The Royal Bank of Scotland Group plc

Report and Accounts 2001

Contents

Foreword

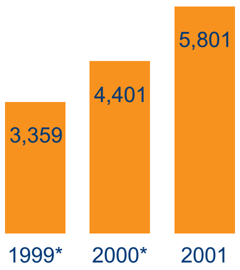
The acquisition of National Westminster Bank Plc ("NatWest") on 6 March 2000 had a significant effect on the Group's financial position. Comparison with the prior period on a statutory basis (which is a 15 month period and includes NatWest from 6 March 2000) is of limited benefit. Accordingly, in order to provide shareholders with additional relevant and meaningful information, the results for the year ended 31 December 2001 are compared with the pro forma results for the year ended 31 December 2000 which assume that the acquisition of NatWest took place on 1 January 1999. This is the primary focus of the operating and financial review.

Comparatives on a statutory basis are for the 15 months ended 31 December 2000 and include NatWest from the date of its acquisition, 6 March 2000. Results on this basis are set out on pages 49 to 102.

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

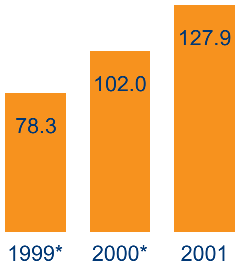
Financial highlights

Profit before tax, goodwill amortisation and integration costs (£m)



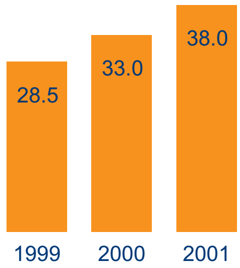
The Group's profit before tax, goodwill amortisation and integration costs rose by 32% to £5,801 million.

Adjusted earnings per share (pence)



Earnings per share, adjusted for goodwill amortisation, integration costs and the dividend on the Additional Value Shares increased by 25% to 127.9p.

Dividend per ordinary share – actual (pence)



The directors have recommended a final dividend of 27.0p which, when added to the interim dividend of 11.0p, makes a total for the year of 38.0p, an increase of 15%.

*pro forma basis assuming NatWest acquisition on 1 January 1999

for the year ended 31 December	2001 £m	Pro forma 2000 £m	Increase %
Profit before tax, goodwill amortisation and integration costs	5,801	4,401	32
Goodwill amortisation	651	640	2
Integration costs	875	434	102
Profit before tax	4,275	3,327	28
Profit attributable to ordinary shareholders	1,868	1,774	5
Cost:income ratio	46.9%	53.5%	—
Adjusted earnings per share	127.9p	102.0p	25

statutory basis	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Profit before tax	4,275	3,373
Adjusted earnings per share	127.9p	126.4p
Dividend per ordinary share	38.0p	33.0p
Dividend cover (times)	1.7	2.1
Total assets	368,782	320,004
Total shareholders' funds – equity	22,404	19,081
– non-equity	5,216	4,035
Risk asset ratio – tier 1	7.1%	6.9%
– total	11.5%	11.5%

To facilitate comparisons, the financial information and commentaries on the Group and divisional performances in the Chairman's statement, the Chief Executive's review and the operating review for the year ended 31 December 2001 are compared with the pro forma results for the year ended 31 December 2000 which have been prepared on the basis described on page 6.

Chairman's statement

2001 was another year of substantial improvement in the strength and profitability of our Group. All our businesses have grown income and improved efficiency, producing notable profit increases. Credit quality remains good, although we have made prudent increases in our level of provisions to reflect the growth in our business combined with the deterioration in the short-term economic outlook and a small number of specific customer situations.

The integration of NatWest is progressing well and we expect to achieve significantly greater revenue benefits and cost savings than originally envisaged.

The Group is well positioned to sustain growth momentum and thereby deliver superior returns to our shareholders.

Financial performance Profit before tax, goodwill amortisation and integration costs increased by 32% to £5,801 million (31 December 2000 – £4,401 million on a pro forma basis). Total income grew by 18%, to £14,581 million, while operating expenses excluding goodwill amortisation and integration costs rose by just 3% to £6,841 million. The growth in income, combined with control of costs and the benefits of integration, enabled us to improve the cost:income ratio from 53.5% to 46.9%. Adjusted earnings per share rose by 25% to 127.9p.

Dividend The directors have recommended a final dividend of 27.0p, which, with the interim dividend of 11.0p, makes a total of 38.0p, an increase of 15%. Also, the first Additional Value Share dividend, of 15.0p per share, was paid on 3 December 2001.

Staff profit sharing I am pleased to announce that the staff profit share has been set at the maximum of 10% of basic salaries for employees of the Group.

Business developments We made a number of tactical acquisitions during 2001, including expanding Direct Line's operations in Europe.

Strategically, we expanded our presence in the US with the acquisition by Citizens, in December 2001, of Mellon Financial Corporation's regional banking franchise based in Pennsylvania for US$2.2 billion.

Board of directors Viscount Younger of Leckie retired from the Board and as Chairman at our annual general meeting on 11 April 2001. As Chairman of the Group between 1991 and last year, George Younger presided over undoubtedly its most successful decade, culminating in the transformational acquisition of NatWest in March 2000. His patience, wisdom and strength were major factors in the success of The Royal Bank of Scotland Group under his leadership.

Murray Stuart and Cameron McLatchie will not be seeking re-election at the annual general meeting on 26 April 2002 and will retire from the Board. Murray Stuart joined the Board in 1996 and Cameron McLatchie in 1998. Both have served the Board extremely well and their contributions to the progress of the Group and to Board discussions during their service were greatly valued.

A number of new non-executive directors were appointed during the year. Bob Scott, formerly group chief executive of CGNU plc, and Peter Sutherland, chairman and managing director of Goldman Sachs International and non-executive chairman of BP plc, both joined the Board on 31 January 2001. Sir Steve Robson, formerly Second Permanent Secretary of HM Treasury, joined the Board on 25 July 2001. On 28 November 2001, Dr Jim Currie, formerly Director General at the European Commission with responsibility for the EU's environmental policy, joined the Board.

Economic situation While the UK and US economies are not as strong as they were twelve months ago, we do have a more positive outlook than was the case immediately after the events of 11 September 2001. The initial signs of recovery in the US are encouraging although it may not be until the second half of 2002 that sustained recovery can be confirmed. In the UK, consumer confidence still holds up well, which should support the UK in continuing to be among the best performing major industrialised countries in 2002. Only time will tell whether this view is correct, and great vigilance is clearly required in case there is further deterioration.

Prospects Our focus on building strategic options for the Group, together with our emphasis on growing income in ways which are beneficial for both customers and shareholders, has delivered another significant uplift in our performance. I am confident that the resultant strength, diversity and flexibility of the Group will enable us to continue to build value.

Sir George Mathewson
Chairman

Chief Executive's review

As indicated in the Chairman's statement, 2001 has been a year of considerable progress. Clear evidence of this can be seen in each of our operating divisions as well as in the Group as a whole.

Our business model recognises that, to deliver superior sustainable value to our shareholders, we need to do the same for our customers and our people. That the 32% increase in our profit before tax, goodwill amortisation and integration costs has been fuelled largely by income growth, which was in turn driven by increased customer numbers, is pleasing, as is the fact that our annual employee opinion survey indicates that our people strongly support what we are doing.

Increased efficiency also contributed to our growth, with our cost:income ratio improving to 46.9% (2000 – 53.5%).

The Group net interest margin for 2001 was 3.1% (2000 – 3.0%). Improved lending spread has more than offset a decline in deposit margins arising from lower interest rates. There was also a small benefit from interest on funds raised in July 2001 for the acquisition of Mellon Financial Corporation's regional banking franchise.

Whilst the credit quality of our loan portfolio remains strong, bad debt provisions have been increased to ensure that we retain a prudent level of reserves against the poorer quality loans in our book, where customers are experiencing difficulty as a result of deterioration in the short-term economic environment.

Corporate Banking and Financial Markets increased its contribution before manufacturing costs by 10% to £3,011 million (2000 – £2,730 million). Corporate Banking and Financial Markets maintained leading positions in the UK in corporate lending, deposits, payments and sterling and euro foreign exchange, and across a wide range of specialised corporate banking activities. Outside the UK, the division expanded its offices in Paris, Frankfurt and Milan and opened an office in Madrid. Euro Sales Finance plc, an invoice finance company, with offices in the UK and Europe, was acquired during the year.

Retail Banking increased its contribution before manufacturing costs by 14% to £2,807 million (2000 – £2,467 million). The Royal Bank of Scotland and NatWest both achieved good growth in current accounts and other personal banking products, and NatWest maintained its market leading position for small business relationships. The Royal Bank of Scotland was voted number one High Street Bank for customer satisfaction in an NOP survey.

Retail Direct increased its contribution before manufacturing costs by 48% to £551 million (2000 – £373 million). This reflected good growth in its principal businesses. The total number of credit card accounts increased by 22% to 9.6 million (2000 – 7.9 million). Tesco Personal Finance grew its customer base by 44% to 2.6 million (2000 – 1.8 million). Virgin One, which became wholly-owned during the year, grew its mortgage balances by 54% to £3.7 billion (2000 – £2.4 billion).

Manufacturing reduced its costs by 6% to £1,568 million (2000 – £1,660 million). Within this amount, technology costs were down by 13% to £632 million (2000 – £723 million). Manufacturing continued to make good progress on the conversion of technology systems to a common platform, and remains confident that it will complete this substantial project within the original timescale of three years from the acquisition of NatWest – that is, by March 2003.

Wealth Management increased its profit before integration costs by 13% to £459 million (2000 – £405 million). Although lower stock market levels had an adverse impact on some elements of income, Wealth Management achieved increases in customer deposits and loans, and reduced its expenses by 2%.

Direct Line Group increased its profit before goodwill amortisation by 30% to £261 million (2000 – £201 million). Direct Line increased its UK motor insurance policies (including those sold through Tesco Personal Finance) by 25%, to 4.0 million (2000 – 3.2 million). Outside the UK, Direct Line continued to make good progress in Spain, and acquired direct motor insurance businesses in Italy and Germany.

Ulster Bank increased its profit before integration costs by 21% to £242 million (2000 – £200 million). Ulster Bank continued its transformation programme, Project Horizon, which is designed to increase focus on customers and reduce costs. At the same time, Ulster Bank introduced a number of new products for personal customers, and coped well with the introduction of euro notes and coins in the Republic of Ireland.

Citizens increased its profit before goodwill amortisation and integration costs by 44% to £501 million (2000 – £349 million). In December 2001, Citizens completed the acquisition of Mellon Financial Corporation's regional banking franchise, located mainly in Pennsylvania. This increased Citizens' network to 546 traditional branches (2000 – 275). During the year, Citizens also agreed to open new branches in over 100 Stop & Shop supermarkets.

Integration Good progress continues to be made on all aspects of integration. As well as enabling an upward revision in the expected total annual benefits of the programme at completion (now £2,030 million, formerly £1,730 million), the benefits being realised during the programme are being achieved earlier than plan. We now anticipate that the benefits realised during integration will be £1,410 million higher than planned. The cost of delivering the entire integration programme has also increased to £2,300 million.

Employees As ever, the Group's performance in 2001 would not have been possible without the efforts and achievements of our people. Their commitment to the Group was again evident throughout the year, and was confirmed in our annual employee opinion survey, which was carried out in the fourth quarter of 2001 by the independent firm International Survey Research (ISR). In this survey, we distributed 100,000 forms across the Group, and the response rate was 75% – the highest we have ever achieved (2000 – 67%). The Group improved its performance in each of the 16 categories measured by ISR.

ISR also evaluates our performance against external benchmarks. The Group outperformed the UK Financial Services norm in every category and showed an excellent performance against the Global Financial Services norm.

That we have been able to make such good progress with integration whilst delivering outstanding "business as usual" results further emphasises how fortunate we are to have such a capable and committed team of people engaged throughout the Group.

Outlook Considerable momentum is evident in each of our divisions, which together with their financial results in 2001 gives confidence for the future. Whilst the economic outlook is shrouded in even greater than usual uncertainty at this time, I remain of the view that the strength, diversity and flexibility of the Group will enable us to deliver superior value in any of the likely outcomes for the economies in which we operate.

Fred Goodwin
Group Chief Executive

Operating and financial review

Profit before tax, goodwill amortisation and integration costs for the year ended 31 December 2001 was £5,801 million (year ended 31 December 2000 – £4,401 million). The profit before tax for the year ended 31 December 2001 was £4,275 million (year ended 31 December 2000 – £3,327 million). Results for the year ended 31 December 2001 with comparative figures for the previous accounting period, the 15 months ended 31 December 2000, are shown on pages 49 to 102.

Basis of preparation and presentation of results

(a) Basis of preparation

The profit and loss account for the year ended 31 December 2001 is extracted from the audited accounts, modified as described in note (b) below.

The pro forma results for the year ended 31 December 2000 have been prepared on the following basis:

1 They incorporate the full year results of NatWest for 2000 and assume that the fair value adjustments were made on 31 December 1998.

2 Goodwill arising on the acquisition of NatWest of £11,483 million has been amortised over its estimated economic life of 20 years.

Goodwill arising on other acquisitions made by the Group after 1 January 1999 has been amortised from the effective dates of acquisition, generally also over 20 years. Goodwill arising on acquisitions prior to 1 January 1999 was written off directly to reserves and has not been reinstated, as permitted by Financial Reporting Standard 10.

3 A surplus of £1,070 million in NatWest Pension Funds has been amortised, from 1 January 1999, over the estimated average remaining service life of members of the schemes.

4 An adjustment has been made to reflect the net funding of the acquisition of NatWest as if acquired on 1 January 1999. The net funding comprises cash paid and loan notes issued to NatWest shareholders of £7,349 million and fees and expenses relating to the acquisition of £176 million less net proceeds of £3,910 million from the issue of new ordinary and preference shares and £20 million of proceeds from the exercise of options over NatWest ordinary shares.

5 The results of businesses disposed of since 1 January 1999 and the profit arising on their sale have been excluded from the pro forma accounts. The principal disposals were RBS Trust Bank, Gartmore and the venture capital investments of NatWest. A funding adjustment has been made to recognise the benefit of estimated net proceeds of £1,500 million assuming that these funds were received on 1 January 1999.

(b) Basis of presentation

The results for the year ended 31 December 2001 and the pro forma results for the year ended 31 December 2000 have been presented on the following basis:

1 Operating profit is stated before goodwill amortisation and integration costs which are shown separately on the face of the profit and loss account.

2 Integration costs comprise expenditure incurred in respect of cost reduction and revenue enhancement targets set in connection with the acquisition of NatWest and the costs of integrating the regional retail and commercial banking operations acquired from Mellon Financial Corporation in December 2001 together with expenditure incurred on the related cost reduction and revenue enhancement targets.

1 Operating review

The Group has performed strongly in 2001, driven by higher income and improvements in efficiency in each of its businesses. Good progress continues to be made on the integration of NatWest; revenue enhancements and cost reductions are now expected to be higher than the initial plan.

Profit Profit before tax, goodwill amortisation and integration costs at £5,801 million was up 32%, £1,400 million, from £4,401 million. Profit before tax at £4,275 million increased by 28% from £3,327 million after charging integration costs of £875 million compared with £434 million in 2000. All businesses contributed to this improvement.

Total income Total income rose by 18%, £2,223 million, to £14,581 million. Strong growth was achieved across all businesses.

Net interest income Net interest income increased by 16%, £940 million, to £6,869 million underpinned by good growth in both corporate and personal lending and deposits. Average interest-earning assets of the Group's banking business increased by 11%, including 14% growth in average loans and advances to customers.

Net interest margin of the banking business improved from 3.0% to 3.1%. Improved lending spread together with the benefit of income from the proceeds of the market placing of ordinary shares in July 2001, prior to deployment in the acquisition of certain businesses from Mellon Financial Corporation in December 2001 (the "Mellon acquisition"), contributed to this improvement and more than offset a small decrease in deposit margins.

Non-interest income Non-interest income, which represents 53% of total income, grew by 16%, £887 million, to £6,337 million, excluding general insurance. Fees and commissions receivable were up 16%, £656 million, to £4,735 million, with strong growth in lending related fees, cards and merchant acquiring and in money transmission fees. Dealing profits were £295 million, 26% ahead of the prior year as a result of strong growth in customer activity levels and favourable market conditions. This additional dealing income contributed approximately £160 million to the Group's profits.

General insurance premium income, after reinsurance, increased by 40%, £396 million, to £1,375 million, reflecting strong volume growth in Direct Line and branch based insurance.

Total expenses Operating expenses, excluding goodwill amortisation and integration costs, rose by 3%, £227 million, to £6,841 million, with increased integration benefits from the NatWest acquisition largely offsetting increases due to inflation, business development and customer service improvement initiatives.

General insurance claims, after reinsurance, increased by 36%, £250 million, to £948 million in line with volume growth.

The number of staff employed in the Group rose by 11,700, 12% to 105,700. The increase reflects approximately 5,000 staff in businesses acquired in the year, as well as additional staff to support the strong growth in business levels and to deliver enhanced customer service in the branch networks. The total also includes short-term appointments in connection with the integration of NatWest.

Cost:income ratio The Group's focus on income growth along with tight control of costs and the benefits of integration have driven the cost:income ratio down from 53.5% to 46.9%.

Credit quality and provisions The Group's lending portfolio is widely diversified and, based on internal grading systems, the composition of the portfolio is broadly unchanged. Overall credit quality remains strong.

New provisions were up 27%, £230 million to £1,071 million. This increase reflects the growth in lending and the deterioration in the short-term economic outlook combined with the impact of a small number of specific customer situations. Recoveries of amounts previously written off were down £116 million, 59% to £80 million. Consequently, the net charge to the profit and loss account was up from £645 million to £991 million.

Total balance sheet provisions for bad and doubtful debts amounted to £3,653 million (31 December 2000 – £3,153 million) equivalent to 81% (31 December 2000 – 83%) of risk elements in lending.

Mellon acquisition Citizens completed the Mellon acquisition on 1 December 2001 for a cash consideration of US$2.2 billion (£1,564 million). The goodwill arising on this acquisition amounted to £1,655 million. Integration benefits anticipated at the time of the announcement of the acquisition have been confirmed and the business is already making good progress.

Integration Integration now comprises two elements:

NatWest Integration costs were £847 million compared with £434 million in 2000. Good progress continues to be made in integrating NatWest. Implementation has been faster which has resulted in revenue benefits and cost savings being achieved ahead of plan. In addition to value being created earlier than planned, additional revenue benefits and cost savings have been identified which will result in combined annual benefits being £300 million more than plan, giving a benefit of £2.0 billion per annum at the end of the programme.

As a consequence of the accelerated implementation and the additional benefits, the cumulative profits from the integration programme to the end of 2003 are expected to be £5.5 billion. This is £1.4 billion greater than the planned £4.1 billion and the overall cost of the programme is now estimated to be £2.3 billion against a plan of £1.4 billion.

Mellon Mellon was acquired in December 2001 and expenditure of £28 million was incurred in the early stages of integrating Mellon with Citizens. No benefits from this integration have yet been recognised, however, the forecast future benefits announced at the time of the Mellon acquisition have been confirmed.

Tax charge The tax charge for the year was £1,537 million, equivalent to 36% of profit before tax of £4,275 million. The rate is affected by goodwill amortisation, which is not allowable for UK tax purposes. The effective tax rate after adjusting for goodwill amortisation was 31% (2000 – 30%).

Shareholder returns Earnings per share, adjusted for goodwill amortisation, integration costs and the Additional Value Shares (“AVS”) dividend, increased by 25%, from 102.0p to 127.9p.

The first dividend of 15.0p per share was paid on the AVS issued in connection with the acquisition of NatWest. This was paid on 3 December 2001 in accordance with the original payment schedule.

A final dividend of 27.0p per ordinary share is recommended resulting in a total dividend for the year of 38.0p per ordinary share, up 15% on 2000. The total ordinary dividend of £1,085 million is covered 3.3 times (2000 – 3.1 times) by earnings before goodwill amortisation, integration costs and the AVS dividend.

Profit attributable to ordinary shareholders after tax, minority interests, preference dividends and perpetual securities interest, at £2,267 million, increased by 28%. After deducting the dividend on the AVS, attributable profit increased by 5%, from £1,774 million to £1,868 million.

Return on equity Group post-tax return on average equity, adjusted for goodwill, integration costs and the AVS dividend increased from 37.0% to 41.1%.

Balance sheet Total assets were £369 billion at 31 December 2001, of which £285 billion (77%) related to banking business and £84 billion (23%) to trading business.

Loans and advances to customers at 31 December 2001 were £190 billion, up 13% from £168 billion at 31 December 2000. Customer deposits increased by 12% from £177 billion to £199 billion.

Capital ratios at 31 December 2001 were 7.1% (tier 1) and 11.5% (total) compared with 6.9% (tier 1) and 11.5% (total) at 31 December 2000.

Consolidated profit and loss account
for the year ended 31 December 2001

	2001 £m	Pro forma 2000 £m
Interest receivable	14,421	14,626
Interest payable	7,552	8,697
Net interest income	**6,869**	5,929
Dividend income	54	46
Fees and commissions receivable	4,735	4,079
Fees and commissions payable	(930)	(804)
Dealing profits	1,426	1,131
Other operating income	1,052	998
	6,337	5,450
General insurance		
– earned premiums	1,804	1,346
– reinsurance	(429)	(367)
Non-interest income	**7,712**	6,429
Total income	**14,581**	12,358
Administrative expenses		
– staff costs	3,461	3,440
– premises and equipment	809	839
– other	1,715	1,566
Depreciation of tangible fixed assets	856	769
Operating expenses	**6,841**	6,614
Profit before other operating charges	**7,740**	5,744
General insurance		
– gross claims	1,263	982
– reinsurance	(315)	(284)
Operating profit before provisions	**6,792**	5,046
Provisions for bad and doubtful debts	984	602
Amounts written off fixed asset investments	7	43
Profit before goodwill amortisation and integration costs	**5,801**	4,401
Goodwill amortisation	651	640
Integration costs	875	434
Profit before tax	**4,275**	3,327
Tax	1,537	1,171
Profit after tax	**2,738**	2,156
Minority interests (including non-equity)	90	54
Profit after minority interests	**2,648**	2,102
Preference dividends – non-equity	358	328
Perpetual regulatory securities interest – non-equity	23	—
	2,267	1,774
Additional Value Shares dividend – non-equity	399	—
Profit attributable to ordinary shareholders	**1,868**	1,774
Basic earnings per 25p ordinary share	**67.6p**	66.7p
Adjusted earnings per 25p ordinary share	**127.9p**	102.0p

The profit and loss account set out above shows goodwill amortisation and integration costs separately after group operating profit. In the statutory profit and loss account on pages 52 and 53, these items are included in the captions prescribed by the Companies Act.

Divisional performance

The results of each division before goodwill amortisation and integration costs are detailed below.

	2001 £m	Pro forma 2000 £m
Corporate Banking and Financial Markets	3,011	2,730
Retail Banking	2,807	2,467
Retail Direct	551	373
Contribution before manufacturing costs	6,369	5,570
Manufacturing	(1,568)	(1,660)
Wealth Management	459	405
Direct Line Group	261	201
Ulster Bank	242	200
Citizens	501	349
Central items	(463)	(664)
Group operating profit before goodwill amortisation and integration costs	**5,801**	4,401

Corporate Banking and Financial Markets

	2001 £m	Pro forma 2000 £m
Net interest income	**2,100**	1,793
Non-interest income	**3,304**	2,856
Total income	**5,404**	4,649
Direct expenses		
– staff costs	**1,119**	998
– other	**359**	310
– operating lease depreciation	**421**	388
Contribution before provisions	**3,505**	2,953
Provisions	**494**	223
Contribution before manufacturing costs	**3,011**	2,730

Direct cost:income ratio (%)	**35.1**	36.5
Total assets – Corporate Banking (£bn)	**95.1**	81.1
– Financial Markets (£bn)	**120.4**	110.0
Loans and advances to customers gross (£bn)	**94.1**	87.6
Customer deposits excluding repos – (£bn)	**56.4**	52.8
Weighted risk assets (£bn)	**117.3**	98.9

Corporate Banking and Financial Markets ("CBFM") is the largest provider of banking services to medium and large businesses in the UK and the leading player in the UK in asset finance. It provides an integrated range of products and services to mid-sized and large corporate and institutional customers in the UK and overseas, including corporate and commercial banking, treasury and capital markets products, structured and leveraged finance, trade finance, leasing and factoring. CBFM expanded its operations in Europe and completed the acquisition of Euro Sales Finance plc during 2001.

Contribution before manufacturing costs was up 10%, £281 million to £3,011 million.

Total income was up 16%, £755 million to £5,404 million. Net interest income was up 17%, £307 million to £2,100 million, primarily due to lending growth in Corporate Banking and also as a result of the benefits of favourable market conditions in Financial Markets. Average loans and advances to customers of the banking business increased by 14%, £9.5 billion to £76.6 billion, predominantly in Corporate Banking, both in the UK and overseas.

Non-interest income was up 16%, £448 million to £3,304 million reflecting growth in customer advances, payment and transmission related fees and dealing profits.

Direct expenses were up 12%, £203 million to £1,899 million. Staff costs increased by 12%, £121 million, mainly due to performance related payments reflecting higher income in Financial Markets. Other expenses, excluding operating lease depreciation, were 16%, £49 million higher reflecting increased business volumes, infrastructure costs supporting European expansion and acquisitions. The direct cost:income ratio improved from 36.5% to 35.1%.

Provisions were up £271 million to £494 million. The increase reflects growth in lending, the global economic slowdown, a small number of specific customer situations and lower recoveries, partially offset by a reduction in amounts written off investments.

Retail Banking

	2001 £m	Pro forma 2000 £m
Net interest income	**2,622**	2,418
Non-interest income	**1,277**	1,128
Total income	**3,899**	3,546
Direct expenses		
– staff costs	**702**	736
– other	**226**	210
Contribution before provisions	**2,971**	2,600
Provisions for bad and doubtful debts	**164**	133
Contribution before manufacturing costs	**2,807**	2,467

Direct cost:income ratio (%)	**23.8**	26.7
Total assets (£bn)	**61.1**	57.9
Loans and advances to customers – gross (£bn)	**49.0**	44.3
Customer deposits (£bn)	**56.8**	53.7
Weighted risk assets (£bn)	**35.2**	31.2

Retail Banking provides a wide range of banking, insurance and related financial services to individuals and small businesses. These services are delivered from a network of Royal Bank of Scotland and NatWest branches throughout Great Britain and through telephone call centres, ATMs and the internet.

Contribution before manufacturing costs increased by 14%, £340 million to £2,807 million.

Total income was up 10%, £353 million to £3,899 million. Net interest income was 8%, £204 million higher at £2,622 million, reflecting strong growth in advances and deposits. Average loans to customers, excluding mortgages, were up 19% to £19.1 billion. Average mortgage lending grew by 9%, £2.3 billion, to £27.1 billion. Average customer deposits were 7%, £3.7 billion higher at £54.1 billion. The customer base continued to grow in both banks, with increased market share of current accounts. The number of personal customers increased by 5% to 12.9 million and small business customers were up 3% to 931,000. NatWest maintained its market leading position for small business relationships.

Non-interest income increased by 13%, £149 million to £1,277 million, resulting from growth in fee paying packaged accounts, up 33%, together with significant benefits from integration initiatives.

Direct expenses at £928 million were down 2%, £18 million, reflecting lower average headcount. The direct cost:income ratio improved from 26.7% to 23.8%.

Provisions for bad and doubtful debts were up 23%, £31 million to £164 million, primarily due to growth in lending.

Retail Direct

	2001 £m	Pro forma 2000 £m
Net interest income	**674**	516
Non-interest income	**696**	565
Total income	**1,370**	1,081
Direct expenses		
– staff costs	**164**	154
– other	**400**	327
Contribution before provisions	**806**	600
Provisions for bad and doubtful debts	**255**	227
Contribution before manufacturing costs	**551**	373

Direct cost:income ratio (%)	**41.2**	44.5
Total assets (£bn)	**17.2**	14.4
Loans and advances to customers – gross: mortgages (£bn)	**5.9**	4.4
: other (£bn)	**11.2**	9.7
Customer accounts (£bn)	**4.3**	2.7
Weighted risk assets (£bn)	**12.5**	11.5

Retail Direct issues a comprehensive range of credit, charge and debit cards to personal and corporate customers and engages in merchant acquisition and processing facilities for retail businesses. It also includes: Tesco Personal Finance ("TPF"), Virgin Direct Personal Finance ("VDPF"), Direct Line Financial Services ("DLFS"), Lombard Direct, the Group's internet banking platform and Comfort Card European businesses, all of them offering products to customers through direct channels. The acquisition of the remaining 50% interest in the Virgin One business was completed in the second half of the year.

Contribution before manufacturing costs rose by 48%, £178 million to £551 million, due to expansion of the Cards businesses and strong sales growth in TPF.

Total income was up 27%, £289 million to £1,370 million driven by strong performances in Cards and TPF. Net interest income was up 31%, £158 million to £674 million. Average card balances were up 12% to £6.6 billion. The total number of credit card accounts grew by 22%, from 7.9 million to 9.6 million. The number of Cards' merchant outlets increased by 8% to 206,000.

Average mortgage lending in DLFS was 17% higher at £2.1 billion and in VDPF the increase was 81%, from £1.7 billion to £3.1 billion. TPF increased its average customer advances and customer deposits by 15% to £1.8 billion, and 29% to £1.4 billion, respectively.

Non-interest income rose 23%, £131 million to £696 million, primarily as a result of increased fees reflecting higher retailer volumes.

Direct expenses at £564 million were 17%, £83 million higher, mainly as a result of increased business volumes and marketing activity. The direct cost:income ratio improved from 44.5% to 41.2%.

Provisions for bad and doubtful debts increased by 12%, £28 million to £255 million reflecting the increase in unsecured lending.

Manufacturing

	2001 £m	Pro forma 2000 £m
Staff costs	**428**	490
Other costs	**1,140**	1,170
Total manufacturing costs	**1,568**	1,660
Analysis:		
Group Technology	**632**	723
Group Property	**467**	486
Customer Support and other operations	**469**	451
Total manufacturing costs	**1,568**	1,660

Manufacturing supports the customer facing businesses, mainly Corporate Banking and Financial Markets, Retail Banking and Retail Direct, and provides operational technology, account management, money transmission, property and other services.

Total manufacturing costs of £1,568 million were 6%, £92 million lower.

Group Technology costs reduced by 13%, £91 million to £632 million reflecting lower staff costs and the benefits of de-duplication initiatives. Expenditure in Customer Support and other operations was up £18 million, 4% to £469 million due to volume growth in lending and account management and costs associated with customer service enhancement initiatives.

Average staff numbers fell by 12%. Integration savings offset a rise in work transferred into the Customer Support areas which extended the Manufacturing service provision and increased support for higher business volumes along with customer service enhancement initiatives.

Wealth Management

	2001 £m	Pro forma 2000 £m
Net interest income	**464**	425
Non-interest income	**469**	463
Total income	**933**	888
Expenses		
– staff costs	**298**	303
– other	**181**	185
Profit before provisions	**454**	400
Net release of provisions for bad and doubtful debts	**5**	5
Profit before integration costs	**459**	405

Cost:income ratio (%)	**51.3**	55.0
Total assets (£bn)	**12.5**	10.4
Investment management assets – excluding deposits (£bn)	**21.4**	21.8
Customer deposits (£bn)	**29.1**	27.6
Weighted risk assets (£bn)	**7.8**	7.1

Wealth Management comprises Coutts Group, Adam & Company and the offshore banking businesses, The Royal Bank of Scotland International and NatWest Offshore. The Coutts Group focuses on private banking through the Coutts, The Royal Bank of Scotland and NatWest Private Banking brands. Adam & Company is a private bank operating primarily in Scotland. The offshore businesses provide retail banking services to local and expatriate customers, and corporate banking and treasury services to corporate, intermediary and institutional clients.

Profit before integration costs increased by 13%, £54 million to £459 million.

Total income was up 5%, £45 million to £933 million. Net interest income grew by 9%, £39 million to £464 million. This was largely due to higher average customer deposits, which were up 7% from £26.6 billion to £28.5 billion as customers moved out of equity investments, and growth in average customer lending, up 16%, £0.9 billion to £6.4 billion, principally in offshore banking.

Non-interest income increased 1%, £6 million to £469 million despite the depressed equity markets and the adverse effect on investor confidence particularly in the second half of 2001. The decline in equity market values affected fees earned on assets under management.

Expenses were 2%, £9 million lower at £479 million. The cost:income ratio improved from 55.0% to 51.3%.

There was a net release of provisions for bad and doubtful debts of £5 million (2000: release of £5 million).

Direct Line Group

	2001 £m	Pro forma 2000 £m
Earned premiums	**1,804**	1,346
Reinsurers' share	**(429)**	(367)
Insurance premium income	**1,375**	979
Other income	**168**	176
Total income	**1,543**	1,155
Expenses		
– staff costs	**152**	124
– other	**182**	132
Gross claims	**1,263**	982
Reinsurers' share	**(315)**	(284)
Profit before goodwill amortisation	**261**	201

In-force policies (000's)		
– Motor: UK	**4,017**	3,219
: International	**601**	286
– Home: UK	**1,360**	1,055
Combined operating ratio – UK (%)	**88.0**	86.2
Insurance reserves – UK (£m)	**1,541**	1,221

Direct Line Group sells and underwrites retail and wholesale insurance on the telephone and the internet. The Direct Division sells general insurance and motor breakdown services direct to the customer and Green Flag is a leading wholesale provider of insurance and motoring related services. Through its International Division, Direct Line sells insurance in Spain and Japan, and in September 2001 expanded into Germany and Italy. The acquisition, subject to regulatory approvals, of Royal & Sun Alliance's direct motor insurance operation in Italy, announced in January 2002, will make Direct Line the second largest direct insurer in Italy with over 300,000 customers.

Profit before goodwill amortisation increased by 30%, £60 million to £261 million. This has been driven by higher volumes, particularly in motor policies, and increases in partnership businesses including the joint venture with TPF.

Total income was up 34%, £388 million to £1,543 million. Earned premiums grew strongly, up 34%, £458 million to £1,804 million. Net insurance premium income increased by 40%, £396 million to £1,375 million. Direct motor business, where in-force policies increased 13% to 3.3 million, contributed £137 million to this increase and Direct home business was up £19 million. Strong growth from the joint venture with TPF and other motor partnerships accounted for £126 million of the increase. The acquisitions in Italy and Germany contributed £11 million of premium income in the three months since completion.

Expenses were up 30%, £78 million to £334 million reflecting business expansion, including the costs of establishing overseas operations in the second half.

Net claims rose 36%, £250 million to £948 million, reflecting increased volumes.

Ulster Bank

	2001 £m	Pro forma 2000 £m
Net interest income	**351**	294
Non-interest income	**185**	172
Total income	**536**	466
Expenses		
– staff costs	**147**	144
– other	**124**	103
Profit before provisions	**265**	219
Provisions for bad and doubtful debts	**23**	19
Profit before integration costs	**242**	200

Cost:income ratio (%)	**50.6**	53.0
Total assets (£bn)	**11.8**	11.1
Loans and advances to customers – gross (£bn)	**8.6**	7.6
Customer deposits (£bn)	**7.7**	7.1
Weighted risk assets (£bn)	**8.7**	7.9
Average exchange rate – €/£	**1.609**	1.642
Spot exchange rate – €/£	**1.637**	1.606

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

Profit before integration costs of £242 million was 21%, £42 million higher. At constant exchange rates, profit before integration costs rose by 19%, £39 million.

Total income increased by 15%, £70 million to £536 million. Net interest income rose by 19%, £57 million to £351 million due to strong growth in customer loans and deposits. Average loans and advances to customers increased by 24%, £1.6 billion, to £8.3 billion, and average customer deposits increased by 11%, £0.7 billion, to £7.3 billion. The number of customers increased by 5%, 36,000 to 744,000.

Non-interest income was up 8%, £13 million to £185 million. The increase is mainly due to higher card, lending and transmission fees.

Expenses rose by 10%, £24 million to £271 million to support business expansion. Staff costs increased by 2%, £3 million. Other expenses increased by 20%, £21 million as a result of higher depreciation on operating lease assets, marketing costs to support business expansion, and expenditure related to the preparation for the issue of euro notes and coins in the Republic of Ireland. The cost:income ratio improved from 53.0% to 50.6%.

Provisions for bad and doubtful debts were up 21%, £4 million to £23 million. The increase is largely due to growth in lending.

Citizens

	2001 £m	Pro forma 2000 £m
Net interest income	**814**	667
Non-interest income	**306**	247
Total income	**1,120**	914
Expenses		
– staff costs	**305**	290
– other	**245**	235
Profit before provisions	**570**	389
Provisions for bad and doubtful debts	**69**	40
Profit before goodwill amortisation and integration costs	**501**	349

	2001	Pro forma 2000
Cost:income ratio (%)	**49.1**	57.4
Total assets (£bn)	**36.2**	20.3
Loans and advances to customers – gross (£bn)	**18.1**	12.0
Customer deposits (£bn)	**29.5**	16.7
Weighted risk assets (£bn)	**24.7**	15.8
Average exchange rate – US$/£	**1.440**	1.516
Spot exchange rate – US$/£	**1.450**	1.493

Citizens is engaged in retail and corporate banking activities through its branch network in the states of Rhode Island, Connecticut, Massachusetts and New Hampshire and is the second largest bank in New England. The acquisition of the regional retail and commercial banking businesses of Mellon Financial Corporation, which was completed on 1 December 2001, has extended Citizens presence to the states of Pennsylvania, Delaware and New Jersey.

Profit before goodwill amortisation and integration costs was up 44%, £152 million to £501 million reflecting strong organic growth and the strengthening of the dollar. At constant exchange rates the increase was 37%, £134 million. The Mellon acquisition, completed on 1 December 2001, contributed £13 million to this increase, £10.1 billion to customer deposits, £4.4 billion to customer loans and advances and added 345 branches to the Citizens network, bringing the total number of branches to 712 at 31 December 2001.

Net interest income rose by 22%, £147 million to £814 million due to growth in customer deposits and secured consumer lending. Non-interest income was up 24%, £59 million to £306 million reflecting growth in deposit service charges, mortgage banking and ATM and debit card income.

Expenses at £550 million were 5%, £25 million higher reflecting organic growth, the Mellon acquisition and the effect of exchange rates. At constant exchange rates expenses declined by 1%, £3 million. The cost:income ratio improved from 57.4% to 49.1%.

Provisions for bad and doubtful debts were £69 million compared with £40 million in 2000, reflecting growth in lending and the economic environment in the US.

Central items

	2001 £m	Pro forma 2000 £m
Funding costs	**188**	217
Central department costs		
– staff costs	**99**	114
– other	**93**	107
Other corporate items – net	**83**	226
Loss before goodwill amortisation and integration costs	**463**	664

The Centre comprises group and corporate functions which provide services to the operating divisions.

The loss before goodwill amortisation and integration costs reduced by £201 million to £463 million.

Funding costs at £188 million were down 13%, £29 million. The current year benefited from the proceeds of the share placing in July 2001 prior to deployment in the Mellon acquisition, contributing £35 million.

Central department costs at £192 million declined £29 million, 13%, due mainly to the benefit of integration initiatives. Other corporate items, which included certain one-off items in both years, reduced by 63%, £143 million to £83 million.

Employee numbers

	31 December 2001	31 December 2000
Corporate Banking and Financial Markets	**14,100**	13,100
Retail Banking	**30,500**	28,900
Retail Direct	**6,200**	5,800
Manufacturing	**20,700**	19,200
Wealth Management	**7,100**	6,800
Direct Line Group	**9,200**	6,700
Ulster Bank	**4,800**	4,600
Citizens	**11,500**	7,300
Centre	**1,600**	1,600
Group total	**105,700**	94,000

Integration information

1 Period to 31 December 2001

In the Offer Document for NatWest issued on 16 December 1999, the Group made various estimates in respect of cost savings, staff reductions and revenue benefits. Those estimates were based on the latest available published information at that time, namely NatWest's interim accounts for the half year to 30 June 1999 and the Group's accounts for the year to 30 September 1999. On 19 April 2000, the Group revised its estimates upwards as a consequence of the experience gained by having detailed access to NatWest following the acquisition on 6 March 2000. These revised estimates are shown in the tables below as "plan".

	Period ended December 2001	Period ended December 2000
Revenue benefits		
Cumulative gross revenue initiatives implemented at the end of each period (£m)		
–plan	350	120
–actual	605	147
Impact on profit before tax (£m)		
–plan	120	50
–actual	312	52

The gross revenue initiatives generated income of £415 million, which, net of costs, claims and provisions added £312 million to profit in the year to 31 December 2001.

Cost savings

	December 2001	December 2000
Cumulative cost savings implemented at the end of each period (£m)		
– plan	900	550
– actual	1,205	653
Impact on profit before tax (£m)		
– plan	700	290
– actual	1,008	448

Staff reductions

	December 2001	December 2000
Cumulative total		
– plan	14,000	9,000
– actual	17,000	13,000

Integration costs

	December 2001	December 2000
Cumulative charge (£m)*		
– plan	1,150	650
– actual	1,394	547

*includes £113 million incurred by NatWest in the second half of 1999.

2 Revised integration plan

The estimated revenue benefits, cost savings and staff reductions for 2002 and 2003, together with related integration costs, are now expected to be as follows:

Revenue benefits	Year ending December 2002	As at March 2003	Year ending December 2003
Cumulative gross revenue initiatives implemented at the end of each period (£m)			
– plan	550	595	
– revised plan	800	890	
Impact on profit before tax (£m)			
– plan	240		390
– revised plan	460		590
Cost savings			
Cumulative cost savings initiatives implemented at the end of each period (£m)			
– plan	1,200	1,340	
– revised plan	1,340	1,440	
Impact on profit before tax (£m)			
– plan	1,050		1,300
– revised plan	1,280		1,400
Staff reductions			
Cumulative total			
– plan	16,000	18,000	
– revised plan	18,000	18,000	
Integration costs			
Cumulative charge (£m)			
– plan	1,350	1,400	
– revised plan	2,200	2,300	

Overall programme

As a consequence, the estimated overall result of the programme to integrate NatWest is as follows:

Annual benefits to profit before tax from 1 January 2004	£m
Revenue benefits	590
Cost savings	1,440
	2,030
One-off integration costs	2,300

Cumulative benefit of integration:

Year	Plan £m	Revised plan £m	Uplift £m
2000	340	500*	160
2001	820	1,320*	500
2002	1,290	1,740	450
2003	1,690	1,990	300
	4,140	5,550	1,410

*actuals

Average balance sheet and related interest

Year ended 31 December	2001 Average balance £m	2001 Interest £m	Rate %	Pro forma 2000 Average balance £m	Pro forma 2000 Interest £m	Pro forma Rate %
Assets						
Treasury and other eligible bills						
UK	231	11	4.8	463	21	4.5
Overseas	277	8	2.9	131	6	4.6
Loans and advances to banks						
UK	18,214	834	4.6	14,965	862	5.8
Overseas	7,467	421	5.6	8,884	591	6.7
Loans and advances to customers						
UK	122,621	8,361	6.8	106,302	8,349	7.9
Overseas	27,327	1,879	6.9	23,271	1,823	7.8
Instalment credit and finance lease receivables						
UK	14,611	1,223	8.4	14,113	1,201	8.5
Overseas	1,520	102	6.7	1,796	125	7.0
Debt securities						
UK	16,632	931	5.6	18,004	1,032	5.7
Overseas	11,427	651	5.7	9,812	616	6.3
Total interest-earning assets – banking business	220,327	14,421	6.6	197,741	14,626	7.4
– trading business*	66,545	3,020	4.5	53,946	3,436	6.4
Total interest-earning assets	286,872	17,441	6.1	251,687	18,062	7.2
Non-interest-earning assets	63,316			52,931		
Total assets	350,188			304,618		
Liabilities						
Deposits by banks						
UK	18,360	760	4.1	13,851	751	5.4
Overseas	8,779	382	4.4	7,667	435	5.7
Customer accounts: demand deposits						
UK	54,237	1,576	2.9	48,533	1,765	3.6
Overseas	6,422	154	2.4	4,132	163	3.9
Customer accounts: savings deposits						
UK	15,892	594	3.7	16,781	768	4.6
Overseas	11,690	435	3.7	9,728	413	4.2
Customer accounts: other time deposits						
UK	43,161	1,967	4.6	40,698	2,401	5.9
Overseas	8,127	338	4.2	8,437	470	5.6
Debt securities in issue						
UK	20,140	1,031	5.1	14,831	869	5.9
Overseas	8,407	384	4.6	7,881	494	6.3
Loan capital						
UK	10,464	634	6.1	9,829	699	7.1
Overseas	171	14	8.2	502	49	9.8
Internal funding of trading business						
UK	(14,626)	(654)	4.5	(10,774)	(528)	4.9
Overseas	(1,576)	(63)	4.0	(1,025)	(52)	5.1
Total interest-bearing liabilities – banking business	189,648	7,552	4.0	171,071	8,697	5.1
– trading business*	63,159	2,626	4.2	50,336	3,095	6.1
Total interest-bearing liabilities	252,807	10,178	4.0	221,407	11,792	5.3
Non-interest-bearing liabilities – demand deposits	25,538			21,938		
– other liabilities	46,062			38,520		
Shareholders' equity	25,781			22,753		
Total liabilities	350,188			304,618		

*Interest receivable and interest payable on trading assets and liabilities are included in dealing profits.

The analysis into UK and Overseas has been compiled on the basis of location of office.

Average interest rates, yields, spreads and margins

Year ended 31 December	2001 Average rate %	Pro forma 2000 Average rate %
The Royal Bank of Scotland plc base rate	**5.1**	6.0*
London inter-bank offered rate		
three month sterling	**5.0**	6.2*
three month eurodollar	**3.8**	6.5*
three month euro	**4.3**	4.4*
Yields, spreads and margins of the banking business:		
Gross yield (1)		
Group	**6.6**	7.4
UK	**6.6**	7.5
Overseas	**6.4**	7.2
Interest spread (2)		
Group	**2.6**	2.3
UK	**2.6**	2.4
Overseas	**2.5**	1.9
Net interest margin (3)		
Group	**3.1**	3.0
UK	**3.2**	3.1
Overseas	**3.0**	2.7

*actual rate

(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.

(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.

(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

Shareholder value The Group's profits have again improved to record levels and the increased dividend is comfortably covered at 3.3 times by earnings before goodwill amortisation, integration costs and the AVS dividend.

Shareholders' funds at 31 December 2001 were £27,620 million (31 December 2000 – £23,116 million). The principal elements in the movement on shareholders' funds during the year to 31 December 2001 were the retained profit of £783 million, £2,759 million from the issues of ordinary and preference share capital and £823 million from the issue of perpetual regulatory tier one securities.

Earnings per share, adjusted for goodwill amortisation, integration costs and the AVS dividend, increased by 25% to 127.9p from 102.0p for the year ended 31 December 2000 on a pro forma basis. The weighted average number of shares in issue during the year was 2,762 million (year ended 31 December 2000 (pro forma) – 2,660 million).

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.

Future development of the business In addition to cost savings and revenue enhancements from the integration of NatWest, the Group will create shareholder value through income growth, the opportunities created by the acquisition of NatWest and the greater range of options for future development – options in business lines, brands, geographies, joint ventures and 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 such as economic value added, discounted cash flows, return on equity, cost:income ratios and return on risk weighted assets.

Improvements to the Group's infrastructure continue with increased expenditure on premises. Total capital expenditure on premises, computers and other equipment for the year to 31 December 2001 was £515 million (15 months to 31 December 2000 – £400 million). Contracts entered into for future capital expenditure but not provided for in the accounts for the year to 31 December 2001 amounted to £47 million (15 months to 31 December 2000 – £85 million).

2 Financial review

(a) Capital resources (statutory basis) The following table analyses the Group's regulatory capital resources at the period end:

	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m	30 September 1997 £m
Capital base					
Tier 1 capital	**15,052**	12,071	4,605	3,235	3,107
Tier 2 capital	**11,734**	10,082	3,256	2,950	2,699
Tier 3 capital	**172**	167	—	—	—
	26,958	22,320	7,861	6,185	5,806
Less investments in insurance subsidiaries, associated undertakings and other supervisory deductions	**(2,698)**	(2,228)	(1,011)	(703)	(489)
Total capital	**24,260**	20,092	6,850	5,482	5,317
Weighted risk assets					
Banking book:					
On-balance sheet	**176,000**	146,600	51,200	44,300	41,700
Off-balance sheet	**22,000**	16,200	4,200	3,500	3,000
Trading book	**12,500**	12,400	1,400	1,300	1,100
	210,500	175,200	56,800	49,100	45,800
Risk asset ratios	%	%	%	%	%
Tier 1	**7.1**	6.9	8.1	6.6	6.8
Total	**11.5**	11.5	12.1	11.2	11.6

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, the Group must have regard to the supervisory requirements of the Financial Services Authority ("FSA"). The FSA uses Risk Asset Ratio ("RAR") as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its weighted risk assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be no less than 8%. At 31 December 2001, the Group's total RAR was 11.5% (31 December 2000 – 11.5%) and the tier 1 RAR was 7.1% (31 December 2000 – 6.9%).

(b) Risk management The management of risk is fundamental to the Group's operations. It has in place a comprehensive risk management framework comprising:

- The Board, providing leadership, setting strategy and monitoring progress.
- Group-wide policies, procedures, processes and systems.
- A comprehensive executive committee structure focusing on risk management at Group level. Where appropriate, this is replicated at divisional level.
- Risk management functions that are independent of business management.

The principal risk management executive committees are:

- Group Executive Management Committee ("GEMC"), a sub-committee of the Board.
- Group Risk Management Committee ("GRMC"), a sub-committee of the GEMC.
- Group Credit Committee ("GCC"), a sub-committee of the Board.
- Group Asset and Liability Management Committee ("GALCO"), a sub-committee of GEMC.

The independent Group Risk function is responsible for advising the Board on the operation and effectiveness of the Group's risk management framework. Within each division, independent risk management units operate, reporting to both divisional executive management and the Head of Group Risk. Supporting GALCO and the Balance Sheet Management Committee, Group Treasury is responsible for capital raising, liquidity and structural hedging policies and the management of the Group's balance sheet.

The most significant risks managed by the Group are:

- **Enterprise risk:** the risk of loss from inadequate or failed internal processes, people and systems or from external events.

- **Credit risk:** the possibility that the Group will incur losses from the failure of a counterparty to meet its obligations or from changes in the credit quality of a counterparty.

- **Market risk:** the possibility that the Group will incur losses from changes in interest rates, foreign exchange rates or the prices of equity shares and indices, commodities, debt securities and other financial contracts, including derivatives.

- **Liquidity risk:** the risk that the Group will be unable to meet its funding requirements at acceptable rates and appropriate maturities.

Enterprise risk Enterprise risk is the term used by the Group to describe those risks faced by the Group that are not managed by credit, liquidity, or market risk processes. These risks, which include operational risks, can arise from inadequate or failed internal processes and systems, staff error and management failure and from changes to the legal, regulatory, political or operating environment of any of the territories where the Group operates.

Primary responsibility for the day-to-day management of enterprise risk lies with business unit executive management. They are responsible for establishing and maintaining appropriate policies, procedures, internal controls and business continuity arrangements. Internal controls include physical controls; segregation of duties; appropriate authorisation limits; and procedures to ensure compliance with laws and regulations. Group Risk is responsible for providing assurance to GEMC on the level of risk within the Group and the effectiveness of the Group's enterprise risk management processes. Within each division, there are independent risk management units. Group Audit advises business unit management and the Group Audit Committee on the quality and effectiveness of the system of internal controls and identifies any significant control deficiencies in the Group.

Credit risk Credit risk is the risk that customers and professional counterparties will not meet their repayment obligations. This risk is managed within the Group's credit risk management framework comprising:

Executive involvement through the GRMC. This sub-committee of the GEMC is chaired by the Group Finance Director and includes other executive directors. It defines the credit risk strategy of the Group and approves both policy changes and other enhancements to the credit risk management framework.

On a day-to-day basis, executive directors and other GEMC members participate in the Group, divisional and subsidiary company credit committees. These committees hold the highest levels of credit authority (below Board level) in the Group.

The Group's Credit Risk Management Principles set out the minimum standards. These include:

- All credit risk exposures require approval before assumption by the Group. Existing credit risk exposures are monitored and reviewed periodically (usually annually with the lower quality exposures being subject to greater frequency of analysis). These approvals can only be given by duly authorised individuals or bodies (credit committees) or (in the case of retail businesses) through authorised automated processes.

- Credit authority is delegated only to competent individuals who are either independent of business revenue generation or to credit committees. Credit authority is not extended to branch or account relationship managers.

- Credit risk exposures originated anywhere in the Group that create obligations from the same counterparty group are aggregated (subject to de minimis thresholds) in determining the appropriate level of credit approval required and managed together.

- Customers/counterparties are assigned a credit rating, which is mapped to a Group scale that reflects the probability of default.

Approval process Distinct approval processes exist for each of the significant counterparty types to ensure appropriate skills and resources are employed:

- Retail and personal businesses combine industry standard credit scoring techniques, adapted for the Group, that process small scale, large volume credit decisions, with traditional analysis and judgement applying to more significant credit risks.

- Credit approvals for the professional counterparties of Financial Markets are supported by a dedicated credit function providing expertise in traded markets product risk and specialisation in financial institutions analysis.

- For the Group's corporate businesses, the judgement exercised over the credit approvals is supported by the relationship management team, the Analysis Rating and Research Unit and the Credit Risk Department.

The balance between risk and reward is managed by the credit approval process and appropriate risk adjusted return measurement tools.

(b) Risk management *(continued)*

Portfolio management The business units and GEMC review monthly reports on the Group's portfolios of credit risks. Portfolio information is examined principally by quality ratings but further sub-divided by: major division/subsidiary; by geography; and by industrial sector. Expected loss and other statistical tools are used in trend analysis.

Oversight of delegated authority Group Risk and divisional credit risk functions undertake reviews to provide independent oversight of delegated authority and compliance with Group practice.

Problem exposure management Credit management within each business unit is the responsibility of business unit credit committees. Specialist units within the Group provide intensive management and control over the Group's impaired loans to minimise the incidence of credit losses. In the Group's corporate businesses, problem loans are managed by Specialised Lending Services which provides dedicated resource experienced in corporate restructuring. The Problem Exposure Review Forum reviews all such significant cases annually. This group is chaired by the Group Chief Executive and includes the appropriate divisional executive, account managers and credit managers. The Group's retail businesses operate automated triggers and filters as part of the monthly monitoring of all accounts. Identified problems are then managed through prescribed processes by centralised credit management units.

Market risk The Group is exposed to market risk because of positions held in its treasury and trading portfolios, as well as due to its non-trading activity.

Market risk in the treasury portfolios arises as a consequence of the management of the Group's liquidity requirements. The instruments that give rise to this type of risk are mainly money-market instruments and interest rate derivatives, and the main risk factor is therefore predominantly interest rates.

Market risk in the trading portfolios is mainly associated with customer-facing trading business, with the market-making operations and with taking positions in tradeable securities. The associated instruments are held on the trading (mark-to-market) books, and the main risk factors are interest rates, credit spreads, and foreign exchange.

Non-trading market risk is associated with the mismatches between the re-pricing of the Group's non-trading financial assets and liabilities; with the Group's investment in overseas subsidiaries, associates and branches; with the Group's venture capital portfolio; with the investments held in Direct Line Group; and with the strategic equity investment in Santander Central Hispano, S.A. ("SCH"). Mismatch risk mainly gives rise to interest-rate exposure which is then transferred to the Group's trading or treasury units for management within their approved limits. The exception is Citizens, where the risk is retained in the non-trading retail and commercial banks. Overseas investments mainly give rise to structural foreign exchange exposure. The strategic investment in SCH, the venture capital portfolio and the Direct Line Group investments mainly give rise to equity exposure.

The Group's long-term assurance assets and liabilities attributable to policyholders have been excluded from these market risk disclosures.

The Group manages the market risk in its trading and treasury portfolios through its market risk management framework, which is based on Value-at-risk ("VaR") limits, together with stress testing, scenario analysis, and position and sensitivity limits. Stress testing measures the impact of abnormal changes in market rates and prices on the fair value of the Group's trading portfolios. GEMC approves the high-level VaR and stress limits for the Group. The Group Risk function, independent from the Group's trading businesses, is responsible for setting and monitoring the adequacy and effectiveness of the Group's market risk management processes.

Value-at-risk – VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group's VaR assumes a time horizon of one day and a confidence level of 95%. In other words, a one-day loss greater than VaR is likely to occur on average on only one in every 20 business days. In addition, the Group's VaR is also estimated assuming a 10-day holding period.

The Group uses historical simulation models in computing VaR. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used. The Group's method, however, does not make any assumption about the nature or type of the underlying loss distribution. The Group typically uses the previous two years of market data.

The Group's VaR should be interpreted in light of the limitations of the methodologies used. These limitations include:

- Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.

- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.

- VaR using a 95% confidence level does not reflect the extent of potential losses beyond that percentile.

- The Group largely computes the VaR of trading portfolios at the close of business and positions may change substantially during the course of the trading day. Controls are in place to limit the Group's intra-day exposure and the VaR for selected portfolios is computed intra-day.

These limitations and the nature of the VaR measure mean that it should not be viewed as a guarantee of the Group's ability to limit its market risk. The Group cannot be certain that losses will not exceed the VaR amounts indicated nor that losses in excess of the VaR amounts will not occur more frequently than once in 20 business days.

For a discussion of the Group's accounting policies for, and information with respect to, its exposures to derivative financial instruments, see accounting policy 15 and Note 38 on the accounts.

Trading The Group's trading activities comprise: market making – quoting firm bid (buy) and offer (sell) prices with the intention of profiting from the spread between the quotes; customer facilitation – providing products to the Group's client base at competitive prices; arbitrage – entering into offsetting positions in different but closely related markets to profit from market imperfections; and proprietary activity – taking positions in financial instruments as principal to take advantage of anticipated market conditions. Financial instruments held in the Group's trading portfolios include, but are not limited to, debt securities, loans, deposits, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options).

The VaR for the Group's trading portfolios, segregated by type of market risk exposure, is presented in the tables below.

	Year ended 31 December 2001			
	Period end £m	Maximum £m	Minimum £m	Average £m
Interest rate	7.9	15.4	7.7	11.1
Currency	0.4	2.6	0.3	1.1
Equity	0.4	1.6	0.3	0.5
Diversification effects	(0.5)			
Total	8.2	15.6	7.7	11.3

	Year ended 31 December 2000			
Pro forma basis	Period end £m	Maximum £m	Minimum £m	Average £m
Interest rate	9.4	11.7	7.8	9.4
Currency	1.0	3.1	0.7	1.6
Equity	0.9	0.9	—	0.2
Diversification effects	(1.5)			
Total	9.8	12.4	8.1	9.7

	15 months ended 31 December 2000			
Statutory basis	Period end £m	Maximum £m	Minimum £m	Average £m
Interest rate	9.4	11.7	0.9	6.6
Currency	1.0	3.1	0.2	1.1
Equity	0.9	0.9	—	0.2
Diversification effects	(1.5)			
Total	9.8	12.4	1.0	6.9

The Group's trading activities are carried out principally by Financial Markets ("FM"). In the year to 31 December 2001, average daily profit including net interest for FM's trading portfolios was £5.2 million (year to 31 December 2000 – pro forma £3.7 million) and the standard deviation of profits was £4.5 million (year to 31 December 2000 – pro forma £3.4 million). On a statutory basis, average daily profit including net interest for the 15 months to 31 December 2000 was £2.5 million and the standard deviation of profits was £3.3 million.

(b) Risk management *(continued)*

Non-trading The Group's portfolios of non-trading financial instruments, arising from its treasury activities, its retail and corporate banking operations and its general insurance business, mainly comprise loans (including finance leases), debt securities, equity shares, deposits, certificates of deposit and other debt securities issued, loan capital and derivatives (mainly interest rate swaps). At 31 December 2001, the VaR for these portfolios was: total £8.9 million, interest rate £7.7 million, currency £0.1 million and equity £7.8 million.

Treasury The Group's treasury activities include its money-market business and the management of internal funds flows with the Group's businesses. Money-market portfolios include cash instruments (principally debt securities, loans and deposits) and related hedging derivatives. VaR for the Group's treasury portfolios, which relates mainly to interest rate risk, is presented below.

	Period end £m	Maximum £m	Minimum £m	Average £m
Year ended 31 December 2001	**4.6**	**5.9**	**3.8**	**4.5**
Year ended 31 December 2000 – pro forma	5.4	5.7	2.8	4.0
15 months ended 31 December 2000 – statutory	5.4	5.7	2.6	3.7

Retail and corporate banking Structural interest rate risk arises in the Group's commercial banking activities where assets and liabilities have different repricing dates. Group policy requires that all material interest rate risk arising from retail and corporate banking activities be transferred to a trading or treasury unit for management within its approved limits. The exception to this approach is Citizens, where the interest rate risk is retained within the regional banks.

Structural interest rate risk is calculated in each business unit on the basis of establishing the repricing behaviour of each asset and liability product. For many products, the actual interest rate repricing characteristics differ from the contractual repricing.

In most cases, the repricing maturity is then determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are reviewed by both the Balance Sheet Management Committee and business unit asset and liability committees annually, or more often if appropriate.

A static maturity gap report is produced as at the month-end for each material business unit, in each functional currency based on the behaviouralised repricing for each product. It is Group policy to include non-financial assets and liabilities, mainly tangible fixed assets and the Group's capital and reserves, spread over medium and longer term maturities, in the gap report. This report also includes hedge transactions, principally derivatives. Any residual non-trading interest rate exposures are measured and monitored against limits using a version of the same VaR methodology, but without discount factors, that is used for the Group's trading portfolios. Limits are also set on the net interest income exposure over 12 months to a 1% parallel movement in interest rates.

This VaR calculation includes all non-trading assets and liabilities in the Group's balance sheet and is undertaken quarterly. At 31 December 2001, the total VaR exposure relating to structural interest rate risk was estimated to be £8.8 million (31 December 2000 – £5.1 million) with the major exposures being to changes in longer term sterling and US dollar interest rates. During the year, the maximum VaR was £13.7 million, the minimum £4.4 million and the average £7.9 million. The major contributor to this non-trading VaR is Citizens, which manages its structural interest rate exposure partly through investment portfolios, which consist mainly of US mortgage-backed securities.

In calculating the VaR exposure for the retail and commercial businesses there are two main limitations.

(i) only principal flows are included in the maturity ladders i.e. interest flows are not included.

(ii) whilst embedded option risk is managed (see below), the related VaR is not included in the above VaR disclosures.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities. An example is where businesses undertake to provide funding to, or to accept deposits from, customers at a future date at a pre-determined fixed interest rate. Derivatives are used to manage the risk of interest rate movements from the date a commitment is made to a customer to the date the transaction closes. Option risk also arises where customers can repay fixed rate loans or withdraw fixed rate deposits before their maturity. In managing this risk, modelling of how the level of early repayment varies with interest rate movements is undertaken for the major fixed rate books. The Group also seeks to protect itself from early repayment risk through the imposition of early repayment interest charges, where applicable. Option risk is also inherent in certain portfolios of investment securities held by the Group, notably US mortgage-backed securities.

Currency risk The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in overseas subsidiary and associated undertakings and their related currency funding. The Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in overseas subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. Gains or losses on foreign currency investments, net of any gains or losses on related foreign currency funding or hedges, are recognised in the statement of total recognised gains and losses.

The tables below set out the Group's structural foreign currency exposures.

	At 31 December 2001			At 31 December 2000		
	Foreign currency net investments £m	Foreign currency liabilities hedging net investments £m	Structural foreign currency exposures £m	Foreign currency net investments £m	Foreign currency liabilities hedging net investments £m	Structural foreign currency exposures £m
Functional currency of net investment:						
US dollar	5,207	5,162	45	2,426	2,354	72
Euro	797	242	555	782	224	558
Swiss franc	250	243	7	201	193	8
Other non-sterling	61	46	15	86	83	3
Total	6,315	5,693	622	3,495	2,854	641

The structural foreign currency exposure in euros at 31 December 2001 is principally due to Ulster Bank running an open structural foreign exchange position to minimise the sensitivity of its capital ratios to possible movements in the euro exchange rate against sterling.

Equity risk Non-trading equity risk arises principally from the Group's strategic investments, its venture capital activities and its general insurance business. The reserves of the Group's general insurance business are invested in cash, debt securities and equity shares. The VaR of the equity element of this portfolio was £7.8 million at 31 December 2001. VaR is not an appropriate risk measure for the Group's venture capital investments, comprising a mix of quoted and unquoted investments, or its portfolio of strategic investments. At 31 December 2001, equity shares held as investment securities had a book value of £1,528 million (31 December 2000 – £1,437 million) and a valuation of £1,792 million (31 December 2000 – £2,094 million).

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

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

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

The short-term liquidity risk is managed on a consolidated basis for the whole Group, excluding the activities of Citizens and the insurance businesses in the UK which are subject to regulatory regimes which necessitate the separate management of liquidity. Internal liquidity mismatch limits are set for all other subsidiaries and non-UK branches which have material local treasury activities in external markets, to ensure those activities do not compromise daily maintenance of the Group's overall liquidity risk position within the Group's policy parameters.

The level of large deposits taken from banks, corporate customers, non-bank financial institutions and other customers, and significant cash outflows there from, are also reviewed to monitor concentration and identify any adverse trends. The degree of maturity mismatch within the overall long-term structure of the Group's assets and liabilities is also managed within internal policy limits, to ensure that term asset commitments may be funded on an economic basis over their life. In managing its overall term structure, the Group analyses and takes into account the effect of retail and corporate customer behaviour on actual asset and liability maturities where that differs materially from the underlying contractual maturities.

Policy parameters for the control of overall balance sheet structure and liquidity risk are set by GALCO. Compliance is monitored and co-ordinated by the Group Treasury function both in respect of internal policy and the regulatory requirements of the UK Financial Services Authority.

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

(b) Risk management *(continued)*
The Group also periodically evaluates various scenarios to analyse the potential impact on its liquidity risk. Contingency plans are maintained to anticipate and respond to any approaching or actual material deterioration in market conditions.

Insurance risk The Group sells and underwrites general insurance and life assurance. The essence of an insurance contract is the transfer of risk from the policyholder to the insurer. The Group controls its insurance exposures through product design and policy wording and through pricing and underwriting procedures. The Group's underwriting experience, the level of retained risk and solvency are closely monitored. Investment strategy reflects the maturity of underwriting liabilities. Underwriting concentrations and catastrophe exposure are reviewed and where necessary mitigated by reinsurance.

Residual value risk The Group's asset finance activities expose the Group to risk of loss if the value of the physical asset at the end of the financing term is less than that required to achieve the planned return. The Group mitigates this risk through portfolio diversification and active management of asset exposures throughout their life, from pricing through to re-marketing at the end of the transaction term.

(c) Financial instruments Financial instruments are fundamental to the Group's business and constitute the core element of its operations. The risks associated with financial instruments are a significant component of the risks faced by the Group. Financial instruments create, modify or reduce the credit, market and liquidity risks of the Group's balance sheet. Each of these risks and the Group's policies and objectives for managing such risks are discussed above.

The purpose for which the Group holds or issues financial instruments can be classified into five main categories.

- **Customer loans and deposits** Customer loans and deposits (both retail and institutional) form a substantial part of the Group's business. The customer loan portfolio is the Group's largest asset and the interest received from such loans is the Group's core source of income.

  The Group has detailed policies and strategies in respect of its customer loans and deposits which seek to minimise the risks associated with these financial instruments.

- **Investments (equity shares and debt securities)** The Group holds shares and other securities, excluding strategic investments, for use on a continuing basis in the Group's activities. The objective of holding such financial instruments is to generate funds over the term of the investment, in the form of distributions and/or appreciation in value. Funds generated are used in the Group's operations.

- **Finance (money market loans and deposits, loan capital, debt securities in issue, preference shares)** The Group issues financial instruments to fund that portion of the Group's assets not funded by customer deposits. The objective of using financial instruments for financing purposes is to manage the Group's balance sheet in terms of minimising market risk. Responsibility for overseeing and implementing balance sheet management lies with Group Treasury.

- **Trading (foreign exchange, derivatives, debt securities, loans and deposits)** The Group trades in financial instruments for customer facilitation and as principal. The objective of trading in financial instruments is to maximise short term gains for both the customer and/or the Group. Trading activity is restricted to certain areas in the Group and is subject to strict policies and limits. Responsibility for setting trading policies and monitoring adherence thereto lies with Group Risk.

- **Hedging (derivatives, loans and deposits, debt securities)** Where financial instruments form part of the Group's risk management strategy they are classified as hedges. The objective for holding financial instruments as hedges is to match or eliminate the risk arising because of adverse movements in interest rates, exchange rates, credit ratings, equity prices or commodity prices. Derivatives are the main instruments used for hedging and are discussed further below.

  Funding in the form of loans and deposits and preference shares is used to hedge certain of the Group's equity investments. Fixed rate debt securities are periodically used to hedge issued preference shares.

(d) Derivatives The following table sets forth activities of a non-trading nature 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 funded by floating rate liabilities	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

(e) Accounting developments The Group's principal accounting policies are set out on pages 49 to 51.

Disclosures required by Financial Reporting Standard ("FRS") 17 'Retirement Benefits' are included in Note 3 on the accounts. Further disclosures under the transitional requirements of this standard will be made in the Group's financial statements for 2002, and full implementation is required from 2003.

Implementation of FRS 18 'Accounting Policies' has not resulted in any changes to the Group's principal accounting policies.

In December 2000, the Accounting Standards Board issued FRS 19 'Deferred Tax', which will be effective for the Group's 2002 accounts. This standard replaces Statement of Standard Accounting Practice 15 'Accounting for deferred tax' and requires recognition of deferred tax assets and liabilities on all timing differences, with specified exceptions. Full provision is to be made for deferred tax liabilities, and deferred tax assets are to be recognised to the extent that it is more likely than not that they will be recovered. Discounting of deferred tax is permitted but not required. The Group is reviewing the requirements of the FRS to determine its effect on the Group's accounts.

In February 2002, the Urgent Issues Task Force ("UITF") issued UITF Abstract 33 'Obligations in capital instruments'. This Abstract sets out guidance on the classification of capital instruments between liabilities and shareholders' funds and is effective for the Group's 2002 accounts. On implementation of this Abstract, the Group's perpetual regulatory tier one securities will be reclassified as liabilities and the interest on these reclassified as interest payable.

Board of directors and secretary

Chairman

Sir George Mathewson Ø#

CBE, DUniv, LLD, FRSE, FCIBS

(age 61), was appointed a director in September 1987 and became Group Chief Executive in January 1992. In March 2000, he was appointed Executive Deputy Chairman and, in April 2001, he was appointed to his present position as Chairman. He is a former chief executive of the Scottish Development Agency and is a director of Santander Central Hispano, S.A. and The Scottish Investment Trust PLC. (Chairman of the Nominations Committee and the Chairman's Advisory Group)

Vice-chairmen

Sir Iain Vallance Ø#

(age 58), was appointed a director in January 1993 and became a vice-chairman in March 1994. He is former chairman of British Telecommunications plc and a former non-executive director of Mobil Corporation. He is President of the Confederation of British Industry, a member of the President's Committee and Advisory Council of Business in the Community and chairman of the European Advisory Committee to the New York Stock Exchange.

Sir Angus Grossart Ø#

CBE, LLD, FRSE, DL, FCIBS

(age 64), 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 The 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 Trinity Mirror Group PLC. He is a former chairman of the Trustees of the National Galleries of Scotland and is a Trustee of the National Heritage Memorial Fund.

Executive directors

Fred Goodwin □#

DUniv, FCIBS, FCIB

Group Chief Executive

(age 43), was appointed Deputy Group Chief Executive in August 1998 and to his present position in March 2000. He was formerly chief executive and director, Clydesdale Bank PLC and Yorkshire Bank PLC. He is chairman of The Prince's Trust: Scotland and a member of The Prince's Trust Council, and is on the Council of Strathclyde Business School. He is a former president of the Chartered Institute of Bankers in Scotland.

Gordon Pell □

FCIB, FCIBS

(age 52), was appointed a director and Chief Executive, Retail Banking on 6 March 2000. On 1 October 2001, he was appointed to his current position as Chairman, Retail Banking and Wealth Management. He was formerly group director, Lloyds TSB UK Retail Banking before joining National Westminster Bank Plc as a director in February 2000.

Iain Robertson □#

CBE, FCIBS

(age 56), was appointed a director in January 1993 and became Chief Executive, Corporate Banking and Financial Markets on 6 March 2000. He was appointed to his present position as Chairman, Corporate Banking and Financial Markets on 1 October 2001. He is also a director of British Empire Securities and General Trust plc.

Lawrence Fish

(age 57), 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 Textron, Inc., a trustee of The Brookings Institution, a director of the Federal Reserve Bank of Boston, and a director of numerous community organisations in the USA.

Norman McLuskie □

FCIBS

(age 57), was appointed a director in June 1992 and is Chief Executive, Retail Direct.

Fred Watt #

FCIBS

(age 41), was appointed to his current position as Group Finance Director on 4 September 2000. He was formerly finance director, Wassall plc.

Non-executive directors

Emilio Botin

(age 67), is chairman of Santander Central Hispano, S.A. He is also chairman of several Santander Central Hispano Group subsidiaries and a director of a number of Spanish companies.

Jim Currie †

(age 60), was appointed on 28 November 2001. He was formerly Director General at the European Commission with responsibility for the EU's environmental policy and previously Director General for Customs and Indirect Taxation.

Juan Inciarte

(age 49), is a general manager of Santander Central Hispano, S.A. in charge of Europe and financial companies of the group. He is also a director of several Santander Central Hispano Group subsidiaries and a number of Spanish companies.

Eileen Mackay †◊□

CB

(age 58), was formerly principal finance officer at The Scottish Office. She is a director of Edinburgh Investment Trust plc, Scottish Enterprise Edinburgh and Lothian Limited and Scottish Financial Enterprise Limited. She is chairman of Trustees of the David Hume Institute and is a member of the Economic and Social Research Council, the Review Board of the UK Accountancy profession and the Court of the University of Edinburgh.

Cameron McLatchie

CBE

(age 55), is chairman and chief executive of British Polythene Industries PLC and formerly deputy chairman of Scottish Enterprise.

Sir Steve Robson ◊

(age 58), was appointed on 25 July 2001. He was formerly a senior civil servant, having retired in January 2001 as Second Permanent Secretary of HM Treasury, where he was managing director of the Finance, Industry and Regulation Directorate.

Bob Scott †Ø#

CBE

(age 60), was appointed on 31 January 2001. He is a former group chief executive of CGNU plc and chairman of the Board of the Association of British Insurers. He is also a non-executive director of Jardine Lloyd Thompson Group plc and a Trustee of the Crimestoppers Trust. (Chairman of the Remuneration Committee)

Peter Sutherland

(age 55), was appointed on 31 January 2001. He is chairman and managing director of Goldman Sachs International and non-executive chairman of BP plc.

Murray Stuart †◊□

CBE

(age 68), is former chairman of Intermediate Capital Group PLC and of Scottish Power plc. He is a non-executive director of Old Mutual plc, CMG plc and a member of the Supervisory Board of Vivendi Environnement. (Chairman of the Personnel Committee)

Bill Wilson †◊Ø#

FCIBS

(age 64), is a Chartered Accountant. He was formerly deputy chairman of Alexander & Alexander Services Inc. His other public directorships include Edinburgh US Tracker Trust plc, First Title Insurance Company plc and Scottish Rugby Union Plc. (Chairman of the Audit Committee)

Secretary

Miller McLean #

FCIBS

(age 52), was appointed Group Secretary in August 1994 and Group Director, Legal and Regulatory Affairs and Group Secretary in March 2000. He is vice-chairman of Banco Santander, Portugal S.A. He is also a Trustee of the Industry and Parliament Trust, non-executive chairman of The Whitehall and Industry Group and a non-executive director of The Scottish Parliament and Business Exchange.

† member of the Remuneration Committee
◊ member of the Audit Committee
□ member of the Personnel Committee
Ø member of the Nominations Committee
member of the Chairman's Advisory Group

Report of the directors

The directors have pleasure in presenting their report together with the audited accounts for the year ended 31 December 2001.

Profit and dividends The profit attributable to the ordinary shareholders of the company for the year ended 31 December 2001 amounted to £1,868 million (after preference dividends of £358 million, the Additional Value Shares dividend of £399 million and perpetual regulatory securities interest of £23 million – see Note 7 on the accounts) as set out in the consolidated profit and loss account on pages 52 and 53.

An interim dividend of 11.0p per ordinary share was paid on 12 October 2001 at a cost of £313 million. The directors now recommend that a final dividend of 27.0p per ordinary share be paid on 7 June 2002 to members on the register at the close of business on 15 March 2002, absorbing £772 million. If this recommendation is approved by the shareholders at the annual general meeting on 26 April 2002, the retained profit for the year will amount to £783 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.

The first dividend of 15.0p per share on the Additional Value Shares issued in connection with the acquisition of NatWest was paid on 3 December 2001 (see page 79).

Activities and business review The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc ("RBS") and National Westminster Bank Plc ("NatWest"), the principal direct operating subsidiary undertakings of the company. The "Group" comprises the company, RBS and its subsidiary and associated undertakings, NatWest and its subsidiary and associated undertakings, GRS Holding Company Limited (the holding company of Angel Train Contracts Limited) and RBS Life Holdings Limited. RBS and NatWest and their subsidiary undertakings are engaged principally in providing a comprehensive range of banking, insurance and other financial services. Details of the principal subsidiary undertakings of the company are shown in Note 19 on the accounts. A review of the business for the year to 31 December 2001, of recent events and of likely future developments is contained in the operating and financial review.

Annual report on Form 20-F An annual report on Form 20-F will be filed with the Securities and Exchange Commission in the USA and copies will be available in April 2002 on request from the secretary.

Business developments In July 2001, RBS completed the acquisition, from its joint venture partners, of the 50% interest in the Virgin One business which it did not previously own.

In August 2001, RBS completed the acquisition of the leading aviation advisory and transaction firm, International Aviation Management (CI) Ltd.

In September 2001, Direct Line expanded into Germany and Italy through the purchase of the European motor insurance business of AllState Corporation.

In September 2001, RBS completed the acquisition of Euro Sales Finance plc, a leading European provider of sales finance.

In December 2001, Citizens completed the acquisition of the regional retail and commercial banking operations of Pennsylvania based Mellon Financial Corporation for a consideration of US$2.2 billion. The acquisition was financed from the proceeds of the placing by the company of 140 million new ordinary shares of 25p each at £14.75 per share, raising £2,065 million before expenses of £23 million.

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.

Ordinary share capital During the year ended 31 December 2001, the ordinary share capital was increased by the following issues:

(a) 140 million ordinary shares were placed in July 2001 at an issue price of £14.75 per ordinary share;

(b) 7 million ordinary shares allotted as a result of the exercise of options under the company's executive, sharesave and option 2000 schemes and a further 11.7 million ordinary shares were allotted in respect of the exercise of options under the NatWest executive and sharesave schemes which had been exchanged for options over the company's shares following the acquisition of NatWest;

(c) 19 million ordinary shares in lieu of cash dividends; and

(d) 3.6 million ordinary shares allotted under the company's profit sharing (share ownership) scheme.

The total consideration for ordinary shares issued during the year amounted to £2,641 million.

Details of the authorised and issued ordinary share capital at 31 December 2001 are shown in Note 34 on the accounts.

Preference share capital In June 2001, the company issued 16 million Series K non-cumulative preference shares of US$0.01 each at US$25 per share, the net proceeds being US$387 million.

In January 2002, the company redeemed the 600 million non-cumulative convertible preference shares of £0.25 each at £1 per share, at a total cost of £600 million.

Details of the authorised and issued preference share capital at 31 December 2001 are shown in Note 34 on the accounts.

Perpetual regulatory tier one securities In August 2001, the company issued 1.2 million Series 1 perpetual regulatory tier one securities at US$1,000 per security, the net proceeds being US$1,188 million (see page 82).

Subordinated liabilities In April 2001, Greenwich Capital Holdings Inc. redeemed US$100 million floating rate notes and issued US$105 million floating rate notes due to mature 2004.

In May 2001, RBS issued €1,000 million 6.00% subordinated notes, the net proceeds being €988 million, the company redeemed £40 million of the £200 million floating rate (minimum 5.25%) notes and NatWest redeemed US$750 million 9.45% subordinated notes and £100 million 11.75% subordinated notes.

In October 2001, RBS issued €500 million 6.00% subordinated notes, the net proceeds being €515 million, and US$50 million subordinated floating rate notes, the net proceeds beings US$50 million.

In November 2001, RBS issued £350 million 6.25% subordinated notes, the net proceeds being £348 million, and £350 million 5.625% subordinated notes, the net proceeds being £346 million.

In December 2001, RBS issued £150 million 5.625% subordinated notes, the net proceeds being £144 million.

Details of the subordinated liabilities are shown in Notes 31 and 32 on the accounts.

Shareholdings At 27 February 2002, the company has been notified of the following interests in its shares, in accordance with section 198 of the Companies Act 1985:

	% held		% held
Ordinary shares:		5½% cumulative preference shares:	
Santander Central Hispano S.A.	8.03	Commercial Union Assurance plc	22.86
CGNU plc	3.41	Guardian Royal Exchange plc	20.25
11% cumulative preference shares:		Bassett-Patrick Securities Limited*	11.56
Guardian Royal Exchange plc	25.97	Mr P. S. and Mrs J. Allen	8.83
Windsor Life Assurance Company Limited	10.30	Mrs Gina Wild	4.95
The Investment Company plc	7.83	Miss Elizabeth Hill	4.03
Mr S. J. and Mrs J. A. Cockburn	6.16	Mr W. T. Hardison Jr.	3.38
Cleaning Tokens Limited	5.10	Trustees of The Stephen Cockburn Limited Pension Scheme	4.18

*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 32 to 33. Following the annual general meeting on 11 April 2001, Sir George Mathewson succeeded Viscount Younger of Leckie as Chairman of the Board. Mr Scott and Mr Sutherland were appointed to the Board as non-executive directors on 31 January 2001 and Sir Steve Robson and Dr Currie were appointed to the Board as non-executive directors on 25 July 2001 and 28 November 2001 respectively. Sir Steve Robson and Dr Currie were appointed since the last annual general meeting and will seek re-election at the forthcoming annual general meeting on 26 April 2002. The directors retiring by rotation are Mr Goodwin, Mr Inciarte, Mr McLatchie, Mr McLuskie, Mr Robertson and Mr Stuart, and all except Mr McLatchie and Mr Stuart will offer themselves for re-election. Details of the service agreements for Mr Goodwin, Mr McLuskie and Mr Robertson are set out on page 41. There are no service contracts in respect of the other directors seeking re-election.

Directors' interests The interests of the directors in the shares of the company at 31 December 2001 are shown on pages 45 and 46. 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 from 1 January 2001 to 27 February 2002.

Staff involvement The Group encourages employee involvement through a process of communication and consultation. This involves internal communications activities, team meetings led by line managers and regular dialogue with employees and employee representatives.

The annual, Group-wide, employee opinion survey forms an integral part of the manner in which the Group communicates and consults with employees. In 2001, the Group recorded its highest ever response rate with 75% of employees completing and returning their survey either on paper or, for the first time, online. As well as representing an impressive 8% increase from the 2000 survey, the response rate is significantly higher than the average for large corporate organisations.

This survey and other employee communication procedures enable the Group to identify and address key issues and to focus its efforts in line with the aspirations and expectations of its people.

It is the Group's intention to launch a European Works Council in 2002 to facilitate discussion amongst representatives on employment matters of a transnational nature affecting more than one European member state.

Involvement in the Group's performance is encouraged by providing employees with the opportunity to acquire shares in the company through profit sharing and sharesave schemes.

Equal opportunities The Group continually strives for improvement of its equal opportunities and has strengthened its commitment in 2001. We have established a Group policy which states:

The Group is committed to valuing and promoting diversity and equal opportunity in all areas of recruitment, employment, training and promotion. The Group will work towards an environment that is based on meritocracy and inclusiveness, where all employees can develop their full potential, irrespective of their race, gender, marital status, age, disability, religious belief, political opinion or sexual orientation.

The Group's active support is also expressed through its membership of forums such as Opportunity Now, Race for Opportunity, the Employers' Forum on Disability and the Employers' Forum on Age.

Disability The Group recognises its responsibility towards disabled employees and the wealth of talent and skills possessed by disabled people. The Group will comply with the relevant legislation and wherever possible seek to exceed the minimum standards.

The views of our disabled employees are also sought through our annual employee opinion survey, allowing us to recognise and meet their requirements.

Health and safety The health, safety, welfare and security of staff is of paramount importance to the Group. The health and safety policy has been revised to take account of changes in the Group's corporate structure and the recently introduced guidance from the Health and Safety Commission on the responsibility of directors for health and safety.

Currently, a systematic review of health and safety policies and procedures is being undertaken to ensure that a consistent approach is taken across the Group. An important part of this process is the Group's involvement in the UK Health and Safety Executive's Lead Authority Partnership Scheme. This scheme is recognised by all UK local authorities, who enforce health and safety standards. The Group participates in a similar scheme with the local fire brigades, who enforce fire safety legislation.

Environmental issues Environmental and social imperatives continue to shape the future, and the diversity and flexibility of the Group's businesses enables it to anticipate and respond to these changes. Business excellence, of necessity, requires that the Group meets changing customer, shareholder, investor, employee and supplier expectations and the Group acknowledges that environmental, social and ethical responsibility is key to the way it does business.

To assist in creating value for all stakeholders, the Group has adopted policies which progressively integrate environment and social issues into all aspects of its business activities. The objective of these policies is to manage the obvious tangible operational impacts on the environment such as energy, raw material, waste and transport and to create additional value through the development of new markets, new products and improved ways of delivering the Group's services.

These principles are driven by the Group's corporate values, underpinned by its management procedures and are reinforced through the Group internal and external social, community and environmental programmes. (For further information, the Environmental Report, is available on the Group's website – www.rbs.co.uk).

Charitable contributions The total amount given for charitable purposes by the company and its subsidiary undertakings during the year ended 31 December 2001 was £14.7 million.

Corporate governance The company is committed to high standards of Corporate Governance and applies the Principles of Good Governance set out in section 1 of the Combined Code. Details are given on pages 38 and 39.

Policy and practice on payment of creditors In the year ending 31 December 2002, the Group will adhere to the following payment policy in respect of all suppliers. The Group is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Group's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

At 31 December 2001, the Group's trade creditors represented 26 days of amounts invoiced by suppliers. The company does not have any trade creditors.

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

By order of the Board.

Miller McLean
Secretary
27 February 2002

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

Corporate governance

The Group is committed to high standards of Corporate Governance and the Board of directors believes that this is a key element in ensuring that we continue to deliver value to our shareholders.

The Board has reviewed its Corporate Governance practices and an explanation of how the Principles of Good Governance, set out in section 1 of the Combined Code, which is appended to the Listing Rules of the Financial Services Authority ("the Code"), have been applied is contained in this report and the Remuneration Report on pages 40 to 44.

Throughout the accounting period to 31 December 2001, the company has complied with the provisions set out in Section 1 of the Code, except in relation to the chairmanship of the Remuneration Committee, which was chaired by Viscount Younger, formerly Executive Chairman, until his retirement. Since the appointment of Mr Scott as chairman of the Remuneration Committee on 11 April 2001, the company has complied fully with the provisions of the Code.

Board of directors The Board of directors comprises the Chairman, six executive directors and twelve non-executive directors. The biographies of the Board members appear on pages 32 and 33.

The Board has overall responsibility for leading and controlling the company and is accountable to shareholders for financial and operational performance.

The Board has adopted a formal schedule of matters detailing key aspects of the company's affairs presented to it for decision. In particular, the Board is responsible for approving policy and strategy. Responsibility for the development of policy and strategy and operational management is delegated to the Group Chief Executive and executive directors.

The roles of Chairman and Group Chief Executive are distinct and separate, with clearly divided responsibilities. The Vice-chairmen perform the role of senior non-executives. The non-executive directors combine broad business and commercial experience with independent and objective judgement. The balance enables the Board to provide clear and effective leadership and maintain the highest standards of integrity across the company's business activities. The Board has reviewed the independence of the non-executive directors and has reaffirmed that, with the exception of Mr Botin and Mr Inciarte, who are representatives of Santander Central Hispano, S.A., all non-executive directors are considered by the Board to be independent.

The Board normally meets monthly and is supplied with comprehensive Board papers in advance of each Board meeting including financial and business reports covering each of the company's principal business activities. Following the appointment of Sir George Mathewson as Chairman, a review was carried out to assess the Board's effectiveness, and as a consequence of that review, a number of enhancements to the Board process have been introduced.

All directors have access to the advice and services of the secretary who is responsible for ensuring that the Board procedures and all applicable rules and regulations are observed. In addition, all directors are able, if necessary, to obtain independent professional advice at the company's expense.

Board committees In order to provide effective oversight and leadership the Board has established a number of committees with particular responsibilities. The principal committees are as follows:

the Audit Committee is responsible for assisting the Board to discharge its responsibilities for accounting policies, financial reporting, internal control, compliance and risk management.

the Remuneration Committee is responsible for considering and making recommendations to the Board, within agreed terms of reference, on the company's executive remuneration policy, the remuneration arrangements of directors and senior executives and the operation of the company's employee share schemes. No director is involved in deciding his own remuneration. The Board's Remuneration Report is contained on pages 40 to 44.

the Nominations Committee is responsible for assisting the Board in the formal selection and appointment of directors.

Relations with shareholders The company has a programme of communication with shareholders through regular interim and annual reports and the annual general meeting. Shareholders are given the opportunity to participate by asking questions at the annual general meeting, or by submitting written questions in advance. The company's website at www.rbs.co.uk contains information on the Group and the products and services it offers and includes webcasts of the Group's public conferences. Communication with the company's largest institutional shareholders is undertaken as part of the company's investor relations programme.

Internal control The Board of directors is responsible for the Group's system of internal control that is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, the Group has regard to the nature and extent of the risk, the likelihood of it crystallising and the cost of controls. A system of internal control is designed to manage, but not eliminate, the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against the risk of material misstatement, fraud or losses.

The Board has established an ongoing process for the identification, evaluation and management of the significant risks faced by the Group, which operated throughout the year ended 31 December 2001 and to 27 February 2002, the date the directors approved the Report and Accounts. This process is regularly reviewed by the Board and meets the requirements of the guidance 'Internal Control: Guidance for Directors on the Combined Code' issued by the Institute of Chartered Accountants in England and Wales in 1999.

The effectiveness of the Group's internal control system is reviewed regularly by the Board and the Group Audit Committee. Executive management committees or boards of directors in each of the Group's businesses receive quarterly reports on significant risks facing their business and how they are being controlled. These reports are combined and submitted to the Board as quarterly risk and control assessments. Additional details of the Group's approach to risk management are given in the 'Risk management' section of the 'Operating and financial review' on pages 24 to 30. The Group Audit Committee also receives regular reports from Group Risk, Group Internal Audit and Group Compliance. In addition, the Group's independent auditors present to the Group Audit Committee reports that include details of any significant internal control matters which they have identified. The system of internal controls of the authorised institutions and other regulated entities in the Group are also subject to regulatory oversight in the UK and overseas.

Remuneration report

Remuneration of non-executive directors Non-executive directors' fees are reviewed annually by the Board in the light of fees payable to non-executive directors for comparable companies.

Executive remuneration policy
The objective is to provide, in the context of the company's business strategy, remuneration in form and amount which will attract, motivate and retain high calibre executives. In order to achieve this objective, the executive remuneration policy is framed around the following core principles:

- Total rewards will be set at levels that are competitive within the relevant market.
- Total potential rewards will be earned through achievement of demanding performance targets based on measures consistent with shareholder interests over the short, medium and longer term.
- Incentive plans and performance metrics will be structured to be robust through the business cycle.
- Remuneration arrangements will be designed to support the company's business strategy, to promote appropriate teamwork and to conform to best practice standards.

Components of remuneration The policy aims to deliver an appropriate balance between long-term incentives, short-term incentives and fixed elements of reward.

Performance rewards – long-term
Options Executive share options focus on absolute share price growth supported by the delivery of underlying financial performance. Options are typically allocated to UK-based executives over one times salary worth of shares each year. The options are not exercisable unless the growth in the company's earnings per share over three years has exceeded the growth in the Retail Price Index plus 9%, as measured from the higher of the earnings per share in the year before the options were granted and the earnings per share in the relevant base year if the performance condition is rolled forward. The condition is reviewed annually.

Medium-term plan UK-based executives are eligible to receive awards under the medium-term performance plan in the form of share or share equivalent awards. This plan is targeted at the most senior group of executives and focuses on achieving superior returns for shareholders compared with other leading financial organisations. Performance is measured over three years using total shareholder return ("TSR"). Awards under this plan will not vest if TSR is below the median of the comparator group or if annualised earnings per share growth is less than the annualised growth of the Retail Price Index plus 3%. Awards will be set at a competitive level within the overall limit of one and a half times earnings. Details of individual awards during the year to 31 December 2001 are set out in the table on page 44 and did not exceed 150% of basic salary for any of the participants.

Performance rewards – short-term
Annual bonus This typically focuses from year to year on the delivery of a balanced scorecard of appropriate Group and individual, financial and operational targets approved by the Remuneration Committee. Individual executives have a maximum annual bonus potential ranging from 60% to 100% of salary although for exceptional performance, as measured by the achievement of significant objectives, bonuses of up to 200% of salary may be awarded.

Fixed elements
Salary Salaries are reviewed annually as part of total remuneration having regard for remuneration paid to executives of comparable companies. The Remuneration Committee uses a range of survey data from leading consultancies and reaches individual salary decisions taking account of the remuneration environment and the performance and responsibilities of the individual director.

Pensions UK-based executives are eligible for defined benefit pensions in accordance with the terms of the relevant pension scheme. Individual arrangements beyond the Inland Revenue limits are detailed below.

Benefits and other share schemes Executives are eligible to receive benefits including the provision of a company car, medical health insurance, death-in-service benefits and beneficial loans on similar terms to other employees.

In addition, UK-based executives are eligible to participate in Group-wide plans including option 2000, sharesave and the Group profit sharing schemes.

US-based executives Separate salary review processes and pension provisions operate in the US reflecting the remuneration practice in that country. Separate incentive arrangements also operate for US-based executives. They are based on similar principles to executive incentives in the UK but are designed to be competitive in the US market and focus on relevant key business objectives for the US businesses.

For executives of Citizens, long-term performance rewards take two forms:

The Phantom 2000 plan, approved by shareholders in 2000, provides a cash based proxy for share options. Under the plan, units are granted on a regular basis and can normally be exercised four or five years from grant, at which point a cash amount equal to the difference in the unit price between grant and exercise is paid. The price of a unit is calculated by reference to Citizens' cumulative economic profit and the growth in economic profit, adjusted to reflect changes in the price/earnings ratio of a group of banks. No individual participant can be awarded more than 20% of the maximum total units available under the plan. Payments under the plan are subject to both a minimum performance target and a maximum total payout cap. Details of awards to Mr Fish during the year are set out in the table on page 44.

A cash based long-term incentive plan rewards the achievement of three year financial targets. The maximum award available under the plan is 105% of salary.

Short-term performance rewards take the form of a discretionary annual bonus which rewards the achievement of Group, business unit and individual financial and non-financial targets. Following an independent review of executive compensation practice in the US, the maximum annual bonus potential has been increased to 200% of salary.

Service contracts The Remuneration Committee has adopted a policy that directors will not normally be given a contract term greater than 12 months. If it is necessary to provide a longer term when recruiting an individual, the contract will revert to 12 months in due course. Existing contract terms will remain in place. Details of individual contract terms for directors due for re-appointment are set out below.

The service agreement of Mr Goodwin is terminable on 12 months notice by RBS and six months notice by Mr Goodwin.

The service agreement of Mr Robertson is terminable on 12 months notice by RBS and six months notice by Mr Robertson.

The service agreement of Mr McLuskie is terminable on three months notice by RBS and three months notice by Mr McLuskie.

None of the other directors who are due to stand for re-election at the forthcoming annual general meeting has a service agreement with the company.

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

Mr Pell was appointed by NatWest with effect from 1 February 2000 and has a service agreement which is terminable by NatWest on 24 months notice for the first two years of employment, decreasing on a monthly basis to 12 months notice after three years employment. The service agreement is terminable on six months notice by Mr Pell.

The Board of directors and the Remuneration Committee considers 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.

Directors' pension arrangements During the year, Viscount Younger, Mr Goodwin, Mr Robertson, Mr McLuskie and Mr Watt participated in The Royal Bank of Scotland Staff Pension Scheme ("the RBS Scheme"). Mr Pell participated in the National Westminster Bank Pension Fund ("the NatWest Scheme"). The RBS Scheme and the NatWest Scheme are defined benefit schemes which provide pensions and other benefits within Inland Revenue limits. Viscount Younger was provided with life assurance benefits only under the RBS Scheme until his retirement as Chairman on 11 April 2001; these were restricted by Inland Revenue limits as set out in the Finance Act 1989. Additional life assurance cover, in excess of that provided by the RBS Scheme, was 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 under the RBS 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 and Mr Watt's entitlements under the RBS Scheme, and Mr Pell's entitlement under the NatWest Scheme are similarly restricted by Inland Revenue limits as set out in the Finance Act 1989. Arrangements have been made to provide Mr Goodwin, Mr Watt and Mr Pell with additional pension benefits and life assurance cover outwith the Schemes. The figures in the table below include the accrual in respect of these 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 a disclosure of director's 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.

Defined benefit arrangements	Age at 31 December 2001	Additional pension earned during the year ended 31 December 2001 £000 p.a.	Accrued entitlement at 31 December 2001 £000 p.a.	Transfer value for the additional pension earned during the year ended 31 December 2001 £000
Viscount Younger	70	6*	117*	88*
Fred Goodwin	43	71	228	585
Norman McLuskie	57	34	142	519
Gordon Pell	51	11	18	139
Iain Robertson	56	3	23	35
Fred Watt	41	2	2	12
Lawrence Fish – Qualified Plan	57	2	17	11
– Excess Plan		12	116	76
– Employee Arrangement		51	165	332

*to or at the date of retirement.

Contributions and allowances paid in the year ended 31 December 2001 under defined contribution arrangements were:

	£000
Lawrence Fish	19
Fred Watt	83

Directors' remuneration The undernoted tables report the remuneration of each director for the year ended 31 December 2001:

	Salary £000	Performance Bonus* £000	Benefits £000	**Total 2001 £000**	Total 2000 (15 months) £000
Chairmen					
Sir George Mathewson	431	34	18	**483**	2,215
Viscount Younger (retired 11 April 2001)	81	—	2	**83**	379
Executive directors					
Fred Goodwin	733	825	14	**1,572**	2,262
Lawrence Fish	637	1,563	13	**2,213**	1,347
Norman McLuskie	385	280	20	**685**	829
Gordon Pell	489	550	—	**1,039**	775
Iain Robertson	611	481	22	**1,114**	2,040
Fred Watt	395	280	15	**690**	176
	3,762	**4,013**	**104**	**7,879**	10,023

*includes profit sharing

Non-executive directors	Board fees £000	Board committee fees £000	**Total 2001 £000**	Total 2000 (15 months) £000
Vice-chairmen				
Sir Iain Vallance	100	—	**100**	88
Sir Angus Grossart	100	—	**100**	88
Emilio Botin	40	—	**40**	31
Jim Currie (appointed 28 November 2001)	3	—	**3**	—
Juan Inciarte	40	—	**40**	31
Eileen Mackay	40	13	**53**	40
Cameron McLatchie	40	—	**40**	31
Sir Steve Robson (appointed 25 July 2001)	17	3	**20**	—
Bob Scott (appointed 31 January 2001)	37	14	**51**	—
Murray Stuart	40	28	**68**	47
Peter Sutherland (appointed 31 January 2001)	37	—	**37**	—
Bill Wilson	40	33	**73**	57
	534	**91**	**625**	413

Aggregate emoluments of directors who served during the year was £8,504,000.

Details of the potential pre-tax gains made by directors on the exercise of share options are included within directors' interests in shares on page 45.

Long-term incentive schemes The following table shows details of awards made to the executive directors under long-term incentive schemes:

	Interest at start of year (units)	Awards granted during year No. of units	Prices	Vest date	Benefits received during year	Interest at end of year (units)
Phantom 2000 plan:						
Lawrence Fish	—	1,000,000	US$0.32	1.1.04	—	1,000,000
Medium-term performance plan:						
Fred Goodwin	—	68,807	£16.35	31.12.03	—	68,807
Norman McLuskie	—	36,697	£16.35	31.12.03	—	36,697
Gordon Pell	—	45,871	£16.35	31.12.03	—	45,871
Iain Robertson	—	57,339	£16.35	31.12.03	—	57,339
Fred Watt	—	36,697	£16.35	31.12.03	—	36,697

Note:
In addition to the Phantom 2000 plan, Mr Fish also participates in the Citizens' long-term incentive plan. Under this plan, awards are linked to three year performance targets based on Citizens' budgets. A separate three year cycle commences each year. Mr Fish can receive a maximum award under this long-term plan of up to 105% of his average salary over the three year cycle.

Directors' interests in shares

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

	31 December 2001	1 January 2001 or date of appointment if later		31 December 2001	1 January 2001 or date of appointment if later
Lawrence Fish	**10,950**	10,950	Iain Robertson	**117,777**	114,780
Fred Goodwin	**64,703**	64,703	Bob Scott	**1,437**	1,437
Eileen Mackay	**6,086**	6,086	Murray Stuart	**3,459**	3,385
Sir George Mathewson	**247,075**	242,843	Sir Iain Vallance	**2,500**	2,500
Norman McLuskie	**145,290**	140,385	Bill Wilson	**9,421**	9,289

Mr Botin, Dr Currie, Sir Angus Grossart, Mr Inciarte, Mr McLatchie, Mr Pell, Sir Steve Robson, Mr Sutherland and Mr Watt did not have an interest in the company's ordinary shares during the year.

Options to subscribe for ordinary shares of 25p each in the company granted to, and exercised by, directors during the year to 31 December 2001 are included in the table below:

	Options at 1 January 2001 or date of appointment if later	Average exercise price £	Options granted Number	Options granted Price £	Options exercised Number	Options exercised Price £	Market price at date of exercise £	Potential pre-tax gain at date of exercise £	Options at 31 December 2001	Average exercise price £
Lawrence Fish	108,027	9.33	—	—	—	—	—	—	**108,027**	9.33
Fred Goodwin	350,351	8.62	43,700	17.18	—	—	—	—	**394,051**	9.57
Sir George Mathewson	530,403	6.43	20,100	17.18	223,276	4.96	16.59	3,607,283	**238,101**	9.08
			1,347	13.64	90,473	5.58	16.75			
Norman McLuskie	73,113	9.11	23,300	17.18	1,333	3.88	16.20	18,400	**95,190**	11.18
			335	13.64	225	7.41	16.20			
Gordon Pell	51,366	7.82	29,100	17.18	—	—	—	—	**80,466**	11.21
Iain Robertson	267,872	9.18	36,400	17.18	—	—	—	—	**304,272**	10.13
Fred Watt	70,148	12.83	23,300	17.18	—	—	—	—	**94,158**	13.91
			710	13.64						
Viscount Younger	110,430	5.11	—	—	32,336	3.98	16.59	1,223,001	**150**	12.40
(retired 11 April 2001)					43,145	4.96	17.05			
					28,003	5.58	14.75			
					6,796	9.33	14.75			

The market price of the company's ordinary shares at 31 December 2001 was £16.72 and the range during the year to 31 December 2001 was £12.56 to £17.82. Outstanding options under the executive share option scheme, the sharesave scheme and the option 2000 scheme are exercisable between now and 13 August 2011; between 1 July 2002 and 31 March 2009 and between 9 August 2003 and 8 August 2006, respectively.

The company's Register of Directors' Interests, which is open to inspection, contains full details of directors' shareholdings and options to subscribe.

Additional Value Shares The following directors held a beneficial interest in the company's Additional Value Shares:

	31 December 2001	1 January 2001 or date of appointment if later		31 December 2001	1 January 2001 or date of appointment if later
Lawrence Fish	10,950	10,950	Iain Robertson	112,747	112,747
Fred Goodwin	64,703	64,703	Murray Stuart	3,361	3,361
Eileen Mackay	6,086	6,086	Sir Iain Vallance	2,500	2,500
Sir George Mathewson	173,674	173,674	Bill Wilson	9,237	9,237
Norman McLuskie	26,584	26,584			

Mr Botin, Dr Currie, Sir Angus Grossart, Mr Inciarte, Mr McLatchie, Mr Pell, Sir Steve Robson, Mr Scott, Mr Sutherland and Mr Watt did not have an interest in the company's Additional Value Shares during the year.

Preference shares No director had an interest in the preference shares during the year.

Loan notes No director had an interest in loan notes during the year.

There has been no change in the directors' interests in the shares of the company shown above between 31 December 2001 and 27 February 2002. No director held a non-beneficial interest in the shares of the company at 31 December 2001, at 1 January 2001 or date of appointment if later.

Statement of directors' responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

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

By order of the Board.

Miller McLean
Secretary
27 February 2002

Independent auditors' report to the members of The Royal Bank of Scotland Group plc

We have audited the consolidated financial statements of The Royal Bank of Scotland Group plc ("the company") and its subsidiaries (together "the Group") for the year ended 31 December 2001 which comprise the accounting policies, the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, the reconciliation of movements in shareholders' funds, and the related notes 1 to 52. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors As described in the 'Statement of directors' responsibilities', the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards, and the Listing Rules of the Financial Services Authority ("the Listing Rules").

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the directors' report and the other information contained in the Report and Accounts for the year ended 31 December 2001 listed in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. 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 circumstances of the company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements 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 as at 31 December 2001 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.

Deloitte & Touche
Chartered Accountants and Registered Auditors
39 George Street
Edinburgh
EH2 2HZ
27 February 2002

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 permitted by section 230(3) of the Companies Act 1985, no profit and loss account is presented for the company.

Disclosures required by Financial Reporting Standard ("FRS") 17 'Retirement Benefits' are included in Note 3 on the accounts. Further disclosures under the transitional requirements of this standard will be made in the Group's financial statements for 2002, and full implementation is required from 2003.

Implementation of FRS 18 'Accounting Policies' has not resulted in any changes to the Group's principal accounting policies.

1 Accounting convention and bases of consolidation The accounts are prepared under the historical cost convention modified by the periodic revaluation of premises and certain investments. To avoid undue delay in the presentation of the Group's accounts, the accounts of certain subsidiary undertakings have been made up to 30 November. There have been no changes in respect of these subsidiary undertakings, in the period from their balance sheet dates to 31 December, that materially affect the view given by the Group's accounts.

2 Goodwill Goodwill is the excess of the cost of acquisition of subsidiary and associated undertakings over the fair value of the Group's share of net tangible assets acquired. Goodwill arising on acquisitions of subsidiary and associated undertakings after 1 October 1998 is capitalised on the balance sheet and amortised on a straight-line basis over its estimated useful economic life. Goodwill arising on acquisitions of subsidiary and associated undertakings prior to 1 October 1998, previously charged directly against profit and loss account reserves, was not reinstated under the transitional provisions of FRS 10 'Goodwill and Intangible Assets'. It will be written back only on disposal of the related subsidiary or associated undertaking and reflected in the calculation of the gains and losses arising.

3 Foreign currencies Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Profit and loss accounts of overseas branches and subsidiary undertakings are translated at the average rates of exchange for the period. Exchange differences arising from the application of closing rates of exchange to the opening net assets of overseas branches and subsidiary undertakings and from restating their results from average to period-end rates are taken to profit and loss account reserves, together with exchange differences arising on related foreign currency borrowings.

4 Pensions and other post-retirement benefits The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees. The cost of defined benefit pension schemes and healthcare plans is assessed by independent professionally qualified actuaries and recognised on a systematic basis over employees' service lives. Contributions to defined contribution pension schemes are recognised in the profit and loss account when payable.

5 Leases Total gross earnings under finance leases are allocated to accounting periods using the actuarial after tax method to give a constant periodic rate of return on the net cash investment. Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease. Progress payments made prior to the commencement of the lease are included at cost. Rental income from operating leases is credited to the profit and loss account on a receivable basis over the term of the lease. Balance sheet carrying values of finance lease receivables and operating lease assets include amounts in respect of the residual values of the leased assets. Unguaranteed residual values are subject to regular review to identify potential impairments. Provisions are made for impairment arising on specific asset categories.

6 General insurance 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 that 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 unearned, 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 Long-term life assurance business The value placed on the Group's long-term life assurance business comprises the net assets of the Group's life assurance subsidiaries, including its interest in the surpluses retained within the long-term assurance funds, and the present value of profits inherent in in-force policies. In calculating the value of in-force policies, future surpluses expected to emerge are estimated using appropriate assumptions as to future mortality, persistency and levels of expenses, which are then discounted at a risk-adjusted rate. Changes in this value, which is determined on a post-tax basis, are included in operating profit, grossed up at the underlying rate of taxation.

Long-term assurance assets attributable to policyholders are valued on the following bases: equity shares and debt securities at market price; investment properties and loans at valuation. These assets are held in the life funds of the Group's life assurance companies, and although legally owned by them, the Group only benefits from these assets when surpluses are declared. To reflect the distinct nature of the long-term assurance assets, they are shown separately on the consolidated balance sheet, as are liabilities attributable to policyholders.

8 Loans and advances The Group makes provisions for bad and doubtful debts, through charges to the profit and loss account, so as to record loans and advances at their expected ultimate net realisable value.

Specific provisions are made against individual loans and advances that the Group no longer expects to recover in full. For the Group's portfolios of smaller balance homogeneous advances, such as credit card receivables, specific provisions are established on a portfolio basis taking into account the level of arrears, security and past loss experience. For loans and advances that are individually assessed, the specific provision is determined from a review of the financial condition of the counterparty and any guarantor and takes into account the nature and value of any security held.

The general provision is made to cover bad and doubtful debts that have not been separately identified at the balance sheet date but are known to be present in any portfolio of advances. The level of general provision is determined in the light of past experience, current economic and other factors affecting the business environment and the Group's monitoring and control procedures, including the scope of specific provisioning procedures.

Specific and general provisions are deducted from loans and advances. When there is significant doubt that interest receivable can be collected, it is excluded from the profit and loss account and credited to an interest suspense account. Loans and advances and suspended interest are written off in part or in whole when there is no realistic prospect of recovery.

9 Taxation Provision is made for taxation at current rates on taxable profits taking into account relief for overseas taxation 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 such timing differences to the extent that they are likely to crystallise in the foreseeable future. It is calculated at rates expected to be applicable when the liabilities or assets are expected to crystallise.

10 Fees receivable Fees receivable that represent a return for services provided are recognised in the profit and loss account so as to match the cost of providing the service. Certain front-end lending fees are recognised over the life of the loan.

11 Debt securities and equity shares Debt securities and equity shares intended for use on a continuing basis in the Group's activities are classified as investment securities and are stated at cost less provision for any permanent diminution in value. The cost of dated investment securities is adjusted for the amortisation of premiums or discounts over periods to redemption and the amortisation is included in interest receivable. Debt securities held for the purpose of hedging are carried at a value that reflects the accounting treatment of the items hedged. Other debt securities and equity shares are carried at fair value, with changes in fair value recognised in the profit and loss account.

12 Shares in subsidiary undertakings The company's shares in subsidiary undertakings are stated in the balance sheet of the company at directors' valuation that takes account of the subsidiary undertakings' net asset values.

13 Interests in associated undertakings Interests in associated undertakings are accounted for by the equity method and are stated in the consolidated balance sheet at the Group's share of their net tangible assets. The Group's share of the results of associated undertakings is included in the consolidated profit and loss account. For this purpose, the latest available audited accounts are used together with available unaudited interim accounts.

14 Tangible fixed assets Freehold and long leasehold properties are revalued on a rolling basis, each property being revalued at least every five years. Other tangible fixed assets are stated at cost less depreciation and provisions for impairment. Costs of adapting premises for the use of the Group are separately identified and depreciated.

Tangible fixed assets are depreciated over their estimated economic lives on a straight-line basis, as follows:

Land	not depreciated
Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

Assets on operating leases are depreciated over their estimated useful lives on a straight-line or reverse-annuity basis.

Investment properties are revalued annually to open market value. No depreciation is charged on freehold investment properties, in accordance with the requirements of Statement of Standard Accounting Practice 19 'Accounting for investment properties'. This is a departure from the requirements of the Companies Act 1985 which requires all tangible fixed assets to be depreciated. Investment properties are held not for consumption but for investment and the directors consider that to depreciate them would not give a true and fair view. It is not practicable to assess estimated useful lives for investment properties, and accordingly the effect of not depreciating them cannot be reasonably quantified.

15 Derivatives The Group enters into derivative transactions including futures, forwards, swaps and options principally in the interest rate, foreign exchange and equity markets. The accounting treatment for these instruments is dependent upon whether they are entered into for trading or non-trading (hedging) purposes.

Trading Derivatives held for trading purposes are recognised in the accounts at fair value. Gains or losses arising from changes in fair value are included in dealing profits in the consolidated profit and loss account. Fair value is based on quoted market prices. Where representative market prices are not available, the fair value is determined from current market information using appropriate pricing or valuation models. Adjustments are made to quoted market prices where appropriate to cover credit risk, liquidity risk and future operational costs. In the consolidated balance sheet, positive fair values (assets) of trading derivatives are included in Other assets and negative fair values (liabilities) in Other liabilities. Positive and negative fair values of trading derivatives are offset where the contracts have been entered into under master netting agreements or other arrangements that give a legally enforceable right of set-off.

Non-trading Non-trading derivatives are entered into by the Group to hedge exposures arising from transactions entered into in the normal course of banking activities. They are recognised in the accounts in accordance with the accounting treatment of the underlying transaction or transactions being hedged. To be classified as non-trading, a derivative must match or eliminate the risk inherent in the hedged item from potential movements in interest rates, exchange rates and market values. In addition, there must be a demonstrable link to an underlying transaction, pool of transactions or specified future transaction or transactions. Specified future transactions must be reasonably certain to arise for the derivative to be accounted for as a hedge. In the event that a non-trading derivative transaction is terminated or ceases to be an effective hedge, the derivative is re-measured at fair value and any resulting profit or loss amortised over the remaining life of the underlying transaction or transactions being hedged. If a hedged item is derecognised, or a specified future transaction is no longer likely to occur, the related non-trading derivative is remeasured at fair value and the resulting profit or loss taken to the profit and loss account.

16 Sale and repurchase transactions Securities which have been sold with an agreement to repurchase continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in reverse sale and repurchase transactions are not recognised in the balance sheet and the purchase price is treated as a loan. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the profit and loss account as interest payable or receivable.

Consolidated profit and loss account

for the year ended 31 December 2001

	Note	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Interest receivable			
– interest receivable and similar income arising from debt securities		**1,582**	1,649
– other interest receivable and similar income		**12,839**	12,845
Interest payable		**(7,552)**	(8,707)
Net interest income		**6,869**	5,787
Dividend income		**54**	54
Fees and commissions receivable		**4,735**	3,885
Fees and commissions payable		**(930)**	(746)
Dealing profits	1	**1,426**	1,003
Other operating income		**1,052**	959
		6,337	5,155
General insurance			
– earned premiums		**1,804**	1,608
– reinsurance		**(429)**	(442)
Non-interest income		**7,712**	6,321
Total income		**14,581**	12,108
Administrative expenses			
– staff costs*	2	**4,059**	3,547
– premises and equipment*		**873**	817
– other*		**1,903**	1,615
Depreciation and amortisation			
– tangible fixed assets*	22	**881**	786
– goodwill	21	**651**	541
Operating expenses		**8,367**	7,306
Profit before other operating charges		**6,214**	4,802
General insurance			
– gross claims		**1,263**	1,205
– reinsurance		**(315)**	(347)
Profit before provisions for bad and doubtful debts		**5,266**	3,944
Provisions for bad and doubtful debts	14	**984**	629
Amounts written off fixed asset investments		**7**	42
Operating profit *(carried forward)*		**4,275**	3,273

All items dealt with in arriving at operating profit relate to continuing operations.

*includes integration expenditure (see Note 5).

	Note	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Operating profit *(brought forward)*		**4,275**	3,273
Profit on disposal of businesses	4	**—**	100
Profit on ordinary activities before tax	5	**4,275**	3,373
Tax on profit on ordinary activities	6	**1,537**	1,157
Profit on ordinary activities after tax		**2,738**	2,216
Minority interests (including non-equity)	33	**90**	47
Profit after minority interests		**2,648**	2,169
Preference dividends – non-equity	7	**358**	322
Perpetual regulatory securities interest – non-equity	7	**23**	—
		2,267	1,847
Additional Value Shares dividend – non-equity	7	**399**	—
Profit attributable to ordinary shareholders		**1,868**	1,847
Ordinary dividends	8	**1,085**	882
Retained profit	35	**783**	965

Earnings per 25p ordinary share	10	**67.6p**	90.0p
Additional Value Shares dividend		**14.5p**	—
		82.1p	90.0p
Goodwill amortisation		**23.2p**	25.8p
Integration costs		**22.6p**	14.0p
Profit on disposal of businesses		**—**	(3.4p)
Adjusted earnings per 25p ordinary share		**127.9p**	126.4p

Diluted earnings per 25p ordinary share	10	**66.3p**	88.9p

Profit on ordinary activities before taxation and the retained profit for the period on a historical cost basis were not materially different from the reported amounts.

Note: Adjusted earnings per share have been calculated to show the after tax effect of excluding goodwill amortisation, integration costs and profit on disposal of businesses, and the Additional Value Shares dividend.

Consolidated balance sheet

at 31 December 2001

	Note	31 December 2001 £m	31 December 2000 £m
Assets			
Cash and balances at central banks		**3,093**	3,049
Items in the course of collection from other banks		**3,288**	2,961
Treasury bills and other eligible bills	11	**10,136**	3,316
Loans and advances to banks	12	**38,513**	32,061
Loans and advances to customers	13	**190,492**	168,076
Debt securities	16	**64,040**	57,789
Equity shares	17	**1,557**	1,553
Interests in associated undertakings	18	**108**	83
Intangible fixed assets	21	**13,325**	12,080
Tangible fixed assets	22	**8,813**	6,121
Other assets	23	**21,473**	18,034
Prepayments and accrued income		**3,696**	4,182
		358,534	309,305
Long-term assurance assets attributable to policyholders	24	**10,248**	10,699
Total assets		**368,782**	320,004

	Note	31 December 2001 £m	31 December 2000 £m
Liabilities			
Deposits by banks	25	40,038	35,130
Items in the course of transmission to other banks		2,109	1,707
Customer accounts	26	198,995	177,302
Debt securities in issue	27	30,669	19,407
Other liabilities	28	37,357	32,959
Accruals and deferred income		7,654	7,172
Provisions for liabilities and charges			
– deferred taxation	29	1,456	1,224
– other provisions	30	341	306
Subordinated liabilities			
– dated loan capital	31	6,681	6,316
– undated loan capital including convertible debt	32	5,029	4,120
Minority interests			
– equity		5	(34)
– non-equity	33	580	580
Called up share capital	34	893	848
Share premium account	35	7,465	6,530
Merger reserve	35	12,029	12,604
Other reserves	35	212	191
Revaluation reserve	35	113	40
Profit and loss account	35	6,073	2,903
Perpetual securities	35	835	—
Shareholders' funds			
– equity		22,404	19,081
– non-equity	35	5,216	4,035
		358,534	309,305
Long-term assurance liabilities to policyholders		10,248	10,699
Total liabilities		368,782	320,004

	Note	31 December 2001 £m	31 December 2000 £m
Memorandum items			
Contingent liabilities	40	13,573	10,671
Commitments (standby facilities, credit lines and other)	40	125,271	94,431

The accounts were approved by the Board of directors on 27 February 2002 and signed on its behalf by:

Sir George Mathewson
Chairman

Fred Goodwin
Group Chief Executive

Fred Watt
Group Finance Director

Statement of consolidated total recognised gains and losses

for the year ended 31 December 2001

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Profit attributable to ordinary shareholders	1,868	1,847
Currency translation adjustments and other movements	(3)	26
Revaluation of premises	72	24
Total recognised gains and losses	**1,937**	1,897

Reconciliation of movements in consolidated shareholders' funds

for the year ended 31 December 2001

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Profit attributable to ordinary shareholders	1,868	1,847
Ordinary dividends	(1,085)	(882)
Retained profit for the period	783	965
Issue of ordinary and preference shares	2,759	18,032
Issue of perpetual regulatory securities	823	—
Redemption of preference shares	—	(300)
Other recognised gains and losses	69	50
Currency translation adjustments on share premium account and perpetual regulatory securities	55	184
Accrued interest on perpetual regulatory securities	15	—
Other movements	—	(17)
Net increase in shareholders' funds	4,504	18,914
Opening shareholders' funds	23,116	4,202
Closing shareholders' funds	**27,620**	23,116

Consolidated cash flow statement

for the year ended 31 December 2001

	Note	Year ended 31 December 2001 £m	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m	15 months ended 31 December 2000 £m
Net cash inflow from operating activities	42		**7,287**		11,328
Dividends received from associated undertakings			**1**		2
Returns on investments and servicing of finance					
Preference dividends paid		**(353)**		(256)	
Additional Value Shares dividend paid		**(399)**		—	
Perpetual regulatory securities interest paid		**(8)**		—	
Dividends paid to minority shareholders in subsidiary undertakings		**(43)**		(38)	
Interest paid on subordinated liabilities		**(644)**		(802)	
Net cash outflow from returns on investments and servicing of finance			**(1,447)**		(1,096)
Taxation					
UK tax paid		**(790)**		(515)	
Overseas tax paid		**(419)**		(212)	
Net cash outflow from taxation			**(1,209)**		(727)
Capital expenditure and financial investment					
Purchase of investment securities		**(27,537)**		(17,873)	
Sale and maturity of investment securities		**20,578**		12,672	
Purchase of tangible fixed assets		**(4,245)**		(1,356)	
Sale of tangible fixed assets		**867**		575	
Net cash outflow from capital expenditure and financial investment			**(10,337)**		(5,982)
Acquisitions and disposals					
Purchase of businesses and subsidiary undertakings (net of cash acquired)	43	**(1,614)**		(4,138)	
Investment in associated undertakings	18	**(47)**		(6)	
Sale of subsidiary and associated undertakings (net of cash sold)	44	**8**		1,224	
Net cash outflow from acquisitions and disposals			**(1,653)**		(2,920)
Ordinary equity dividends paid			**(653)**		(386)
Net cash (outflow)/inflow before financing			**(8,011)**		219
Financing					
Proceeds from issue of ordinary share capital		**2,131**		2,173	
Proceeds from issue of preference share capital		**281**		2,510	
Proceeds from issue of perpetual regulatory securities		**823**			
Redemption of preference share capital		**—**		(300)	
Issue of subordinated liabilities		**1,882**		294	
Repayment of subordinated liabilities		**(693)**		(146)	
(Decrease)/increase in minority interests		**(13)**		75	
Net cash inflow from financing			**4,411**		4,606
(Decrease)/increase in cash	47		**(3,600)**		4,825

Balance sheet – the company

at 31 December 2001

	Note	31 December 2001 £m	31 December 2000 £m
Fixed assets			
Investments:			
Shares in Group undertakings	19	**19,226**	14,816
Loans to Group undertakings	20	**1,341**	1,348
		20,567	16,164
Current assets			
Debtors:			
Due by subsidiary undertakings		**2,063**	1,415
Debtors and prepayments		**38**	108
		2,101	1,523
Creditors			
Amounts falling due within one year:			
Due to banks		**79**	77
Dated loan capital	31	**40**	—
Debt securities in issue		**1,555**	1,613
Other creditors		**172**	120
Proposed final dividend	8	**772**	629
		2,618	2,439
Net current liabilities		**(517)**	(916)
Total assets less current liabilities		**20,050**	15,248
Creditors			
Amounts falling due beyond one year:			
Loans from subsidiary undertakings		**491**	685
Dated loan capital	31	**598**	665
Undated loan capital including convertible debt	32	**625**	606
		1,714	1,956
Capital and reserves			
Called up share capital	34	**893**	848
Share premium account	35	**7,465**	6,530
Other reserves	35	**6**	6
Revaluation reserve	35	**4,707**	2,512
Profit and loss account	35	**4,430**	3,396
Perpetual securities	35	**835**	—
Shareholders' funds			
– equity		**13,120**	9,257
– non-equity	35	**5,216**	4,035
		20,050	15,248

The accounts were approved by the Board of directors on 27 February 2002 and signed on its behalf by:

Sir George Mathewson *Chairman*	Fred Goodwin *Group Chief Executive*	Fred Watt *Group Finance Director*

1 Dealing profits

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Foreign exchange (1)	**450**	404
Securities		
Equities (2)	**10**	68
Debt (3)	**682**	345
Interest rate derivatives (4)	**284**	186
	1,426	1,003

Dealing profits include interest income and expense recognised on trading-related interest-earning assets and interest-bearing liabilities.

Notes:

(1) Includes spot and forward foreign exchange contracts and currency swaps, futures and options and related hedges and funding.

(2) Includes equities, equity derivatives, commodity contracts and related hedges and funding.

(3) Includes debt securities and related hedges and funding.

(4) Includes interest rate swaps, forward rate agreements, interest rate options, interest rate futures and credit derivatives and related hedges and funding.

2 Administrative expenses – staff costs

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Wages and salaries	**3,006**	2,732
Social security costs	**212**	199
Pension costs (see Note 3)	**180**	144
Other staff costs	**661**	472
	4,059	3,547

The average number of persons employed by the Group during the year, excluding temporary staff, was 99,400 (15 months ended 31 December 2000 – 83,300).

3 Pension costs

The Group operates a number of pension schemes throughout the world. The main schemes are defined benefit schemes whose assets are independent of the Group's finances. The total pension cost for the Group was £180 million (15 months ended 31 December 2000 – £144 million). At 31 December 2001, there was a pension cost prepayment of £115 million and accrual of £33 million (31 December 2000 – prepayment of £90 million and accrual of £14 million).

There are two main UK pension schemes – The Royal Bank of Scotland Staff Pension Scheme and the National Westminster Bank Pension Fund. Scheme valuations are carried out by independent professionally qualified actuaries to determine pension costs, using the projected unit method; any imbalance between assets and liabilities is adjusted over the average future service life of members of the scheme. The assumptions that have the most significant effect on the results of the valuations are those relating to the valuation rate of interest and the rates of increases in salaries and pensions.

On the acquisition of NatWest in March 2000, a surplus of £1,070 million on its major schemes was recognised in the consolidated balance sheet, and is being amortised over the average future service life of members of the schemes. The unamortised balance as at 31 December 2001 was £920 million and is included in 'Other assets'.

3 Pension costs *(continued)*

The latest formal valuation of The Royal Bank of Scotland Staff Pension Scheme took place on 30 September 1999 and that for the National Westminster Bank Pension Fund on 31 March 2001. The results of these valuations, the principal actuarial assumptions and the pension costs relating to these schemes were:

	The Royal Bank of Scotland Staff Pension Scheme 30 September 1999	National Westminster Bank Pension Fund 31 March 2001
Market value of scheme assets (£m)	2,041	11,053
Funding level	119%	111%
Valuation rate of interest		
past service liabilities (per annum)	6.5%	5.5-6.0%
future service liabilities (per annum)	7.0%	6.75%
Salary growth (per annum) (1)	4.5%	4.25%
Pension increases (per annum)	2.5-2.75%	2.5%
Price inflation (per annum)	2.75%	2.5%

Notes:

(1) In addition, allowance is made for promotional salary increases.

(2) Assumptions for rate of dividend increases are not relevant to the bases of valuations adopted.

	The Royal Bank of Scotland Staff Pension Scheme		National Westminster Bank Pension Fund	
Pension costs for the period	**Year ended 31 December 2001 £m**	15 months ended 31 December 2000 £m	**Year ended 31 December 2001 £m**	6 March to 31 December 2000 £m
Regular cost	**66**	75	**140**	115
Variation	**(39)**	(45)	**(108)**	(95)
Prior year service costs	**—**	—	**14**	—
Amortisation of surplus recognised on acquisition of NatWest	**—**	—	**77**	63
Net pension cost	**27**	30	**123**	**83**

The Group also provides other post-retirement benefits, principally through subscriptions to private healthcare schemes in the UK and the US. Provision for the costs of these benefits is charged to the profit and loss account over the average remaining future service lives of the eligible employees.

In accordance with the transitional requirements of FRS 17 'Retirement Benefits' the full actuarial valuations of the Group's schemes were updated to 31 December 2001 by independent actuaries, using the following assumptions:

	Main UK schemes	**Other Group schemes***
Rate of increase in salaries (per annum)	**4.25%**	**3.2%**
Rate of increase in pensions in payment (per annum)	**2.5%**	**2.3%**
Discount rate (per annum)	**6.0%**	**6.1%**
Inflation assumption (per annum)	**2.5%**	**2.2%**

*weighted average

The values of the assets and liabilities of the schemes at 31 December 2001 were as follows:

	Main UK schemes £m	Other Group schemes £m
Equities	**7,899**	**717**
Bonds	**4,203**	**176**
Other	**465**	**167**
Total market value of assets	**12,567**	**1,060**
Present value of scheme liabilities	**(12,121)**	**(1,014)**
Net surplus in the schemes	**446**	**46**
Related notional deferred tax liability	**(133)**	**(10)**
Net unrecognised pension surplus	**313**	**36**
Prepayments less accruals currently recognised, net of deferred tax	**(53)**	**(5)**
Pension assets recognised on the acquisition of NatWest, net of deferred tax and amortisation	**(602)**	**(42)**
Effect on Group profit and loss account reserves	**(342)**	**(11)**

The assumptions for long-term rates of return on the principal classes of assets at 31 December 2001 were equities 8.4%, gilts 5.0%, other bonds 6.0%, property 6.8% and cash 4.5%.

4 Profit on disposal of businesses

During the 15 months ended 31 December 2000, an exceptional gain of £100 million (tax charge £31 million) was realised from the sale of the investor services business.

5 Profit on ordinary activities before tax

Group profit on ordinary activities before tax is stated after taking account of the following:

		Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Income	Aggregate amounts receivable under finance leases, hire purchase and conditional sale contracts	**1,575**	1,550
	Aggregate amounts receivable under operating leases	**707**	714
	Profit on disposals of investment securities, subsidiary and associated undertakings	**48**	345
	Share of associated undertakings' net (loss)/profit	**(6)**	1
Expenses	Operating lease rentals of premises	**214**	238
	Operating lease rentals of computers and other equipment	**18**	10
	Finance charges on leased assets	**40**	41
	Interest on subordinated liabilities	**651**	750
	Integration expenditure* relating to:		
	– acquisition of National Westminster Bank Plc	**847**	345
	– other acquisitions	**28**	56
	Goodwill amortisation	**651**	541

*Integration expenditure comprises:		
Staff costs	**598**	255
Premises and equipment	**64**	27
Other administrative expenses	**188**	107
Depreciation	**25**	12
	875	401

Auditors' remuneration

The auditors' remuneration for statutory audit work was £106,000 for the company (15 months ended 31 December 2000 – £100,000) and £5.4 million for the Group (15 months ended 31 December 2000 – £4.9 million). Fees paid to the auditors and their associates for non-audit work were £7.0 million for the Group (15 months ended 31 December 2000 – current auditors – £4.0 million; former auditors – £5.1 million) and comprised £2.3 million for management consultancy services and £4.7 million for regulatory, tax, attestation and other advisory services.

6 Tax on profit on ordinary activities

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Based on the profit for the period:		
UK corporation tax at 30% (15 months to 31 December 2000 – 30%)	984	782
Relief for overseas taxation	(98)	(38)
Deferred taxation	255	220
	1,141	964
Overseas taxation	381	191
	1,522	1,155
Share of associated undertakings	2	2
	1,524	1,157
Prior year items – UK	6	—
– Overseas	7	—
	1,537	1,157

The tax charge of £1,537 million, equivalent to 36% of profit before tax of £4,275 million, is higher than the standard UK corporation tax rate of 30% mainly due to goodwill amortisation, which is not allowable for UK tax.

7 Preference and other non-equity dividends and interest

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Non-cumulative preference shares of US$0.01	140	149
Non-cumulative convertible preference shares of US$0.01	115	76
Non-cumulative convertible preference shares of €0.01	32	25
Non-cumulative convertible preference shares of £0.25	49	66
Non-cumulative preference shares of £0.01	15	1
11% cumulative preference shares of £1 (1)	—	—
5.5% cumulative preference shares of £1 (2)	—	—
Appropriation for premium payable on redemption and issue costs	7	5
Total preference dividends	358	322
Perpetual regulatory securities interest	23	—
Additional Value Shares dividend	399	—
Total non-equity dividends and interest	780	322

Notes:

(1) Dividends for the year ended 31 December 2001 amounted to £55,000 (15 months ended 31 December 2000 – £82,500).

(2) Dividends for the year ended 31 December 2001 amounted to £22,000 (15 months ended 31 December 2000 – £33,000).

8 Ordinary dividends

	Year ended 31 December 2001 p per share	15 months ended 31 December 2000 p per share	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Interim – paid 12 October 2001	11.0	9.5	313	253
Proposed final	27.0	23.5	772	629
Total dividends on equity shares	38.0	33.0	1,085	882

9 Profit dealt with in the accounts of the company

Of the profit attributable to shareholders, £1,056 million (15 months ended 31 December 2000 – £4,723 million) has been dealt with in the accounts of the company.

10 Earnings per ordinary share

The earnings per share are based on the following:

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Earnings:		
Profit attributable to ordinary shareholders	**1,868**	1,847

	Number of shares – millions	
Number of ordinary shares:		
Weighted average number of ordinary shares in issue during the period	**2,762**	2,053
Effect of dilutive share options and convertible non-equity shares	**55**	26
Diluted weighted average number of ordinary shares in issue during the period	**2,817**	2,079

11 Treasury bills and other eligible bills

	31 December 2001 £m	31 December 2000 £m
Treasury bills and similar securities	**6,324**	1,308
Other eligible bills	**3,812**	2,008
	10,136	3,316
Banking business	**1,937**	479
Trading business	**8,199**	2,837
Amounts above include:		
Subject to sale and repurchase agreements	**1,353**	101

Treasury and other eligible bills are principally of short-term maturity and their market value is not materially different from carrying value.

12 Loans and advances to banks

	31 December 2001 £m	31 December 2000 £m
Repayable on demand	**3,934**	7,578
Remaining maturity		
– three months or less	**26,200**	17,167
– one year or less but over three months	**7,884**	6,671
– five years or less but over one year	**260**	390
– over five years	**243**	269
	38,521	32,075
Specific bad and doubtful debt provisions	**(8)**	(14)
	38,513	32,061
Banking business	**21,679**	20,014
Trading business	**16,834**	12,047
Amounts above include:		
Due from associated undertakings – unsubordinated	**3**	—

13 Loans and advances to customers

	31 December 2001 £m	31 December 2000 £m
On demand or short notice	**17,434**	18,141
Remaining maturity		
– three months or less	**33,774**	32,624
– one year or less but over three months	**25,279**	19,673
– five years or less but over one year	**46,054**	37,413
– over five years	**71,596**	63,364
	194,137	171,215
General and specific bad and doubtful debt provisions	**(3,645)**	(3,139)
	190,492	168,076
Banking business	**178,476**	154,454
Trading business	**12,016**	13,622
Amounts above include:		
Subordinated advances	**52**	—
Due from associated undertakings – unsubordinated	**164**	154
Amounts receivable under finance leases	**7,315**	7,010
Amounts receivable under hire purchase and conditional sale agreements	**3,678**	3,376

The cost of assets acquired during the year for the purpose of letting under finance leases and hire purchase agreements was £4,082 million (15 months ended 31 December 2000 – £3,770 million).

The Group's exposure to risk from its lending activities is widely diversified both geographically and industrially. With the exception of lending for house mortgage and other personal 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).

Residual value exposures The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (see above) and operating lease assets (see Note 22).

	Year in which the residual value will be recovered				
	Within one year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
Operating leases					
Transportation	**8**	**56**	**488**	**825**	**1,377**
Cars and light commercial vehicles	**212**	**98**	**103**	**—**	**413**
Other	**20**	**21**	**70**	**61**	**172**
Finance leases	**75**	**30**	**80**	**106**	**291**
At 31 December 2001	**315**	**205**	**741**	**992**	**2,253**
At 31 December 2000	326	179	611	1,139	2,255

14 Provisions for bad and doubtful debts

	Year ended 31 December 2001 Specific £m	General £m	Total £m	15 months ended 31 December 2000 Specific £m	General £m	Total £m
At beginning of period	2,585	568	3,153	567	170	737
Currency translation and other adjustments	14	3	17	48	(4)	44
Acquisition of businesses	221	33	254	1,997	393	2,390
Amounts written off	(835)	—	(835)	(824)	—	(824)
Recoveries of amounts written off in previous periods	80	—	80	177	—	177
Charge to profit and loss account	974	10	984	620	9	629
At 31 December	**3,039**	**614**	**3,653**	2,585	568	3,153

15 Interest in suspense

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

	31 December 2001 £m	31 December 2000 £m
Loans and advances on which interest is being placed in suspense:		
– before specific provisions	**1,550**	1,044
– after specific provisions	**816**	560
Loans and advances on which interest is not being applied:		
– before specific provisions	**2,386**	2,177
– after specific provisions	**828**	689

16 Debt securities

	31 December 2001 Book value £m	31 December 2001 Valuation £m	31 December 2000 Book value £m	31 December 2000 Valuation £m
Investment securities:				
British government	376	376	885	886
Other government	10,083	10,072	6,286	6,293
Other public sector bodies	673	697	847	860
Bank and building society	7,344	7,364	3,589	3,593
Other issuers	14,815	14,780	14,879	14,848
	33,291	33,289	26,486	26,480
Other debt securities:				
British government	1,229	1,229	1,398	1,398
Other government	6,089	6,089	13,617	13,617
Other public sector bodies	145	145	194	194
Bank and building society	3,600	3,600	4,947	4,947
Other issuers	19,686	19,686	11,147	11,147
	64,040	64,038	57,789	57,783
Due within one year	11,954		14,682	
Due one year and over	52,086		43,107	
	64,040		57,789	
Investment securities:				
Listed	25,816	25,828	16,847	16,876
Unlisted	7,475	7,461	9,639	9,604
	33,291	33,289	26,486	26,480
Other debt securities:				
Listed	13,580	13,580	9,885	9,885
Unlisted	17,169	17,169	21,418	21,418
	64,040	64,038	57,789	57,783
Banking business	34,372		27,546	
Trading business	29,668		30,243	
Amounts above include:				
Subordinated debt securities	263		416	
Due from associated undertakings – unsubordinated	28		—	
Unamortised discounts less premiums on investment securities	(2)		23	
Debt securities subject to sale and repurchase agreements	27,576		20,738	

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

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

	Cost £m	Discounts and premiums £m	Provisions £m	Book value £m
At 1 January 2001	26,597	(97)	(14)	26,486
Currency translation and other adjustments	114	—	(2)	112
Additions	27,107	65	—	27,172
Maturities and disposals	(20,349)	54	1	(20,294)
Amounts written off	(2)	—	2	—
Transfers	(153)	—	—	(153)
Amortisation of discounts and premiums	—	(32)	—	(32)
At 31 December 2001	33,314	(10)	(13)	33,291

17 Equity shares

	31 December 2001 Book value £m	31 December 2001 Valuation £m	31 December 2000 Book value £m	31 December 2000 Valuation £m
Investment securities:				
Listed	**1,096**	**1,350**	1,084	1,691
Unlisted	**432**	**442**	353	403
	1,528	**1,792**	1,437	2,094
Other securities:				
Listed	**9**	**9**	116	116
Unlisted	**20**	**20**	—	—
	1,557	**1,821**	1,553	2,210
Banking business	**1,545**		1,547	
Trading business	**12**		6	

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

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

	Cost £m	Provisions £m	Book value £m
At 1 January 2001	1,506	(69)	1,437
Currency translation and other adjustments	(3)	(3)	(6)
Additions	365	—	365
Disposals	(237)	1	(236)
Provisions made net of write backs	—	(7)	(7)
Transfers	(90)	65	(25)
At 31 December 2001	**1,541**	**(13)**	**1,528**

18 Interests in associated undertakings

Movements in interests in associated undertakings during the year were as follows:

	Share of net assets £m
At 1 January 2001	83
Currency translation adjustments	(5)
Additions	47
Disposals	(8)
Share of losses	(9)
At 31 December 2001	**108**

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

	31 December 2001 £m	31 December 2000 £m
Cost	**185**	147
Provisions	**(85)**	(66)
At 31 December	**100**	81

Interests in associated undertakings are analysed as follows:

	31 December 2001 £m	31 December 2000 £m
Banks – unlisted	**20**	18
Others	**88**	65
	108	83

18 Interests in associated undertakings *(continued)*

The principal associated undertakings are:

	Total issued share and loan capital at 31 December 2001	% held	Share of results based on accounts made up to	Nature of business
Banco Santander, Portugal S.A. (incorporated in Portugal)	31.1m ordinary shares of Esc 1,000 Esc 17.5m loan capital	12.8	31 December*	Banking
Linea Directa Aseguradora S.A. (incorporated in Spain)	2,400m 5 Ptas ordinary shares	50.0	31 December*	Insurance

*Incorporating unaudited interim accounts.

Banco Santander, Portugal S.A. operates in Portugal and Linea Directa Aseguradora S.A. operates in Spain. Dividends receivable from associated undertakings (excluding related tax credits) totalled £1 million (15 months ended 31 December 2000 – £2 million).

Associated undertakings are accounted for as such due to the Group's interest being held on a long-term basis for the purpose of securing a contribution to its activities by the exercise of influence.

19 Shares in Group undertakings

Movements in shares in Group undertakings during the year were as follows:

	£m
At 1 January 2001	14,816
Currency translation adjustments	72
Additions	4,185
Capital repayment	(2,042)
Increase in net assets of subsidiary undertakings	2,195
At 31 December 2001	**19,226**

On the historical cost basis, shares in Group undertakings at 31 December 2001 would have been included at a cost of £14,521 million (31 December 2000 – £12,306 million).

The principal subsidiary undertakings of the company are shown below. Their capital consists of ordinary and preference shares which are unlisted with the exception of certain preference shares issued by National Westminster Bank Plc. RBS, NatWest and RBS Life Holdings are directly owned by the company, and all of the other subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, by RBS or by NatWest, and are all wholly-owned. All of these subsidiaries are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operation
The Royal Bank of Scotland plc	Banking	Great Britain
Citizens Financial Group, Inc.	Banking	USA
Direct Line Insurance plc	Insurance	Great Britain
The Royal Bank of Scotland International Limited	Banking	Jersey
National Westminster Bank Plc (1)	Banking	Great Britain
Coutts & Co (2)	Private banking	Great Britain
Coutts Bank (Switzerland) Limited	Private banking	Switzerland
Greenwich Capital Markets Inc	Broker dealer	USA
Lombard North Central PLC	Banking, credit finance, leasing and hire purchase	Great Britain
National Westminster Home Loans Limited	Home mortgage finance	Great Britain
Ulster Bank Limited (3)	Banking	Northern Ireland
RBS Life Holdings Limited	Life assurance	Great Britain

Notes:

(1) The company does not hold any of the NatWest preference shares in issue.

(2) Coutts & Co is incorporated with unlimited liability.

(3) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

20 Loans to subsidiary undertakings

Movements during the year:	£m
At 1 January 2001	1,348
Currency translation adjustments	32
Additions and other movements	1
Repayments	(40)
At 31 December 2001	**1,341**

21 Intangible fixed assets

Goodwill	£m
Cost:	
At 1 January 2001	12,622
Currency translation and other adjustments	4
Arising on acquisitions during the year	1,802
Additional goodwill relating to the acquisition of NatWest	93
Disposals	(8)
At 31 December 2001	**14,513**
Amortisation:	
At 1 January 2001	542
Currency translation and other adjustments	3
Charge for the year	651
Disposals	(8)
At 31 December 2001	**1,188**
Net book value at 31 December 2001	**13,325**
Net book value at 31 December 2000	12,080

22 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 1 January 2001	2,176	287	463	3,128	3,567	9,621
Currency translation and other adjustments	3	—	1	4	2	10
Final fair value adjustments on the acquisition of NatWest	(24)	10	(6)	(10)	—	(30)
Reclassifications	196	28	127	(365)	14	—
Acquisition of subsidiaries	43	—	22	33	—	98
Additions	1,603	35	199	409	1,999	4,245
Disposals and write-off of fully depreciated assets	(362)	(40)	(125)	(483)	(847)	(1,857)
Revaluation adjustments	35	37	—	—	—	72
At 31 December 2001	**3,670**	**357**	**681**	**2,716**	**4,735**	**12,159**
Consisting of:						
At valuation – 2001	642	134	—	—	—	776
At valuation – 2000 and prior	440	91	—	—	—	531
At cost	2,588	132	681	2,716	4,735	10,852
	3,670	**357**	**681**	**2,716**	**4,735**	**12,159**
Accumulated depreciation and amortisation:						
At 1 January 2001	408	91	237	1,959	805	3,500
Currency translation and other adjustments	—	—	1	3	—	4
Final fair value adjustments on the acquisition of NatWest	—	—	—	(6)	—	(6)
Reclassifications	80	14	52	(156)	10	—
Acquisition of subsidiaries	—	—	—	12	—	12
Disposals and write-off of fully depreciated assets	(268)	(39)	(103)	(430)	(205)	(1,045)
Charge for the year	47	21	35	336	442	881
At 31 December 2001	**267**	**87**	**222**	**1,718**	**1,052**	**3,346**
Net book value at 31 December 2001	**3,403**	**270**	**459**	**998**	**3,683**	**8,813**
Net book value at 31 December 2000	1,768	196	226	1,169	2,762	6,121

On the historical cost basis, the Group's freehold and long leasehold premises would have been included at £3,368 million (31 December 2000 – £1,726 million).

Freehold and long leasehold properties are revalued on a rolling basis, each property being valued at least every five years. Interim valuations outwith the 5 year cycle will be carried out on properties where there is an indication that their value has changed significantly, given market conditions. The directors are not aware of any material change in the valuation of the Group's properties and therefore no additional interim valuations were required.

Properties occupied by the Group are valued on the basis of Existing Use Value, except for certain specialised properties which are valued on a Depreciated Replacement Cost basis. Investment and development properties and properties to be disposed of are valued to reflect Open Market Value.Valuations are carried out by internal and external qualified surveyors who are members of the Royal Institution of Chartered Surveyors or, in the case of some overseas properties, locally qualified valuers.

	31 December 2001 £m	31 December 2000 £m
Land and buildings occupied for own use	**2,313**	2,027
Investment properties	**1,731**	36
Properties under development	**71**	90
Properties to be disposed of	**17**	37
Net book value at 31 December	**4,132**	2,190
Net book value of assets held under finance leases	**25**	28
Depreciation for the period of assets held under finance leases	**2**	2
Contracts not provided for in the accounts at period end	**47**	85

23 Other assets

	31 December 2001 £m	31 December 2000 £m
Trading derivatives (Note 38)	**10,850**	10,299
Settlement balances	**5,804**	1,617
Other	**4,819**	6,118
	21,473	18,034

24 Long-term assurance business

The long-term assurance assets and liabilities attributable to policyholders comprise:

	31 December 2001 £m	31 December 2000 £m
Investments	**10,652**	10,992
Value of in-force policies	**388**	402
Computers and other equipment	**—**	6
Net current assets	**—**	4
	11,040	11,404
Long-term assurance business attributable to shareholders*	**(792)**	(705)
	10,248	10,699

The increase in the shareholders' interest in the long-term assurance business included in the profit and loss account is calculated as follows:

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Increase in value for the period before tax	**55**	34
Tax	**(17)**	(10)
Increase in value for the period after tax	**38**	24

*The value of the long-term assurance business is calculated by discounting estimated future flows of statutory profits from in-force business at a discount rate that includes a risk margin. The future flows are based on prudent assumptions about long-term economic and business experience determined with the advice of qualified actuaries. The risk margin is designed to reflect uncertainties in expected future flows.

The key assumptions used are:

	31 December 2001 %	31 December 2000 %
Risk discount rate (net of tax)	**10.00**	10.00
Growth of unit-linked funds (gross of tax)	**7.25**	7.25
Growth of non-unit-linked funds (gross of tax)	**5.50**	6.00
Basic tax rate	**22.00**	22.00
Shareholder taxation – life	**30.00**	29.00
Expense inflation	**3.75**	3.75

25 Deposits by banks

	31 December 2001 £m	31 December 2000 £m
Repayable on demand	**7,259**	12,455
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**25,560**	19,985
– one year or less but over three months	**4,137**	1,912
– five years or less but over one year	**1,132**	447
– over five years	**1,950**	331
	40,038	35,130
Banking business	**28,884**	27,749
Trading business	**11,154**	7,381

26 Customer accounts

	31 December 2001 £m	31 December 2000 £m
Repayable on demand	**115,054**	96,837
With agreed maturity dates or periods of notice, by remaining maturity		
– three months or less	**70,479**	69,300
– one year or less but over three months	**8,057**	6,404
– five years or less but over one year	**4,062**	2,771
– over five years	**1,343**	1,990
	198,995	177,302
Banking business	**183,058**	159,595
Trading business	**15,937**	17,707
Amounts above include:		
Due to associated undertakings	**4**	28

27 Debt securities in issue

	31 December 2001 £m	31 December 2000 £m
Bonds and medium term notes, by remaining maturity		
– one year or less	**3,136**	2,224
– two years or less but over one year	**1,582**	483
– five years or less but over two years	**3,128**	3,949
– over five years	**1,249**	1,149
	9,095	7,805
Other debt securities in issue, by remaining maturity		
– three months or less	**12,368**	9,021
– one year or less but over three months	**9,196**	2,517
– two years or less but over one year	**10**	54
– five years or less but over two years	**—**	10
	21,574	11,602
	30,669	19,407
Banking business	**30,669**	19,407

Issues are made under the Bank's £7.0 billion euro medium term note programme from time to time. Notes issued, which have a minimum maturity of six months from the date of issue, are included in the above amounts.

28 Other liabilities

	31 December 2001 £m	31 December 2000 £m
Notes in circulation	**1,405**	1,369
Trading derivatives (Note 38)	**11,075**	12,269
Settlement balances	**6,010**	2,398
Short positions:		
Debt securities – Government	**12,207**	10,640
– Other issuers	**2,415**	2,161
Current taxation	**912**	934
Dividends	**831**	675
Obligations under finance leases (analysed below)	**205**	335
Other liabilities	**2,297**	2,178
	37,357	32,959

Analysis of obligations under finances leases:	31 December 2001 £m	31 December 2000 £m
Amounts falling due within one year	**43**	156
Amounts falling due between one and five years	**38**	58
Amounts falling due after more than five years	**124**	121
	205	335

29 Deferred taxation

Provision for deferred taxation has been made at 30% (31 December 2000 – 30%) being the anticipated rate of UK corporation tax when the liability is expected to crystallise.

	31 December 2001 £m	31 December 2000 £m
Short-term timing differences	**(107)**	(66)
Capital allowances	**1,522**	1,234
Deferred gains	**41**	56
	1,456	1,224

Movements during the year:	£m
At 1 January 2001	1,224
Currency translation and other adjustments	(7)
Acquisition of subsidiaries	(15)
Charge to profit and loss account	254
At 31 December 2001	**1,456**

No provision has been made for the following potential amounts of deferred taxation:

	31 December 2001 £m	31 December 2000 £m
Short-term timing differences	**—**	4
Capital allowances	**272**	259
	272	263

Provision is also not made for any liability which might arise in the event of:

(i) Group undertakings and properties being realised at balance sheet values. Most of these assets are expected to be retained for the long term. In view of the large number of properties involved and rules relating to roll-over relief, it is considered that no useful purpose would be served by quantifying the potential amounts involved.

(ii) The reserves of overseas subsidiary and associated undertakings being remitted. A substantial proportion of such reserves are required to be retained by the overseas undertakings to meet local regulatory requirements.

30 Other provisions

	Property(1) £m	Pensions and other similar obligations(2) £m	Other(3) £m	Total £m
At 1 January 2001	215	34	57	306
Currency translation and other adjustments	3	—	2	5
Charge to profit and loss account	42	4	21	67
Provisions utilised	(27)	(2)	(8)	(37)
At 31 December 2001	**233**	**36**	**72**	**341**

Notes:

(1) The Group has a number of leasehold properties where rents payable and other unavoidable costs exceed the value to the Group. This provision has been discounted due to the long-term nature of certain of these obligations.

(2) The Group operates various unfunded post-retirement benefit plans and provision is made for the expected costs.

(3) Other provisions arise in the normal course of business.

31 Dated loan capital

	31 December 2001 £m	31 December 2000 £m
The company		
£200 million floating rate (minimum 5.25%) notes 2005 (1,2)	160	200
US$400 million 6.4% subordinated notes 2009 (1)	274	267
US$300 million 6.375% subordinated notes 2011 (1)	204	198
	638	665
The Royal Bank of Scotland plc		
£125 million subordinated floating rate notes 2005 (3)	125	125
£150 million 8.375% subordinated notes 2007	149	149
DEM500 million 5.25% subordinated notes 2008	155	158
€300 million 4.875% subordinated notes 2009	182	186
US$150 million floating rate notes 2009 (3)	103	100
£35 million floating rate step-up subordinated notes 2010	35	35
£150 million 10.5% subordinated bonds 2013 (4)	149	149
€1,000 million 6.0% fixed rate subordinated notes 2013 (issued May 2001) (5)	604	—
€500 million 6.0% fixed rate subordinated notes 2013 (issued October 2001) (6)	315	—
US$50 million floating rate subordinated notes 2013 (issued October 2001) (7)	35	—
£250 million 9.625% subordinated bonds 2015	247	246
US$125.6 million floating rate subordinated notes 2020	87	84
RBSG Capital Corporation		
US$250 million 10.125% guaranteed capital notes 2004 (1,4)	172	167
National Westminster Bank Plc		
£100 million 11.75% subordinated notes 2001 (8)	—	102
US$750 million 9.45% subordinated notes 2001 (8)	—	506
US$250 million guaranteed floating rate subordinated notes 2002	172	168
US$500 million 9.375% guaranteed capital notes 2003 (9)	355	350
£100 million 12.5% subordinated unsecured loan stock 2004	112	116
US$400 million guaranteed floating rate capital notes 2005	274	265
US$1,000 million 7.375% subordinated notes 2009	678	656
US$650 million floating rate subordinated step-up notes 2009 (callable October 2004)	450	437
€600 million 6.0% subordinated notes 2010	361	367
£300 million 8.125% step-up subordinated notes 2011 (callable December 2006)	307	308
€500 million 5.125% subordinated notes 2011	285	286
£300 million 7.875% subordinated notes 2015	321	327
£300 million 6.5% subordinated notes 2021	298	299
Greenwich Capital Holdings Inc.		
US$100 million subordinated loan capital 2001 floating rate notes (10)	—	65
US$105 million subordinated loan capital 2004 floating rate notes (issued April 2001) (11)	72	—
	6,681	6,316

	31 December 2001 £m	31 December 2000 £m
Dated loan capital in issue, by remaining maturity, repayable		
– in one year or less	212	713
– in two years or less but over one year	395	208
– in five years or less but over two years	1,592	1,580
– in more than five years	4,482	3,815
	6,681	6,316

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis.

(2) Repayable in five equal annual instalments in May in each of the years 2001 to 2005.

(3) Repayable in whole, at the option of The Royal Bank of Scotland plc, prior to maturity, on conditions governing the respective debt obligation, including prior approval of the UK Financial Services Authority.

(4) Unconditionally guaranteed by the company.

(5) Net proceeds received €988 million, £613 million.

(6) Net proceeds received €515 million, £323 million.

(7) Net proceeds received US$50 million, £35 million.

(8) Redeemed on maturity in May 2001.

(9) Loan due by a subsidiary undertaking and on-lent to National Westminster Bank Plc on a subordinated basis. It has been guaranteed as to the payment of principal and interest by National Westminster Bank Plc.

(10) Redeemed on maturity in April 2001.

(11) Net proceeds received US$105 million, £73 million.

(12) In the event of certain changes in the tax laws of the UK, all of the dated loan capital issues are redeemable in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior approval of the UK Financial Services Authority.

(13) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.

(14) Interest payable on Group floating rate dated issues is at a margin over London interbank rates. Interest on £1,450 million, US$2,450 million, €1,900 million and DEM500 million of fixed rate dated issues is swapped into floating rates at a margin over London interbank rates.

32 Undated loan capital including convertible debt

	31 December 2001 £m	31 December 2000 £m
The company		
US$350 million undated floating rate primary capital notes (callable on any interest payment date) (1,2)	**241**	235
US$200 million 8.5% exchangeable capital securities, Series A (callable June 2004) (1,3)	**137**	132
US$50 million undated 7.993% capital securities (callable November 2005) (1)	**34**	33
US$35 million undated 7.755% capital securities (callable December 2005) (1)	**24**	23
US$200 million undated 7.375% reset capital securities (callable April 2006) (1)	**137**	133
US$75 million floating rate perpetual capital securities (callable September 2007) (1)	**52**	50
	625	606
The Royal Bank of Scotland plc		
£125 million 9.25% undated subordinated step-up notes (callable April 2006)	**124**	124
£150 million undated subordinated floating rate step-up notes (callable March 2007)	**149**	149
FRF1,000 million 5.875% undated subordinated notes (callable October 2008)	**92**	94
£175 million 7.375% undated subordinated notes (callable August 2010)	**173**	173
£350 million 6.25% undated subordinated notes (issued November 2001; callable December 2012) (4)	**348**	—
£200 million 9.5% undated subordinated bonds (callable August 2018) (5)	**197**	196
£350 million 5.625% undated subordinated notes (issued November 2001; callable June 2032) (6)	**346**	—
£150 million 5.625% undated subordinated notes (issued December 2001; callable June 2032) (7)	**144**	—
National Westminster Bank Plc		
US$500 million primary capital floating rate notes, Series A (callable on any interest payment date)	**345**	335
US$500 million primary capital floating rate notes, Series B (callable on any interest payment date)	**345**	335
US$500 million primary capital floating rate notes, Series C (callable on any interest payment date)	**345**	335
US$500 million 7.875% exchangeable capital securities (callable November 2003) (8)	**329**	305
US$500 million 7.75% reset subordinated notes (callable October 2007)	**336**	326
€100 million floating rate undated subordinated step-up notes (callable October 2009)	**61**	62
€400 million 6.625% fixed/floating rate undated subordinated notes (callable October 2009)	**241**	246
£325 million 7.625% undated subordinated step-up notes (callable January 2010)	**331**	332
£200 million 7.125% undated subordinated step-up notes (callable October 2022)	**203**	203
£200 million 11.5% undated subordinated notes (callable December 2022) (9)	**295**	299
	5,029	4,120

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis.

(2) Interest is payable at a rate of 0.25% per annum over an average calculated by reference to six month euro dollar deposits in London for each interest period.

(3) Redeemable in certain circumstances related to changes in the tax laws of the UK, in whole or in part, at the option of the company on any interest payment date. Exchangeable, in whole or in part, at the option of the company on any interest payment date, or in certain circumstances related to changes in the tax laws of the UK, in whole but not in part, into the company's non-cumulative preference shares of US$0.01 each.

(4) Net proceeds received £348 million.

(5) Guaranteed by the company.

(6) Net proceeds received £346 million.

(7) Net proceeds received £144 million.

(8) Exchangeable at the option of the issuer into 20 million 8.75% (gross) non-cumulative preference shares of US$25 each of National Westminster Bank Plc at any time.

(9) Exchangeable at the option of the issuer into 200 million 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.

(10) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.

(11) Except as stated above, interest payable on Group floating rate undated issues is at a margin over London interbank rates. Interest on £1,875 million, US$985 million, €400 million and FRF1,000 million of fixed rate undated issues is swapped into floating rates at a margin over London interbank rates.

(12) Where the issuer has the ability to redeem the undated loan capital, this is subject to prior approval of the UK Financial Services Authority.

33 Minority interests – non-equity

	31 December 2001 £m	31 December 2000 £m
Non-equity shares issued by NatWest:		
Non-cumulative preference shares of US$25 (1)	**355**	337
Non-cumulative preference shares of £1 (2)	**166**	166
	521	503
Other non-equity minority interests	**59**	77
Total	**580**	580

Notes:

(1) The US$250 million non-cumulative preference shares, Series B, of US$25 each which carry a gross dividend of 8.75% inclusive of associated tax credit, are redeemable at the option of NatWest exercisable to 9 June 2003, at a premium per share of US$0.30. There is no redemption premium if the date of redemption falls after 9 June 2003.

The US$300 million non-cumulative preference shares, Series C, of US$25 each carry a gross dividend of 8.625% inclusive of associated tax credit. They are redeemable at the option of NatWest from 9 April 2002 to 8 April 2008 inclusive, at a premium per share of US$1.50 in 2002 reducing by US$0.30 in each successive year. There is no redemption premium if the date of redemption falls after 8 April 2007.

(2) The £140 million 9% non-cumulative preference shares, Series A, of £1 each are non-redeemable.

(3) Minority interests in the consolidated profit and loss account includes £50 million (15 months ended 31 December 2000 – £41 million) in respect of non-equity interests.

34 Share capital

	Allotted, called up and fully paid 1 January 2001 £m	Issued during the year £m	31 December 2001 £m	Authorised 31 December 2001 £m	31 December 2000 £m
Equity shares					
Ordinary shares of 25p	669	45	**714**	**1,020**	1,020
Non-voting deferred shares of £0.01	—	—	**—**	**323**	323
Total equity share capital	669	45	**714**	**1,343**	1,343
Non-equity shares					
Additional Value Shares of £0.01	27	—	**27**	**27**	27
Non-cumulative preference shares of US$0.01	1	—	**1**	**2**	2
Non-cumulative convertible preference shares of US$0.01	—	—	**—**	**—**	—
Non-cumulative preference shares of €0.01	—	—	**—**	**—**	—
Non-cumulative convertible preference shares of €0.01	—	—	**—**	**—**	—
Non-cumulative convertible preference shares of £0.25	150	—	**150**	**225**	225
Non-cumulative convertible preference shares of £0.01	—	—	**—**	**—**	—
Cumulative preference shares of £1	1	—	**1**	**1**	1
Non-cumulative preference shares of £1	—	—	**—**	**300**	300
Total non-equity share capital	179	—	**179**	**555**	555
Total share capital	848	45	**893**	**1,898**	1,898

Number of shares – thousands	Allotted, called up and fully paid 31 December 2001	31 December 2000	Authorised 31 December 2001	31 December 2000
Equity shares				
Ordinary shares of 25p	**2,859,520**	2,678,273	**4,079,375**	4,079,375
Non-voting deferred shares of £0.01	**—**	—	**32,300,000**	32,300,000
Non-equity shares				
Additional Value Shares of £0.01	**2,660,556**	2,660,556	**2,700,000**	2,700,000
Non-cumulative preference shares of US$0.01	**106,000**	90,000	**238,500**	238,500
Non-cumulative convertible preference shares of US$0.01	**1,900**	1,900	**3,900**	2,000
Non-cumulative preference shares of €0.01	**—**	—	**66,000**	66,000
Non-cumulative convertible preference shares of €0.01	**750**	750	**3,000**	2,000
Non-cumulative convertible preference shares of £0.25	**600,000**	600,000	**900,000**	900,000
Non-cumulative convertible preference shares of £0.01	**200**	200	**1,000**	500
Cumulative preference shares of £1	**900**	900	**900**	900
Non-cumulative preference shares of £1	**—**	—	**300,000**	300,000

Ordinary shares In July 2001, in order to finance the Mellon acquisition, 140 million ordinary shares were allotted in exchange for 100% of the equity and preference share capital of a newly formed subsidiary company and placed in the market at a price of £14.75. The proceeds of the placing, totalling £2,065 million before expenses of £23 million, were paid to the company by way of redemption of the subsidiary company's preference shares. The closing market price of the company's ordinary shares on the day of the placing was £15.09.

In addition, the following issues of ordinary shares were made during the year to 31 December 2001:

(a) 7 million ordinary shares following the exercise of options under the company's executive, sharesave and option 2000 schemes and a further 11.7 million ordinary shares in respect of the exercise of options under the NatWest executive and sharesave schemes which had been exchanged for options over the company's shares following the acquisition of NatWest;

(b) 19 million ordinary shares in lieu of cash in respect of the final dividend for the 15 months ended 31 December 2000 and the interim dividend for the year ended 31 December 2001; and

(c) 3.6 million ordinary shares under the company's profit sharing (share ownership) scheme.

The total consideration for ordinary shares issued during the year amounted to £2,641 million.

During the year to 31 December 2001, options were granted over 24.9 million ordinary shares under the company's executive, sharesave and option 2000 schemes. At 31 December 2001, options granted under the company's various schemes, exercisable up to 2011 at prices ranging from 246p to 1718p per share, were outstanding in respect of 65.5 million ordinary shares. In addition, options granted under the NatWest schemes were outstanding in respect of 24.7 million ordinary shares exercisable up to 2009 at prices ranging from 318p to 924p per share. The Group has taken advantage of the exemption in UITF 17 'Employee share schemes' applicable to SAYE schemes, and accordingly no cost has been recognised on the grant of sharesave options.

Additional Value Shares Approximately 2.7 billion Additional Value Shares ("AVS") with a total nominal value of £27 million were issued to shareholders by way of a bonus issue in July 2000 in connection with the acquisition of NatWest.

Each AVS is expected to attract dividends, at the discretion of the directors, in aggregate of £1 per share. A dividend of 15 pence per AVS was paid on 3 December 2001 and future dividends, if declared, are due to be paid as follows: 30 pence per AVS on 1 December 2002 and 55 pence per AVS on 1 December 2003.

If on or before 1 December 2003 aggregate dividends of £1 per AVS have not been paid, the AVS will convert into ordinary shares and reasonable efforts will be made to procure bids so as to result in the proceeds from the sale of which ordinary shares to bring the amount per AVS equal to £1 less the aggregate amount of any dividend paid in respect of each AVS.

Preference shares In June 2001, the company issued 16 million Series K non-cumulative preference shares of US$0.01 each at US$25 per share, the net proceeds being US$387 million.

In January 2002, the company redeemed the 600 million non-cumulative convertible preference shares of £0.25 each at £1 per share, at a total cost of £600 million.

34 Share capital *(continued)*

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

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

Class of preference share	Series	Number of shares in issue	Redemption date on or after	Redemption price per share
Non-cumulative preference shares of US$0.01	Series B	8 million	23 August 2001	US$25.00
	Series C	16 million	27 August 2001 and	
			prior to 27 August 2002	US$25.23
			27 August 2002	US$25.00
	Series D	7 million	14 September 2005	US$25.00
	Series E	8 million	17 October 2006	US$25.00
	Series F	8 million	31 March 2007	US$25.00
	Series G	10 million	31 March 2003	US$25.00
	Series H	12 million	31 March 2004	US$25.00
	Series I	12 million	30 September 2004	US$25.00
	Series J	9 million	31 December 2004	US$25.00
	Series K	16 million	30 June 2006	US$25.00
Non-cumulative convertible preference shares of US$0.01	Series 1	1 million	31 March 2010	US$1,000
	Series 2	0.5 million	31 March 2005	US$1,000
	Series 3	0.4 million	31 December 2005	US$1,000
Non-cumulative convertible preference shares of €0.01	Series 1	0.75 million	31 March 2005	€1,000
Non-cumulative convertible preference shares of £0.01	Series 1	0.2 million	31 December 2010	£1,000

In the event that the non-cumulative convertible preference shares are not redeemed on or before the redemption date, the holder may convert the non-cumulative convertible preference shares into ordinary shares in the company.

Under existing arrangements, no redemption or purchase of any non-cumulative preference shares may be made by the company without the prior consent of the UK Financial Services Authority.

On a winding-up or liquidation of the company, the holders of the non-cumulative preference shares will be entitled to receive, out of 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 preference shares as regards participation in the surplus assets of the company, a liquidation distribution of US$25 per non-cumulative preference share of US$0.01, US$1,000 per non-cumulative convertible preference share of US$0.01, €1,000 per non-cumulative convertible preference share of €0.01 and £1,000 per non-cumulative convertible preference share of £0.01, together with an amount equal to dividends for the then current dividend period accrued to the date of payment, before any distribution or payment may be made to holders of the ordinary shares as regards participation in the surplus assets of the company.

Except as described above, the holders of the non-cumulative preference shares have no right to participate in the surplus assets of the company.

Holders of the non-cumulative preference shares are not entitled to receive notice of or attend general meetings of the company except if any resolution is proposed for adoption by the shareholders of the company to vary or abrogate any of the rights attaching to the non-cumulative preference shares or proposing the winding-up or liquidation of the company. In any such case, they are entitled to receive notice of and to attend the general meeting of shareholders at which such resolution is to be proposed and will be entitled to speak and vote on such resolution (but not on any other resolution). In addition, in the event that, prior to any general meeting of shareholders, the company has failed to pay in full the three most recent quarterly dividend payments due on the non-cumulative dollar preference shares, the two most recent semi-annual dividend payments due on the non-cumulative convertible dollar preference shares and the most recent annual dividend payments due on the non-cumulative convertible euro preference shares and on the non-cumulative convertible sterling preference shares, the holders shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters together with the holders of the ordinary shares, and in these circumstances only, the rights of the holders of the non-cumulative preference shares so to vote shall continue until the company shall have resumed the payment in full of the dividends in arrears.

35 Reserves

	The Group £m	The Company £m
Share premium account		
At 1 January 2001	6,530	6,530
Currency translation adjustments	58	58
Shares issued during the year	870	870
Other movements	7	7
At 31 December 2001	**7,465**	**7,465**
Merger reserve		
At 1 January 2001	12,604	—
Shares issued to finance the Mellon acquisition	2,007	2,007
Transfer to profit and loss account	(2,582)	(2,007)
At 31 December 2001	**12,029**	**—**
Other reserves		
At 1 January 2001	191	6
Transfer of increase in value of long-term life assurance business	17	—
Other movements	4	—
At 31 December 2001	**212**	**6**
Revaluation reserve		
At 1 January 2001	40	2,512
Revaluation of interests in subsidiary undertakings	—	2,195
Revaluation of premises	72	—
Transfer from profit and loss account	1	—
At 31 December 2001	**113**	**4,707**
Profit and loss account		
At 1 January 2001	2,903	3,396
Currency translation adjustments and other movements	(14)	(1)
Retention for the year	783	(809)
Employee share option payments	(163)	(163)
Transfer from merger reserve	2,582	2,007
Transfer of increase in value of long-term life assurance business	(17)	—
Transfer to revaluation reserve	(1)	—
At 31 December 2001	**6,073**	**4,430**

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 £1,140 million at 31 December 2001 and 31 December 2000.

In 1997, the Group established a Qualifying Employee Share Ownership Trust ('QUEST') for the purposes of delivering shares on the exercise of options under the sharesave scheme. During the year ended 31 December 2001, the Group received £221 million (15 months ended 31 December 2000 – £225 million) on the issue of 13.5 million shares (15 months ended 31 December 2000 – 19.8 million shares) in respect of options under the sharesave scheme. Employees paid £58 million (15 months ended 31 December 2000 – £64 million) to the Group for the issue of these shares. A transfer of £163 million (15 months ended 31 December 2000 – £161 million) has been made from the profit and loss account reserves to the share premium account in respect of this transaction.

At 31 December 2001, 816,254 shares were held by the QUEST and are included in Other assets at an amount which reflects the share price of the options that the shares are expected to be used to satisfy.

Exchange losses of £27 million (15 months ended 31 December 2000 – losses £123 million) arising on foreign currency borrowings have been offset in the Group's profit and loss account reserves against differences on retranslating the net investment in overseas subsidiary and associated undertakings financed by these borrowings.

The tax effect of gains and losses taken directly to reserves was £1 million charge (15 months ended 31 December 2000 – £2 million charge).

35 Reserves *(continued)*

Perpetual regulatory tier one securities ("PROs") In August 2001, the company issued 1.2 million Series 1 PROs at US$1,000 per security, the net proceeds being US$1,188 million. These securities are classified as non-equity shareholders' funds.

The PROs have no maturity date and are not redeemable at the option of the holders at any time. The company has the option to redeem the securities on or after 30 September 2031 or on any interest payment date thereafter or at any time on the occurrence of certain events. No redemption of the PROs may be made by the company without the prior consent of the UK Financial Services Authority.

Interest on the PROs is payable semi-annually in arrears at a fixed rate of 7.648% per annum until 30 September 2031 and thereafter quarterly in arrears at a variable rate of 2.5% per annum above three month dollar LIBOR. The company can satisfy interest payment obligations by issuing ordinary shares to appointed Trustees sufficient to enable them, on selling these shares, to settle the interest payment.

Movements in perpetual securities during the year were as follows:

	The Group £m	The Company £m
Perpetual regulatory securities issued during the year	823	823
Currency translation adjustments	(3)	(3)
Accrued interest	15	15
At 31 December 2001	**835**	**835**

Non-equity shareholders' funds comprise:

	31 December 2001 £m	31 December 2000 £m
Non-cumulative preference shares of US$0.01	**1,805**	1,492
Non-cumulative convertible preference shares of US$0.01	**1,298**	1,257
Non-cumulative convertible preference shares of €0.01	**455**	463
Non-cumulative convertible preference shares of £0.25	**600**	600
Non-cumulative convertible preference shares of £0.01	**195**	195
Cumulative preference shares of £1	**1**	1
Total preference shares	**4,354**	4,008
Perpetual regulatory securities	**835**	—
Additional Value Shares of £0.01	**27**	27
	5,216	4,035

36 Lease commitments

The annual rental commitments of the Group under non-cancellable operating leases were as follows:

	31 December 2001		31 December 2000	
	Premises £m	Equipment £m	Premises £m	Equipment £m
Expiring within one year	**16**	**2**	13	3
Expiring between one and five years	**49**	**9**	38	8
Expiring after five years	**183**	**2**	154	1
	248	**13**	205	12

37 Analysis of Group total assets and liabilities

		31 December 2001 £m	31 December 2000 £m
Assets:	denominated in sterling	**204,690**	186,065
	denominated in currencies other than sterling	**164,092**	133,939
		368,782	320,004
Liabilities:	denominated in sterling	**205,031**	181,759
	denominated in currencies other than sterling	**163,751**	138,245
		368,782	320,004

38 Derivatives

In the normal course of business, the Group enters into a variety of derivative transactions principally in the foreign exchange and interest rate markets. These are used to provide financial services to customers and to take, hedge and modify positions as part of trading activities. Derivatives are also used to hedge or modify risk exposures arising on the balance sheet from a variety of activities including lending and securities investment.

The principal types of derivative contracts into which the Group enters are described below.

Swaps These are over-the-counter ("OTC") agreements between two parties to exchange periodic payments of interest, or payments for the change in value of a commodity, or related index, over a set period based on notional principal amounts. The Group enters into swap transactions in several markets. Interest rate swaps exchange fixed rates for floating rates of interest based on notional amounts. Basis swaps exchange floating or fixed interest calculated using different bases. Cross currency swaps are the exchange of interest based on notional values of different currencies. Equity and commodity swaps exchange interest for the return on an equity or commodity, or equity or commodity index.

Options Currency and interest rate options confer the right, but not the obligation, on the buyer to receive or pay a specific quantity of an asset or financial instrument for a specified price at or before a specified date. Options may be exchange traded or OTC agreements. The Group principally buys and sells currency and interest rate options.

Futures and forwards Short-term interest rate futures, bond futures and forward foreign exchange contracts are all agreements to deliver, or take delivery of, a specified amount of an asset or financial instrument based on the specified rate, price or index applied against the underlying asset or financial instrument, at a specified date. Futures are exchange traded at standardised amounts of the underlying asset or financial instrument. Forward contracts are OTC agreements and are principally dealt in by the Group in interest rates as forward rate agreements and in currency as forward foreign exchange contracts.

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

Maturity of replacement cost of over-the-counter contracts (trading and non-trading) Replacement cost indicates the Group's derivatives credit exposure. The following table sets forth the gross positive fair values by maturity. The net replacement cost of internal trades is not included as there is no credit risk associated with them.

	31 December 2001				31 December 2000			
	Within one year £m	One to five years £m	Over five years £m	Total £m	Within one year £m	One to five years £m	Over five years £m	Total £m
Before netting:								
Exchange rate contracts	10,146	2,083	409	12,638	12,651	1,870	463	14,984
Interest rate contracts	10,055	16,846	9,952	36,853	4,510	10,426	7,797	22,733
Equity and commodity contracts	52	134	2	188	63	45	2	110
	20,253	19,063	10,363	49,679	17,224	12,341	8,262	37,827
Banks and investment firms				39,613				31,013
Others				10,066				6,814
				49,679				37,827

At 31 December 2001, the potential credit risk exposure, which is after netting and allowing for collateral received, of the Group's trading and non-trading derivatives, was £5,480 million to banks and investment firms and £4,064 million to other counterparties.

Exchange traded contracts are excluded from the above table. Such contracts generally involve lower credit risk than OTC contracts as they are cleared through exchanges that require margin from participants and the daily settlement of gains and losses.

38 Derivatives *(continued)*

Trading derivatives The following table shows the fair values of instruments in the derivatives trading portfolio:

	31 December 2001 End of period fair value Assets £m	31 December 2001 End of period fair value Liabilities £m	31 December 2000 End of period fair value Assets £m	31 December 2000 End of period fair value Liabilities £m
Exchange rate contracts:				
Spot, forwards and futures	7,271	7,086	10,159	10,277
Currency swaps	2,439	2,452	2,258	2,507
Options purchased	2,876	—	2,511	—
Options written	—	3,057	—	2,526
	12,586	12,595	14,928	15,310
Interest rate contracts:				
Interest rate swaps	33,186	33,415	20,154	21,767
Options purchased	2,858	—	1,960	—
Options written	—	2,820	—	1,952
Futures and forwards	594	616	455	438
	36,638	36,851	22,569	24,157
Equity and commodity contracts	472	475	95	95
	49,696	49,921	37,592	39,562
Netting	(38,846)	(38,846)	(27,293)	(27,293)
	10,850	11,075	10,299	12,269
Average fair values (before netting):				
Exchange rate contracts	13,781	14,079	7,962	8,176
Interest rate contracts	30,203	30,862	11,157	12,071
Equity and commodity contracts	244	262	107	134
	44,228	45,203	19,226	20,381

Gains and losses on exchange traded contracts subject to daily margining requirements are settled daily. The fair value of such contracts included above reflects the last day's variation margin.

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

	31 December 2001 Within one year £bn	31 December 2001 One to five years £bn	31 December 2001 Over five years £bn	31 December 2001 Total £bn	31 December 2000 Within one year £bn	31 December 2000 One to five years £bn	31 December 2000 Over five years £bn	31 December 2000 Total £bn
Exchange rate contracts:								
Spot, forwards and futures	464.7	20.3	0.3	485.3	468.3	22.0	0.1	490.4
Currency swaps	45.3	38.7	14.6	98.6	27.3	27.6	11.7	66.6
Options purchased	100.7	5.0	0.1	105.8	85.8	4.5	0.1	90.4
Options written	95.1	3.7	0.1	98.9	83.6	3.3	0.1	87.0
	705.8	67.7	15.1	788.6	665.0	57.4	12.0	734.4
Interest rate contracts:								
Interest rate swaps	925.8	998.0	387.3	2,311.1	878.9	763.5	300.9	1,943.3
Options purchased	86.7	89.4	47.2	223.3	59.9	79.7	40.3	179.9
Options written	61.2	94.8	47.4	203.4	27.5	78.3	38.6	144.4
Futures and forwards	717.7	203.1	0.1	920.9	523.1	223.9	1.0	748.0
	1,791.4	1,385.3	482.0	3,658.7	1,489.4	1,145.4	380.8	3,015.6
Equity and commodity contracts	14.8	3.8	—	18.6	0.8	0.3	—	1.1

Non-trading derivatives The Group establishes non-trading derivatives positions externally with third parties and also internally. It should be noted that the following tables include the components of the internal hedging programme that transfers risks to the trading portfolios in the Group or to external third party participants in the derivatives markets.

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

	31 December 2001				31 December 2000			
	Fair value		Book value		Fair value		Book value	
	Positive £m	Negative £m	Positive £m	Negative £m	Positive £m	Negative £m	Positive £m	Negative £m
Exchange rate contracts:								
Spot, forwards and futures	57	53	27	32	50	56	34	19
Currency swaps and options	134	122	114	101	138	91	142	45
	191	175	141	133	188	147	176	64
Interest rate contracts:								
Interest rate swaps	1,836	2,078	690	771	1,534	1,559	941	1,044
Futures, forwards and options	10	6	—	—	7	2	—	—
	1,846	2,084	690	771	1,541	1,561	941	1,044
Equity and commodity contracts	21	15	21	15	15	19	15	19
Total	2,058	2,274	852	919	1,744	1,727	1,132	1,127

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

	31 December 2001				31 December 2000			
	Within one year £bn	One to five years £bn	Over five years £bn	Total £bn	Within one year £bn	One to five years £bn	Over five years £bn	Total £bn
Exchange rate contracts:								
Spot, forwards and futures	8.5	0.1	—	8.6	4.2	—	—	4.2
Currency swaps and options	2.4	1.5	1.4	5.3	1.5	1.8	1.6	4.9
	10.9	1.6	1.4	13.9	5.7	1.8	1.6	9.1
Interest rate contracts:								
Interest rate swaps	34.9	45.5	26.7	107.1	34.7	49.7	22.7	107.1
Futures, forwards and options	0.9	0.7	—	1.6	2.8	0.7	—	3.5
	35.8	46.2	26.7	108.7	37.5	50.4	22.7	110.6
Equity and commodity contracts	0.2	0.6	—	0.8	0.3	0.6	—	0.9

39 Financial instruments

The Group's objectives and policies in managing the risks that arise in connection with the use of financial instruments are set out on pages 24 to 31 of the operating and financial review under 'risk management', financial instruments', and 'derivatives'.

Interest rate sensitivity gap The tables below summarise the Group's interest rate sensitivity gap for its non-trading book at 31 December 2001 and 31 December 2000. The tables show the contractual re-pricing for each category of asset, liability and for off-balance sheet items. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. Contractual repricing terms do not reflect the potential impact of early repayment or withdrawal. Positions may not be reflective of those in subsequent periods. Major changes in positions can be made promptly as market outlooks change. In addition, significant variations in interest rate sensitivity may exist within the re-pricing periods presented and among the currencies in which the Group has interest rate positions.

At 31 December 2001	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non-interest bearing funds £m	Banking book total £m	Trading book total £m	Total £m
Assets									
Loans and advances to banks	16,865	2,381	2,184	16	42	191	21,679	16,834	38,513
Loans and advances to customers	122,258	11,514	7,263	26,055	8,943	2,443	178,476	12,016	190,492
Treasury bills and debt securities	16,401	2,359	2,727	9,891	4,931	—	36,309	37,867	74,176
Other assets	—	—	—	—	—	47,963	47,963	17,638	65,601
Total assets	155,524	16,254	12,174	35,962	13,916	50,597	284,427	84,355	368,782
Liabilities									
Deposits by banks	24,138	1,988	620	675	561	902	28,884	11,154	40,038
Customer accounts	147,428	3,938	2,767	2,822	326	25,777	183,058	15,937	198,995
Debt securities in issue	16,412	5,882	4,477	3,126	772	—	30,669	—	30,669
Subordinated liabilities	2,941	517	—	1,736	6,444	—	11,638	72	11,710
Other liabilities	10	11	22	38	124	25,570	25,775	33,975	59,750
Shareholders' funds	—	—	—	—	—	26,218	26,218	1,402	27,620
Internal funding of trading business	(20,804)	(903)	(95)	—	—	(13)	(21,815)	21,815	—
Total liabilities	170,125	11,433	7,791	8,397	8,227	78,454	284,427	84,355	368,782
Off-balance sheet items	(3,402)	(5,757)	827	(885)	9,217	—			
Interest rate sensitivity gap	(18,003)	(936)	5,210	26,680	14,906	(27,857)			
Cumulative interest rate sensitivity gap	(18,003)	(18,939)	(13,729)	12,951	27,857				

At 31 December 2000	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non-interest bearing funds £m	Banking book total £m	Trading book total £m	Total £m
Assets									
Loans and advances to banks	14,238	2,668	2,436	331	45	296	20,014	12,047	32,061
Loans and advances to customers	103,911	8,904	5,391	25,216	9,546	1,486	154,454	13,622	168,076
Treasury bills and debt securities	14,958	2,802	2,189	4,670	3,406	—	28,025	33,080	61,105
Other assets	—	—	—	—	—	45,038	45,038	13,724	58,762
Total assets	133,107	14,374	10,016	30,217	12,997	46,820	247,531	72,473	320,004
Liabilities									
Deposits by banks	25,811	766	146	68	235	723	27,749	7,381	35,130
Customer accounts	125,963	3,112	3,020	2,812	298	24,390	159,595	17,707	177,302
Debt securities in issue	12,572	1,718	1,200	2,768	1,149	—	19,407	—	19,407
Subordinated liabilities	2,687	101	503	1,336	5,744	—	10,371	65	10,436
Other liabilities	135	20	100	33	86	24,614	24,988	29,625	54,613
Shareholders' funds	—	—	—	—	—	22,168	22,168	948	23,116
Internal funding of trading business	(15,745)	(941)	—	—	—	(61)	(16,747)	16,747	—
Total liabilities	151,423	4,776	4,969	7,017	7,512	71,834	247,531	72,473	320,004
Off-balance sheet items	(2,225)	2,627	1,112	(7,865)	6,351	—			
Interest rate sensitivity gap	(20,541)	12,225	6,159	15,335	11,836	(25,014)			
Cumulative interest rate sensitivity gap	(20,541)	(8,316)	(2,157)	13,178	25,014				

The tables do not indicate the effect of interest rate options used by the Group to hedge its own positions. At 31 December 2001, the Group had non-trading interest rate options purchased outstanding with a principal amount of £716 million (31 December 2000 – £610 million) and interest rate options written with a principal amount of £7 million (31 December 2000 – £7 million).

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

The Group's structural currency exposures were as follows:

	31 December 2001			31 December 2000		
Functional currency of net investment	Net investments in overseas operations £m	Foreign currency borrowings hedging net investments £m	Structural foreign currency exposures £m	Net investments in overseas operations £m	Foreign currency borrowings hedging net investments £m	Structural foreign currency exposures £m
US dollar	5,207	5,162	45	2,426	2,354	72
Euro	797	242	555	782	224	558
Swiss franc	250	243	7	201	193	8
Other non-sterling	61	46	15	86	83	3
Total	6,315	5,693	622	3,495	2,854	641

Trading book market risk An explanation of the value-at-risk ("VaR") methodology of estimating potential losses arising from the Group's exposure to market risk in its trading book and the main assumptions and parameters underlying it is given on pages 26 and 27.

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

	31 December 2001 £m	Year ended 31 December 2001 Maximum £m	Minimum £m	Average £m	31 December 2000 £m	15 months ended 31 December 2000 Maximum £m	Minimum £m	Average £m
Interest rate	7.9	15.4	7.7	11.1	9.4	11.7	0.9	6.6
Currency	0.4	2.6	0.3	1.1	1.0	3.1	0.2	1.1
Equity	0.4	1.6	0.3	0.5	0.9	0.9	—	0.2
Diversification effects	(0.5)				(1.5)			
Total	8.2	15.6	7.7	11.3	9.8	12.4	1.0	6.9

39 Financial instruments *(continued)*

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

Trading business	Note	31 December 2001 Carrying amount £m	31 December 2001 Fair value £m	31 December 2000 Carrying amount £m	31 December 2000 Fair value £m
Assets					
Treasury bills and other eligible bills	(a)	**8,199**	**8,199**	2,837	2,837
Loans and advances to banks and customers	(a)	**28,850**	**28,850**	25,669	25,669
Debt securities	(a)	**29,668**	**29,668**	30,243	30,243
Equity shares	(a)	**12**	**12**	6	6
Derivatives	(b)	**10,850**	**10,850**	10,299	10,299
Liabilities					
Deposits by banks and customer accounts	(c)	**27,091**	**27,091**	25,088	25,088
Short positions in securities	(a)	**14,622**	**14,622**	12,801	12,801
Subordinated loan capital	(a)	**72**	**72**	65	65
Derivatives	(b)	**11,075**	**11,075**	12,269	12,269

Banking business	Note	31 December 2001 Carrying amount £m	31 December 2001 Fair value £m	31 December 2000 Carrying amount £m	31 December 2000 Fair value £m
Assets					
Cash and balances at central banks	(a)	**3,093**	**3,093**	3,049	3,049
Items in the course of collection from other banks	(a)	**3,288**	**3,288**	2,961	2,961
Treasury bills and other eligible bills	(a)	**1,937**	**1,937**	479	479
Loans and advances to banks and customers	(d)	**200,155**	**200,811**	174,468	174,938
Debt securities	(e)	**34,372**	**34,370**	27,546	27,540
Equity shares	(e)	**1,545**	**1,809**	1,547	2,204
Derivatives – net	(b)	**(67)**	**(216)**	5	17
Liabilities					
Items in the course of transmission to other banks	(a)	**2,109**	**2,109**	1,707	1,707
Deposits by banks and customer accounts	(c)	**211,942**	**212,079**	187,344	187,349
Debt securities in issue	(f)	**30,669**	**30,933**	19,407	19,457
Subordinated loan capital	(g)	**11,638**	**12,072**	10,371	10,420
Non-equity minority interests	(g)	**580**	**632**	580	621
Non-equity shareholders' funds	(g)	**5,216**	**7,625**	4,035	6,312

Notes:

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

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

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

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

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

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

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

(h) Fair values are not given for financial commitments and contingent liabilities. The diversity of the fee structures, the lack of an established market and the difficulty of separating the value of the instruments from the value of the overall relationship involve such uncertainty that it is not meaningful to provide an estimate of their fair value. (The principal amounts of these instruments are given in Note 40).

Hedges As described in the accounting policies on pages 50 and 51, derivatives and debt securities held for hedging purposes are accounted for in accordance with the treatment of the hedged transaction. As a result any gains or losses on the hedging instrument arising from changes in fair values are not recognised in the profit and loss account immediately but are accounted for in the same manner as the hedged item.

	Year ended 31 December 2001		15 months ended 31 December 2000	
	Unrecognised gains and losses £m	Deferred gains and losses £m	Unrecognised gains and losses £m	Deferred gains and losses £m
At beginning of period – gains	759	124	57	133
– losses	(725)	(35)	(238)	(18)
	34	89	(181)	115
Recognised gains that arose in previous periods	(161)	(18)	(21)	(15)
Recognised losses that arose in previous periods	194	7	109	2
Unrecognised gains and losses arising in the period	(189)	—	126	—
Unrecognised gains and losses deferred in the period	(6)	6	1	(13)
At 31 December	**(128)**	**84**	34	89
Of which – gains	**1,201**	**148**	759	124
– losses	**(1,329)**	**(64)**	(725)	(35)
	(128)	**84**	34	89
Gains expected to be recognised in the year to 31 December 2002 (year to 31 December 2001)	**273**	**35**	156	17
Gains expected to be recognised in the year to 31 December 2003 or later (year to 31 December 2002 or later)	**928**	**113**	603	107
	1,201	**148**	759	124
Losses expected to be recognised in the year to 31 December 2002 (year to 31 December 2001)	**(310)**	**(22)**	(182)	(7)
Losses expected to be recognised in the year to 31 December 2003 or later (year to 31 December 2002 or later)	**(1,019)**	**(42)**	(543)	(28)
	(1,329)	**(64)**	(725)	(35)

40 Memorandum items

Contingent liabilities and commitments

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

	31 December 2001 £m	31 December 2000 £m
Contingent liabilities:		
Acceptances and endorsements	2,814	830
Guarantees and assets pledged as collateral security	4,653	3,506
Other contingent liabilities	6,106	6,335
	13,573	10,671
Commitments:		
Documentary credits and other short-term trade related transactions	2,107	1,495
Undrawn formal standby facilities, credit lines and other commitments to lend		
– less than one year	93,324	70,128
– one year and over	29,502	22,345
Other commitments	338	463
	125,271	94,431

Acceptances are obligations to pay on maturity the face value of a bill of exchange to a third party. Most acceptances are short-term and extend for one year or less. By endorsing a document, the Group accepts liability for payment if it is dishonoured.

Documentary credits are commercial letters of credit providing for payment by the Group to a named beneficiary against delivery of specified documents.

Commitments to lend include commitments which are unconditionally cancellable and agreements to lend to a customer so long as all conditions established in the loan agreement have been satisfied or waived. A substantial proportion of the Group's loans is by way of overdrafts. Unutilised overdraft facilities constitute commitments to lend which, although unconditionally cancellable, are normally granted for a specific period of time. Unutilised overdraft facilities are included in commitments to lend.

Other commitments and contingent obligations usually have fixed expiry dates or other termination clauses.

Banking commitments and contingent obligations which have been entered into on behalf of customers and for which there are corresponding obligations by customers are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual notional amount of those instruments. Many commitments are expected to expire without being drawn and do not necessarily represent future cash requirements.

Litigation Members of the Group are engaged in litigation in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them which arise in the ordinary course of business. The directors of the company, after reviewing the claims pending and threatened against Group undertakings and taking into account the advice of the relevant legal advisers, are satisfied that the outcome of these claims will not have a material adverse effect on the net assets of the Group.

41 Acquisitions

Acquisitions during the year

The acquisitions made by the Group during the year ended 31 December 2001 are set out below. All acquisitions have been accounted for using acquisition accounting principles.

(a) Acquisition from Mellon Financial Corporation

On 1 December 2001, Citizens completed the acquisition of the regional retail and commercial banking operations of Mellon Financial Corporation for a cash consideration of approximately US$2.2 billion.

The provisional fair values of the assets and liabilities acquired at the date of acquisition, and the consideration paid, are shown in the table below:

	Book value of net assets acquired £m	Revaluations £m	Accounting policy alignments £m	**Fair value to the Group £m**
Cash and balances at central banks	138	—	—	**138**
Loans and advances to banks	5,305	—		**5,305**
Loans and advances to customers	4,535	(68)	(38)	**4,429**
Tangible fixed assets	81	—	—	**81**
Other assets	50	—	—	**50**
Customer accounts	(10,095)	(14)	—	**(10,109)**
Other liabilities	(14)	15	14	**15**
Net liabilities acquired	—	(67)	(24)	**(91)**
Goodwill				**1,655**
Total consideration				**1,564**
Satisfied by:				
Payment of cash				**1,535**
Fees and expenses relating to the acquisition				**29**
				1,564

Notes:

(i) Revaluations reflect the restatement of loans and deposits to their estimated fair values at the date of acquisition, and the related tax effect.

(ii) Accounting policy alignments reflect the adoption of Group accounting policies in respect of provisioning for loans and advances, together with the related tax effects.

(iii) The goodwill arising on acquisition is being amortised over its estimated economic life of 20 years, resulting in a charge of US$118 million (£83 million) per annum.

The estimated contribution (excluding the funding cost associated with the acquisition and a notional benefit of equity) to the Group's results for the year ended 31 December 2001 is shown below.

	Month ended 31 December 2001 £m
Net interest income	**21**
Non-interest income	**9**
Total income	**30**
Operating expenses	**(24)**
Operating profit	**6**
Goodwill amortisation	**(7)**
Contribution	**(1)**

The contribution above is after charging goodwill amortisation and includes the post-acquisition effect of fair value adjustments.

As the acquisition consists of a portfolio of assets and liabilities which were not a discrete segment of Mellon Financial Corporation's banking operations, no pre-acquisition results are available.

41 Acquisitions *(continued)*

(b) Other acquisitions

On 27 July 2001, The Royal Bank of Scotland plc ("RBS") acquired from its joint venture partners, the 50% interest in the Virgin One business which it did not previously own, for a consideration of £100 million.

On 3 August 2001, RBS completed the acquisition of International Aviation Management (CI) Ltd. for a cash consideration of £16 million.

On 24 September 2001, RBS completed the acquisition of Euro Sales Finance plc for a cash consideration of £70 million.

On 28 September 2001, Direct Line completed the acquisition of the European motor insurance businesses in Germany and Italy of AllState Corporation for a cash consideration of US$20 million.

The provisional fair values of the assets and liabilities acquired at the dates of acquisition, and the consideration paid for these acquisitions in aggregate were as follows:

	Book value of net assets acquired £m	Fair value adjustments £m	Fair value to the Group £m
Cash and balances at central banks	18	—	18
Treasury bills and other eligible bills	24	—	24
Loans and advances to customers	358	(18)	340
Intangible fixed assets	6	(6)	—
Tangible fixed assets	11	(6)	5
Other assets	20	6	26
Deposits by banks	(304)	—	(304)
Other liabilities	(52)	(4)	(56)
Minority interests	6	—	6
Net assets acquired	87	(28)	59
Goodwill			147
Total consideration			206
Satisfied by:			
Payment of cash			199
Fees and expenses relating to the acquisitions			7
			206

Fair value adjustments represent principally the revaluation of loans, and tangible and intangible assets, to their estimated market values at the date of acquisition together with the related tax effects.

The estimated contribution before funding costs of the acquisitions is shown below.

	Year ended 31 December 2001* £m
Total income	18
Operating expenses	(29)
Operating loss	(11)
Goodwill amortisation	(3)
Contribution	(14)

*from the dates of acquisition.

The contribution above is after charging goodwill amortisation and includes the post-acquisition effect of fair value adjustments.

National Westminster Bank Plc and its subsidiaries

The Group acquired NatWest on 6 March 2000. Estimated fair values were assigned to the assets and liabilities of NatWest for inclusion in the Group's 2000 financial statements. Final adjustments, shown in the table below, to those provisional fair values have now been made. As a result, goodwill on acquisition has increased by £93 million to £11,483 million.

	Fair value as stated in the 2000 financial statements £m	Final fair value adjustments £m	Notes	**Fair value to the Group £m**
Cash and balances at central banks and items in the course of collection	3,680	—		**3,680**
Treasury bills and other eligible bills	2,736	—		**2,736**
Loans and advances to banks	32,927	—		**32,927**
Loans and advances to customers	89,213	(139)	(i)	**89,074**
Debt securities	37,905	(11)	(i)	**37,894**
Equity shares	450	(4)	(i)	**446**
Tangible fixed assets	3,544	(24)	(i)	**3,520**
Other assets	23,426	(7)	(i)	**23,419**
Subsidiaries held for resale	1,243	—		**1,243**
Deposits by banks and items in the course of transmission	(26,607)	—		**(26,607)**
Customer accounts	(97,987)	—		**(97,987)**
Debt securities in issue	(10,309)	—		**(10,309)**
Other liabilities	(43,249)	92	(i),(ii),(iii)	**(43,157)**
Subordinated liabilities	(6,900)	—		**(6,900)**
Preference shares	(475)	—		**(475)**
Net assets	9,597	(93)		**9,504**
Goodwill	11,390			**11,483**
Consideration paid	20,987			**20,987**

Notes:

(i) Revaluations – adjustments have been made to the fair values assigned provisionally to NatWest's financial instruments and its property portfolio in the light of further detailed reviews. As a result, the fair values of certain asset and liability categories detailed above have been reduced.

(ii) Accounting policy alignments – application of the Group accounting policy in respect of insurance commissions following additional analysis of historic customer behaviour increased Other liabilities by £9 million.

(iii) Other adjustments – changes to provisions recognised in 2000 as further evidence became available about conditions at the date of acquisition decreased Other liabilities by £53 million.

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

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Operating profit	4,275	3,273
Decrease/(increase) in prepayments and accrued income	486	(1,151)
Interest on subordinated liabilities	651	750
Increase in accruals and deferred income	475	2,236
Amortisation of and provisions against investment securities	39	(7)
Provisions for bad and doubtful debts	984	629
Loans and advances written off net of recoveries	(755)	(634)
Profit on sale of tangible fixed assets	(55)	(12)
Loss/(profit) from associated undertakings	6	(1)
Profit on sale of investment securities	(48)	(345)
Provisions for liabilities and charges	67	42
Provisions utilised	(37)	(76)
Depreciation and amortisation of tangible and intangible fixed assets	1,532	1,327
(Decrease)/increase in value of long-term assurance business	(55)	34
Net cash inflow from trading activities	7,565	6,065
(Increase)/decrease in items in the course of collection	(327)	1,538
(Increase)/decrease in treasury and other eligible bills	(6,796)	121
(Increase)/decrease in loans and advances to banks	(4,785)	8,193
Increase in loans and advances to customers	(18,038)	(25,793)
Decrease/(increase) in securities	760	(1,749)
Increase in other assets	(3,315)	(1,434)
Increase/(decrease) in items in the course of transmission	402	(891)
Increase in deposits by banks	4,604	3,179
Increase in customer accounts	11,584	27,378
Increase/(decrease) in debt securities in issue	11,262	(659)
Increase/(decrease) in other liabilities	4,271	(3,926)
Effect of other accruals/deferrals and other non-cash movements	100	(694)
Net cash inflow from operating activities	7,287	11,328

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

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Cash consideration paid	(1,770)	(9,603)
Cash acquired	156	5,465
Net outflow of cash	(1,614)	(4,138)

44 Sale of subsidiary and associated undertakings

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Net assets disposed of	8	1,119
Goodwill	—	5
Profit on disposal	—	100
Net inflow of cash in respect of disposals (net of expenses)	8	1,224

45 Analysis of changes in financing during the period

	Share capital (including share premium)		Loan capital	
	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
At beginning of period	7,378	2,354	10,436	3,032
Currency translation adjustments	58	184	85	356
Net cash inflow from financing	2,412	4,383	1,189	148
Acquisition of subsidiary undertakings	—	391	—	6,900
Amount credited to merger reserve	(2,007)	—	—	—
Other non-cash movements	517	66	—	—
At 31 December	8,358	7,378	11,710	10,436

46 Analysis of cash

	31 December 2001 £m	31 December 2000 £m	Change in year £m
Cash and balances at central banks	3,093	3,049	44
Loans and advances to banks repayable on demand	3,934	7,578	(3,644)
Cash	7,027	10,627	(3,600)

Certain subsidiary undertakings are required to maintain balances with the Bank of England which, at 31 December 2001, amounted to £188 million (31 December 2000 – £183 million). Certain subsidiary undertakings are required by law to maintain reserve balances with the Federal Reserve Bank in the US. Such reserve balances amounted to US$489 million at 31 December 2001 (31 December 2000 – US$277 million).

47 Analysis of changes in cash during the period

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
At beginning of period	10,627	5,802
Net cash (outflow)/inflow	(3,600)	4,825
At 31 December	7,027	10,627

48 Segmental analysis

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

a) Classes of business

Year ended 31 December 2001	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses and other operating charges £m	Provisions for bad and doubtful debts £m	Amounts written off investments £m	Profit/(loss) on ordinary activities before tax £m
Corporate Banking and Financial Markets	**2,100**	**3,304**	**5,404**	**(1,899)**	**(487)**	**(7)**	**3,011**
Retail Banking	**2,622**	**1,277**	**3,899**	**(928)**	**(164)**	**—**	**2,807**
Retail Direct	**674**	**696**	**1,370**	**(564)**	**(255)**	**—**	**551**
Manufacturing	**—**	**—**	**—**	**(1,568)**	**—**	**—**	**(1,568)**
Wealth Management	**464**	**469**	**933**	**(479)**	**5**	**—**	**459**
Direct Line Group	**129**	**1,414**	**1,543**	**(1,282)**	**—**	**—**	**261**
Ulster Bank	**351**	**185**	**536**	**(271)**	**(23)**	**—**	**242**
Citizens	**814**	**306**	**1,120**	**(550)**	**(69)**	**—**	**501**
Central items	**(285)**	**61**	**(224)**	**(248)**	**9**	**—**	**(463)**
Operating profit before goodwill amortisation and integration costs	**6,869**	**7,712**	**14,581**	**(7,789)**	**(984)**	**(7)**	**5,801**
Goodwill amortisation	**—**	**—**	**—**	**(651)**	**—**	**—**	**(651)**
Integration costs	**—**	**—**	**—**	**(875)**	**—**	**—**	**(875)**
Profit on ordinary activities before tax	**6,869**	**7,712**	**14,581**	**(9,315)**	**(984)**	**(7)**	**4,275**

15 months ended 31 December 2000	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses and other operating charges £m	Provisions for bad and doubtful debts £m	Amounts written off investments £m	Profit/(loss) on ordinary activities before tax £m
Corporate Banking and Financial Markets	1,718	2,738	4,456	(1,576)	(171)	(42)	2,667
Retail Banking	2,259	1,015	3,274	(902)	(153)	—	2,219
Retail Direct	541	534	1,075	(477)	(232)	—	366
Manufacturing	—	—	—	(1,550)	—	—	(1,550)
Wealth Management	400	411	811	(437)	5	—	379
Direct Line Group	118	1,264	1,382	(1,165)	—	—	217
Ulster Bank	245	139	384	(205)	(15)	—	164
Citizens	787	284	1,071	(606)	(44)	—	421
Central items	(286)	(72)	(358)	(291)	(19)	—	(668)
Operating profit before goodwill amortisation and integration costs	5,782	6,313	12,095	(7,209)	(629)	(42)	4,215
Goodwill amortisation	—	—	—	(541)	—	—	(541)
Integration costs	—	—	—	(401)	—	—	(401)
Exited businesses	5	8	13	(13)	—	—	—
Operating profit	5,787	6,321	12,108	(8,164)	(629)	(42)	3,273
Profit on disposal of businesses							100
Profit on ordinary activities before tax							3,373

	Total assets 31 December 2001 £m	Total assets 31 December 2000 £m	Net assets 31 December 2001 £m	Net assets 31 December 2000 £m
Corporate Banking and Financial Markets	**215,525**	191,083	**8,777**	7,161
Retail Banking	**61,054**	57,942	**3,144**	2,772
Retail Direct	**17,158**	14,355	**891**	790
Manufacturing	**3,323**	2,611	**176**	181
Wealth Management	**12,510**	10,428	**561**	492
Direct Line Group	**3,475**	2,480	**779**	632
Ulster Bank	**11,798**	11,068	**925**	809
Citizens	**36,152**	20,323	**3,600**	1,699
Central items	**7,787**	9,714	**8,767**	8,580
	368,782	320,004	**27,620**	23,116

(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.

Year ended 31 December 2001	UK £m	USA £m	Rest of the World £m	Total £m
Interest receivable	**11,360**	**1,816**	**1,245**	**14,421**
Dividend income	**28**	**9**	**17**	**54**
Fees and commissions receivable	**4,079**	**412**	**244**	**4,735**
Dealing profits	**816**	**532**	**78**	**1,426**
Other operating income	**1,039**	**6**	**7**	**1,052**
General insurance premium income (net of reinsurance)	**1,364**	**—**	**11**	**1,375**
Gross income	**18,686**	**2,775**	**1,602**	**23,063**
Profit on ordinary activities before tax	**3,293**	**628**	**354**	**4,275**
Total assets	**243,381**	**99,006**	**26,395**	**368,782**
Net assets	**22,346**	**4,170**	**1,104**	**27,620**
15 months ended 31 December 2000				
Interest receivable	11,053	2,359	1,082	14,494
Dividend income	26	12	16	54
Fees and commissions receivable	3,369	318	198	3,885
Dealing profits	718	240	45	1,003
Other operating income	923	38	(2)	959
General insurance premium income (net of reinsurance)	1,166	—	—	1,166
Gross income	17,255	2,967	1,339	21,561
Profit on ordinary activities before tax	2,784	256	333	3,373
Total assets	229,839	67,943	22,222	320,004
Net assets	20,039	2,002	1,075	23,116

49 Directors' emoluments

	Year ended 31 December 2001 £000	15 months ended 31 December 2000 £000
Non-executive directors – emoluments	625	449
Executive directors – emoluments	7,879	10,023
– contributions and allowances in respect of defined contribution pension schemes	102	93
	8,606	10,565
Executive directors – gains on exercise of share options	4,849	5,630
– long-term cash incentive and shadow equity plans	—	9,330
	13,455	25,525

Retirement benefits are accruing to six directors (31 December 2000 – eight) under defined benefit schemes, two (31 December 2000 – three) of whom also accrued benefits under defined contribution schemes.

The emoluments of the highest paid director, Sir George Mathewson (15 months ended 31 December 2000 – Mr Fish) were as follows:

	Year ended 31 December 2001 £000	15 months ended 31 December 2000 £000
Aggregate emoluments including long-term cash incentive and shadow equity plans	483	10,677
Gains on exercise of share options	3,607	—
Pension contributions	—	36
Defined benefit pension scheme – accrued pension at end of period	—	220

The executive directors may also participate in the company's executive share option, sharesave and option 2000 schemes and details of their interests in the company's shares arising from their participation are contained in Directors' interests in shares on pages 45 and 46. Details of the remuneration received by each director during the year and each directors' pension arrangements are given on pages 42 to 44.

50 Transactions with directors, officers and others

(a) At 31 December 2001, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group were £37,127,866 in respect of loans to 18 persons who were directors of the company (or persons connected with them) at any time during the financial period and £20,177 to one person who was an officer of the company at any time during the financial period.

(b) Sir George Mathewson, Chairman of the company, RBS and NatWest, had a right to repurchase from RBS his former dwellinghouse which RBS purchased from him and his wife in May 1988 at a price of £125,000. Any repurchase was to be at the higher of the purchase price paid by RBS or a price determined by independent professional valuation at the time of exercise of the right to repurchase. The right to repurchase became exercisable upon Sir George's appointment as Chairman on 11 April 2001. However, Sir George chose not to exercise the right which has lapsed and ceased to be exercisable.

(c) There were no contracts of significance to the business of the company and its subsidiaries which subsisted at 31 December 2001, or during the year then ended, 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 19. In accordance with Financial Reporting Standard ("FRS") 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 18. The amounts of loans and advances due from associated undertakings at 31 December 2001 are shown in Notes 12 and 13, and the amounts of deposits received from associated undertakings as at 31 December 2001 are shown in Note 26. 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 arm's-length terms depending on their nature. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under FRS 8.

The Royal Bank of Scotland Staff Pension Scheme (the "Scheme") RBS recharges the Scheme with the cost of administration services incurred by it. The amounts involved are not material to the Group.

Santander Central Hispano, S.A. ("SCH") Under the terms of an alliance agreement, the Group and SCH co-operate in certain banking and financial activities in Europe. The Group holds 2.90% of SCH's capital stock and 10.3 million preference shares of US$25 and SCH holds 8.03% 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 Report on pages 40 to 44. Details of transactions with directors, officers and others connected to them are shown in Note 50.

52 Significant differences between UK and US generally accepted accounting principles

The company has a reporting obligation under the Securities Exchange Act of 1934 in respect of certain securities issued in the US. An annual report on Form 20-F is being filed with the Securities and Exchange Commission ("SEC") in the US and, although much of the detailed financial analyses therein is also shown in this report and accounts, the additional disclosures in this note 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 US.

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

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

The fair value of the surplus on pension schemes is restricted under UK GAAP to the amount expected to be realised by way of reduced contributions or refunds. Under US GAAP, the full surplus is recognised as a fair value adjustment.

Under US GAAP, the consideration for the acquisition includes the value of certain options granted to holders of options over the acquired entity's shares under employee share option schemes.

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

(b) **Goodwill** Under the Group's accounting policy, goodwill arising on acquisitions after 1 October 1998 is capitalised on the balance sheet and amortised on a straight-line basis over its estimated useful economic life. Goodwill arising on acquisitions before 1 October 1998 was deducted from reserves immediately. Under US GAAP, goodwill on acquisitions completed before 30 June 2001 is amortised over the period estimated to benefit, which, in the Group's case, is periods of up to 25 years. Under the transitional provisions of Statement of Financial Accounting Standards ("SFAS") 142 'Goodwill and Other Intangible Assets', goodwill arising on acquisitions completed after 30 June 2001 is not amortised.

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

52 Significant differences between UK and US generally accepted accounting principles *(continued)*

(d) **Depreciation** Depreciation charged under UK GAAP is based on the revalued amount of freehold and long leasehold properties; no depreciation is charged on investment properties. Under US GAAP, the depreciation charge is based on the historical cost of all properties.

(e) **Dividends** Under UK GAAP, dividends are recorded in the period to which they relate, whereas under US GAAP dividends are recorded in the period in which they are declared.

(f) **Loan origination fees** Certain loan fees are recognised when received. Under US GAAP, all loan fees and certain direct costs are deferred and recognised as an adjustment to the yield on the related loan or facility.

(g) **Pension costs** Pension costs, based on actuarial assumptions and methods, are charged in the consolidated accounts so as to allocate the cost of providing benefits over the service lives of employees in a consistent manner approved by the actuary. US GAAP prescribes the method of actuarial valuation and also requires assets to be assessed at fair value and the assessment of liabilities to be based on current interest rates.

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

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

(j) **Debt securities and equity shares** 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. Investment securities are stated at cost less provision for any permanent diminution in value. Premiums and discounts on dated securities are amortised to interest income over the period to maturity. Under US GAAP, the Group's investment debt securities and marketable investment equity shares are classified as available-for-sale securities with unrealised gains and losses reported in a separate component of shareholders' equity.

(k) **Derivatives and hedging activities** SFAS 133 'Accounting for Derivative Instruments and Hedging Activities' was effective for the Group's US GAAP information from 1 January 2001. The Group has not made changes in its use of non-trading derivatives to meet the hedge criteria of SFAS 133. As a result, from 1 January 2001, for US GAAP purposes, the Group's portfolio of non-trading derivatives has been remeasured to fair value and changes in fair value reflected in net income. Under UK GAAP, these derivatives continue to be classified as non-trading and accounted for in accordance with the underlying transaction or transactions. The Group's UK and US GAAP reconciliations also reflect transition adjustments on initial application of SFAS 133. These adjustments are: a cumulative-effect-type adjustment increasing net income by £45 million (£65 million less tax of £20 million); and a cumulative-effect-type adjustment decreasing other comprehensive income by £51 million (£73 million less tax of £22 million).

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

(m) **Deferred taxation** Deferred taxation is provided only where it is probable that a taxation liability will crystallise and is calculated at rates expected to be applicable when the liabilities or assets are expected to crystallise. Under US GAAP, deferred taxation is recognised on all temporary differences. Deferred tax assets and liabilities are measured using enacted rates in effect for the year in which the differences are expected to be recovered or settled.

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

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

Recent developments in US GAAP In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS 141 'Business Combinations'. SFAS 141 requires all business combinations initiated after 30 June 2001 to be accounted for using the purchase accounting method, specifies how goodwill and other intangible assets should be measured on initial recognition, and sets out disclosure requirements relating to business combinations.

In June 2001, the FASB issued SFAS 142 'Goodwill and Other Intangible Assets'. The main provisions of SFAS 142, effective for the Group's 2002 financial statements, state how goodwill and other intangible assets should be accounted for subsequent to acquisition and specifies that goodwill should not be amortised but tested for impairment at least annually. Under the transitional provisions of SFAS 142, goodwill arising on acquisitions completed after 30 June 2001 is not amortised.

In June 2001, the FASB issued SFAS 143 'Accounting for Asset Retirement Obligations'. SFAS 143 sets out requirements for the accounting treatment of obligations associated with the retirement of long-lived assets, and is effective for the Group's 2003 financial statements.

In August 2001, the FASB issued SFAS 144 'Accounting for the Impairment or Disposal of Long-Lived Assets'. SFAS 144 amends existing requirements for the recognition and measurement of impairment losses relating to long-lived assets, and the accounting treatment of long-lived assets that are to be disposed of, and is effective for the Group's 2002 financial statements.

The Group is reviewing each of these statements to determine their effect on its US GAAP reporting.

52 Significant differences between UK and US generally accepted accounting principles *(continued)*

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

Consolidated statement of income – net income	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Profit for the financial period – UK GAAP	2,648	2,169
Adjustments in respect of:		
Acquisition accounting	(113)	311
Amortisation of goodwill	(48)	(57)
Property depreciation	(13)	3
Property disposals	1	2
Loan fees and costs	(95)	(70)
Pension costs	242	165
Long-term assurance business	(25)	118
Leasing	(68)	(26)
Derivatives	(125)	60
Software development costs	442	235
Tax effect on the above adjustments	(44)	(217)
Deferred taxation	40	(30)
Net income for the financial period – US GAAP	2,842	2,663
Preference dividends	(358)	(322)
Additional Value Shares dividend	(399)	—
Perpetual regulatory securities interest	(23)	—
Net income available for ordinary shareholders – US GAAP	2,062	2,341

Comprehensive income	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m
Net income available for ordinary shareholders – US GAAP	2,062	2,341
Net unrealised (losses)/gains on available-for-sale securities	(228)	225
Derivatives	(19)	—
Net currency translation differences on foreign currency net investment	(3)	26
Comprehensive income – US GAAP	1,812	2,592

Consolidated shareholders' equity	31 December 2001 £m	31 December 2000 £m
Shareholders' equity – UK GAAP	27,620	23,116
Adjustments in respect of:		
Acquisition accounting	418	531
Goodwill	860	908
Elimination of revaluation surplus on properties less depreciation	(292)	(186)
Proposed dividend	772	629
Loan fees and costs	(169)	(74)
Pension costs	400	158
Long-term assurance business	(84)	(59)
Leasing	(94)	(26)
Net unrealised gains on available-for-sale securities	272	598
Derivatives	(112)	39
Software development costs	677	235
Tax effect on cumulative UK/US GAAP income adjustments	(200)	(156)
Deferred taxation	(145)	(290)
Shareholders' equity – US GAAP	29,923	25,423

Total assets under US GAAP, adjusted to reflect the inclusion of acceptances and the grossing-up of certain repurchase balances offset under UK GAAP, together with the effect of adjustments made to net income and shareholders' funds, were £387 billion (31 December 2000 – £324 billion).

Financial analyses

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:

	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m	30 September 1997 £m
UK					
Central and local government	**706**	1,957	150	78	116
Manufacturing	**7,401**	6,806	2,715	2,075	1,739
Construction	**3,018**	2,615	648	543	404
Finance	**8,517**	9,944	2,891	2,197	3,100
Service industries	**19,169**	17,242	5,585	4,968	4,660
Agriculture, forestry and fishing	**2,391**	2,373	673	643	613
Property	**12,274**	10,415	3,668	2,935	2,617
Business and other services	**5,864**	3,661	2,477	2,011	2,140
Individuals					
– home mortgage	**36,976**	32,600	9,544	8,317	7,371
– other	**20,076**	17,881	6,283	4,550	3,530
Instalment credit and other loans	**5,347**	4,929	1,059	900	856
Finance leases	**5,911**	5,887	2,555	2,587	2,569
Total domestic	**127,650**	116,310	38,248	31,804	29,715
Overseas residents	**24,164**	19,257	2,799	2,248	1,880
Total UK offices	**151,814**	135,567	41,047	34,052	31,595
USA	**29,230**	23,050	6,807	5,811	6,063
Rest of World	**13,093**	12,598	2,223	1,787	1,407
Total overseas offices	**42,323**	35,648	9,030	7,598	7,470
Loans and advances to customers – gross	**194,137**	171,215	50,077	41,650	39,065
Provisions for bad and doubtful debts	**(3,645)**	(3,139)	(737)	(633)	(459)
Loans and advances to customers – net	**190,492**	168,076	49,340	41,017	38,606

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

	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m	30 September 1997 £m
UK					
Demand deposits					
– interest-free	**22,396**	22,913	4,006	4,451	5,741
– interest-bearing	**70,895**	62,727	26,158	23,712	19,444
Time deposits					
– savings	**16,436**	19,945	3,486	4,183	3,354
– other	**62,339**	50,838	14,584	11,176	12,355
Total UK offices	**172,066**	156,423	48,234	43,522	40,894
Overseas					
Demand deposits					
– interest-free	**6,719**	4,206	1,197	1,052	1,014
– interest-bearing	**10,787**	8,127	1,903	1,468	1,560
Time deposits					
– savings	**21,343**	15,293	6,563	6,121	6,522
– other	**28,118**	28,383	3,701	2,959	2,987
Total overseas offices (see below)	**66,967**	56,009	13,364	11,600	12,083
Total deposits	**239,033**	212,432	61,598	55,122	52,977

	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m	30 September 1997 £m
Overseas					
USA	**49,815**	39,567	10,510	8,614	8,651
Rest of the World	**17,152**	16,442	2,854	2,986	3,432
Total overseas	**66,967**	56,009	13,364	11,600	12,083

Risk elements in lending The Group's loan 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. The figures incorporate estimates and are stated before deducting the value of security held or related provisions.

	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m	30 September 1997 £m
Loans accounted for on a non-accrual basis:					
Domestic	2,829	2,482	378	416	462
Foreign	737	344	170	148	75
Total	3,566	2,826	548	564	537
Accruing loans which are contractually overdue 90 days or more as to principal or interest*:					
Domestic	643	662	322	311	217
Foreign	142	168	110	117	14
Total	785	830	432	428	231
Loans not included above which are classified as 'troubled debt restructurings' by the SEC:					
Domestic	26	43	13	15	13
Foreign	116	122	104	5	—
Total	142	165	117	20	13
Total risk elements in lending	4,493	3,821	1,097	1,012	781
Closing provisions for bad and doubtful debts as a % of total risk elements in lending	81%	83%	67%	63%	59%
Risk elements in lending as a % of gross loans and advances to customers	2.31%	2.23%	2.19%	2.43%	2.00%

*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 management has serious doubts as to the ability of the borrower to comply with contractual repayment terms, totalled approximately £1,080 million at 31 December 2001 (31 December 2000 – £772 million). Substantial security is held in respect of these loans and appropriate provisions have already been made in accordance with the Group's provisioning policy for bad and doubtful debts.

Cross border outstandings in excess of 0.75% of total assets The table below sets out the Group's cross border outstandings in excess of 0.75% of Group total assets (including acceptances) of £371.6 billion (31 December 2000 – £320.8 billion). None of these countries has experienced repayment difficulties which have required refinancing of outstanding debt.

	31 December 2001 £m	31 December 2000 £m
USA	8,901	6,520
Germany	7,969	6,156
Cayman Islands	5,501	2,878
France	4,930	3,310
Netherlands	4,596	3,446
Switzerland	3,646	3,137

Cross border outstanding to Japan were less than 0.75% of Group total assets (including acceptances) at 31 December 2001 (31 December 2000 – £3,891 million).

Selected country exposures The table below sets out the Group's exposure to certain selected countries.

	31 December 2001			31 December 2000		
	Bank £m	Non-bank £m	Total £m	Bank £m	Non-bank £m	Total £m
Brazil	158	22	180	193	38	231
Mexico	108	62	170	155	87	242
Turkey	38	102	140	153	35	188
Venezuela	—	99	99	—	91	91
Argentina	39	12	51	113	63	176

Five-year financial summary – statutory basis

	Year ended 31 December 2001 £m	15 months ended 31 December 2000 £m	Year ended 30 September 1999 £m	1998 £m	1997 £m
Profit before provisions and exceptional items	**5,266**	3,944	1,490	1,212	909
Provisions for bad and doubtful debts	**(984)**	(629)	(266)	(195)	(139)
Amounts written off fixed asset investments	**(7)**	(42)	(13)	(10)	(2)
Profit before exceptional items	**4,275**	3,273	1,211	1,007	768
Operating exceptional items	**—**	—	—	(63)	(70)
Operating profit	**4,275**	3,273	1,211	944	698
Profit on disposal of businesses	**—**	100	—	57	62
Profit on ordinary activities before taxation	**4,275**	3,373	1,211	1,001	760
Tax on profit on ordinary activities	**(1,537)**	(1,157)	(361)	(286)	(219)
Profit on ordinary activities after taxation	**2,738**	2,216	850	715	541

Earnings per 25p ordinary share					
– adjusted	**127.9p**	126.4p	87.8p	72.3p	53.5p
– unadjusted	**67.6p**	90.0p	87.8p	73.4p	55.4p
Dividend per 25p ordinary share	**38.0p**	33.0p	28.5p	24.6p	21.4p
Dividend cover (times)	**1.7**	2.1	3.1	3.0	2.6
Cost:income ratio	**57.4%**	60.3%	49.3%	50.5%	53.4%
Net asset value per 25p ordinary share	**783p**	712p	320p	242p	268p
Share price at period end	**1672p**	1582p	1303p	670p	690p

	£m	£m	£m	£m	£m
Shareholders' funds	**27,620**	23,116	4,202	2,953	3,042
Minority interests	**585**	546	146	92	190
Dated loan capital	**6,681**	6,316	1,917	1,391	1,383
Undated loan capital including convertible debt	**5,029**	4,120	1,115	1,220	1,167
Capital resources	**39,915**	34,098	7,380	5,656	5,782

	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers	**190.5**	168.1	49.3	41.0	38.6
Customer accounts – deposits	**199.0**	177.3	55.2	50.7	47.6
Total assets	**368.8**	320.0	88.9	79.7	72.6

Number of:					
Bank branches	**3,265**	2,900	933	984	959
Employees at period end	**105,700**	94,000	32,670	31,680	30,900

Three-year financial summary – pro forma basis

	Year ended 31 December 2001 £m	2000* £m	1999* £m
Profit before provisions	**6,792**	5,046	3,901
Provisions for bad and doubtful debts	**(984)**	(602)	(526)
Amounts written off fixed asset investments	**(7)**	(43)	(16)
Profit before goodwill amortisation and integration costs	**5,801**	4,401	3,359
Goodwill amortisation	**(651)**	(640)	(581)
Integration costs	**(875)**	(434)	(113)
Profit before tax	**4,275**	3,327	2,665
Tax	**(1,537)**	(1,171)	(917)
Profit after tax	**2,738**	2,156	1,748
Adjusted earnings per 25p ordinary share	**127.9p**	102.0p	78.3p
Cost:income ratio	**46.9%**	53.5%	59.3%

*the figures for the years ended 31 December 1999 and 2000 are on a pro forma basis assuming the acquisition of NatWest occurred on 1 January 1999.

Principal offices

The company
42 St Andrew Square Edinburgh EH2 2YE

The Royal Bank of Scotland plc
42 St Andrew Square Edinburgh EH2 2YE
Waterhouse Square 138-142 Holborn London EC1N 2TH
135 Bishopsgate London EC2M 3UR

National Westminster Bank Plc
135 Bishopsgate London EC2M 3UR

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

Ulster Bank
11-16 Donegall Square East Belfast BT1 5UB
George's Quay Dublin 2

Direct Line Group
Direct Line House 3 Edridge Road Croydon CR9 1AG

Greenwich Capital Markets Inc
600 Steamboat Road Greenwich Connecticut 06830 USA

Lombard North Central PLC
3 Princess Way Redhill Surrey RH1 1NP

Coutts Group
440 Strand London WC2R 0QS

The Royal Bank of Scotland International Limited
Royal Bank House 71 Bath Street St Helier Jersey Channel Islands JE4 8PJ

NatWest Offshore
23/25 Broad Street St Helier Jersey Channel Islands JE4 8QG

Analyses of ordinary shareholders

at 31 December 2001

	shareholdings	millions	% of total
Individuals	156,693	251.0	8.8
Banks and nominee companies	17,796	2,238.0	78.3
Investment trusts	378	1.2	0.1
Insurance companies	406	37.6	1.3
Other companies	7,753	299.1	10.4
Pension trusts	32	20.4	0.7
Other corporate bodies	48	12.2	0.4
	183,106	2,859.5	100.0

	shareholdings	millions	% of total
Range of shareholdings:			
1–1,000	113,989	41.8	1.5
1,001–10,000	63,169	177.1	6.2
10,001–100,000	4,660	114.3	4.0
100,001–1,000,000	976	307.9	10.8
1,000,001–10,000,000	263	767.2	26.8
10,000,001 and over	49	1,451.2	50.7
	183,106	2,859.5	100.0

Shareholder information

Annual general meeting	26 April 2002 at 11.00 am, Edinburgh International Conference Centre, The Exchange, Morrison Street, Edinburgh
Interim results	7 August 2002
Final results	27 February 2003
Dividends	
Payment dates:	
*Ordinary shares (2001 Final)	7 June 2002
Ordinary shares (2002 Interim)	October 2002
Cumulative preference shares	31 May and 31 December 2002
Series B to K non-cumulative dollar preference shares	28 March, 28 June, 30 September and 31 December 2002
Ex-dividend dates:	
*Ordinary shares (2001 Final)	13 March 2002
Cumulative preference shares	8 May 2002
Record dates:	
*Ordinary shares (2001 Final)	15 March 2002
Cumulative preference shares	10 May 2002

*If the necessary approval for the payment of the final dividend is obtained from shareholders at the annual general meeting on 26 April 2002, as an alternative to cash, a scrip dividend election will be offered and shareholders will receive details of this by letter after that date.

Shareholder enquiries

Your shareholding in the company may be checked by visiting our website (www.rbs.co.uk/shareholder). You will need the holder identifier number printed on your share certificate or tax voucher to gain access to this information.

Capital gains tax

For shareholders who held RBSG ordinary shares at 31 March 1982, the market value of one ordinary share held was 103p. After adjusting for the 1 March 1985 rights issue, the 1 September 1989 capitalisation issue and the bonus issue of Additional Value Shares on 12 July 2000, the adjusted 31 March 1982 base value of one ordinary share held currently is 46.1p.

For shareholders who held NatWest ordinary shares at 31 March 1982, the market value of one ordinary share held was 85.16p for shareholders who accepted the basic terms of the RBSG offer. This takes account of the August 1984 and June 1986 rights issues and the June 1989 bonus issue of NatWest shares as well as the subsequent issue of Additional Value Shares.

When disposing of shares, shareholders are also entitled to indexation allowance (to April 1998 only in the case of individuals and non-corporate holders), which is calculated on the 31 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. Individuals and non-corporate shareholders may also be entitled to some taper relief to reduce the amount of any chargeable gain on disposal of shares.

The information set out above is intended as a general guide only and is based on current United Kingdom legislation and Inland Revenue practice as at this date. This information deals only with the position of individual shareholders who are resident in the United Kingdom for tax purposes, who are the beneficial owners of their shares and who hold their shares as an investment. It does not deal with the position of shareholders other than individual shareholders, shareholders who are resident outside the United Kingdom for tax purposes or certain types of shareholders, such as dealers in securities.

Published by The Royal Bank of Scotland Group plc.
Printed by Pillans & Wilson, Edinburgh.