ROYAL BANK OF SCOTLAND GROUP PLC
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

8 August 2007

The Royal Bank of Scotland Group plc

Gogarburn
PO Box 1000
Edinburgh EH12 1HQ
Scotland
United Kingdom

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F X   Form 40-F___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):___

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes _   No X

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-___

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Explanatory note

The Royal Bank of Scotland Group plc is filing this report in order for its wholly-owned subsidiary, The Royal Bank of Scotland plc (hereafter the "Bank" or "Company"), to meet the requirements of item 1115 of Regulation AB issued by the Securities and Exchange Commission. This report contains selected financial data (on pages 4 - 8) and audited financial statements (on pages 12 - 98) as required by Item 3.A. and Item 17 of Form 20-F respectively and other related information. In filing this report, the Bank is omitting certain financial information and selected financial data as permitted by Instruction G 'First-Time Application of International Financial Reporting Standards' of Form 20-F.

Presentation of information

For the purpose of this report, the term 'Group' means the Bank and its subsidiary and associated undertakings and the term 'RBS Group' means The Royal Bank of Scotland Group plc and its subsidiary and associated undertakings. The term 'the holding company' means The Royal Bank of Scotland Group plc.

The Bank publishes its financial statements in pounds sterling ("£" or "sterling"). The abbreviations '£m' and '£bn' represent 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' represen millions and thousands of millions of euros, respectively.

The results, assets and liabilities of individual business units are classified as trading or non-trading based on their predominant activity. 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.

International Financial Reporting Standards

As required by the Companies Act 1985 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together 'IFRS') as adopted by the European Union. On implementationof IFRS on 1 January 2005, the Group took advantage of the option in IFRS 1 'First-time Adoption of International Financial Reporting Standards' to implement IAS 39 'Financial Instruments: Recognition and Measurement' and IAS 32 'Financial Instruments: Disclosure and Presentation' from 1 January 2005 without restating its 2004 income statement and balance sheet. The date of transition to IFRS for the Group and the date of its opening IFRS balance sheet is 1 January 2004.

The Group's 2004 financial statements were prepared in accordance with then current UK generally accepted accounting principles ("UK GAAP" or "previous GAAP") comprising standards issued by the UK Accounting Standards Board, pronouncements of the Urgent Issues Task Force, relevant Statements of Recommended Accounting Practice and provisions of the Companies Act 1985.

The Group also presents information under generally accepted accounting principles in the US ("US GAAP").

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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 ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘believes’, ‘should’, ‘intend’, ‘plan’, ‘probability’, ‘risk’, ‘Value-at-Risk (“VaR”)’, ‘target’, ‘goal’, ‘objective’, ‘w ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on such expressions.

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 fluctuations 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 report 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 on certain risks faced by the Group, see Risk Factors on page 11.

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SELECTED FINANCIAL DATA

The Group's accounts are prepared in accordance with IFRS, which differ in certain significant respects from US GAAP. For a discussion of such differences and a reconciliation between IFRS and US GAAP, see Note 45 on the accounts.

The dollar financial information included below has been translated for convenience at the rate of £1.00 to US$1.9586, the Noon Buying Rate on 29 December 2006 (the last business day of the year).

Amounts in accordance with IFRS

				2004	
	2006		2005	Discontinued*	Continuing
Summary consolidated income statement	**$m**	**£m**	£m	£m	£m
Net interest income	**20,354**	**10,392**	9,711	263	8,790
Non-interest income (excluding insurance net premium income)	**21,889**	**11,176**	9,963	(35)	8,441
Insurance net premium income	-	**-**	-	3,357	-
Total income	**42,243**	**21,568**	19,674	3,585	17,231
Operating expenses	**22,212**	**11,341**	10,672	656	9,225
Profit before other operating charges and impairment losses	**20,031**	**10,227**	9,002	2,929	8,006
Insurance net claims	**-**	**-**	-	2,418	-
Impairment losses	**3,669**	**1,873**	1,709	-	1,485
Loss on disposal of interests in subsidiaries	**-**	**-**	-	96	-
Operating profit before tax	**16,362**	**8,354**	7,293	415	6,521
Tax	**4,765**	**2,433**	2,267	157	1,751
Profit after tax	**11,597**	**5,921**	5,026	258	4,770
Discontinued operations	**-**	**-**	**-**		258
Profit for the year	**11,597**	**5,921**	5,026		5,028
Minority interests	**88**	**45**	27		53
Preference dividends	**494**	**252**	154		315
Profit attributable to ordinary shareholders	**11,015**	**5,624**	4,845		4,660
Ordinary dividends	**6,365**	**3,250**	1,928		2,689

* On 31 December 2004 the general insurance businesses were transferred to The Royal Bank of Scotland Group plc.

	2006		2005	2004
Summary consolidated balance sheet	**$m**	**£m**	£m	£m
Loans and advances	**1,071,436**	547,042	485,488	405,512
Debt securities and equity shares	**248,000**	126,621	120,351	91,356
Derivatives and settlement balances	**243,156**	124,148	101,677	23,586
Other assets	**98,745**	50,416	49,806	50,436
Total assets	**1,661,337**	848,227	757,322	570,890
Shareholders' equity	**74,301**	37,936	34,510	34,320

Minority interests	**776**	396	104	679
Subordinated liabilities	**54,422**	27,786	28,422	21,262
Deposits	**1,011,542**	516,462	452,729	383,669
Derivatives, settlement balances and short positions	**328,240**	167,589	140,493	52,101
Other liabilities	**192,056**	98,058	101,064	78,859
Total liabilities and equity	**1,661,337**	848,227	757,322	570,890

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SELECTED FINANCIAL DATA (continued)

Other financial data

	2006	2005	2004
Based upon IFRS			
Return on average total assets[1]	**0.70%**	0.67%	0.92%
Return on average ordinary shareholders' equity[2]	**18.4%**	16.9%	17.6%
Average shareholders' equity as a percentage of total assets	**4.4%**	4.4%	6.2%
Risk asset ratio			
- Tier 1	**6.7%**	6.8%	N/A[4]
- Total	**12.1%**	12.3%	N/A[4]
Ratio of earnings to fixed charges and preference dividends[3]			
- including interest on deposits	**1.57**	1.62	1.83
- excluding interest on deposits	**6.30**	6.77	6.79
Ratio of earnings to fixed charges only[3]			
- including interest on deposits	**1.59**	1.64	1.91
- excluding interest on deposits	**7.54**	7.73	9.37

Notes:
(1) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.
(2) Return on average ordinary shareholders' equity represents profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.
(3) For this purpose, earnings consist of income before taxes and minority interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).
(4) Upon adoption of IFRS by listed banks in the UK on 1 January 2005, the Financial Services Authority ("FSA") changed its regulatory requirements such that the measurement of capital adequacy was based on IFRS subject to a number of prudential filers. The Risk Asset Ratios as at 31 December 2006 and 2005 have been presented in compliance with these revised FSA requirements.

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SELECTED FINANCIAL DATA (continued)

Amounts in accordance with US GAAP

	2006	2005	2004
	£m	£m	£m
Net income available for ordinary shareholders	**4,741**	4,195	3,588
Shareholders' equity	**39,485**	39,637	36,860
Total assets	**752,273**	682,116	613,630

Based upon US GAAP			
Return on average total assets (1)	**0.66 %**	0.65 %	0.65 %
Return on average ordinary shareholders' equity (2)	**13.8 %**	12.1 %	12.4 %
Ratio of earnings to fixed charges and preference dividends (3)			
- including interest on deposits	**1.46**	1.50	1.67
- excluding interest on deposits	**5.30**	5.68	5.63
Ratio of earnings to fixed charges only (3)			
- including interest on deposits	**1.51**	1.56	1.73
- excluding interest on deposits	**7.79**	8.88	7.77

Notes:
(1) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.
(2) Return on average ordinary shareholders' equity represents profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.
(3) For this purpose, earnings consist of income before taxes and minority interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

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SELECTED FINANCIAL DATA (continued)

Amounts in accordance with UK GAAP

	2004				
	Continuing	Discontinued*	Total	2003	2002
Summary consolidated income statement	£m	£m	£m	£m	£m
Net interest income	8,886	257	9,143	8,338	7,952
Non-interest income (excluding insurance net premium income)	8,531	(26)	8,505	7,553	6,696
Insurance net premium income	-	3,248	3,248	2,793	1,894
Total income	17,417	3,479	20,896	18,684	16,542
Operating expenses excluding goodwill amortisation	8,777	626	9,403	8,295	8,447
Goodwill amortisation	857	15	872	750	731
Profit before other operating charges and provisions	7,783	2,838	10,621	9,639	7,364
General net insurance claims	-	2,340	2,340	1,999	1,350
Provisions for bad and doubtful debts	1,428	-	1,428	1,461	1,286
Amounts written off fixed asset investments	83	-	83	33	59
Loss on disposal of interests in subsidiary undertakings	-	119	119	-	-
Profit on ordinary activities before tax	6,272	379	6,651	6,146	4,669
Tax on profit on ordinary activities			2,074	1,891	1,565
Profit on ordinary activities after tax			4,577	4,255	3,104
Minority interests (including non-equity)			131	122	175
Preference dividends - non-equity			315	280	280
Profit attributable to ordinary shareholders			4,131	3,853	2,649
Ordinary dividends			2,689	2,400	1,668

*On 31 December 2004 the general insurance businesses were transferred to The Royal Bank of Scotland Group plc

Summary consolidated balance sheet	2004 £m	2003 £m	2002 £m
Loans and advances	402,898	306,341	271,295
Debt securities and equity shares	90,859	80,813	68,840
Intangible fixed assets	16,657	12,342	12,695
Other assets	56,959	44,688	47,701
Total assets	567,373	444,184	400,531
Shareholders' funds	35,874	29,683	28,438

Minority interests	1,013	826	795
Subordinated liabilities	21,262	17,897	14,779
Deposits	384,684	304,582	274,454
Debt securities in issue	56,301	38,120	32,008
Other liabilities	68,239	53,076	50,057
Total liabilities	567,373	444,184	400,531

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SELECTED FINANCIAL DATA (continued)

Other financial data

	2004	2003	2002
Based upon UK GAAP			
Return on average total assets[(1)]	0.82%	0.91%	0.69%
Return on average ordinary shareholders' equity[(2)]	14.9%	15.2%	10.7%
Average shareholders' equity as a percentage of total assets	6.5%	6.9%	7.3%
Risk asset ratio			
- Tier 1	6.8%	7.6%	7.1%
- Total	12.7%	13.0%	11.8%
Ratio of earnings to fixed charges and preference dividends[(3)]			
- including interest on deposits	1.81	1.97	1.75
- excluding interest on deposits	6.42	6.87	5.13
Ratio of earnings to fixed charges only[(3)]			
- including interest on deposits	1.88	2.07	1.84
- excluding interest on deposits	8.79	9.55	6.96

Notes:
(1) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.
(2) Return on average ordinary shareholders' equity represents profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.
(3) For this purpose, earnings consist of income before taxes and minority interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

Description of business

Introduction

The Royal Bank of Scotland plc is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc, one of the world's largest banking and financial services groups. 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.

Organisational structure and business overview

The Group's activities are organised in the following business divisions: Corporate Markets (comprising Global Banking & Markets and UK Corporate Banking), Retail Markets (comprising Retail and Wealth Management), Ulster Bank, Citizens and Manufacturing. A description of each of the divisions is given below.

Corporate Markets is focused on the provision of banking, investment and risk management services to medium and large businesses and financial institutions in the UK and around the world. Corporate Banking and Financial Markets was renamed Corporate Markets on 1 January 2006 when we reorganised our activities into two businesses, Global Banking & Markets and UK Corporate Banking, in order to enhance the service provided to these two customer segments.

Global Banking & Markets ("GBM") is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt financing, risk management and investment services to its customers. GBM has a wide range of clients across its chosen markets. It has relationships with an overwhelming majority of the largest UK, European and US corporations and institutions. GBM's principal activity in the US is conducted through RBS Greenwich Capital.

UK Corporate Banking is the largest provider of banking, finance and risk management services to UK corporate customers. Through its network of relationship managers across the country it distributes the full range of Corporate Markets' products and services to companies.

Retail Markets was established in June 2005 to lead coordination and delivery of our multi-brand retail strategy across our product range and comprises Retail (including our direct channels businesses) and Wealth Management.

Retail comprises both the Royal Bank and NatWest retail brands, and a number of direct providers offering a full range of banking products and related financial services to the personal, premium and small business markets across several distribution channels.

In core retail banking, Retail offers a comprehensive product range across the personal and small business market: money transmission, savings, loans and mortgages. Customer choice and product flexibility are central to the retail banking proposition and customers are able to access services through a full range of channels, including the largest network of branches and ATMs in the UK, the internet and the telephone.

Retail also includes the Group's non-branch based retail businesses that issue a comprehensive range of credit and charge cards to personal and corporate customers and provides card processing services for retail businesses. Retail is the leading merchant acquirer in Europe and ranks fourth globally.

It also includes Tesco Personal Finance, The One account, First Active UK, Direct Line Financial Services and Lombard Direct, all of which offer products to customers through direct channels principally in the UK.

Wealth Management provides private banking and investment services to its clients through a number of leading UK and overseas private banking subsidiaries and offshore banking businesses. Coutts is one of the world's leading international wealth managers with offices in Switzerland, Dubai, Monaco, Hong Kong and Singapore, as well as its premier position in the UK. Adam & Company is the major private bank in Scotland. The offshore banking businesses – The Royal Bank of Scotland International and NatWest Offshore – deliver retail banking services to local and expatriate customers, principally in the Channel Islands, the Isle of Man and Gibraltar.

Ulster Bank Group brings together the Ulster Bank and First Active businesses to provide a comprehensive range of products and services to retail and corporate customers in the island of Ireland.

Ulster Bank Retail Markets serves personal customers through both the Ulster Bank and First Active brands. Ulster Bank provides branch banking and direct banking services throughout the island of Ireland. First Active, through its branch network, serves personal customers in the Republic of Ireland with its separately branded product offerings, including mortgages and savings.

Ulster Bank Corporate Markets caters for the banking needs of business and corporate customers, including treasury and money market activities, asset finance, e-banking, wealth management and international services. Business and corporate banking services are provided via centrally-based relationship management teams and dedicated Business Centres located across both Northern Ireland and the Republic of Ireland.

Citizens is the second largest commercial banking organisation in New England and the eighth largest commercial banking organisation in the US measured by deposits. Citizens provides retail and corporate banking services under the Citizens brand in Connecticut, Delaware, Massachusetts, New Hampshire, New Jersey, New York state, Pennsylvania, Rhode Island and Vermont and the Charter One brand in Illinois, Indiana, Michigan and Ohio. Through its branch network Citizens provides a full range of retail and corporate banking services, including personal banking, residential mortgages and cash management.

In addition, Citizens engages in a wide variety of commercial lending, consumer lending, commercial and consumer deposit products, merchant credit card services, trust services and retail investment services. Citizens includes RBS National Bank, our US credit card business, RBS Lynk, our merchant acquiring business, and Kroger Personal Finance, our credit card joint venture with the second largest US supermarket group.

Manufacturing supports the customer-facing businesses and provides operational, technology and customer support in telephony, account management, lending and money transmission, global purchasing, property and other services.

Manufacturing drives optimum efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group’s purchasing power and has become the centre of excellence for managing large-scale and complex change.

The expenditure incurred by Manufacturing relates to costs principally in respect of the Group’s banking operations in the UK and Ireland. These costs reflect activities that are shared between the various customer-facing divisions and consequently cannot be directly attributed to individual divisions. Instead, the Group monitors and controls each of its customer-facing divisions on revenue generation and direct costs whilst in Manufacturing such control is exercised through appropriate efficiency measures and targets. For financial reporting purposes the Manufacturing costs have been allocated to the relevant customer-facing divisions on a basis management considers to be reasonable.

The Centre comprises group and corporate functions, such as capital raising, finance, risk management, legal, communications and human resources. The Centre manages the Group’s capital requirements and Group-wide regulatory projects and provides services to the operating divisions.

Competition

The Group faces intense competition in all the markets it serves. In the UK, the Group’s principal competitors are the other UK retail and commercial banks, building societies and the other major international banks represented in London.

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities. In asset finance, the Group competes with banks and specialised asset finance providers, both captive and non-captive.

In the small business banking market, the Group competes with other UK clearing banks, specialist finance providers and building societies.

In the personal banking segment the Group competes with UK banks and building societies, major retailers and internet-only players. In the mortgage market the Group competes with UK banks and building societies.

In the UK credit card market large retailers and specialist card issuers, including major US operators, are active in addition to the UK banks. Competitive activity is across a number of dimensions including introductory and longer term pricing, loyalty and reward schemes, and packaged benefits. In addition to physical distribution channels, providers compete through direct marketing activity and the internet. The market remains very competitive, both between issuers and with other payment methods.

In Wealth Management, The Royal Bank of Scotland International competes with other UK and international banks to offer offshore banking services. Coutts and Adam & Company compete as private banks with UK clearing and private banks, and with international private banks. Competition in wealth management activities has intensified as banks have increased their focus on competing for affluent and high net worth customers.

In Ireland, Ulster Bank and First Active compete 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 UK, Irish and other European institutions seek to expand their businesses.

In the United States, where competition is intense, Citizens competes in the New England, Mid-Atlantic and Midstates retail and mid-corporate banking markets with local and regional banks and other financial institutions. The Group also competes in the US 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 are also 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 Group's business and earnings are affected by general business and geopolitical conditions
The performance of the Group is influenced by economic conditions particularly in the UK, US and Europe. Downturns in these economies could result in a general reduction in business activity and a consequent loss of income for the Group. It could also cause a higher incidence of credit losses and losses in the Group's trading portfolios. Geopolitical conditions can also affect the Groups earnings. Terrorist acts and threats and the response of governments in the UK, US and elsewhere to them could affect the level of economic activity. The Group's business is also exposed to the risk of business interruption and economic slowdown following the outbreak of a pandemic.

The financial performance of the Group is affected by borrower credit quality
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, US, European 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 impairment losses 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.

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 losses can result from fraud, errors by employees, failure to document transactions properly or to obtain proper 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 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 and US, if changed could

materially affect the Group’s business, the products and services offered or the value of assets.

Future growth in the Group’s 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.

The risk of litigation is inherent in the Group’s operations

In the ordinary course of the Group’s business, legal actions, claims against and by the Group and arbitrations arise; the outcome of such legal proceedings could affect the financial performance of the Group.

The Group is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes in the jurisdictions in which it operates

The Group’s activities are subject to tax at various rates around the world computed in accordance with local legislation and practice. Action by governments to increase tax rates or to impose additional taxes would reduce the profitability of the Group. Revisions to tax legislation or to its interpretation might also affect the Group's results in the future.

Report of independent registered public accounting firm to the members of The Royal Bank of Scotland plc

We have audited the accompanying balance sheets of The Royal Bank of Scotland plc (the “Bank”) and its subsidiary undertakings (together “the Group”) as at 31 December 2006 and 2005, and the related income statements, the statements of recognised income and expense and the cash flow statements for each of the three years in the period ended 31 December 2006. These financial statements are the responsibility of the directors. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of The Royal Bank of Scotland plc and subsidiaries as at 31 December 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended 31 December 2006 in conformity with International Financial Reporting Standards (“IFRS”).

IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 45 to the financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Edinburgh, United Kingdom

8 August 2007

Accounting policies

1. Presentation of accounts
The accounts are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (“IASB”), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together “IFRS”) as adopted by the European Union (“EU”). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB. The date of transition to IFRS for the Group and the Bank and the date of their opening IFRS balance sheets was 1 January 2004.

The Bank is incorporated in the UK and registered in Scotland. The accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated as at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

The Bank accounts are presented in accordance with the Companies Act 1985.

Change of accounting policy
As permitted by IFRS 1, the Group and the Bank implemented IAS 32 ’Financial Instruments: Disclosure and Presentation’ and IAS 39 ‘Financial Instruments: Recognition and Measurement’ with effect from 1 January 2005. The Group adopted the second amendment to IAS 39 ‘The Fair Value Option’ issued by the IASB in June 2005 also from 1 January 2005. The effect of implementing IAS 32 and IAS 39 on the Group and Bank balance sheets and shareholders’ funds as at 1 January 2005 is set out in Note 44. In preparing the 2004 comparatives, UK GAAP principles then current have been applied to financial instruments. The main differences between UK GAAP and IFRS on financial instruments are summarised in Note 44 on the accounts.

The IASB’s amendment to IAS 39 ‘Cash Flow Hedge Accounting of Forecast Intragroup Transactions’, published in April 2005, amended IAS 39 to permit the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in consolidated financial statements. The amendment, effective for annual periods beginning on or after 1 January 2006, had no material effect on the financial statements of the Group or the Bank.

The IASB’s amendment to IAS 39, ‘Financial Guarantee Contracts’, published in August 2005 and amended IAS 39. The amendment defines a financial guarantee contract and requires such contracts to be recorded initially at fair value and subsequently at higher of the provision determined in accordance with IAS 37 ‘Provisions, Contingent Liabilities and Contingent Assets’ and the amount initially recognised less amortisation. The amendment, effective for annual periods beginning on or after 1 January 2006, had no material effect on the Group or the Bank.

In December 2005, the IASB issued an amendment to IAS 21 ‘The Effects of Changes in Foreign Exchange Rates’ to clarify that a monetary item can form part of the net investment in overseas operations regardless of the currency in which it is denominated and that the net investment in a foreign operation can include a loan from a fellow subsidiary. The amendment, adopted by the EU in May 2006, had no material effect on the Group or the Bank.

2. Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Bank and entities (including certain special purpose entities) controlled by the Group (its subsidiaries). Control exists where the Group has the power to govern the financial and operating policies of the entity; generally conferred by holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated

accounts at their fair value. Any excess of the cost (the fair value of assets given, liabilities incurred or assumed and equity instruments issued by the Group plus any directly attributable costs) of an acquisition over the fair value of the net assets acquired is recognised as goodwill. The interest of minority shareholders is stated at their share of the fair value of the subsidiary's net assets.

The results of subsidiaries acquired are included in the consolidated income statement from the date control passes to the Group. The results of subsidiaries sold are included up until the Group ceases to control them.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared using uniform accounting policies.

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables, available-for-sale or held-to-maturity and interest expense on financial liabilities other than those at fair value through profit or loss are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows. Financial assets and financial liabilities held-for-trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss together with dividends and interest receivable and payable.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

Payment services: this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account, monthly or quarterly in arrears. Accruals are raised for services provided but not charged at period end.

Card related services: fees from credit card business include:

Commission received from retailers for processing credit and debit card transactions: income is accrued to the income statement as the service is performed.

Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and Automated Teller Machine networks. These fees are accrued once the transaction has taken place.

An annual fee payable by a credit card holder is deferred and taken to profit or loss over the period of the service i.e. 12 months.

Insurance brokerage: this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

Investment management fees: fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised.

4. Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside profit or loss and presented in the statement of recognised income and expense.

Contributions to defined contribution pension schemes are recognised in the income statement when payable.

5. Intangible assets and goodwill

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss using methods that best reflect the economic benefits over their estimated useful economic lives and is included in depreciation and amortisation. The estimated useful economic lives are as follows:

Core deposit intangibles	6 to 10 years
Other acquired intangibles	5 to 10 years
Computer software	3 to 5 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overhead. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overhead. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Acquired goodwill being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries and joint ventures is included in the balance sheet caption 'Intangible assets' and that on associates within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Accounting policies continued

On implementation of IFRS, the Group did not restate business combinations that occurred before January 2004. Under previous GAAP, goodwill arising on acquisitions after 1 October 1998 was capitalised and amortised over its estimated useful economic life. Goodwill arising on acquisitions before 1 October 1998 was deducted from equity. The carrying amount of goodwill in the Group's opening IFRS balance sheet was £12,342 million, its carrying value under previous GAAP.

6. Property, plant and equipment
Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately. Property that is being constructed or developed for future use as investment property is classified as property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases (except investment property - see accounting policy 19 below)) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

Under previous GAAP, the Group's freehold and long leasehold property occupied for its own use was recorded at valuation on the basis of existing use value. The Group elected to use this valuation as at 31 December 2003 as deemed cost for its opening IFRS balance sheet (1 January 2004).

7. Impairment of intangible assets and property, plant and equipment
At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash generating unit that have not been reflected in the estimation of future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

8. Foreign currencies
The Group's consolidated financial statements are presented in sterling which is the functional currency of the Bank.

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in the available-for-sale reserve in equity unless the asset is the hedged item in a fair value hedge.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity and included in profit or loss on its disposal.

9. Leases
Contracts to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer. Other contracts to lease assets are classified as operating leases.

Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is credited to the income statement on a receivable basis over the term of the lease. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see accounting policy 6 above).

10. Taxation
Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate. Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

11. Financial assets
On initial recognition financial assets are classified into held-to-maturity investments; available-for-sale financial assets; held-for-trading; designated as at fair value through profit or loss; or loans and receivables.

Held-to-maturity investments - a financial asset is classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 3 above) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

The Group has designated financial assets as at fair value through profit or loss principally: (a) where the assets are economically hedged by derivatives and fair value designation eliminates the measurement inconsistency that would arise if the assets were carried at amortised cost or classified as available-for-sale and (b) financial assets held in the Group's venture capital portfolio managed on a fair value basis.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 3 above) less any impairment losses.

Available-for-sale - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy 3 above). Other changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

Accounting policies continued

12. Impairment of financial assets
The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of current observable data, to reflect the effects of current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

13. Financial liabilities
On initial recognition a financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

The principal category of financial liabilities designated as at fair value through profit or loss is structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

All other financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 3 above).

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price times the number of units of the instrument held or issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities.

14. Derecognition

A financial asset is derecognised when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires.

15. Capital instruments
The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms. An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

16. Derivatives and hedging
Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is carried at fair value through profit or loss.

Gains and losses arising from changes in fair value of a derivative are recognised as they arise in profit or loss unless the derivative is the hedging instrument in a qualifying hedge. The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally documented at inception. The documentation includes identification of the hedged item and the hedging instrument, details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting or if the hedging instrument expires or is sold, terminated or exercised or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecast transaction, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. The ineffective portion is recognised in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity in the same periods in which the asset or liability affects profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss recognised in equity is recognised in profit or loss when the hedged cash flow occurs or, if the forecast transaction results in the recognition of a financial asset or financial liability, in the same periods during which the asset or liability affects profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is recognised in profit or loss immediately.

Hedge of net investment in a foreign operation - where a foreign currency liability hedges a net investment in a foreign operation, the portion of foreign exchange differences arising on translation of the liability determined to be an effective hedge is recognised directly in equity. Any ineffective portion is recognised in profit or loss.

17. Share-based payments

Options over shares in The Royal Bank of Scotland Group plc are granted to Group employees under various share option schemes. The Group has applied IFRS 2 ‘Share-based Payment’ to grants under these schemes after 7 November 2002 that had not vested on 1 January 2005. The expense for these transactions is measured based on the fair value on the date the options are granted. The fair value is estimated using valuation techniques which take into account the option’s exercise price, its term, the risk free interest rate and the expected volatility of the market price of The Royal Bank of Scotland Group plc’s shares. Vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting the number of options

Accounting policies continued

included in the measurement of the transaction such that the amount recognised reflects the number that actually vest. The fair value is expensed on a straight-line basis over the vesting period.

18. Investment property
Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. It is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

19. Cash and cash equivalents
Cash and cash equivalents comprises cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

20. Shares in Group entities
The Bank's investments in its subsidiaries are stated at cost less any impairment.

21. General insurance
On 31 December 2004, the general insurance business was transferred to The Royal Bank of Scotland Group plc. The accounting policy below applied to the general insurance business for the year ended 31 December 2004:

The Group makes provision for the full cost of settling outstanding claims arising from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling expenses. Claims are recognised in the accounting period in which the loss occurs.

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. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims at the balance sheet date. Also included in the estimation of outstanding claims are other assumptions such as the inflationary factor used for bodily injury claims which is based on historical trends and, therefore, allows for some increase due to changes in common law and statute. Costs for both direct and indirect claims handling expenses are also included. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

The outstanding claims provision is based on information available to management and the eventual outcome may vary from the original assessment. Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of settling individual claims may exceed that assumed.

Critical accounting policies and key sources of accounting judgements
The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS 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. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial

Statements. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the 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.

Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2006, gross loans and advances to customers totalled £472,433 million (2005 - £422,803 million) and customer loan impairment provisions amounted to £3,927 million (2005 - £3,883 million).

There are two components to the Group's loan impairment provisions: individual and collective.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collective impaired loan provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). These are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends.

Pensions

The Group operates a number of defined benefit pension schemes as described in Note 3 on the accounts. The assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). In determining the value of scheme liabilities, assumptions are made as to price inflation, dividend growth, pension increases, earnings growth and employees. There is a range of assumptions that could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 3 on the accounts. The pension deficit recognised in the balance sheet at 31 December 2006 was £1,971 million (2005 - £3,709 million).

Fair value

Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. In the balance sheet, financial assets carried at fair value are included within Treasury and other eligible bills, Loans and advances to banks, Loans and advances to customers, Debt securities and Equity shares as appropriate. Financial liabilities carried at fair value are included within the captions Deposits by banks, Customer accounts, Debt securities in issue and Subordinated liabilities. Derivative assets and Derivative liabilities are shown separately on the face of the balance sheets. Gains or losses arising from changes in fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised. The carrying value of a financial asset or a financial liability carried at cost or amortised cost that is the hedged item in a qualifying hedge relationship is adjusted by the gain or loss attributable to the hedged risk.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates. Financial assets carried at fair value include government, asset backed and corporate debt securities, reverse repos, loans, corporate equity shares and derivatives. Financial liabilities carried at fair value include deposits, repos, short positions in securities and debt securities issued. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Where observable prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The Group's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. The fair value of over-the-counter instruments is derived from pricing models which take account of contract terms, including maturity, as well as quoted market parameters such as interest rates and volatilities. Most of the Group's pricing models do not entail material subjectivity because the methodologies utilised do not incorporate significant judgement and the parameters included in the models can be calibrated to actively quoted market prices. Values established from pricing models are adjusted for credit risk, liquidity risk and future servicing costs.

A negligible proportion of the Group's trading derivatives are valued directly from quoted prices, the majority being valued using appropriate valuation techniques. The fair value of substantially all securities positions carried at fair value is determined directly from quoted prices.

Details of financial instruments carried at fair value are given in Note 33 on the accounts.

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as disclosed in accounting policy 5. The carrying value of goodwill as at 31 December 2006 was £16,834 million (2005 - £17,766 million).

Goodwill is the excess of the cost of an acquisition over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash generating units with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an arm's length transaction between knowledgeable, willing parties. Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed.

Accounting policies continued

Accounting developments
International Financial Reporting Standards
The IASB issued IFRS 7 'Financial Instruments: Disclosures' in August 2005. The standard replaces IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions' and the disclosure provisions in IAS 32. IFRS 7 requires disclosure of the significance of financial instruments for an entity's financial position and performance and of qualitative and quantitative information about exposure to risks arising from financial instruments. The standard is effective for annual periods beginning on or after 1 January 2007.

In August 2005, the IASB issued an amendment, 'Capital Disclosures' to IAS 1 'Presentation of Financial Statements'. It requires disclosures about an entity's capital and the way it is managed. This amendment is effective for annual periods beginning on or after 1 January 2007.

The Group is reviewing IFRS 7 and the amendment to IAS 1 to determine their effect on its financial reporting.

The International Financial Reporting Interpretations Committee ('IFRIC') issued interpretation IFRIC 9 'Reassessment of Embedded Derivatives' in March 2006. Entities are required to assess financial instruments for the existence of embedded derivatives; this interpretation prohibits subsequent reassessment unless there is a change of terms that significantly changes the terms of the financial instrument. The interpretation is effective for accounting periods starting on or after 1 June 2006 and is not expected to have a material effect on the Group or Bank.

The IFRIC issued interpretation IFRIC 10 'Interim Financial Reporting and Impairment' in July 2006. Entities recognising an impairment of an intangible asset, goodwill or a financial asset in their interim financial statements are not allowed to reverse that impairment if the asset had recovered its value at the next reporting date. The interpretation is effective for accounting periods beginning on or after 1 November 2006 and is not expected to have a material effect on the Group or Bank.

The IFRIC issued interpretation IFRIC 11 'Group and Treasury Share Transactions' in November 2006. Entities which buy their own shares, or whose shareholders buy shares in the reporting entity, in order to provide incentives to employees shall account for those incentives on an equity-settled basis. This principle applies also to the accounting by subsidiaries. The interpretation is effective for annual accounting periods beginning on or after 1 March 2007 and is not expected to have a material effect on the Group or Bank.

The IFRIC issued interpretation IFRIC 12 'Service Concession Arrangements' in December 2006. Entities providing infrastructure and services to governments under concession arrangements shall account for each component of the arrangement separately. Infrastructure provided under these arrangements may be recognised as either a financial asset or an intangible asset. The interpretation is effective for accounting periods beginning on or after 1 January 2008 and is not expected to have a material effect on to the Group or Bank.

The IASB issued IFRS 8 'Operating Segments' in December 2006. This will replace IAS 14 'Segment Reporting' for accounting periods beginning on or after 1 January 2009. IFRS 8 is very similar to US Statement of Financial Accounting Standard No.131 'Disclosures about Segments of an Enterprise and Related Information' and requires entities to report segment information as reported to management and reconcile it to the financial statements. Disclosures required by SFAS 131 are included on pages 81 to 83.

The IFRIC issued interpretation IFRIC 13 'Customer Loyalty Programmes' in June 2007. The interpretation requires revenue to be allocated to loyalty award credits as part of a sales transaction. Revenue is recognised when the credits are redeemed or when the obligation for redemption is passed to a third party. The interpretation is effective for annual accounting periods beginning on or after1 July 2008.

The IFRIC issued interpretation IFRIC 14 ‘IAS 19 – the Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction’ in July 2007. IFRIC 14 clarifies the circumstances in which refunds and contribution reductions for a defined benefit plan are available to an entity for the purpose of recognising a net benefit asset. It also covers the effect of a minimum funding requirement (’MFR’) on the asset and when an MFR may result in an additional liability. The interpretation is effective for annual accounting periods beginning on or after 1 January 2008.

The Group is reviewing IFRIC 13 and IFRIC 14 to determine their effect on its financial reporting.

Consolidated income statement for the year ended 31 December 2006

	Note	2006 £m	2005 £m	2004 Discontinued* £m	2004 Continuing £m
Interest receivable		24,319	21,037	301	16,286
Interest payable		(13,927)	(11,326)	(38)	(7,496)
Net interest income		10,392	9,711	263	8,790
Fees and commissions receivable		7,060	6,676	43	6,382
Fees and commissions payable		(1,426)	(1,381)	(95)	(1,398)
Income from trading activities	1	2,543	2,363	-	1,989
Other operating income		2,999	2,305	17	1,468
Insurance premium income		-	-	3,687	-
Reinsurers' share		-	-	(330)	-
Non-interest income		11,176	9,963	3,322	8,441
Total income		21,568	19,674	3,585	17,231
Staff costs		6,280	5,451	218	4,779
Premises and equipment		1,405	1,261	8	1,161
Other administrative expenses		2,241	2,400	417	1,825
Depreciation and amortisation		1,415	1,560	13	1,460
Operating expenses	2	11,341	10,672	656	9,225
Profit before other operating charges and impairment losses		10,227	9,002	2,929	8,006
Insurance claims		-	-	2,650	-
Reinsurers' share		-	-	(232)	-
Impairment losses	15	1,873	1,709	-	1,485
Loss on disposal of interests in subsidiaries		-	-	96	-
Operating profit before tax		8,354	7,293	415	6,521
Tax	5	2,433	2,267	157	1,751
Profit after tax		5,921	5,026	258	4,770
Discontinued operations		-	-		258
Profit for the year		5,921	5,026		5,028
Profit attributable to:					
Minority interests		45	27		53
Preference shareholders	6	252	154		315
Ordinary shareholders		5,624	4,845		4,660
		5,921	5,026		5,028

*On 31 December 2004 the general insurance businesses were transferred to The Royal Bank of Scotland Group plc.

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Balance sheets at 31 December 2006

		Group		Bank	
		2006	2005	2006	2005
	Note	£m	£m	£m	£m
Assets					
Cash and balances at central banks		6,121	4,759	3,694	2,102
Treasury and other eligible bills subject to repurchase agreements	31	1,426	896	1,201	172
Other treasury and other eligible bills		4,072	4,642	4,169	4,595
Treasury and other eligible bills	9	5,498	5,538	5,370	4,767
Loans and advances to banks	10	78,536	66,568	78,503	64,356
Loans and advances to customers	11	468,506	418,920	244,818	213,001
Debt securities subject to repurchase agreements	31	58,874	53,475	26,488	23,108
Other debt securities		62,304	61,836	47,790	43,008
Debt securities	12	121,178	115,311	74,278	66,116
Equity shares	13	5,443	5,040	3,368	3,208
Investments in Group undertakings	14	—	—	21,918	21,965
Intangible assets	16	17,771	18,810	172	178
Property, plant and equipment	17	15,050	14,742	2,022	1,940
Settlement balances		7,425	6,005	3,829	2,068
Derivatives	18	116,723	95,672	117,087	95,641
Prepayments, accrued income and other assets	19	5,976	5,957	2,874	1,957
Total assets		848,227	757,322	557,933	477,299
Liabilities					
Deposits by banks	20	131,742	109,889	149,739	115,591
Customer accounts	21	384,720	342,840	172,704	130,356
Debt securities in issue	22	82,606	86,222	41,814	64,804
Settlement balances and short positions	23	49,476	43,988	25,207	22,412
Derivatives	18	118,113	96,505	118,257	96,839
Accruals, deferred income and other liabilities	24	11,563	10,040	5,351	3,962
Retirement benefit liabilities	3	1,971	3,709	27	23
Deferred taxation	25	1,918	1,093	—	—
Subordinated liabilities	26	27,786	28,422	22,403	22,001
Total liabilities		809,895	722,708	535,502	455,988
Equity					
Minority interests	27	396	104	—	—
Shareholders' equity					
Called up share capital	28	5,482	5,481	5,482	5,481
Reserves	29	32,454	29,029	16,949	15,830
Total equity		38,332	34,614	22,431	21,311
Total liabilities and equity		848,227	757,322	557,933	477,299

The accounts were approved by the Board of directors on 28 March 2007 and signed on its behalf by:

Sir Tom McKillop Sir Fred Goodwin Guy Whittaker

Chairman	*Group Chief Executive*	*Group Finance Director*

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Statements of recognised income and expense for the year ended 31 December 2006

	Group			Bank		
	2006	2005	2004	2006	2005	2004
	£m	£m	£m	£m	£m	£m
Available-for-sale investments						
Net valuation gains/(losses) taken direct to equity	340	(160)		122	(3)	
Net profit taken to income on sales	(196)	(561)		(71)	(38)	
Cash flow hedges						
Net (losses)/gains taken direct to equity	(108)	20		(138)	(80)	
Net (gains)/losses taken to earnings	(143)	(91)		2	(37)	
Exchange differences on translation of foreign operations	(1,347)	787	(418)	1	(2)	3
Actuarial gains/(losses) on defined benefit plans	1,776	(792)	(1,601)	2	(1)	(4)
Income/(expense) before tax on items recognised direct in equity	322	(797)	(2,019)	(82)	(161)	(1)
Tax on items recognised direct in equity	(512)	517	465	13	81	1
Net expense recognised direct in equity	(190)	(280)	(1,554)	(69)	(80)	—
Profit for the year	5,921	5,026	5,028	3,519	1,544	5,169
Total recognised income and expense for the year	5,731	4,746	3,474	3,450	1,464	5,169
Attributable to:						
Equity shareholders	5,756	4,721	3,440	3,450	1,464	5,169
Minority interests	(25)	25	34	—	—	—
	5,731	4,746	3,474	3,450	1,464	5,169
Effect of changes in accounting policies on implementation of IFRS						
Equity shareholders	—	(6,148)	(1,006)	—	(16,498)	(14,236)
Minority interests	—	(867)	(313)	—	—	—
	—	(7,015)	(1,319)	—	(16,498)	(14,236)

Cash flow statements for the year ended 31 December 2006

		Group			Bank		
		2006	2005	2004	2006	2005	2004
	Note	£m	£m	£m	£m	£m	£m
Operating activities							
Operating profit before tax		8,354	7,293	6,936	4,039	2,067	5,477
Adjustments for:							
Depreciation and amortisation		1,415	1,560	1,473	390	403	368
Interest on subordinated liabilities		1,161	978	728	878	704	566
Charge for defined benefit pension schemes		578	460	396	8	3	3
Cash contribution to defined benefit pension schemes		(533)	(450)	(1,145)	(1)	(2)	(1)
Elimination of foreign exchange differences		4,515	(2,359)	1,873	1,345	499	537
Other non-cash items		(1,134)	(2,208)	8,428	218	526	3,096
Net cash inflow from trading activities		14,356	5,274	18,689	6,877	4,200	10,046
Changes in operating assets and liabilities		3,292	6,240	(12,010)	16,815	(3,076)	1,689
Net cash flows from operating activities before tax		17,648	11,514	6,679	23,692	1,124	11,735
Income taxes paid		(2,122)	(1,830)	(1,467)	(298)	(437)	(345)
Net cash flows from operating activities	35	15,526	9,684	5,212	23,394	687	11,390
Investing activities							
Sale and maturity of securities		25,810	38,549	42,470	15,240	20,635	22,251
Purchase of securities		(17,803)	(36,107)	(41,392)	(10,609)	(16,888)	(22,916)
Sale of property, plant and equipment		2,926	2,188	1,746	180	87	101
Purchase of property, plant and equipment		(3,938)	(4,423)	(3,916)	(509)	(797)	(655)
Net investment in business interests and intangible assets	36	(19)	(209)	(6,266)	(445)	(1,374)	(6,153)
Net cash flows from investing activities		6,976	(2)	(7,358)	3,857	1,663	(7,372)
Financing activities							
Issue of ordinary shares		-	-	2,645	-	-	2,645
Issue of equity preference shares		1,092	2,028	2,472	1,092	2,028	2,472
Issue of subordinated liabilities		3,027	1,234	4,631	2,936	943	4,282
Proceeds of minority interests issued		427	70	182	—	—	—
Redemption of minority interests		(81)	(121)	(2)	—	—	—
		(1,318)	(1,553)	(718)	(672)	(1,513)	(216)

Repayment of subordinated liabilities						
Dividends paid	(3,531)	(2,098)	(3,052)	(3,502)	(2,082)	(3,004)
Interest on subordinated liabilities	(1,181)	(1,027)	(655)	(890)	(739)	(509)
Net cash flows from financing activities	(1,565)	(1,467)	5,503	(1,036)	(1,363)	5,670
Effects of exchange rate changes on cash and cash equivalents	(3,475)	1,659	(820)	(2,036)	312	(215)
Net increase in cash and cash equivalents	17,462	9,874	2,537	24,179	1,299	9,473
Cash and cash equivalents 1 January	52,685	42,811	40,274	39,407	38,108	28,635
Cash and cash equivalents 31 December	70,147	52,685	42,811	63,586	39,407	38,108

Notes on the accounts

1 Income from trading activities

	Group		
	2006	2005	2004
	£m	£m	£m
Foreign exchange (1)	612	661	599
Interest rates (2)	967	951	674
Credit (3)	841	666	670
Equities and commodities (4)	123	85	46
	2,543	2,363	1,989

The analysis of trading income is based on how the business is organised and the underlying risks managed; 2005 and 2004 have been restated to reflect this. The total income from trading activities is unchanged.

Notes:
Trading income comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs. The types of instruments include:

(1) Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
(2) Interest rates: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
(3) Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
(4) Equities and commodities: equity derivatives, commodity contracts and related hedges and funding.

2 Operating expenses

	Group		
	2006	2005	2004
	£m	£m	£m
Wages, salaries and other staff costs	5,285	4,632	4,256
Social security costs	342	304	279
Shared-based compensation	65	44	36
Pension costs (see Note 3)			
- defined benefit schemes	578	460	396
- defined contribution schemes	10	11	30
Staff costs	6,280	5,451	4,997
Premises and equipment	1,405	1,261	1,169
Other administrative expenses	2,241	2,400	2,242
Property, plant and equipment (see Note 17)	1,055	1,075	954
Intangible assets (see Note 16)	360	485	519
Depreciation and amortisation	1,415	1,560	1,473
	11,341	10,672	9,881

Integration costs included in operating expenses comprise expenditure incurred in respect of cost reduction and revenue enhancement targets set in connection with the various acquisitions made by the Group:

	Group		
	2006	2005	2004
	£m	£m	£m
Staff costs	76	67	67
Premises and equipment	10	22	33
Other administrative expenses	18	127	117
Depreciation and amortisation	16	133	282
	120	349	499

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Notes on the accounts continued

The average number of persons employed by the Group during the year, excluding temporary staff, was 122,600 (2005 - 121,900; 2004 - 124,400). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2006	2005	2004
Global Banking & Markets	7,500	6,600	8,200
UK Corporate Banking	8,800	8,200	7,800
Retail	43,800	44,200	42,900
Wealth Management	4,600	4,300	4,200
Ulster Bank	4,800	4,500	4,200
Citizens	24,600	26,000	25,900
Manufacturing	26,100	26,500	25,800
Centre	2,500	2,300	2,200
Total	122,700	122,600	121,200
UK	88,300	87,700	87,200
USA	26,200	27,500	27,100
Europe	6,900	6,500	6,100
Rest of the World	1,300	900	800
Total	122,700	122,600	121,200

	Bank		
	2006	2005	2004
	£m	£m	£m
Wages, salaries and other staff costs	2,847	2,316	2,215
Social security costs	193	160	139
Shared-based compensation	65	44	36
Pension costs			
- defined benefit schemes	8	3	3
- defined contribution schemes	295	252	215
Staff costs	3,408	2,775	2,608

The average number of persons employed by the Bank during the year, excluding temporary staff, was 60,900 (2005 - 59,700; 2004 - 57,400). The number of persons employed by the Bank at 31 December, excluding temporary staff, was as follows:

	Bank		
	2006	2005	2004
Global Banking & Markets	5,100	4,700	6,600
UK Corporate Banking	6,900	6,400	6,100
Retail	22,000	21,900	19,000
Manufacturing	24,800	25,300	24,900
Centre	2,500	2,300	2,200
Total	61,300	60,600	58,800

UK	60,100	59,400	57,800
Europe	1,100	1,100	1,000
Rest of the World	100	100	—
Total	61,300	60,600	58,800

3 Pension costs

Members of the Group sponsor a number of pension schemes in the UK and overseas, predominantly of the defined benefit type, whose assets are independent of the Group's finances. Defined benefit pensions generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement. Employees do not make contributions for basic pensions but may make voluntary contributions to secure additional benefits on a money-purchase basis. Since October 2006 the defined benefit section of The Royal Bank of Scotland Group Pension Fund ('Main Scheme') has been closed to new entrants.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of the eligible employees. The amounts are not material.

There is no contractual agreement or policy on the way that the cost of The Royal Bank of Scotland Group defined benefit pension schemes and healthcare plans are allocated to the Bank. It therefore accounts for the charges it incurs as payments to a defined contribution scheme.

Interim valuations of the Group's schemes were prepared to 31 December by independent actuaries, using the following assumptions:

Principal actuarial assumptions at 31 December (weighted average)	2006	2005	2004
Discount rate	5.3%	4.8%	5.4%
Expected return on plan assets	6.9%	6.5%	6.8%
Rate of increase in salaries	4.1%	3.9%	3.9%
Rate of increase in pensions in payment	2.8%	2.6%	2.7%
Inflation assumption	2.9%	2.7%	2.7%

Major classes of plan assets as a percentage of total plan assets	2006	2005	2004
Equities	60.7%	61.5%	57.2%
Index-linked bonds	16.1%	16.8%	15.4%
Government fixed interest bonds	3.3%	2.6%	2.8%
Corporate and other bonds	13.9%	14.6%	12.7%
Property	4.5%	3.7%	3.2%
Cash and other assets	1.5%	0.8%	8.7%

Ordinary shares of the holding company with a fair value of £89 million (2005 - £78 million) are held by the Group's pension schemes together with holdings of other financial instruments issued by the Group with a value of £258 million (2005 - £299 million).

The expected return on plan assets at 31 December 2006 is based upon the weighted average of the following assumed returns on the major classes of plan assets:

Equities	8.1%	7.7%	8.1%
Index-linked bonds	4.5%	4.1%	4.5%
Government fixed interest bonds	4.5%	4.1%	4.5%
Corporate and other bonds	5.3%	4.8%	5.4%
Property	6.3%	5.9%	6.3%

Cash and other assets	4.4%	3.7%	4.5%

The expected return on Main scheme assets at 31 December 2004 was adjusted to reflect the investment, in early January 2005, of payments made to the fund on 31 December 2004 and included as cash and other assets at that date.

Post-retirement mortality assumptions (Main scheme)	2006	2005	2004
Longevity at age 60 for current pensioners (years)			
Males	26.0	25.4	25.4
Females	28.9	28.2	28.2
Longevity at age 60 for future pensioners (years)			
Males	26.8	26.2	26.2
Females	29.7	29.0	29.0

Notes on the accounts continued

Changes in value of net pension liability	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension liability £m
At 1 January 2005	14,752	17,674	2,922
Currency translation and other adjustments	27	26	(1)
Income statement:			
Expected return	1,013		(1,013)
Interest cost		949	949
Current service cost		520	520
Past service cost		4	4
	1,013	1,473	460
Statement of recognised income and expense:			
Actuarial gains and losses	1,654	2,446	792
Disposal of subsidiaries	—	(14)	(14)
Contributions by employer	450	—	(450)
Contributions by plan participants	3	3	—
Benefits paid	(549)	(549)	—
Expenses included in service cost	(19)	(19)	—
At 1 January 2006	17,331	21,040	3,709
Currency translation and other adjustments	(58)	(65)	(7)
Income statement:			
Expected return	1,069		(1,069)
Interest cost		981	981
Current service cost		643	643
Past service cost		23	23
	1,069	1,647	578
Statement of recognised income and expense:			
Actuarial gains and losses	585	(1,191)	(1,776)
Contributions by employer	533	—	(533)
Benefits paid	(538)	(538)	—
Expenses included in service cost	(28)	(28)	—
At 31 December 2006	18,894	20,865	1,971

The Group expects to contribute £460 million to its defined benefit pension schemes in 2007. Of the net pension liability, £106 million (2005 - £104 million) relates to unfunded schemes.

Cumulative net actuarial losses of £617 million (2005 - £2,393 million; 2004 - £1,601 million) have been recognised in the statement of recognised income and expense.

History of defined benefits schemes	2006 £m	2005 £m	2004 £m	2003 £m
Present value of defined benefit obligations	20,865	21,040	17,674	14,881
Fair value of plan assets	18,894	17,331	14,752	12,849
Net deficit	1,971	3,709	2,922	2,032

Experience losses on plan liabilities	(20)	(68)	(631)
Experience gains on plan assets	585	1,654	408
Actual return on pension schemes assets	1,654	2,667	1,327

4 Auditors' remuneration

Amounts paid to the auditors for statutory audit and other services were as follows:

	Group		
	2006	2005	2004
	£m	£m	£m
Audit services			
- Statutory audit	8.8	8.0	6.7
- Audit related regulatory reporting	0.4	5.2	0.4
	9.2	13.2	7.1
Tax compliance services	—	0.1	0.4
All other services	2.8	3.0	4.8
Total	12.0	16.3	12.3

5 Tax

	Group		
	2006	2005	2004
	£m	£m	£m
Current taxation:			
Charge for the year	2,355	2,254	2,046
Over provision in respect of prior periods	(167)	(132)	(233)
Relief for overseas taxation	(147)	(171)	(213)
	2,041	1,951	1,600
Deferred taxation:			
Charge for the year	365	404	291
Under/(over) provision in respect of prior periods	27	(88)	17
Tax charge for the year	2,433	2,267	1,908

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

	2006	2005	2004
	£m	£m	£m
Expected tax charge	2,506	2,188	2,082
Non-deductible items	280	310	163
Non-taxable items	(252)	(154)	(143)
Taxable foreign exchange movements	(33)	75	(62)
Group relief at nonstandard rates	—	—	29
Foreign profits taxed at other rates	61	74	51
Unutilised losses brought forward and carried forward	11	(6)	4
Adjustments in respect of prior periods	(140)	(220)	(216)
Actual tax charge for the year	2,433	2,267	1,908

Notes on the accounts continued

6 Profit attributable to preference shareholders

	Group				
	Dividends paid to equity preference shareholders 2006 £m	Finance cost included in interest payable 2006(1) £m	Dividends paid to equity preference shareholders 2005 £m	Finance cost included in interest payable 2005(1) £m	Finance cost of non-equity shares 2004 £m
Non-cumulative preference shares of US$0.01	160	209	103	261	281
Non-cumulative preference shares of €0.01	92	—	51	—	4
Non-cumulative preference shares of £1	—	24	—	24	24
Appropriation for premium payable on redemption and issue costs	—	4	—	6	6
Total (2)	252	237	154	291	315

Notes:

(1) Following the implementation of IAS 32 on 1 January 2005, several of the Group's preference share issues are now included in subordinated liabilities and the related finance cost in interest payable.

(2) Between 1 January 2007 and the date of approval of these accounts, dividends amounting to US$61 million have been declared in respect of equity preference shareholders for payment on 30 March 2007.

7 Ordinary dividends

	2006 £m	2005 £m	2004 £m
Dividends on ordinary equity shares	3,250	1,928	2,689

8 Profit dealt with in the accounts of the Bank

As permitted by section 230(3) of the Companies Act 1985, no income statement for the Bank has been presented as a primary financial statement. Of the profit attributable to ordinary shareholders, £3,267 million (2005 - £1,390 million; 2004 - £4,854 million) has been dealt with in the accounts of the Bank.

9 Treasury and other eligible bills

	Group		Bank	
	2006 £m	2005 £m	2006 £m	2005 £m
Treasury bills and similar securities	5,407	5,402	5,369	4,767
Other eligible bills	91	136	1	—
	5,498	5,538	5,370	4,767
Held-for-trading	4,516	3,004	4,437	2,279
Available-for-sale	982	2,534	933	2,488

	5,498	5,538	5,370	4,767

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10 Loans and advances to banks

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Held-for-trading	52,735	44,964	46,248	33,045
Designated as at fair value through profit or loss	376	282	—	—
Loans and receivables	25,425	21,322	32,255	31,311
	78,536	66,568	78,503	64,356
Amounts above include:				
Reverse repurchase agreements	54,152	41,804	41,703	28,669
Items in the course of collection from other banks	3,471	2,901	793	669
Due from subsidiaries	—	—	19,159	18,791

11 Loans and advances to customers

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Held-for-trading	73,696	55,091	55,667	41,313
Designated as at fair value through profit or loss	1,327	616	243	20
Loans and receivables	381,962	351,481	188,908	171,668
Finance leases	11,521	11,732	—	—
	468,506	418,920	244,818	213,001
Amounts above include:				
Reverse repurchase agreements	62,908	48,887	39,924	33,851
Due from holding company	738	938	—	97
Due from subsidiaries	—	—	50,970	45,186
Due from fellow subsidiaries	2,299	2,082	2,189	2,039

Notes on the accounts continued

Securitisations

The Group engages in securitisation transactions of its financial assets including commercial and residential mortgage loans, commercial and residential mortgage related securities, US Government agency collateralised mortgage obligations, and other types of financial assets. In such transactions, the assets, or interests in the assets, are transferred generally to a special purpose entity ("SPE") which then issues liabilities to third party investors.

Securitisations may, depending on the individual arrangement, result in continued recognition of the securitised assets; continued recognition of the assets to the extent of the Group's continuing involvement in those assets; or derecognition of the assets and the separate recognition, as assets or liabilities, of any rights and obligations created or retained in the transfer (see Accounting policy on pages 17 and 18). The Group has securitisations in each of these categories.

Continued recognition

The table below sets out the asset categories together with the carrying amounts of the assets and associated liabilities.

	Group			
	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Asset type	£m	£m	£m	£m
Residential mortgages (1,7)	15,698	15,375	2,388	2,366
Finance lease receivables (2)	1,211	953	1,467	1,170
Other loans (3, 6)	1,931	1,346	2,189	1,543
Credit card receivables (4,8)	2,891	2,685	2,836	2,836
Commercial paper conduits (5)	8,360	8,284	6,688	6,685

Notes:

(1) Mortgages have been transferred to special purpose vehicles, held ultimately by charitable trusts, funded principally through the issue of floating rate notes. The Group has entered into arm's length fixed/floating interest rate swaps and cross currency swaps with the securitisation vehicles and provides mortgage management and agency services to the vehicles. On repayment of the financing, any further amounts generated by the mortgages will be paid to the Group.

(2) Certain finance lease receivables (leveraged leases) involve the Group as lessor obtaining non-recourse funding from third parties. This financing is secured on the underlying leases and the provider of the finance has no recourse whatsoever to the other assets of the Group.

(3) Other loans originated by the Group have been transferred to special purpose vehicles funded through the issue of notes. Any proceeds from the loans in excess of the amounts required to service and repay the notes are payable to the Group after deduction of expenses.

(4) Credit card receivables in the UK have been securitised. Notes have been issued by a special purpose vehicle. The note holders have a proportionate interest in a pool of credit card receivables that have been equitably assigned by the Group to a receivables trust. The Group continues to be exposed to the risks and rewards of the transferred receivables through its right to excess spread (after charge-offs).

(5) The Group sponsors commercial paper conduits. Customer assets are transferred into an SPE which issues notes in the commercial paper market. The Group supplies certain services and contingent liquidity support to these vehicles on an arm's length basis as well as programme credit enhancement.

(6) Bank and Group.

(7) Includes £4,115 million (2005 - nil) assets attributable to the Bank and related liabilities of £3,965 million (2005 - nil).

(8) Includes £1,507 million (2005 - £1,604 million) assets attributable to the Bank and related liabilities of £1,399 million (2005 - £1,604 million).

Continuing involvement
In certain US securitisations of residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control, as defined by IFRS, of the assets and continues to recognise the assets to the extent of its continuing involvement which takes the form of retaining certain subordinated bonds issued by the securitisation vehicles. These bonds have differing rights and, depending on their terms, they may expose the Group to interest rate risk where they carry a fixed coupon or to credit risk depending on the extent of their subordination. Certain bonds entitle the Group to additional interest if the portfolio performs better than expected and others give the Group the right to prepayment penalties received on the securitised mortgages. At 31 December 2006, securitised assets were £37.3 billion (2005 - £39.8 billion); retained interests £930 million (2005 -£863 million); subordination assets £694 million (2005 - £609 million) and related liabilities £694 million (2005 - £609 million).

Mortgage-backed securities
The Group sells originated mortgage loans to US government sponsored enterprises (“GSEs”) in return for securities backed by these loans and guaranteed by the Agency whilst retaining the rights to service the mortgages. These securities may be subsequently sold. The purchaser has recourse to the Group for losses up to pre-determined levels on certain designated mortgages. The Group is not obliged, and does not intend, to support losses that may be suffered by the Agencies. Under the terms of the sale agreements, the Agencies have agreed to seek repayment only from the cash from the mortgage loans. Once the securities exchanged for the loans have been sold the Group’s exposure is restricted to the amount of the recourse. At 31 December 2006 mortgages amounting to £144 million (2005 - £385 million) had been sold with recourse to US GSEs. These loans have been derecognised.

12 Debt securities

Group									
2006	UK government £m	US government state and federal agency £m	Other government £m	US government sponsored entity £m	Bank and building society £m	Mortgage-backed securities[1] £m	Corporate £m	Other £m	Total £m
Held-for-trading	8,122	10,965	13,839	10,065	34	28,658	23,194	316	95,193
Designated as at fair value through profit or loss	1,285	—	85	—	470	98	1,203	292	3,433
Available-for-sale	307	6,227	1,210	6,651	4,019	2,760	493	324	21,991
Loans and receivables	—	—	—	—	—	—	21	540	561
At 31 December 2006	9,714	17,192	15,134	16,716	4,523	31,516	24,911	1,472	121,178
Available-for-sale									
Gross unrealised gains	—	6	4	1	1	5	9	—	26
Gross unrealised losses	(1)	(88)	(20)	(142)	(8)	(46)	(2)	(13)	(320)
2005									
Held-for-trading	4,386	8,783	10,480	8,166	8	28,396	19,233	1,201	80,653
Designated as at fair value through profit or loss	4	—	6	—	230	37	521	770	1,568
Available-for-sale	—	7,811	1,511	8,553	8,541	3,364	1,436	1,086	32,302
Loans and receivables	—	—	—	—	—	—	—	788	788
At 31 December 2005	4,390	16,594	11,997	16,719	8,779	31,797	21,190	3,845	115,311
Available-for-sale									
Gross unrealised gains	—	3	2	10	3	4	14	—	36
Gross unrealised losses	—	(117)	(13)	(147)	(5)	(59)	(3)	(2)	(346)

Note:
(1) Excludes securities issued by US federal agencies and government sponsored entities.

Gross gains of £33 million (2005 - £65 million) and gross losses of £16 million (2005 - £10 million) were realised by the Group on the sale of available-for-sale securities.

Bank									
2006	UK government £m	US government state and federal agency £m	Other government £m	US government sponsored entity £m	Bank and building society £m	Mortgage-backed securities[1] £m	Corporate £m	Other £m	Total £m

Held-for-trading	8,122	725	13,752	1	34	22,136	22,969	311	68,050
Designated as at fair value									
through profit or loss	—	—	—	—	—	98	840	—	938
Available-for-sale	307	566	286	—	3,207	601	323	—	5,290
At 31 December 2006	8,429	1,291	14,038	1	3,241	22,835	24,132	311	74,278
Available-for-sale									
Gross unrealised gains	—	2	—	—	1	5	9	—	17
Gross unrealised losses	(1)	—	—	—	(2)	(4)	—	—	(7)
2005									
Held-for-trading	4,386	1,764	10,480	57	8	19,854	17,481	1,145	55,175
Designated as at fair value									
through profit or loss	—	—	—	—	—	632	126	—	758
Available-for-sale	—	263	644	219	7,382	376	1,108	191	10,183
At 31 December 2005	4,386	2,027	11,124	276	7,390	20,862	18,715	1,336	66,116
Available-for-sale									
Gross unrealised gains	—	—	—	8	1	3	14	—	26
Gross unrealised losses	—	(3)	(6)	—	(3)	—	(3)	—	(15)

Note:
(1) Excludes securities issued by US federal agencies and government sponsored entities.

Notes on the accounts continued

13 Equity shares

	Group					
	2006			2005		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	3,033	5	3,038	2,937	4	2,941
Designated as at fair value through profit or loss	35	555	590	39	421	460
Available-for-sale	87	1,728	1,815	58	1,581	1,639
	3,155	2,288	5,443	3,034	2,006	5,040
Available-for-sale						
Gross unrealised gains	35	178	213	9	54	63
Gross unrealised losses	—	(6)	(6)	(3)	(8)	(11)
	35	172	207	6	46	52

Gross gains of £239 million (2005 - £592 million) and gross losses of £3 million (2005 - £1 million) were realised by the Group on the sale of available-for-sale equity shares.

Dividend income earned from available-for-sale equity shares was £67 million (2005 - £90 million; 2004 - £79 million).

At 31 December 2006, gross unrealised losses of £6 million represented 22 equity issues with a fair value of £26 million. No securities were in an unrealised loss position for more than 12 months.

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include the Group's investments in the Federal Home Loans Bank and Federal Reserve Bank that are redeemable at cost of £0.8 billion (2005 - £0.8 billion) and in a fellow subsidiary £129 million (2005 - £255 million), together with a number of individually small shareholdings. Disposals in the year generated gains of £56 million (2005 - £85 million; 2004 - £96 million).

	Bank					
	2006			2005		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	2,991	5	2,996	2,912	3	2,915
Available-for-sale	51	321	372	28	265	293
	3,042	326	3,368	2,940	268	3,208
Available-for-sale						
Gross unrealised gains	20	64	84	1	39	40
Gross unrealised losses	—	—	—	(3)	—	(3)
	20	64	84	(2)	39	37

Disposals in the year of unquoted equity instruments classified as available-for-sale financial assets generated gains of £21 million (2005 - £58 million; 2004 - £9 million).

14 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	Bank	
	2006	2005
	£m	£m
At 1 January	21,965	20,388
Implementation of IAS 32 and IAS 39 on 1 January 2005	—	(431)
Currency translation and other adjustments	(391)	476
Additions	235	228
Additional investments in group undertakings	449	1,312
Repayment of investments	(340)	(8)
At 31 December	21,918	21,965
Banks	9,035	8,642
Other	12,883	13,323

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

	Nature of business	Country of incorporation and principal area of operation
National Westminster Bank Plc (1)	Banking	Great Britain
Citizens Financial Group, Inc.	Banking	US
Coutts & Co (2)	Private Banking	Great Britain
Greenwich Capital Markets Inc (3)	Broker dealer	US
Ulster Bank Limited (3, 4)	Banking	Northern Ireland

Notes:
(1) The Bank does not hold any of the NatWest preference shares in issue.
(2) Coutts & Co is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.
(3) Shares are not directly held by the Bank.
(4) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

The above information is provided in relation to the principal related undertakings as permitted by section 231(5) of the Companies Act 1985. Full information on all related undertakings will be included in the Annual Return delivered to the Registrar of Companies for Scotland.

Notes on the accounts continued

15 Impaired and past-due financial assets

	Group					
	2006			2005		
	Cost £m	Provision £m	Net book value £m	Cost £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and receivables and finance leases	6,217	3,336	2,881	5,925	3,343	2,582
Available-for-sale	63	50	13	94	67	27
	6,280	3,386	2,894	6,019	3,410	2,609

	Group		
	2006 £m	2005 £m	2004 £m
Impairment losses charged to the income statement			
Loans and receivables and finance leases (see table below)	1,873	1,705	
Available-for-sale	—	4	
Loans and advances (see table below)			1,402
Amounts written-off fixed asset investments			83
Total	1,873	1,709	1,485

The following table shows the movement in impairment allowances for loans and receivables and finance leases.

	Group					
	Individually assessed £m	Collectively assessed £m	Latent £m	Total 2006 £m	2005 £m	2004 £m
At 1 January	756	2,587	543	3,886	4,171	3,885
Implementation of IAS 39 on 1 January 2005	—	—	—	—	(28)	
Currency translation and other adjustments	(18)	(7)	(37)	(62)	52	(101)
Acquisitions	—	—	—	—	—	290
Amounts written-off (1)	(255)	(1,586)	—	(1,841)	(2,040)	(1,449)
Recoveries of amounts previously written-off	24	191	—	215	170	144
Charged to the income statement	217	1,569	87	1,873	1,705	1,402
Unwind of discount	(27)	(115)	—	(142)	(144)	
At 31 December (2)	697	2,639	593	3,929	3,886	4,171

Notes:
(1) Amounts written-off include £2 million in 2005 relating to loans and advances to banks.
(2) Impairment losses at 31 December 2006 include £2 million relating to loans and advances to banks (2005 - £3 million; 2004 - £6 million).

	Bank					
	Cost £m	Provision £m	Net book value £m	Cost £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and receivables and finance leases	2,200	1,158	1,042	2,027	1,097	930
Available-for-sale	3	3	—	33	11	22
	2,203	1,161	1,042	2,060	1,108	952

	Bank		
	2006 £m	2005 £m	2004 £m
Impairment losses charged to the income statement			
Loans and receivables and finance leases (see table below)	692	677	
Available-for-sale	—	(1)	
Loans and advances (see table below)			480
Amounts written-off fixed asset investments			19
Total	692	676	499

The following table shows the movement in impairment allowances for loans and receivables and finance leases.

	Bank					
	Individually assessed £m	Collectively assessed £m	Latent £m	Total 2006 £m	2005 £m	2004 £m
At 1 January	417	680	122	1,219	1,350	1,261
Implementation of IAS 39 on 1 January 2005	—	—	—	—	(23)	
Currency translation and other adjustments	(25)	63	38	76	25	(21)
Acquisitions	—	—	—	—	2	—
Amounts written-off	(152)	(482)	—	(634)	(803)	(514)
Transfers from subsidiaries	—	—	—	—	—	84
Recoveries of amounts previously written-off	14	49	—	63	48	60
Charged to the income statement	123	534	35	692	677	480
Unwind of discount	(15)	(48)	—	(63)	(57)	
At 31 December	362	796	195	1,353	1,219	1,350

16 Intangible assets

2006	Goodwill £m	Core deposit intangibles £m	Group Other purchased intangibles £m	Internally generated software £m	Total £m
Cost:					
At 1 January 2006	17,766	299	325	2,209	20,599
Currency translation and other adjustments	(922)	(34)	(48)	(1)	(1,005)
Additions	—	—	19	337	356
Disposal of subsidiaries	(10)	—	(1)	—	(11)
Disposals and write-off of fully amortised assets	—	—	(20)	(27)	(47)
At 31 December 2006	16,834	265	275	2,518	19,892
Accumulated amortisation and impairment:					
At 1 January 2006	—	85	65	1,639	1,789
Currency translation and other adjustments	—	(12)	(8)	—	(20)
Disposals and write-off of fully amortised assets	—	—	—	(8)	(8)
Charge for the year	—	54	40	266	360
At 31 December 2006	—	127	97	1,897	2,121
Net book value at 31 December 2006	16,834	138	178	621	17,771
2005					
Cost:					
At 1 January 2005	17,055	268	261	2,033	19,617
Currency translation and other adjustments	784	31	30	—	845
Acquisition of subsidiaries	35	—	—	—	35
Additions	—	—	34	287	321
Disposals and write-off of fully amortised assets	(108)	—	—	(111)	(219)
At 31 December 2005	17,766	299	325	2,209	20,599
Accumulated amortisation and impairment:					
At 1 January 2005	—	22	22	1,357	1,401
Currency translation and other adjustments	—	5	4	—	9
Disposals and write-off of fully amortised assets	—	—	—	(106)	(106)

Charge for the year	—	58	39	388	485
At 31 December 2005	—	85	65	1,639	1,789
Net book value at 31 December 2005	17,766	214	260	570	18,810

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Notes on the accounts continued

2006	Goodwill £m	Bank Internally generated software £m	Total £m
Cost:			
At 1 January 2006	10	520	530
Additions	—	105	105
Disposals and write-off of fully amortised assets	—	(8)	(8)
At 31 December 2006	10	617	627
Accumulated amortisation and impairment:			
At 1 January 2006	—	352	352
Disposals and write-off of fully amortised assets	—	(8)	(8)
Charge for the year	—	111	111
At 31 December 2006	—	455	455
Net book value at 31 December 2006	10	162	172
2005			
Cost:			
At 1 January 2005	52	558	610
Currency translation and other adjustments	(2)	—	(2)
Additions	—	59	59
Disposals and write-off of fully amortised assets	(40)	(97)	(137)
At 31 December 2005	10	520	530
Accumulated amortisation and impairment:			
At 1 January 2005	—	331	331
Disposals and write-off of fully amortised assets	—	(96)	(96)
Charge for the year	—	117	117
At 31 December 2005	—	352	352
Net book value at 31 December 2005	10	168	178

The weighted average amortisation period of purchased intangible assets held by the Group, other than goodwill, subject to amortisation are:

	Years
Core deposit intangibles	6
Other purchased intangibles	6

The Group's amortisation expense in respect of core deposit intangibles and other purchased intangibles for each of the next five years is currently estimated to be:

	£m
2007	95
2008	95

2009	71
2010	17
2011	15

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Impairment review
The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash generating unit to which goodwill has been allocated with its carrying value. There was no impairment recognised in 2006 or 2005.

Cash generating units where goodwill is significant were as follows:

		Goodwill at 30 September	
		2006	2005
	Basis	£m	£m
Global Banking & Markets	Fair value less costs to sell	2,341	—
UK Corporate Banking	Fair value less costs to sell	1,630	—
Corporate Markets	Fair value less costs to sell	—	3,966
Retail	Fair value less costs to sell	4,365	4,365
Wealth Management	Fair value less costs to sell	1,105	1,123
Citizens - Midstates	Value in use	5,598	—
Charter One	Value in use	—	4,471
Mid-Atlantic	Value in use	—	1,450

On 1 January 2006 the Corporate Markets division was reorganised into Global Banking & Markets and UK Corporate Banking; Retail Markets was reorganised during the second half of 2006 into Retail and Wealth Management; goodwill was reallocated using relative fair values calculated as a weighted average of headcount, risk-weighted assets and profitability.

The recoverable amounts for all CGUs, except for Citizens -Midstates were based on fair value less costs to sell. Fair value was based upon a price-earnings methodology using current earnings for each unit. Approximate price earnings multiples, validated against independent analyst information were applied to each CGU. The multiples used for both 2006 and 2005 were in the range 7.0 - 13.0 times earnings after charging manufacturing costs.

The goodwill allocated to Global Banking & Markets, UK Corporate Banking, Retail and Wealth Management arose from the acquisition of NatWest in 2000. The recoverable amount of these cash generating units exceeds their carrying value by over £15 billion. The multiples or earnings would have to be less than half those used to cause the value in use of the units to equal their carrying value.

Developments in Citizens, including the integration of Charter One, acquired in 2004, have led to changes in its management structure during 2006 resulting in the new Citizens Midstates cash-generating unit. The recoverable amount was based on a value in use methodology using management forecasts to 2014 (2005 - 2012). A projection period of greater than five years was used reflecting Citizens' sustained historical growth rates, independently projected industry growth rates and the execution of Citizens' commercial banking strategy in the Midstates operating area. A terminal growth rate of 5% (2005 - 4%) and a discount rate of 10% (2005 - 10.7%) was used. The recoverable amount of Citizens Midstates exceeds its carrying value by over $4 billion. The profit growth rate would have to be approximately half the projected rate to cause the value in use of the unit to equal its carrying amount.

Notes on the accounts continued

17 Property, plant and equipment

				Group			
2006	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation:							
At 1 January 2006	4,346	2,495	337	1,046	3,220	7,311	18,755
Currency translation and other adjustments	14	(38)	(1)	(29)	(98)	(579)	(731)
Reclassifications	—	26	(41)	12	—	3	—
Additions	632	287	26	266	525	2,219	3,955
Expenditure on investment properties	16	—	—	—	—	—	16
Change in fair value of investment properties	486	—	—	—	—	—	486
Disposals and write-off of fully depreciated assets	(610)	(350)	(45)	(41)	(685)	(1,803)	(3,534)
Disposals of subsidiaries	—	—	—	—	(3)	—	(3)
At 31 December 2006	4,884	2,420	276	1,254	2,959	7,151	18,944
Accumulated depreciation and amortisation:							
At 1 January 2006	—	383	122	320	1,867	1,321	4,013
Currency translation and other adjustments	—	(2)	—	(11)	(41)	(94)	(148)
Reclassifications	—	4	(6)	3	(1)	—	—
Disposals and write-off of fully depreciated assets	—	(6)	(28)	(16)	(536)	(438)	(1,024)
Disposals of subsidiaries	—	—	—	—	(2)	—	(2)
Depreciation charge for the year	—	56	7	78	343	571	1,055
At 31 December 2006	—	435	95	374	1,630	1,360	3,894
Net book value at 31 December 2006	4,884	1,985	181	880	1,329	5,791	15,050
2005							
Cost or valuation:							
At 1 January 2005	4,159	2,709	371	842	3,052	5,747	16,880
Currency translation and other adjustments	(55)	18	11	18	66	477	535
Additions	348	326	25	322	578	2,771	4,370
Expenditure on investment properties	53	—	—	—	—	—	53
Change in fair value of investment properties	26	—	—	—	—	—	26
Disposals and write-off of fully depreciated assets	(176)	(539)	(70)	(126)	(446)	(1,573)	(2,930)
Disposals of subsidiaries	(9)	(19)	—	(10)	(30)	(111)	(179)
At 31 December 2005	4,346	2,495	337	1,046	3,220	7,311	18,755

Accumulated depreciation and amortisation:							
At 1 January 2005	—	407	137	280	1,828	1,015	3,667
Currency translation and other adjustments	—	4	2	6	30	137	179
Disposals and write-off of fully depreciated assets	—	(83)	(24)	(27)	(337)	(361)	(832)
Disposals of subsidiaries	—	—	—	(2)	(21)	(53)	(76)
Depreciation charge for the year	—	55	7	63	367	583	1,075
At 31 December 2005	—	383	122	320	1,867	1,321	4,013
Net book value at 31 December 2005	4,346	2,112	215	726	1,353	5,990	14,742

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	Group 2006 £m	Group 2005 £m	Bank 2006 £m	Bank 2005 £m
Contracts for future capital expenditure not provided for in the accounts at the year end (excluding investment properties and operating lease assets)	117	38	—	2
Contractual obligations to purchase, construct or develop investment properties or to repair, maintain or enhance investment properties	6	4	—	—
Property, plant and equipment pledged as security	42	77	—	—

Investment properties are valued to reflect fair value, that is, the market value of the Group's interest at the reporting date excluding any special terms or circumstances relating to the use or financing of the property and transaction costs that would be incurred in making a sale. Observed market data such as rental yield, replacement cost and useful life, reflect relatively few transactions involving property that, necessarily, is not identical to property owned by the Group.

Valuations are carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body. The 31 December 2006 valuation for a significant majority of the Group's investment properties was undertaken by external valuers.

The fair value of investment properties includes £450 million (2005 - £100 million) of appreciation since purchase.

Rental income from investment properties was £270 million (2005 - £226 million; 2004 - £240 million). Direct operating expenses of investment properties were £54 million (2005 - £61 million; 2004 - £72 million).

Property, plant and equipment, excluding investment properties include £436 million (2005 - £84 million) assets in the course of construction.

	Bank					
2006	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation:						
At 1 January 2006	922	57	414	2,114	124	3,631
Currency translation and other adjustments	(1)	—	(4)	(2)	—	(7)
Additions	108	1	93	268	(1)	469
Disposals and write-off of fully depreciated assets	(12)	(3)	(1)	(597)	1	(612)
Transfer from subsidiary	—	—	7	3	—	10
At 31 December 2006	1,017	55	509	1,786	124	3,491
Accumulated depreciation and amortisation:						
At 1 January 2006	135	21	113	1,347	75	1,691
Currency translation and other adjustments	—	—	(2)	(1)	—	(3)
Disposals and write-off of fully depreciated assets	1	—	—	(510)	3	(506)
Depreciation charge for the year	28	2	28	205	16	279

Transfer from subsidiary	—	—	5	3	—	8
At 31 December 2006	164	23	144	1,044	94	1,469
Net book value at 31 December 2006	853	32	365	742	30	2,022
2005						
Cost or valuation:						
At 1 January 2005	631	60	324	2,090	114	3,219
Currency translation and other adjustments	—	—	1	1	—	2
Additions	369	13	97	306	12	797
Disposals and write-off of fully depreciated assets	(78)	(16)	(8)	(283)	(2)	(387)
At 31 December 2005	922	57	414	2,114	124	3,631
Accumulated depreciation and amortisation:						
At 1 January 2005	150	30	97	1,359	60	1,696
Disposals and write-off of fully depreciated assets	(34)	(11)	(6)	(238)	(2)	(291)
Depreciation charge for the year	19	2	22	226	17	286
At 31 December 2005	135	21	113	1,347	75	1,691
Net book value at 31 December 2005	787	36	301	767	49	1,940

Notes on the accounts continued

18 Derivatives
Companies in the Group enter into derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, credit and interest rate risk. Derivatives include swaps, forwards, futures and options. They may be traded on an organised exchange (exchange-traded) or over-the-counter (OTC). Holders of exchange traded derivatives are generally required to provide margin daily in the form of cash or other collateral.

Swaps include currency swaps, interest rate swaps, credit default swaps, total return swaps and equity and equity index swaps. A swap is an agreement to exchange cash flows in the future in accordance with a pre-arranged formula. In currency swap transactions, interest payment obligations are exchanged on assets and liabilities denominated in different currencies; the exchange of principal may be notional or actual. Interest rate swap contracts generally involve exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts.

Forwards include forward foreign exchange contracts and forward rate agreements. A forward contract is a contract to buy (or sell) a specified amount of a physical or financial commodity, at agreed price, on an agreed future date. Forward foreign exchange contracts are contracts for the delayed delivery of currency on a specified future date. Forward rate agreements are contracts under which two counterparties agree on the interest to be paid on a notional deposit of a specified maturity at a specific future date; there is no exchange of principal.

Futures are exchange-traded forward contracts to buy (or sell) standardised amounts of underlying physical or financial commodities. The Group buys and sells currency, interest rate and equity futures.

Options include exchange-traded options on currencies, interest rates and equities and equity indices and OTC currency and equity options, interest rate caps and floors and swaptions. They are contracts that give the holder the right but not the obligation to buy (or sell) a specified amount of the underlying physical or financial commodity at an agreed price on an agreed date or over an agreed period.

The Group enters into fair value and cash flow hedges and hedges of net investments in foreign operations. Fair value hedges principally involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Similarly the majority of the Group's cash flow hedges relate to exposure to variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities and hedged by interest rate swaps for periods of up to 26 years. The Group hedges its net investments in foreign operations with currency borrowings.

For cash flow hedge relationships of interest rate risk the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk the hedged items are typically large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

	Group					
	2006			2005		
	Notional amounts £bn	Assets £m	Liabilities £m	Notional amounts £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,168	11,295	11,806	885	10,759	10,215
Currency swaps	261	5,060	4,734	222	3,228	3,904
Options purchased	361	7,408	—	301	6,438	—
Options written	364	—	6,646	315	—	6,101
Interest rate contracts						
Interest rate swaps	12,056	76,671	78,980	7,234	65,626	67,165
Options purchased	1,763	10,852	—	814	5,988	—
Options written	1,589	—	10,490	719	—	5,559
Futures and forwards	1,823	285	328	1,482	268	325
Credit derivatives	346	2,336	2,338	217	1,455	1,355
Equity and commodity contracts	82	2,816	2,791	61	1,910	1,881
		116,723	118,113		95,672	96,505
Included in the above are cash flow hedging derivatives as follows:						
Spot, forwards and futures		41	—		5	25
Interest rate swaps		336	451		431	373
Included in the above are fair value hedging derivatives as follows:						
Interest rate swaps		804	384		1,096	676
Amounts above include:						
Due from/to fellow subsidiaries		—	2		9	6
Due from/to holding company		42	—		—	55

	Bank					
	2006			2005		
	Notional amounts £bn	Assets £m	Liabilities £m	Notional amounts £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,158	11,464	11,758	889	10,721	10,282
Currency swaps	263	5,562	4,756	224	3,196	3,914
Options purchased	361	7,416	—	298	6,318	—
Options written	364	—	6,626	313	—	6,025
Interest rate contracts						
Interest rate swaps	11,904	76,504	79,119	7,103	65,920	67,433
Options purchased	1,603	10,831	—	780	5,921	—
Options written	1,488	—	10,473	677	—	5,522
Futures and forwards	1,627	284	328	1,324	267	324
Credit derivatives	357	2,345	2,333	219	1,460	1,351

Equity and commodity contracts	82	2,681	2,864	60	1,838	1,988
		117,087	118,257		95,641	96,839
Included in the above are cash flow hedging derivatives as follows:						
Spot, forwards and futures		41	—		5	25
Interest rate swaps		227	414		316	350
Included in the above are fair value hedging derivatives as follows:						
Interest rate swaps		451	219		861	341
Amounts above include:						
Due from/to subsidiaries		1,968	1,596		1,686	1,690
Due from/to fellow subsidiaries		—	2		5	2
Due from/to holding company		42	—		—	55

Notes on the accounts continued

19 Prepayments, accrued income and other assets

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Prepayments	662	771	243	249
Accrued income	659	805	470	613
Deferred expenses	37	29	27	20
Other assets	4,618	4,352	2,134	1,075
	5,976	5,957	2,874	1,957
Amounts above include:				
Due from fellow subsidiaries	—	—	4	227
Due from subsidiaries	—	—	—	6

20 Deposits by banks

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Held-for-trading	57,452	32,067	66,805	32,467
Amortised cost	74,290	77,822	82,934	83,124
	131,742	109,889	149,739	115,591
Amounts above include:				
Repurchase agreements	76,376	47,905	52,134	28,336
Items in the course of transmission to other banks	799	722	425	376
Due to subsidiaries	—	—	60,675	46,540

21 Customer accounts

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Held-for-trading	48,057	35,696	37,151	28,982
Designated as at fair value through profit or loss (1)	1,677	1,445	14	17
Amortised cost	334,986	305,699	135,539	101,357
	384,720	342,840	172,704	130,356
Amounts above include:				
Repurchase agreements	63,984	48,754	24,165	21,492
Due to fellow subsidiaries	2,146	1,687	1,517	429
Due to holding company	653	1,126	653	2,049
Due to subsidiaries	—		55,530	29,655

Note:

(1)

No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premiums payable by the Group. The carrying amount is £140 million (2005 - £114 million) greater than the principal amount.

22 Debt securities in issue

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Held-for-trading	2,141	1,469	2,058	1,469
Designated as at fair value through profit or loss (1)	10,499	11,068	10,355	10,890
Amortised cost	69,966	73,685	29,401	52,445
	82,606	86,222	41,814	64,804
Amounts above include:				
Bonds and medium term notes	40,689	22,211	18,774	17,811
Certificates of deposit and other commercial paper	41,917	64,011	23,040	46,993

Note:

(1) No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable by the Group. The carrying amount is £383 million (2005 - £365 million) lower than the principal amount.

23 Settlement balances and short positions

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Settlement balances - amortised cost	5,667	6,561	2,866	3,484
Short positions - held-for-trading:				
Debt securities - Government	36,901	30,749	17,747	13,904
- Other issuers	5,843	5,355	3,820	4,007
Treasury and other eligible bills	654	1,178	416	872
Equity shares	411	145	358	145
	49,476	43,988	25,207	22,412

24 Accruals, deferred income and other liabilities

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Notes in circulation	1,453	1,365	1,048	989
Current taxation	738	797	315	121
Accruals	4,241	3,541	2,544	1,962
Deferred income	482	451	276	217
Other liabilities	4,649	3,886	1,168	673
	11,563	10,040	5,351	3,962
Amounts above include:				
Due to subsidiaries	—	—	24	—

Note:

(1) Other liabilities include £10 million (2005 - £10 million) in respect of share-based compensation.

Included in other liabilities are provisions for liabilities and charges as follows:

	Group	Bank
	£m	£m
At 1 January 2006	159	50
Currency translation and other movements	(1)	—
Charge to income statement	100	29
Releases to income statement	(19)	(3)
Provisions utilised	(40)	(11)
At 31 December 2006	199	65

Note:
(1) Comprises property provisions and other provisions arising in the normal course of business.

Notes on the accounts continued

25 Deferred taxation

Provision for deferred taxation has been made as follows:

	Group		Bank	
	2006 £m	2005 £m	2006 £m	2005 £m
Deferred tax liability	1,918	1,093	—	—
Deferred tax asset (included in Prepayments, accrued income and other assets, Note 19)	(156)	(156)	(549)	(557)
Net deferred tax	1,762	937	(549)	(557)

Group

	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IAS transition £m	Fair value of financial instruments £m	Intangibles £m	Hedging £m	Other £m	Total £m
At 1 January 2005	(928)	2,637	(666)	128	(336)	71	150	18	136	1,210
Charge to income statement	(15)	433	87	(6)	8	33	(15)	—	(209)	316
Charge to equity directly	(237)	—	—	—	—	(218)	—	(62)	(39)	(556)
Other	3	15	(34)	—	—	(4)	4	—	(17)	(33)
At 1 January 2006	(1,177)	3,085	(613)	122	(328)	(118)	139	(44)	(129)	937
Charge to income statement	56	230	315	131	(362)	(36)	91	(4)	4	425
Charge to equity directly	517	—	—	12	7	2	—	(41)	(14)	483
Acquisitions/(disposals) of subsidiaries	—	3	—	(1)	3	—	—	—	9	14
Other	(20)	(94)	20	2	16	9	(20)	(5)	(5)	(97)
At 31 December 2006	(624)	3,224	(278)	266	(664)	(143)	210	(94)	(135)	1,762

Bank

	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IAS transition £m	Fair value of financial instruments £m	Intangibles £m	Hedging £m	Other £m	Total £m
At 1 January 2005	92	60	(181)	14	(177)	(21)	21	(41)	(5)	(238)
Charge to income statement	57	8	—	14	—	—	(26)	—	(8)	45
Charge to equity directly	—	—	—	—	—	(19)	—	(62)	(39)	(120)
Other	(266)	—	—	—	—	—	31	—	(9)	(244)
At 1 January 2006	(117)	68	(181)	28	(177)	(40)	26	(103)	(61)	(557)
Charge to income statement	52	(20)	64	9	(84)	40	(26)	(7)	(3)	25
Charge to equity directly	1	—	—	—	9	(1)	—	(26)	(14)	(31)

Acquisitions/(disposals) of subsidiaries	—	—	—	19	—	—	—	—	—	19
Other	(3)	—	—	—	(5)	—	—	—	3	(5)
At 31 December 2006	(67)	48	(117)	56	(257)	(1)	—	(136)	(75)	(549)

Notes:

(1) Deferred tax assets of £47 million (2005 - £17 million) have not been recognised in respect of tax losses carried forward of £142 million (2005 - £52 million) as it is not considered probable that taxable profits will arise against which they could be utilised. Of these losses, £44 million will expire within one year. The balance of tax losses carried forward has no time limit.

(2) Deferred tax liabilities of £649 million (2005 - £830 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation.

No taxation is expected to arise in the foreseeable future in respect of held-over gains.

26 Subordinated liabilities

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Designated as at fair value through profit or loss	124	150	124	150
Amortised cost	27,662	28,272	22,279	21,851
	27,786	28,422	22,403	22,001

	Group		Bank	
	2006	2005	2006	2005
	£m	£m	£m	£m
Dated loan capital	13,776	13,024	11,123	9,845
Undated loan capital	10,473	11,125	8,189	8,360
Preference shares	3,537	4,273	3,091	3,796
	27,786	28,422	22,403	22,001

Certain preference shares are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 1985.

The following tables analyse the remaining maturity of subordinated liabilities by (1) the final redemption date; and (2) the next callable date.

	Group						
	2007	2008	2009-2011	2012-2016	Thereafter	Perpetual	Total
2006 - final redemption	£m	£m	£m	£m	£m	£m	£m
Sterling	352	—	—	772	391	6,085	7,600
US$	112	87	1,123	3,941	230	4,896	10,389
Euro	187	173	955	2,656	1,578	2,381	7,930
Other	24	—	—	984	445	414	1,867
Total	675	260	2,078	8,353	2,644	13,776	27,786

	Group							
	Currently	2007	2008	2009-2011	2012-2016	Thereafter	Perpetual	Total
2006 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	—	502	—	1,103	2,161	3,668	166	7,600
US$	1,843	1,200	469	3,838	1,862	1,177	—	10,389
Euro	—	274	948	1,634	4,473	565	36	7,930
Other	—	24	—	701	1,043	99	—	1,867
Total	1,843	2,000	1,417	7,276	9,539	5,509	202	27,786

	Group						
	2006	2007	2008-2010	2011-2015	Thereafter	Perpetual	Total
2005 - final redemption	£m	£m	£m	£m	£m	£m	£m
Sterling	51	150	—	1,123	412	6,232	7,968
US$	414	—	811	3,541	556	6,519	11,841
Euro	157	—	836	3,003	1,164	2,540	7,700

Other	9	—	356	425	—	123	913
Total	631	150	2,003	8,092	2,132	15,414	28,422

Group

Currently 2006