceptional items, including a gain of £96 million on the flotation of Superdiplo, the Spanish supermarket group, a profit of £57 million on the sale of part of our shareholding in Banco Santander, and provisions amounting to £146 million against possible bad debts and investments in the Far East.

Year 2000 We recognise the importance of the Year 2000 issue and the implications for our suppliers and customers. A programme of work has been in place since 1996 and good progress has been made during the current year in line with the original timescale.

Outlook It seems likely that economic conditions will be somewhat more difficult in the next year or two. In these circumstances, we should benefit from the strength and diversity of our business – in particular, the high quality of the income from our UK network operations and from Citizens. At the same time, our diverse and flexible culture will enable us to expand our core businesses in response to appropriate opportunities as they emerge.

Operating and financial review

The following review is based on the financial statements on pages 39 to 81 of this report and accounts. It discusses and analyses the Group's performance for the year to 30th September 1998 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.

Operating review

Group profit before tax rose by 32%, from £760 million to £1,001 million. Profit before tax and exceptional items increased by 31%, from £768 million to £1,007 million.

Net interest income grew by 13% to £1,598 million. Strong growth was achieved in both corporate and personal lending. Group average interest-earning assets increased by 12%. The interest margin was maintained at 2.5%.

Non-interest income, excluding general insurance and exceptional items, grew by £413 million to £1,416 million. Of this increase, £228 million came from Angel Trains. The balance came from increased fees and commissions and higher dealing profits. In addition to this, an exceptional gain of £96 million was achieved on our investment in Superdiplo, the Spanish supermarket group.

General insurance premium income, after reinsurance, increased by 12% to £600 million.

Total income, excluding exceptional items, increased by 22% to £3,614 million. Excluding Angel Trains, Investor Services and the New Retail Financial Services Businesses, the increase was 13%.

Operating expenses were up by 21% to £1,879 million. Excluding Angel Trains, Investor Services and the New Retail Financial Services Businesses, the increase was 9% – mainly because of higher technology charges to support growth in business volumes.

Group cost:income ratio improved from 52.5% to 52.0% as a result of the movements in income and expenses.

General insurance claims, after reinsurance, increased by 6% to £518 million. In Direct Line Insurance, claims fell by 1%.

Provisions for bad debts, excluding exceptional provisions for bad debts in the Far East, increased by £54 million to £200 million, mainly because of higher formula-driven provisions associated with strong growth in credit cards and personal loans.

Exceptional provisions of £146 million have been made to cover the Group's exposure in the Far East. Of this amount, £53 million was provided in the first half, £93 million in the second half. At 30th September 1998, provisions in Indonesia amounted to £118 million, or 50% of the outstanding balances.

Other exceptional items include a gain of £57 million on the sale of 3.6 million shares in Banco Santander. This sale, together with recent share issues by Banco Santander, reduced the Group's shareholding from 4.9% to 3.4%.

The tax charge was £302 million on profits before exceptional items – an effective rate of 30%. On the exceptional items, there was a net tax credit of £16 million, reflecting the tax credit associated with the write-down of finance leases.

Profit attributable to ordinary shareholders after tax, minority interests and preference dividends, increased by 39%, from £457 million to £637 million.

Earnings per share increased by 32%, from 55.4p to 73.4p. After adjusting for the exceptional items, earnings per share increased by 35%, from 53.5p to 72.3p.

Group return on equity, after tax, increased from 23% to 28%.

Group total assets increased by 10% to £79.7 billion. Within this, loans and advances to customers grew by 6% to £41.0 billion. The acquisition of Angel Trains added over £800 million to the Group balance sheet: this is mainly included in tangible fixed assets.

Group risk-weighted assets increased from £45.8 billion to £49.1 billion. At 30th September 1998, the capital ratios were 6.6% (tier 1) and 11.2% (total).

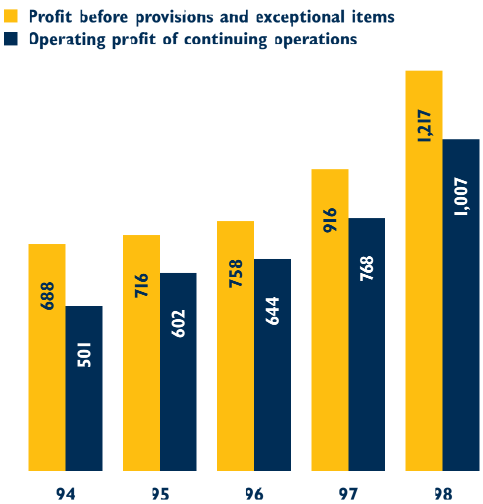
Year 2000 The directors recognise the importance of the Year 2000 issue and the implications for the Group and its suppliers and customers. A programme of work has been in place since 1996 and good progress has been made during the current year. Regular reports are made to the Group Board in order that they monitor this progress. Furthermore, any new systems being developed or deployed incorporate only Year 2000 compliant components.

During 1999, final trials will be undertaken to ensure that our key customer services are fully Year 2000 compliant. In addition, existing business continuity arrangements will be enhanced to cope with the unique risks posed by the Millennium, in the light of discussions with other banks, counterparties and utilities.

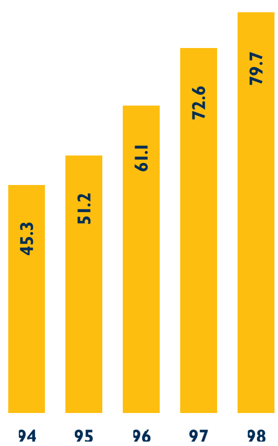
A provision of £29 million was made in the UK Bank in the year ended 30th September 1997 in connection with Year 2000. Expenditure of £14 million was set against this provision during the current year (1997 – £6 million).

EMU The introduction of European Economic & Monetary Union (EMU) represents the most significant economic change of recent years, with important implications both for companies in countries in the first phase and UK companies. A detailed programme has been established to address the requirements of the initial phase and the cost of this work is not expected to exceed £11 million. The Bank will be in a position to meet customers' EMU requirements from January 1999.

Profit
(£m)



Total assets
(£bn)



Divisional performances
The UK Bank

	1998 £m	1997 £m
Net interest income	**1,067**	921
Non-interest income	**800**	733
Total income	**1,867**	1,654
Total expenses	**1,020**	945
Profit before provisions	**847**	709
Provisions for bad and doubtful debts	**158**	116
Amounts written off investments	**9**	2
Profit before exceptional items	**680**	591

Five-year financial summary	1998 £m	1997 £m	1996 £m	1995* £m	1994* £m
Profit before provisions	**847**	709	610	486	469
Provisions and investment write-offs	**(167)**	(118)	(113)	(94)	(158)
Profit before exceptional items	**680**	591	497	392	311
Cost:income ratio (%)	**54.6**	57.1	58.7	63.9	63.8
Pre-tax return on ordinary equity (%)	**39**	39	36	34	31
Total assets (£bn)	**52.5**	51.5	45.5	40.5	35.3
Shareholders' funds (£m)	**2,292**	2,232	1,819	1,728	1,500
Employees at 30th September	**18,870**	18,380	17,360	17,980	18,950

*pro-forma

The UK Bank increased its profit before exceptional items by 15%, from £591 million to £680 million.

Income increased by 13%, costs by 8%. As a result of this, the UK Bank's cost:income ratio improved further, from 57.1% to 54.6%. In addition to this there was exceptional income of £96 million in respect of the investment in Superdiplo.

UK Bank provisions for bad debts increased from £116 million to £158 million, mainly because of increased formula-driven provisions associated with strong growth in credit cards and personal loans. Provisions against UK corporate lending increased by £17 million. In addition to these provisions, exceptional provisions of £146 million were made against possible bad debts and investments in the Far East.

As in previous years, approximately half of the UK Bank's income came from Retail Banking, and half from Corporate & Institutional Banking.

Retail Banking increased its credit card and personal loan portfolios by over 25%, and expanded its mortgages by almost 10%. It also increased its income from money transmission products and 500,000 customers are now using its fee-earning Royalties current account. In small business banking, Retail Banking increased its activities and was highly rated in the financial press for customer service.

Corporate and Institutional Banking increased its income from a broad range of corporate and commercial customers across the UK by over 10%. Treasury income grew by 15%. Payments continued to achieve strong growth in electronic banking services. In its various specialist areas, Corporate and Institutional Banking maintained its leading positions in the Private Finance Initiative and in acquisition finance, and was highly rated in development capital.

Notes: The UK Bank excludes RBSI, Angel Trains, Investor Services (i.e. RBS Trust Bank and RBS Global Custody), Tesco Personal Finance, Virgin Direct Personal Finance and RBS Advanta, which are disclosed separately.

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.

The Royal Bank of Scotland International (RBSI)

	1998 £m	1997 £m
Net interest income	**68**	56
Non-interest income	**36**	30
Total income	**104**	86
Total expenses	**49**	40
Profit before provisions	**55**	46
Provisions for bad and doubtful debts	**—**	1
Profit before tax	**55**	45

Five-year financial summary	**1998 £m**	1997 £m	1996 £m	1995* £m	1994* £m
Profit before provisions	**55**	46	38	29	29
Provisions	**—**	(1)	—	(2)	(1)
Profit before tax	**55**	45	38	27	28
Cost:income ratio (%)	**47.1**	46.5	44.1	38.3	29.3
Pre-tax return on ordinary equity (%)	**20**	20	22	19	21
Total assets-gross (£m)	**7,259**	6,130	4,511	3,237	3,205
Shareholders' funds (£m)	**299**	254	194	147	134
Employees at 30th September	**890**	680	590	440	400

*pro-forma

The Royal Bank of Scotland International, headquartered in Jersey, increased its profit from offshore banking by 22%, to £55 million (1997 – £45 million).

Income rose by 21%, and costs by 22%, reflecting growth in the business and the full-year impact of the acquisition in March 1997 of the offshore custody business of S. G. Warburg & Co. Ltd. Excluding the custody business, income was up by 12%, costs by 9%.

RBSI has made good progress in each of its four main activities:

In Offshore Personal Banking, profits increased by 24%.

The two custody businesses have been integrated and the combined business is one of the largest custodians in Jersey, responsible for funds amounting to £14 billion.

The Treasury operation has a leading position in offshore money market and foreign exchange business. Its income grew by 26%.

RBSI expanded its corporate banking services, including electronic banking services, for offshore financial intermediaries.

Angel Trains

	1998 £m	1997 £m
Operating lease rentals	**228**	—
Interest payable	**(45)**	—
Total income	**183**	—
Depreciation and maintenance	**118**	—
Administrative expenses	**19**	—
Profit before tax	**46**	—
Cost:income ratio (%)	**75**	—
Total assets (£m)	**887**	—
Shareholders funds (£m)	**235**	—
Employees at 30th September	**80**	—

Angel Trains was acquired by the Group in December 1997 for £395 million. It is one of the three rolling stock leasing companies which were privatised in 1996. Angel Trains acquires rolling stock from manufacturers, leases the rolling stock to train operating companies and contracts to manage the maintenance of the rolling stock.

In the nine months following the acquisition of Angel Trains, it fully met the Group's expectations, with a profit of £46 million.

A combination of technical and financial skills has enabled Angel Trains to be very successful in winning new business, including orders for Regional Railways North East and English, Welsh and Scottish Railways.

Note: The purchase of Angel Trains for £395 million was funded by equity of £200 million and borrowings of £195 million. The interest on those borrowings has been deducted in arriving at the profit disclosed above.

Investor Services

	1998 £m	1997 £m
Net interest income	**17**	20
Non-interest income	**120**	94
Total income	**137**	114
Total expenses	**132**	126
Profit/(loss) before tax	**5**	(12)
Analysis:		
RBS Trust Bank	**30**	12
RBS Trust Bank (Holdings)	**(13)**	(7)
RBS Global Custody	**(13)**	(20)
Computershare/Registrars	**1**	3
	5	(12)

Five-year financial summary	**1998 £m**	1997 £m	1996 £m	1995 £m	1994 £m
Profit/(loss) before exceptional items	**5**	(12)	(17)	(13)	1
Cost:income ratio (%)	**96**	111	134	127	110
Shareholders' funds (£m)	**55**	48	5	3	2
Employees at 30th September	**1,190**	2,020	1,240	1,170	880

In March 1997 the Group acquired the global custody and related businesses of S.G.Warburg & Co. Ltd. and Mercury Asset Management, and formed a combined unit, RBS Trust Bank, which offers global custody and fund administration services.

Investor Services had a very successful year. It moved from a loss of £12 million to a profit of £5 million. In both global custody and fund administration, RBS Trust Bank achieved significant growth. The substantial transfer of customers from RBS Global Custody to RBS Trust Bank was completed successfully in October 1998.

RBS Trust Bank made a profit of £30 million. RBS Trust Bank (Holdings), which carries the funding cost of the investment in RBS Trust Bank, recorded a deficit of £13 million. During 1998, while RBS Global Custody was being run down, it recorded a loss of £13 million.

RBS Trust Bank is now custodian to £300 billion of assets, including assets of the pension funds of more than half the companies in the FTSE 100 Index. RUFUS, RBS Trust Bank's fund administration system, supports about 20% of the collective investment market in the UK.

In March 1998, the Group completed the disposal of the Registrars business to Computershare Limited, in return for an 11% stake in Computershare, worth £23 million at that time. This increased the Group's shareholding in Computershare to 20%. Investor Services includes the Registrars business up to 1st January 1998, the effective date of the disposal, and the interest in 20% of Computershare thereafter. At 30th September 1998 the Group's shareholding in Computershare had a market value of £50 million against a book value of £26 million.

Direct Line Insurance

	1998 £m	1997 £m
Earned premiums	**672**	644
Reinsurers' share	**(119)**	(118)
Insurance premium income	**553**	526
Net interest income	**66**	66
Non-interest income	**46**	47
Total income	**665**	639
Expenses	**128**	124
Gross claims	**561**	571
Reinsurers' share	**(88)**	(92)
Profit before tax	**64**	36
In-force policies (000)		
Motor	**2,053**	2,063
Home	**863**	833
Total	**2,916**	2,896
Gross written premium (£m)		
Motor	**490**	472
Home	**172**	157
Creditor	**55**	39
Rescue	**5**	—
Travel	**6**	3
Total	**728**	671

Five-year financial summary	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Profit before exceptional items	**64**	36	26	112	110
Operating ratio (%)	**101**	106	107	89	80
Pre-tax return on equity (%)	**18**	11	8	39	52
Total assets (£m)	**1,201**	1,124	1,042	911	781
Insurance reserves – net (£m)	**872**	773	720	620	507
Shareholders' funds (£m)	**315**	343	326	311	258
Employees at 30th September	**3,200**	3,020	2,690	2,850	2,610

Direct Line Insurance increased its profit from £36 million to £64 million. Profit from motor insurance was up by £16 million, profit from home insurance by £9 million. Overall, premium income was up by 5%, while expenses were up by 3%. Claims fell by 1%.

In motor insurance, policy numbers were stable at 2.1 million. Prices maintained the improving trend which began around July 1997. Average written motor premiums were up by 4%. In motor insurance, the combined operating ratio (the total of expense ratio and claims ratio) improved from 113% to 109%.

Since Direct Line Rescue was launched in May 1998, the number of policies has grown rapidly to 94,000, including many motorists not already customers of Direct Line.

In home insurance, the policy numbers increased from 833,000 to 863,000. The increase in average written premiums was 2%. In home insurance, the combined operating ratio improved from 88% to 85%.

In May 1998, Direct Line Insurance paid a dividend of £70 million to the Group.

Note: These accounts are prepared on the basis of the Group's normal accounting policies. Direct Line Insurance's own accounts are prepared in line with normal insurance industry practice.

New Retail Financial Services Businesses

	1998 £m	1997 £m
Net interest income	**82**	36
Non-interest income – associated companies	**(4)**	(7)
– other	**40**	23
Insurance premium income	**47**	9
Total income	**165**	61
Expenses	**145**	75
General insurance claims	**45**	8
Loss before provisions	**(25)**	(22)
Provisions	**27**	13
Loss before tax	**(52)**	(35)

Five-year financial summary	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Loss before provisions	**(25)**	(22)	(39)	(15)	(7)
Provisions	**(27)**	(13)	(4)	(1)	—
Loss before tax	**(52)**	(35)	(43)	(16)	(7)
Ordinary shareholders' funds – Group's share (£m)	**131**	55	42	23	25
Total assets (£m)	**3,129**	1,984	837	273	61
Employees at 30th September	**2,390**	1,840	690	220	110

All these New Retail Financial Services Businesses are treated as subsidiaries, except Direct Line Life and Unit Trusts and Linea Directa, which are treated as associated companies.

Direct Line Financial Services

	Commenced trading	% owned	1998 £m	1997 £m
Profit/(loss) before tax	March 1993	100	**6**	(10)

Direct Line Financial Services moved from a loss of £10 million in 1997 to a profit of £6 million in 1998. Direct Line Financial Services grew its mortgages by 20%, from £1.2 billion to £1.4 billion, and its personal loans by 75%, from £122 million to £214 million.

Privilege Insurance

	Commenced trading	% owned	1998 £m	1997 £m
Loss before tax	October 1994	100	**(4)**	(2)

Privilege Insurance expanded its policy numbers from 152,000 to 264,000, and established a joint initiative with Barclays Bank. Increased losses in 1998 reflect start-up costs associated with this and other initiatives.

In September 1998, the Group reached agreement to acquire the 40% minority shareholding in Privilege.

Direct Line Life and Unit Trusts

	Commenced trading	% owned	1998 £m	1997 £m
(Loss)/profit before tax	February 1995	50	**(2)**	3

There was a loss of £2 million in 1998, after a profit of £3 million in 1997. However, the 1997 figure included a gain of £5 million on the sale of 50% of these companies to Scottish Widows. During the year Direct Line Life added personal pensions to its range of products.

Linea Directa

	Commenced trading	% owned	1998 £m	1997 £m
Loss before tax	June 1995	50	**(2)**	(5)

Linea Directa is achieving increasing recognition in Spain. Market testing has identified that its name has prompted awareness of over 80%. It increased its policy numbers from 131,000 to 177,000. The Group's share of its losses reduced from £5 million in 1997 to £2 million in 1998. Linea Directa broke even in the second half of 1998.

Direct Line Accident Management

	Commenced trading	% owned	1998 £m	1997 £m
Loss before tax	August 1995	100	**(9)**	(8)

Direct Line Accident Management's loss of £9 million reflects the continuing investment in repair centres. Six repair centres have been fully operational during the year, with repairs carried out on 35,000 cars.

RBS Advanta

	Commenced trading	% owned	1998 £m	1997 £m
Profit/(loss) before tax	February 1996	100	**7**	(2)

RBS Advanta continued to expand rapidly. The number of credit cards issued by it increased from 400,000 to 640,000. RBS Advanta moved from a loss of £2 million in 1997 to a profit before tax of £7 million in 1998.

In July 1998, the Group acquired the 49% minority shareholding in RBS Advanta.

Tesco Personal Finance

	Commenced trading	% owned	1998 £m	1997 £m
Loss before tax	July 1997	50	**(35)**	(11)

During the year, Tesco Personal Finance extended its range of financial products, with the launch of personal loans, home and travel insurance. By September 1998, Tesco Personal Finance had acquired over 600,000 customers. Its loss of £35 million in 1998 reflects start-up costs; after minority interests, the Group's share of this loss was £17.5 million. In 1998, the second half loss of £12 million was substantially lower than the £23 million loss in the first half.

Virgin Direct Personal Finance

	Commenced trading	% owned	1998 £m	1997 £m
Loss before tax	October 1997	50	**(13)**	—

Virgin Direct Personal Finance launched its innovative *One* Account to Virgin's own customers in October 1997, and more broadly in May 1998. The first year loss of £13 million was caused by start-up and customer acquisition costs.

Citizens

	1998 £m	1997 £m
Net interest income	**376**	352
Non-interest income	**117**	98
Gain on sale of consumer credit card portfolio	**33**	—
Total income	**526**	450
Expenses	**264**	245
Profit before provisions	**262**	205
Provisions	**15**	16
Profit before exceptional items	**247**	189

Five-year financial summary	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Profit before provisions	**262**	205	166	125	88
(Provisions)/net releases	**(15)**	(16)	2	(18)	(20)
Profit before exceptional items	**247**	189	168	107	68
US$/£ rate of exchange – average	**1.65**	1.63	1.54	1.58	1.51
Cost:income ratio (%)	**50.2**	54.4	54.9	56.6	63.4
Pre-tax return on equity (%)	**39**	37	41	32	25
Total assets (£m)	**9,714**	9,565	8,854	6,148	5,752
Shareholders' funds (£m)	**707**	575	522	337	314
Employees at 30th September	**5,010**	4,910	4,580	3,160	3,150

Citizens maintained its track record, with a 31% increase in its profit before exceptional items from £189 million to £247 million. In 1993 Citizens' profit was £36 million. Over the last five years, Citizens has completed 12 acquisitions and all of these banks have been converted to a common technology platform. Citizens is now one of the top 50 banks in the United States.

In Citizens, income was up by 17%, expenses by 8%. This led to an improvement in the cost:income ratio from 54.4% to 50.2%. Provisions for bad debts were similar to last year.

The increase in Citizens' income reflects strong volume growth in loans and deposits. Citizens also increased its income from service fees, mutual funds and trust funds, and made a profit of £33 million on the sale of its consumer credit card portfolio.

During the year, Citizens focused on improving its core business. It introduced many initiatives to improve its service to its personal and small business customers. Citizens also filled gaps in its network through the acquisitions of Woburn National Bank, near Boston, and branches of Branford Savings Bank in Connecticut.

In September 1998, the Group acquired the Bank of Ireland's 23.5% shareholding in Citizens for US$750 million.

Central items

The Centre's deficit for the year ended 30th September 1998 was as follows:

	1998 £m	1997 £m
Central income less expenses	**2**	(16)
Funding costs	**(40)**	(30)
Deficit before exceptional items	**(38)**	(46)

The Centre's balance sheet at 30th September 1998 was as follows:

	1998 £m	1997 £m
Book value of the shareholders' funds of business units:		
UK Bank	**2,292**	2,232
RBSI	**299**	254
Angel Trains	**235**	—
Investor Services	**55**	48
Direct Line Insurance	**315**	343
New Retail Financial Services Businesses	**131**	55
Citizens (net of minority interests in 1997)	**707**	440
Banco Santander (cost of shares – see note below)	**140**	180
	4,174	3,552
Net borrowing by the Centre	**(1,221)**	(510)
	2,953	3,042
Funded by Group shareholders' funds:		
Preference shares	**838**	734
Ordinary shareholders' funds	**2,115**	2,308
	2,953	3,042

Investment in Banco Santander As at 30th September 1998, the total cost of the Group's 3.4% shareholding in Banco Santander was £140 million and the market value was £370 million, giving an unrealised pre-tax gain of £230 million (1997 – £300 million), after realising gains of £57 million during the year.

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. Retail Banking focuses entirely on small businesses and personal customers. Corporate and Institutional Banking covers all corporate and commercial customers throughout the UK. Each area within the UK Bank 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 the 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.

To develop its business, Corporate and Institutional Banking will continue to 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.

Offshore, The Royal Bank of Scotland International will continue to develop new added-value products and services by complementing the onshore businesses within the Group.

Angel Trains, one of three rolling stock leasing companies which were privatised in 1996, has been very successful in winning new business.

Investor Services has strong links with Corporate and Institutional Banking through common customers. RBS Trust Bank has merged the Bank's Global Custody business with that of S.G. Warburg & Co. Ltd. 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. Direct Line Rescue has made a successful start and it is expected to grow strongly in the future. 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.

The New Retail Financial Services Businesses continue to introduce new customers and markets to the Group and help develop and expand the customer base.

Citizens now has total assets of US$16.5 billion. 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 1998, the Group continued to invest in new businesses such as RBS Advanta, Direct Line Financial Services, Direct Line Life and Unit Trusts, Tesco Personal Finance and Virgin Direct Personal Finance. Profits are already being generated in two of the new businesses, RBS Advanta and Direct Line Financial Services. 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 1998 was £254 million (1997 – £240 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 1998 amounted to £18 million (1997 – £19 million).

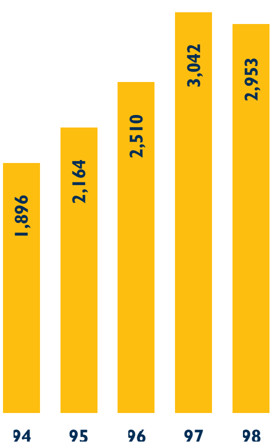
Shareholder value The Group's profits have again improved to record levels and the increased dividend is comfortably covered at 3.0 times.

Shareholders' funds at 30th September 1998 were £2,953 million (1997 – £3,042 million). The principal elements in the movement on shareholders' funds during the year were the retained profit of £422 million and the proceeds of £239 million from the issues of ordinary and preference share capital, less £754 million goodwill written off acquisitions in the year.

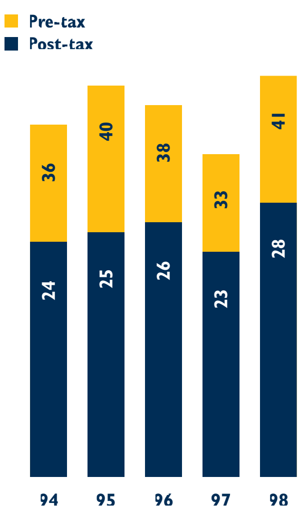
Earnings per share increased by 32% to 73.4p. The adjusted earnings per share, which excludes exceptional items, increased by 35% from 53.5p to 72.3p. The return on ordinary shareholders' equity (excluding the share premium account for dollar preference shares) continues to be high at 41% pre-tax and 28% 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.

Shareholders' funds (£m)



Return on equity (%)



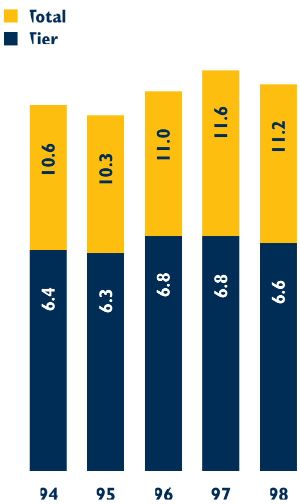
2 Financial review

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:

	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Capital base					
Tier 1 capital	**3,235**	3,107	2,539	2,092	1,857
Tier 2 capital	**2,950**	2,699	2,388	1,929	1,757
Total capital	**6,185**	5,806	4,927	4,021	3,614
Less investments in insurance subsidiaries, associated undertakings and other supervisory deductions	**(703)**	(489)	(812)	(596)	(534)
Capital base	**5,482**	5,317	4,115	3,425	3,080
Weighted risk assets					
On-balance sheet	**44,354**	41,750	34,367	30,082	25,909
Off-balance sheet	**4,736**	4,066	3,114	3,230	3,011
	49,090	45,816	37,481	33,312	28,920
Risk asset ratio	%	%	%	%	%
Tier 1	**6.6**	6.8	6.8	6.3	6.4
Total	**11.2**	11.6	11.0	10.3	10.6

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 Financial Services Authority ("FSA") 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 FSA 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 1998, the Group's risk asset ratio was 11.2% (1997 – 11.6%) and the tier 1 ratio was 6.6% (1997 – 6.8%).

Capital ratios (%)



Risk management Through its normal operations, the Group is exposed to a number of risks, the most significant of which are liquidity, credit, operational and market risk; responsibility for these is vested in the Group Executive Management Committee, a sub committee of the Board of Directors. Beneath this, Group Risk Management ("GRM") are responsible for formulating high level risk policies, setting standards, monitoring concentrations and providing an independent review.

Liquidity risk The FSA requires that the Group should be able to meet its sterling obligations without recourse to the wholesale money market for a period of at least five business days, and the Group measures and manages its cashflow on a daily basis in order to meet this requirement. It does this by maintaining a diversified portfolio of high quality liquid assets. Longer term funds are raised through its Euro Medium Term Note programme. Monthly reports are made to the FSA covering sterling liquidity, whilst for other currencies a series of periodic returns are made covering non-sterling balances and their maturities.

The Group uses various methods, including predictions of daily cash positions, to monitor and manage its liquidity risk to avoid undue concentration of funding requirements at any point in time or from any particular source. Maturity mismatches between lending and funding are managed within internal risk policy limits.

Credit risk Credit risk arises where the possibility exists of a counterparty defaulting on its obligations. The most important step in managing this risk is the initial decision whether or not to extend credit. The Group's strong credit culture extends to the management of resultant exposures via individual counterparty and concentration limits.

The day-to-day management of credit risk is devolved to individual business units, each of which has specialist credit functions which perform regular appraisals of counterparty credit quality through the analysis of qualitative and quantitative information. Credit authority is based on defined limits with responsibility for significant transactions residing with a Group Executive Credit Committee.

If the Group requires collateral, this may be cash, or more commonly, security over a customer's assets.

Transactions are netted where the Group has the legal right to insist on net settlement.

Operational risk Operational risk arises from the potential for inadequate systems, errors, poor management, breaches in internal controls, fraud and external events to result in financial loss or reputational damage. The Group's business units manage this risk through appropriate risk controls and loss mitigation actions. These actions include a balance of policies, procedures, internal controls and business continuity arrangements.

GRM ensure progress occurs on significant risk issues and provide the businesses with the assistance, tools and techniques to improve operational risk management.

Market risk Market risk is the risk that changes in the level of interest rates, the rate of exchange between currencies or the price of securities and other financial contracts including derivatives will have an adverse impact.

The Group's management of its exposure to market risk recognises a fundamental distinction between the core (retail) balance sheet and the Group's foreign exchange, money market and trading (wholesale) activities.

Interest rate risk arising from the core balance sheet is managed by transferring exposure to trading desks specialising in controlling specific market risks. Non-trading currency risk exposure arises primarily out of the Group's investments in overseas branches, subsidiaries and other foreign currency investments, (principally Citizens and Banco Santander).

The primary market risks within the Group's trading activities are interest rate and currency risk. The most significant currencies in which the Group has transactions are US Dollars and major European currencies.

The Group does not have any material exposure to adverse movements in the value of commodities and equities other than its holdings of equity shares as shown in Note 19 on the accounts. At 30th September 1998, equity shares held as investment securities had a book value of £766 million (1997 – £407 million) and a valuation of £956 million (1997 – £826 million).

Market risk – Quantitative measures for trading risk

Value at Risk The Group's primary mechanism for estimating potential losses is a mathematical methodology, Value at Risk ("VaR") which estimates the Group's exposure to market risk within a given level of confidence, over a defined time period. This is regularly reviewed to ensure it remains relevant and captures all significant risks.

The Group uses a 97.5% confidence interval. This means that daily losses exceeding the VaR figure are likely to occur, on average, in only one in every 40 business days. The assumed holding period of any exposure and the historic market rate data observation period vary according to the trading activity.

Other controls include more detailed limits and individual trader mandates, designed to supplement the VaR framework. This enables market risk exposure to be monitored throughout the day at a detailed, disaggregated level and on a Group basis.

The VaR approach is applied to all the Group's trading businesses. The model is based on historic movements which may not be indicative of future market conditions but this and other limitations are continuously researched and other complimentary measures and methods implemented. The Group has adopted stress testing to simulate extreme conditions.

The following table shows details of the VaR and daily revenues:

VaR	**As at 30th September 1998 £m**	As at 30th September 1997 £m	**Average for the year to 30th September 1998 £m**	Average for the year to 30th September 1997 £m
Market risk related (including trading)	**3.2**	3.0	**2.7**	2.4
Trading	**1.1**	1.5	**1.1**	1.5

Daily revenues	**Average for the year to 30th September 1998 £m**	Average for the year to 30th September 1997 £m	**Standard deviation for the year to 30th September 1998 £m**	Standard deviation for the year to 30th September 1997 £m
Market risk related (including trading)	**0.7**	0.4	**0.7**	0.3
Trading	**0.1**	0.1	**0.2**	0.2

Market risk – non trading

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 1998, for 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. Major changes in position are made promptly as market outlook changes.

	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							
Interest earning assets	43,425	5,047	3,040	8,088	5,174	—	64,774
Non-interest earning assets	—	—	—	—	—	14,902	14,902
Total assets	43,425	5,047	3,040	8,088	5,174	14,902	79,676
Liabilities							
Interest bearing liabilities	46,811	3,056	2,269	4,316	2,917	—	59,369
Interest free liabilities	—	—	—	—	—	17,354	17,354
Shareholders' equity	—	—	—	—	—	2,953	2,953
Total liabilities	46,811	3,056	2,269	4,316	2,917	20,307	79,676
Off-balance sheet items affecting interest rate sensitivity	(1,008)	417	(81)	(1,327)	1,999	—	—
	45,803	3,473	2,188	2,989	4,916	20,307	79,676
Interest rate sensitivity gap	(2,378)	1,574	852	5,099	258	(5,405)	—
Cumulative interest rate sensitivity gap	(2,378)	(804)	48	5,147	5,405	—	—
Cumulative interest rate sensitivity gap as a percentage of interest earning assets	(3.7%)	(1.2%)	0.1%	7.9%	8.3%	—	—

Derivatives – trading In the normal course of business, the Group enters into a variety of derivative transactions principally in the foreign exchange and interest rate markets. These are used to provide financial services to customers and to actively take, hedge and modify positions as part of trading activities. Derivatives are also used to hedge or modify risk exposures arising on the balance sheet from a variety of activities including lending and securities investment. The 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. Analyses of the derivatives entered into by the Group both for trading and non-trading purposes are provided in Note 38 to the financial statements. The principal types of derivative contracts into which the Group enters are described below.

Swaps Over-the-counter agreements between two parties to exchange periodic payments of interest, or payments for the change in value of a commodity, or related index, over a set period based on notional principal amounts.

Over-the-counter and exchange traded options Currency and interest rate options, which 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.

Futures and forwards Short term interest rate futures, bond futures, forward rate agreements and forward foreign exchange contracts all of which are agreements to deliver or take delivery of a specified amount of an asset or financial instrument based on the specified rate, price or index applied against the underlying asset or financial instrument, at a specified date. Futures are exchange traded at standardised amounts of the underlying asset or financial instrument. Forward contracts are over-the-counter.

Derivatives – non trading The following table sets forth non-trading activities undertaken by the Group, the related risks associated with such activities and provides details of the types of derivatives used in managing such risks.

Activity	Risk	Type of Hedge
Management of the return on variable rate assets funded by shareholders' funds and net non-interest bearing liabilities	Reduced profitability due to falls in short-term interest rates	Receive fixed interest rate swaps Purchased interest rate options
Fixed-rate lending	Sensitivity to increases in short-term interest rates Sensitivity to decreases in medium/long term interest rates, due to prepayment	Pay fixed interest rate swaps Purchased interest rate caps
Fixed-rate retail and wholesale funding	Sensitivity to falls in short-term interest rates	Receive fixed interest rate swaps
Fixed-rate asset investments	Sensitivity to increases in short-term interest rates	Pay fixed interest rate swaps
Investment in foreign currency assets	Sensitivity to strengthening of sterling against other currencies	Cross-currency swaps Foreign currency funding
Profit earned in foreign currencies	Sensitivity to strengthening of sterling against other currencies	Forward foreign exchange contracts Purchased currency options

Five-year financial summary

	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Profit from continuing businesses before provisions	**1,217**	916	758	716	688
Provisions	**(200)**	(146)	(113)	(112)	(182)
Investment write-offs	**(10)**	(2)	(1)	(2)	(5)
Profit from continuing businesses before exceptional items	**1,007**	768	644	602	501
Gain on Superdiplo	**96**	—	—	—	—
Far East bad debt provisions	**(132)**	—	—	—	—
Far East investment write-off	**(14)**	—	—	—	—
Write-down of finance leases	**(13)**	(41)	—	—	—
Year 2000 costs	**—**	(29)	—	—	—
Restructuring costs – Citizens Bank New Hampshire	**—**	—	(21)	—	—
Director's contract variation payment	**—**	—	—	—	(21)
Group operating profit	**944**	698	623	602	480
Profit on sale of fixed asset investment	**57**	34	—	—	—
Profit on sale of US mortgage servicing business	**—**	28	—	—	—
Profit on sales of investments in associated undertakings	**—**	—	72	—	52
Profit on ordinary activities before taxation	**1,001**	760	695	602	532
Tax on profit on ordinary activities	**(286)**	(219)	(191)	(202)	(146)
Profit on ordinary activities after taxation	**715**	541	504	400	386

Earnings per 25p ordinary share					
before exceptional items	**72.3p**	53.5p	46.4p	43.9p	36.7p
after exceptional items	**73.4p**	55.4p	54.0p	43.9p	41.4p
Dividends per 25p ordinary share	**24.6p**	21.4p	18.6p	16.2p	13.75p
Dividend cover (times)	**3.0**	2.6	2.9	2.7	3.0
Cost: income ratio – Group	**52.0%**	52.5%	50.0%	51.7%	53.2%
– UK Bank	**54.6%**	57.1%	58.7%	63.9%	63.8%
Return on ordinary shareholders' equity – pre-tax	**41%**	33%	38%	40%	36%
(including exceptional items) – post-tax	**28%**	23%	26%	25%	24%
Net asset value per 25p ordinary share	**242p**	268p	229p	192p	174p
Share price at 30th September	**670p**	690p	489p	450p	415p
Average base rate	**7.3%**	6.3%	6.2%	6.5%	5.4%
Interest spread	**2.0%**	2.0%	2.0%	2.1%	2.2%
Interest margin	**2.5%**	2.5%	2.5%	2.6%	2.7%

	£m	£m	£m	£m	£m
Shareholders' funds	**2,953**	3,042	2,510	2,164	1,896
Minority interests	**92**	190	150	19	16
Dated loan capital	**1,391**	1,383	1,241	1,075	929
Undated loan capital	**1,220**	1,167	1,009	714	729
Capital resources	**5,656**	5,782	4,910	3,972	3,570

	£bn	£bn	£bn	£bn	£bn
Customer accounts – deposits	**50.7**	47.6	38.1	32.7	29.5
Loans and advances to customers	**41.0**	38.6	33.4	29.2	25.9
Total assets	**79.7**	72.6	61.1	51.2	45.3

Bank branches	**984**	959	930	849	891
Other branches	**69**	67	53	69	112
Number of employees at 30th September – Group	**31,680**	30,900	27,200	25,870	26,150
– UK Bank	**18,870**	18,380	17,360	17,980	18,950

Board of directors and secretary

Viscount Younger of Leckie ✻†Ø
KT, KCVO, TD, DL
Chairman
(age 67), is a Privy Councillor and has held the offices of Secretary of State for Defence and Secretary of State for Scotland. He was appointed chairman in January 1991 having been appointed a director in October 1989. He holds a number of other directorships including Banco Santander, S.A. He is also chairman of a number of the Murray Johnstone Investment Trusts. (Chairman of the remuneration committee).

Sir Iain Vallance †Ø
Vice-chairman
(age 55), was appointed a director in January 1993 and became a vice-chairman in March 1994. He is chairman of British Telecommunications plc and a non-executive director of Mobil Corporation. He is a member of the Confederation of British Industry President's Committee, the President's Committee and Advisory Council of Business in the Community and the governing body of the London Business School.

Sir Angus Grossart †◊Ø
CBE, LLD, FRSE, DL
Vice-chairman
(age 61), was appointed a director in September 1985 and became a vice-chairman in April 1996. He is chairman and managing director of Noble Grossart Limited. He is chairman of Scottish Investment Trust PLC and deputy chairman of Edinburgh Fund Managers plc. He is a director of other public companies including Scottish and Newcastle PLC and Mirror Group PLC. He is a former chairman of the Trustees of the National Galleries of Scotland.

Executive directors

Dr George Mathewson ✻□Ø
CBE, LLD, FRSE, FCIBS
(age 58), Group Chief Executive, was appointed a director in September 1987 and to his present position in January 1992. He is a former chief executive of the Scottish Development Agency and his current directorships include Citizens Financial Group, Inc., Interbank On-Line System Limited, Direct Line Group Limited, of which he is chairman, and Scottish Investment Trust PLC.

Bob Speirs
(age 62), formerly Group Finance director, he retired on 23rd October 1998. He is chairman of Direct Line Insurance plc and deputy chairman of Direct Line Group Limited, chairman of Privilege Insurance Company Limited, a director of Citizens Financial Group, Inc., and a director of Stagecoach Holdings plc.

Fred Goodwin ✻Ø
FCIBS
(age 40), was appointed Deputy Group Chief Executive on 1st August 1998. He was formerly Chief Executive and Director, Clydesdale Bank PLC and Yorkshire Bank PLC. He is on the Council of Strathclyde Business School and is the current president of the Chartered Institute of Bankers in Scotland.

Iain Robertson ✻Ø
(age 52), was appointed a director in January 1993. He was appointed Chief Executive, UK Bank on 1st July 1998 and is chairman of Royal Bank Development Capital Limited and RBS Mezzanine Limited. He is also chairman of Computershare Services plc, a director of Privilege Insurance Company Limited and British Empire Securities and General Trust plc.

Lawrence Fish ✻
(age 54), was appointed a director in January 1993. He is chairman, president and chief executive officer of Citizens Financial Group, Inc. He is also a director of John Hancock Financial Services and numerous community organisations in the USA.

Norman McLuskie ✻□
(age 54), was appointed a director in June 1992 and is Deputy Chief Executive, UK Bank. He is chairman of BACS Limited, RBS Advanta, RoyScot Financial Services Limited and the Bank's Pension Fund Trustees. He is chairman of RBS Cards Limited and deputy chairman of Tesco Personal Finance Limited and APACS.

Non-executive directors

Emilio Botin
(age 64), is chairman of Banco Santander, S.A. He is also chairman or a director of several Banco Santander Group subsidiaries and a director of a number of Spanish companies.

Sir Robin Duthie †◊Ø
CBE, LLD
(age 70), is a chartered accountant. He was formerly chairman of Britoil plc and of the Scottish Development Agency. He is a director of a number of other public companies. He is also vice-chairman of the Scottish Advisory Board of BP. (Chairman of the audit committee).

Ian Grant □
JP, DL
(age 59), is managing director of Glenmoriston Estates Limited and is Trustee of the Bartlett Funds. He is a director of a number of British and overseas public companies in Holland, Hong Kong and the US as well as Banco Santander, S.A. (Chairman of the personnel committee).

Juan Inciarte
(age 46), is a director and an executive vice president of Banco Santander, S.A. He is also a director of several Banco Santander Group subsidiaries and a number of Spanish companies, as well as a director of Instituto Bancario San Paolo di Torino.

Eileen Mackay ◊
CB
(age 55), was formerly principal finance officer at The Scottish Office. She is a director of Edinburgh Investment Trust plc, Lothian and Edinburgh Enterprise Limited and Scottish Television (Regional) Limited. She is chairman of the Government's Standing Advisory Committee on Trunk Road Assessment and a member of the Commission on Local Government, the Financial Issues Advisory Group for the Scottish Parliament, Scottish Screen and the Court of the University of Edinburgh.

Cameron McLatchie
CBE
(age 51), was appointed on 1st October 1998. He is chairman and chief executive of British Polythene Industries PLC and deputy chairman of Scottish Enterprise.

Murray Stuart †□
CBE
(age 65), is chairman of Scottish Power plc, Hammersmith Hospitals NHS Trust and Intermediate Capital Group PLC. He is also a non-executive director of CMG plc and of the Royal Scottish National Orchestra Society Limited.

Bill Wilson †◊
(age 61), is a chartered accountant. He was formerly deputy chairman of Alexander & Alexander Services, Inc. His other public directorships include Edinburgh US Tracker Trust plc and New London Capital plc.

Secretary

Miller McLean Ø
FCIBS
(age 48), was appointed director, Group Legal and Regulatory Affairs and Group Secretary in August 1994. He is vice-chairman of Banco Santander, Portugal S.A., a non-executive director of Adam & Company Group PLC, chairman of the Council and Management Committee of the Industry and Parliament Trust and a member of the Financial Issues Advisory Group for the Scottish Parliament.

✻ Executive
† member of the Remuneration Committee
◊ member of the Audit Committee
□ member of the Personnel Committee
Ø member of the Chairman's Advisory Group/Nomination Committee

Report of the directors

The directors have pleasure in presenting their report together with the audited accounts for the year ended 30th September 1998.

Profit and dividends The profit attributable to the ordinary shareholders of the company amounted to £637 million (after preference dividends of £58 million – see Note 8 on page 51) as set out in the consolidated profit and loss account on pages 42 and 43.

An interim dividend of 7.13p per ordinary share was paid on 17th July 1998 at a cost of £62 million. The directors now recommend that a final dividend of 17.47p per ordinary share be paid on 19th February 1999 to members on the register at the close of business on 18th December 1998, absorbing £153 million. If this recommendation is approved by the shareholders at the annual general meeting on 14th January 1999, the retained profit for the year will amount to £422 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 78.

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, GRS Holding Company Limited (see corporate structure below) and 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 1998, 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 1999 on request from the secretary. 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 58.

On 17th October 1997, the Group announced its joint venture with Virgin Direct, Virgin Direct Personal Finance Limited, to launch the Virgin *One* Account, a 24 hour telephone-based bank account.

On 15th December 1997, the Group announced that it had agreed, in principle, to sell its Registrars business to Computershare Limited. Consideration for the sale was in the form of shares and increased the Bank's shareholding in Computershare Limited from 9% to 20%. The sale was completed on 13th March 1998.

On 17th December 1997, the Group announced that it had agreed to acquire GRS Holding Company Limited ("GRSH") for a cash consideration of £395 million. A further sum of up to £13 million may be paid by way of deferred consideration relating to certain new build rolling stock contracts. GRSH is the holding company of Angel Train Contracts Limited, a rail rolling stock leasing company.

On 7th April 1998, Citizens Financial Group, Inc. ("Citizens") announced the acquisition of Woburn National Corporation, parent of Woburn National Bank, for US$45 million payable in cash. The acquisition was completed on 13th August 1998.

On 28th April 1998, the Group announced that it had exercised its right to acquire the remaining 49% of RBS Advanta, not already owned by it, from Fleet Financial Group, Inc. of Boston, USA. The acquisition was completed on 17th July 1998.

On 29th April 1998, Citizens announced the acquisition of four branches from Branford Savings Bank, a subsidiary of North Fork Bancorp, for a premium of US$6 million payable in cash. The acquisition was completed on 16th October 1998.

On 2nd June 1998, the Group announced the cancellation of its framework agreement with Birmingham Midshires Building Society ("Birmingham Midshires") in relation to the proposed acquisition by the Bank of the business of Birmingham Midshires. The Group received £5 million from Birmingham Midshires in recognition of costs incurred and will receive a further £10 million if the Birmingham Midshires business is transferred to Halifax plc before 1st January 2000.

On 24th July 1998, the Group announced that it had agreed to sell its 33.12% holding in Newton Management Limited to Mellon Bank Corporation for £56 million. The sale was completed on 16th October 1998.

On 14th August 1998, the Group announced that the Bank of Ireland had exercised its option to require the Group to acquire its 23.5% stake in Citizens. The acquisition was completed on 4th September 1998 for a cash consideration of US$750 million (approximately £445 million).

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

(a) 5,579,323 ordinary shares allotted as a result of the exercise of options under the company's executive and sharesave schemes;

(b) 8,127,104 ordinary shares in lieu of cash dividends; and

(c) 1,763,742 ordinary shares allotted under the company's profit sharing (share ownership) scheme.

The proceeds from the above issues of shares amounted to £82 million. Details of the current authorised and issued ordinary share capital are shown on page 67.

Preference share capital On 12th February 1998, the company issued 10 million Series G non-cumulative dollar preference shares of US$0.01 each at US$25.00 per share, the net proceeds being US$242 million. Details of the authorised and issued preference share capital at 30th September 1998 are shown on page 67.

Subordinated liabilities On 24th March 1998, the Bank repaid £125 million 10⅝% subordinated bonds.

On 27th March 1998, the Bank issued FRF1,000 million 5⅞% undated subordinated notes at an issue price of 99.27%, the net proceeds being FRF986.45 million.

On 23rd April 1998, the final US$40 million tranche of US$200 million guaranteed floating rate notes 1994/98 were repaid by Royscot International Finance B.V.

On 22nd July 1998, the Bank issued DEM500 million 5¼% dated subordinated notes due 2008 at an issue price of 99.263%, the net proceeds being DEM494.315 million.

Details of the current subordinated liabilities are shown on pages 64, 65 and 66.

Shareholdings The company has been notified of the following interests in its shares as at 2nd December 1998.

	% held		% held
Ordinary shares:		Preference shares 5½% *cumulative*:	
Banco Santander, S.A.	9.89	Commercial Union Assurance plc	22.86
Tiger Management L.L.C.	6.05	Guardian Royal Exchange plc	20.25
Scottish Widows Fund and Life Assurance Society	5.01	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

*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 and brief biographical details of the directors are shown on pages 24 and 25. Mr J. Botin, Mr G.A. Schofield and Mr R. Speirs retired from the board of directors on 25th February 1998, 31st March 1998 and 23rd October 1998, respectively. The directors retiring by rotation are Mr I. F. H. Grant, Sir Angus Grossart, Mr N. C. McLuskie and Sir Robin Duthie and being eligible, Mr I. F. H. Grant, Sir Angus Grossart and Mr N. C. McLuskie offer themselves for re-appointment. Mr J. R. Inciarte, Mr F. A. Goodwin and Mr C. McLatchie were appointed directors on 25th February 1998, 1st August 1998 and 1st October 1998 respectively. In accordance with the articles of association, all the directors appointed after 15th January 1998 will retire at the annual general meeting and, being eligible, they offer themselves for re-appointment. The unexpired terms of the service contracts of Mr Goodwin and Mr McLuskie are shown on page 34. 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 1998 are shown on page 37.

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 1997 and 2nd December 1998.

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, Mr C. M. Stuart, Sir Iain Vallance and Mr W. M. Wilson.

Staff The weekly average number of persons employed by the company and its subsidiary undertakings in the UK was 29,645 (1997 – 26,699) and their aggregate remuneration for the year amounted to £621 million (1997 – £544 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 1998 are sums totalling £43 million for payments to staff eligible to participate in the Group profit sharing schemes (1997 – £36 million).

Share option schemes were introduced in 1986. On 5th June 1998, options were granted over 3,767,604 ordinary shares, at a price of 799p per share, under the company's sharesave scheme. On 11th May and 7th July 1998, options were granted over 1,035,172 ordinary shares, at prices of 1006.5p and 1006p per share, respectively, 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 almost 34% of middle management and over 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. The Bank is also a member of Race for Opportunity and is committed to eliminating racism in the workplace.

Charitable contributions The total amount given for charitable purposes by the company and its subsidiary undertakings during the year was £2,277,923.

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 1998.

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 30 and 31.

Policy and practice on payment of creditors In the year ending 30th September 1999, 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 receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

The proportion which the amount owed to trade creditors at 30th September 1998 bears to the amounts invoiced by suppliers during the year then ended equated to a 27 days proportion of 365 days.

Auditors Following the merger of Coopers & Lybrand and Price Waterhouse, Coopers & Lybrand resigned as auditors and the directors appointed the new firm, PricewaterhouseCoopers to fill the casual vacancy thus arising. PricewaterhouseCoopers have indicated their willingness to continue in office and 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
2nd December 1998

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. In relation to the Hampel Combined Code, which is effective for Annual Reports and Accounts published in respect of accounting periods ending on or after 31st December 1998, the company has applied the general principles of the code fully throughout the year.

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 10 non-executive directors on the board who are of varied backgrounds and experience and who individually and collectively exercise independent and objective judgement;
- 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 33 to 36.

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 shown on pages 24 and 25 identify the members of the Audit Committee, the Remuneration Committee, the Chairman's Advisory Group/Nomination Committee 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 risk strategy to the Group Executive Management Committee and for day to day risk management to the Group Risk Management Committee, both of 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 Audit Committee's consideration of the independent reviews of the operation of the system of internal financial control is informed, in the case of internal audit, by its direct reporting line to the Committee and, in the case of the external auditors, by its discussion with them of the work they have undertaken and the conclusions they have reached in their reviews. The effectiveness of the Group's internal financial control system for the period from 1st October 1997 to 2nd December 1998 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 30 and 31 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 30 and 31, and going concern on page 30, 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 30 and 31 appropriately reflects the company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

PricewaterhouseCoopers
Chartered Accountants
Edinburgh
2nd December 1998

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 and comprises Viscount Younger, Sir Iain Vallance, Sir Angus Grossart, Sir Robin Duthie, Mr C. M. Stuart and Mr W. M. Wilson. The chairman of the Remuneration Committee is Viscount Younger. 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 Group 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 board 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. There has been no increase in non-executive directors' fees other than those as approved at the 1998 annual general meeting.

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 37. 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, 1997 and 1998, the growth in 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 The company has provided profit sharing for employees since 1980. 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 1998, the notice period required to be given by the Bank to Dr Mathewson was 19 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 F. A. Goodwin is terminable on 24 months' notice by the Bank, reducing to 12 months' notice on 1st August 1999, and on six months' notice by Mr Goodwin.

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 service agreement of Mr N. C. McLuskie is terminable on 3 months' notice by the Bank and on 3 months' notice by Mr McLuskie. In addition, in case of redundancy under certain circumstances, Mr McLuskie is entitled to an additional payment based on the length of his service with the Bank.

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, 50% of salary for Mr F. A. Goodwin and Mr I. S. Robertson and 40% of salary for Mr N. C. McLuskie. 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 1998, the value of the units held by Mr Fish increased by US$3,006,360 and as at

30th September 1998 the value of units held by Mr Fish was US$7,329,420. The increase in the value of Mr Fish's phantom units, is included in the remuneration table shown on page 36. To date no cash withdrawals have been made by Mr Fish.

The remuneration table on page 36 includes incentive payments in the year in which they were earned.

Directors' pension arrangements Viscount Younger, Dr G. R. Mathewson, Mr F. A. Goodwin, Mr I. S. Robertson and Mr N. C. McLuskie 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 Goodwin's pension entitlement in the Scheme is similarly restricted by Inland Revenue limits as set out in the Finance Act 1989. Arrangements are being made to provide Mr Goodwin with additional pension benefits and life assurance cover outwith the Scheme. The figures in the table below reflect a notional accrual in respect of these additional arrangements. Mr Fish accrues pension benefits under a number of arrangements in the US. 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 requires disclosure of directors' pension entitlement on the basis of 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 1998	Additional pension earned during the year ended 30th September 1998 £000 p.a.	Accrued entitlement at 30th September 1998 £000 p.a.	Transfer value for the additional pension earned during the year ended 30th September 1998 £000
Viscount Younger	67	24	87	313
Dr G. R. Mathewson	58	28	214	448
Mr F. A. Goodwin (appointed 1st August 1998)	40	1	1	7
Mr I. S. Robertson	53	2	14	27
Mr N. C. McLuskie	54	7	72	93
Mr G. A. Schofield (retired 31st March 1998)	58	7	154	333
Mr L. K. Fish – Qualified Plan	54	1	10	6
– Excess Plan		8	51	45
– Employee Arrangement		—	47	—

Contributions paid in the year ended 30th September 1998 under defined contribution arrangements were:

	£000		£000
Viscount Younger	34	Mr L. K. Fish	78
Mr R. Speirs (retired 23rd October 1998)	17		

In respect of Mr Schofield and Mr Speirs the relevant periods of accrual/contributions are from 1st October 1997 until 31st March 1998 and 30th September 1998, respectively.

The transfer value of the increase in accrued pension for Mr Schofield is made up of £109,860 in respect of the additional accrual and £223,320 in respect of an augmentation to benefits on early retirement. The pre-commutation pension paid from retirement date was £154,386 p.a.

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	Other £000	**Total 1998 £000**	Total 1997 £000
Chairman								
Viscount Younger	252	—	—	34	10	—	**296**	277
Executive directors								
Dr G. R. Mathewson	438	260	38	56	17	—	**809**	725
F. A. Goodwin (appointed 1st August 1998)	60	—	—	8	3	90	**161**	—
R. Speirs (retired 23rd October 1998)	250	120	23	17	12	—	**422**	380
L. K. Fish	470	2,750	—	78	4	—	**3,302**	2,249
N. C. McLuskie	233	81	22	30	16	—	**382**	356
I. S. Robertson	314	175	27	12	18	—	**546**	479
G. A. Schofield (retired 31st March 1998)	116	42	22	14	6	390	**590**	355
1998	**2,133**	**3,428**	**132**	**249**	**86**	**480**	**6,508**	
1997	2,002	2,330	104	299	86	—		4,821

Mr F. A. Goodwin received a payment of £90,000 on the commencement of his employment with the Group on 1st August 1998.

In accordance with his contract of employment, Mr G. A. Schofield received a payment of £390,288 on his retirement from the Group on 31st March 1998 after 40 years of service.

Non-executive directors	Board fees £000	Board committee fees £000	Fees from subsidiary companies £000	**Total 1998 £000**	Total 1997 £000
Vice-chairmen					
Sir Iain Vallance	27	3	25	**55**	50
Sir Angus Grossart	27	6	25	**58**	50
E. Botin	12	—	10	**22**	20
J. Botin (retired 25th February 1998)	5	—	4	**9**	20
Sir Robin Duthie	17	13	15	**45**	43
I. F. H. Grant	12	5	10	**27**	25
J. R. Inciarte (appointed 25th February 1998)	8	—	6	**14**	—
E. A. Mackay	12	3	10	**25**	23
C. M. Stuart	12	4	10	**26**	22
W. M. Wilson	12	6	10	**28**	27
Sir Ian Wood (retired 22nd October 1997)	1	—	—	**1**	20
1998	**145**	**40**	**125**	**310**	
1997	135	30	135		300
Aggregate remuneration of directors who served during the year				**6,818**	5,121

Details of the potential pre-tax gains made by directors on the exercise of share options are contained in directors' interests in shares on page 37.

Directors' interests in shares

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

	30th September 1998	1st October 1997 or date of appointment if later		**30th September 1998**	1st October 1997 or date of appointment if later
Sir Robin Duthie	**21,506**	20,946	R. Speirs	**26,722**	25,276
I. F. H. Grant	**4,515**	4,398	C. M. Stuart	**3,221**	3,137
Dr G. R. Mathewson	**62,094**	65,918	Sir Iain Vallance	**2,500**	2,500
N. C. McLuskie	**85,234**	132,283	W. M. Wilson	**7,777**	7,610
E. A. Mackay	**3,080**	3,000	Viscount Younger	**13,251**	15,751
I. S. Robertson	**38,706**	88,047			

Options to subscribe for ordinary shares of 25p each in the company granted to, and exercised by, directors during the year to 30th September 1998 are included in the table below.

	Options at 1st October 1997 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 1998**	Average exercise price £
			Number	Price £	Number	Price £				
L. K. Fish	23,000	4.29	100,000	10.065	23,000	4.29	9.455	118,795	**100,000**	10.065
Dr G. R. Mathewson	430,961	4.86	64,200	10.065	—	—	—	—	**495,161**	5.53
N. C. McLuskie	218,885	5.26	15,400	10.065	1,399	2.12	10.39	11,570	**233,095**	5.60
			209	7.99						
I. S. Robertson	302,554	4.36	52,500	10.065	3,417	2.12	10.39	28,259	**351,637**	5.23
G. A. Schofield	213,875	5.55	—	—	125,000	6.01	10.42	1,039,148	**—**	—
(retired 31st March 1998)					58,000	5.35	10.42			
					10,000	3.99	10.42			
					19,000	4.29	10.42			
					418	3.44	8.31			
					1,334	2.12	10.39			
R. Speirs	121,000	4.50	—	—	—	—	—	—	**121,000**	4.50
Viscount Younger	276,000	3.54	6,300	10.065	—	—	—	—	**282,300**	3.69

The market price of the company's ordinary shares at 30th September 1998 was 670p and the range during the year to 30th September 1998 was 617p to 1127p. Outstanding options under the executive share option scheme and the sharesave scheme are exercisable between now and 10th May 2008 and between now and 31st December 2002, respectively. An option over 123 ordinary shares under the sharesave scheme lapsed unexercised at the retirement of Mr G. A. Schofield. Mr E. Botin, Mr J. Botin, Mr F. A. Goodwin, Sir Angus Grossart and Mr J. R. Inciarte did not have an interest in the company's ordinary shares during the year.

Preference shares No director had an interest in the preference shares during the year. Except as disclosed above, there has been no change in the directors' interests in the shares of the company shown above between 30th September 1998 and 2nd December 1998. No director held a non-beneficial interest in the shares of the company at 30th September 1998, at 1st October 1997 or date of appointment if later.

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
2nd December 1998

Report of the auditors

To the members of The Royal Bank of Scotland Group plc We have audited the financial statements on pages 39 to 81 which have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on pages 39 to 41.

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 1998 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Edinburgh
2nd December 1998

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 1998, the principal rate of exchange for foreign currency translations was US$1.7001=£1 (1997 – US$1.6148=£1). The principal average rate of exchange for foreign currency translations for the year to 30th September 1998 was US$1.6536=£1 (1997 – US$1.6327=£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. Operating lease rentals are credited to the profit and loss account on a receivable basis over the term of the lease.

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 **Loans and advances** 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. Fee income relating to loans and advances is recognised in the profit and loss account to match the cost of providing a continuing service to the borrower, except where the fee is charged in lieu of interest when it is recognised on a level yield basis over the life of the advance. Other fees are recognised when they are receivable.

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 undertakings** The company's shares in subsidiary undertakings are stated in the balance sheet of the company at a directors' valuation which reflects the subsidiary undertakings' 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. Assets on operating leases are depreciated on a straight-line basis over periods related to the estimated useful lives of such assets.

14 Derivatives A description of the derivatives into which the Group enters for both trading and non-trading purposes is given on page 22 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.

Consolidated profit and loss account

for the year ended 30th September 1998

	Note	Before exceptional items £m	Exceptional items £m	1998 Total £m	1997 Total £m
Interest receivable	1				
– interest receivable and similar income arising from debt securities		**745**	**—**	**745**	558
– other interest receivable and similar income		**4,378**	**—**	**4,378**	3,567
Interest payable	2	**(3,525)**	**—**	**(3,525)**	(2,711)
Net interest income		**1,598**	**—**	**1,598**	1,414
Dividend income from equity shares		**28**	**—**	**28**	24
Fees and commissions receivable		**923**	**—**	**923**	809
Fees and commissions payable		**(84)**	**—**	**(84)**	(76)
Dealing profits (see note below)	6	**172**	**96**	**268**	117
Other income		**377**	**—**	**377**	129
		1,416	**96**	**1,512**	1,003
General insurance – earned premiums		**740**	**—**	**740**	658
– reinsurance		**(140)**	**—**	**(140)**	(123)
Non-interest income		**2,016**	**96**	**2,112**	1,538
Total income		**3,614**	**96**	**3,710**	2,952
Administrative expenses					
– staff costs	3	**884**	**—**	**884**	794
– staff profit share		**43**	**—**	**43**	36
– premises and equipment		**280**	**—**	**280**	227
– other		**429**	**—**	**429**	385
Depreciation and amortisation	24	**243**	**—**	**243**	107
Year 2000 costs*		**—**	**—**	**—**	29
Operating expenses		**1,879**	**—**	**1,879**	1,578
Profit before other operating charges		**1,735**	**96**	**1,831**	1,374
General insurance – gross claims		**625**	**—**	**625**	582
– reinsurance		**(107)**	**—**	**(107)**	(95)
Profit before provisions for bad and doubtful debts		**1,217**	**96**	**1,313**	887
Provisions for bad and doubtful debts					
– excluding Far East	15	**200**	**—**	**200**	139
– Far East	6,15	**—**	**132**	**132**	7
Amounts written off fixed asset investments					
– excluding Far East		**10**	**—**	**10**	2
– Far East	6	**—**	**14**	**14**	—
Write-down of finance leases*	6	**—**	**13**	**13**	41
Group operating profit *(carried forward)*		**1,007**	**(63)**	**944**	698

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

*Exceptional item in 1997

	Note	Before exceptional items £m	Exceptional items £m	1998 Total £m	1997 Total £m
Group operating profit *(brought forward)*		**1,007**	**(63)**	**944**	698
Profit on sale of fixed asset investment	6	**—**	**57**	**57**	34
Profit on sale of US mortgage servicing business		**—**	**—**	**—**	28
Profit on ordinary activities before tax	5	**1,007**	**(6)**	**1,001**	760
Tax on ordinary activities	7	**(302)**	**16**	**(286)**	(219)
Profit on ordinary activities after tax		**705**	**10**	**715**	541
Minority interests		**(20)**	**—**	**(20)**	(31)
Profit after minority interests		**685**	**10**	**695**	510
Preference dividends	8	**58**	**—**	**58**	53
Profit attributable to ordinary shareholders		**627**	**10**	**637**	457
Ordinary dividends	9	**215**	**—**	**215**	179
Retained profit	35	**412**	**10**	**422**	278

	Note	1998	1997
Earnings per 25p ordinary share	11	**73.4p**	55.4p
Adjustments:			
Gain on Superdiplo		**(7.7p)**	—
Far East provisions		**11.7p**	—
Write-down of finance leases		**(0.1p)**	1.5p
Profit on sale of fixed asset investment		**(5.0p)**	(4.0p)
Year 2000 costs		**—**	2.3p
Profit on sale of US mortgage servicing business		**—**	(1.7p)
Adjusted earnings per 25p ordinary share (see note below)		**72.3p**	53.5p

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

The acquisition of Angel Trains in December 1997 was accounted for by the acquisition method of accounting and the contribution to Group operating profit in the year ended 30th September 1998 was £46 million.

With the exception of the disposal of the Registrars business which, as detailed in Note 43 contributed nil to the Group operating profit for the year, all items dealt with in arriving at Group operating profit for 1998 and 1997 relate to continuing operations.

Consolidated balance sheet

at 30th September 1998

	Note	1998 £m	1997 £m
Assets			
Cash and balances at central banks		**1,295**	1,213
Treasury bills and other eligible bills	12	**639**	629
Loans and advances to banks	13	**11,514**	14,091
Items in course of collection due from other banks		**1,652**	1,070
Loans and advances to customers	14	**41,017**	38,606
Debt securities		**13,021**	9,925
Less: non-recourse borrowings		**(247)**	—
	18	**12,774**	9,925
Equity shares	19	**857**	463
Interests in associated undertakings	20	**43**	52
Tangible fixed assets	24	**2,005**	1,078
Other assets	25	**6,801**	4,566
Prepayments and accrued income		**1,079**	908
Total assets		**79,676**	72,601

	Note	1998 £m	1997 £m
Liabilities			
Deposits by banks	26	**4,437**	5,395
Items in course of collection due to other banks		**520**	636
Customer accounts	27	**50,685**	47,582
Debt securities in issue	28	**7,459**	4,997
Other liabilities	29	**8,076**	6,147
Accruals and deferred income		**2,419**	1,807
Provisions for liabilities and charges			
– deferred taxation	30	**395**	190
– pensions and other similar obligations	31	**20**	42
– other provisions	31	**9**	23
Subordinated liabilities			
– dated loan capital	32	**1,391**	1,383
– undated loan capital including convertible debt	33	**1,220**	1,167
Minority interests			
– equity		**73**	178
– non-equity		**19**	12
Called up share capital	34	**220**	216
Share premium account	35	**1,458**	1,229
Reserves	35	**113**	103
Revaluation reserve	35	**(10)**	(19)
Profit and loss account	35	**1,172**	1,513
Shareholders' funds			
– equity		**2,115**	2,308
– non-equity	34	**838**	734
Total liabilities		**79,676**	72,601
Memorandum items:			
Contingent liabilities	39		
– acceptances and endorsements		**1,024**	863
– guarantees and assets pledged as collateral security		**921**	951
– other contingent liabilities		**869**	827
		2,814	2,641
Commitments	39		
– other commitments (standby facilities, credit lines and other)		**15,581**	17,133

Viscount Younger of Leckie	George Mathewson	Fred Goodwin
Chairman	*Group Chief Executive*	*Deputy Group Chief Executive*

2nd December 1998

Balance sheet – the company

at 30th September 1998

	Note	1998 £m	1997 £m
Fixed assets			
Investments:			
Shares in subsidiary undertakings	22	**3,632**	3,205
Loans to subsidiary undertakings	23	**1,209**	1,252
		4,841	4,457
Current assets			
Debtors:			
Due by subsidiary undertakings		**298**	372
Creditors			
Amounts falling due within one year:			
Deposits by banks		**67**	71
Due to subsidiary undertakings		**77**	2
Creditors		**13**	13
Current taxation		**38**	33
Proposed final dividend	9	**153**	131
		348	250
Net current (liabilities)/assets		**(50)**	122
Assets less liabilities		**4,791**	4,579
Creditors			
Amounts falling due beyond one year:			
Loan from subsidiary undertakings		**—**	80
Dated loan capital	32	**373**	381
Undated loan capital including convertible debt	33	**647**	700
		1,020	1,161
Capital and reserves			
Called up share capital	34	**220**	216
Share premium account	35	**1,458**	1,229
Reserves	35	**20**	20
Revaluation reserve	35	**2,024**	1,922
Profit and loss account	35	**49**	31
Shareholders' funds			
– equity		**2,933**	2,684
– non-equity	34	**838**	734
		4,791	4,579

Viscount Younger of Leckie
Chairman

George Mathewson
Group Chief Executive

Fred Goodwin
Deputy Group Chief Executive

2nd December 1998

Statement of total recognised gains and losses

for the year ended 30th September 1998

	1998 £m	1997 £m
Profit attributable to ordinary shareholders	**637**	457
Currency translation adjustments on foreign currency net investments	**(3)**	(1)
Movements in revaluations of premises	**14**	3
Movements in net unrealised gains and losses on debt securities and equity shares	**(4)**	(3)
Total recognised gains and losses	**644**	456

Note of historical cost profits and losses

for the year ended 30th September 1998

	1998 £m	1997 £m
Profit on ordinary activities before tax	**1,001**	760
Realisation of premises revaluation gains of previous years	**1**	1
Historical cost profit on ordinary activities before tax	**1,002**	761
Historical cost profit for the year retained after tax, minority interests and dividends	**423**	279

Reconciliation of movements in shareholders' funds

for the year ended 30th September 1998

	1998 £m	1997 £m
Profit attributable to ordinary shareholders	**637**	457
Ordinary dividends	**(215)**	(179)
Retained profit	**422**	278
Other recognised net gains and losses relating to the year	**7**	(1)
Currency translation adjustment on share premium account	**(42)**	(17)
Increase in share capital	**4**	11
Premium arising on issues of shares	**239**	493
Premium arising on redemption of shares	**—**	(132)
Elimination of goodwill on acquisitions	**(754)**	(58)
Write-back of goodwill on disposals	**50**	—
Tax on unrealised currency translation gains	**4**	(14)
Other movements	**(19)**	(28)
Net (decrease)/increase in shareholders' funds	**(89)**	532
Shareholders' funds at 1st October	**3,042**	2,510
Shareholders' funds at 30th September	**2,953**	3,042

Cash flow statement

for the year ended 30th September 1998

	Note	1998 £m	1998 £m	1997 £m	1997 £m
Net cash inflow from operating activities	40		**1,087**		2,338
Returns on investments and servicing of finance					
Dividends received from associated undertakings		**2**		1	
Preference dividends paid		**(60)**		(50)	
Interest paid on subordinated liabilities		**(227)**		(206)	
Net cash outflow from returns on investments and servicing of finance			**(285)**		(255)
Taxation			**(135)**		(150)
Capital expenditure and financial investment					
Purchase of investment securities		**(14,393)**		(11,594)	
Sale of investment securities		**13,474**		10,247	
Purchase of tangible fixed assets		**(391)**		(240)	
Sale of tangible fixed assets		**51**		51	
Sale of fixed asset investment	6	**83**		75	
Net cash outflow from capital expenditure and financial investment			**(1,176)**		(1,461)
Acquisitions and disposals					
Purchase of subsidiary undertakings (net of cash acquired)	42	**(903)**		(127)	
Investment in associated undertakings	20	**(14)**		(3)	
Sale of subsidiary and associated undertakings	43	**—**		78	
Sale of US mortgage servicing business	6	**—**		88	
Net cash (outflow)/inflow from acquisitions and disposals			**(917)**		36
Ordinary equity dividends paid			**(193)**		(158)
Net cash inflow before financing			**(1,619)**		350
Financing					
Issue of subordinated liabilities (net of expenses)		**277**		368	
Repayments of subordinated liabilities		**(150)**		(25)	
Issue of preference and ordinary share capital (net of expenses)		**243**		505	
Redemption of preference share capital		**—**		(132)	
Net cash inflow from financing	44		**370**		716
(Decrease)/increase in cash	46		**(1,249)**		1,066

1 Interest receivable

	1998 £m	1997 £m
Treasury bills and other eligible bills	**50**	41
Loans and advances to banks	**874**	722
Loans and advances to customers	**3,143**	2,534
Leasing and hire purchase income	**311**	270
Debt securities	**745**	558
	5,123	4,125

2 Interest payable

	1998 £m	1997 £m
Deposits by banks	**347**	315
Customer accounts		
– demand deposits	**1,092**	766
– savings deposits	**504**	405
– other time deposits	**898**	671
Debt securities in issue	**458**	344
Subordinated liabilities	**226**	210
	3,525	2,711

3 Administrative expenses – staff costs

	1998 £m	1997 £m
Wages and salaries	**694**	589
Social security costs	**54**	50
Pension costs (see Note 4)	**46**	64
Other staff costs	**90**	91
	884	794

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. During the year ended 30th September 1998 the principal actuarial assumptions were revised to the following:

Valuation rate of interest	8¼%
Salary growth (in addition, allowance is made for promotional salary increases)	6%
Pension increases	3-3½%

At the valuation date the market value of the assets of the Scheme was £1,350 million and, as a result of the revised assumptions, this was sufficient to cover 104% of the value of the benefits that had accrued to members after making allowance for expected future increases in salaries. 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 £1 million in respect of these overseas schemes has been included in expenses for the year to 30th September 1998.

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:

		1998 £m	1997 £m
Income	Aggregate amounts receivable, including capital repayments, under finance leases, hire purchase and conditional sale contracts	**310**	302
	Aggregate amounts receivable under operating leases	**228**	—
	Increase in value of long-term life assurance business	**39**	18
	Income from listed investments	**472**	369
	Profits less losses on disposals of investment securities	**72**	71
Expenses	Hire of equipment	**65**	57
	Operating lease rentals of premises	**53**	43
	Operating lease rentals of computers and other equipment	**4**	4
	Finance charges on leased assets	**18**	13

Auditors' remuneration

The auditors' remuneration for statutory audit work was £58,750 for the company (1997 – £56,500) and £2.2 million for the Group (1997 – £1.7 million). The auditors' remuneration for non-audit work in the year ended 30th September 1998 was £1.3 million for the Group (1997 – £1.2 million).

6 Exceptional items

The Group has recognised an exceptional gain of £96 million in respect of its investment in Superdiplo, the Spanish supermarket chain which was floated on the Madrid and Valencia Stock Exchanges in May 1998.

Exceptional provisions of £146 million have been made to cover the Group's exposure in the Far East. This includes an amount of £14 million written off investments.

A change in the UK corporation tax rate enacted in the Finance Act 1998 affected tax variation clauses in finance lease contracts written by leasing subsidiaries in the Group. This resulted in an exceptional charge of £13 million to Group operating profit totally offset by a reduction in the charge to taxation.

A gain of £57 million was realised from the disposal of 3.6 million shares in Banco Santander. This sale, together with recent share issues by Banco Santander, reduced the Group's shareholding from 4.9% to approximately 3.4% at 30th September 1998.

7 Tax on ordinary activities

	1998 £m	1997 £m
Based on the profit for the year:		
UK corporation tax at 31% (1997 – 32%)	**207**	113
Relief for overseas taxation	**(2)**	(2)
Deferred taxation	**23**	19
	228	130
Overseas taxation	**72**	83
	300	213
Prior year items	**(14)**	5
Share of associated undertakings	**—**	1
	286	219

The tax charge of £302 million on profit before exceptional items of £1,007 million represents an effective rate of 30%. A net tax credit of £16 million arises on the exceptional items. Tax has been provided on the Superdiplo and Santander investment gains. Tax credits arise in respect of the Far East bad debt provisions and on the write-down of finance lease contracts resulting from the reduction in the corporation tax rate to 30% from 1st April 1999.

8 Preference dividends

Dividends were paid on the non-cumulative dollar preference shares of 1 cent each on 31st December 1997, 31st March, 30th June and 30th September 1998 as follows:

	1998 £m	1997 £m
Series A redeemed on 16th October 1996 (1997 – US$1 million)	**—**	1
Series B at US$0.70 per share totalling US$18 million (1997 – US$18 million)	**11**	11
Series C at US$0.59375 per share totalling US$30 million (1997 – US$30 million)	**18**	18
Series D at US$0.5703125 per share totalling US$13 million (1997 – US$13 million)	**8**	8
Series E at US$0.5625 per share totalling US$14 million (1997 – US$14 million)	**8**	8
Series F at US$0.53125 per share totalling US$14 million (1997 – US$7 million)	**8**	4
Series G at US$0.578125 per share totalling US$12 million (1997 – nil)	**7**	—
Appropriation for premium payable on redemption and issue costs	**(2)**	3
Total dividends on non-equity shares	**58**	53

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 29th May 1998 at a cost of £27,000. The directors have declared the dividends for the half-year ended 30th September 1998 on the cumulative preference shares which will also cost £27,000.

9 Ordinary dividends

	1998 p per share	1997 p per share	1998 £m	1997 £m
Interim	**7.13**	6.2	**62**	48
Proposed final	**17.47**	15.2	**153**	131
Total dividends on equity shares	**24.6**	21.4	**215**	179

10 Profit dealt with in the accounts of the company

Of the profit attributable to ordinary shareholders, £262 million (1997 – £168 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 867.2 million (1997 – 824.6 million) ordinary shares in issue during the year, profit attributable to ordinary shareholders of £627 million (1997 – £441 million) before the exceptional items, net of taxation and minority interests relating thereto, and profit attributable to ordinary shareholders of £637 million (1997 – £457 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

	1998 £m	1997 £m
Treasury bills and similar securities	**77**	19
Other eligible bills	**562**	610
	639	629

13 Loans and advances to banks

	1998 £m	1997 £m
Repayable on demand	**2,632**	3,963
Remaining maturity		
– three months or less	**7,379**	8,019
– one year or less but over three months	**1,252**	1,838
– five years or less but over one year	**64**	12
– over five years	**187**	259
	11,514	14,091
Amounts above include due from associated undertakings – unsubordinated	**2**	7

Certain subsidiary undertakings are required to maintain balances with the Bank of England which, at 30th September 1998, amounted to £41 million (1997 – £87 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$163 million at 30th September 1998 (1997 – US$158 million).

14 Loans and advances to customers

	1998 £m	1997 £m
On demand or short notice	**5,061**	7,038
Remaining maturity		
– three months or less	**4,895**	3,927
– one year or less but over three months	**5,112**	4,179
– five years or less but over one year	**7,437**	7,076
– over five years	**19,145**	16,845
	41,650	39,065
General and specific bad and doubtful debt provisions	**(633)**	(459)
	41,017	38,606
Amounts above include:		
Due from associated undertakings – unsubordinated	**25**	3
Amounts receivable under finance leases	**3,453**	2,627

The cost of assets acquired during the year for the purpose of letting under finance leases and hire purchase agreements was £408 million (1997 – £644 million).

15 Provisions for bad and doubtful debts

	1998 Specific £m	1998 General £m	1997 Specific £m	1997 General £m
At 1st October	**354**	**105**	379	95
Currency translation adjustments	**(6)**	**(2)**	(3)	(1)
Amounts written off	**(174)**	**—**	(211)	—
Additions on acquisitions	**—**	**1**	—	21
Released on disposal	**(12)**	**—**	—	—
Recoveries of amounts written off in previous years	**35**	**—**	33	—
Transfers between provisions	**(3)**	**3**	11	(11)
Charge to profit and loss account	**194**	**6**	145	1
Exceptional charge to profit and loss account	**66**	**66**	—	—
At 30th September	**454**	**179**	354	105

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.

	1998 £m	1997 £m
Loans and advances on which interest is being placed in suspense:		
– before specific provisions	**280**	163
– after specific provisions	**194**	78
Loans and advances on which interest is not being applied:		
– before specific provisions	**565**	537
– after specific provisions	**197**	268

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). Details of financial instruments with off-balance sheet risk are contained in Notes 38 and 39.

18 Debt securities

	1998 Book value £m	1998 Valuation £m	1997 Book value £m	1997 Valuation £m
Investment securities:				
British government	**550**	**550**	105	105
Other government	**2,271**	**2,312**	2,583	2,595
Other public sector bodies	**109**	**113**	195	199
Bank and building society loans and certificates of deposit	**1,287**	**1,379**	1,424	1,441
Other issuers	**3,243**	**3,237**	1,970	1,971
	7,460	**7,591**	6,277	6,311
Other debt securities:				
British government	**611**	**611**	1,169	1,270
Other government	**104**	**126**	444	460
Other public sector bodies	**—**	**—**	3	3
Bank and building society loans and certificates of deposit	**3,893**	**3,895**	1,238	1,238
Other issuers	**706**	**707**	794	800
	12,774	**12,930**	9,925	10,082
Due within one year	**5,426**		2,927	
Due one year and over	**7,348**		6,998	
	12,774		9,925	
Investment securities:				
Listed on a recognised UK exchange	**1,217**	**1,214**	540	542
Listed elsewhere	**4,055**	**4,102**	3,669	3,687
Unlisted	**2,188**	**2,275**	2,068	2,082
	7,460	**7,591**	6,277	6,311
Other debt securities:				
Listed on a recognised UK exchange	**984**	**987**	1,812	1,913
Listed elsewhere	**417**	**439**	717	740
Unlisted	**3,913**	**3,913**	1,119	1,118
	12,774	**12,930**	9,925	10,082
Amounts above include:				
Subordinated debt securities	**55**		9	
Unamortised (premiums)/discounts on investment securities	**(3)**		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 1997	6,280	(3)	—	6,277
Currency translation adjustments	(218)	—	—	(218)
Additions	14,297	(11)	—	14,286
Disposals	(13,361)	4	—	(13,357)
Transfers	481	—	—	481
Provisions made	—	—	(12)	(12)
Amortisation of discounts and premiums	—	3	—	3
At 30th September 1998	**7,479**	**(7)**	**(12)**	**7,460**

Securitised asset-backed portfolio and related assets

In April 1998, the Bank sold a portfolio of asset-backed bonds amounting to £306 million to Ben Nevis One (Asset Backed Securities) Limited ("Ben Nevis"). The share capital of Ben Nevis has been issued to Mourant & Co. Trustees Limited as share trustee. The Company does not own, directly or indirectly, any of the share capital of Ben Nevis. Ben Nevis issued floating rate notes secured on the asset-backed bonds to refinance its purchase. The issue terms of the notes include provisions that their holders have no recourse to the Bank. Neither the Bank nor any other member of the Group are obliged, or intend, to support any losses, should they occur, of Ben Nevis. The proceeds of the asset-backed portfolio are used to pay the capital and interest due on borrowings and other administration expenses in order of priority to holders of Class A, Class B and Class C notes, respectively. Any residue is payable to the Bank. In the year ended 30th September 1998 this amounted to nil.

The balance sheet of Ben Nevis comprised principally of debt securities of £285 million, deposits with the Bank of £24 million and floating rate note borrowings of £300 million, of which £53 million is held by the Group. The profit and loss account, other recognised gains and losses and cashflows of Ben Nevis are not material to the Group. Ben Nevis has also entered into certain interest rate, basis rate and currency swaps with the Bank as follows:

In respect of each of the securities held by Ben Nevis which pay a fixed rate of interest, Ben Nevis has entered into an interest rate swap under which it pays an amount equal to the interest receivable on those securities and receives interest at a rate linked to LIBOR.

In respect of each of the securities held by Ben Nevis which is denominated in a currency other than US dollars, Ben Nevis has entered into a currency swap transaction under which it will pay on the interest payable date of the relevant securities, an amount equal to the interest payable and principal outstanding on those securities and will receive an amount equal to the US dollar equivalent of that amount.

In respect of each of the securities held by Ben Nevis, it has entered into a basis rate swap under which it pays an amount equal to interest calculated at the rate payable in respect of the relevant securities and will receive an amount of interest based on LIBOR.

19 Equity shares

	1998 Book value £m	1998 Valuation £m	1997 Book value £m	1997 Valuation £m
Investment securities:				
Listed on a recognised UK exchange	**289**	**266**	1	1
Listed elsewhere	**231**	**451**	223	541
Unlisted	**246**	**239**	183	284
	766	**956**	407	826
Other securities:				
Listed on a recognised UK exchange	**7**	**7**	15	15
Listed elsewhere	**84**	**84**	18	18
Unlisted	**—**	**—**	23	23
	857	**1,047**	463	882

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 1997	413	(6)	407
Currency translation adjustments	(6)	—	(6)
Additions	96	(1)	95
Disposals	(72)	1	(71)
Provisions made	—	(10)	(10)
Transfers	351	—	351
At 30th September 1998	**782**	**(16)**	**766**

20 Interests in associated undertakings

Movements in interests in associated undertakings were as follows:

	Share of net assets £m
At 1st October 1997	52
Acquisitions	14
Goodwill charged to reserves	(29)
Goodwill written back	41
Disposals	(1)
Transfers	(20)
Share of losses	(3)
Other movements	(11)
At 30th September 1998	**43**

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

	1998 £m	1997 £m
Cost	**142**	129
Provisions	**(4)**	—
Net book value at 30th September	**138**	129

An analysis of interests in associated undertakings is as follows:	1998 £m	1997 £m
Banks		
– listed elsewhere	**15**	16
– unlisted	**—**	6
Others	**28**	30
	43	52

The principal associated undertakings are:	Total issued share and loan capital at 30th September 1998	% held	Share of results based on accounts made up to	Nature of business
Banco Santander, Portugal S.A.				
(registered in Portugal)	31.1m ordinary shares of Esc 1,000	12.8	30th September*	Banking
	Esc 17.5m loan capital	—		
Linea Directa Aseguradora S.A.	2,400m 5 Ptas ordinary shares	50.0	30th September*	Insurance
(registered in Spain)				
Direct Line Life Holdings Limited	44m £1 ordinary shares	50.0	30th September	Insurance
(registered in England)				
Computershare Limited	116.5m ordinary shares of Aus$0.20	20.0	30th September*	Registration services
(registered in Australia)				
P.T. Bank Multicor	1.2m shares of Rp 50,000	24.0	30th September*	Banking
(registered in Indonesia)	Rp 32,750m loan capital	—		
The Scottish Agricultural	2m £1 ordinary shares	33.3	30th June*	Agricultural lending
Securities Corporation p.l.c.	£19m loan capital			
(registered in Scotland)				

*Incorporating unaudited interim accounts.

Banco Santander, Portugal S.A. operates in Portugal, Linea Directa Aseguradora S.A. operates in Spain, Computershare Limited operates in Australia 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 £2 million (1997 – £1 million).

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 1998, the capital of which consists of ordinary and preference shares, are shown below. Except for Angel Train Contracts Limited and the Bank, which are 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
Angel Train Contracts Limited	Leasing	England
The Royal Bank of Scotland plc	Banking	Scotland
Adam & Company Group PLC	Banking	Scotland
*Citizens Bank of Rhode Island	Banking	USA
*Citizens Bank of Connecticut	Banking	USA
*Citizens Bank of Massachusetts	Banking	USA
*Citizens Bank New Hampshire	Banking	USA
Direct Line Insurance plc	Insurance	England
Direct Line Financial Services Limited	Banking	England
Privilege Insurance Company Limited	Insurance	England
RBS Advanta	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 (Jersey) 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
Virgin Direct Personal Finance Limited (50%)	Banking	England

22 Shares in subsidiary undertakings

Movements during the year:	£m
At 1st October 1997	3,205
Currency translation adjustment	(42)
Dollar preference shares issued by the Bank	148
Additions	203
Other movements	(6)
Increase in net assets of the Bank	124
At 30th September 1998	**3,632**

On the historical cost basis, shares in the subsidiary undertakings at 30th September 1998 would have been included at a cost of £1,586 million (1997– £1,283 million).

23 Loans to subsidiary undertakings

Movements during the year:	£m
At 1st October 1997	1,252
Currency translation adjustment	(48)
Additions and other movements	5
At 30th September 1998	**1,209**

24 Tangible fixed assets

	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Assets on operating leases £m	Total £m
Cost or valuation:						
At 1st October 1997	495	14	112	1,042	—	1,663
Currency translation adjustments	(5)	—	(3)	(4)	—	(12)
Additions	19	—	8	227	137	391
Additions on acquisitions	1	—	—	2	820	823
Disposals	(22)	(1)	(5)	(45)	—	(73)
Revaluation adjustments	13	1	—	—	—	14
At 30th September 1998	**501**	**14**	**112**	**1,222**	**957**	**2,806**
Consisting of:						
At valuation	**296**	**13**	**—**	**—**	**—**	**309**
At cost	**205**	**1**	**112**	**1,222**	**957**	**2,497**
	501	**14**	**112**	**1,222**	**957**	**2,806**
Accumulated depreciation and amortisation:						
At 1st October 1997	—	—	37	548	—	585
Currency translation adjustments	—	—	(3)	(3)	—	(6)
Additions on acquisitions	—	—	—	1	—	1
Disposals	—	—	(1)	(21)	—	(22)
Depreciation and amortisation charge for year	—	—	7	118	118	243
At 30th September 1998	**—**	**—**	**40**	**643**	**118**	**801**
Net book value at 30th September 1998	**501**	**14**	**72**	**579**	**839**	**2,005**
Net book value at 30th September 1997	495	14	75	494	—	1,078

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 £381 million (1997 – £378 million).

Land and buildings occupied for own activities:	**1998 £m**	1997 £m
Net book value (including plant and works of adaptation) at 30th September	**555**	554

Future expenditure:	**1998 £m**	1997 £m
Contracts not provided for in the accounts	**18**	19

25 Other assets

	1998 £m	1997 £m
Long-term assurance fund assets attributable to policyholders (see note below)	**1,709**	1,464
Foreign exchange and interest rate contracts	**2,603**	1,910
Other	**2,489**	1,192
	6,801	4,566

Long-term assurance policies

The increase in the shareholders' interest in the long-term assurance fund is calculated as follows:

	1998 £m	1997 £m
Value of shareholders' interest at 1st October	**101**	89
Value of shareholders' interest at 30th September	**128**	101
Increase for the year before tax	**39**	18
Increase for the year after tax	**27**	12

The value placed on long-term assurance business is calculated by discounting estimated future flows of statutory profits from in-force policies at a discount rate that includes a risk margin. The future flows are based on prudent assumptions about long-term economic and business experience. The risk margin is designed to reflect uncertainties in expected future flows. The principal economic assumptions are as follows:

	1998 %	1997 %
Risk discount rate (net of tax)	**12.5**	12.5
Return on unit linked funds (gross of tax)	**10.0**	10.0
Return on non linked funds (gross of tax)	**7.0**	8.0
Expense inflation	**6.0**	6.0

In the consolidated balance sheet the assets and liabilities of the long-term assurance funds are presented separately from those of other businesses in order to reflect the different nature of the shareholders' interest in them. The amount of these assets, which are valued at market value, and liabilities of the long-term assurance funds included in the consolidated balance sheet are as follows:

	1998 £m	1997 £m
Investments	**163**	143
Assets held to cover linked liabilities	**1,371**	1,158
Debtors and prepayments	**20**	12
Other assets	**155**	151
Assets of the long-term assurance funds	**1,709**	1,464
Technical provisions	**93**	81
Technical provisions for linked liabilities	**1,469**	1,258
Other creditors	**147**	125
Liabilities of the long-term assurance funds	**1,709**	1,464

26 Deposits by banks

	1998 £m	1997 £m
Repayable on demand	**1,486**	1,155
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**1,989**	3,099
– one year or less but over three months	**687**	1,018
– five years or less but over one year	**20**	27
– over five years	**255**	96
	4,437	5,395
Amounts above include due to associated undertakings	**2**	5

27 Customer accounts

	1998 £m	1997 £m
Repayable on demand	**32,232**	29,896
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**14,507**	13,417
– one year or less but over three months	**2,607**	2,713
– five years or less but over one year	**1,023**	1,252
– over five years	**316**	304
	50,685	47,582
Amounts above include due to associated undertakings	**315**	—

28 Debt securities in issue

	1998 £m	1997 £m
Bonds and medium term notes, by remaining maturity		
– three months or less	**566**	586
– one year or less but over three months	**103**	181
– two years or less but over one year	**193**	81
– five years or less but over two years	**1,141**	324
– over five years	**965**	1,007
	2,968	2,179
Other debt securities in issue, by remaining maturity		
– three months or less	**3,462**	2,616
– one year or less but over three months	**999**	181
– two years or less but over one year	**25**	21
– five years or less but over two years	**5**	—
	4,491	2,818
	7,459	4,997

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

	1998 £m	1997 £m
Notes in circulation	**930**	900
Long-term assurance fund liabilities to policyholders (see Note 25)	**1,709**	1,464
Foreign exchange and interest rate contracts	**2,709**	2,173
Short positions (analysed below)	**732**	204
Current taxation	**229**	127
Proposed final dividend	**153**	131
Obligations under finance leases (analysed below)	**210**	219
Other liabilities	**1,404**	929
	8,076	6,147

Short positions are analysed as follows:

	1998 £m	1997 £m
Debt securities:		
British government	**657**	198
Other government	**1**	6
Other issuers	**74**	—
	732	204
Debt securities:		
Listed on a recognised UK exchange	**688**	198
Listed elsewhere	**32**	6
Unlisted	**12**	—
	732	204

Obligations under finance leases are analysed as follows:

	1998 £m	1997 £m
Amounts falling due within one year	**20**	18
Amounts falling due between one and five years	**59**	64
Amounts falling due after more than five years	**131**	137
	210	219

30 Deferred taxation

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

	1998 £m	1997 £m
Short-term timing differences	**(92)**	(93)
Capital allowances on computers and other equipment	**47**	57
Capital allowances on lease receivables	**439**	238
Advance corporation tax recoverable	**(39)**	(35)
Deferred gains	**40**	23
	395	190

Movements during the year:	£m
At 1st October 1997	190
Charge to profit and loss account	
– current year	23
– prior year	—
Arising on acquisitions	204
Other movements	(22)
At 30th September 1998	**395**

No provision has been made for the following potential amounts of deferred taxation:	1998 £m	1997 £m
Capital allowances on lease receivables	**137**	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 Other provisions

	Pensions and other similar obligations £m	Other £m
At 1st October 1997	42	23
Charge to profit and loss account	46	—
Provisions utilised	(68)	(14)
At 30th September 1998	**20**	**9**

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

	£m
– The Royal Bank of Scotland Staff Pension Scheme	13
– Citizens Financial Group	7
	20

32 Dated loan capital

	1998 £m	1997 £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$300 million 6⅜% subordinated notes 2011	**174**	182
	373	381
The Royal Bank of Scotland plc		
£125 million 10⅝% subordinated bonds 1998*	**—**	125
£150 million 10½% subordinated bonds 2013*	**149**	149
£250 million 9⅝% subordinated bonds 2015	**246**	246
£125 million subordinated floating rate notes 2005	**125**	124
£150 million 8⅜% subordinated notes 2007	**148**	148
DEM500 million 5¼% subordinated notes 2008	**174**	—
Royscot International Finance B.V.		
US$ guaranteed floating rate notes 1994/1998* (1997 – US$40 million)	**—**	25
RBSG Capital Corporation		
US$250 million 10⅛% guaranteed capital notes 2004*	**146**	155
RBSTB (Holdings) Limited		
£30 million convertible unsecured loan stock 2016	**30**	30
	1,391	1,383
Dated loan capital in issue, by remaining maturity		
– repayable within one year or less, or on demand	**—**	150
– repayable between two and five years	**120**	80
– repayable in five years or more	**1,271**	1,153
	1,391	1,383

*Loans unconditionally guaranteed by the company.

Interest on dated loan capital repayable within five years was £9 million (1997 – £16 million) and after five years was £100 million (1997 – £99 million).

The proceeds of the dated loan capital issued by the company 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 were repaid 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	1998 £m	1997 £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)	**206**	217
US$400 million undated floating rate primary capital notes	(b)	**117**	141
US$200 million exchangeable capital securities, Series A	(c)	**116**	121
US$50 million undated 7.993% capital securities	(d)	**29**	31
US$35 million undated 7.755% capital securities	(d)	**20**	21
US$75 million floating rate perpetual capital securities	(d)	**44**	46
US$200 million undated 7.375% reset capital securities	(e)	**115**	123
		647	700
The Royal Bank of Scotland plc			
£200 million 9½% undated subordinated bonds	(f)	**196**	196
£125 million 9¼% undated subordinated step-up notes	(g)	**124**	123
£150 million undated subordinated floating rate step-up notes	(h)	**149**	148
FRF1,000 million 5⅞% undated subordinated notes	(i)	**104**	—
		1,220	1,167

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.

(i) The FRF1,000 million 5⅞% undated subordinated notes are callable on 25th October 2008 at the option of the Bank and at 5-yearly intervals thereafter.

34 Share capital

At 30th September 1998 (number of shares – million)	Ordinary shares of 25p each	Cumulative preference shares of £1 each	Non-cumulative dollar preference shares of 1 cent each	Non-cumulative sterling preference shares of £1 each	
Authorised	1,040	0.9	83	300	
Allotted, called up and fully paid	875.6	0.9	57	—	
	£m	£m	£m	£m	Total £m
Allotted, called up and fully paid:					
At 1st October 1997	214	1	1	—	216
Issued during the year	4	—	—	—	4
At 30th September 1998	**218**	**1**	**1**	**—**	**220**

Non-equity shareholders' funds are £838 million (1997 – £734 million) comprising £1 million (1997 – £1 million) of nominal non-cumulative dollar preference shares and £837 million (1997 – £733 million) of share premium relating thereto.

Ordinary shares During the year to 30th September 1998, the following ordinary shares were issued:

(a) 5,579,323 ordinary shares were allotted following the exercise of options under the company's executive and sharesave schemes;

(b) 8,127,104 ordinary shares were allotted in lieu of cash in respect of the final dividend for the year ended 30th September 1997 and the interim dividend for the year ended 30th September 1998; and

(c) 1,763,742 ordinary shares were allotted under the company's profit sharing (share ownership) scheme.

Also, during the year to 30th September 1998, options were granted over 4,802,776 ordinary shares under the company's executive and sharesave schemes. At 30th September 1998, options under the schemes exercisable between 1998 and 2008 at prices ranging from 150p to 1006.5p per share were outstanding in respect of 28,443,547 ordinary shares.

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$25.84 per share on or after 23rd August 1998 and prior to 22nd August 1999, 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$25.94 per share on or after 27th August 1998 and prior to 26th August 1999, 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.

34 Share capital *(continued)*

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.

The 10.0 million Series G 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 2003 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 FSA.

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 1997	1,229	1,229	—
Currency translation adjustment	(42)	(42)	—
Shares issued during the year	239	239	—
Employee share option payments	34	34	—
Other movements	(2)	(2)	—
At 30th September 1998	**1,458**	**1,458**	**—**
Reserves:			
At 1st October 1997	103	20	—
Increase in value of long-term life assurance business	19	—	—
Other movements	(9)	—	—
At 30th September 1998	**113**	**20**	**—**
Revaluation reserves:			
At 1st October 1997	(19)	1,922	—
Revaluation of interest in subsidiary undertaking	—	102	—
Movements in revaluations of premises	14	—	—
Movements in net unrealised gains and losses on debt securities and equity shares	(4)	—	—
Other movements	(1)	—	—
At 30th September 1998	**(10)**	**2,024**	**—**
Profit and loss account:			
At 1st October 1997	1,513	31	(12)
Currency translation adjustment	(3)	—	(11)
Goodwill on acquisitions	(754)	—	—
Goodwill written back	50	—	—
Tax on unrealised currency translation gains	4	4	—
Transfer to equity shares	—	—	(2)
Retentions for the year	422	47	(2)
Employee share option payments	(34)	(34)	—
Other movements	(26)	1	—
At 30th September 1998	**1,172**	**49**	**(27)**

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 £1,168 million at 30th September 1998 (1997 – £464 million).

36 Lease commitments

At 30th September 1998, the annual rental commitments under non-cancellable operating leases were:

	1998 Premises £m	**1998 Equipment £m**	1997 Premises £m	1997 Equipment £m
Expiring within one year	**4**	**1**	2	1
Expiring between one and five years	**10**	**5**	10	6
Expiring after five years	**42**	**3**	36	—
	56	**9**	48	7

37 Analysis of total assets and liabilities

	1998 £m	1997 £m
Assets:		
Denominated in sterling	**54,854**	47,684
Denominated in currencies other than sterling	**24,822**	24,917
	79,676	72,601
Liabilities:		
Denominated in sterling	**54,526**	48,294
Denominated in currencies other than sterling	**25,150**	24,307
	79,676	72,601

38 Derivatives

The following table analyses the net replacement cost, by maturity, of all the Group's derivatives:

	Within one year £m	One to five years £m	Over five years £m	1998 Total £m	1997 Total £m
Exchange rate contracts	**1,712**	**58**	**7**	**1,777**	1,485
Interest rate contracts	**83**	**338**	**451**	**872**	467
Equity and commodity contracts	**24**	**10**	**—**	**34**	32
Effect of netting (see Credit Risk, page 20)				**(963)**	
Total net replacement cost				**1,720**	

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 £30,144 million at 30th September 1998 (1997 – £17,436 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.

Net replacement cost is used to indicate the Group's credit exposure. The figures in the above, and the following, table represent the gross positive fair values, without giving effect to offsetting positions with the same counterparty. The table does not include the net replacement cost of internal trades as there is no credit risk associated with them.

The Group may require collateral in respect of the credit risk in derivative transactions.

The following tables analyse the net replacement cost of the Group's derivatives 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:				
At 30th September 1998	**1,661**	**116**	**1,694**	**83**
At 30th September 1997	1,367	118	1,376	109
Interest rate contracts:				
At 30th September 1998	**656**	**216**	**856**	**16**
At 30th September 1997	381	86	462	5
Equity and commodity contracts:				
At 30th September 1998	**27**	**7**	**34**	**—**
At 30th September 1997	26	6	32	—

Trading derivatives The following tables show, for each type of instrument in the trading derivatives portfolio, the end of period fair value and the average fair value:

	1998		1997	
	End of period fair value		End of period fair value	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Exchange rate contracts	**1,759**	**1,758**	1,474	1,452
Interest rate contracts	**872**	**1,003**	440	728
Equity and commodity contracts	**23**	**8**	9	8
Cash	**381**	**186**	273	5
Gilts and bonds	**92**	**60**	—	—
	3,127	**3,015**	2,196	2,193

	1998		1997	
	Average fair value		Average fair value	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Exchange rate contracts	**1,580**	**1,573**	1,567	1,565
Interest rate contracts	**600**	**809**	454	715
Equity and commodity contracts	**15**	**11**	6	5
Cash	**264**	**122**	222	6
Gilts and bonds	**125**	**36**	—	—
	2,584	**2,551**	2,249	2,291

For the year ended 30th September 1998 the Group made a net trading gain from derivatives, including gains from cash instruments held within the derivatives book, of £108 million (1997 – net gain £88 million).

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

	Within one year £m	One to five years £m	Over five years £m	Total £m
Exchange rate contracts:				
At 30th September 1998	**113,571**	**2,444**	**363**	**116,378**
At 30th September 1997	92,872	2,217	121	95,210
Interest rate contracts:				
At 30th September 1998	**36,107**	**52,893**	**11,372**	**100,372**
At 30th September 1997	35,163	35,713	4,875	75,751
Equity and commodity contracts:				
At 30th September 1998	**157**	**10**	**—**	**167**
At 30th September 1997	156	14	—	170

38 Derivatives (*continued*)

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 derivatives markets.

The following table summarises the fair values and book values of derivatives held for non-trading activities:

	30th September 1998				30th September 1997			
	Positive fair value £m	**Negative fair value £m**	**Positive book value £m**	**Negative book value £m**	Positive fair value £m	Negative fair value £m	Positive book value £m	Negative book value £m
Exchange rate contracts	**44**	**57**	**14**	**15**	27	36	16	15
Interest rate contracts	**357**	**309**	**296**	**222**	108	184	69	98
Equity and commodity contracts	**15**	**34**	**15**	**34**	24	4	24	4

The following table analyses the notional principal amounts, by maturity, of the Group's non-trading derivatives (third party, intra-company and intra-group) by contract type:

	Within one year £m	One to five years £m	Over five years £m	Total £m
Exchange rate contracts:				
At 30th September 1998	**2,052**	**140**	**84**	**2,276**
At 30th September 1997	1,567	200	99	1,866
Interest rate contracts:				
At 30th September 1998	**5,623**	**6,561**	**4,127**	**16,311**
At 30th September 1997	3,663	5,591	1,647	10,901
Equity and commodity contracts:				
At 30th September 1998	**26**	**697**	**—**	**723**
At 30th September 1997	—	479	—	479

At 30th September 1998, there were gross deferred gains of £13 million relating to terminated non-trading contracts (1997 – loss of £6 million). The amortisation profile of the £13 million gain was a £4 million gain in under one year, a £4 million loss in the period one to five years and a £13 million gain in the period over five years.

As at 30th September 1998, 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 1998 was to decrease net interest by £3 million (1997 – decrease of £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.

	1998			1997		
	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	**1,024**	**1,024**	**816**	863	863	691
Guarantees and irrevocable letters of credit	**917**	**917**	**610**	946	946	703
Assets pledged as collateral security	**4**	**—**	**—**	5	—	—
Other contingent liabilities	**869**	**434**	**426**	827	414	406
	2,814	**2,375**	**1,852**	2,641	2,223	1,800
Commitments:						
Documentary credits and trade related transactions	**1,207**	**241**	**142**	1,184	237	118
Forward asset purchases and forward deposits placed	**9**	**9**	**9**	137	137	88
Undrawn note issuance and revolving underwriting facilities	**12**	**6**	**1**	20	10	4
Undrawn formal standby facilities, credit lines and other commitments to lend						
– less than one year (a)	**11,114**	**—**	**—**	13,592	—	—
– one year and over	**3,239**	**1,618**	**1,489**	2,200	1,098	972
	15,581	**1,874**	**1,641**	17,133	1,482	1,182

Notes:

(a) Included in this category are facilities of £6,930 million at 30th September 1998 (1997 – £6,684 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 £279 million of total capital would be required to support the total risk weighted amount of £3,493 million.

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

	1998 £m	1997 £m
Operating profit – the company and its subsidiary undertakings	**944**	690
Increase in interest receivable and prepaid expenses	**(150)**	(132)
Increase in interest payable and accrued expenses	**607**	256
(Decrease)/increase in other provisions	**(14)**	23
Increase/(decrease) in provisions for bad and doubtful debts	**182**	(11)
Interest payable on subordinated liabilities	**226**	210
Depreciation and diminution in value of fixed assets	**243**	107
Profit on sales of tangible fixed assets	**(10)**	(18)
Profit on sales of investment securities	**(72)**	(71)
Profit on sale of fixed asset investment	**(57)**	(34)
Profit on sale of US mortgage servicing business	**—**	(28)
Other non-cash movements	**208**	23
Net cash inflow from trading activities	**2,107**	1,015
Net decrease in deposits by banks	**(958)**	(46)
Net increase in customer accounts	**3,018**	6,311
Net increase/(decrease) in debt securities in issue	**1,864**	(556)
Net increase in loans to customers	**(2,530)**	(4,432)
Net decrease/(increase) in loans to banks	**1,293**	(536)
Increase in items in course of collection due from other banks	**(582)**	(42)
Decrease in items in course of collection due to other banks	**(116)**	(139)
Increase in treasury bills and other eligible bills	**(10)**	(69)
(Increase)/decrease in debt securities and equity shares (other than investment securities)	**(2,480)**	777
Increase in other assets	**(1,985)**	(737)
Increase in other liabilities	**1,466**	792
Net cash inflow from operating activities	**1,087**	2,338

41 Purchase of subsidiary undertakings

(a) 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 1998 and 30th September 1997. Apart from the acquisition of Angel Trains (see below), 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. The figures below relate to acquisitions by the Group. The acquisition by the company is detailed in note (b) below.

	1998 £m	1997 £m
Net assets acquired:		
Cash	**17**	86
Debt securities	**16**	2,118
Equity shares	**5**	—
Loans and advances to customers and banks	**109**	1,292
Prepayments and accrued income	**22**	—
Other assets	**10**	112
Tangible fixed assets	**822**	23
Deposits by banks and customer accounts	**(85)**	(3,355)
Debt securities in issue	**(574)**	—
Accruals and deferred income	**(11)**	—
Deferred taxation	**(204)**	—
Other liabilities	**(74)**	(139)
Minority shareholder's interest	**166**	18
	219	155
Goodwill charged to Group reserves	**725**	58
	944	213
Satisfied by (see Note 42):		
Net cash paid	**920**	213
Debt securities issued	**24**	—
	944	213

(b) The acquisition of GRS Holding Company Limited (parent company of Angel Trains) by the company in December 1997 for £395 million was accounted for by the acquisition method of accounting and the contribution to Group operating profit in the period since acquisition to 30th September 1998 was £46 million. In accordance with Financial Reporting Standard 7 – "Fair Values in Acquisition Accounting", the assets and liabilities acquired, with the exception of goodwill which was written off in accordance with Group accounting policy, were revalued to determine the estimated fair values.

	Initial book value £m	Restatement to fair value £m	Fair value to Group £m
Assets on operating leases	563	257	820
Goodwill	217	(217)	—
Current assets	83	—	83
	863	40	903
Current liabilities	(50)	(32)	(82)
Debt	(574)	—	(574)
Provision for maintenance	(111)	111	—
Provision for deferred tax	(127)	(77)	(204)
Net assets	1	42	43

42 Analysis of the net outflow of cash in respect of the purchase of subsidiary undertakings

	1998 £m	1997 £m
Cash consideration paid	**(920)**	(213)
Cash acquired	**17**	86
Net outflow of cash	**(903)**	(127)

43 Sale of subsidiary and associated undertakings

	1998 £m	1997 £m
(a) Net assets disposed of	**19**	65
Goodwill written back	**9**	—
Profit on disposal	**—**	13
Net proceeds received (net of expenses)	**28**	78
Less non-cash receipts	**28**	—
Net inflow of cash in respect of disposals	**—**	78

(b) The Registrars business was sold to Computershare Limited with effect from 1st January 1998. The following table shows the amounts relating to the business disposed of which are included in Group operating profit:

	1998 £m	1997 £m
Net interest income	**4**	10
Non-interest income	**9**	40
Total income	**13**	50
Expenses	**13**	47
Operating profit	**—**	3

44 Analysis of changes in financing during the year

	Share capital (including premium)		Loan capital	
	1998 £m	1997 £m	1998 £m	1997 £m
At 1st October	**1,445**	1,086	**2,550**	2,250
Effect of foreign exchange differences	**(42)**	(17)	**(52)**	(26)
Cash inflow from financing	**243**	373	**127**	343
Other non-cash movements	**32**	3	**(14)**	(17)
At 30th September	**1,678**	1,445	**2,611**	2,550

45 Analysis of cash

	1998 £m	1997 £m	Change in year £m
Cash and balances at central banks	**1,295**	1,213	**82**
Loans and advances to banks repayable on demand	**2,632**	3,963	**(1,331)**
Cash	**3,927**	5,176	**(1,249)**

46 Analysis of changes in cash during the year

	1998 £m	1997 £m
At 1st October	**5,176**	4,110
Net cash (outflow)/inflow	**(1,249)**	1,066
At 30th September	**3,927**	5,176

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

1998	UK and offshore banking £m	Direct Line Insurance £m	Citizens Bank £m	Other* £m	Group total £m
Net interest income	**1,135**	**66**	**376**	**21**	**1,598**
Non-interest income	**836**	**46**	**150**	**384**	**1,416**
General insurance premium income (net of reinsurance)	**—**	**553**	**—**	**47**	**600**
Total income	**1,971**	**665**	**526**	**452**	**3,614**
Operating expenses	**1,069**	**128**	**264**	**418**	**1,879**
General insurance claims (net of reinsurance)	**—**	**473**	**—**	**45**	**518**
Profit before provisions	**902**	**64**	**262**	**(11)**	**1,217**
Provisions for bad and doubtful debts	**158**	**—**	**15**	**27**	**200**
Investment write downs	**9**	**—**	**—**	**1**	**10**
Segment result	**735**	**64**	**247**	**(39)**	**1,007**
Exceptional items	**(63)**	**—**	**—**	**57**	**(6)**
Profit on ordinary activities before tax	**672**	**64**	**247**	**18**	**1,001**
Total assets	**57,396**	**1,201**	**9,714**	**11,365**	**79,676**
Net assets	**2,591**	**315**	**707**	**(660)**	**2,953**

1997	£m	£m	£m	£m	£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

**Note:* Other comprises net central financing costs, central expenses, the results of Investor Services, New Retail Financial Services Businesses and Angel Trains. These segmental results can be analysed as follows:

	1998 £m	1997 £m
Central costs	**(38)**	(46)
Investor Services	**5**	(12)
New Retail Financial Services Businesses	**(52)**	(35)
Angel Trains	**46**	—
	(39)	(93)

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.

1998	UK £m	Continental Europe £m	USA £m	Rest of the World £m	Group total £m
Interest receivable	**4,088**	**57**	**761**	**217**	**5,123**
Dividend income	**14**	**11**	**3**	**—**	**28**
Fees and commissions receivable	**795**	**10**	**113**	**5**	**923**
Dealing profits	**262**	**—**	**3**	**3**	**268**
General insurance premium income (net of reinsurance)	**600**	**—**	**—**	**—**	**600**
Income from associated undertakings	**2**	**(3)**	**—**	**1**	**—**
Other income	**311**	**(1)**	**67**	**—**	**377**
Gross income	**6,072**	**74**	**947**	**226**	**7,319**
Profit on ordinary activities before tax	**737**	**74**	**251**	**(61)**	**1,001**
Total assets	**66,527**	**818**	**9,903**	**2,428**	**79,676**
Net assets	**2,037**	**217**	**700**	**(1)**	**2,953**

1997	£m	£m	£m	£m	£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

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:

	1998 £m	1997 £m
Capital cost of assets financed	**545**	644
General insurance business	**833**	720
Credit card business and other non-banking activities	**352**	273
	1,730	1,637

49 Directors' emoluments

	1998 £000	1997 £000
Non-executive directors – emoluments	**310**	360
Executive directors – emoluments	**6,259**	4,829
– pension contributions in respect of defined contribution schemes	**129**	1,078
	6,698	6,267
– gains on exercise of share options	**1,198**	996
	7,896	7,263

Retirement benefits are accruing to seven directors under defined benefit schemes and three directors under defined contribution schemes.

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

	1998		1997	
	£000	US$000	£000	US$000
Aggregate emoluments and gains on exercise of share options	**3,343**	**5,528**	2,162	3,530
Pension contributions	**78**	**129**	87	142
Defined benefit pension scheme – accrued pension at end of year	**108**	**179**	101	165

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 37. Details of the remuneration received by each director during the year and directors' pension arrangements are given on pages 35 and 36.

50 Transactions with directors, officers and others

(a) At 30th September 1998, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group were £22,737,019 in respect of loans to 13 persons who were directors of the company (or persons connected with them) at any time during the financial year and £242,348 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 £100,000 in respect of certain obligations of one director.

(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) On 30th September 1998, the Bank reached agreement with, amongst others, Mr P. J. Wood and associates of Mr Wood, Mr I. C. Chippendale, Mr M. P. Flaherty and Mr L. N. Thomas pursuant to which the Bank agreed to acquire the issued share capital of Privilege Insurance Holdings Limited ("Privilege") not already owned by the Group. The acquisition was completed on 7th October 1998. Mr Wood, Mr Chippendale and Mr Flaherty were all directors of Privilege and Privilege Insurance Company Limited ("Privilege Company") (together "the Privilege Group") as at 30th September 1998 and Mr Chippendale is a director of Direct Line Group Limited and other subsidiaries of the Group. Mr Thomas resigned as a director of the Privilege Group on 5th November 1997.

The shareholdings acquired by the Bank were as follows:

- 500,000 'B' ordinary shares and 250,000 'C' ordinary shares owned by associates of Mr Wood purchased for a total consideration of £20 million, satisfied by the allotment to an associate of Mr Wood of £20 million of loan stock in the capital of the Bank.
- 50,000 'C' ordinary shares owned by associates of Mr Chippendale purchased for a total consideration of £1 million, satisfied by the allotment to an associate of Mr Chippendale of £1 million of loan stock in the capital of the Bank.
- 100,000 'C' ordinary shares owned by associates of Mr Flaherty purchased for a total consideration of £2 million, satisfied by the allotment to an associate of Mr Flaherty of £2 million of loan stock in the capital of the Bank.
- 50,000 'C' ordinary shares owned by associates of Mr Thomas purchased for a total consideration of £1 million, satisfied by the allotment to an associate of Mr Thomas of £1 million of loan stock in the capital of the Bank.

The directors of the Group, having taken advice, consider the transaction in respect of Mr Wood to be fair and reasonable so far as the shareholders of the Group are concerned. Mr Wood resigned his directorships of the Privilege Group on 7th October 1998, the date of completion of the acquisition ("Completion").

At Completion, all arrangements existing between the Privilege Group, the Group and Mr Wood and his associates were terminated. At Completion, Privilege Company entered into a consultancy agreement under which the consultancy services of Mr Wood are provided to Privilege Company until 6th October 1999 for an aggregate fee of £199,999. Additionally, Privilege Company agreed to assign a lease of property to an associate of Mr Wood which is now responsible for all outgoings in relation to the property.

(d) 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 1998 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 1998 are shown in Notes 13 and 14 and the amounts of deposits received from associated undertakings as at 30th September 1998 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.

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 1998 was £0.3 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 3.4% of Santander's capital stock and Santander holds 9.89% of the company's ordinary shares and in addition has a 50% minority shareholding in The Royal Bank of Scotland (Gibraltar) Limited.

Directors, officers and others Details of directors' emoluments are set out in Note 49 and the Remuneration Committee report on pages 33 to 36. Details of transactions with directors, officers and others connected to them are shown in Note 50.

52 Approval of accounts

The accounts were approved by the board of directors on 2nd December 1998.

Average balance sheet and related interest

	1998 Average Balance* £m	Rate %	1998 Interest £m	1997 Average Balance* £m	Rate %	1997 Interest £m
Assets						
Treasury and other eligible bills						
UK	646	7.5	49	633	6.2	39
overseas	30	5.0	1	38	4.8	2
Loans and advances to banks						
UK	11,804	6.6	783	11,262	5.5	621
overseas	1,582	5.7	91	1,769	5.7	101
Loans and advances to customers						
UK	28,777	8.9	2,550	24,927	7.9	1,980
overseas	7,188	8.3	593	6,667	8.3	554
Lease and HP receivables						
UK	3,358	9.0	301	3,207	8.2	264
overseas	133	7.4	10	78	7.5	6
Debt securities						
UK	6,845	7.4	503	5,076	6.7	342
overseas	3,739	6.5	242	3,370	6.4	216
Interest earning assets	64,102	8.0	5,123	57,027	7.2	4,125
Non-interest earning assets	10,538	—	—	8,895	—	—
Total average assets	74,640	6.9	5,123	65,922	6.3	4,125
Liabilities						
Deposits by banks						
UK	4,144	6.6	273	3,935	5.8	229
overseas	1,289	5.7	74	1,583	5.4	86
Customer demand deposits						
UK	18,912	5.2	983	16,156	4.3	697
overseas	2,131	5.1	109	1,840	3.8	69
Customer savings deposits						
UK	4,136	6.0	247	2,819	5.0	142
overseas	6,253	4.1	257	5,963	4.4	263
Customer other time deposits						
UK	12,265	7.2	881	10,769	6.1	655
overseas	348	5.0	17	327	4.9	16
Debt securities in issue						
UK	5,750	7.2	417	5,132	6.1	313
overseas	812	5.0	41	621	5.0	31
Loan capital	2,517	9.0	226	2,386	8.8	210
Interest bearing liabilities	58,557	6.0	3,525	51,531	5.2	2,711
Interest free liabilities						
demand deposits	2,877	—	—	2,716	—	—
other liabilities	10,144	—	—	8,760	—	—
Shareholders' funds	3,062	—	—	2,915	—	—
Total average liabilities	74,640	4.7	3,525	65,922	4.1	2,711

*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.

Financial analyses

Interest rates, yields, spreads and margins

	1998 Average rate %	1997 Average rate %
UK		
The Royal Bank of Scotland plc base rate	**7.3**	6.3
London inter-bank offered rate		
three month sterling	**7.5**	6.6
three month eurodollar	**5.6**	5.6
Yields, spreads and margins:		
Gross yield[1]		
total	**8.0**	7.2
UK	**8.2**	7.2
overseas	**7.4**	7.4
Interest spread[2]		
total	**2.0**	2.0
UK	**1.8**	1.7
overseas	**2.8**	2.9
Interest margin[3]		
total	**2.5**	2.5
UK	**2.3**	2.2
overseas	**3.5**	3.5

[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 1998.

	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
Germany	131	—	2,679	2,810	3.5
USA	1,661	145	675	2,481	3.1
France	90	—	1,932	2,022	2.5
Japan	44	—	999	1,043	1.3
Spain	123	46	832	1,001	1.2

*Assets comprise total assets as reported in the consolidated balance sheet plus acceptances and endorsements as reported in the memorandum items below the consolidated balance sheet, which together totalled £80,700 million at 30th September 1998.

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	**1998 £m**	1997 £m	1996 £m	1995 £m	1994 £m
UK					
ECGD and government	**78**	116	90	112	116
Manufacturing	**2,075**	1,739	1,732	1,682	1,289
Construction	**543**	404	530	471	501
Finance	**2,197**	3,100	3,173	3,231	2,722
Service industries	**4,968**	4,660	3,374	3,296	2,706
Agriculture, forestry and fishing	**643**	613	493	473	490
Property	**2,935**	2,617	1,525	1,263	1,200
Business and other services	**2,011**	2,140	2,715	2,384	2,108
Persons					
– home mortgages (including staff)	**8,317**	7,371	6,532	6,201	5,601
– other	**4,550**	3,530	2,713	2,319	2,360
Instalment credit and other loans	**900**	856	630	660	597
Finance leases	**2,587**	2,569	2,333	1,623	1,559
Overseas residents	**2,248**	1,880	1,403	1,178	819
Total UK	**34,052**	**31,595**	**27,243**	**24,893**	**22,068**
Overseas					
Continental Europe	**484**	426	408	350	294
USA	**5,811**	6,063	5,416	3,942	3,743
Rest of the World	**1,303**	981	853	572	391
Total overseas	**7,598**	7,470	6,677	4,864	4,428
Total loans and advances to customers	**41,650**	39,065	33,920	29,757	26,496

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 1997, the Bank reclassified all its non-personal customer accounts and took the opportunity to review and update industrial codes on all business customer accounts. As a result of this exercise in 1997 there were 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	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
UK					
Demand deposits					
– interest free	**4,451**	5,741	3,437	2,944	2,320
– interest bearing	**23,712**	19,444	14,725	13,470	12,755
Time deposits					
– savings	**4,183**	3,354	3,987	2,957	2,693
– other	**11,176**	12,355	10,659	10,417	8,179
Total UK	**43,522**	40,894	32,808	29,788	25,947
Overseas					
Demand deposits					
– interest free	**1,052**	1,014	696	543	467
– interest bearing	**1,468**	1,560	1,246	698	657
Time deposits					
– savings	**6,121**	6,522	5,664	4,501	4,279
– other	**2,959**	2,987	2,996	2,040	1,995
Total overseas (see below)	**11,600**	12,083	10,602	7,782	7,398
Total deposits	**55,122**	52,977	43,410	37,570	33,345
Overseas					
Continental Europe	**767**	496	417	445	696
USA	**8,614**	8,651	7,633	6,121	5,454
Rest of the World	**2,219**	2,936	2,552	1,216	1,248
Total overseas	**11,600**	12,083	10,602	7,782	7,398

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 40. 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 UK Bank charged a total of £29 million to the consolidated profit and loss account for the year ended 30th September 1997 for the costs of completing work on its computer systems to ensure that they are Year 2000 compatible. Of this amount £14 million was expended in the year ended 30th September 1998 (1997 – £6 million). 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	**1998 £m**	1997 £m
Net income as reported under UK GAAP	**695**	510
Disposal of revalued property	**1**	1
Deferred tax	**(28)**	(22)
Amortisation of goodwill	**(47)**	(4)
Loan origination fees	**12**	15
Pension costs	**(2)**	28
Long-term assurance policies	**(26)**	2
Leasing	**6**	6
Year 2000 costs	**(14)**	23
Approximate net income under US GAAP	**597**	559
Preference dividends	**(58)**	(53)
Approximate net income available for ordinary shareholders under US GAAP	**539**	506

Shareholders' funds	**1998 £m**	1997 £m
Shareholders' funds as reported under UK GAAP	**2,953**	3,042
Revaluation of property less depreciation	**(133)**	(138)
Deferred tax	**(198)**	(213)
Goodwill	**1,039**	392
Loan origination fees	**(12)**	(24)
Proposed dividend	**153**	131
Pension costs	**(1)**	1
Leasing	**4**	(2)
Long-term assurance policies	**(130)**	(104)
Debt securities and equity shares	**322**	453
Year 2000 costs	**9**	23
Approximate shareholders' funds under US GAAP	**4,006**	3,561

Total assets	**1998 £m**	1997 £m
Total assets as reported under UK GAAP	**79,676**	72,601
Revaluation of property less depreciation	**(133)**	(138)
Goodwill	**1,039**	396
Acceptances	**1,023**	862
Long-term assurance policies	**(128)**	(101)
Loans and advances to customers	**3**	(1)
Debt securities and equity shares	**322**	453
Approximate total assets under US GAAP	**81,802**	74,072

Risk elements in lending The Group's provisioning policy for bad and doubtful debts is described under Accounting policies Note 9 on page 40. 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	**1998 £m**	1997 £m	1996 £m	1995 £m	1994 £m
Loans accounted for on a non-accrual basis:					
domestic	**416**	462	534	591	755
foreign	**148**	75	86	99	76
Accruing loans which are contractually overdue 90 days or more as to principal or interest*:					
domestic	**311**	217	236	207	176
foreign	**117**	14	3	13	20
Loans not included above which are classified as "troubled debt restructurings" by the SEC:					
domestic	**15**	13	34	87	94
foreign	**5**	—	—	6	5
Total	**1,012**	781	893	1,003	1,126
Total provisions as a % of risk elements in lending	**63%**	59%	53%	54%	56%

*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 in respect of which the Group has serious doubts about the ability of the borrower to comply with loan repayment terms, totalled approximately £143 million at 30th September 1998 (1997 – £116 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 1998 under the original terms of non-accrual and restructured loans amounted to £57 million from domestic loans (1997 – £42 million) and £20 million from foreign loans (1997 – £12 million). Interest on non-accrual and restructured loans included in the consolidated profit and loss account in the year ended 30th September 1998, totalled £14 million from domestic loans (1997 – £2 million) and £7 million from foreign loans (1997 – £4 million).

Principal UK and overseas offices

The company
42 St Andrew Square Edinburgh EH2 2YE
Waterhouse Square 138-142 Holborn London EC1N 2TH

The Royal Bank of Scotland plc
42 St Andrew Square Edinburgh EH2 2YE

Retail Banking
Regional Retail Offices
38 West Register Street Edinburgh EH2 2YE
100 West George Street Glasgow G2 1PP
37 Lowther Street Carlisle Cumbria CA3 8EL
13-19 Derby Road Nottingham NG1 5AA
49 Charing Cross London SW1A 2DX

Royal Scottish Assurance plc
31 St Andrew Square Edinburgh EH2 2AG

Private Banking
Adam & Company Group PLC
22 Charlotte Square Edinburgh EH2 4DF
38 Mosley Street Manchester M60 2BE
42 Pall Mall London SW1Y 5JG

Corporate and Institutional Banking
Waterhouse Square 138-142 Holborn London EC1N 2TH
42 St Andrew Square Edinburgh EH2 2YE
36 St Andrew Square Edinburgh EH2 2YB
Drummond House 1 Redheughs Avenue
Edinburgh EH12 9JN
100 West George Street Glasgow G2 1PP
9 Rubislaw Terrace Aberdeen AB9 8YQ
29 Harbour Road Inverness IV1 1NU
Unit 1 Gemini Crescent Technology Park
Dundee DD2 1SW
38 Mosley Street Manchester M60 2BE
55 Spring Gardens Manchester M2 2BY
1 Exchange Flags Liverpool L2 3XN
30 East Parade Leeds LS1 5PS
13-19 Derby Road Nottingham NT1 5AA
79-83 Colmore Row Birmingham B3 2AP
St Johns House East Street Leicester LE1 6NB
1 Redcliffe Street Bristol BS99 7NH
Gervase House 111-113 Friargate Derby DE11 1EX
Charnley House 13 Winckley Square Preston PR1 3JJ
31 Grey Street Newcastle Upon Tyne NE1 6ES
Brunel House 17-27 Station Road Reading RG1 1LG
62-63 Threadneedle Street London EC2R 8LA
49 Charing Cross London SW1A 2DX
28 Cavendish Square London W1M 0DB
5-10 Great Tower Street London EC3P 3HX

Royal Bank Invoice Finance Limited
City Link House 4 Addiscombe Road Croydon CR0 5TT

RoyScot Trust plc
RoyScot House The Promenade Cheltenham GL50 1PL

Royal Bank Insurance Services Limited
152 West Regent Street Glasgow G2 2RQ

Royal Bank Insurance Services (Independent Financial Advisers) Limited
49 Peter Street Manchester M2 3NR

Structured Finance
Waterhouse Square 138-142 Holborn London EC1N 2TH
Drummond House 1 Redheughs Avenue
Edinburgh EH12 9JN
6 Battery Road 27-01 Singapore 049909
Wall Street Plaza 88 Pine Street 26th Floor New York
NY 10005-1801 USA

Angel Train Contracts Limited
Portland House Stag Place Victoria London SW1E 5BH

RBS Trust Bank Ltd.
67 Lombard Street London EC3P 3DL

Regent's House 42 Islington High Street London N1 8XL

RBS Retail Funds Services
12 Blenheim Place Edinburgh EH7 5ZR

Shipping Business Centre
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61 Akti Miaouli GR-185 10 Piraeus Greece

Treasury and Capital Markets
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55 Spring Gardens Manchester M2 2BY
Drummond House 1 Redheughs Avenue
Edinburgh EH12 9JN
Wall Street Plaza 88 Pine Street 26th Floor New York
NY 10005-1801 USA
6 Battery Road 27-01 Singapore 049909

Trustee and Depositary Services
Drummond House 1 Redheughs Avenue
Edinburgh EH12 9JN

Royal Bank Development Capital Limited
26 St Andrew Square Edinburgh EH2 1AF
Waterhouse Square 138-142 Holborn London EC1N 2TH
Moncrieff House 69 West Nile Street Glasgow G1 2LT

Privilege Insurance Company Limited
Privilege Wharf Neville Street Leeds LS1 4AZ

Royal Bank Mezzanine Limited
Waterhouse Square 138-142 Holborn London EC1N 2TH

Royal Bank Leasing Limited
The Quadrangle The Promenade Cheltenham GL50 1PX
Waterhouse Square 138-142 Holborn London EC1N 2TH
57 Calthorpe Road Edgbaston Birmingham B15 1TT
100 West George Street Glasgow G2 1PP

Service and Operations
42 St Andrew Square Edinburgh EH2 2YE
Drummond House 1 Redheughs Avenue
Edinburgh EH12 9JN
34 Fettes Row Edinburgh EH3 6UY
Regent's House 42 Islington High Street London N1 8XL
Credit Card Centre 200 Priory Crescent Southend-on-Sea
SS99 9EE
Moncrieff House 69 West Nile Street Glasgow G1 2LT
38 Mosley Street Manchester M60 2BE
24 Chiswell Street London EC1Y 4SP

RoyScot Financial Services Limited
1st Floor The Guild Hall 57 Queen Street Glasgow G1 3EN

RBS Advanta
113 Dundas Street Edinburgh EH3 5EB

Tesco Personal Finance Limited
113 Dundas Street Edinburgh EH3 5EB

Virgin Direct Personal Finance Limited
Discovery House Whiting Road Norwich NR4 6EJ

The Royal Bank of Scotland International Limited
Royal Bank House 71 Bath Street St Helier
Jersey Channel Islands

The Royal Bank of Scotland Trust Company (Jersey) Limited
6-7 Mulcaster Street St Helier
Jersey Channel Islands

The Royal Bank of Scotland Trust Company (Guernsey) Limited
22 High Street St Peter Port Guernsey Channel Islands

The Royal Bank of Scotland Trust Company (I.O.M.) Limited
Victory House Prospect Hill Douglas Isle of Man

The Royal Bank of Scotland (Gibraltar) Limited
1 Corral Road PO Box 766 Gibraltar

The Royal Bank of Scotland (Nassau) Limited
3rd Floor Bahamas Financial Centre PO Box N-3045
Shirley & Charlotte Streets Nassau NP Bahamas

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Direct Line House 3 Edridge Road Croydon CR9 1AG
Direct Line House 73 Colmore Row Birmingham B3 2AN
Direct Line House 14-18 Cadogan Street
Glasgow G2 6QN
Direct Line House 44 Peter Street Manchester M2 5GQ
Direct Line House 1 Cathedral Square Trinity Street
Bristol BS1 5DL
Direct Line House The Headrow Leeds LS1 8HZ

Direct Line Financial Services Limited
Direct Line House 250 St Vincent Street Glasgow G2 5SH

Direct Line Life Holdings Limited
Direct Line House 3 Edridge Road Croydon CR9 1AG

Direct Line Accident Management Limited
Marlowe Way Croydon CR9 2XP

Linea Directa Aseguradora, S.A.
Isaac Newton 7, 28760 Tres Cantos Madrid Spain

Citizens Financial Group, Inc.
One Citizens Plaza Providence Rhode Island 02903 USA

Citizens Bank of Rhode Island
One Citizens Plaza Providence Rhode Island 02903 USA

Citizens Leasing Corporation
One Citizens Plaza Providence Rhode Island 02903 USA

Citizens Bank of Massachusetts
28 State Street Boston Massachusetts 02109 USA

Citizens Bank New Hampshire
875 Elm Street Manchester New Hampshire 03101 USA

Citizens Capital, Inc.
28 State Street Boston Massachusetts 02109 USA

Citizens Bank of Connecticut
63 Eugene O'Neill Drive New London
Connecticut 06320 USA

Analyses of ordinary shareholders

	shareholdings	millions	% of total
Individuals	44,379	104.7	11.96
Banks and nominee companies	8,117	652.2	74.49
Investment trusts	119	0.6	0.06
Insurance companies	13	9.3	1.06
Other companies	689	8.6	0.98
Pension trusts	19	4.9	0.56
Other corporate bodies	386	95.3	10.89
	53,722	875.6	100.00
Range of shareholdings:			
1– 1,000	26,221	9.4	1.07
1,001– 10,000	24,580	72.5	8.27
10,001– 100,000	2,402	56.6	6.47
100,001– 1,000,000	415	136.0	15.54
1,000,001–10,000,000	94	262.2	29.95
10,000,001 and over	10	338.9	38.70
	53,722	875.6	100.00

Shareholder information

Annual general meeting	14th January 1999 at 12 noon, Edinburgh International Conference Centre, The Exchange, Morrison Street, Edinburgh
Interim results	6th May 1999
Final results	25th November 1999
Dividends	
Payment dates:	
*Ordinary shares (1998 Final)	19th February 1999
Ordinary shares (1999 Interim)	16th July 1999
Cumulative preference shares	31st December 1998, 31st May and 31st December 1999
Series B, C, D, E, F and G non-cumulative dollar preference shares	31st March, 30th June, 30th September and 31st December 1999
Ex-dividend dates:	
Ordinary shares (1998 Final)	14th December 1998
Cumulative preference shares	30th November 1998
Record dates:	
Ordinary shares (1998 Final)	18th December 1998
Cumulative preference shares	4th December 1998

*If the necessary approval for the payment of the final dividend is obtained from shareholders at the annual general meeting on 14th January 1999 as an alternative to cash, a scrip dividend election will be offered and shareholders will receive details of this by letter after that date.

Capital gains tax The market value of one ordinary share held at 31st March 1982 was £1.03. After adjusting for the 1st March 1985 rights issue and the 1st September 1989 capitalisation issue, the adjusted 31st March 1982 base value of one ordinary share held currently is £0.4976. When disposing of shares, shareholders are also entitled to indexation relief, which is calculated on the 31st March 1982 value, on the cost of subsequent purchases from the date of purchase and on the subscription for rights from the date of that payment. Further adjustments must be made where a shareholder has chosen to receive shares instead of cash for dividends.

Notice of meeting

Notice is hereby given that the thirty first annual general meeting of the members of The Royal Bank of Scotland Group plc will be held in the Edinburgh International Conference Centre, The Exchange, Morrison Street, Edinburgh on 14th January 1999, at 12 noon, for the following purposes:

1 To receive and approve the accounts to 30th September 1998 and the reports of the directors and auditors thereon (resolution numbered 1 on the proxy form).
2 To declare a final dividend on the ordinary shares (resolution numbered 2 on the proxy form).
3 To re-appoint directors (resolutions numbered 3 to 8 inclusive on the proxy form).
4 To re-appoint PricewaterhouseCoopers as auditors, special notice having been given, pursuant to S.379 and S.388 of the Companies Act 1985 (resolution numbered 9 on the proxy form).
5 To authorise the directors to fix the remuneration of the auditors (resolution numbered 10 on the proxy form).
6 To authorise the directors to issue shares on a non-pre-emptive basis (resolution numbered 11 on the proxy form).
7 To approve the creation of an additional 30 million category II non-cumulative dollar preference shares of US$0.01 each (resolution numbered 12 on the proxy form).
8 To create a new Executive Share Option Scheme (resolution numbered 13 on the proxy form).
9 To create a new Profit Sharing (Share Ownership) Scheme (resolution numbered 14 on the proxy form).

The resolutions to be proposed as additional business at the annual general meeting in respect of items 6 to 9 above are set out in full in Appendix 1 to the circular letter to shareholders dated 11th December 1998 accompanying this Report and Accounts of which this notice forms part.

By order of the board.
M. R. McLean
Secretary

36 St. Andrew Square, Edinburgh
16th December 1998

Note:
Pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995, the company gives notice that only those shareholders entered on the register of members of the company at close of business on 12th January 1999 will be entitled to attend or vote at the aforesaid meeting in respect of the number of shares registered in their name at that time. Changes to entries on the register after close of business on Tuesday 12th January 1999 will be disregarded in determining the rights of any person to attend or vote at the meeting. Every member entitled to attend and vote at the meeting is entitled to appoint a proxy or proxies to attend and, on a poll, vote instead of the member. A proxy need not be a member of the company. A form appointing a proxy is enclosed with this notice and may be returned in the enclosed pre-paid envelope. To be effective, it must be completed and be received at the company's transfer office not less than 48 hours before the time fixed for the meeting. A statement of all transactions of each director of the company and, so far as each director is aware or can reasonably ascertain, of their family interests in the shares of the company and of its subsidiaries and in the loan capital of the company and its subsidiaries covering the period from 11th December 1997 to 15th December 1998, will be available for inspection at the company's registered office during the usual business hours on any weekday (Saturdays and public holidays excepted) from the date of this notice until the date of the meeting and at the place of the meeting for at least 15 minutes prior to the meeting and during the meeting.

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Facsimile: 0131 557 6140

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Facsimile: 0131 442 4924

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Chartered Accountants and
Registered Auditors
Edinburgh

Published by The Royal Bank of Scotland Group plc.
Printed by Pillans & Wilson Greenaway – Edinburgh, Glasgow, London and Manchester. The cover and text pages are printed on Mega Matt paper which is made from 50% recycled and 50% chlorine-free pulp from countries which operate an intensive tree replanting policy.