ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 19, 2003

FORM 20-F

(Mark one)	o	REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR	x	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended		31 December 2002
OR	o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from __________ to __________
Commission file number		1-10306

The Royal Bank of Scotland Group plc
Scotland
42 St Andrew Square, Edinburgh EH2 2YE United Kingdom

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
American Depositary Shares Series B*, C*, D, E, F, G, H, I, J and K, each representing one Non-Cumulative Dollar Preference Share, Series B*, C*, D, E, F, G, H, I, J and K, respectively	New York Stock Exchange
Exchangeable Capital Securities, Series A	New York Stock Exchange
Non-Cumulative Dollar Preference Shares**	New York Stock Exchange
Dollar Perpetual Regulatory tier one securities, Series 1	New York Stock Exchange

*Redeemed on 30 January 2003
** Issuable upon exchange of the Exchangeable Capital Securities

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Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

Non-cumulative convertible dollar preference shares - Series 1 to 3
Guarantee, relating to 10.125% Guaranteed Capital Notes Due 2004 of RBSG Capital Corporation:
Payment of Principal and Interest Guaranteed on a Subordinated Basis by The Royal Bank of Scotland Group plc (suspended)
Ordinary shares of 25 pence each
7.375% Reset Capital Securities
6.40% Subordinated Notes due 1 April 2009
6.375% Subordinated Notes due 1 February 2011
5% Subordinated Notes due 1 October 2014

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary shares of 25 pence each	2,900,861,071	Non-cumulative dollar preference shares, Series B to K*	106,000,000
Additional Value Shares	2,660,556,304	Non-cumulative convertible dollar preference shares, Series 1 to 3	1,900,000
11% cumulative preference shares	500,000	Non-cumulative convertible euro preference shares, Series 1	750,000
5 ½% cumulative preference shares	400,000	Non-cumulative convertible sterling preference shares, Series 1	200,000

*8,000,000 Series B and 16,000,000 Series C were redeemed on 30 January 2003

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x **YES** o **NO**

Indicate by check mark which financial statement item the registrant has elected to follow. o **Item 17** x **Item 18**

Report and Accounts 2002

Incorporating the Annual Report on Form 20-F

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Presentation of information

This report comprises the Report and Accounts of the company for the year ended 31 December 2002 and includes the information the company is required to provide to the Securities and Exchange Commission (SEC) in the United States on Form 20-F.

For the purposes of this report, and unless specified otherwise, the term company means The Royal Bank of Scotland Group plc, RBS or the Group means the company and its subsidiary undertakings, the Royal Bank means The Royal Bank of Scotland plc and NatWest means National Westminster Bank Plc.

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

Certain information in this report is presented separately for domestic and foreign activities. Domestic activities primarily consist of UK domestic transactions of the Group. Foreign activities comprise the Group s transactions conducted through

those offices in the UK specifically organised to service international banking transactions and transactions conducted through offices outside the UK.

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

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

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

Forward-looking statements

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

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

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

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

For a further discussion of certain risks faced by the Group,see Risk factors on page 9.

Financial highlights

Profit before tax, goodwill amortisation and integration costs (£m)
The Group's profit before tax, goodwill amortisation and integration costs rose by 12% to £6,451 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 13% to 144.1p.

Dividend per ordinary share (pence)
The directors have recommended a final dividend of 31.0p which, when added to the interim dividend of 12.7p, makes a total for the year of 43.7p, an increase of 15%.

			Pro forma	
	2002	2001[2]	2000[1,2]	2000[2]
for the year ended 31 December	£m	£m	£m	£m
Profit before tax, goodwill amortisation and integration costs	6,451	5,778	4,401	3,896
Profit before tax	4,763	4,252	3,327	2,970
Profit attributable to ordinary shareholders	1,971	1,868	1,768	1,572
Cost:income ratio (%) (3)	45.6	47.0	53.5	53.1
Basic earnings per share (pence)	68.4	67.6	66.5	66.9
Adjusted earnings per share (pence) (4)	144.1	127.9	101.8	101.2
Dividend cover (times) (5)	3.3	3.3	3.1	2.7

	2002	2001[2]	2000[2]
at 31 December	£m	£m	£m
Total assets	412,000	368,859	320,069
Loans and advances to customers	223,324	190,492	168,076
Shareholders funds	27,052	26,668	22,999
Risk asset ratio tier 1 (%)	7.3	7.1	6.9
total (%)	11.7	11.5	11.5

Notes:

(1) On a pro forma basis (see page 13).

(2) Restated for the implementation of FRS 19 and the issuance of UITF 33. Details are set out on page 10.

(3) Cost:income ratio represents operating expenses excluding goodwill amortisation and integration costs expressed as a percentage of total income.

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

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

To facilitate comparisons, the financial information and commentaries on the Group and divisional performances in the Operating and financial review are compared with the pro forma results for 2000, which have been prepared on the basis described on page 13, and with the statutory results for 2000.

Chairman's statement

In 2002 the Group continued to make good progress. The undoubted highlight was the completion of the NatWest IT integration on to the Royal Bank platform. This project one of the largest integration projects ever undertaken worldwide was completed ahead of schedule, with benefits well in excess of those promised to shareholders during the bid for NatWest.

In the US, the Mellon Regional Franchise was successfully integrated on to the Citizens platform, and again the project was completed ahead of schedule. The success of both these integration projects was a result of good planning, teamwork and sheer hard work on the part of our staff.

On a range of key measures of success including income, profitability, customer numbers, credit quality and return on capital the Group continues to perform well. This is particularly pleasing given that 2002 was by any standard a challenging year.

Financial performance

Profit before tax, goodwill amortisation and integration costs was up 12% to £6,451 million (2001 £5,778 million). Total income grew by 16% to £16,815 million. Our cost:income ratio has again fallen, to 45.6%, down from 47.0% last year, as a result of our strong growth in income, tight control of our cost base and delivery of the benefits from integration. Adjusted earnings per share rose by 13% to 144.1p.

Dividend

The Board has recommended a final dividend for the year of 31.0p which, with the interim dividend of 12.7p, makes a total of 43.7p, an increase of 15%. Our second Additional Value Share dividend of 30.0p was paid on 2 December 2002.

Staff profit sharing

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

Business developments

During 2002 we purchased Dixon Motors PLC which, as one of the UK s largest car dealerships, complements Lombard s existing activities. Direct Line continued its European expansion with the acquisition in Italy of the direct insurance business of Royal Insurance from Royal & Sun Alliance. Citizens Bank announced two further acquisitions in the past year, Medford Bancorp and Commonwealth Bancorp, making it the 17th largest bank by deposits in the US.

Board of directors

We were deeply saddened by the death of Viscount Younger of Leckie on 26th January 2003. Viscount Younger was an outstanding Chairman of the Group over 10 years which saw unparalleled growth and development, culminating in the takeover of NatWest. The business achievements of the Group during that time very much reflect the personal qualities and attributes he brought to the role: he inspired loyalty and warmth amongst his colleagues, as well as providing the Group with vision and leadership of the highest order.

On 1 June 2002, we appointed Colin Buchan as a non-executive director. Colin has spent most of his professional career with UBS Warburg from where he retired as Global Head of Equities.

Having participated in the Review of the Role and Effectiveness of Non-executive Directors undertaken by Derek Higgs during 2002, we are considering his recommendations to ensure that we continue to apply the highest standards of governance.

Economic outlook
While the UK economy is not as strong as it was 12 months ago, we do expect a moderate improvement in growth throughout 2003. Activity in the UK is underpinned by consumer and government spending, which seem set to continue. We expect to see the UK among the best performing industrialised nations again this year. The US economy has made steady progress after the traumas of 2001, aided by a substantial policy stimulus. The gradual improvement should continue in 2003, but the US economy is unlikely to achieve trend growth until next year.

That said, we are clearly in a period of heightened geopolitical and economic risk, which has resulted in increased volatility on many fronts. This continues to colour the sense of optimism which we would otherwise feel on the strength of the underlying fundamentals in the economies in which we principally operate.

Prospects
We remain focussed on building strategic options for the Group and growing income in ways which will provide value for our shareholders, customers and staff. I am confident that the strength, diversity and flexibility of the Group provides us with an excellent platform to build value in the future.

Sir George Mathewson
Chairman

Group Chief Executive's review

The Group continued to make good progress both financially and operationally during 2002. As a result, we increased our Group profit before tax, goodwill amortisation and integration costs by 12%, adjusted earnings per share by 13% and our dividend per share by 15%.

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.

Our customers
All divisions of the Group increased their customer numbers during 2002, arguably the clearest evidence that we are delivering value for our customers. Our divisions achieved consistently good results in various surveys of customer satisfaction, and won a number of awards for customer service. For example, in the important area of small businesses, NatWest was voted   Best Bank that I would recommend to a small business   in the NOP Opinion Formers Survey, while The Royal Bank of Scotland won the award for   Best Small Business Bank   from the Chartered Institute of Management Accountants.

Notwithstanding these pleasing results, there is, as always, no room for complacency and we continue to strive for improvements.

Our people
As ever, the success of the Group is only made possible by the efforts and achievements of our people. Each year, a survey is carried out by the independent firm International Survey Research, which evaluates employee opinion under a number of criteria and relative to various external benchmarks. The response rate to the latest survey was our best ever at 83%, significantly higher than the response rate of 75% to the previous survey.

The latest survey shows that we have further improved our performance from the very good level achieved in the last survey and continue to perform as well as a number of the world s best companies. I am also pleased to report that we are

again ahead of the UK financial services sector in every category and improved our performance relative to both the global financial services and global high performance norms.

Our shareholders

To create value for our shareholders, we concentrate on the simple fundamentals of growing our income and improving our efficiency, whilst disciplining ourselves to retain a bias away from activities and geographies which may bring undue volatility to our results.

During 2002 we grew income across the Group as a whole by 16%. Income growth was particularly strong in Citizens, Direct Line and Retail Direct. This growth was supported by increased customer numbers and business volumes: the Group s net interest margin remained stable at 3.1% (2001 3.1%). A more detailed review of the performance of our individual businesses is outlined later in this document.

In addition to growing its income, the Group improved its efficiency in 2002. On a comparable basis, the Group cost:income ratio improved further to 45.0% (2001 47.0%), and to 45.6% including acquisitions, a level that keeps us at the forefront of efficiency when compared to similar banks in the UK and internationally. This represents a substantial improvement since 1999, when the pro forma cost:income ratio for the enlarged Group, including NatWest, was almost 60%.

Provisions for bad debts were higher in 2002 than in 2001, reflecting the deterioration in the short-term economic environment. However, during 2002, provisions continued at a rate consistent with the second half of 2001 and the growth in our loan portfolio. As ever we remain focussed on ensuring that our balance sheet carries adequate provision for bad debts and our provision coverage remains at 81% of risk elements in lending.

Integration

The large and complex NatWest IT integration was completed successfully in October 2002, several months ahead of schedule. In recognition of this outstanding achievement, an integration bonus amounting to 5% of salary was paid to all employees whose business units were involved in integration.

Last year we announced increased targets for annual transaction benefits amounting to £2,030 million (formerly £1,730 million). These transaction benefits had been fully implemented by February 2003, although their full impact will not show through to profits until 2004.

Our achievements in integration are without doubt one of the principal highlights of the last year. It would however, be a pity if the successful integration were to obscure the strong underlying organic growth which took as much planning, teamwork and effort to be achieved.

Review of divisions

Corporate Banking and Financial Markets increased its contribution before manufacturing costs by 6% to £3,203 million (2001 £3,024 million). Corporate Banking and Financial Markets maintained leading positions in the UK in corporate lending, leasing, deposits, payments, derivatives and foreign exchange and across a wide range of specialised corporate banking activities. Outside the UK, the division achieved good growth in Continental Europe through its offices in Paris, Frankfurt, Milan and Madrid. In the US, the division improved its already strong position in US treasuries and asset-backed securities.

Retail Banking increased its contribution before manufacturing costs by 8% to £3,019 million (2001 £2,807 million). Retail Banking increased its total personal customers by 3% to 13.1 million (2001 12.7 million) and total small business customers by 3% to 1.1 million. Both The Royal Bank of Scotland and NatWest achieved good growth in current accounts, including packaged current accounts, mortgages, personal loans and deposits and small business loans and deposits. NatWest maintained its market leading position for small business relationships.

Retail Direct increased its contribution before manufacturing costs by 27% to £701 million (2001 £551 million). Retail Direct increased its credit card accounts by 4% to 9.5 million (2001 9.1 million), while increasing both credit card balances and fee income associated with these accounts. Tesco Personal Finance grew its customer account base by 29% to 3.4 million (2001 2.6 million). The One account s (formerly Virgin One) average mortgage balances increased by 36% to £4.3 billion (2001 £3.1 billion).

Manufacturing costs increased by 7% to £1,682 million (2001 £1,568 million). Within this amount, technology costs were up by 5% to £662 million (2001 £632 million) and customer support and other operations were also up by 5% to £492 million (2001 £469 million), both reflecting increased volumes and scope across a wide range of activities. Manufacturing completed the conversion of NatWest systems on to the RBS IT platform in October 2002, some months ahead of the original target.

Wealth Management contribution declined by 6% to £432 million (2001 £459 million), principally due to reduced fee income reflecting lower stock market values. However, Coutts, which is investing in its UK regional branch network, increased its total customer base by 5% to over 75,000. Offshore Banking launched a new expatriate service offering a full range of banking and investment services.

Direct Line Group increased its contribution by 36% to £355 million (2001 £261 million). Direct Line Group increased its UK motor insurance policies (including those sold through Tesco Personal Finance) by 16%, to 4.7 million (2001 4.0 million) and its UK home insurance policies by 17%, to 1.6 million (2001 1.4 million). In Continental Europe, Direct Line businesses in Spain, Italy and Germany doubled their total policy numbers to 1.2 million (2001 0.6 million).

Ulster Bank increased its contribution by 7% to £244 million (2001 £229 million). Ulster Bank increased its personal current accounts by 5% and business current accounts by 2%, mainly in the Republic of Ireland. During the year Ulster Bank completed its transformation programme, Project Horizon, which was designed to increase focus on customers across its branch network.

Citizens increased its contribution by 53% to £766 million (2001 £501 million). Citizens increased its personal customer base by 13% to 2.0 million (2001 1.8 million), partly by increasing its distribution capacity through supermarkets. Citizens also increased its business customers by 6% to 197,000 (2001 185,000). In August 2002, Citizens successfully completed the conversion to its own systems of Mellon Financial Corporation s regional banking franchise. Citizens also acquired Medford Bancorp, New England completing conversion in December 2002 and announced the acquisition of Commonwealth Bancorp, Pennsylvania in September 2002.

Outlook

International uncertainty inevitably casts something of a shadow over an otherwise reasonable prognosis for the key economies in which we operate. Whilst we have no particular insights as to how events might unfold, it is clear that the strength, diversity and flexibility of our Group present many options for future growth not only in the UK, but also in the US and in Continental Europe.

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

Fred Goodwin
Group Chief Executive

Description of business

Introduction

The Royal Bank of Scotland Group plc is the holding company of one of the world s largest banking and financial services groups, with a market capitalisation of £43 billion at the end of 2002. Headquartered in Edinburgh, the Group operates in

the UK and internationally through its two principal subsidiaries, The Royal Bank of Scotland plc (the Royal Bank), and National Westminster Bank Plc (NatWest), which it acquired on 6 March 2000. Both the Royal Bank and NatWest are major UK clearing banks whose origins go back over 275 years. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

The Group had total assets of £412 billion and ordinary shareholder s equity of £23.5 billion at 31 December 2002. RBS is strongly capitalised with a total capital ratio of 11.7% and tier 1 capital ratio of 7.3% as at 31 December 2002.

Organisational structure and business overview

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

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

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

On 1 January 2002, Ulster Bank s leasing business was transferred to CBFM and in May 2002, Lombard, the leasing arm of CBFM, completed the acquisition of Dixon Motors PLC, one of the UK s largest car dealerships.

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 and NatWest branches throughout Great Britain and through the telephone, ATMs and the internet. It also has complementary subsidiary businesses covering life assurance and pensions.

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

In December 2002, the Royal Bank acquired Royal Bank of Scotland Unit Trust Management Limited and Royal Bank of Scotland Portfolio Management Limited.

Retail Direct issues a comprehensive range of credit, charge and debit cards to personal and corporate customers and engages in merchant acquisition and processing facilities for retail businesses. It also includes Tesco Personal Finance (TPF), The One account (formerly Virgin One), Direct Line Financial Services (DLFS), Lombard Direct, the Group s internet banking platform, the Primeline brand and in Europe, the Comfort Card businesses, all of them offering products to customers through direct channels. In June 2002, Retail Direct completed the acquisition of the remaining interest that it did not previously own in WorldPay Limited, a well established provider of payment services to businesses trading through the internet.

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

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

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. The offshore businesses deliver retail banking services to local and expatriate customers, and corporate banking and treasury services to corporate, intermediary and institutional clients. Adam & Company is a private bank operating primarily in Scotland.

In September 2002, Wealth Management sold 50% of its interest in NatWest Stockbrokers Limited to TD Waterhouse, part of Toronto Dominion Bank of Canada.

Direct Line Group sells and underwrites retail and wholesale insurance on the telephone and the internet. The Retail Division sells general insurance and motor breakdown services direct to the customer and UKI Partnerships (formerly Green Flag) is a leading wholesale provider of insurance and motoring related services. Through its International Division, Direct Line sells insurance in Spain, Germany, Italy and Japan. The acquisition of Royal & Sun Alliance s direct motor insurance operation in Italy was completed in September 2002, making Direct Line the leading direct motor insurer in Italy.

Ulster Bank provides a comprehensive range of retail and wholesale financial services in Northern Ireland and the Republic of Ireland. Retail Banking has a network of branches throughout Ireland and operates in the personal, commercial and wealth management sectors. Corporate Banking and Financial Markets provides a wide range of services in the corporate and institutional markets. On 1 January 2002, Ulster Bank s leasing business was transferred to CBFM.

Citizens is engaged in retail and corporate banking activities through its branch network in the states of Rhode Island, Connecticut, Massachusetts, New Hampshire, Pennsylvania, Delaware and New Jersey. Citizens is the second largest bank in New England and the 17th largest commercial bank in the US measured by deposits. Citizens provides a full range of retail and corporate banking services, including personal banking, residential mortgages and home equity loans. In addition, Citizens engages in a wide variety of commercial loans (including real estate), consumer lending, credit card services, trust services and retail investment services. Citizens also operates subsidiaries primarily engaged in equipment lease financing.

In October 2002, Citizens completed the acquisition of Medford Bancorp Inc, a Massachusetts savings bank, and in January 2003, completed the acquisition of Pennsylvania based commercial bank, Commonwealth Bancorp Inc.

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

Competition The company and its subsidiaries are subject to intense competition in all aspects of their business. In the UK, the Royal Bank and NatWest s principal competitors are other clearing banks, building societies (which are similar to savings and loans associations in the US) and the other major international banks.

Competition to serve corporate and institutional customers in the UK remains strong. In addition to the UK clearing bank groups, large US and European financial institutions are also active and offer combined investment and commercial banking capabilities. The capital markets continue to innovate and provide a broad range of financing and risk management solutions for corporate customers. In asset finance, Lombard competes with both banks and specialised asset finance providers.

In the small business banking market, the Group competes with other UK clearing bank groups, with specialised finance providers and building societies. During 2002, competition within small business banking remained strong as former building societies continued to develop their offerings.

In the personal banking market, competition remains intense. In addition to UK banks and building societies, major retailers, life assurance companies and internet-only players are active in the market. NatWest Life and Royal Scottish Assurance compete with Independent Financial Advisors and life assurance companies. The competitive situation in the long term savings market is dynamic due to regulatory changes and the impact of highly volatile securities markets on both customer confidence and traditional with-profits life assurance companies solvency.

The UK credit card market is highly competitive. Major retailers, utilities and specialist card issuers, including the major US operators, are active in the market in addition to UK banks and building societies. Competition is across a range of dimensions, including aggressive pricing, loyalty and reward schemes and packaged benefits. In addition to physical distribution channels, providers compete through direct marketing activity and increasingly, the internet.

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

Direct Line competes in personal insurance. The market is highly competitive, particularly the motor segment. Direct Line faces competition from a range of insurance companies who now operate telephone and internet direct sales business. Direct Line also competes in the direct motor insurance markets in Spain, Italy, Germany and Japan.

In Northern Ireland and the Republic of Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market. Competition is intensifying as both UK and Irish institutions seek to expand their businesses.

 Description of business continued

In the United States, Citizens, through its banking subsidiaries, competes primarily in New England, and from December 2001, in Pennsylvania, in retail and mid-corporate banking markets with local and regional banks and other financial institutions. The Royal Bank of Scotland Group also competes in the US through RBS Greenwich Capital and branches of RBS and NatWest, in large corporate lending and specialised finance markets, and in fixed-income trading and sales. Competition is principally with the large US commercial and investment banks and international banks active in the US.

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

Risk factors

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

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

Changes in interest rates,foreign exchange rates,equity prices and other market factors affect the Group s business The most significant market risks the Group faces are interest rate, foreign exchange and bond and equity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Changes in currency rates, particularly in the sterling-dollar and sterling-euro exchange rates, affect the value of assets and liabilities denominated in foreign currencies and affect earnings reported by the Group s non-UK subsidiaries, mainly Citizens, RBS Greenwich Capital and Ulster Bank, and may affect income from foreign exchange dealing. The performance of financial markets may cause changes in the value of the Group s investment and trading portfolios. The Group has implemented risk management methods to mitigate and control these

and other market risks to which the Group is exposed. However, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group s financial performance and business operations.

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

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

Each of the Group s businesses is subject to substantial regulation and regulatory oversight.Any significant regulatory developments could have an effect on how the Group conducts its business and on the Group s results of operations The Group is subject to financial services laws, regulations, administrative actions and policies in each location in which the Group operates. This supervision and regulation, in particular in the UK, if changed could materially affect the Group s business, the products and services offered or the value of assets.

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

Operating and financial review

Critical accounting policies

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Group s principal accounting policies are set out on pages 93 to 95. UK company law and accounting standards require the directors, in preparing the Group s financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. Where UK GAAP allows a choice of policy, Financial Reporting Standard (FRS) 18 Accounting Policies requires an entity to adopt those policies judged to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.

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

Loans and advances provisions for bad and doubtful debts The Group provides for losses existing in its lending book so as to state its loan portfolio at its expected ultimate net realisable value. Specific provisions are established against individual exposures and the general provision covers advances impaired at the balance sheet date but which have not been identified as such. For exposures 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 value of any security. For certain portfolios of homogeneous loans, specific provisions are established on a portfolio basis, based on historical loss experience and the level of arrears. The general provision is assessed in the light of general economic conditions, the size and diversity of the Group s portfolio, a review of internal credit risk classifications and the scope of specific provisioning procedures.

The determination of the Group s specific and general bad debt provisions involves numerous estimates and judgements. These include the identification of deteriorating loans, the amounts and timing of loan cash flows and the realisable value of collateral.

Loans and advances recognition of interest income Interest is accrued on loans and advances unless its receipt is in significant doubt. Doubtful interest is not credited to the profit and loss account but to an interest in suspense account. Interest is not accrued on loans that have been written off.

Fair value Securities and derivatives held for trading purposes are carried at fair value with changes in this value reflected in the profit and loss account. Fair values are based on quoted market prices where available. If quoted prices are not available for an instrument, fair value is determined from market prices for its components using appropriate pricing models. Where the Group s position is of such a size that the price obtainable would be materially different from the quoted price, the quoted price is adjusted based on management s estimate of the price that the Group would realise from the holding in current market conditions. Where instruments such as over-the-counter derivatives are valued using pricing models, the value of the instrument and changes in that value are affected by the model and its underlying assumptions.

General insurance claims The Group makes provision 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. Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions.

Goodwill The Group capitalises acquired goodwill and amortises it over its useful economic life. Under UK GAAP, there is a rebuttable presumption that the useful economic life of purchased goodwill is limited and does not exceed 20 years from the date of acquisition.

Accounting developments

UK GAAP The Group has implemented FRS 19 Deferred Tax which requires recognition of deferred tax assets and liabilities on all timing differences, with specified exceptions. Previously, provision was made for deferred tax only to the extent that timing differences were expected to reverse and the deferred tax liability crystallise in the foreseeable future. The effect of adopting the new policy is to increase the tax charge for 2002 by £45 million and to reduce profit and loss account reserves at 31 December 2002 by £162 million. Prior periods have been restated as follows:

	2001 £m	2000 £m	Pro forma 2000 £m
Decrease in profit and loss account reserves at 31 December	(117)	(117)	(117)
Increase in deferred tax asset at 31 December	77	65	65
Increase in deferred tax liability at 31 December	194	182	182
Increase in tax charge for the year	-	21	6

Following the issuance of Urgent Issues Task Force Abstract 33 Obligations in capital instruments (UITF 33) in February 2002, the Group has reclassified its perpetual regulatory tier one securities, issued in August 2001, from non-equity shareholders funds to subordinated liabilities and the interest on these securities (£60 million in 2002) is now included in interest payable rather than non-equity dividends. Comparative figures have been restated resulting in an increase in interest payable of £23 million in 2001, a reduction in non-equity shareholders funds of £835 million, an increase in

undated loan capital of £820 million and an increase in accruals and deferred income of £15 million as at 31 December 2001.

International Financial Reporting Standards (IFRS) In June 2002, the European Parliament and Council of the European Union issued a Regulation that will require all EU listed companies to prepare their consolidated accounts in accordance with IFRS rather than existing national GAAP. The Regulation takes effect from 2005, consequently the accounting framework under which the Group reports will change. The Group will produce its consolidated accounts in accordance with IFRS for the year ended 31 December 2005.

US GAAP The following USGAAP developments have no material affect on the Group s USGAAP reporting.

In April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 145 Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections . SFAS 145 rescinds existing requirements for accounting for extinguishments of debt, removes an inconsistency in the existing requirements for accounting by lessees for certain lease amendments, and makes other technical corrections to existing statements.

In October 2002, the FASB issued SFAS 147 Acquisitions of Certain Financial Institutions . SFAS 147 requires certain acquisitions that fell within the scope of SFAS 72 Accounting for Certain Acquisitions of Banking or Thrift Institutions to be accounted for in accordance with SFAS 141 Business Combinations , and includes transitional provisions to deal with unidentified intangible assets recognised under SFAS 72. SFAS 147 is effective from 1 October 2002.

The Group is currently considering the effect, if any, of the following US GAAP developments on its USGAAP reporting.

In July 2002, the FASB issued SFAS 146 Accounting for Costs Associated with Exit or Disposal Activities . SFAS 146 addresses the recognition and measurement of employee termination costs, contract termination costs and other costs associated with exit or disposal activities, and related disclosures. SFAS 146 is applicable to exit and disposal activities initiated after 31 December 2002.

In November 2002, the FASB issued FASB Interpretation No. (FIN) 45 Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34 . FIN 45 requires guarantees entered into or modified after 31 December 2002 to be recognised and measured initially at their fair value. The Group is reviewing the initial recognition and measurement requirements of this Statement to assess their effect on its US GAAP reporting.

In December 2002, the FASB issued SFAS 148 Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of FASB Statement No. 123 . SFAS 148 addresses the treatment of a voluntary change in accounting for stock-based employee compensation from the intrinsic value method under APB Opinion No. 25, Accounting for Stock Issued to Employees , to the fair value based method under SFAS 123. The Group is currently not contemplating moving to accounting for stock-based compensation using the fair value based method of SFAS.

In January 2003, the FASB issued FASB Interpretation No. 46 Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 . FIN 46 addresses accounting for variable interest entities, which are entities where the equity investment at risk is not sufficient to permit the entity to finance its activities without subordinated support from other parties to absorb losses, or where the equity investors lack certain essential characteristics of a controlling financial interest. FIN 46 requires the primary beneficiary of a variable interest entity to consolidate that entity. An enterprise is the primary beneficiary of a variable interest entity if it holds an interest that will absorb the majority of its expected losses or receive a majority of its expected residual returns. FIN 46 requires the holder of a significant variable interest in a variable interest entity to make certain disclosures. The requirements of FIN 46 apply to new variable interest entities created after 31 January 2003, or where the reporting entity acquires an interest after that date, and to other variable interest entities in the first fiscal year or interim period beginning after 15 June 2003.

However, FIN 46 requires disclosures in financial statements issued after 31 January 2003 about variable interest entities that, when FIN 46 becomes effective, it is reasonably possible that the reporting enterprise will consolidate or about which the enterprise will disclose information in accordance with FIN 46. The Group has undertaken a review to identify variable interest entities in which it is the primary beneficiary or in which it has a significant variable interest. The Group has concluded that it is reasonably possible that it is the primary beneficiary of, or has a significant interest in a number of commercial paper conduits and other asset securitisation vehicles that meet FIN 46 s definition of a variable interest entity. These entities acquire financial assets from third parties or from the Group funded by the issue of commercial paper or other debt instruments. The Group

supplies certain administrative services and provides credit enhancement, liquidity facilities and derivative transactions to some or all of the entities on an arm s length basis. In the case of the commercial paper conduits, the Group provides programme wide credit enhancement by letters of credit or loan facilities across all tranches of assets funded by conduits. The Group provides funding in the form of reverse repurchase agreements on bonds owned by one variable interest entity. At 31 December 2002, the Group held loan notes issued by these entities with a principal amount of £19 million, had outstanding undrawn liquidity lines amounting to £3.6 billion, and total rate of return swaps with a notional amount of £0.7 billion. The Group s maximum exposure to loss, in the event of non-performance of the entire portfolio of assets in these entities and if all counterclaims proved valueless, is represented by the contractual amount of these instruments.

As experience with FIN 46 develops, the Group is continuing to review its existing interests to identify other variable interest entities in which the Group may have a significant variable interest or of which the Group may be the primary beneficiary.

Overview of results

In the review and analysis of results on pages 14 to 26, the Group s 2002 results are compared with 2001. In addition, the 2001 results are compared with 2000 on both a pro forma and a statutory basis. The acquisition of NatWest had a significant effect on the Group s financial position in 2000. Pro forma results for the year ended 31 December 2000 were prepared on the assumption that NatWest was acquired on 1 January 2000, and a number of other assumptions detailed below. Management believes that this approach facilitates relevant and meaningful comparisons and provides a benchmark against which the Group s current and future performance can be judged.

Basis of presentation and preparation of results

(1) Basis of presentation

The results for the three years ended 31 December 2002 have been presented on the following basis:

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

Integration costs comprise expenditure incurred in respect of cost reduction and revenue enhancement targets set in connection with the acquisition of NatWest, costs of integrating the regional retail and commercial banking operations acquired from Mellon Financial Corporation in December 2001 (the Mellon Regional Franchise), together with expenditure incurred on the related cost reduction and revenue enhancement targets, and the costs of integrating Medford Bancorp Inc. acquired in October 2002.

(2) Basis of preparation of 2000 pro forma results

The pro forma results for 2000 have been prepared on the basis set out below:

They incorporate the full year results of NatWest for 2000 and assume that the fair value adjustments were made on 31 December 1999.

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 2000 has been amortised from the effective dates of acquisition, generally also over 20 years. Goodwill arising on acquisitions prior to 1 January 2000 was written off directly to reserves and has not been reinstated, as permitted by FRS 10.

A surplus of £1,070 million in NatWest Pension Funds has been amortised, from 1 January 2000, over the estimated average remaining service life of members of the schemes.

An adjustment has been made to reflect the net funding of the acquisition of NatWest as if acquired on 1 January 2000. 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.

The results of NatWest businesses disposed of since 1 January 2000 and the profit arising on their sale have been excluded from the pro forma results. The principal disposals were 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 2000.

The derivation of the pro forma results for 2000 is set out on page 160.

Summary consolidated profit and loss account for the year ended 31 December 2002

The profit and loss account set out below shows goodwill amortisation and integration costs separately. In the statutory profit and loss account on pages 96 and 97, these items are included in the captions prescribed by the Companies Act.

	2002 £m	2001* £m	2000* £m	Pro forma 2000* £m
Net interest income	7,849	6,846	5,286	5,929
Dividend income	58	54	44	46
Fees and commissions receivable	5,308	4,735	3,614	4,079
Fees and commissions payable	(965)	(930)	(706)	(804)
Dealing profits	1,462	1,426	933	1,131
Other operating income	1,209	1,052	874	998
	7,072	6,337	4,759	5,450
General insurance premium income - net	1,894	1,375	950	979
Non-interest income	8,966	7,712	5,709	6,429
Total income	16,815	14,558	10,995	12,358
Staff costs	3,942	3,461	3,019	3,440
Other operating expenses	3,727	3,380	2,815	3,174

Operating expenses	**7,669**	6,841	5,834	6,614
Profit before other operating charges	**9,146**	7,717	5,161	5,744
General insurance claims net	**1,350**	948	673	698
Operating profit before provisions	**7,796**	6,769	4,488	5,046
Provisions for bad and doubtful debts	**1,286**	984	550	602
Amounts written off fixed asset investments	**59**	7	42	43
Profit before goodwill amortisation and integration costs	**6,451**	5,778	3,896	4,401
Goodwill amortisation	**731**	651	537	640
Integration costs	**957**	875	389	434
Profit before tax	**4,763**	4,252	2,970	3,327
Tax	**1,556**	1,537	1,054	1,177
Profit after tax	**3,207**	2,715	1,916	2,150
Minority interests (including non-equity)	**133**	90	50	54
Preference dividends - non-equity	**305**	358	294	328
	2,769	2,267	1,572	1,768
Additional Value Shares dividend - non-equity	**798**	399	-	-
Profit attributable to ordinary shareholders	**1,971**	1,868	1,572	1,768
Earnings per ordinary share	**68.4p**	67.6p	66.9p	66.5p
Additional Value Shares dividend	**27.7p**	14.5p	-	-
	96.1p	82.1p	66.9p	66.5p
Goodwill amortisation	**24.2p**	23.2p	22.4p	23.6p
Integration costs	**23.8p**	22.6p	11.9p	11.7p
Adjusted earnings per ordinary share	**144.1p**	127.9p	101.2p	101.8p

* restated (see page 10)

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

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

million against £875 million in 2001.

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

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

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

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

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

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

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

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

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

Cost:income ratio Strong income growth coupled with tight cost management resulted in a further improvement in the Group s cost:income ratio, to 45.6% from 47.0%. Excluding the effect of acquisitions, the cost:income ratio improved to 45.0%.

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

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

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

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

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

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

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

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

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

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

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

In the US, Citizens completed the IT integration of the Mellon Regional Franchise in August 2002, earlier than planned. Benefits from this transaction have been delivered more quickly than was envisaged, and are on track to be delivered in full.

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

A second dividend of 30.0p per share was paid on 2 December 2002 to the holders of AVS issued in connection with the acquisition of NatWest. By the end of 2002, a total of 45.0p per AVS had been paid, in accordance with the original payment schedule. The third and final AVS dividend, if declared by the directors, of 55.0p per AVS will be paid on 1 December 2003.

A final dividend of 31.0p per ordinary share is recommended, resulting in a total ordinary dividend for the year of 43.7p per ordinary share, an increase of 15%. The total dividend is covered 3.3 times by earnings before goodwill amortisation, integration costs and the AVS dividend.

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

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

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

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

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

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

2001 compared with 2000

The year ended 31 December 2001 included a full year s results of NatWest whereas the year ended 31 December 2000 only included the results of NatWest from the date of its acquisition, 6 March 2000. This has contributed to the year on year variances in addition to factors included in the following discussion on a statutory basis. For a comparison of the results for the year ended 31 December 2001 with the pro forma results for the year ended 31 December 2000, see page 18.

Profit before tax for the year ended 31 December 2001 at £4,252 million was up 43%, £1,282 million, from £2,970 million for the year ended 31 December 2000. All businesses contributed to this improvement.

Total income rose by 32%, £3,563 million, to £14,558 million.

Net interest income increased by 30%, £1,560 million, to £6,846 million due to strong growth in lending and deposits across all businesses.

Non-interest income, excluding net general insurance premiums, grew by 33%, £1,578 million, to £6,337 million. Fees and commissions receivable were up 31%, £1,121 million, to £4,735 million. Dealing profits increased by 53%, £493 million, to £1,426 million due to increased customer activity and favourable market conditions. This additional dealing income contributed approximately £160 million to the Group s profits. Other operating income was 20%, £178 million higher at £1,052 million.

General insurance premium income, after reinsurance, increased by 45%, £425 million, to £1,375 million.

Operating expenses rose by 17%, £1,007 million, to £6,841 million primarily due to inflation, business development and customer service improvement initiatives. Staff expenses were up 15%, £442 million to £3,461 million. Other expenses were up 20%, £565 million, to £3,380 million.

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.

General insurance claims, after reinsurance, increased by 41%, £275 million, to £948 million.

New provisions were up 42%, £315 million, to £1,071 million. This increase reflected 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 £84 million, 51% to £80 million. Consequently, the net charge to the profit and loss account was up from £592 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.

Citizens completed the acquisition of the regional retail and commercial banking operations of Mellon Financial Corporation on 1 December 2001 for a cash consideration of approximately US$2.2 billion (£1,564 million). The goodwill arising on this acquisition amounted to £1,655 million.

Integration costs for NatWest were £847 million compared with £345 million in 2000; £28 million was incurred in the early stages of integrating the Mellon Regional Franchise with Citizens.

The tax charge for the year was £1,537 million, equivalent to 36% of profit before tax of £4,252 million. The rate was affected by goodwill amortisation, which is not allowable for UK tax purposes. The effective tax rate after adjusting for goodwill amortisation was 32% (2000 30%).

Earnings per share, adjusted for goodwill amortisation, integration costs and the dividend on the AVS, increased from 101.2 pence to 127.9 pence.

The first dividend of 15.0 pence per share was paid on 3 December 2001 on the AVS issued in connection with the acquisition of NatWest.

The total dividend for the year was 38.0 pence per ordinary share, up 15% on 2000. The total ordinary dividend is covered 3.3 times by earnings before goodwill amortisation, integration costs and the AVS dividend.

Profit attributable to ordinary shareholders after tax, minority interests and preference dividends at £2,267 million, increased by 44%. After deducting the dividend on the AVS, attributable profit increased by 19%, from £1,572 million to £1,868 million.

Group 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.

2001 compared with pro forma 2000

The Group performed strongly in 2001, driven by higher income and improvements in efficiency in each of its businesses. Good progress continued to be made on the integration of NatWest.

Profit before tax, goodwill amortisation and integration costs at £5,778 million was up 31%, £1,377 million, from £4,401 million. Profit before tax at £4,252 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 rose by 18%, £2,200 million, to £14,558 million. Strong growth was achieved across all businesses.

Net interest income increased by 15%, £917 million, to £6,846 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 rose 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 December 2001 in the acquisition of the Mellon Regional Franchise, contributed to this improvement and more than offset a small decrease in deposit margins.

Non-interest income, which represented 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 up £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.

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 Group s focus on income growth along with tight control of costs and the benefits of integration led to a reduction in the cost:income ratio down from 53.5% to 47.0%.

New provisions were up 27%, £230 million to £1,071 million. This increase reflected 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.

Earnings per share, adjusted for goodwill amortisation, integration costs and the AVS dividend, increased by 26%, from 101.8 pence to 127.9 pence.

Analysis of results

Net interest income

	2002	2001*	2000	Pro forma 2000
	£m	£m	£m	£m
Interest receivable	13,561	14,421	13,218	14,626
Interest payable	(5,712)	(7,575)	(7,932)	(8,697)
Net interest income	7,849	6,846	5,286	5,929
	%	%	%	%
Gross yield on interest-earning assets of banking business	5.4	6.6	7.4	7.4
Cost of interest-bearing liabilities of banking business	(2.7)	(4.0)	(5.1)	(5.1)

Interest spread of banking business	**2.7**	2.6	2.3	2.3
Benefit from interest-free funds	**0.4**	0.5	0.7	0.7
Net interest margin of banking business	**3.1**	3.1	3.0	3.0

Yields, spreads and margins of the banking business	**%**	%	%	%
Gross yield				
Group	**5.4**	6.6	7.4	7.4
UK	**5.6**	6.6	7.5	7.5
Overseas	**5.0**	6.4	7.3	7.2
Interest spread				
Group	**2.7**	2.6	2.3	2.3
UK	**2.7**	2.6	2.4	2.4
Overseas	**2.7**	2.5	2.0	1.9
Net interest margin				
Group	**3.1**	3.1	3.0	3.0
UK	**3.1**	3.2	3.0	3.1
Overseas	**3.1**	3.0	2.8	2.7
The Royal Bank of Scotland plc base rate	**4.0**	5.1	6.0	6.0
London inter-bank three month offered rates:				
Sterling	**4.1**	5.0	6.2	6.2
Eurodollar	**1.8**	3.8	6.5	6.5
Euro	**3.3**	4.3	4.4	4.4

* restated (see page 10)

(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.

2002 compared with 2001

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

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

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

2001 compared with 2000 and pro forma 2000

Net interest income increased by 30% and 15%, compared with 2000 and pro forma 2000 respectively, to £6,846 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 compared with pro forma 2000.

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 December 2001 in the acquisition of the Mellon Regional Franchise, contributed to this improvement and more than offset a small decrease in deposit margins.

Average balance sheet and related interest

	2002			2001*		
	Average balance	Interest	Rate	Average balance	Interest	Rate
Year ended 31 December	£m	£m	%	£m	£m	%
Assets						
Treasury and other eligible bills						
UK	910	24	2.6	231	11	4.8
Overseas	351	6	1.7	277	8	2.9
Loans and advances to banks						
UK	13,439	532	4.0	18,214	834	4.6
Overseas	9,811	304	3.1	7,467	421	5.6
Loans and advances to customers						
UK	154,202	9,141	5.9	137,232	9,584	7.0
Overseas	35,759	1,963	5.5	28,847	1,981	6.9
Debt securities						
UK	17,950	675	3.8	16,632	931	5.6
Overseas	18,188	916	5.0	11,427	651	5.7
Total interest-earning assets						
banking business	250,610	13,561	5.4	220,327	14,421	6.6
trading business (3)	78,380			66,545		
Total interest-earning assets	328,990			286,872		
Non-interest-earning assets	65,898			63,385		
Total assets	394,888			350,257		
Percentage of assets applicable to overseas operations	32.0%			27.1%		

Liabilities and shareholders equity

Deposits by banks						
UK	**21,090**	**544**	**2.6**	18,360	760	4.1
Overseas	**9,058**	**215**	**2.4**	8,779	382	4.4
Customer accounts: demand deposits						
UK	**58,618**	**1,062**	**1.8**	54,237	1,576	2.9
Overseas	**8,275**	**99**	**1.2**	6,422	154	2.4
Customer accounts: savings deposits						
UK	**16,002**	**463**	**2.9**	15,892	594	3.7
Overseas	**11,742**	**229**	**2.0**	11,690	435	3.7
Customer accounts: other time deposits						
UK	**45,902**	**1,542**	**3.4**	43,161	1,967	4.6
Overseas	**16,264**	**462**	**2.8**	8,127	338	4.2
Debt securities in issue						
UK	**24,154**	**965**	**4.0**	20,140	1,031	5.1
Overseas	**8,693**	**209**	**2.4**	8,407	384	4.6
Loan capital						
UK	**13,154**	**640**	**4.9**	10,779	657	6.1
Overseas	**166**	**17**	**10.2**	171	14	8.2
Internal funding of trading business						
UK	**(20,129)**	**(709)**	**3.5**	(14,626)	(654)	4.5
Overseas	**(1,301)**	**(26)**	**2.0**	(1,576)	(63)	4.0
Total interest-bearing liabilities						
banking business	**211,688**	**5,712**	**2.7**	189,963	7,575	4.0
trading business (3)	**75,059**			63,159		
Total interest-bearing liabilities	**286,747**			253,122		
Non-interest-bearing liabilities						
Demand deposits						
UK	**21,848**			21,025		
Overseas	**6,401**			4,513		
Other liabilities	**52,600**			46,249		
Shareholders funds						
equity	**23,553**			21,073		
non-equity	**3,739**			4,275		
Total liabilities and shareholders equity	**394,888**			350,257		
Percentage of liabilities applicable to overseas operations	**30.4%**			27.5%		

* restated (see page 10)

Notes:

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

(2) Loans and advances to customers include non-accrual loans. Interest income includes income on non-accruing loans only to the extent cash payments have been received.

(3) Interest receivable and interest payable on trading assets and liabilities are included in dealing profits.

	2000*			Pro forma 2000*		
Year ended 31 December	Average balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets						
Treasury and other eligible bills						
UK	444	21	4.7	463	21	4.5
Overseas	78	4	5.1	131	6	4.6
Loans and advances to banks						
UK	12,880	759	5.9	14,965	862	5.8
Overseas	7,429	508	6.8	8,884	591	6.7
Loans and advances to customers						
UK	108,242	8,622	8.0	120,415	9,550	7.9
Overseas	23,396	1,844	7.9	25,067	1,948	7.8
Debt securities						
UK	15,855	896	5.7	18,004	1,032	5.7
Overseas	9,014	564	6.3	9,812	616	6.3
Total interest-earning assets						
banking business	177,338	13,218	7.4	197,741	14,626	7.4
trading business (3)	45,122			53,946		
Total interest-earning assets	222,460			251,687		
Non-interest-earning assets	46,667			53,044		
Total assets	269,127			304,731		
Percentage of assets applicable to overseas operations	27.7%			27.5%		
Liabilities and shareholders equity						
Deposits by banks						
UK	12,325	686	5.6	13,851	751	5.4
Overseas	6,472	375	5.8	7,667	435	5.7
Customer accounts: demand deposits						
UK	43,337	1,593	3.7	48,533	1,765	3.6
Overseas	3,677	145	3.9	4,132	163	3.9

Customer accounts: savings deposits						
UK	14,820	681	4.6	16,781	768	4.6
Overseas	9,717	411	4.2	9,728	413	4.2
Customer accounts: other time deposits						
UK	36,300	2,163	6.0	40,698	2,401	5.9
Overseas	7,524	426	5.7	8,437	470	5.6
Debt securities in issue						
UK	13,797	815	5.9	14,831	869	5.9
Overseas	6,799	433	6.4	7,881	494	6.3
Loan capital						
UK	8,941	647	7.2	9,829	699	7.1
Overseas	413	40	9.7	502	49	9.8
Internal funding of trading business						
UK	(8,943)	(440)	4.9	(10,774)	(528)	4.9
Overseas	(827)	(43)	5.2	(1,025)	(52)	5.1
Total interest-bearing liabilities banking business	154,352	7,932	5.1	171,071	8,697	5.1
trading business (3)	42,046			50,336		
Total interest-bearing liabilities	196,398			221,407		
Non-interest-bearing liabilities						
Demand deposits						
UK	15,581			18,206		
Overseas	3,531			3,732		
Other liabilities	34,239			38,715		
Shareholders funds						
equity	15,933			18,838		
non-equity	3,445			3,833		
Total liabilities and shareholder s equity	269,127			304,731		
Percentage of liabilities applicable to overseas operations	27.6%			27.6%		

* restated (see page 10)

Notes:

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

(2) Loans and advances to customers include non-accrual loans. Interest income includes income on non-accruing loans only to the extent cash payments have been received.

(3) Interest receivable and interest payable on trading assets and liabilities are included in dealing profits.

Analysis of change in net interest income - volume and rate analysis

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

	2002 over 2001			2001 over 2000*			2001 over pro forma 2000*		
	Increase/(decrease) due to changes in:			Increase/(decrease) due to changes in:			Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m
Interest-earning assets									
Treasury and other eligible bills									
UK	20	(7)	13	(10)	-	(10)	(11)	1	(10)
Overseas	2	(4)	(2)	6	(2)	4	5	(3)	2
Loans and advances to banks									
UK	(199)	(103)	(302)	268	(193)	75	167	(195)	(28)
Overseas	108	(225)	(117)	3	(90)	(87)	(87)	(83)	(170)
Loans and advances to customers									
UK	1,105	(1,548)	(443)	2,106	(1,144)	962	1,229	(1,195)	34
Overseas	423	(441)	(18)	395	(258)	137	275	(242)	33
Debt securities									
UK	69	(325)	(256)	43	(8)	35	(78)	(23)	(101)
Overseas	348	(83)	265	141	(54)	87	95	(60)	35
Total interest receivable of banking business									
UK	995	(1,983)	(988)	2,407	(1,345)	1,062	1,307	(1,412)	(105)
Overseas	881	(753)	128	545	(404)	141	288	(388)	(100)
	1,876	(2,736)	(860)	2,952	(1,749)	1,203	1,595	(1,800)	(205)
Interest-bearing liabilities									
Deposits by banks									
UK	(101)	317	216	(279)	205	(74)	(211)	202	(9)
Overseas	(12)	179	167	(114)	107	(7)	(57)	110	53
Customer accounts: demand deposits									
UK	(119)	633	514	(355)	372	17	(192)	381	189
Overseas	(36)	91	55	(80)	71	(9)	(69)	78	9
Customer accounts: savings deposits									
UK	(4)	135	131	(47)	134	87	39	135	174
Overseas	(2)	208	206	(77)	53	(24)	(77)	55	(22)
Customer accounts: other time deposits									
UK	(119)	544	425	(366)	562	196	(138)	572	434
Overseas	(257)	133	(124)	(32)	120	88	17	115	132
Debt securities in issue									
UK	(184)	250	66	(336)	120	(216)	(282)	120	(162)
Overseas	(13)	188	175	(89)	138	49	(31)	141	110
Loan capital									
UK	(130)	147	17	(121)	111	(10)	(64)	106	42

Overseas	-	(3)	(3)	21	5	26	28	7	35
Internal funding of trading business									
UK	213	(158)	55	257	(43)	214	176	(50)	126
Overseas	(10)	(27)	(37)	32	(12)	20	24	(13)	11
Total interest payable of banking business									
UK	(444)	1,868	1,424	(1,247)	1,461	214	(672)	1,466	794
Overseas	(330)	769	439	(339)	482	143	(165)	493	328
	(774)	2,637	1,863	(1,586)	1,943	357	(837)	1,959	1,122
Movement in net interest income									
UK	551	(115)	436	1,160	116	1,276	635	54	689
Overseas	551	16	567	206	78	284	123	105	228
	1,102	(99)	1,003	1,366	194	1,560	758	159	917

* restated (see page 10)

Non-interest income

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Dividend income	58	54	44	46
Fees and commissions receivable	5,308	4,735	3,614	4,079
Fees and commissions payable	(965)	(930)	(706)	(804)
Dealing profits	1,462	1,426	933	1,131
Other operating income	1,209	1,052	874	998
	7,072	6,337	4,759	5,450
General insurance premium income				
Earned premiums	2,383	1,804	1,344	1,346
Reinsurance	(489)	(429)	(394)	(367)
	1,894	1,375	950	979
	8,966	7,712	5,709	6,429

2002 compared with 2001

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

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

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

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

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

2001 compared with 2000

Non-interest income, which represented 53% of total income, grew by 33%, £1,578 million, to £6,337 million, excluding general insurance. 2001 included a full year s results for NatWest compared with 2000, which included its results from the date of acquisition, 6 March 2000. Fees and commissions receivable were up 31%, £1,121 million, to £4,735 million, with growth in lending related fees, cards and merchant acquiring and in money transmission fees. Dealing profits were £493 million, 53% ahead of the prior year as a result of 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 45%, £425 million, to £1,375 million, reflecting strong volume growth in Direct Line and branch-based insurance.

2001 compared with pro forma 2000

Non-interest 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 up £295 million, 26% 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.

Operating expenses (excluding goodwill amortisation and integration costs)

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Administrative expenses				
Staff costs	**3,942**	3,461	3,019	3,440
Premises and equipment	**879**	809	726	839
Other administrative	**1,955**	1,715	1,380	1,566

Total administrative expenses	**6,776**	5,985	5,125	5,845
Depreciation of tangible fixed assets	**893**	856	709	769
Operating expenses	**7,669**	6,841	5,834	6,614

2002 compared with 2001

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

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

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

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

Strong income growth coupled with tight cost management resulted in a further improvement in the Group s cost income ratio, to 45.6% from 47.0%. Excluding the effect of acquisitions the cost:income ratio improved to 45.0%.

2001 compared with 2000

Operating expenses rose by 17%, £1,007 million, to £6,841 million. Other than the inclusion of a full year s costs of NatWest in 2001 compared with 2000, which included its costs from the date of acquisition, 6 March 2000, the increase was primarily due to inflation, business development and customer service improvement initiatives.

The number of staff employed in the Group rose by 11,700, 12% to 105,700. The increase reflected 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.

2001 compared with pro forma 2000

Operating expenses 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.

Integration costs

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m

Staff costs	**530**	598	255	286
Premises and equipment	**127**	64	27	27
Other administrative expenses	**298**	188	95	109
Depreciation of tangible fixed assets	**2**	25	12	12
Integration costs	**957**	875	389	434

The IT integrations of NatWest and the Mellon Regional Franchise were completed during the year, ahead of schedule in both cases.

Integration costs in relation to NatWest were £810 million compared with £847 million in 2001 and £345 million in 2000. Implementation has been faster which has resulted in revenue benefits and cost savings being achieved ahead of plan.

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

Provisions

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Gross new provisions	**1,408**	1,071	756	841
less: recoveries	**(63)**	(80)	(164)	(196)
Charge to profit and loss account	**1,345**	991	592	645
Comprising:				
Provisions for bad and doubtful debts	**1,286**	984	550	602
Amount written off fixed asset investments	**59**	7	42	43
Charge to profit and loss account	**1,345**	991	592	645

2002 compared with 2001

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

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

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

2001 compared with 2000 and pro forma 2000

Gross new provisions were up 42% and 27% compared with 2000 and pro forma 2000 respectively, to £1,071 million. The increase reflected 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 £84 million and £116 million, compared with 2000 and pro forma 2000 respectively, to £80 million. Consequently the net charge to the profit and loss account increased to £991 million, up £399 million, 67% and £346 million, 54% on 2000 and pro forma 2000 respectively.

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

Taxation

	2002 £m	2001* £m	2000* £m	Pro forma 2000* £m
Tax on profit on ordinary activities	**1,556**	1,537	1,054	1,177
	%	%	%	%
UK corporation tax rate	**30.0**	30.0	30.0	30.0
Effective tax rate	**32.7**	36.1	35.5	35.4

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

	2002 £m	2001 £m	2000* £m	Pro forma 2000* £m
Expected tax charge	**1,429**	1,276	891	998
Goodwill amortisation	**183**	169	162	194
Contributions to employee share trust	**(40)**	(48)	(47)	(47)
Non-deductible items	**179**	251	197	189
Non-taxable items	**(163)**	(92)	(217)	(229)
Capital allowances in excess of depreciation	**(340)**	(280)	(143)	(143)
Other	**7**	(7)	(14)	(10)
Adjustments in respect of prior periods	**(15)**	15	(79)	(79)
Current tax charge for year	**1,240**	1,284	750	873
Deferred taxation:				
Origination and reversal of timing differences	**372**	255	225	225
Adjustments in respect of prior periods	**(56)**	(2)	79	79
Actual tax charge	**1,556**	1,537	1,054	1,177

* restated (see page 10)

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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Corporate Banking and Financial Markets*	3,203	3,024	2,431	2,740
Retail Banking	3,019	2,807	2,116	2,467
Retail Direct	701	551	341	373
Manufacturing	(1,682)	(1,568)	(1,426)	(1,660)
Wealth Management	432	459	354	405
Direct Line Group	355	261	201	201
Ulster Bank*	244	229	155	190
Citizens	766	501	349	349
Central items	(587)	**(486)	(625)	(664)
Profit before goodwill amortisation and integration costs	6,451	5,778	3,896	4,401

* Restated to reflect the transfer of Ulster Bank s leasing business to Corporate Banking and Financial Markets, with effect from 1 January 2002.

** Restated following the implementation of UITF 33 in 2002 (see page 11).

The performance of each of the divisions is reviewed on pages 28 to 43. These discussions include:

(1) Results for the year ended 31 December 2002 compared with the results for the year ended 31 December 2001.

(2) Results for the year ended 31 December 2001 compared with the results for the year ended 31 December 2000.

(3) Results for the year ended 31 December 2001 compared with the pro forma results for the year ended 31 December 2000.

The 2001 results include a full year s contribution from NatWest businesses whereas the year ended 31 December 2000 only includes NatWest businesses from the date of acquisition, 6 March 2000. In order to provide a more relevant basis for comparing performance, pro forma results for 2000 have been prepared assuming that NatWest was acquired on 1 January 2000. The basis of preparation of pro forma results is set out on page 13.

Corporate Banking and Financial Markets

	2002 £m	2001* £m	2000* £m	Pro forma 2000* £m
Net interest income	2,349	2,138	1,612	1,828
Non-interest income	3,703	3,319	2,510	2,864
Total income	6,052	5,457	4,122	4,692
Direct expenses				
staff costs	1,271	1,131	931	1,008
operating lease depreciation	461	434	358	400
other	392	366	196	314
Contribution before provisions	3,928	3,526	2,637	2,970
Provisions	725	502	206	230
Contribution	3,203	3,024	2,431	2,740

	2002	2001*	2000*	Pro forma 2000*
Direct cost:income ratio (%)	35.1	35.4	36.0	36.7
Total assets** Corporate Banking (£bn)	104.7	96.1	82.1	82.1
Financial Markets (£bn)	98.8	91.6	85.9	85.9
Loans and advances to customers gross (£bn)**	95.7	83.7	74.9	74.9
Customer deposits (£bn)**	62.2	56.4	52.8	52.8
Weighted risk assets (£bn)	136.5	118.3	100.1	100.1

* restated (see page 27)

** excluding repos and reverse repos

2002 compared with 2001

Contribution increased by 6% or £179 million to £3,203 million. Contribution before provisions was up by 11%, £402 million to £3,928 million.

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

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

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

Direct expenses increased by 10% or £193 million to £2,124 million. Excluding acquisitions, expenses were up £133 million or 7%, of which £106 million was higher staff costs reflecting business growth and £27 million was higher operating lease depreciation. The direct cost:income ratio improved from 35.4% to 35.1%.

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

2001 compared with 2000

Contribution was up 24%, £593 million, to £3,024 million. The results for the year ended 31 December 2001 included a full year s contribution from NatWest whereas the year ended 31 December 2000 only included NatWest from the date of its acquisition, 6 March 2000. This, together with factors discussed below, contributed to the improvement in performance.

Total income was up 32%, £1,335 million to £5,457 million. Net interest income was up 33%, £526 million, to £2,138 million, largely due to lending growth in Corporate Banking and also as a result of favourable market conditions in Financial Markets.

Non-interest income was up 32%, £809 million, to £3,319 million. The increase reflected growth in customer advances, payment and transmission related fees and higher dealing profits.

Direct expenses were up 30%, £446 million, to £1,931 million mainly due to performance related payments to staff reflecting higher income in Financial Markets, increased business volumes and infrastructure costs of supporting European expansion and acquisitions.

Provisions were up £296 million to £502 million reflecting 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.

2001 compared with pro forma 2000

Contribution was up 10%, £284 million, to £3,024 million.

Total income was up 16%, £765 million, to £5,457 million. Net interest income was up 17%, £310 million, to £2,138 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%, £9.7 billion, to £77.6 billion, predominantly in Corporate Banking, both in the UK and overseas.

Non-interest income was up 16%, £455 million, to £3,319 million reflecting growth in customer advances, payment and transmission related fees and dealing profits.

Direct expenses were up 12%, £209 million, to £1,931 million. Staff costs increased by 12%, £123 million, mainly due to performance related payments reflecting higher income in Financial Markets. Other expenses, excluding operating lease depreciation, were 17%, £52 million higher, reflecting increased business volumes and infrastructure costs of supporting European expansion and acquisitions. The direct cost:income ratio improved from 36.7% to 35.4%.

Provisions were up £272 million to £502 million. The increase reflected 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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Net interest income	2,840	2,622	2,109	2,418
Non-interest income	1,353	1,277	961	1,128
Total income	4,193	3,899	3,070	3,546
Direct expenses				
staff costs	707	702	636	736
other	254	226	192	210
Contribution before provisions	3,232	2,971	2,242	2,600
Provisions for bad and doubtful debts	213	164	126	133
Contribution	3,019	2,807	2,116	2,467
Direct cost:income ratio (%)	22.9	23.8	27.0	26.7
Total assets (£bn)	66.1	61.1	57.9	57.9
Loans and advances to customers gross				
mortgages (£bn)	31.7	28.5	25.8	25.8
other (£bn)	23.5	20.5	18.5	18.5
Customer deposits (£bn)	61.7	56.8	53.7	53.7
Weighted risk assets (£bn)	38.6	35.2	31.2	31.2

2002 compared with 2001

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

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

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

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

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

The direct cost:income ratio improved from 23.8% to 22.9%.

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

2001 compared with 2000

Contribution was up 33%, £691 million to £2,807 million. The results for the year ended 31 December 2001 included a full year s contribution from NatWest whereas the year ended 31 December 2000 only included NatWest from the date of its acquisition, 6 March 2000. This, together with factors discussed below, have contributed to the improvement in performance.

Total income was up 27%, £829 million to £3,899 million. Net interest income was 24%, £513 million higher at £2,622 million, reflecting strong growth in advances and deposits.

Non-interest income increased by 33%, £316 million to £1,277 million, resulting largely from growth in fee paying packaged accounts together with benefits from integration initiatives.

Direct expenses at £928 million were up 12%, £100 million.

Provisions for bad and doubtful debts were up 30%, £38 million to £164 million, largely due to growth in lending.

2001 compared with pro forma 2000

Contribution 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%. 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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Net interest income	**749**	674	473	516
Non-interest income	**841**	696	501	565
Total income	**1,590**	1,370	974	1,081
Direct expenses				

staff costs		**190**	164	136	154
other		**418**	400	291	327
Contribution before provisions		**982**	806	547	600
Provisions for bad and doubtful debts		**281**	255	206	227
Contribution		**701**	551	341	373
Direct cost:income ratio (%)		**38.2**	41.2	43.8	44.5
Total assets (£bn)		**19.8**	17.2	14.4	14.4
Loans and advances to customers	gross: mortgages (£bn)	**7.4**	5.9	4.4	4.4
	gross: other (£bn)	**12.4**	11.2	9.7	9.7
Customer accounts (£bn)		**4.4**	4.3	2.7	2.7
Weighted risk assets (£bn)		**14.6**	12.5	11.5	11.5

2002 compared with 2001

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

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

Net interest income was up 11% or £75 million to £749 million. Average customer lending increased by 16% to £17.9 billion. In TPF, average personal loans rose by 29% to £1.1 billion and average customer deposits rose by 26% to £1.9 billion. Average mortgage lending in The One account was 36% higher at £4.3 billion and in DLFS was up 10% to £2.3 billion. Average personal lending in DLFS and Lombard Direct increased by 20% to £2 billion.

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

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

The direct cost:income ratio improved from 41.2% to 38.2%.

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

2001 compared with 2000

Contribution was up 62%, £210 million to £551 million. The results for the year ended 31 December 2001 included a full year s contribution from NatWest whereas the year ended 31 December 2000 only included NatWest from the date of its acquisition, 6 March 2000. This, together with factors discussed below, have contributed to the improvement in performance.

Total income was up 41%, £396 million to £1,370 million driven largely by strong performances in Cards and TPF. Net interest income was up £201 million to £674 million. Average mortgage lending in DLFS was 17% higher at £2.1 billion and in The One account (formerly Virgin One) the increase was 81%, from £1.7 billion to £3.1 billion. TPF increased

average customer advances and customer deposits by 15% to £1.8 billion, and 29% to £1.4 billion respectively.

Non-interest income rose 39%, £195 million to £696 million largely as a result of increased fees reflecting higher retailer volumes.

Direct expenses at £564 million were 32%, £137 million higher, largely as a result of increased business volumes and marketing activity.

Provisions for bad and doubtful debts increased by 24%, £49 million to £255 million reflecting the increase in unsecured lending.

2001 compared with pro forma 2000

Contribution 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 Cards merchant outlets increased by 8% to 206,000.

Average mortgage lending in DLFS was 17% higher at £2.1 billion and in The One account 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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Staff costs	**479**	428	409	490
Other costs	**1,203**	1,140	1,017	1,170
Total manufacturing costs	**1,682**	1,568	1,426	1,660
Analysis:				
Group Technology	**662**	632	618	723
Group Purchasing and Property Operations	**528**	467	420	486
Customer Support and other operations	**492**	469	388	451
Total manufacturing costs	**1,682**	1,568	1,426	1,660

2002 compared with 2001

Total manufacturing costs at £1,682 million were 7% or £114 million higher than 2001.

The increase in costs reflects growth in business volumes arising from customer accounts, mortgage applications, personal loans and ATM transactions, and initiatives to enhance customer service, particularly in NatWest telephony. Extending the scope of Manufacturing with transfers from other parts of the Group also contributed to this increase.

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

2001 compared with 2000

Total manufacturing costs of £1,568 million were 10%, £142 million higher. The year ended 31 December 2001 included a full year s costs in respect of NatWest whereas the year ended 31 December 2000 included NatWest from the date of its acquisition, 6 March 2000. This, together with the factors discussed below contributed to the increase in costs.

Expenditure in Customer Support and other operations increased due to volume growth in lending and account management and costs associated with customer service enhancement initiatives.

2001 compared with pro forma 2000

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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Net interest income	**460**	464	373	425
Non-interest income	**447**	469	395	463
Total income	**907**	933	768	888
Expenses				
staff costs	**317**	298	260	303
other	**169**	181	159	185
Contribution before provisions	**421**	454	349	400

Net release of provisions for bad and doubtful debts	**11**	5	5	5
Contribution	**432**	459	354	405
Cost:income ratio (%)	**53.6**	51.3	54.6	55.0
Total assets (£bn)	**13.4**	12.5	10.4	10.4
Investment management assets excluding deposits (£bn)	**20.5**	21.4	21.8	21.8
Customer deposits (£bn)	**29.1**	29.1	27.6	27.6
Weighted risk assets (£bn)	**8.4**	7.8	7.1	7.1

2002 compared with 2001
Contribution at £432 million was £27 million, 6% lower primarily due to the effect of the fall in equity markets on the level of activity and ad valorem fee income.

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

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

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

Expenses were up 1% or £7 million to £486 million.

The cost:income ratio was adversely affected by the fall in income, increasing to 53.6% from 51.3%.

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

2001 compared with 2000
Contribution increased by 30%, £105 million to £459 million. The results for the year ended 31 December 2001 included a full year s contribution from NatWest whereas the year ended 31 December 2000 only included NatWest from the date of its acquisition, 6 March 2000. This, together with factors discussed below, have resulted in the improvement in performance.

Total income was up 21%, £165 million to £933 million. Net interest income grew by 24%, £91 million to £464 million. Non-interest income increased 19%, £74 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 14%, £60 million higher at £479 million.

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

2001 compared with pro forma 2000
Contribution 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

	2002 £m	2001 £m	2000 £m	Pro forma 2000 £m
Earned premiums	2,383	1,804	1,344	1,346
Reinsurers share	(489)	(429)	(394)	(367)
Insurance premium income	1,894	1,375	950	979
Other income	245	168	176	176
Total income	2,139	1,543	1,126	1,155
Expenses				
staff costs	178	152	124	124
other	256	182	128	132
Gross claims	1,693	1,263	981	982
Reinsurers share	(343)	(315)	(308)	(284)
Contribution	355	261	201	201
In-force policies (000 s)				
Motor: UK	4,668	4,017	3,219	3,219
: International	1,224	601	286	286
Home: UK	1,587	1,360	1,055	1,055
Combined operating ratio UK (%)	89.4	88.0	86.2	86.2
Insurance reserves UK (£m)	1,946	1,541	1,221	1,221

2002 compared with 2001

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

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

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

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

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

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

2001 compared with 2000

Contribution increased by 30%, £60 million to £261 million. This was driven by higher volumes, particularly in motor policies, and increases in partnership businesses including the joint venture with TPF.

Total income was up 37%, £417 million to £1,543 million. Earned premiums grew strongly, up 34%, £460 million to £1,804 million. Net insurance premium income increased by 45%, £425 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 33%, £82 million to £334 million reflecting business expansion, including the costs of establishing overseas operations in the second half of the year.

Net claims rose 41%, £275 million to £948 million, reflecting increased volumes.

2001 compared with pro forma 2000

Contribution increased by 30%, £60 million to £261 million. This was 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

	2002 £m	2001* £m	2000* £m	Pro forma 2000* £m
Net interest income	**339**	313	216	259
Non-interest income	**181**	170	132	164
Total income	**520**	483	348	423
Expenses				
staff costs	**145**	135	112	134
other	**109**	104	72	87
Contribution before provisions	**266**	244	164	202
Provisions for bad and doubtful debts	**22**	15	9	12
Contribution	**244**	229	155	190
Cost:income ratio (%)	**48.8**	49.5	52.9	52.2
Total assets (£bn)	**12.7**	10.8	10.1	10.1
Loans and advances to customers gross (£bn)	**9.1**	7.6	6.7	6.7
Customer deposits (£bn)	**8.8**	7.7	7.1	7.1
Weighted risk assets (£bn)	**9.0**	7.7	6.7	6.7
Average exchange rate /£	**1.591**	1.609	1.642	1.642
Spot exchange rate /£	**1.536**	1.637	1.606	1.606

* restated (see page 27)

2002 compared with 2001

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

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

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

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

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

The cost:income ratio improved from 49.5% to 48.8%.

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

2001 compared with 2000

Contribution for the year ended 31 December 2001 of £229 million was 48%, £74 million, higher than £155 million for the period from 6 March 2000 (when Ulster Bank became part of the Group as a result of the acquisition of NatWest) to 31 December 2000.

Total income increased by 39%, £135 million to £483 million. Net interest income rose by 45%, £97 million to £313 million due to strong growth in customer loans and deposits. Average loans and advances to customers increased to £7.2 billion, and average customer deposits increased to £7.3 billion.

Non-interest income was up 29%, £38 million to £170 million. The increase was mainly due to higher card, lending and transmission fees.

Expenses rose by 30%, £55 million to £239 million to support business expansion and expenditure related to the preparation for the issue of euro notes and coins in the Republic of Ireland.

Provisions for bad and doubtful debts were up 67%, £6 million, to £15 million. The increase was largely due to growth in lending.

2001 compared with pro forma 2000

Contribution of £229 million was 21%, £39 million higher.

Total income increased by 14%, £60 million to £483 million. Net interest income rose by 21%, £54 million to £313 million due to strong growth in customer loans and deposits. Average loans and advances to customers increased by 24%, £1.4 billion, to £7.3 billion, and average customer deposits increased by 11%, £0.7 billion to £7.4 billion.

Non-interest income was up 4%, £6 million to £170 million. The increase was mainly due to higher card, lending and transmission fees.

Expenses rose by 8%, £18 million to £239 million to support business expansion. Staff costs increased by £1 million. Other expenses increased by 20%, £17 million as a result of higher 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 52.2% to 49.5%.

Provisions for bad and doubtful debts were up 25%, £3 million to £15 million. The increase was largely due to growth in lending.

Citizens

	2002 £m	2001 £m	2000 £m
Net interest income	**1,248**	814	667
Non-interest income	**468**	306	247
Total income	**1,716**	1,120	914
Expenses			
- staff costs	**485**	305	290
- other	**370**	245	235

Contribution before provisions	**861**	570	389
Provisions for bad and doubtful debts	**95**	69	40
Contribution	**766**	501	349
Cost:income ratio (%)	**49.8**	49.1	57.4
Total assets ($bn)	**61.1**	52.4	30.3
Loans and advances to customers - gross ($bn)	**31.4**	26.3	17.9
Customer deposits ($bn)	**51.1**	42.8	24.9
Weighted risk assets ($bn)	**38.8**	35.8	23.6
Average exchange rate - $/£	**1.503**	1.440	1.516
Spot exchange rate - $/£	**1.613**	1.450	1.493

2002 compared with 2001
Contribution increased by 53% or £265 million to £766 million. Excluding the incremental contribution of £219 million from the Mellon Regional Franchise and Medford (the acquisitions) and a £21 million adverse impact of exchange rate translation, contribution increased by 14% or £67 million.

Total income was up 53% or £596 million to £1,716 million. Excluding acquisitions and exchange rate fluctuations, organic income growth was 15% or £158 million.

Net interest income rose by 53% or £434 million to £1,248 million. Excluding acquisitions, which added £364 million, and exchange rate fluctuations, net interest income was up 14% or £104 million, as a result of strong organic growth in customer loans and deposits.

Non-interest income rose by 53% or £162 million to £468 million. Excluding acquisitions, which added £121 million, and movements in exchange rates, non-interest income was up 19% or £54 million, as a result of growth in deposit service charges and mortgage banking.

Expenses increased by 55% or £305 million to £855 million. Excluding acquisitions, which added £256 million, and exchange rate fluctuations, expenses increased by 14% or £72 million, to support higher business volumes. Citizens increased its in-store banking activities by opening new branches in 58 Stop&Shop supermarkets. The cost of establishing presence in these stores contributed to the increase in operating expenses.

The cost:income ratio increased from 49.1% to 49.8%. Excluding acquisitions and the impact of exchange rate translation, the underlying cost:income ratio improved from 48.7% to 48.2%.

Provisions were up from £69 million to £95 million. Excluding the Mellon Regional Franchise which added £10 million, provisions were broadly consistent with the second half of 2001.

2001 compared with 2000
Contribution 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 acquisition of the Mellon Regional Franchise, 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 acquisition of the Mellon Regional Franchise 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

	2002 £m	2001* £m	2000* £m	Pro forma 2000* £m
Funding costs	215	211	262	217
Central department costs				
- staff costs	108	99	86	114
- other	102	93	85	107
Other corporate items - net	162	83	192	226
Total Central items	587	486	625	664

* restated (see page 11)

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

2002 compared with 2001

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

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

Other corporate items increased to £162 million compared with £83 million in 2001, which benefited from certain one-off items.

2001 compared with 2000

Total Central items reduced by £139 million to £486 million.

Funding costs at £211 million were down 19%, £51 million. 2001 benefited from the proceeds of the share placing in July 2001 prior to deployment in the acquisition of the Mellon Regional Franchise, contributing £35 million. Other costs at £275 million declined £88 million, 24%, due largely to the benefit of integration initiatives.

2001 compared with pro forma 2000

Total Central items reduced by £178 million to £486 million.

Funding costs at £211 million were down 3%, £6 million. 2001 benefited from the proceeds of the share placing in July 2001 prior to deployment in the Mellon Regional Franchise 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

* Prior periods have been restated to reflect the transfer of Ulster Bank s leasing business to Corporate Banking and Financial Markets.

2002 compared with 2001

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

2001 compared with 2000

The number of employees 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 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.

Integration information

1 NatWest integration

In the Offer Document for NatWest issued on 16 December 1999, the Group made various estimates in respect of revenue benefits, cost savings and staff reductions. Those estimates were based on the latest available published information at that time, namely NatWest 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 . Subsequently the Group further revised the integration targets upwards in February 2002 for the remainder of the programme based on actual achievements. These targets are shown in the tables below as revised plan .

In February 2003 all integration initiatives were completed and the annualised benefits of £890 million for revenue benefits and £1,440 million for cost savings from the full programme achieved.

Revenue benefits	Period ending December 2000	December 2001	December 2002	March 2003
Cumulative gross revenue initiatives implemented at the end of each period (£m)				
plan	120	350	550	595
revised plan			800	890
actual	147	605	805	

	December 2000	December 2001	December 2002	December 2003
Impact on profit before tax (£m)				
plan	50	120	240	390
revised plan			460	590
actual	52	312	472	

The gross revenue initiatives generated income of £712 million in the year to 31 December 2002 which, net of costs, claims and provisions added £472 million to profit before tax.

Cost savings	Period ending December 2000	December 2001	December 2002	March 2003
Cumulative cost savings implemented at the end of each period (£m)				
plan	550	900	1,200	1,340
revised plan			1,340	1,440
actual	653	1,205	1,350	

	December 2000	December 2001	December 2002	December 2003
Impact on profit before tax (£m)				
plan	290	700	1,050	1,300
revised plan			1,280	1,400
actual	448	1,008	1,284	

Staff reductions	Period ending December 2000	December 2001	December 2002	March 2003
Cumulative total				
plan	9,000	14,000	16,000	18,000
revised plan			18,000	18,000
actual	13,000	17,000	18,000	

Period ending

Integration costs	December 2000	December 2001	December 2002	March 2003
Cumulative charge (£m)				
plan	650	1,150	1,350	1,400
revised plan			2,200	2,300
actual	547	1,394	2,204	

2 Mellon Regional Franchise integration

In the announcement relating to the acquisition of the Mellon Regional Franchise issued on 17 July 2001, the Group disclosed various estimates in respect of cost savings and revenue benefits. Those estimates were based on the unaudited management accounts of the Mellon Regional Franchise for the four months ended 20 April 2001 and Citizens financial statements for the year ended 31 December 2000. These estimates were confirmed as part of the Group s 2001 year end reporting.

	Period ending		
Revenue benefits	December 2002	December 2003	December 2004
Cumulative gross revenue initiatives implemented at the end of each period ($m)			
plan	57	136	242
actual	70		
Impact on profit before tax ($m)			
plan	2	34	104
actual	19		

The gross revenue initiatives generated income of $43 million in the year to 31 December 2002 which, net of costs, claims and provisions, added $19 million to profit before tax.

	Period ending		
Cost savings	December 2002	December 2003	December 2004
Cumulative cost savings implemented at the end of each period ($m)			
plan	71	95	101
actual	95		
Impact on profit before tax ($m)			
plan	46	83	98
actual	70		

Integration costs	Period ending December 2001	December 2002	December 2003	December 2004
Cumulative charge ($m)				
plan	101	241	260	267
actual	41	239		

2 Medford

Integration costs relating to the Medford acquisition amounted to $22 million.

The above discussions should be read in the light of the forward-looking statements cautionary note.

Overview of balance sheet

Summary consolidated balance sheet at 31 December 2002

	2002 £m	2001* £m
Assets		
Cash and balances at central banks and items in the course of collection from other banks	6,222	6,381
Treasury bills and other eligible bills	11,459	10,136
Loans and advances to banks	44,296	38,513
Loans and advances to customers	223,324	190,492
Debt securities and equity shares	68,928	65,597
Intangible fixed assets	12,697	13,325
Other assets	35,963	34,167
	402,889	358,611
Long-term assurance assets attributable to policyholders	9,111	10,248
Total assets	412,000	368,859
Liabilities		
Deposits by banks	54,720	40,038
Items in the course of transmission to other banks	1,258	2,109
Customer accounts	219,161	198,995
Debt securities in issue	33,938	30,669
Other liabilities	50,956	47,017
Subordinated liabilities	13,965	12,530
Minority interests including non-equity interests	1,839	585

Shareholders' funds including non-equity interests	**27,052**	26,668
	402,889	358,611
Long-term assurance liabilities attributable to policyholders	**9,111**	10,248
Total liabilities	**412,000**	368,859
Analysis by banking and trading businesses		
Banking businesses	**311,488**	284,471
Trading businesses	**100,512**	84,388
	412,000	368,859
Analysis of repurchase agreements included above		
Reverse repurchase agreements and stock borrowing		
Loans and advances to banks	**20,578**	17,721
Loans and advances to customers	**21,941**	11,588
	42,519	29,309
Repurchase agreements and stock lending		
Deposits by banks	**20,097**	10,446
Customer accounts	**25,060**	17,455
	45,157	27,901

* restated (see page 10)

2002 compared with 2001

Total assets of £412.0 billion at 31 December 2002 were up £43.1 billion, 12%, compared with 31 December 2001 due to business growth.

Treasury bills and other eligible bills increased by £1.3 billion, 13%, to £11.5 billion reflecting liquidity management partially offset by reduced trading activity.

Loans and advances to banks rose £5.8 billion, 15%, to £44.3 billion. Bank placings were up £2.9 billion, 14% to £23.7 billion and reverse repos increased by £2.9 billion, 16%, to £20.6 billion.

Loans and advances to customers were up £32.8 billion, 17%, to £223.3 billion, including reverse repos which increased £10.3 billion to £21.9 billion. Excluding reverse repos, lending increased by £22.5 billion, 13% to £201.4 billion. Growth in customer lending was across all divisions with increases of £11.8 billion in CBFM, £6.3 billion in Retail Banking, £2.6

billion in Retail Direct, £1.4 billion in Ulster Bank and £1.3 billion in Citizens. In $ terms, customer lending in Citizens was up 20% or $5.1 billion, including $0.6 billion arising from the acquisition of Medford.

Debt securities and equity shares increased by £3.3 billion, 5%, to £68.9 billion, principally due to increased holdings in Financial Markets, together with growth in Wealth Management s investment portfolio of investment grade asset-backed securities and Citizens portfolio of US government securities.

Intangible fixed assets declined by £0.6 billion, 5% to £12.7 billion, primarily because of amortisation. Goodwill arising on acquisitions during the year, £0.4 billion, was largely offset by the effect of exchange rate movements.

All other assets rose by £1.6 billion, 4%, to £42.2 billion. Tangible fixed assets were up £1.7 billion, 19% to £10.5 billion mainly reflecting increased operating lease assets in CBFM. Growth in the mark-to-market value of trading derivatives, up £2.4 billion as a result of increased trading activity, was largely offset by lower settlement balances and other assets.

Long term assurance assets and liabilities attributable to policyholders declined £1.1 billion, 11% to £9.1 billion reflecting the fall in equity markets, partially offset by increased investments.

Deposits by banks increased by £14.7 billion, 37% to £54.7 billion, with repos up £9.7 billion, to £20.1 billion and inter-bank deposits up £5.0 billion, 17% to £34.6 billion.

Customer accounts were up £20.2 billion, 10% at £219.2 billion, including repos up £7.6 billion, 44% to £25.1 billion. Excluding repos, deposits rose £12.6 billion, 7% to £194.1 billion with increases of £5.8 billion in CBFM, £4.9 billion in Retail Banking and £1.6 billion in Citizens. In $ terms, Citizens grew by $7.0 billion, 18%, of which $1.1 billion related to Medford.

Debt securities in issue were up £3.3 billion, 11%, to £33.9 billion primarily to meet the Group s funding requirements.

All other liabilities increased by £3.1 billion, 6% to £52.2 billion. Higher mark-to-market value of trading derivatives, up £3.7 billion, short positions, up £1.8 billion and accruals and deferred income, up £1.0 billion, were partially offset by lower settlement balances.

Subordinated liabilities were up £1.4 billion, 11% to £14.0 billion. The issue of £1.2 billion ($1,850 million) $ denominated and £0.1 billion (230 million) denominated dated loan capital and £0.8 billion £ denominated undated loan capital were partially offset by the £0.2 billion ($250 million and £40 million) redemption of dated loan capital and the effect of exchange rate movements of £0.5 billion.

Minority interests increased by £1.3 billion to £1.8 billion principally reflecting the issues of 1,250 million and $750 million trust preferred securities by subsidiaries of the Group.

Shareholders funds rose £0.4 billion to £27.1 billion principally due to retentions of £0.7 billion and the issue of £0.6 billion of equity shares in respect of scrip dividend and the exercise of share options, partly offset by the redemption of £0.6 billion non-equity preference shares in January 2002 and the adverse effect of exchange rate movements on share premium account, £0.3 billion.

Cash flow

	2002 £m	2001 £m	2000 £m
Net cash inflow from operating activities	**13,737**	7,287	8,997
Dividends received from associated undertakings	**1**	1	2

Returns on investment and servicing of finance	**(1,901)**	(1,447)	(1,005)
Taxation	**(1,107)**	(1,209)	(705)
Capital expenditure and financial investment	**(9,185)**	(10,337)	(5,119)
Acquisitions and disposals	**(281)**	(1,653)	(1,779)
Equity dividends paid	**(729)**	(653)	(386)
Financing	**2,711**	4,411	4,604
Increase/(decrease) in cash	**3,246**	(3,600)	4,609

2002

The major factors contributing to the net cash inflow of £13,737 million from operating activities in 2002 were the operating profit of £4,763 million and an increase in deposits, debt securities in issue and other liabilities of £39,761 million, which were partially offset by the increase in loans and advances of £35,426 million.

The Additional Value Shares dividend of £798 million, interest payments of £674 million on subordinated liabilities and dividend payments on preference shares of £313 million were the main contributors to returns on investments and servicing of finance.

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

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

2001

Operating profit of £4,252 million and an increase of £31,721 million in deposits, debt securities in issue and other liabilities, partially offset by increases in loans and advances of £22,823 million and in treasury and other eligible bills of £6,796 million, were the major factors in the net cash inflow from operating activities of £7,287 million.

The first dividend on the Additional Value Shares of £399 million, interest of £652 million on subordinated liabilities and dividend payments on preference shares of £353 million contributed to the outflow of £1,447 from returns on investment and servicing of finance.

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

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

2000

The major factors contributing to the net cash inflow of £8,997 million from operating activities in 2000 were the operating profit of £2,970 million, an increase in deposits of £25,667 million and decrease in bank lending of £9,720 million, which were partially offset by the increase in customer loans and advances of £22,014 million and decrease in debt securities in issue and other liabilities of £6,799 million.

Interest payments of £739 million on subordinated liabilities and dividend payments of £228 million on preference shares were the main contributors to returns on investments and servicing of finance.

Net purchase of investment securities of £4,385 million and fixed assets of £734 million, including operating lease assets, comprised the net cash outflow from capital expenditure and financial investment.

The issue of £4,681 million ordinary and preference share capital, primarily to fund the acquisition of NatWest, together with the issue of £294 million subordinated debt were partially offset by the redemption of preference shares of £300 million and repayment of £146 million of subordinated debt, and were the main contributors to the net cash inflow from

financing of £4,604 million.

UK GAAP compared with US GAAP
The Group s financial statements are prepared in accordance with UK GAAP, which differs in certain material respects from US GAAP.

The net income available for ordinary shareholders under US GAAP was £3,108 million, £1,137 million higher than profit attributable to ordinary shareholders under UK GAAP of £1,971 million. The principal reasons for the increase are:

US GAAP requires all derivatives to be recorded at fair value and changes in fair value recognised currently in earnings unless certain hedge conditions are met. The Group has not changed its use of non-trading derivatives to meet these conditions. Therefore, under US GAAP, the Group s portfolio of non-trading derivatives has been remeasured to fair value with changes in fair value included in net income together with gains and losses on non-trading derivatives deferred under UK GAAP. Additionally, under US GAAP, certain derivatives embedded in other instruments are accounted for separately and non-derivative financial instruments cannot be designated as a hedge of the foreign exchange exposure of available-for-sale securities. The resulting adjustment increases US GAAP net income before tax by £770 million.

Goodwill amortisation is charged to the profit and loss account under UK GAAP, whereas under US GAAP only intangible assets other than goodwill are amortised, resulting in an increase in net income before tax of £681 million.

Certain software development costs have been charged to the profit and loss account under UK GAAP; under US GAAP such costs are capitalised and depreciated over the estimated useful life of the software, resulting in a net increase in net income before tax of £283 million.

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

	31 December 2002 £m	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m
Capital base					
Tier 1 capital	17,155	15,052	12,071	4,605	3,235
Tier 2 capital	13,271	11,734	10,082	3,256	2,950
Tier 3 capital	-	172	167	-	-
	30,426	26,958	22,320	7,861	6,185
Less investments in insurance subsidiaries, associated undertakings and other supervisory deductions	(3,146)	(2,698)	(2,228)	(1,011)	(703)
Total capital	27,280	24,260	20,092	6,850	5,482
Weighted risk assets					
Banking book:					
On-balance sheet	193,800	176,000	146,600	51,200	44,300
Off-balance sheet	28,700	22,000	16,200	4,200	3,500
Trading book	11,500	12,500	12,400	1,400	1,300

	234,000	210,500	175,200	56,800	49,100
Risk asset ratios	%	%	%	%	%
Tier 1	**7.3**	7.1	6.9	8.1	6.6
Total	**11.7**	11.5	11.5	12.1	11.2

It is the Group s policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the Financial Services Authority (FSA). The FSA uses Risk Asset Ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank s capital resources with its weighted risk assets (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a tier 1 component of not less than 4%. At 31 December 2002, the Group s total RAR was 11.7% (2001 11.5%) and the tier 1 RAR was 7.3% (2001 7.1%).

Risk management

The management of risk is a fundamental management activity performed throughout the Group. As such it underpins the Group s reputation, performance and future success. It is therefore critically important that the adequacy and effectiveness of our risk management processes are of appropriate standard.

To achieve this the Group has put in place a risk management framework comprising:

Leadership, strategy and culture set by the Board and put into effect through Executive Management.

Policies, procedures, processes and systems to execute effective risk management throughout the Group.

A comprehensive committee structure operating at Group level to direct, approve and review actions taken to manage risk. Where appropriate this is replicated at a divisional level.

Risk management functions that are independent of the business management to enforce agreed policy.

Supporting the Board, the following executive committees operate that have risk management as partly or wholly their mandate:

Group Executive Management Committee (GEMC), a sub-committee of the Board determines the Group s risk management framework.

Group Risk Management Committee (GRMC), a sub-committee of the GEMC, provides leadership and oversight of the Group s risk management and control process, including policies and risk appetite.

Group Credit Committee (GCC), a sub-committee of the Board, approves facility limits in excess of the authorities delegated to business Credit Committees and makes recommendations to the Board for facilities in excess of its own authority.

The Group Asset and Liability Management Committee (GALCO), a sub-committee of the GEMC, sets policy for the management of the overall Group balance sheet in respect of capital ratios, structural hedging and liquidity.

The Group Risk Management function plays a key role in the Group s Risk Management framework. The Group Risk Management function is independent from the businesses and reports through the Group Finance Director to the Group Chief Executive.

Within each Division independent risk management units operate, reporting to both divisional executive management and the Director, Group Risk Management. An assessment of the adequacy and effectiveness of each divisional risk management unit is undertaken by Group Risk Management on a continuous basis to ensure effective control.

Supporting GALCO, Group Treasury is responsible for capital raising, liquidity and structural hedging policies and the management of the Group s balance sheet. Operational responsibility for asset and liability management is in turn delegated to appropriate management in each major business grouping.

The most significant risks managed by the Group are:

Credit risk: the risk arising from the possibility that the Group will incur losses from the failure of a customer to meet its obligations.

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

Market risk: the risk arising from 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.

Regulatory risk: the risk of material loss, reputational damage or liability arising from the Group s failure to comply with the requirements of the Group s regulators and relevant Codes of Best Practice that oversee the conduct of regulated business in all geographic regions where the Group has operations.

Enterprise risk: the risk of loss from inadequate or failed internal processes, people and systems or from external events. Insurance risk arising from insurance as a source of risk and as a tool to reduce other risk exposure is also managed as part of enterprise risk.

Group Risk Management is also responsible for the Group wide coordination of the Group s response to key regulatory developments affecting risk and capital management. In carrying out this responsibility, Group Risk Management coordinates across the Group Risk Management, Group Treasury and Group Finance functions. Key regulatory developments, which are explained in greater detail under Supervision and regulation on page 163, are the New Basel Accord and the related EU Capital Adequacy Directive, the FSA s Integrated Prudential Sourcebook and the EU Financial Conglomerates Directive.

Effective coordination and control of the Group s internal and external approach to these regulatory developments are ensured through the oversight of executive and divisional steering committees and through a Programme team which has been established within Group Risk Management. The Group is represented and actively participates in the international and UK industry associations providing input on these regulatory developments to the Basel Committee, EU Commission and the FSA. In addressing these regulatory changes, the Group s objective is to ensure that the ways it decides to enhance its risk and capital management practices to meet its own internal requirements will also result in the Group being well positioned to meet the demands of current and future regulatory regimes.

Credit risk

Credit risk is the risk arising from the possibility that the Group will incur losses from the failure of a customer to meet its obligations.

This risk is managed within the Group s Credit Risk Management framework comprising:

Executive involvement through the GRMC.

The Group s principles for managing credit risk.

The Group s credit approval processes and credit assessments.

Credit portfolio management.

The review and oversight of delegated authorities.

Problem exposure management.

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 principles for managing credit risk set out minimum standards for managing credit risk. These include principles for maintaining the credit culture of the Group, approving credit risk taken by the Group, credit stewardship and reviewing the effectiveness of the credit culture. As a minimum:

All credit risk exposures require approval before assumption by the Group. Existing credit risk exposures are monitored and reviewed periodically against approved risk limits. Review occurs at least annually with the lower quality exposures being subject to greater frequency of analysis and assessment. Approvals in respect of credit exposure can only be given by duly authorised individuals or bodies (Credit Committees) or if below certain specified thresholds through authorised automated processes.

Credit authority is delegated only to competent individuals who are independent of business revenue generation or to established credit committees. Other than in specialist areas which operate under strict parameters, 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 customer group are aggregated (subject to de minimis thresholds) in order to determine the appropriate level of credit approval required and to facilitate consolidated credit risk management.

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

Credit approval processes exist for each of the significant customer types in order to ensure appropriate skills and resources are employed in credit assessment and approval:

Retail and personal businesses use industry standard credit scoring techniques, adapted for the Group, to process small scale, large volume credit decisions. These are combined with traditional analysis and judgment to support more significant credit risks in this area.

Credit approvals for the professional counterparties of Financial Markets are supported by a dedicated credit function, which provides expertise in traded markets product risk and which specialises in the analysis and assessment of financial

institutions.

For the Group s corporate businesses, the relationship management team, the Analysis Rating and Research Unit and the Credit Risk Department, support the judgment exercised over credit approvals.

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

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

The review and oversight of delegated authorities Both Group Risk Management and divisional credit risk functions undertake reviews in order to provide independent oversight of delegated authorities and to ensure compliance with Group practice.

Problem exposure management is facilitated through specialised units, which provide intensive management to minimise the incidence of credit risk losses. Credit management within each business unit is the responsibility of business unit Credit Committees and specialist units within the Group provide appropriate management and control over the Group s impaired and potential problem loans.

In the Group s corporate businesses, problem loans and exposures are managed by Specialised Lending Services, which provides dedicated resource experienced in corporate restructuring. The Problem Exposure Review Forum reviews all such significant cases at least 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.

Residual value risk The Group s asset finance activities also 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.

Loan portfolio The Group s loan portfolio consists of loans (including overdraft facilities), instalment credit and finance lease receivables.

Overdraft facilities provide the customer with a demand deposit account and demand credit facility combined in a single checking (current) account. An overdraft is effected whenever a customer s drawings on a demand deposit account exceed the credit balance of the account, the balance of which may alternate between debit and credit. While overdrafts are contractually repayable on demand, unless a fixed term has been agreed, in practice customers will from time to time make deposits into the account thereby reducing indebtedness or increasing a credit balance in accordance with their requirements. Borrowing limits on the overdraft facility are established and full repayment is normally only required if the customer fails to honour the conditions on which the limit was granted or their financial position has so deteriorated such that it is necessary to take protective action. Overdraft facilities are usually reviewed at least annually. Interest is generally calculated on the daily outstanding balance by reference to the Group s base rate and is typically charged monthly. Overdrafts accounted for approximately 10.7% of the Group s total domestic loan portfolio at 31 December 2002 (2001 12.6%; 2000 11.0%).

Provisioning policy The Group s approach to managing credit risk is discussed under Credit risk above and its accounting policy for loans and advances is set out on page 94. The Group provides for losses existing in its lending book to record loans and advances at their expected ultimate net realisable value.

Specific provisions are made against loans when, as a result of review, it is considered that recovery is in serious doubt. Each loan portfolio is considered and monitored separately using a variety of systems, reports and models.

Homogeneous portfolios, including credit card receivables and mortgages, comprise a significant proportion of the Group s loans. Provisions on these portfolios are calculated using a formulaic approach based on number of days in arrears and the predicted risk of loss on the loan.

For other portfolios, customers are assigned a credit grading which is mapped on to the Group scale. Credit grades are reviewed at least annually. Where deterioration is detected, the credit is downgraded as appropriate. If it is determined that more intensive management is required, the credit is passed to a specialist unit. Specific provision is made where a review of the advance reveals that the credit-worthiness of the borrower has undergone a significant deterioration and that recovery of the advance is in significant doubt taking account of available security. This review will also consider the cancellation or reduction of unutilised limits, the appointment of an investigating accountant and other actions that are designed to mitigate the credit risk faced by the Group. The amount of the specific provision will reflect the financial condition of the borrower, the realisable value of any security and the costs of recovery or realisation of that security as at the balance sheet date.

The Group establishes a general provision through charges to the profit and loss account in order to cover losses that have not been specifically identified but are known from experience to be present in any portfolio of loans. The level of general provision reflects the size and diversity of the Group s loan portfolio, past experience, the current state of the economies in which the Group operates and the scope of specific provisioning procedures.

The Group monitors its credit loss experience in each of its loan portfolios. The assumptions used to determine the level of provisions, in homogeneous portfolios and in other portfolios, are adjusted to reflect the actual experience.

Bad and doubtful debt provisions made during the year (less amounts released and recoveries of amounts written-off in previous years) are charged to the profit and loss account. Where the collectability of interest is in doubt it is not credited to the profit and loss account but to a suspense account. Loans classified as bad debts and any related suspended interest are written-down to their estimated net realisable value when it is identified that there is no realistic prospect of recovery of all or part of the loan. There are differences in accounting practices between UK and US banks. In the UK, loans and the related accrued interest are written-off only when, as a matter of banking judgment, there is no realistic prospect of recovery. When management determines that a write-off is appropriate, the principal amount and accrued interest on the obligation are written down their to estimated net realisable value. Banks in the US may write-off impaired lending more quickly. In the UK, interest receivable on loans is recognised as income as it accrues provided that its collectability is not subject to significant doubt. In contrast, banks in the US typically cease accruing interest when loans become overdue by 90 days. The effect of these differences is that the Group s gross lendings, its provisions for bad and doubtful debts and provision cover ratios may be greater than would be the case using US practice.

An analysis of the Group s loans and advances to customers before provisions is contained on page 54. An analysis of provisions for bad and doubtful debts, write-offs and recoveries is also included on pages 55 to 57. The Group s loan control and review procedure do not include the classification of loans as non-accrual, accruing past due, restructured and potential problem loans, as defined by the SEC in the US. The table on page 58 shows the estimated amount of loans which would be reported using the SEC c classifications.

Cross border outstandings and selected country exposures The Group proactively manages its country risk exposure with the view to minimising exposures to countries which may be adversely affected by global economic pressure. An analysis of these countries is contained in page 59. Cross border outstandings in excess of 0.75% of Group total assets (including acceptances) are disclosed on page 59.

Analysis of loans and advances to customers The following table analyses loans and advances to customers before provisions by remaining maturity, geographical area and type of customer. Overdrafts are included in the Within 1 year category.

	Within 1 year £m	After 1 but within 5 years £m	After 5 years £m	31 December 2002 Total £m	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m
UK								
Central and local government	1,514	3	4	1,521	706	1,957	150	78
Manufacturing	5,632	827	927	7,386	7,401	6,806	2,715	2,075
Construction	2,257	692	519	3,468	3,018	2,615	648	543
Finance	10,042	1,133	1,221	12,396	8,517	9,944	2,891	2,197
Service industries and business activities	13,726	4,685	7,611	26,022	25,033	20,903	8,062	6,979
Agriculture, forestry and fishing	1,295	476	692	2,463	2,391	2,373	673	643
Property	7,697	3,346	4,896	15,939	12,274	10,415	3,668	2,935
Individuals - home mortgages	1,579	3,513	37,009	42,101	36,976	32,600	9,544	8,317
- other	11,173	6,943	4,139	22,255	20,076	17,881	6,283	4,550
Finance leases and instalment credit	2,809	4,520	4,394	11,723	11,258	10,816	3,614	3,487
Total domestic	57,724	26,138	61,412	145,274	127,650	116,310	38,248	31,804
Overseas residents	21,005	853	1,799	23,657	24,164	19,257	2,799	2,248
Total UK offices	78,729	26,991	63,211	168,931	151,814	135,567	41,047	34,052
Overseas								
US	21,525	10,101	9,382	41,008	29,230	23,050	6,807	5,811
Rest of the World	10,726	3,272	3,307	17,305	13,093	12,598	2,223	1,787
Total overseas offices	32,251	13,373	12,689	58,313	42,323	35,648	9,030	7,598
Loans and advances to customers - gross	110,980	40,364	75,900	227,244	194,137	171,215	50,077	41,650
Provisions for bad and doubtful debts				(3,920)	(3,645)	(3,139)	(737)	(633)
Loans and advances to customers - net				223,324	190,492	168,076	49,340	41,017
Fixed rate	38,315	16,179	25,832	80,326	62,282	53,983	15,959	11,738
Variable rate	72,665	24,185	50,068	146,918	131,855	117,232	34,118	29,912
Gross loans and advances to customers - by maturity	110,980	40,364	75,900	227,244	194,137	171,215	50,077	41,650

Provisions for bad and doubtful debts For a discussion of the factors considered in determining the amount of the provisions, see Provisioning policy on page 53. The following table shows the elements of provisions for bad and doubtful debts.

	31 December 2002 £m	31 December 2001 £m	31 December 2000 £m	3 months ended 31 December 1999 £m	30 September 1999 £m	30 September 1998 £m
Provisions at the beginning of the period						
Domestic	2,467	2,370	484	433	347	316
Foreign	1,186	783	332	304	286	143
	3,653	3,153	816	737	633	459
Currency translation and other adjustments						
Domestic	(4)	4	(1)	-	-	-
Foreign	(58)	13	43	2	10	(8)
	(62)	17	42	2	10	(8)
Acquisitions of businesses						
Domestic	11	83	1,871	2	-	-
Foreign	12	171	494	23	-	(11)
	23	254	2,365	25	-	(11)
Amounts written-off						
Domestic	(743)	(645)	(599)	(35)	(175)	(144)
Foreign	(293)	(190)	(185)	(5)	(51)	(26)
	(1,036)	(835)	(784)	(40)	(226)	(170)
Recoveries of amounts written-off in previous periods						

Domestic	**37**	54	142	10	44	20
Foreign	**26**	26	22	3	10	15
	63	80	164	13	54	35
Charged to profit and loss account						
Domestic	**813**	601	473	74	217	155
Foreign	**473**	383	77	5	49	173
	1,286	984	550	79	266	328
Provisions at the end of the period (1)						
Domestic	**2,581**	2,467	2,370	484	433	347
Foreign	**1,346**	1,186	783	332	304	286
	3,927	3,653	3,153	816	737	633
Gross loans and advances to customers						
Domestic	**145,274**	127,650	116,310	41,045	38,248	31,804
Foreign	**81,970**	66,487	54,905	13,892	11,829	9,846
	227,244	194,137	171,215	54,937	50,077	41,650
Closing customer provisions as a % of gross loans and advances to customers (2)						
Domestic	**1.78%**	1.93%	2.04%	1.18%	1.13%	1.09%
Foreign	**1.63%**	1.77%	1.40%	2.39%	2.57%	2.90%
Total	**1.73%**	1.88%	1.83%	1.49%	1.47%	1.52%
Customer charge against profit as a % of gross loans and advances to customers						
Domestic	**0.56%**	0.47%	0.41%	0.72%	0.57%	0.49%
Foreign	**0.58%**	0.58%	0.14%	0.14%	0.41%	1.76%
Total	**0.57%**	0.51%	0.32%	0.58%	0.53%	0.79%

Notes:

(1) Includes closing provisions against loans and advances to banks of £7 million (31 December 2001 £8 million; 31 December 2000 - £14 million).

(2) Closing customer provisions exclude closing provisions against loans and advances to banks.

Provisions for bad and doubtful debts *(continued)* The following table presents additional information with respect to the provisions for bad and doubtful debts.

	31 December			30 September	
	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Loans and advances to customers (gross)	227,244	194,137	171,215	50,077	41,650
Provisions at end of period:					
Specific provisions - customers	3,323	3,031	2,571	567	454
Specific provisions - banks	7	8	14	-	-
General provision	597	614	568	170	179
	3,927	3,653	3,153	737	633
Customer provision at end of period as % of loans and advances to customers at end of period:					
Specific provisions	1.47%	1.56%	1.50%	1.13%	1.09%
General provision	0.26%	0.32%	0.33%	0.34%	0.43%
	1.73%	1.88%	1.83%	1.47%	1.52%
Average loans and advances to customers (gross)	211,206	181,584	142,288	45,807	39,456
As a % of average loans and advances to customers during the period:					
Total customer provisions charged to profit and loss	0.61%	0.54%	0.39%	0.58%	0.83%
Amounts written-off (net of recoveries) - customers	0.46%	0.42%	0.44%	0.38%	0.34%

Analysis of closing provisions for bad and doubtful debts The following table analyses customer provisions for bad and doubtful debts by geographical area and type of domestic customer.

31 December						30 September			
2002		2001		2000		1999		1998	
Closing provision £m	% of loans to total	Closing provision £m	% of loans to total	Closing provision £m	% of loans to total	Closing provision £m	% of loans to total	Closing provision £m	% of loans to total

		loans %		loans %		loans %		loans %		loans %
Domestic										
Central and local government	-	0.6	-	0.4	-	1.1	-	0.3	-	0.3
Manufacturing	205	3.2	209	3.8	148	4.0	16	5.4	16	5.0
Construction	65	1.5	72	1.6	77	1.5	8	1.3	9	1.3
Finance	71	5.5	73	4.4	75	5.8	4	5.8	3	5.3
Service industries and business activities	699	11.5	627	12.9	665	12.2	124	16.1	95	16.7
Agriculture, forestry and fishing	29	1.1	31	1.2	33	1.4	3	1.4	2	1.5
Property	40	7.0	39	6.3	55	6.1	11	7.3	13	7.0
Individuals - home mortgages	60	18.5	53	19.1	35	19.0	22	19.1	17	20.0
- other	855	9.8	855	10.3	797	10.5	167	12.5	121	10.9
Finance leases and instalment credit	208	5.2	164	5.8	149	6.3	12	7.2	7	8.4
Total domestic	2,232	63.9	2,123	65.8	2,034	67.9	367	76.4	283	76.4
Foreign	1,091	36.1	908	34.2	537	32.1	200	23.6	171	23.6
Specific provisions	3,323	100.0	3,031	100.0	2,571	100.0	567	100.0	454	100.0
General provision	597		614		568		170		179	
Total provisions	3,920		3,645		3,139		737		633	

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Analysis of write-offs The following table analyses amounts written-off by geographical area and type of domestic customer.

	Year ended 31 December			Year ended 30 September	
	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Domestic					
Manufacturing	111	61	55	4	11
Construction	18	19	30	5	5
Finance	35	8	5	1	2
Service industries and business activities	180	176	146	38	41
Agriculture, forestry and fishing	10	5	5	1	2
Property	9	14	7	4	4
Individuals - home mortgages	2	3	12	9	5
- others	333	297	230	107	70
Finance leases and instalment credit	45	62	109	6	4
Total domestic	743	645	599	175	144
Foreign	293	190	185	51	26

Total write-offs*	**1,036**	835	784	226	170

* Includes amounts written-off in respect of banks of £1 million (2001 £6 million; 2000 £5 million).

Analysis of recoveries The following table analyses recoveries of amounts written-off by geographical area and type of domestic customer.

	Year ended 31 December			Year ended 30 September	
	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Domestic					
Manufacturing	**1**	2	12	2	1
Construction	**-**	1	13	1	3
Finance	**-**	1	3	8	1
Service industries and business activities	**1**	5	45	4	6
Agriculture, forestry and fishing	**-**	-	3	-	-
Property	**1**	1	6	-	1
Individuals - home mortgages	**-**	-	-	1	-
- others	**27**	41	57	28	8
Finance leases and instalment credit	**7**	3	3	-	-
Total domestic	**37**	54	142	44	20
Foreign	**26**	26	22	10	15
Total recoveries	**63**	80	164	54	35

Risk elements in lending and potential problem loans 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 in the US. The following table shows the estimated amount of loans that 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 2002 £m	31 December 2001 £m	31 December 2000 £m	30 September 1999 £m	30 September 1998 £m
Loans accounted for on a non-accrual basis (3):					
Domestic	**3,077**	2,829	2,482	378	416
Foreign	**1,098**	737	344	170	148
Total	**4,175**	3,566	2,826	548	564
Accruing loans which are contractually overdue 90 days					

or more as to principal or interest (4):					
Domestic	363	643	662	322	311
Foreign	129	142	168	110	117
Total	492	785	830	432	428
Loans not included above which are classified as troubled debt restructurings by the SEC:					
Domestic	144	26	43	13	15
Foreign	60	116	122	104	5
Total	204	142	165	117	20
Total risk elements in lending	4,871	4,493	3,821	1,097	1,012
Potential problem loans (5)					
Domestic	639	801	699	171	98
Foreign	544	279	73	75	45
	1,183	1,080	772	246	143
Closing provisions for bad and doubtful debts as a % of total risk elements in lending	81%	81%	83%	67%	63%
Risk elements in lending as a % of gross loans and advances to customers	2.14%	2.31%	2.23%	2.19%	2.43%

Notes:

(1) For the analysis above, Domestic consists of the UK domestic transactions of the Group. Foreign comprises the Group s transactions conducted through offices outside the UK and through those offices in the UK specifically organised to service international banking transactions.

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

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

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

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

	Year ended 31 December			Year ended 30 September	
	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Gross income not recognised but which would have been					

recognised under the original terms of non-accrual and restructured loans					
Domestic	**234**	173	148	53	57
Foreign	**73**	60	48	32	20
	307	233	196	85	77

Interest on non-accrual and restructured loans included in net interest income					
Domestic	**47**	42	30	4	14
Foreign	**7**	14	8	13	7
	54	56	38	17	21

Cross border outstandings in excess of 0.75% of total assets Cross border outstandings consist of loans to banks and customers (including finance lease and instalment credit receivables) and other monetary assets, including non-local currency claims of overseas offices on local residents. The Group monitors the geographical breakdown of outstandings based on the country of domicile of the borrower or guarantor of ultimate risk. The table below sets out the Group s cross border outstandings in excess of 0.75% of Group total assets (including acceptances) of £414.4 billion (2001 £371.7 billion; 2000 £320.9 billion). None of these countries has experienced repayment difficulties that have required refinancing of outstanding debt.

31 December	As % of total assets %	Total £m	Banks and other financial institutions £m	Governments and official institutions £m	Commercial, industrial and other private sector £m

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

	Bank £m	Non-bank £m	31 December 2002 Total £m	Bank £m	Non-bank £m	31 December 2001 Total £m	Bank £m	Non-bank £m	31 December 2000 Total £m
Argentina	**30**	**15**	**45**	39	12	51	113	63	176
Brazil	**-**	**14**	**14**	158	22	180	193	38	231
Mexico	**66**	**91**	**157**	108	62	170	155	87	242
Turkey	**25**	**65**	**90**	38	102	140	153	35	188
Venezuela	**-**	**115**	**115**	-	99	99	-	91	91

Off balance sheet arrangements The Group is involved with several types of off-balance sheet arrangements, including special purpose vehicles, lending commitments and financial guarantees.

Special purpose vehicles (SPVs) are vehicles set up for a specific, limited purpose that do not carry out a business or trade and typically have no employees. They take a variety of legal forms trusts, partnerships and companies and fulfil many different functions. They constitute a key element of securitisation transactions in which an SPV acquires financial assets funded by the issue of securities.

In the normal course of business, the Group arranges securitisations to facilitate client transactions and undertakes securitisations to sell financial assets or to obtain funding. It has established a number of SPVs to act as commercial paper conduits for customers. SPVs are also utilised in its fund management activities to structure investment funds to which the Group provides investment management services.

Lending commitments and other commitments Under a loan commitment, the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term, may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities. Other commitments include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities.

Guarantees and other contingent liabilities The Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer s obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount. The Group expects most guarantees it provides to expire unused. Other contingent liabilities include contingent liabilities arising out of acceptances, endorsements, standby letters of credit, performance and customs bonds, warranties and indemnities. In accepting a bill of exchange drawn on it by a customer a bank undertakes to pay the holder of the bill at maturity. Most acceptances are presented for payment and reimbursement by the customer is usually immediate. In the UK, bills accepted by certain banks designated by the Bank of England are eligible for rediscount at the Bank of England. Under US GAAP, acceptances and the corresponding customer obligation are recognised on the balance sheet. In endorsing a bill of exchange, a bank accepts liability for payment of any shortfall on the bill at maturity. Unlike acceptances, the endorsing bank receives value for the bill, which is then rediscounted.

The Group s contingent liabilities and commitments are set out in Note 41 on the accounts.

Contractual obligations The table below summarises the Group s contractual cash obligations by remaining maturity as at 31 December 2002.

	Less than 1 year £m	More than 1 year but less than 3 years £m	More than 3 years but less than 5 years £m	Over 5 years £m	Total £m

Contractual cash obligations					
Dated loan capital	355	1,183	454	5,610	7,602
Operating leases	247	454	408	2,247	3,356
Finance leases	29	10	4	128	171
Unconditional obligations to purchase goods or services	489	420	3	1	913
Total	1,120	2,067	869	7,986	12,042

The table above does not include undated loan capital. The maturity of deposits by banks is given in Note 24, of customer accounts in Note 25, and of debt securities in issue in Note 26.

Liquidity risk

Liquidity management within the Group focuses on both overall balance sheet structure and the control within prudent limits of risk arising from the mismatch of maturities across the balance sheet and from 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, can be met as they arise from day to day, either from cash inflows from maturing assets, new borrowing or from the sale or repurchase of various debt securities held.

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

The level of large deposits taken from banks, corporate customers, non-bank financial institutions and other customers, and significant cash outflows therefrom, 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 they differ materially from the underlying contractual maturities.

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

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.

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

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

	2002		2001	
	£m	%	£m	%
Customer accounts:				
repayable on demand	127,320	39	115,054	41
time deposits (excluding repos)	66,781	21	66,486	23
Total customer accounts	194,101	60	181,540	64
Repo agreements with customers	25,060	8	17,455	6
Deposits by banks (including repos)	54,720	17	40,038	14
Debt securities in issue	33,938	10	30,669	11
Short positions	16,381	5	14,622	5
Total deposits including repo agreements, debt securities in issue and short positions	324,200	100	284,324	100

Customer accounts, excluding repo agreements, grew by £12,561 million, 7% and represent 60% of the Group s funding excluding capital and other liabilities. In reflection of the higher rate of growth in customer loans and advances excluding reverse repos, up £22,754 million, 12%, the proportion of funding from wholesale sources has increased.

Repo agreements with corporate and institutional customers are undertaken primarily by RBS Greenwich Capital in the USA and by Financial Markets. Repo activity with customers increased to represent 8% of the Group s funding excluding capital and other liabilities at 31 December 2002 (2001 6%).

Deposits by banks increased by £14,682 million to represent 17% of the Group s funding, excluding capital and other liabilities. Deposits by banks are taken from a wide range of counterparties, with the largest single depositor continuing to represent less than 1% of the Group s total funding.

Debt securities in issue increased by £3,269 million to represent 10% of the Group s funding, excluding capital and other liabilities, at 31 December 2002 (2001 11%). Total debt securities in issue at 31 December 2002 includes £6,035 million (2001 £5,969 million) with a maturity of over 1 year, reflecting the activity of the Group in raising term funds through its Euro Medium Term Note programme and other term issues.

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

Net customer activity Net customer lending rose by £10,193 million as the growth in loans and advances to customers exceeded the growth in customer accounts, thus increasing the degree of reliance on wholesale market funding to support loan growth. Structural liquidity risk continues to be maintained well within the Group s policy parameters.

	2002 £m	2001 £m
Loans and advances to customers (excluding reverse repos)	**205,303**	182,549
Customer accounts (excluding repos)	**194,101**	181,540
Customer lending less customers accounts	**11,202**	1,009
Customer accounts (excluding repos) as % of loans and advances to customers (excluding reverse repos)	**94.5**%	99.4%

In prevailing economic conditions and with interest rates at historically low levels in the UK, US and Europe, it is anticipated that the growth in demand for further borrowing by customers will in the medium term continue to exceed that for customer deposits received, thus increasing net customer lending further and increasing gradually over time the Group s dependence on the wholesale market for funding. The Group has evaluated a range of balance sheet management strategies to address the consequent impact on its liquidity risk position and has developed plans to contain that within its normal policy parameters.

Net wholesale market activity

	2002 £m	2001 £m
Deposits by banks (including repos) :		
repayable on demand	**15,559**	7,259
less than 3 months maturity	**35,125**	25,560
over 3 months maturity	**4,036**	7,219
	54,720	40,038
Repos with customers	**25,060**	17,455
Debt securities in issue	**33,938**	30,669
Short positions	**16,381**	14,622
Wholesale liabilities	**130,099**	102,784
Loans and advances to banks (including reverse repos):		
repayable on demand	**6,792**	3,934
less than 3 months maturity	**28,537**	26,200
over 3 months maturity	**8,974**	8,387
	44,303	38,521
Reverse repo agreements with customers	**21,941**	11,588
Debt securities, treasury bills and other eligible bills	**78,501**	74,176
Wholesale assets	**144,745**	124,285
Net surplus of wholesale assets	**14,646**	21,501

The Group s net surplus of wholesale assets reduced by £6,855 million, but overall structural liquidity risk remains well within the Group s policy parameters.

Comparing the maturity and level of deposits by banks with loans and advances to banks shows an increased reliance on shorter term interbank funding. Deposits by banks net of loans and advances to banks increased from £1,517 million to £10,417 million and the maturity structure has shortened. Net bank deposits repayable on demand rose by £5,442 million and net bank deposits of less than 3 months maturity rose by £7,228 million, whilst net bank lending of over 3 months maturity rose by £3,770 million.

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

	2002 £m	2001 £m	2000 £m
UK			
Domestic:			
Demand deposits - interest-free	**22,067**	21,095	20,721
- interest-bearing	**66,118**	63,609	53,903
Time deposits - savings	**12,180**	13,226	13,778
- other	**59,819**	40,360	37,388
Overseas residents:			
Demand deposits - interest-free	**908**	1,301	2,192
- interest-bearing	**8,897**	7,286	8,824
Time deposits - savings	**1,559**	3,210	6,167
- other	**21,824**	21,979	13,450
Total UK offices	**193,372**	172,066	156,423
Overseas			
Demand deposits - interest-free	**6,698**	6,719	4,206
- interest-bearing	**10,148**	10,787	8,127
Time deposits - savings	**15,189**	21,343	15,293
- other	**48,474**	28,118	28,383
Total overseas offices (see below)	**80,509**	66,967	56,009
Total deposits	**273,881**	239,033	212,432
Banking business	**230,144**	211,942	187,344
Trading business	**43,737**	27,091	25,088
Total deposits	**273,881**	239,033	212,432

Overseas			
US	**61,738**	49,815	39,567
Rest of the World	**18,771**	17,152	16,442
Total overseas	**80,509**	66,967	56,009

Short-term borrowings The following table shows details of the Groups short-term borrowings:

	2002 £m	2001 £m	2000 £m
Commercial paper:			
Outstanding at year end	**3,515**	273	681
Maximum amount outstanding at any month-end during year	**3,515**	643	1,073
Approximate average amount outstanding during year	**868**	572	737
Approximate weighted average interest rate during the year	**2.0%**	4.3%	6.2%
Approximate weighted average interest rate at year end	**1.6%**	4.1%	4.7%
Other short-term borrowings:			
Outstanding at year end	**72,069**	47,750	38,926
Maximum amount outstanding at any month-end during year	**72,264**	56,890	45,993
Approximate average amount outstanding during year	**58,246**	50,628	32,437
Approximate weighted average interest rate during year	**2.9%**	4.8%	5.6%
Approximate weighted average interest rate at year end	**2.2%**	3.8%	5.8%

Average interest rates during the year are computed by dividing total interest expense by the average amount borrowed. Average interest rates at year end are average rates for a single day and as such may reflect one-day market distortions which may not be indicative of generally prevailing rates. Original maturities of commercial paper are not in excess of one year. Other short-term borrowings consist principally of borrowings in the money markets included within Deposits by banks and Customer accounts in the accounts, and generally have original maturities of one year or less.

Certificates of deposit and other time deposits The following table shows details of the Group s certificates of deposit and other time deposits over $100,000 or equivalent by remaining maturity.

	Within 3 months £m	Over 3 months but within 6 months £m	Over 6 months but within 12 months £m	Over 12 months £m	2002 Total £m
UK based companies and branches					
Certificates of deposit	**17,130**	**416**	**306**	**810**	**18,662**
Other time deposits	**58,045**	**3,097**	**2,038**	**2,600**	**65,780**
Overseas based companies and branches					

Certificates of deposit	6,144	495	803	-	7,442
Other time deposits	33,873	493	410	1,674	36,450
Total	115,192	4,501	3,557	5,084	128,334

Sterling liquidity Over 53% of the Group s total assets are denominated in sterling. The FSA requires the Group on a consolidated basis to maintain daily a minimum ratio of 100% between:

a stock of qualifying high quality liquid assets (primarily UK government securities, treasury bills, eligible bank bills, and cash held in branches) and

the sum of :

sterling wholesale net outflows contractually due within 5 working days (offset up to a limit of 50%, by 85% of sterling certificates of deposit held which mature beyond 5 working days), and

5% of retail deposits with a residual contractual maturity of 5 working days or less.

The Group has exceeded the minimum ratio requirement throughout 2002.

The FSA also set an absolute minimum level for the stock of qualifying liquid assets that the Group is required to maintain each day. The Group has exceeded that minimum stock requirement at all times during 2002.

The Group s operational processes are actively managed to ensure that both the minimum sterling liquidity ratio and the minimum stock requirement are achieved or exceeded at all times.

Liquidity in non-sterling currencies For non-sterling currencies, no specific regulatory liquidity requirement is set for the Group by the FSA. However, the importance of managing prudently the liquidity risk in its non-sterling activities is recognised and the Group manages its non-sterling liquidity risk daily within net mismatch limits set for the 0-8 calendar day and 0-1 month periods as a percentage of the Group s total deposit liabilities.

In measuring its non-sterling liquidity risk, due account is taken of the marketability within a short period of the wide range of debt securities held. Appropriate adjustments are applied in each case, dependent on various parameters, to determine the Group s ability to realise cash at short notice via the sale or repo of such marketable assets if required to meet unexpected outflows.

The level of contingent risk from the potential drawing of undrawn or partially drawn commitments, back-up lines, standby lines and other similar facilities is also actively monitored and reflected in the measures of the Group s non-sterling liquidity risk. Particular attention is given to the US$ commercial paper market and the propensity of the Group s corporate counterparties who are active in raising funds from that market to switch to take up facilities offered by the Group in the event of either counterparty specific difficulties or a significant widening of interest spreads generally in the commercial paper market.

The Group also provides liquidity back-up facilities to both its own conduits and certain other conduits which take funding from the US$ commercial paper market. Limits sanctioned for such facilities totalled less than £6,000 million at 31 December 2002. The short-term contingent liquidity risk in providing such back-up facilities is also mitigated by the spread of maturity dates typically over a 3-month period of the commercial paper taken by the conduits.

The Group has operated within its non-sterling liquidity policy mismatch limits at all times during 2002 and operational processes are actively managed to ensure that is the case going forward.

Contingency plans are also maintained to enable the Group to respond effectively to unforeseen market liquidity or major payment systems problems that may emerge from time to time.

Analysis of deposits currency analysis The following table shows the distribution of deposits by banks and customer accounts by sterling and other currencies.

	2002 £m	2001 £m	2000 £m
Deposits by banks			
Sterling	**10,998**	9,027	3,330
Other currencies	**43,722**	31,011	31,800
Total deposits by banks	**54,720**	40,038	35,130
Customer accounts			
Sterling	**133,404**	125,425	122,420
Other currencies	**85,757**	73,570	54,882
Total customer accounts	**219,161**	198,995	177,302
Total deposits	**273,881**	239,033	212,432

Market risk
The Group is exposed to market risk because of positions held in its treasury and trading portfolios, as well as 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 interest rates.

Market risk in the trading portfolios is mainly associated with customer-facing trading businesses through the market-making operations and through 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 SCH.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities.

Mismatch risk mainly gives rise to interest-rate exposure that 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.

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.

Non-trading equity risk arises principally from the Group s strategic investments, its venture capital activities and its general insurance business.

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, but not limited to, stress testing, scenario analysis, and position and sensitivity limits. Stress testing measures the impact of abnormal changes in market rates and prices on the fair value of the Group s trading portfolios. GEMC approves the high-level VaR and stress limits for the Group. The Group Market Risk function, independent from the Group s trading businesses, is responsible for setting and monitoring the adequacy and effectiveness of the Group s market risk management processes.

Value-at-risk VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group s VaR assumes a time horizon of one day and a confidence level of 95%. In other words, a one-day loss greater than VaR is likely to occur on average on only one in every 20 business days. The Group uses historical simulation models in computing VaR. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used. The Group s method, however, does not make any assumption about the nature or type of underlying loss distribution. The Group typically uses the previous two years of market data. The Group s VaR should be interpreted in light of the limitations of the methodology used. These limitations include:

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

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

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

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

These limitations and the nature of the VaR measure mean that the Group cannot guarantee that losses will not exceed the VaR amounts indicated 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 39 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 in order to profit from market imperfections; and proprietary activity taking positions in financial instruments as principal in order to take advantage of anticipated market conditions.

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.

2002	Period end £m	Maximum £m	Minimum £m	Average(1) £m
Interest rate (2)	8.4	11.6	6.0	9.0
Currency	1.2	2.5	0.4	1.2
Equity	0.6	1.0	0.2	0.5
Diversification effects	(1.8)			
Total	8.4	11.8	5.6	9.1

2001	Period end £m	Maximum £m	Minimum £m	Average(1) £m
Interest rate (2)	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

Notes:

(1) Calculated as the arithmetic average of daily VaR figures.

(2) Includes credit spreads.

The largest part of the Group s trading activities are carried out by Financial Markets. In the year to 31 December 2002, average daily profit including net interest for the trading portfolios in Financial Markets was £5.2 million (2001 £5.2 million) and the standard deviation of profits was £4.1 million (2001 £4.5 million).

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). The VaR for these portfolios is presented below.

	2002 Period end £m	2002 Maximum £m	2002 Minimum £m	2002 Average £m	2001 Period end £m
Interest rate	34.7	34.7	9.7	14.5	7.7
Currency (1)	0.2	0.4	0.2	0.2	0.1
Equity	8.6	8.6	6.8	7.4	7.8
Diversification effects	(11.0)				(6.7)
Total	32.5	32.5	10.8	14.8	8.9

(1) Excludes the Group s structural foreign currency exposures (see page 69).

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
2002	**6.5**	**6.7**	**3.5**	**4.4**
2001	4.6	5.9	3.8	4.5

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 seeks to minimise the sensitivity of net interest income to changes in interest rates. The 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 which is covered by the policy but its stance on risk minimisation differs to other parts of the Group in that it seeks to maximise yield on its investment portfolio whilst staying within interest rate risk limits set by GALCO and local banking regulators.

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 approved by Group Treasury and business unit asset and liability committees annually, or more often if appropriate. The key conventions are reviewed annually by GALCO.

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.

Residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the individual balance sheets. Potential exposures to interest rate movements in the medium to long term are measured and controlled using a version of the same VaR methodology, but without discount factors, that is used for the Group s trading portfolios. Short-term exposures are measured and controlled in terms of net interest income sensitivity over 12 months to a 1% parallel movement in interest rates. These exposures are monitored against limits approved by GALCO and reported to GALCO monthly.

A VaR calculation aggregating all non-trading assets and liabilities in the Group s balance sheet is undertaken quarterly. At 31 December 2002, the total VaR exposure relating to structural interest rate risk was estimated to be £31.2 million (2001 £8.8 million) with the major exposure being to changes in US dollar interest rates. During the year, the maximum VaR was £31.2 million (2001 £13.7 million), the minimum £8.0 million (2001 £4.4 million) and the average £13.4 million (2001 £7.9 million). The major contributor to this non-tradingVaR is Citizens.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities. An example is where customers can repay fixed rate loans or withdraw fixed rate deposits before their maturity. Extensive modelling is undertaken to identify potential levels of early repayment in differing interest rate environments. The Group also seeks to protect itself from early repayment risk through the imposition of early repayment interest charges, where applicable. Option risk also arises where businesses undertake to provide funding to, or to accept deposits from, customers at a future date at a pre-determined fixed interest rate and where deposit pricing reaches effective floors. The VaR numbers stated above do not reflect any for embedded option risk.

The two main embedded option risks within the Group s commercial banking activities are:

(i) Citizens has a sizable investment portfolio consisting largely of mortgage-backed securities which are fixed rate instruments which can be subject to significant refinancing activity in a falling interest rate environment and extension risk in a rising interest rate environment. The embedded option risk is primarily managed by controlling Citizens sensitivity to changes in interest rates of the economic value of equity (EVE) which represents the present value of the cashflows generated by the current balance sheet. The sensitivity of EVE to a two per cent parallel movement upwards and downwards in US interest rates is shown in the table below.

	Increase/(decrease) in EVE	
2002	2% parallel upward movement in US interest rates %	2% parallel downward movement in US interest rates (no negative rates allowed) %
Period end	(5.7)	(7.4)
Maximum	(8.7)	(9.5)
Minimum	8.7	(0.3)
Average	(4.6)	(6.3)

(ii) In a low interest rate environment deposit pricing may reach effective floors below which it is not reasonable to reduce rates further whilst variable rate asset pricing continues to decline. A sustained low rate scenario would also generate reduced income from the medium and long term hedging of the Group s net non-interest bearing liabilities. GALCO regularly reviews the impact of successive declines in rates to ensure that appropriate risk management strategies are employed.

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 the subsidiary s regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. Gains or losses on foreign currency investments net of any gains or losses on related foreign currency funding or hedges are recognised in the statement of total recognised gains and losses.

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

	At 31 December 2002		
Functional currency of net investments	Net investments in overseas operations	Foreign currency borrowings hedging net investments	Structural foreign currency exposures

	£m	£m	£m
US dollar	**5,190**	**5,107**	**83**
Euro	**1,019**	**558**	**461**
Swiss franc	**306**	**295**	**11**
Other non-sterling	**35**	**30**	**5**
Total	**6,550**	**5,990**	**560**

	At 31 December 2001		
Functional currency of net investments	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
Euro	797	242	555
Swiss franc	250	243	7
Other non-sterling	61	46	15
Total	6,315	5,693	622

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

Equity risk Non-trading equity risk arises principally from the Group s strategic investments, its venture capital activities and its general insurance business. The reserves of the Group s general insurance business are invested in cash, debt securities and equity shares. The VaR of the equity element of this portfolio was £8.6 million at 31 December 2002 (2001 £7.8 million). VaR is not an appropriate risk measure for the Group s venture capital investments, comprising a mix of quoted and unquoted investments, or its portfolio of strategic investments. At 31 December 2002, equity shares held as investment securities had a book value of £1,783 million (2001 £1,528 million) and a valuation of £1,699 million (2001 £1,792 million).

Regulatory risk Regulatory risk is defined as the risk of material loss, reputational damage or liability arising from failure to comply with the requirement of the Group s lead regulator, the FSA and other regulators or related codes of best practice that oversee regulated businesses in any locations in which the Group operates.

The Group s current businesses operate under the supervision of over 100 regulators in over 20 countries. Other overseas regulators who supervise major parts of the Group include:

Overseas regulator	RBS division	Territory
Securities and Exchange Commission	CBFM/Citizens/Wealth Management	US

Federal Reserve Bank of Boston	CBFM/Citizens	US
National Association of Securities Dealers	CBFM/Wealth Management	US
Central Bank of Ireland	CBFM/Ulster Bank/Wealth Management	Republic of Ireland
Bundesanstalt für Finanzdienstleistungsaufsicht	CBFM/Direct Line Group/Retail Direct	Germany
Financial Services Authority	CBFM/Direct Line Group	Japan
Cayman Islands Monetary Authority	CBFM/Wealth Management	Cayman Islands
Financial Services Commission	Ulster Bank/Wealth Management	Isle of Man
Hong Kong Monetary Authority	CBFM/Wealth Management	Hong Kong

The Group analyses regulatory risk into:

Upstream risk: the risk to which the Group may be exposed by its failure to identify and engage with regulators on developments which are in course of consideration or preparation by Government, regulators and other bodies, including the European Union. This has become an increasingly important area given the rapid and growing rate at which such developments have been tabled by regulators and other relevant bodies round the world.

Downstream risk: the risk to the Group from failing to comply with extant rules (analogous to traditional compliance risk). This is an increasing challenge given the growing intricacy of the rules in place and the scale and complexity of the Group s businesses.

Regulator risk: the risk to the Group of a failure to manage effectively its relationships with its regulators. Given that the Group includes businesses operating under the supervision of many regulatory bodies in many jurisdictions, the management of this risk is a complex and continuous process.

During the year, a Group Regulatory Risk Team was created within Group Risk Management, as a successor to the previous Group Compliance function. Its objective has been to enhance management of regulatory risk by incorporating the identification and management process into the Group s wider risk management structure and methodologies.

Enterprise risk

Enterprise risk management is the term used within the Group to describe the risk of an actual or potential loss to the Group that is not managed directly by existing liquidity, regulatory, market or credit risk management processes. Such risks can arise internally from inadequate or failed internal processes and systems, staff error and management failure or externally from changes to the legal, physical, political or business environment within any of the territories where the Group conducts business. Enterprise risk management also includes the potential or actual impact on our corporate reputation arising from any of the Group s activities.

Operational risk management Operational risk is defined as the risk arising from within the organisation. It has four major components:

People risks arising from an inappropriate level of staff, inadequately skilled or managed.

Process risk caused by inadequate or failed internal processes.

Systems risks of inadequately designed or maintained systems.

Assets risk of damage, misappropriation or theft of the Group s physical, logical and intangible assets.

Within each Division there are independent operational risk management units, reporting to both divisional executive management, who have the final responsibility for managing divisional operational risk, and Group Risk.

External risk management External risk is defined as the risk arising from outside of the organisation in three main areas;

Business risks arising from competitor activity, supplier unreliability or customer activity.

Political risks caused by non-compliance with, or changes to, current legislation, political unrest or uncertainty, lobbying activity or targeted sabotage.

Environment risk caused by demographic, macro economic or environmental change.

External risk management is primarily performed at a Group level and requires close co-operation across Group functions. As these risks can arise from changes to the legal, physical, political or business environment in any of the territories where the Group conducts business, close liaison with the relevant divisional risk management teams is also critical to the assessment and management of the Group s risk exposure in these areas.

A key component of the risk management processes is the fight against financial crime. This includes the anti-money laundering processes in place across the Group. There are divisional and business unit anti-money laundering teams acting under the licence of, and monitored by, a Group anti-money laundering function. This monitoring ranges from monthly reporting of key indicators through to a full annual report by the money laundering Reporting Officer to the Board.

The monitoring and reporting covers the full spectrum of anti-money laundering responsibilities as follows:

Ensuring the required Know Your Customer procedures are in operation.

Transaction monitoring in order to identify suspicious or untoward incidents that may indicate money laundering activity.

Documentation requirements are met to support information requests from the regulators and law enforcement agencies.

Training and competence assessments of the Group s staff.

The Group also manages insurance risk arising from insurance as a source of risk and as a tool to reduce other risk exposures.

Insurance is a source of risk where the Group sells and underwrites general insurance and life assurance. The essence of an insurance contract is the transfer of risk from the policyholder to the insurer. The Group controls its insurance exposures through product design and policy wordings, and through pricing and underwriting procedures. Investment strategy reflects the maturity of underwriting liabilities. Underwriting concentrations and catastrophe exposure are reviewed and, where necessary, mitigated by reinsurance. Group Risk Management provides the framework within which the consolidated insurance exposure is managed and provides guidance and challenge as appropriate.

The Group s underwriting experience, the level of retained risk and solvency are monitored at business and Group level.

The Insurance Risk Department is responsible for the Group-wide purchase of insurance as a means of reducing other risk exposures. As such, it is a key component of the Group Insurance Risk Management process and reports its activities to the GEMC.

Board of directors and secretary

Chairman

Sir George Mathewson (3)(4)

CBE, DUniv, LLD, FRSE, FCIBS
(age 62), has a wide background in finance, technology and management and has spent some of his career in the United States. He 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 president of the British Bankers Association. He is a director of Santander Central Hispano, S.A., The Scottish Investment Trust PLC and The International Monetary Conference. He was chief executive of the Scottish Development Agency from 1981 to 1987. (Chairman of the Nominations Committee and the Chairman's Advisory Group)

Vice-chairmen

Sir Iain Vallance (3)(4)
FCIBS
(age 59), is an experienced businessman. He has held a range of positions, including president, CBI, chairman, British Telecommunications p.l.c., chairman, European Advisory Committee to NYSE, deputy chairman, Financial Reporting Council and a member of the board of directors of the Mobil Corporation. He was appointed a director in January 1993 and became a vice-chairman in March 1994. He is currently chairman, European Services Forum and a member of the supervisory board of Siemens AG.

Sir Angus Grossart (3)(4)
CBE, LLD, FRSE, DL, FCIBS
(age 65), an advocate and chartered accountant, he has a background in merchant banking and is chairman of Noble Grossart Limited. He was appointed a director in September 1985 and became a vice-chairman in April 1996. He is also chairman of The Scottish Investment Trust PLC. He is a director of other public companies including Scottish and Newcastle PLC, Trinity Mirror PLC and Edinburgh US Tracker Trust plc. He is a Trustee of the National Heritage Memorial Fund and a former chairman of the Trustees of the National Galleries of Scotland. He has served on the boards of a wide range of public companies in the UK, the USA and Canada.

Executive directors

Fred Goodwin (4)
DUniv, FCIBS, FCIB
Group Chief Executive
(age 44), a chartered accountant, was appointed as 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. He is a former president of the Chartered Institute of Bankers in Scotland.

Lawrence Fish
(age 58), 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 58), a chartered accountant, was appointed a director in June 1992 and is Chief Executive, Retail Direct.

Gordon Pell
FCIB, FCIBS
(age 53), was appointed as 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(4)
CBE, FCIBS
(age 57), a chartered accountant, 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 chairman of British Empire Securities and General Trust plc.

Fred Watt (4)
FCIBS
(age 42), a chartered accountant, was appointed to his current position as Group Finance Director in September 2000. He

was formerly finance director, Wassall plc.

(1) member of the Remuneration Committee
(2) member of the Audit Committee
(3) member of the Nominations Committee
(4) member of the Chairman's Advisory Group

Non-executive directors

Emilio Botin
(age 68), of Spanish nationality, 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 including Bankinter SA. He is chairman of Universia.net, an internet venture between Santander Central Hispano and 650 universities in Spain, Portugal and the main countries in Latin America.

Colin Buchan[2]
(age 49), was appointed on 1 June 2002. He was educated in South Africa and spent the early part of his career in South Africa and the Far East. He retired as a member of the group management board of UBS AG and head of equities of UBS Warburg in March 2001. He has considerable international investment banking experience, as well as experience with very large risk management in the equities business. He was appointed a director of SG Warburg Group plc in 1995. His public directorships include Merrill Lynch World Mining Trust Plc. His other directorships include Merrill Lynch Gold Limited, Royal Scottish National Orchestra Society Limited, Standard Life Investments Limited, UBS Bunting Warburg Limited and World Mining Investment Company Limited.

Jim Currie[1]
(age 61), was appointed in November 2001. A highly experienced international civil servant, he spent many years working in Brussels and Washington. He was formerly Director General at the European Commission with responsibility for the EU's Environmental Policy and previously Director General for Customs and Indirect Taxation. He is also a director of British Nuclear Fuels Limited and International Adviser to Eversheds.

Juan Inciarte
(age 50), of Spanish nationality, is a general manager of Santander Central Hispano in charge of Europe and financial companies of the group. He is a former director of First Union Corporation, now Wachovia, and Interbank On-line System Limited. He is also a director of several Santander Central Hispano Group subsidiaries and a number of Spanish and European companies including CC-Bank AG and Sanpaolo IMI S.P.A.

Eileen Mackay[1][2]
CB, FCIBS
(age 59), is a former UK civil servant who held posts in Scotland, HM Treasury and the Cabinet Office and was principal finance officer at The Scottish Office. She is a director of Edinburgh Investment Trust plc and Scottish Financial Enterprise. She is chairman of Trustees of the David Hume Institute and is a member of the Economic and Social Research Council and the Review Board of the UK Accountancy profession and the Court of the University of Edinburgh

Sir Steve Robson[2]
(age 59), was appointed in July 2001. He was formerly a senior civil servant, with responsibility for a wide variety of Treasury interests. His early career included the post of Private Secretary to the Chancellor of the Exchequer and secondment to ICFC, (now 3i). He retired in January 2001 as Second Permanent Secretary of HM Treasury, where he was managing director of the Finance and Regulation Directorate. He is a non-executive director of Cazenove Group Plc, Xstrata Plc and Partnerships UK plc.

Bob Scott(1)(3)(4)
CBE
(age 61), of Australian nationality, was appointed in January 2001. He has many years experience in the international insurance business and played a leading role in the consolidation of the UK insurance industry. He is a former group chief executive of CGNU plc and chairman of the Board of the Association of British Insurers. He is also a non-executive director of Jardine Lloyd Thompson Group plc, Swiss Reinsurance Company Zurich, Focus Wickes Group Limited, Yell Group Limited and a Trustee of the Crimestoppers Trust. (Chairman of the Remuneration Committee)

Peter Sutherland
(age 56), born in Ireland, was appointed in January 2001. He is a former attorney general of Ireland and was, from 1985 to 1989, European Commissioner responsible for competition policy. From 1989 to 1995, he was the chairman of Allied Irish Bank. From 1993 to 1995 he was director general of GATT and, subsequently, the World Trade Organisation. He is chairman of BP plc and chairman of Goldman Sachs International. He is also a director of Investor AB and Telefonaktiebolaget LM Ericsson.

Bill Wilson(1)(2)(3)(4)
FCIBS
(age 65), a chartered accountant, has a background in accounting and insurance and spent a number of years based in North America. He was formerly deputy chairman of Alexander & Alexander Services Inc., now part of the Aon Group. His other public directorships are Edinburgh US Tracker Trust plc, First Title plc, First American Title Insurance (U.K.) Co plc and Scottish Rugby Union Plc. (Chairman of the Audit Committee)

Secretary
Miller McLean(4)
FCIBS
(age 53), 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., 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.

Report of the directors

The directors have pleasure in presenting their report together with the audited accounts for the year ended 31 December 2002.

The Board remains firmly committed to the importance of good corporate governance and welcomed the opportunity during 2002 to participate in the Review of the Role and Effectiveness of Non-executive Directors undertaken by Derek Higgs. The Board is considering the recommendations contained in the Higgs Report which was issued in January 2003 to ensure that it continues to apply the highest standards of governance.

Profit and dividends The profit attributable to the ordinary shareholders of the company for the year ended 31 December 2002 amounted to £1,971 million (after preference dividends of £305 million and the Additional Value Shares dividend of £798 million) compared with £1,868 million for the year ended 31 December 2001, as set out in the consolidated profit and loss account on pages 96 and 97.

An interim dividend of 12.7p per ordinary share was paid on 11 October 2002 totalling £368 million (2001 £313 million). The directors now recommend that a final dividend of 31.0p per ordinary share be paid on 6 June 2003 to members on the register at the close of business on 14 March 2003, totalling £899 million (2001 £772 million). If this recommendation is approved by shareholders at the annual general meeting on 28 April 2003, the retained profit for the year will amount to £704 million (2001 £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 second dividend of 30p per share on the Additional Value Shares issued in connection with the acquisition of NatWest was paid on 2 December 2002.

Activities and business review The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc (the Royal Bank), the principal direct operating subsidiary undertaking of the company. The Group comprises the company, the Royal Bank and its subsidiary and associated undertakings, including National Westminster Bank Plc (NatWest) and its subsidiary and associated undertakings, Angel Trains Limited, RBSG Capital Corporation, RBS Life Holdings Limited and RBSG Collective Investments Holdings Limited. The Royal Bank and NatWest and their subsidiary undertakings are engaged principally in providing a comprehensive range of banking, insurance and other financial services. Details of the principal subsidiary undertakings of the company are shown in Note 18. A review of the business for the year to 31 December 2002, of recent events and of likely future developments is contained in the Operating and financial review.

Business developments In May 2002, Lombard North Central PLC completed the acquisition of Dixon Motors PLC.

In June 2002, the Royal Bank purchased the 86% interest in WorldPay Limited that it did not previously own.

In June 2002, ownership of RBSG Capital Corporation was transferred to the company from the Royal Bank.

In September 2002, Citizens announced the acquisition of Pennsylvania based commercial bank, Commonwealth Bancorp Inc. This acquisition was completed in January 2003.

In September 2002, Direct Line Group completed the acquisition of Royal & Sun Alliance s direct motor insurance operation in Italy.

In October 2002, Citizens completed the acquisition of Medford Bancorp Inc., a Massachusetts savings bank.

In December 2002, the Royal Bank exercised its option to purchase Royal Bank of Scotland Portfolio Management and Royal Bank of Scotland Unit Trust Management from Newton Management Limited. In January 2003, 49% of the Royal Bank s economic interest in Royal Bank of Scotland Unit Trust Management was sold to Aviva plc.

In January 2003, the entire issued share capital of NatWest was transferred to the RoyalBank from the company. Also in January 2003, the entire issued share capital of Lombard North Central PLC was transferred from NatWest to the Royal Bank.

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 2002, the ordinary share capital was increased by the following issues:

(a) 5.1 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 10.1 million ordinary shares allotted in respect of the exercise of options under the NatWest executive and sharesave schemes which had been exchanged for options over the company s shares following the acquisition of NatWest;

(b) 22.5 million ordinary shares allotted in lieu of cash dividends; and

(c) 3.5 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 £697 million.

Details of the authorised and issued ordinary share capital at 31 December 2002 are shown in Note 33.

Preference share capital 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.

In January 2003, the company redeemed the 8 million Series B and the 16 million Series C, non-cumulative preference shares of US$0.01 each, at a total cost of US$600 million.

Details of the authorised and issued preference share capital at 31 December 2002 are shown in Note 33.

Trust preferred securities In June 2002, a subsidiary of the company issued 1.25 million Series A non-cumulative trust preferred securities at 1,000 per security, the net proceeds being 1,237 million.

In December 2002, a subsidiary of the company issued 750,000 Series B non-cumulative trust preferred securities at US$1,000 per security, the net proceeds being US$735 million.

Subordinated liabilities In March 2002, the Royal Bank issued £500 million 6.2% subordinated notes, the net proceeds being £497 million and US$350 million subordinated floating rate notes, the net proceeds being US$349 million.

In April 2002, the Royal Bank issued 130 million subordinated floating rate notes, the net proceeds being 130 million and US$500 million subordinated floating rate notes, the net proceeds being US$499 million.

In September 2002, the Royal Bank issued £300 million 5.625% subordinated notes, the net proceeds being £298 million; and NatWest redeemed US$250 million subordinated floating rate notes.

In October 2002, the company issued US$750 million 5% subordinated notes, the net proceeds being US$744 million.

In November 2002, the company issued US$250 million 5% subordinated notes, the net proceeds being US$244 million; and the Royal Bank issued 100 million subordinated floating rate notes, the net proceeds being 100 million.

Details of the subordinated liabilities are shown in Notes 30 and 31.

Shareholdings At 26 February 2003, the company has been notified of the following interests in its shares, in accordance with section 198 of the Companies Act 1985:

	Number of shares	% held		Number of shares	% held
Ordinary shares:			5 ½% cumulative preference shares:		
Santander Central Hispano S.A.	146,187,191	5.04	Commercial Union Assurance plc	91,429	22.86
Barclays PLC	87,592,044	3.02	Axa S.A.	81,000	20.25
11% cumulative preference shares:			Bassett-Patrick Securities Limited*	46,255	11.56
Guardian Royal Exchange			Mr P. S. and Mrs J. Allen	35,999	9.00
Assurance plc	129,830	25.97	E M Behrens Charitable Trust	20,000	5.00
Windsor Life Assurance			Mrs Gina Wild	19,800	4.95
Company Limited	51,510	10.30	Trustees of The Stephen Cockburn	16,730	4.18
The Investment Company plc	39,165	7.83	Limited Pension Scheme	16,730	4.18
Mr S. J. and Mrs J. A. Cockburn	30,810	6.16	Miss Elizabeth Hill	16,124	4.03
Cleaning Tokens Limited	25,500	5.10	Mr W. T. Hardison Jr.	13,532	3.38

* Notification has been received on behalf of Mr A. W. R. Medlock and Mrs H. M. Medlock that they each have an interest in the holding of 5 ½% cumulative preference shares registered in the name of Bassett-Patrick Securities Limited noted above and that there are further holdings of 5,300 and 5,000 shares, respectively, of that class registered in each of their names.

Directors The names and brief biographical details of the directors are shown on pages 72 and 73. Mr Cameron McLatchie and Mr Murray Stuart retired from the Board on 26 April 2002. Mr Colin Buchan was appointed to the Board as a non-executive director on 1 June 2002. Mr Buchan was appointed since the last general meeting and will seek re-election at the forthcoming annual general meeting on 28 April 2003. All directors served throughout the year and to the date of signing of the financial statements, apart from those noted above. The directors retiring by rotation are Mr Botin, Miss Mackay, Mr Scott, Mr Sutherland, Mr Watt and Mr Wilson and all will offer themselves for re-election. Details of the service agreement for Mr Watt are set out on page 84. None of the other directors seeking re-election has a service agreement.

Directors interests The interests of the directors in the shares of the company at 31 December 2002 are shown on page 90. None of the directors held an interest in the loan capital of the company or in the shares and loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2002 to 26 February 2003.

Employee proposition The company encourages employees to contribute to the Group s performance through Total Reward, one of the most comprehensive remuneration packages in the financial services industry. Employee choice, rewarding performance and sharing in the Group s success are key features of Total Reward.

Some 34,000 employees participated in RBS*elect*, a benefits choice programme, in 2002. Employees can choose from a range of options including discounted childcare and shopping vouchers, private medical insurance and telephone legal advice.

Employees can also participate in business-specific bonus or incentive plans, Group profit sharing and sharesave schemes. In each of the last five years, eligible employees have received a further ten percent of their basic salary per annum through Group profit sharing. Both Group profit sharing and sharesave allow employees to acquire shares, and therefore a stake, in the future success of the company. A bonus of five per cent of basic salary was paid to all UK employees whose business units were involved in recognition of their contribution to the successful integration of NatWest.

The Group provides pension scheme membership for the majority of its employees in the UK and overseas. The largest scheme is The Royal Bank of Scotland Group Pension Fund, which has some 73,000 employees as members. This is a non-contributory, final salary pension fund and is open to full-time and part-time staff, including fixed-term contractors.

Employee communication The Group also encourages employee involvement through a process of employee communication. This includes internal communication activities through a corporate intranet, an in-house magazine, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Group Chief Executive and other senior Group executives regularly communicate directly with employees via Question Time style programmes broadcast on the internal television network RBTV, and visits to Group offices. Short films explaining the Group s annual and interim financial results are also broadcast on RBTV.

Employee consultation The Group places great importance on consulting with employees. Every year the Group undertakes an employee opinion survey, which seeks views and feedback on a variety of key topics including leadership, communication, employee involvement, training and development. The latest survey took place in January 2003 when over 110,000 employees were invited to complete surveys either on paper or online, which have been translated into seven different languages. A response rate of 83% was achieved, which is significantly higher than the average for comparable organisations.

As a result of the growth in the Group s business interests in mainland Europe a process has been initiated to establish a European employee information and consultation body to facilitate dialogue amongst employee representatives on employment matters. In addition, an agreement covering the Group is being negotiated with employee representatives from across the Group s European operations.

Diversity The Group is committed to diversity in all areas of recruitment, employment, training and promotion. The Group supports a business model that is based on meritocracy and inclusiveness, where all members of staff can develop their full potential, irrespective of their race, gender, marital status, age, disability, religious belief, political opinion, or sexual orientation. To help it achieve its long term business objectives the Group draws on a wide ranging and diverse pool of talent. The Group also embraces and promotes individual, organisational and cultural differences.

Each year the Group participates in a number of diversity-related benchmarking exercises, including the Opportunity Now and Race for Opportunity annual benchmarking exercises, on gender and ethnicity. This enables the Group to evaluate its current position in respect of diversity issues and to identify actions required to further enhance diversity across its businesses.

In May 2002, the Group received the Opportunity Now Silver Award. This means that out of 20 financial sector organisations that participate in the survey, the Group was equal to or above the norm for the sector in all categories. In June 2002, the Group received the Race for Opportunity Bronze Award, coming 9th in the ranking of private sector organisations. The Group is also a Core Member of the Employer s Forum on Age and a Gold Card Member of the Employer s Forum on Disability, as well as participating in a number of other diversity networks.

The Group has established a diversity team which works across its businesses to ensure that diversity remains a key driver in everything it does.

Health and safety The health, safety and security of employees is of paramount importance to the Group. Where feasible, single, harmonised policies are in force across the Group. These are now subject to regular review to ensure that they continue to meet current legislation, best practice and the operational needs of the business.

Disabled staff The Group recognises its responsibility towards staff with disabilities and seeks to eliminate discrimination on the grounds of disability. The Group recognises the wealth of experience, talent and skill that people with disabilities can bring to the workforce and strives to achieve equality of opportunity in the recruitment, employment and retention of all staff, including those with disabilities.

Corporate social responsibility The Group recognises that 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 requires that the Group meets changing customer, shareholder, investor, employee and supplier expectations and the Group believes that meeting high standards of environmental, social and ethical responsibility is key to the way it does business.

To assist in creating value for all stakeholders, the Group has adopted policies which progressively integrate environmental and social issues into all aspects of its business activities. The objective of these policies is to ensure that its business is conducted in a sustainable and socially responsible way, and to safeguard and enhance the Group s business and reputation.

The Board regularly considers corporate social responsibility issues and receives a formal report on the relevant matters twice each year.

Charitable contributions The total amount given for charitable purposes by the company and its subsidiary undertakings during the year ended 31 December 2002 was £14.7 million (2001 £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 78 and 79.

Policy and practice on payment of creditors In the year ending 31 December 2003, 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 2002, the Group s trade creditors represented 27 days (2001 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
26 February 2003

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 Directors remuneration report on pages 80 to 89.

Throughout the year ended 31 December 2002, the company has complied with the provisions set out in Section 1 of the Code.

Board of directors The Board of directors comprises the Chairman, six executive directors and eleven non-executive directors. The biographies of the Board members appear on pages 72 and 73.

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 other executive directors.

The roles of Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. Mr Bob Scott has been nominated as the senior independent director. 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 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.

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

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 in discharging its responsibilities for accounting policies, financial reporting, internal control, compliance and risk management. The Committee also reviews the independence of the external auditors and the relationship between audit and non-audit work performed by the external auditors. During 2002, it was agreed that all non-audit work performed by the auditors would be approved in advance by the Committee.

The Remuneration Committee assists the Board in discharging its responsibilities for executive remuneration policy and the remuneration arrangements for directors. The Directors remuneration report is contained on pages 80 to 89.

The Nominations Committee is responsible for assisting the Board in the formal selection and appointment of directors. The Committee considers potential candidates and recommends appointments of new directors to the Board. This process was followed in respect of the appointment of Mr Colin Buchan to the Board during 2002.

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 and 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 2002 and to 26 February 2003, the date the directors approved the Report and Accounts. This process is regularly reviewed by the Board and meets the requirements of the guidance Internal Control: Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales in 1999.

The effectiveness of the Group s internal control system is reviewed regularly by the Board and the Audit Committee. Executive management committees or boards of directors in each of the Group s businesses receive quarterly reports on significant risks facing their business and how they are being controlled. These reports are combined and submitted to the

Board as quarterly risk and control assessments. Additional details of the Group s approach to risk management are given in the Risk management section of the Operating and financial review on pages 50 to 71. The Audit Committee also receives regular reports from Group Risk Management and Group Internal Audit. In addition, the Group s independent auditors present to the Audit Committee reports that include details of any significant internal control matters which they have identified. The system of internal controls of the authorised institutions and other regulated entities in the Group are also subject to regulatory oversight in the UK and overseas.

Sarbanes-Oxley Act

Under the US Sarbanes-Oxley Act of 2002, new and enhanced standards of corporate governance, and business and financial disclosure, will apply to US public companies and non-US companies, including the company, with securities registered in the US. Some of the new standards and rules affecting the company are already in force and others will come into force during 2003. New standards directly applicable to the company include certifications of the Annual Report on Form 20-F by the Group Chief Executive and Group Finance Director, changes to the role of the Audit Committee and new rules relating to internal controls. The Group is following these developments closely and intends to implement all necessary changes as the new rules come into force.

Controls and procedures

Evaluation of disclosure controls and procedures

The Group Chief Executive and Group Finance Director, after evaluating the effectiveness of the company s disclosure controls and procedures (as defined in rules under the US Securities Exchange Act) as of a date (the evaluation date) within 90 days of the filing date of this annual report, have concluded that as of the evaluation date, the company s disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the company and its consolidated subsidiaries would be made known to them by others within those entities.

Changes in internal controls There were no significant changes in the company s internal controls or, to the knowledge of the Group Chief Executive and Group Finance Director, in other factors that could significantly affect those internal controls subsequent to the evaluation date.

Directors remuneration report

The Remuneration Committee

The following directors, all of whom are independent non-executive directors, were members of the Remuneration Committee during the year ended 31 December 2002.

Bob Scott (Chairman)
Bill Wilson
Eileen Mackay (from 27 February 2002)
Jim Currie (from 27 February 2002)
Sir Iain Vallance (until 27 February 2002)
Sir Angus Grossart (until 27 February 2002)
Murray Stuart (until 26 April 2002, when he also retired from the Board).

During the accounting period, the Remuneration Committee appointed Hewitt Associates and Ernst & Young to provide advice on matters relating to directors remuneration. In addition, the Remuneration Committee has taken account of the views of Sir George Mathewson, Chairman, and Fred Goodwin, Group Chief Executive, on performance assessment of the other executive directors. During the early part of 2002, Arthur Andersen, who had been appointed by the Remuneration Committee previously, also provided advice on directors remuneration. In addition to advising the Remuneration Committee, Hewitt Associates provided services in connection with the provision of the company s UK benefits package and Ernst & Young reviewed the company s distressed lending policies and seconded staff to Group Compliance.

Remuneration policy

The executive remuneration policy is kept under review by the Remuneration Committee and is set out below. There have

been no material changes to the policy which was approved by shareholders at the company s annual general meeting in 2002.

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

Total rewards will be set at levels that are competitive within the relevant market, taking each executive director s total remuneration package as a whole.

Total potential rewards will be earned through achievement of demanding performance targets based on measures consistent with shareholder interests over the short, medium and longer-term.

Remuneration arrangements will strike an appropriate balance between fixed and performance related rewards. Performance related elements will comprise the major part of executive remuneration packages.

Incentive plans and performance metrics will be structured to be robust through the business cycle.

Remuneration arrangements will be designed to support the company s business strategy, to promote appropriate teamwork and to conform to best practice standards.

For the Chairman and non-executive directors, fees are reviewed annually by the Board, on the recommendation of the executive. The level of remuneration reflects the responsibility and time commitment of directors, and the level of fees paid to chairmen and non-executive directors of comparable major UK companies. Non-executive directors do not participate in any incentive or performance plan.

Components of executive remuneration

UK based directors

Fixed elements

Salary Salaries are reviewed annually as part of total remuneration having regard to remuneration packages received by executives of comparable companies. The Remuneration Committee uses a range of survey data from remuneration consultants and reaches individual salary decisions taking account of the remuneration environment and the performance and responsibilities of the individual director.

Benefits UK-based executive directors are eligible to participate in The Royal Bank of Scotland Group Pension Fund (the RBS Fund). The RBS Fund is a non-contributory defined benefit fund which provides pensions and other benefits within Inland Revenue limits. Certain directors receive additional pension and life assurance benefits in excess of Inland Revenue limits. Details of pension arrangements are shown on page 89.

Executives directors are eligible to receive a choice of various employee benefits or a cash equivalent, on a similar basis as other employees. In addition, executive directors are eligible to participate in sharesave and the Group profit sharing scheme, which currently pays up to 10 per cent of salaries, depending on the Group s performance. The sharesave and profit sharing schemes are not subject to performance conditions since they are operated on an all-employee basis. Executive directors also receive death in service benefits.

Short-term annual incentives

This typically focuses from year to year on the delivery of a combination of appropriate Group and individual financial and operational targets approved by the Remuneration Committee. Individual UK-based executive directors normally have a maximum annual bonus potential of 100 per cent of salary, although for exceptional performance, as measured by the achievement of significant objectives, bonuses of up to 200 per cent of salary may be awarded.

UK-based executive directors received total annual bonuses of up to 200 per cent of salary for the year ended 31 December 2002. The payment of these bonuses reflected the excellent trading results and the exceptional performance culminating in the successful integration of NatWest. The integration was achieved ahead of the targets announced at the time of the NatWest takeover and delivered considerable income benefits and cost savings, details of which are given on page 44.

Longer-term incentives
The company provides longer-term incentives in the form of share options and share or share equivalent awards. Their objective is to encourage the creation of value over the longer-term and to align the rewards of the executive directors with the returns to shareholders.

Medium-term performance plan The medium-term performance plan was approved by shareholders in April 2000. Each executive director is eligible for an annual award under the plan in the form of share or share equivalent awards, within the overall limit of one and a half times earnings. The awards made in 2002 were one times salary.

The plan is highly geared to the company s relative performance. All awards under the plan are subject to three-year performance targets. First, the annual growth in the company s earnings per share must exceed the annualised growth of the Retail Prices Index (RPI) plus 3 per cent. If this condition is satisfied, the company s total shareholder return (TSR) is compared with the TSR of a comparator group of certain companies in the financial services sector, referred to below. Awards under the plan will not vest if the company s TSR is below the median of the comparator group. Achievement of the EPS target and median TSR performance against the comparator companies will result in the vesting of 50 per cent of the award, increasing on a sliding scale to 100 per cent at upper quartile performance and 200 per cent at upper decile performance. This combination of EPS and TSR performance targets measures the underlying financial performance of the company and ensures a direct link between the value delivered to shareholders and the levels of incentive payment.

The companies in the comparator group are Abbey National plc; Aviva plc; Barclays PLC; Citigroup; HBOS plc; HSBC Holdings plc; Legal & General Group plc; Lloyds TSB Group plc; Prudential plc and Standard Chartered PLC. In choosing the comparator group, it was recognised that while the company has significant international business, the bulk of its operations are UK based. Consequently the comparator group for the award in 2001 focused on the UK financial services sector. In respect of grants made in 2002 and subsequent years, the comparator group was reviewed and, following the merger of Halifax with Bank of Scotland, Citigroup was added to the group.

Options The executive share option scheme was approved by shareholders in January 1999. Each executive director is eligible for the annual grant of an option, typically equal to one times salary, over shares at the market value at date of grant. No payment is made by the executive on the grant of an option award.

All executive options are subject to a performance target, which is currently that the options are not exercisable unless the growth in the company s earnings per share (EPS) over three years has exceeded the growth in RPI plus 9 per cent. This EPS performance target, which is consistent with market practice, measures underlying financial performance and represents a stretching long-term test of performance.

Should the company fail the performance condition at the end of the initial three-year period, performance will be re-tested at the end of the following year and subsequent years within the lifetime of the grant. The test of performance after the initial three-year period uses either the EPS in the final year immediately preceding the three-year period, or the EPS in the year preceding the grant, whichever is the higher. The Remuneration Committee believes that this provides a significant test, more stretching than that applied normally for organisations allowing retesting, and allows the share options to form an incentive for corporate performance in the long term. The condition is reviewed annually.

US based director Mr Lawrence Fish
Fixed elements
Salary Mr Fish s salary is reviewed annually as part of total remuneration having regard to levels of remuneration paid to

executives of comparable US companies and Mr Fish s performance.

Benefits Mr Fish accrues pension benefits under a number of arrangements in the US. Details are provided on page 89. In addition, Mr Fish is entitled to receive other benefits on a similar basis to other employees.

Short-term annual incentives
Mr Fish s short-term performance rewards take the form of an annual incentive plan which rewards the achievement of Group, business unit and individual financial and non-financial targets. In line with US market practice, the maximum annual bonus potential is normally 200 per cent of salary, although additional amounts may be awarded, at the discretion of the Remuneration Committee, for exceptional performance as measured by the achievement of significant objectives.

In addition to his annual bonus targets set at the beginning of the year, Mr Fish was set stretching targets during 2002 in relation to the integration of the Mellon Regional Franchise. Having successfully met these targets and completed the integration of the Mellon Regional Franchise during the year, the Remuneration Committee has exercised its discretion and awarded Mr Fish a special bonus of an additional 200 per cent of salary.

Longer-term incentives
Mr Fish participates under two longer-term incentive plans established for executives of Citizens. The Remuneration Committee believes that it is appropriate to include, as part of his total remuneration package, an element of reward which is based on the value created in Citizens. It is also necessary to ensure that Mr Fish s total remuneration package is competitive for the US market.

Citizens long term incentive plan Mr Fish is eligible for an annual award under the Citizens Long Term Incentive Plan, a cash compensation plan designed to reward participants for achieving long-term financial results. A separate three-year cycle commences each year. The maximum award payable to him annually is 105 per cent of his average salary over the previous three-year period. These awards are not, in normal circumstances, payable until the relevant three-year performance target has been met. Each three-year performance target is based on the annual pre-tax income target for Citizens. For the maximum award to be paid in respect of each three-year target, Citizens must achieve 130 per cent of the three-year aggregate budgeted profit figure. This performance target has been chosen because it focuses on the profit targets of Citizens, which the Remuneration Committee believes are challenging, and aligns Mr Fish s reward with the performance of Citizens. This performance target is measured by taking the pre-tax income for Citizens, which is a simple and transparent method of measuring a profit figure target.

Citizens Phantom 2000 plan Mr Fish has received two annual grants of awards under the Phantom 2000 Plan and, in line with the grant schedule put in place when the plan was approved by shareholders in 2000, no further awards will be made to him. Under this plan, units are awarded which are a cash-based proxy for share options. The value of the units at the time of vesting is performance-linked and depends on a formula, based on the absolute cumulative levels of economic profit generated by Citizens, the trend in economic profit earnings, and on the external market trends in the US banking sector, using the price/earnings ratios of comparator banks. This performance target has been chosen because it establishes a clear link between the level of potential incentive and the performance of Citizens. It is designed to provide competitive executive rewards in the US environment. Mr Fish may, in normal circumstances, exercise the award only between four and five years from the date of grant.

The performance graph
The undernoted performance graph illustrates the performance of the company over the past five years in terms of total shareholder return compared with that of the companies comprising the FTSE 100 index. This index has been selected because it represents a cross-section of leading UK companies.

Service contracts
The company s policy in relation to the duration of contracts with directors is that executive directors contracts generally

continue until termination by either party, subject to the required notice, or until retirement date. The notice period under the service contracts of executive directors will not normally exceed 12 months. However, the notice period may exceed 12 months if existing service contracts have notice periods greater than 12 months and the Remuneration Committee considers it appropriate not to reduce the existing notice period. In relation to newly recruited executive directors, subject to the prior approval of the Remuneration Committee, the notice period from the employing company required to terminate the contract will not normally exceed 12 months unless there is a clear case for this. Where a longer period of notice is initially approved on appointment, it will normally be structured such that it will automatically reduce to 12 months in due course.

All new service contracts for executive directors will be subject to approval by the Remuneration Committee. It will be the norm to include in those contracts standard clauses covering the performance review process, the company s normal disciplinary procedure, and terms for dismissal in the event of failure to perform or in situations involving actions in breach of the Group s policies.

Any compensation payment made in connection with the departure of an executive director will be subject to approval by the Remuneration Committee, having regard to the terms of the service contract and the reasons for termination. Information regarding executive directors service contracts is summarised in the table and notes below.

Name	Date of current contract/ Employing company	Normal retirement age	Notice period - from company	Notice period - from executive
Fred Goodwin	25 June 1998	60	12 months	6 months
	The Royal Bank of Scotland plc			
Norman McLuskie	9 October 1997	60	3 months	3 months
	The Royal Bank of Scotland plc			
Gordon Pell	22 May 2002	60	13 months	6 months
	National Westminster Bank Plc			
Iain Robertson	27 March 2002	60	12 months	6 months
	The Royal Bank of Scotland plc			
Fred Watt	28 September 2000	60	12 months	6 months
	The Royal Bank of Scotland plc			
Lawrence Fish	1 July 1996		24 months	12 months
	Citizens Financial Group Inc			

Except as noted below, in the event of severance of contract where any contractual notice period is not worked, the employing company may pay a sum to the executive in lieu of this period of notice. Any such payment would, at maximum, comprise his base salary and a cash value in respect of fixed benefits (including pension plan contributions). In the event of failure to perform, or in situations involving breach of the employing company s policies resulting in dismissal, reduced or no compensation will be made to the executive. Depending on the circumstances of the termination of employment, the executive may be entitled, or the Remuneration Committee may exercise its discretion to allow, the executive to exercise outstanding awards under long-term incentive arrangements. Exceptions to these severance arrangements are as follows:

If Mr McLuskie s contract is terminated by the Bank before he reaches age 60, he is entitled to a payment of three months base salary, annual bonus and benefits in lieu of notice plus up to 57 weeks pay and an immediate pension without actuarial reduction. If his contract is terminated by the Bank within 12 months of a change of control, he is entitled to a payment equal to twice his annual salary at the time of such notice, and an immediate pension.

Mr Pell s contractual notice period was 13 months as at 31 December 2002, and this reduced to 12 months at 5 January 2003. If Mr Pell s contract is terminated early by NatWest without notice, he is entitled to a compensation payment of base salary relating to the notice period, his annual bonus to the date of termination, a payment equal to the average annual bonus over the previous three years, payment in lieu of contractual benefits and allowances including pension and extra payments by way of funded or unfunded pension and death in service contributions relating to the notice period.

If Mr Watt s contract is terminated through redundancy, he is entitled to payment in lieu of notice and a cash payment calculated by reference to his length of service. Currently this entitlement is equal to 9 months salary, and an additional payment calculated by reference to age and service which is less than one week s salary.

Mr Fish s notice period and termination arrangements reflect market practice in the US at the time the contract was entered into and it is not considered in the best interests of shareholders to seek to renegotiate Mr Fish s contract at this time. If his contract is terminated without cause, or if Mr Fish terminates the contract for good reason (as defined in the contract, including a change of control of Citizens, the company or the Royal Bank), he is entitled to a lump sum payment to compensate him for the loss of salary, annual bonus and bonus paid under the Citizens Long Term Incentive Plan in relation to the period he would have worked had notice been given by Citizens. Mr Fish would also be entitled to receive for this period health, life insurance and long term disability coverage and any other benefits determined in accordance with the plans, policies and practices of Citizens at the time of termination. If his contract is terminated by Citizens without cause within twelve months following a change of control, Mr Fish is entitled to receive a lump sum payment and benefits as set out above, but calculated by reference to a period of 36 months.

Chairman and non-executive directors

The original date of appointment as a director of the company and the scheduled date for the next re-election is as follows:

	Date first appointed	Next re-election
Sir George Mathewson	1.9.87	29.4.04
Sir Iain Vallance	14.1.93	29.4.04
Sir Angus Grossart	30.9.85	29.4.04
Emilio Botin	23.1.91	28.4.03
Colin Buchan	1.6.02	28.4.03
Jim Currie	28.11.01	29.4.04
Juan Inciarte	25.2.98	4.05
Eileen Mackay	16.5.96	28.4.03
Cameron McLatchie	1.10.98	Retired on 26.4.02
Sir Steve Robson	25.7.01	4.05
Bob Scott	31.1.01	28.4.03
Murray Stuart	24.1.96	Retired on 26.4.02
Peter Sutherland	31.1.01	28.4.03
Bill Wilson	26.5.93	28.4.03

Non-executive directors do not have service contracts or notice periods, although under the company s articles of association, all directors must retire by rotation and seek re-election by shareholders at least every three years.

No compensation would be paid to the Chairman or to any non-executive director in the event of early termination.

The tables and explanatory notes on pages 86 to 89 report the remuneration of each director for the year ended 31 December 2002. This information has been audited by the company s auditors, Deloitte & Touche.

Directors' remuneration

	Salary/ fees £000	Performance bonus* £000	Benefits £000	2002 Total £000	2001 Total £000
Chairman					
Sir George Mathewson	449	-	19	**468**	483
Executive directors					
Fred Goodwin	832	1,733	15	**2,580**	1,572
Lawrence Fish	665	2,661	26	**3,352**	2,213
Norman McLuskie	447	913	15	**1,375**	685
Gordon Pell	570	1,155	-	**1,725**	1,039
Iain Robertson	656	687	10	**1,353**	1,114
Fred Watt	466	966	1	**1,433**	690

* includes 10% non-pensionable profit sharing

Basic salary is the only component of the remuneration package which is pensionable.

Non-executive directors	Board fees £000	Board committee fees £000	2002 Total £000	2001 Total £000
Vice-chairmen				
Sir Iain Vallance	100	-	**100**	100
Sir Angus Grossart	100	-	**100**	100
Emilio Botin	44	-	**44**	40
Colin Buchan (appointed 1 June 2002)	25	3	**28**	-
Jim Currie	44	8	**52**	3
Juan Inciarte	44	-	**44**	40
Eileen Mackay	44	19	**63**	53
Cameron McLatchie (retired 26 April 2002)	14	-	**14**	40
Sir Steve Robson	44	10	**54**	20
Bob Scott	44	23	**67**	51
Murray Stuart (retired 26 April 2002)	14	10	**24**	68
Peter Sutherland	44	-	**44**	37
Bill Wilson	44	38	**82**	73

No director received any expense allowances chargeable to UK income tax or compensation for loss of office/termination payment. The non-executive directors did not receive any bonus payments or benefits.

Share options

Options to subscribe for ordinary shares of 25p each in the company granted to, and exercised by, directors during the year to 31 December 2002 are included in the table below:

			Options exercised in 2002			Options held at 31 December 2002	
	Options held at 1 January 2002	Options granted in 2002	Number	Market price date at of exercise £	Option Price £	Number	Exercise Period
Sir George Mathewson	69,257				9.33	69,257	11.5.01 - 10.5.08
	147,247				7.81	147,247	29.3.03 - 28.3.10
	150				12.40	150	9.08.03 - 8.08.06*
	20,100				17.18	20,100	14.08.04 - 13.08.11
	1,347				13.64	1,347	1.10.08 - 31.03.09*
		19,500			18.18	19,500	14.03.05 - 13.03.12
	238,101	19,500	-			257,601	
Fred Goodwin	164,571				8.75	164,571	7.12.01 - 6.12.08
	2,963				11.18	2,963	4.3.02 - 3.3.09
	27,306				11.97	27,306	3.6.02 - 2.6.09
	153,648				7.81	153,648	29.3.03 - 28.3.10
	150				12.40	150	9.8.03 - 8.8.06*
	43,700				17.18	43,700	14.8.04 - 13.8.11
	1,713				9.85	1,713	1.10.05 - 31.3.06*
		41,300			18.18	41,300	14.3.05 - 13.3.12
	394,051	41,300	-			435,351	
Lawrence Fish	107,877				9.33	107,877	11.5.01 - 10.5.08
	150				12.40	150	9.8.03 - 8.8.06*
	108,027	-	-			108,027	
Norman McLuskie	1,046		1,046	18.29	4.61	-	
	149		149	18.29	10.06	-	
	16,613				9.33	16,613	11.5.01 - 10.5.08
	8,860				11.18	8,860	4.3.02 - 3.3.09
	11,356						