The Group's profit before tax for 1998 of £2,142 million was a record. In 1997 profit before tax was £975 million.

The Group's earnings for each ordinary share were 91.2p for 1998, compared with 34.5p for 1997.

This represented an after-tax return on ordinary shareholders' funds of 20% for 1998, compared with 7.8% for 1997.

The Group will pay a final dividend of 24.2p for each ordinary share on 4 May 1999 which, together with the interim dividend of 11.8p, gives total ordinary dividends for 1998 of 36p, compared with 32.2p for 1997.

Contents

Presentation of information

This document comprises National Westminster Bank Plc's 1998 Annual Report and Accounts and its 1998 Annual Report on Form 20-F to the Securities and Exchange Commission ('SEC') in the United States of America ('US'). In this report, the term 'Bank' means National Westminster Bank Plc and 'Group' or 'NatWest Group' means the Bank and its subsidiary undertakings. 'Continuing operations' means, in any period, the operations of the Group excluding the results of Bancorp, the Group's US retail and commercial banking operation, and Banco NatWest España SA ('BNWE'). These businesses were disposed of in 1996.

Certain information relating to the Group's activities is presented separately for domestic and international operations. For this purpose, domestic operations consist of the United Kingdom ('UK') domestic transactions of the Bank and its UK subsidiary undertakings (but exclude the Republic of Ireland transactions of Ulster Bank Limited). International operations consist of the Group's international transactions through those offices in the UK specifically organised to service international banking transactions (International offices – UK) and through offices outside the UK, including the Republic of Ireland transactions of Ulster Bank Limited and its subsidiaries. US-based business recorded in the Bahamas is included in International offices – US.

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

Reporting currency

The Bank publishes its accounts in pounds sterling ('£' or 'sterling'). References to 'dollars' or '$' are to US dollars. The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, and the abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars respectively. Amounts in dollars, unless otherwise stated, for any financial (fiscal) year have been translated from sterling at the rate prevailing on 31 December used by the Bank, as shown below under Exchange Rates. This rate should not be construed as a representation that the sterling amounts actually denote such dollar amounts or have been, could have been, or could be converted into dollars at the rate indicated.

Exchange rates

Except as stated, the following table sets forth, for the dates or periods indicated, the Noon Buying Rate in New York for cable transfers in sterling as certified for customs purposes by the Federal Reserve Bank of New York (the 'Noon Buying Rate').

	1998	1997	1996 (dollars per £1)	1995	1994
31 December	**1.663**	1.643	1.712	1.554	1.567
Average [1]	**1.660**	1.640	1.573	1.580	1.539
High	**1.722**	1.712	1.712	1.644	1.637
Low	**1.611**	1.578	1.495	1.530	1.462
31 December rate used by the Bank [2]	**1.659**	1.655	1.700	1.544	1.564
Average rate used by the Bank [2]	**1.658**	1.639	1.561	1.578	1.532

1 The average of the Noon Buying Rates on the last day of each month during the financial year.
2 The rates used by the Bank in the preparation of its consolidated accounts.

On 22 February 1999, the Noon Buying Rate was $1.624 = £1.00.

Financial highlights

	1998 £m	1997[1] £m	1996[1] £m	1995[1] £m	1994[1] £m
Consolidated profit and loss account					
Continuing operations					
Operating income	**7,367**	6,974	6,885	6,157	5,979
Operating expenses	**(5,055)**	(5,274)	(4,724)	(4,304)	(4,170)
Trading surplus	**2,312**	1,700	2,161	1,853	1,809
Provisions for bad and doubtful debts	**(499)**	(562)	(549)	(571)	(549)
NatWest UK	**1,058**	1,012	701	694	729
Lombard	**185**	218	218	228	220
Ulster Bank	**155**	144	135	119	103
NatWest Wealth Management	**310**	152	197	153	29
Global Financial Markets	**393**	244	252	213	151
Greenwich NatWest	**(72)**	(322)	34	17	118
Other Businesses	**(79)**	(53)	(21)	(26)	(2)
Head Office costs and other central items	**(102)**	(149)	(48)	(50)	(51)
Profit before finance lease adjustment and termination and disposal of businesses	**1,848**	1,246	1,468	1,348	1,297
Finance lease adjustment [2]	**(55)**	(106)	–	–	–
Profit/(loss) on termination and disposal of businesses	**265**	(244)	224	–	46
Profit before tax	**2,058**	896	1,692	1,348	1,343
Group including discontinued operations					
Profit on ordinary activities before tax	**2,142**	975	1,337	1,696	1,559
Profit attributable to ordinary shareholders	**1,566**	591	617	1,120	1,022
Retention for the year	**953**	34	122	674	651

	£bn	£bn	£bn	£bn	£bn
Consolidated balance sheet [3]					
Shareholders' funds	**8.5**	8.0	7.7	8.0	7.1
Total assets	**186.0**	185.5	185.5	169.1	158.7
Weighted risk assets	**96.4**	103.2	104.7	110.0	103.4
Loans and advances to customers and operating lease assets	**80.3**	86.2	82.6	88.5	81.3
Customer accounts	**96.3**	89.9	84.2	88.4	84.0

	pence	pence	pence	pence	pence
Per ordinary share [3]					
Dividends – net	**36.0**	32.2	29.0	25.3	21.6
Earnings – basic	**91.2**	34.5	35.3	64.3	61.0
– diluted	**90.1**	33.9	34.9	63.3	60.0
– headline [4]	**78.1**	46.9	66.6	64.9	56.6
Net asset value	**471**	425	427	427	385

	%	%	%	%	%
Ratios [3]					
Post-tax return on average equity	**20.0**	7.8	8.3	15.8	16.7
Headline post-tax return on average equity	**17.2**	10.6	15.6	16.0	15.4
Post-tax return on average total assets	**0.8**	0.3	0.4	0.6	0.6
Tier 1 capital	**8.3**	7.2	6.7	6.7	6.4
Total capital	**13.2**	11.7	10.8	10.7	11.0

1 Restated following implementation of Financial Reporting Standard ('FRS') 10 'Goodwill and Intangible Assets' (see page 79).
2 For finance leases with tax variation clauses, the net benefit of the changes in UK Corporation Tax enacted in the Finance Act 1998 (including the reduction in the rate from 31% to 30%) is passed to the lessee in the form of reduced future rentals. The effect of this reduction, amounting to £55m, has been recognised in 1998. It is matched by a corresponding release of deferred tax credited to the tax charge for the period, leaving profit after tax and earnings per share unaffected. A similar adjustment of £106m resulting from the reduction in the rate of UK Corporation Tax from 33% to 31% was recognised in 1997.
3 Continuing and discontinued operations.
4 Headline earnings per ordinary share are defined on page 41.

Description of business

Introduction

The Bank was incorporated in England in 1968 and was formed from the merger of National Provincial Bank Limited and Westminster Bank Limited. These two banking groups had themselves grown through a series of mergers involving banks whose origins in some cases dated back to the seventeenth century.

The Group is engaged in a wide range of banking, financial and related activities in the UK and in 25 other countries. Operations are conducted directly through the Bank, which is one of the major London clearing banks, and banking and non-banking subsidiary undertakings. Outside the UK, only the US accounted for more than 10% of Group total assets as at 31 December 1998 or Group profit before tax for the year ended 31 December 1998. At that date, the Group employed approximately 64,400 full-time equivalent staff worldwide.

The Group comprises six main business segments: NatWest UK, Lombard North Central ('Lombard'), Ulster Bank Group ('Ulster Bank'), NatWest Wealth Management ('NWWM'), Global Financial Markets ('GFM'), Greenwich NatWest ('GNW') and Other Businesses. Group functions are contained within the Group Head Office.

NatWest UK

NatWest UK, the Group's principal domestic financial services arm, is organised into five business units.

– **Retail Banking Services** covers the personal and small business markets and is responsible for the branch network.

– **Mortgage Services** offers mortgages to personal customers for the purchase of residential properties and further secured advances for the purchase of major consumer items.

– **Insurance Services** provides insurance services and offers independent financial advice on life and pensions products to customers.

– **Card Services** issues credit, charge and debit cards to personal and corporate customers and engages in acquisition and processing facilities for retail businesses.

– **Corporate Banking Services** deals with mid-sized and large corporate customers including the provision of international trade finance services.

During 1998, NatWest UK continued its policy of extending relationship management to certain categories of personal customers and to most business customers. Corporate Banking Services currently has approximately 41,000 corporate relationships (generally with companies which have revenues of more than £1m per annum) served by more than 600 dedicated relationship managers.

Overdraft and loan facilities, generally at variable interest rates, are offered to borrowers in all segments of British industry and commerce and to personal customers. Fixed rate loans are also provided to small and mid-corporate businesses and to personal customers for the purchase of property and consumer goods.

Retail sterling deposits comprising current accounts, demand, savings and time deposits are gathered through the branch network from both personal customers and businesses.

The Bank is a member of both the VISA and MasterCard payment systems. A comprehensive range of credit, charge and debit cards is offered to both personal and corporate customers.

The Bank is a member of the Switch electronic debit card scheme and issues the NatWest Servicecard as its Switch payment card. The servicecard also acts as a UK cheque guarantee card and enables customers to obtain cash through automated teller machines ('ATMs') throughout the UK and abroad.

Mortgage Services products are sold primarily through a qualified salesforce.

Lombard North Central

Lombard is the finance house subsidiary of NatWest Group. Its comprehensive product range covers leasing, hire purchase, factoring and invoice discounting, contract hire and unsecured personal loans. Following a review of its operations and in line with the Group's overall strategy of concentrating on developing profitable and sustained multi-product relationships direct with its customers rather than through third parties, Lombard disposed of a number of businesses during 1998. The remaining businesses are being restructured. The Group will focus on developing its market leading position as a provider of business asset finance through the Lombard brand whilst continuing to build its successful consumer finance business in key areas such as Lombard Direct. From 1 January 1999 the commercial businesses, Lombard Asset Finance Group, form part of Corporate Banking Services, and Lombard Direct is included in Card Services.

Ulster Bank Group

Ulster Bank provides a comprehensive range of retail and wholesale financial services in Ireland.

- **Ulster Bank Retail**, which has branch networks in both Northern Ireland and the Republic of Ireland, operates in the personal and commercial sectors where it undertakes lending (including residential mortgages, leasing, instalment credit and invoice discounting business) and deposit taking. It is also active in credit and debit card operations and in insurance services.
- **Ulster Bank Markets** provides a wide range of investment banking products and services which include foreign exchange, money market services, lending, stockbroking and fund management and administrative and custodial operations, to the corporate and institutional markets.

NatWest Wealth Management

NWWM brings together the Group's businesses that focus on the longer term savings, investments and private banking markets. Through working closely together, they deliver the full range of skills required to meet the wealth management needs of the Group's customers.

- **Coutts NatWest** ('Coutts NW') is the UK and international private banking arm of the Group. It has a network of offices in major private banking centres of the world offering an extensive range of investment, fiduciary and banking services. In January 1998, Coutts NW announced that it would exit from domestic US client business and concentrate its US resources on the servicing of Latin American clients out of its Miami office. NatWest Investments and NatWest Stockbrokers were transferred to Coutts NW from NatWest Life and Investment Services on 1 January 1998. NatWest Investments provides portfolio management services and NatWest Stockbrokers is one of the largest retail stockbrokers in the UK.
- **Gartmore** is one of the UK's leading companies in the management of equity and fixed income assets, providing a full range of services for retail, corporate and institutional clients. Investment management is predominantly carried out in the UK, but the company is represented in Tokyo, New York, Charlotte (North Carolina), Frankfurt and Singapore. Gartmore is the focal point of asset management across the Group under both the NatWest and Gartmore brands.
- **NatWest Life and Investment Services** ('NWLIS') provides life and investment products to NatWest UK's retail and corporate customer base. Its salesforce, comprising around 800 financial planning managers, advises on its own life and investment products, and, through the Single Marketing Group established in 1996, it has access to the unit trust, personal equity plan and other investment products of Gartmore.
- **NatWest Equity Partners** is one of the UK's leading providers of private equity finance. In the past few years, it has expanded its activities in Europe through a network of offices in France, Germany, Italy and Spain.

Global Financial Markets

GFM provides foreign exchange, money market, currency derivative and rate risk management services to corporate and institutional clients with its activities largely centred in London, New York, Tokyo, Hong Kong and Singapore. It also engages in similar activities for its own account and provides treasury services support to the Group itself and its constituent businesses.

Greenwich NatWest

GNW was formed in March 1998 and its ongoing business comprises trading and capital markets businesses based primarily in London, Greenwich (Connecticut) and Tokyo. Its main activities are: global interest rate derivatives trading; securitisation origination and trading; securities/credit trading; futures brokerage and project and structured trade finance origination. A Portfolio Management Group was formed to manage down corporate lending activities, including debt structuring and finance leases with the residual portfolio transferred, effective 1 January 1999, to Corporate Banking Services. Sales of substantially all of the cash business and the majority of the derivatives activities of Global Equities were completed on 27 April 1998 and 3 March 1998 respectively.

Other Businesses

Other Businesses comprise Corporate Advisory and the Group's remaining operations, mainly in Germany and Greece, which are primarily involved in commercial banking. Corporate Advisory, including Hawkpoint Partners Limited (formerly NatWest Markets Corporate Advisory Limited), gives advice on commercial and financial strategy, capital raising, mergers and acquisitions, disposals, privatisations, bids and restructurings. Corporate Advisory was transferred from GNW in 1998 and comparative figures have been restated accordingly.

Group Head Office

Group Head Office comprises Group wide functions including audit, compliance, corporate affairs, finance, human resources, information technology, legal, operations and risk. It also provides operational support to the business segments, such as property services, catering and event management, security, payroll, learning and development, management consultancy and economic intelligence.

Group Risk

Group Risk is responsible for overseeing the implementation of the risk policy set by the board of directors and for the management of credit, market and operational risk issues for the Group.

Group Risk is independent of the Businesses and is headed by the Director of Group Risk who, in turn, reports to the Executive Director, Group Operations. In addition, the Director of Group Risk has executive responsibility for the Group's Year 2000 risk management project. See 'Year 2000' for further discussion of the Group's Year 2000 project.

Group Audit and Group Compliance

Group Audit and Group Compliance are independent of each of the business units and report directly to the Audit and Compliance Committee of the board. Their directors report to the Executive Director, Group Operations and to the General Counsel respectively, with both having a right of direct access to the Group Chief Executive.

The audit function has overall responsibility for advising local and Group executive management and the Audit and Compliance Committee on the quality and effectiveness of internal controls and the identification of significant operating control deficiencies within the Group.

The role of Group Compliance is to ensure that investment business is conducted in accordance with local laws and regulations or with the Group's minimum standards, whichever are more strict. Each business unit has its own independent compliance function which is responsible for day-to-day compliance.

Discontinued operations

Results from discontinued operations reflect the losses in 1996 on the sale of the three main operating entities of Bancorp ('Bancorp') and the sale of 80% of the Group's investment in BNWE, its retail and commercial bank in Spain. The remaining interest in BNWE was sold in 1998. The Bancorp sale agreement provided for contingent consideration of up to $560m which will be included in the Group profit if and when received. A total of £163m ($270m) has been received and recognised to date, £84m ($142m) in 1998 and £79m ($128m) in 1997.

Year 2000

Millennium or Year 2000 problems result from the use of only two digits to identify a year in computer systems and other equipment that uses embedded chips. Consequently, such systems and equipment may fail to operate reliably when handling dates after 31 December 1999 i.e. as year 19(99) passes into year 20(00).

The Millennium issue has potential consequences throughout the Group's businesses, as well as for our customers and for governments and businesses around the world. In common with many businesses in the financial industry, the Group is heavily dependent on computer systems and embedded chips in its operations. If not remedied, Millennium problems could cause serious disruption to the Group's dealing, settlement, money transmission and other activities, and affect the reliability of its records. The Group has undertaken action to address the problem as a major operational priority since 1996. The objective of the NatWest Group Millennium Programme is to ensure the Group passes through the Millennium date change without operational disruption and that we maintain a smooth and uninterrupted service into the Year 2000. This requires potential problems to be addressed and resolved within the Group's operations themselves and also in its relationships with other participants in the financial services industry as a whole and the national infrastructures of countries where we are represented or have an interest.

This has entailed an extensive programme of activities across all Group businesses. Principally, these included the creation of an inventory through 1996 and into early 1997 of all IT and non-IT date-dependent systems and equipment used within the Group and suppliers of services outside the Group with whom we have a business relationship. Impact analysis was then undertaken to define the remedial work required. Planning and implementation took place from 1997 through to the end of 1998. An extensive test programme was run in parallel to the implementation phase through 1998.

The assessment, modification, implementation and testing programmes were successfully completed by the end of 1998 for almost 98% of the approximately 10,000 IT systems and products identified across the Group.

There were 234 situations where compliance was not achievable by the end of 1998. Each of these situations was assessed and the Group did not consider them to pose a risk operationally. Clear paths to compliance were established for each situation, with the majority of rectification projected for completion by the end of June 1999. A large number of these situations arose because third party suppliers were unable to achieve compliance themselves by the end of 1998.

In addition to the work required to make IT systems and products compliant, the Group has also taken action to address the potential problem posed by embedded chips in properties occupied by Group businesses. These properties include 1,850 sites in the UK alone, around 150 of which have been classified as critical to the Group. An inventory of 35,000 assets, such as security systems, lift components, lighting systems, and air conditioning units was raised. Surveys of the critical sites indicated that about 10% of these assets contained a sensitivity to dates requiring testing and possible rectification. Approximately 440 (1.3%) of these items had a problem requiring rectification during 1998 and largely centred on building management systems, perimeter access control systems and intruder alarms.

Having largely completed their modification and testing programmes, all businesses have implemented management procedures to keep all systems and equipment compliant through the period of transition, and will be implementing change freeze policies towards the end of 1999 and over the rollover period into 2000, to ensure the stability of our computer systems during this critical period. The focus of Millennium planning activities during 1999 will switch to more business-related activities and issues. In particular this will involve the refining, testing and improving of our contingency, business continuity and Millennium roll-over period plans, including ensuring that adequate data back-ups are maintained and resources available, to minimise any disruption to the Group's business in the event of systems failure either within the Group or in international financial markets, settlement and payment systems. The Group is also participating in industry-wide testing.

The total expenditure to make the Group Millennium compliant is expected to be in the region of £170m. The total costs to date are £123m, including £10m capital expenditure, of which £83m was spent during 1998. The aggregate cost of the project is subject to change as work progresses and more precise costs for various items become known, and there can be no assurance that the aggregate cost of the project will not be significantly higher. At its peak, the Programme had 804 full-time staff and 333 part-time staff working to address the Millennium issue. These numbers will continue to fall significantly through 1999. The completion of the Millennium compliance work has had some impact on IT and other business priorities as it has drawn on significant numbers of IT staff overall, and has tied up staff with particular fields of expertise, thus affecting, to some extent, the prioritisation and timing of other Business programmes and plans.

There are a number of significant risks that are outside the Group's direct control. The inventory work undertaken early in the Programme, highlighted our dependence on over 2,000 service suppliers to the Group (such as utility companies, information handlers, cash handlers etc.) over which we have no direct control. About 300 of these are classed as critical to the Group's business. Each supplier has been contacted, risk analysis undertaken to ascertain their preparedness, and then re-checked as they reach a compliant state. However, the Group remains dependent on the effectiveness of the preparations carried out by each supplier. Key suppliers are also being approached by Group Purchasing to confirm that, in the event of a service failure, the Group is placed high on the provider's rectification priority list.

Group businesses are reviewing the potential impact of supplier failure and including appropriate steps in their business continuity and contingency plans, including dual sourcing and stockpiling of essential supplies.

Year 2000 continued

The possibility exists that as we approach the Millennium, customer and market behaviour may become unpredictable or irrational. Capital market movements and volatility may increase, as may unusual demands for cash and statements, investment transactions and so on. Such actions by customers, if carried out on a wide scale, would have the potential to cause significantly greater disruption to business than the Millennium problem itself. To help counteract these possibilities, the Bank has built up its communications programme to allay customer and market fears, with the intention of mitigating risks in these areas. We are also working closely with Action 2000, Global 2000, the British Bankers' Association and the Association for Payment Clearing Services to ensure a co-ordinated approach is taken to inform key media representatives, publish detailed progress reports of our readiness and generally respond quickly to any scaremongering that may occur later this year.

The Group has always tried to take a wider perspective on this issue than just ensuring our own internal compliance. In addition to our active participation with the organisations listed above, the Group was instrumental in helping to develop the original BSI Millennium standard that is now in use across all commercial, financial and manufacturing sectors in the UK. We have particularly concentrated on support to our customers and the business community at large, having published a Millennium guide for small and medium sized businesses called "The Year 2000 Computer Problem – a practical guide for businesses", made and contributed to presentations and seminars across the UK, and produced and marketed, in partnership with IBM, a software toolkit to enable businesses to identify and rectify software problems within computer systems. The Group was the first financial organisation to offer a Millennium loan product to customers to assist with the financial aspect of achieving compliance.

While considerable resource is being devoted to preparing for the Millennium, the Group cannot be certain that all of the numerous computer systems involved will be fully corrected prior to the change date. This could result in systems failures, miscalculations or product service malfunctions, which could have a material adverse affect on the Group, and which may not be amenable to effective contingency plans.

Overall, the Group has made significant progress in achieving Millennium compliance, and the few situations that remain outstanding are being managed closely. The challenge for 1999 is in maintaining compliance throughout the year, managing customer and market perceptions of the issue, refining and testing our plans in the event of service failure and preparing for the Millennium period itself.

Economic and Monetary Union (EMU)

On 1 January 1999 eleven member states of the European Union replaced their national currencies with a new currency, the euro. The previous national currencies will continue to be used as denominations of the euro until the end of the transitional period on 31 December 2001. Euro notes and coins are to be introduced by 1 January 2002 and the changeover completed by 1 July 2002. Although the UK did not join EMU with the first wave of participating member states, the introduction of the euro has widespread effects on the business of the Group.

A successful EMU within the European Union will speed up other strategic changes – the completion of Single Market, demographic changes, and the growth of direct financial services made possible by new technology. However, EMU has still to prove itself and its ability to withstand external shocks. The Group decided in 1996 that the pace and priority of EMU change should be primarily a matter for individual business units, as they each face different customer demands as a result of EMU. The businesses have been supported by a small Group team which champions EMU related developments, ensuring that it remains at the forefront of attention, and which represents NatWest Group at industry level for those important parts of the EMU programme which require inter-bank co-operation. Group Audit and Group Risk have been closely involved throughout to ensure that the right balance between cost and safe conversion has been maintained. The Group incurred costs of some £45m to the end of 1998 on EMU preparation of which £35m was incurred in 1998.

The Group's major conversion programmes proceeded without difficulty and the Group was fully ready to deal in euros when the markets opened on 4 January 1999. Readiness for EMU has involved extensive preparations to support our customers in many markets. In the London financial markets – foreign exchange, money markets, bonds, derivatives and equities – GFM and GNW were fully prepared for EMU, with a full range of euro products. We believe that the London markets will thrive whether the UK is in or out of EMU, but we are also represented in other European centres, and especially in Dublin where Ulster Bank Markets offers a full range of services in a country in the first wave of EMU.

Corporate banking is critically affected by EMU, and as the United Kingdom's leading bank in this sector, NatWest's Corporate Banking Services was the first UK bank to offer euro products and services, very early in 1998. We are able to offer payment products through a range of channels. Our concern has been to ensure that all our customers are ready, particularly the mid-corporates. This has required an extensive communications programme throughout 1997 and 1998, as well as extensive staff training.

Economic and Monetary Union (EMU) continued
In the Funds Management area, Gartmore has faced considerable change to systems and procedures to be able to handle, from 1 January 1999, securities redenomination, new settlement processes, historic performance analysis and multiple base currency client reporting. These changes were implemented successfully and on time.

The Group's UK retail banking operations already have euro products available. However demand for these is expected to remain subdued until any UK entry into the single currency; even then we do not believe that there would be strong demand for euro services from most personal and small business customers until towards the end of any transition period. In the Republic of Ireland, however Ulster Bank will be delivering retail euro services from 1999, and NatWest should subsequently benefit from this experience in building services for our UK customers, if the UK finally decides to enter EMU.

The UK Government has announced that it would in principle like the UK to enter EMU early in the next Parliament subject to economic tests and a referendum. We are continuing to develop our plans for UK entry, but timing of entry will need to be more certain before we commit the investment required for full scale euro preparation in retail banking. The Group continues to work closely with the UK Government to ensure that the National Changeover Plan takes full account of the practical needs of banks and of our customers.

Competition
In the UK, the Bank competes with other clearing and international banks in both the personal and corporate sectors. In the personal sector, banks and building societies (which are similar to savings and loan associations in the US) compete in the lending and home mortgage markets. Together with National Savings (saving schemes promoted and guaranteed by the UK government), they also participate in the market for retail deposits. The Bank is also engaged in the increasingly competitive UK credit and debit card markets. Competition within the personal sector has grown considerably with a number of non-traditional participants in the market, most notably supermarkets some of whom now provide lending, investment products and deposit taking services through joint ventures with banks.

Lombard competes in diverse markets with other finance houses, banks, retailers and niche players. The pricing of non-lending products such as insurance and vehicle management reflects these individual markets.

Ulster Bank competes with other financial institutions in Northern Ireland and the Republic of Ireland in both the personal and corporate sectors. It conducts business in both the retail and wholesale financial services markets.

Gartmore and Coutts NW, which are part of NWWM, face strong competition across investment management, trust and fiduciary, and private banking markets.

GNW and GFM compete in corporate and institutional markets with UK and with international commercial and investment banks across a wide range of products.

Factors which influence pricing by the Group include the Basle Committee's capital adequacy standards, risk, the economic environment and competitor activity.

Through GNW and GFM, the Group continues to compete in corporate and institutional banking in the US, contending with super-regional banks that conduct banking activities in many states as well as with money centre, investment and international banks. Non-bank financial institutions are also competitors in the US.

Accounting developments
The Group's principal accounting policies are set out in note 1 to the Group's consolidated accounts on pages 79 and 80. Financial Reporting Standard ('FRS') 9 'Associates and Joint Ventures', FRS 11 'Impairment of Fixed Assets and Goodwill', and FRS 14 'Earnings per Share' all applied for the first time in 1998. FRS 9 and FRS 11 have not had a material effect. Following implementation of FRS 14 the Group now discloses diluted earnings per share.

The Group's accounting policy for goodwill has been changed in line with FRS 10 'Goodwill and Intangible Assets'. Purchased goodwill is capitalised, classified as an asset and amortised over its useful economic life. The gain or loss on the disposal of a subsidiary or associated undertaking is calculated by comparing the carrying value of the net assets sold (including any unamortised goodwill) with the proceeds received. Previously the Group's policy was for goodwill to be either deducted from profit and loss account reserves or capitalised. Goodwill eliminated from reserves in prior periods has been reinstated by means of a prior year adjustment and comparatives restated. The effects of this change of policy on the Group's profit and loss account and balance sheet are set out in note 26 on page 97.

During 1998 the Accounting Standards Board also published FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' and FRS 13 'Derivatives and Other Financial Instruments: Disclosures'. These standards will be effective for the Group's 1999 accounts.

Operating and financial review

	Year ended 31 December		
	1998 £m	1997[1] £m	1996[1] £m
Continuing operations			
Interest receivable	**9,547**	9,028	8,575
Interest payable	**(5,681)**	(5,258)	(4,998)
Adjustment for finance leases [2]	**(55)**	(106)	–
Net interest income	**3,811**	3,664	3,577
Non-interest income	**3,556**	3,310	3,308
Operating income	**7,367**	6,974	6,885
Operating expenses	**(5,055)**	(5,274)	(4,724)
Trading surplus	**2,312**	1,700	2,161
Provisions for bad and doubtful debts	**(499)**	(562)	(549)
Provisions for contingent liabilities and commitments	**–**	(5)	(10)
Amounts written off fixed asset investments	**(28)**	(31)	(32)
Operating profit	**1,785**	1,102	1,570
Income from associated undertakings	**29**	13	23
Disposal of tangible fixed assets	**(21)**	25	(125)
Profit before termination and disposal of businesses	**1,793**	1,140	1,468
Losses on termination of Equities operations	**–**	(287)	–
Profit on disposal of businesses	**265**	43	224
Profit on continuing operations before tax	**2,058**	896	1,692
Discontinued operations			
Profit to date of sale	**–**	–	93
Additional consideration on sale of Bancorp	**84**	79	–
Profit/(loss) on disposals	**–**	–	(448)
Profit on ordinary activities before tax	**2,142**	975	1,337
Tax on profit on ordinary activities (after release of deferred tax provision in 1998 of £59m following change in rate of corporation tax; 1997 £114m; 1996 nil)	**(501)**	(309)	(653)
Profit on ordinary activities after tax	**1,641**	666	684
	%	%	%
Continuing and discontinued operations			
Post-tax return on average equity	**20.0**	7.8	8.3
Post-tax return on average total assets	**0.8**	0.3	0.4
	pence	pence	pence
Per ordinary share			
Dividends	**36.0**	32.2	29.0
Earnings – basic	**91.2**	34.5	35.3
– diluted	**90.1**	33.9	34.9
– headline [3]	**78.1**	46.9	66.6
Net asset value	**471**	425	427

1 Restated for the implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 For finance leases with tax variation clauses, the net benefit of the changes in UK Corporation Tax enacted in the Finance Act 1998 (including the reduction in the rate from 31% to 30%) is passed to the lessee in the form of reduced future rentals. The effect of this reduction, amounting to £55m, has been recognised in 1998. It is matched by a corresponding release of deferred tax credited to the tax charge for the period, leaving profit after tax and earnings per share unaffected. A similar adjustment of £106m resulting from the reduction in the rate of UK Corporation Tax from 33% to 31% was recognised in 1997.
3 Headline earnings per ordinary share are defined on page 41.

Overview

The Group's profit before tax was £2,142m, up £1,167m, 120%, compared with 1997. Profit before tax for both years was affected by a number of substantial items, mainly the profit on disposal/termination of businesses of £265m (1997 loss £244m) and an adjustment for finance leases of £55m (1997 £106m). Profit from ongoing business, before the finance lease adjustments and disposals, rose £463m, 34%, to £1,832m.

Operating income rose £393m, 6%, to £7,367m. Net interest income before the adjustment for finance leases was up £96m, 3%, to £3,866m. The increase in the ongoing business was £218m, 7% to £3,518m benefiting from an increase in current account balances and lending growth in the retail and commercial businesses. Non-interest income rose by £246m, 7%, to £3,556m. The increase for ongoing business was £326m, 10%, to £3,455m excluding the 1997 options mispricing charge. This largely reflected an improved performance in the Wholesale and Wealth Management businesses.

Operating expenses fell by £219m, 4%, to £5,055m. Excluding the additional £100m pension mis-selling provision in 1998, operating expenses for the ongoing business rose by £104m, 2% to £4,637m. This was principally due to a £69m, 26%, rise to £339m in revenue investment expenditure in NatWest UK, a £21m provision to rationalise office accommodation in central London and increases in Gartmore and GFM.

Provisions for bad and doubtful debts were down £63m, 11%, to £499m. Specific provisions rose £23m, 5% to £488m. Improvements in the NatWest UK businesses and at Coutts NW were more than offset by increases in GNW, reflecting specific provisions for South East Asian and Russian counterparties; higher charges in Other Businesses relating to Acquisition Finance and the residual businesses; and in Lombard. In 1997 a general provision of £80m was established in respect of credit exposures in South East Asia and South Korea.

During 1998 the Group exited or disposed of several businesses. Profit on disposal of businesses amounted to £265m. This included £197m relating to disposals by Lombard, £44m on the sale of two operations by Coutts NW, £19m on the sale of Equities businesses and operations in Australia and Canada by GNW and additional consideration on businesses disposed of by Gartmore in 1997. Loss on disposals for 1997 included a £287m provision for the termination of Equities operations and profit on the disposal of Gartmore operations in Australia, Canada and France.

During the year the Group received the second tranche of the additional consideration on the sale of Bancorp of £84m (1997 £79m). Of the contingent consideration of up to $560m, $270m has now been received.

The tax charge was £501m, equivalent to 23.4% of pre-tax profit after releasing deferred tax provisions of £59m following the change in rate of UK Corporation Tax. Excluding this and taxation relating to profits on the disposal of businesses, the underlying tax rate was 29.5% of pre-tax profit.

The Group has changed its accounting policy for goodwill following implementation of FRS 10 'Goodwill and Intangible Assets'. The effect of this change in policy is set out on page 97.

Profit before tax on continuing operations in 1997 fell £796m, 47% to £896m largely due to substantial losses in the Group's Equities business including those relating to its termination. Operating income rose by £89m, 1%, to £6,974m. Excluding the finance lease adjustment of £106m the rise was £195m, 3%. On the same basis, net interest income was up £193m, 5% to £3,770m. Non-interest income was broadly flat. Operating expenses rose by £550m, 12%, to £5,274m, mainly due to acquisitions, growth in Equities costs and strengthening the infrastructure and controls in the wholesale markets businesses, as well as investment expenditure in NatWest UK.

The 1997 tax charge was £309m (31.7%) after releasing a deferred tax provision of £114m following the change in the rate of corporation tax.

Operating and financial review – Results by nature of income and expense

Net interest income	Year ended 31 December		
	1998 £m	1997 £m	1996 £m
Continuing operations			
Interest receivable	**9,547**	9,028	8,575
Interest payable	**(5,681)**	(5,258)	(4,998)
Ongoing business	**3,518**	3,300	3,164
Businesses exited or sold	**348**	470	413
Net interest income before adjustment for finance leases	**3,866**	3,770	3,577
Adjustment for finance leases	**(55)**	(106)	–
Net interest income	**3,811**	3,664	3,577

	£bn	£bn	£bn
Average balances of banking business			
Continuing operations			
Loans and advances to customers[1]	**79.7**	76.7	75.2
Loans and advances to banks	**21.8**	25.3	26.9
Debt securities	**15.7**	13.1	10.4
Treasury and other eligible bills	**0.5**	0.6	0.8
Total interest-earning assets of banking business	**117.7**	115.7	113.3
Customer accounts	**72.7**	68.9	65.6
Deposits by banks	**20.3**	25.5	28.4
Other interest-bearing liabilities	**21.4**	22.7	18.6
Internal funding of trading business	**(13.6)**	(18.1)	(15.0)
Total interest-bearing liabilities of banking business	**100.8**	99.0	97.6
Net interest-free funds of banking business	**16.9**	16.7	15.7

	%	%	%
Gross yield on interest-earning assets of banking business	**8.11**	7.80	7.57
Cost of interest-bearing liabilities of banking business	**(5.63)**	(5.31)	(5.12)
Interest spread of banking business [2,3]	**2.48**	2.49	2.45
Benefit from interest-free funds	**0.80**	0.77	0.71
Net interest margin of banking business [2,4]	**3.28**	3.26	3.16

1 Includes operating lease assets of £1.6bn (1997 £1.4bn; 1996 £1.2bn).
2 Excluding adjustment for finance leases.
3 The difference between the rate of interest earned on average interest-earning assets of banking business and the rate of interest paid on average interest-bearing liabilities of banking business.
4 Net interest income of banking business expressed as a percentage of average interest-earning assets of banking business.

Net interest income rose by £147m, 4%, to £3,811m. Excluding the contribution of businesses exited or sold and the finance lease adjustment in both years, the rise was £218m, 7%, to £3,518m. Average loans and advances to customers rose by £3.0bn, 4%, to £79.7bn and total average interest-earning assets of the banking business rose by £2.0bn, 2%, to £117.7bn.

Interest spread declined 1 basis point with lending growth mainly in relatively low margin business offsetting the effects of the change in asset mix towards higher margin retail and commercial products. Net interest-free funds rose by £0.2bn, 1%, to £16.9bn, offsetting the decline in spread and leading to an increase in the net interest margin of 2 basis points to 3.28%.

In 1997, excluding the adjustment for finance leases, net interest income rose by £193m, 5%, to £3,770m. Interest spread of the banking business rose by 4 basis points to 2.49% and net interest-free funds of banking business grew by £1.0bn, 6% to £16.7bn. Consequently the net interest margin of banking business rose by 10 basis points to 3.26%.

Average lending

	1998 Total £bn	1998 Ongoing business £bn	1997 Total £bn	1997 Ongoing business £bn	1996 Total £bn	1996 Ongoing business £bn
						Year ended 31 December
Continuing operations						
Average loans to customers of banking business						
NatWest UK	**48.4**	**48.4**	43.0	43.0	41.5	41.5
Lombard [1]	**13.4**	**8.4**	12.5	7.4	10.9	6.5
Ulster Bank	**5.2**	**5.2**	4.5	4.5	3.9	3.9
Retail and Commercial Businesses	**67.0**	**62.0**	60.0	54.9	56.3	51.9
NatWest Wealth Management	**3.3**	**3.3**	3.2	3.2	3.0	3.0
Wholesale Businesses [2]	**8.5**	**8.4**	12.6	12.4	14.6	14.1
Other Businesses	**0.9**	**0.9**	0.9	0.9	1.3	1.3
Total average loans and advances to customers of banking business	**79.7**	**74.6**	76.7	71.4	75.2	70.3

1 'Total' Includes operating lease assets of £1.6bn (1997 £1.4bn; 1996 £1.2bn).
2 Comprising GNW and GFM.

Average lending to customers in Retail and Commercial Businesses rose by £7.0bn, 12%, to £67.0bn including £2.3bn transferred from GNW to NatWest UK. Excluding this, growth in NatWest UK was predominantly in corporate, mortgage and card lending. At Lombard, average lending in the ongoing business rose by £1.0bn, 14% to £8.4bn. Average loans at Ulster Bank were up £0.7bn, 16%, to £5.2bn with particularly strong growth in the Republic of Ireland. In the Wholesale Businesses, lending declined by £4.1bn, 33%, to £8.5bn largely reflecting the transfers to NatWest UK and reductions in structured finance transactions.

In 1997, average lending to customers in the Retail and Commercial Businesses rose by £3.7bn, 7%, to £60.0bn. In NatWest UK, there was growth in mortgage, corporate and card lending. This was partially offset by a decline in lending to small business and personal customers. Lombard benefited from growth in corporate and motor business, and higher levels of direct and point-of-sale personal finance. Ulster Bank's average lending to customers increased by £0.6bn, 15%, to £4.5bn, with particularly strong growth in the Republic of Ireland. At GNW, specialised lending increased, but securitisation of assets and the continuing policy of shedding low yielding loans and commitments led to an overall decline of £1.6bn in lending to customers.

Non-interest income

	1998 Total £m	1998 Ongoing business £m	1997[1] Total £m	1997[1] Ongoing business £m	1996[1] Total £m	1996[1] Ongoing business £m
						Year ended 31 December
Continuing operations						
Dividend income	**18**	**18**	25	25	21	21
Fees and commissions						
Receivable	**2,745**	**2,626**	2,883	2,461	2,822	2,459
Payable	**(563)**	**(510)**	(576)	(436)	(491)	(401)
Net fees and commissions	**2,182**	**2,116**	2,307	2,025	2,331	2,058
Dealing profits						
Foreign exchange	**363**	**363**	276	279	180	186
Securities						
Debt	**258**	**258**	204	225	83	149
Equities	**(19)**	**6**	(87)	7	114	5
Interest rate derivatives	**246**	**244**	136	136	123	117
Mispricing of interest rate options and swaptions	**–**	**–**	(85)	(85)	–	–
Total dealing profits	**848**	**871**	444	562	500	457
Other operating income	**508**	**450**	534	432	456	386
Total non-interest income	**3,556**	**3,455**	3,310	3,044	3,308	2,922

1 Restated (see page 79).

Non-interest income rose £246m, 7%, to £3,556m. Excluding the charge for options mispricing in GNW in 1997, non-interest income increased by £161m, 5%. This increase largely reflected improvements in the Wholesale and Wealth Management Businesses which more than offset the decrease in contribution from businesses exited or sold, down £165m, 62%, on 1997.

Non-interest income continued

In 1997, total non-interest income was broadly unchanged at £3,310m. Improvements, particularly in GFM and GNW were offset by the £85m charge relating to the mispricing of interest rate option and swaption portfolios and a decline in GNW's total dealing profits. Net fees and commissions growth in NWWM, mostly in Gartmore, was more than offset by lower transmission fees in NatWest UK, largely as a result of price reductions, and a decline in lending and underwriting fees in GNW.

Dealing profits, excluding the £85m charge for the options mispricing, rose by £29m, 6%, to £529m in 1997. Strong customer transaction flows in GFM and the inclusion of a full year's trading from Greenwich which was acquired in October 1996 contributed to the increase. However, the options mispricing in GNW's interest rate options operation led to a decline in trading activity which was also affected by the uncertainty over its future.

Ongoing business

Net fees rose by £91m, 4%, to £2,116m. Card fees (net) increased by £46m, 16%, to £325m as a result of higher personal and business card turnover. Money transmission fees declined £40m, 8%, to £484m largely due to tariff reductions and increased use of automated payment mechanisms. Lending fees rose £11m, 3%, to £412m. Other fees (net) rose by £74m, 9%, to £895m mainly due to higher investment management and brokerage fees in Coutts NW, Gartmore and Ulster Bank, a rise in insurance commissions in NatWest UK and increased securitisation fees in GNW.

Dealing profits increased by £224m, 35%, to £871m excluding the 1997 options mispricing charge. Foreign exchange was up £84m, 30%, to £363m as a result of strong performances in spot, forward and currency options trading. Profits on debt securities dealing rose £33m, 15%, to £258m despite difficult trading conditions in bond markets during the second half of the year. Income from swaps and other interest rate derivatives rose by £108m, 79%, to £244m reflecting interest rate positioning opportunities taken primarily in anticipation of falling and converging rates in the run up to the introduction of the euro and further development of the GNW business.

Other operating income rose £18m, 4%, to £450m due to higher investment realisation profits at NatWest Equity Partners.

Operating expenses — Year ended 31 December

	1998		1997[1]		1996[1]	
	Total £m	**Ongoing business £m**	Total £m	Ongoing business £m	Total £m	Ongoing business £m
Continuing operations						
Staff costs	**2,738**	**2,598**	2,894	2,541	2,611	2,310
Other administrative expenses	**1,211**	**1,126**	1,355	1,105	1,098	938
Depreciation and amortisation						
Tangible fixed assets	**281**	**275**	271	257	245	227
Goodwill	**80**	**78**	88	81	60	54
	361	**353**	359	338	305	281
Other operating charges	**745**	**660**	666	549	710	599
Operating expenses	**5,055**	**4,737**	5,274	4,533	4,724	4,128
Restructuring costs included in operating expenses	**122**	**120**	145	145	198	198

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Operating expenses decreased by £219m, 4%, to £5,055m. Excluding businesses exited or sold, operating expenses rose £204m, 5%, to £4,737m including an additional provision of £100m following the publication of the Consultation Paper by the Financial Services Authority ('FSA')/Personal Investment Authority to extend the review of pension mis-selling beyond priority cases. Of this £65m was charged in the first half of the year; in light of further clarification issued by the FSA and likely higher cost of compensation due to declines in long term interest rates a further £35m was charged in the second half.

In 1997, total operating expenses increased by £550m, 12% to £5,274m. GNW accounted for £290m of the increase due to acquisitions made in 1996, the expansion of the Equities operations and costs associated with restructuring the ongoing businesses. Higher revenue investment expenditure, especially in respect of building a new retail bank was the major cause of the rise in NatWest UK. There were also increases in other business units.

Ongoing business

NatWest UK's operating expenses were up £161m, 7%, to £2,560m reflecting the additional provision of £100m for pensions mis-selling together with higher revenue investment expenditure up £69m, 26%, to £339m. Excluding these and restructuring costs, underlying costs at NatWest UK were up £5m to £2,080m. Costs of the ongoing business in the rest of the Group rose £43m, 2%, to £2,177m. The increase included a provision of £21m to rationalise office accommodation in central London.

Operating expenses continued

Staff costs were up £57m, 2%, to £2,598m. Increased revenue investment expenditure in NatWest UK along with higher performance related emoluments in GFM and Wealth Management led to the increase. These increases were partially offset by lower restructuring costs.

Other administrative expenses rose £21m, 2%, to £1,126m, principally due to higher software costs relating to investment programmes in NatWest UK.

Depreciation of tangible fixed assets rose £18m, 7%, to £275m. The increase was due to the expanding ATM network in NatWest UK and higher capital expenditure on information technology equipment. Goodwill amortisation was £3m, 4% lower at £78m.

Other operating charges rose £111m, 20%, to £660m entirely due to the £100m additional pension mis-selling provision in NatWest UK and the provision to rationalise office accommodation in central London.

Restructuring costs were down £25m, 17%, to £120m. NatWest UK's charge declined £13m, 24%, to £41m reflecting lower voluntary severance costs. Provisions amounting to £31m were made for closure of some offices in central London and rationalisation of certain central services. Lombard included a £20m charge to restructure operations following the disposal of its point of sale businesses. Coutts NW incurred restructuring charges of £13m. A charge of £48m was made in GNW in 1997 to restructure its operations following the termination of Global Equities.

NatWest UK's revenue investment expenditure was £69m, 26%, higher than in 1997 at £339m. The increase was largely due to expenses incurred in making information systems Year 2000 compliant and ready for the introduction of the euro. Group-wide, total expenditure on millennium compliance is expected to be £170m, of which £123m (including capital expenditure of £10m) had been incurred by 31 December 1998 (£83m in 1998). Conversion costs relating to the introduction of the euro amounted to £45m (£35m in 1998).

The 5% increase in costs was outweighed by 11% income growth. Consequently, the cost:income ratio of the ongoing business reduced to 68.5% from 72.7%.

Staff numbers

	31 December				
	1998	1997[1]		1996[1]	
	Total	Total	Ongoing business	Total	Ongoing business
Continuing operations					
NatWest UK	**43,800**	43,300	43,300	45,000	45,000
Lombard	**3,000**	5,200	3,300	5,000	3,200
Ulster Bank	**4,400**	4,300	4,300	3,900	3,900
NatWest Wealth Management	**8,000**	8,300	8,000	8,200	7,900
Global Financial Markets	**1,100**	800	800	800	800
Greenwich NatWest	**2,300**	5,400	3,100	5,600	3,900
Other Businesses	**600**	1,000	1,000	900	900
Group Central Services and Group Head Office	**1,200**	1,700	1,700	1,600	1,600
Total permanent staff (full-time equivalent)	**64,400**	70,000	65,500	71,000	67,200

1 Restated to reflect staff transferred between business units and the transfer of Corporate Advisory from Greenwich NatWest to Other Businesses.

Permanent staff numbers have fallen by 5,600, 8%, since 31 December 1997 to 64,400. Excluding the exited businesses, permanent staff numbers have fallen by 1,100, 2%. In GNW, permanent staff numbers were down by 800, 26%, to 2,300 due to closures of overseas offices, benefits of restructuring and transfers to GFM and NatWest UK. In Group Central Services and Group Head Office, staff numbers fell by 500, 29%, to 1,200. At NatWest UK there was an increase of 500, 1%, to 43,800 permanent staff principally to support business growth in Corporate Banking Services.

Temporary staff employed in the ongoing business fell 900, 11%, to 7,300. In Retail Banking Services there was a reduction of 500, 10%, to 4,300 as permanent staff replaced temporary staff at the new processing centres. There were also reductions at GNW.

In 1997, total permanent staff numbers fell by 1,000. Headcount in NatWest UK fell by 1,700, reflecting the streamlining of the branch network and centralisation of back office functions, while staff numbers increased in other segments, notably Ulster Bank and Lombard, reflecting business expansion.

Bad and doubtful debt provisions

Year ended 31 December

	1998 Total £m	1998 Ongoing business £m	1997 Total £m	1997 Ongoing business £m	1996 Total £m	1996 Ongoing business £m
Continuing operations						
Specific provisions against lending to customers						
NatWest UK	**113**	**113**	184	184	290	290
Lombard	**194**	**77**	179	61	141	49
Ulster Bank	**13**	**13**	9	9	5	5
NatWest Wealth Management	**10**	**10**	67	67	8	8
Global Financial Markets	**6**	**6**	–	–	–	–
Greenwich NatWest	**47**	**47**	(5)	(5)	33	22
Other Businesses	**67**	**67**	35	35	34	34
	450	**333**	469	351	511	408
Specific provisions against lending to banks						
NatWest UK	**5**	**5**	–	–	(1)	(1)
NatWest Wealth Management	**(1)**	**(1)**	–	–	–	–
Global Financial Markets	**2**	**2**	–	–	–	–
Greenwich NatWest	**32**	**32**	(4)	(4)	(11)	(11)
	38	**38**	(4)	(4)	(12)	(12)
General provision						
South East Asia and South Korea	**–**	**–**	80	80	–	–
Other	**11**	**11**	17	17	50	50
Total general provision	**11**	**11**	97	97	50	50
Total charge against profit	**499**	**382**	562	444	549	446

At 31 December

	1998	1997	1996
	£bn	£bn	£bn
Continuing operations			
Loans and advances to customers at 31 December			
Loans and advances to customers	**80.3**	85.9	82.7
Less reverse repurchase agreements and stock borrowing	**(5.1)**	(8.5)	(8.6)
Group total	**75.2**	77.4	74.1
	£m	£m	£m
Loans and advances to customers: closing provisions at 31 December			
Specific	**924**	998	1,156
General	**407**	397	300
	1,331	1,395	1,456
Loans and advances to banks: closing specific provisions at 31 December	**41**	7	14
Group total	**1,372**	1,402	1,470
Loans and advances to customers: customer charge against profit as a % of gross lending[1]			
Group total	**0.61**	0.73	0.76
Loans and advances to customers: customer closing provisions as a % of gross lending[1]			
Specific	**1.23**	1.29	1.56
General	**0.54**	0.51	0.40
Group total	**1.77**	1.80	1.96
Loans and advances to banks and customers: closing specific provisions as a % of non-accrual loans[2]			
Group total	**51.5**	44.1	44.3

1 Excluding reverse repurchase agreements, stock borrowing and operating lease assets.
2 See page 51 for further analysis.

Bad and doubtful debt provisions continued

The total charge against profit for bad and doubtful debts declined by £63m, 11%, to £499m. Specific provisions rose £23m, 5% to £488m. Substantial reductions in NatWest UK and Coutts NW were more than offset by higher provisions in GNW, Other Businesses and Lombard. The 1997 charge included a general provision of £80m relating to South East Asian and South Korean exposures.

In NatWest UK, specific provisions against lending to customers were down £71m, 39%, to £113m, reflecting significant improvements in Retail Banking Services. Provisions in Corporate Banking Services, however, increased in the second half of the year. At Lombard, specific provisions in the ongoing business of £77m were £16m, 26%, higher than in 1997. In Ulster Bank specific provisions rose £4m, 44%, to £13m partly due to problems in the agribusiness sector. In Wealth Management, specific provisions at Coutts NW were considerably lower than in 1997 when a small number of significant provisions was charged in the US.

The £52m increase to £47m in GNW's charge against lending to customers largely reflects specific provisions raised in respect of Indonesian and Thai counterparties. Other Businesses' specific provisions for bad and doubtful debts rose £32m, 91%, to £67m with increased provisions in Acquisition Finance and in residual businesses.

Provisions against lending to banks amounted to £38m (1997 release £4m) primarily in respect of exposures to Russian and South East Asian counterparties.

In 1997, the total charge against profit for bad and doubtful debts rose by £13m to £562m, although the total charge for specific provisions declined by £34m to £465m. The benefit of substantial reductions in NatWest UK and Other Businesses, due to improved economic climates and strengthened credit management, was masked by higher provisions in Coutts NW and Lombard, due to a small number of significant provisions, higher volumes and changes in business mix. The total general provision at £97m was £47m higher than 1996, mainly reflecting a charge of £80m in respect of South East Asia and South Korea.

Taxation

									Year ended 31 December
			1998			1997			1996
	Profit £m	**%**	**Tax £m**	Profit £m	%	Tax £m	Profit £m	%	Tax £m
Profit and tax on profit on ordinary activities	**2,142**	**23.4**	**501**	975	31.7	309	1,337	48.8	653
Effect of change in Corporation Tax rate from 31% to 30% (1997 33% to 31%)									
Finance leases	**55**		**55**	106		106	–		–
Other	**–**		**4**	–		8	–		–
Losses on termination of Equities operations	**–**		**–**	287		23	–		–
Provisions relating to the redesign of the retail bank, for which full tax relief has not been assumed	**–**		**–**	–		–	186		9
Discontinued operations – trading	**–**		**–**	–		–	(93)		(29)
(Profit)/loss on disposal of subsidiary and associated undertakings	**(349)**		**(14)**	(122)		(4)	448		(57)
Profit on sale of interest in 3i Group plc	**–**		**–**	–		–	(224)		(56)
Continuing operations – underlying	**1,848**	**29.5**	**546**	1,246	35.5	442	1,654	31.4	520

The tax charge for the year, £501m, equivalent to 23.4% of pre-tax profit, benefited from a release of deferred tax of £59m following the reduction in the rate of Corporation Tax from 31% to 30% and a low tax charge on the profit on disposal of businesses. Excluding these items, the underlying tax rate was 29.5% (1997 35.5%). This was less than the 1998 effective UK tax rate of 31% reflecting non-taxable income and overseas profits taxed at lower rates, partially offset by overseas losses for which no relief is currently available, overseas profits taxed at higher rates and other items, mainly goodwill amortisation, which are not allowable for tax purposes.

In 1997, the tax charge was equivalent to 31.7% of pre-tax profit on ordinary activities, reflecting a release of deferred tax of £114m due to the reduction in the rate of Corporation Tax and the utilisation of capital losses and overseas losses. The underlying tax rate of 35.5% reflects overseas losses for which no relief is currently available, goodwill amortisation and general bad debt provisions.

Profit/(loss) by business segments

	Pre-tax 1998 £m	Pre-tax 1997[1] £m	Pre-tax 1996[1] £m	Post-tax 1998 £m	Post-tax 1997[1] £m	Post-tax 1996[1] £m
Continuing operations						
NatWest UK	**1,058**	1,012	701	**744**	736	425
Lombard [2]						
Ongoing business	**121**	140	119	**88**	84	71
Trading profits of businesses sold	**64**	78	99	**47**	75	76
	185	218	218	**135**	159	147
Ulster Bank	**155**	144	135	**113**	107	94
NatWest Wealth Management						
Ongoing business	**302**	145	178	**201**	61	117
Trading profits of businesses sold	**8**	7	19	**6**	4	16
	310	152	197	**207**	65	133
Global Financial Markets	**393**	244	252	**260**	160	165
Greenwich NatWest [2,3]						
Ongoing business	**(16)**	(114)	52	**73**	(63)	60
Trading losses of businesses terminated or sold	**(56)**	(208)	(18)	**(43)**	(157)	–
	(72)	(322)	34	**30**	(220)	60
Other Businesses [3]	**(79)**	(53)	(21)	**(83)**	(63)	(35)
Head Office costs and other central items [4]	**(102)**	(149)	(48)	**(100)**	(132)	(32)
Ongoing business	**1,832**	1,369	1,368	**1,296**	890	865
Trading profits/(losses) of businesses terminated or sold	**16**	(123)	100	**10**	(78)	92
Profit before finance lease adjustment, termination and disposal of businesses and discontinued operations	**1,848**	1,246	1,468	**1,306**	812	957
Finance lease adjustment [5]	**(55)**	(106)	–	**–**	–	–
Profit/(loss) on termination and disposal of businesses	**265**	(244)	224	**253**	(225)	168
	2,058	896	1,692	**1,559**	587	1,125

Year ended 31 December

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 Excluding finance lease adjustments.
3 Corporate Advisory which was previously reported in GNW is now included in Other Businesses.
4 Including £80m general provision for South East Asia and South Korea which is held centrally.
5 See note 2 on page 3.

Operating and financial review – Business segments

NatWest UK	**1998 £m**	1997[1] £m	1996[1] £m
			Year ended 31 December
Net interest income	**2,266**	2,107	1,999
Dividend income	**1**	–	–
Net fees and commissions	**1,384**	1,389	1,415
Other operating income	**104**	86	69
Non- interest income	**1,489**	1,475	1,484
Operating income	**3,755**	3,582	3,483
Staff costs	**(1,281)**	(1,263)	(1,252)
Other administrative expenses	**(697)**	(666)	(562)
Depreciation and amortisation	**(166)**	(154)	(146)
Other operating charges	**(416)**	(316)	(368)[2]
Operating expenses	**(2,560)**	(2,399)	(2,328)
Trading surplus	**1,195**	1,183	1,155
Provisions for bad and doubtful debts	**(123)**	(189)	(332)
Provisions for contingent liabilities and commitments	**–**	(3)	(10)
Amounts written off fixed asset investments	**(1)**	–	–
Income from associated undertakings	**–**	1	14
Disposal of tangible fixed assets	**(13)**	20	(126)[2]
Profit before tax	**1,058**	1,012	701
Tax	**(314)**	(276)	(276)
Profit after tax	**744**	736	425
Cost: income ratio	**68.2%**	67.0%	66.8%
Post-tax return on average equity [3]	**23.7%**	28.8%	16.6%
Average interest-earning assets	**£50.0bn**	£43.9bn	£42.3bn
Net interest margin [4]	**4.53%**	4.80%	4.73%
Weighted risk assets	**£50.4bn**	£46.2bn	£42.0bn

1 From 1 January 1998, the basis of remunerating NatWest UK for business introduced to GFM was revised and comparative figures have been restated. The effect has been to increase 1998 operating income by £62m (1997 £50m; 1996 £50m). See also note 1 on page 79.
2 Provisions totalling £186m were made in 1996 and comprised £121m for the disposal of tangible fixed assets and £65m for branch closures.
3 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
4 Calculated after the elimination of intra-Group assets.

NatWest UK's profit before tax rose £46m, 5%, to £1,058m. Excluding the £100m provision for pension mis-selling, profit was up £146m, 14%. Operating income increased by £173m, 5%, to £3,755m. Operating expenses were up £161m, 7%, to £2,560m including the additional £100m provision for pension mis-selling. Provisions for bad and doubtful debts declined £66m, 35%, to £123m.

Net interest income increased by £159m, 8%, to £2,266m primarily as a result of growth in customer lending and current account balances. Average interest earning assets were up £6.1bn, 14%, to £50.0bn including £2.3bn of loans to major corporates and £0.2bn to banks for which relationship management has been transferred from GNW. Growth in corporate, mortgage and card lending was partly offset by a slight decline in small business lending. Net interest margin declined 27 basis points to 4.53%, mainly due to volume growth in lower margin loans to larger corporates, including transfers from GNW, partially offset by an increase in current accounts balances. Excluding the effects of the transfers of assets from GNW, net interest margin was 6 basis points lower.

Non-interest income increased by £14m, 1%, to £1,489m. Higher net fees and commissions from growth in credit and debit card usage and increased insurance commissions were more than offset by lower money transmission fees and unauthorised borrowing fees. Other operating income increased £18m, 21%, to £104m.

Operating expenses increased £161m, 7%, to £2,560m, including an additional provision of £100m for pension mis-selling. Revenue investment expenditure increased £69m, 26%, to £339m of which £67m was incurred in making the information technology systems Year 2000 compliant and in preparation for the introduction of the euro. A further 34 processing centres were opened, ahead of schedule, as part of the programme to "Build a New Retail Bank". The remaining two centres are scheduled to be opened in the first half of 1999. The total cost of the Retail Transformation Programme was planned at £700m (including capital expenditure of £250m). At the end of 1998 £420m (including capital expenditure of £200m) had been incurred. Restructuring costs declined £13m, 24%, to £41m. Excluding the pension mis-selling provision, revenue investment expenditure and restructuring, underlying costs were up £5m to £2,080m.

NatWest UK continued

Staff costs were up £18m, 1%, to £1,281m, principally due to an increase in the average number of contractor/temporary staff employed during the year to support investment programmes and the migration to the new processing centres. Salary increases were largely offset by lower pension contributions following the triennial actuarial valuation. Restructuring costs, which were mainly staff related, decreased by £13m, 24%, to £41m due to lower take up of severance packages through greater natural wastage.

Permanent staff numbers rose by 500, 1%, to 43,800 to support business growth, principally in Corporate Banking Services (up 400). Temporary staff numbers reduced by 800, 12%, to 5,700, leading to an overall reduction of 300. In Retail Banking Services 4,100 jobs have been created in the new processing centres during the year; this was more than offset by a reduction of 4,500 in total staff within other parts of Retail Banking Services. Corporate Banking Services have added 300 staff to support business growth.

Other administrative expenses increased £31m, 5%, to £697m. Higher software costs and professional fees, both relating to investment programmes, and increased telecommunication costs were partly offset by lower advertising expenditure.

Depreciation rose by £12m, 8%, to £166m resulting from increased capital expenditure on information technology equipment and ATMs.

Other operating charges rose by £100m, 32%, to £416m due to the additional £100m provision for pension mis-selling.

Provisions for bad and doubtful debts fell by £66m, 35%, to £123m. In Retail Banking Services provisions fell by £75m, 60%, to £50m, largely from a reduction in new provisions reflecting favourable economic conditions. Reductions were also achieved in Card Services of £4m, 11%, to £34m and in Mortgage Services of £1m, 13%, to £7m. A reduction in recoveries resulted in an increase of £14m, 78%, to £32m in Corporate Banking Services.

Disposal of tangible fixed assets resulted in a loss of £13m (1997 profit £20m) on properties and information technology equipment.

The tax charge, at £314m, was 30% of profit before tax, compared with 27% in 1997, which benefited from payments made to employee share option plans.

Profit before tax in 1997 was £1,012m. Excluding provisions made in 1996 totalling £186m in connection with the building a new retail bank programme, profit before tax increased by £125m, 14%. Operating income rose £99m, 3%, to £3,582m, benefiting from increases in customer lending and current account balances. Operating expenses, excluding the 1996 branch closure provision of £65m, rose by £136m, 6% to £2,399m, principally due to the higher level of revenue investment expenditure. Provisions for bad and doubtful debts fell £143m, 43% to £189m, as a result of improved credit management and favourable economic conditions.

Retail Banking Services' income increased by £8m to £2,035m. Net interest income increased by £39m, 3%, to £1,433m as a result of growth in average current account balances. Loans and advances to customers excluding £0.5bn transferred to Lombard declined £0.2bn, 2%, to £10.0bn since 31 December 1997, as selective lending policies were maintained. Non-interest income fell £31m, 5%, to £602m. Market share in the small business sector was maintained at over 26% in terms of number of relationships. Personal current account market share decreased during the year to 16%.

Mortgage Services' income grew by £36m, 27%, to £169m due to improved margins on the lending book and increased volumes. High levels of mortgage completions resulted in the mortgage book growing by £1.0bn, 7%, to £15.6bn since 31 December 1997. Mortgage Services achieved a 4.1% market share of new advances net of redemptions.

Insurance Services' income rose by £16m, 12%, to £146m with growth in credit protection and household insurance.

Card Services' income rose by £35m, 9%, to £409m reflecting continuing progress in both the issuing and acquiring businesses in the UK and Europe. Streamline, the UK merchant acquiring business, achieved further strong growth with total volumes increasing 21% against market growth of 14%. Card lending increased by £0.3bn, 12%, to £2.9bn since 31 December 1997, together with strong growth in card turnover. Increased competition resulted in a decline in issuing market share. In continental Europe cards in issue increased by 48% to 1.44 million.

Corporate Banking Services' income rose by £78m, 8%, to £996m. Net interest income increased by £58m, 12%, to £557m. Customer lending increased £2.9bn, 17%, to £19.9bn, excluding £1.1bn transferred from GNW, since 31 December 1997. Customer accounts increased £0.8bn, 5%, to £16.6bn since 31 December 1997. Continued modest erosion in traditional money transmission activity, as customers switched to lower priced automated payment mechanisms, constrained growth in non-interest income which was up £20m, 5%, to £439m. Overall market leadership in the corporate sector has been maintained.

Lombard

	1998 Total £m	1998 Ongoing business £m	1997[1] Total £m	1997[1] Ongoing business £m	1996[1] Total £m	1996[1] Ongoing business £m
Net interest income excluding adjustment for finance leases	**710**	**371**	728	371	663	331
Adjustment for finance leases [2]	**(10)**	**(10)**	(26)	(26)	–	–
Net interest income	**700**	**361**	702	345	663	331
Net fees and commissions	**(9)**	**6**	(16)	–	(13)	4
Other operating income	**207**	**156**	222	153	207	151
Non-interest income	**198**	**162**	206	153	194	155
Operating income	**898**	**523**	908	498	857	486
Staff costs	**(236)**	**(157)**	(220)	(143)	(200)	(140)
Other administrative expenses	**(120)**	**(85)**	(130)	(91)	(121)	(90)
Depreciation and amortisation						
Tangible fixed assets	**(17)**	**(11)**	(23)	(17)	(18)	(13)
Goodwill	**(1)**	**(1)**	(2)	(2)	(1)	(1)
	(18)	**(12)**	(25)	(19)	(19)	(14)
Other operating charges	**(177)**	**(101)**	(179)	(87)	(173)	(89)
Operating expenses	**(551)**	**(355)**	(554)	(340)	(513)	(333)
Trading surplus	**347**	**168**	354	158	344	153
Provisions for bad and doubtful debts	**(194)**	**(77)**	(179)	(61)	(141)	(49)
Income from associated undertakings	**20**	**18**	16	16	15	15
Disposal of tangible fixed assets	**2**	**2**	1	1	–	–
Profit on disposal of businesses	**197**	**–**	–	–	–	–
Profit before tax	**372**	**111**	192	114	218	119
Tax	**(65)**	**(23)**	(33)	(30)	(71)	(48)
Profit after tax	**307**	**88**	159	84	147	71
Analysis of profit before tax						
Ongoing business	**121**	**121**	140	140	119	119
Businesses sold	**64**	**–**	78	–	99	–
	185	**121**	218	140	218	119
Adjustment for finance leases	**(10)**	**(10)**	(26)	(26)	–	–
Profit on disposal of businesses	**197**	**–**	–	–	–	–
	372	**111**	192	114	218	119
Profit before tax, finance lease adjustment and termination and disposal of businesses	**£185m**	**£121m**	£218m	£140m	£218m	£119m
Cost: income ratio	**61.4%**	**67.9%**	61.0%	68.3%	59.9%	68.5%
Cost: income ratio excluding adjustment for finance leases and restructuring charge	**58.5%**	**62.9%**	59.3%	64.9%	59.9%	68.5%
Post-tax return on average equity [3]	**32.6%**	**12.0%**	15.0%	11.1%	15.5%	12.3%
Average interest-earning assets	**£13.6bn**		£12.6bn		£11.0bn	
Net interest margin [4]	**5.21%**		5.77%		6.01%	
Weighted risk assets	**£9.8bn**	**£9.8bn**	£14.1bn	£8.8bn	£12.9bn	£7.8bn

Year ended 31 December

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 See note 2 on page 3.
3 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
4 Calculated after the elimination of intra-Group assets and excluding finance lease adjustment.

Following a strategic review, Lombard disposed of a number of businesses. Lombard's 50 per cent controlling interest in Lex Vehicle Leasing ('LVL') was sold in two tranches, on 28 August 1998 and 31 December 1998, at a profit of £78m: three point of sale businesses, Lombard Motor Finance, Lombard Tricity Finance and Lombard Business Equipment Leasing were sold on 30 December 1998 at a profit of £115m; the 75 per cent holding in Lombard NatWest Bank in Cyprus was sold on 30 September 1998. The profit for the year includes the results of these businesses to their respective dates of sale.

Profit before tax increased by £180m, 94%, to £372m. The increase was entirely due to a profit of £197m on the sale of businesses. Profit before tax was also affected by a £20m charge to restructure the ongoing business and an adjustment of £10m (1997 £26m) relating to finance leases, following a reduction in the rate of Corporation Tax. Excluding these and the profits on disposals, profit before tax declined by £13m, 6%, to £205m.

Lombard continued

Operating income before the finance lease adjustment fell by £26m, 3%, to £908m with net interest income down by £18m, 2%, to £710m. Operating expenses before the charge for restructuring the ongoing business were £23m, 4%, lower at £531m. Provisions for bad and doubtful debts were £15m, 8%, higher at £194m.

The tax charge for the year at £65m represented 17% of pre-tax profit. The low tax charge was due to a release of deferred tax of £13m following the change in the rate of Corporation Tax, and utilisation of capital losses brought forward which sheltered much of the profit on disposals.

Total profit before tax in 1997 at £192m was down £26m, 12%, on 1996. Excluding the finance lease adjustment operating income grew by £77m, 9%, to £934m, benefiting from a rise in average interest-earning assets and growth in new business volumes, notably in Lombard Business Finance, Lombard Motor Finance and Lombard Direct. Operating expenses rose £41m, 8%, to £554m to support this growth. Staff costs rose £20m, 10%, to £220m due to higher staff numbers required to support business growth and increased pay awards. Provisions for bad and doubtful debts rose £38m, 27%, to £179m. This reflects growth in lending and a change in the mix of business towards higher margin personal finance, principally Lombard Direct and Tricity which carries a higher risk than traditional vehicle and equipment finance.

Ongoing business

Lombard's remaining businesses are being restructured. From 1 January 1999 the commercial businesses, which provide asset finance under the Lombard brand, form part of Corporate Banking Services. The personal finance business, Lombard Direct, was transferred to Card Services. Profit before tax from the ongoing business was down £3m, 3%, to £111m, but up £1m, 1%, to £141m excluding the finance lease adjustment in both years and the charge in 1998 to restructure the ongoing business.

Operating income before the finance lease adjustments increased by £9m, 2%, to £533m with net interest income flat at £371m. Overall net interest margin declined 61 basis points reflecting a highly competitive environment, growth in lower margin Lombard Direct business replacing traditional lending in Lombard Bank, and lower residual values. Average interest earning assets rose £1.1bn, 15%, to £8.5bn (including £0.1bn relating to a total of £0.5bn of loans and advances transferred from Retail Banking Services in October 1998), due to additional large corporate deals in Lombard Business Finance and increased volumes in Lombard Direct. Non-interest income increased by £9m, 6%, reflecting higher insurance commission in Lombard Bank and growth in corporate fee income in Lombard Business Finance.

Operating expenses, excluding the costs of restructuring the ongoing business, were £5m, 1% down to £335m. Staff costs rose £14m, 10%, to £157m but by £2m, 1%, to £145m excluding the restructuring costs. Other administrative expenses declined by £6m, 7%, to £85m due to lower costs for information technology and marketing. Excluding the restructuring charge for the ongoing business, other operating charges rose £7m, 8%, to £94m reflecting higher service costs.

Provisions for bad and doubtful debts rose £16m, 26%, to £77m reflecting higher provisions resulting from growth in lending at Lombard Bank and a small number of specific provisions in Lombard Business Finance.

Ulster Bank

	Year ended 31 December		
	1998 £m	1997[1] £m	1996[1] £m
Net interest income	**256**	243	229
Dividend income	**–**	1	–
Net fees and commissions	**89**	73	72
Dealing profits	**43**	48	46
Other operating income	**3**	4	3
Non-interest income	**135**	126	121
Operating income	**391**	369	350
Staff costs	**(128)**	(126)	(125)
Other administrative expenses	**(50)**	(46)	(42)
Depreciation and amortisation			
Tangible fixed assets	**(20)**	(19)	(19)
Goodwill	**(1)**	(1)	(1)
	(21)	(20)	(20)
Other operating charges	**(21)**	(21)	(20)
Operating expenses	**(220)**	(213)	(207)
Trading surplus	**171**	156	143
Provisions for bad and doubtful debts	**(16)**	(12)	(8)
Profit before tax	**155**	144	135
Tax	**(42)**	(37)	(41)
Profit after tax	**113**	107	94
Cost: income ratio	**56.3%**	57.7%	59.1%
Post-tax return on average equity [2]	**24.1%**	28.0%	24.5%
Average interest-earning assets of banking business	**£7.6bn**	£7.0bn	£6.3bn
Net interest margin of banking business [3]	**3.39%**	3.46%	3.62%
Weighted risk assets	**£6.4bn**	£5.6bn	£5.0bn

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
3 Calculated after the elimination of intra-Group assets.

Ulster Bank's profit before tax rose by £11m, 8%, to £155m. The increase was £18m, 13%, excluding the adverse effect of the strength of sterling relative to the Irish pound. Operating income was up £22m, 6%, to £391m. Operating expenses grew by £7m, 3%, to £220m. Provisions for bad and doubtful debts increased by £4m, 33%, to £16m.

Net interest income was up £13m, 5%, to £256m. Excluding the effect of the exchange rate movement, the increase was £22m, 9%. Average interest-earning assets increased by £0.6bn, 9%, to £7.6bn with average loans and advances to customers up £0.7bn, 16%, to £5.2bn. The growth was mainly in the Republic of Ireland, reflecting the buoyant economy. Net interest margin declined by 7 basis points as a result of competitive pressure on lending margins which was only partially offset by growth in non-interest bearing current account balances and a modest improvement in the spread on time deposits.

Non-interest income increased by £9m, 7%, to £135m. Excluding the effect of the exchange rate movement the rise was £16m, 13%. Net fees and commissions rose by £16m, 22%, to £89m largely as a result of increased retail and corporate lending fees, higher brokerage income and growth in card and investment management commissions. Dealing profits fell by £5m, 10%, to £43m reflecting substantially lower derivative business volumes prior to the introduction of the euro.

Operating expenses rose by £7m, 3%, to £220m. Excluding the impact of the exchange rate movement the increase was £15m, 7%. Staff costs rose by £2m, 2%, to £128m due to growth in staff numbers to service the increased business volumes. Other administrative expenses grew by £4m, 9%, to £50m reflecting expenditure on preparation for the euro and Year 2000. Depreciation and amortisation was up by £1m, 5%, to £21m. Other operating charges were flat at £21m.

Provisions for bad and doubtful debts rose by £4m, 33%, to £16m. The increase was largely in Northern Ireland reflecting the effect of the strength of sterling on exporters and pressure on the agribusiness sector. Overall the specific charge, at 0.24% of loans and advances to customers, remains at a modest level. This reflects the quality of the lending book and the buoyant economic climate in the Republic of Ireland.

Ulster Bank continued

Profit before tax in 1997 at £144m was up £9m, 7%, on 1996. Operating income increased £19m, 5%, to £369m, due to higher loan volumes, particularly in the Republic of Ireland, partially offset by competitive pressure on margins. Non-interest income rose £5m to £126m as a result of increased corporate advisory income, higher insurance brokerage and growth in fees from share dealing and card services. Dealing profits were also higher reflecting an increased share of the corporate treasury market in the Republic of Ireland. Operating expenses were up £6m, 3%, to £213m due to a rise in staff costs as a result of higher staff numbers, expenditure on information systems and higher advertising expenditure.

Ulster Bank Retail, which encompasses the core branch banking, mortgage, instalment credit, leasing, invoice discounting, cards and insurance broking businesses, increased profit before tax by £18m, 20%, to £109m due to growth in net interest income from higher loan volumes and increased fee and commission income.

Ulster Bank Markets, the corporate banking, treasury, investment management and stockbroking business, saw profit before tax decline by £7m, 13%, to £46m largely as a result of lower derivative business volumes and the strength of sterling partially offset by growth in brokerage income and higher investment management commissions.

NatWest Wealth Management

	Year ended 31 December					
	1998		1997[1]		1996[1]	
	Total £m	**Ongoing business £m**	Total £m	Ongoing business £m	Total £m	Ongoing business £m
Net interest income	**290**	**282**	262	252	241	230
Dividend income	**14**	**14**	23	23	20	20
Net fees and commissions	**474**	**459**	461	418	437	385
Dealing profits	**25**	**25**	26	26	21	21
Other operating income	**213**	**213**	192	191	170	164
Non-interest income	**726**	**711**	702	658	648	590
Operating income	**1,016**	**993**	964	910	889	820
Staff costs	**(402)**	**(390)**	(390)	(363)	(364)	(332)
Other administrative expenses	**(181)**	**(178)**	(204)	(194)	(196)	(184)
Depreciation and amortisation						
Tangible fixed assets	**(24)**	**(24)**	(26)	(25)	(26)	(24)
Goodwill	**(21)**	**(21)**	(21)	(21)	(16)	(16)
	(45)	**(45)**	(47)	(46)	(42)	(40)
Other operating charges	**(46)**	**(46)**	(56)	(47)	(41)	(37)
Operating expenses before integration costs	**(674)**	**(659)**	(697)	(650)	(643)	(593)
Integration costs	**–**	**–**	–	–	(10)	(10)
Operating expenses	**(674)**	**(659)**	(697)	(650)	(653)	(603)
Trading surplus	**342**	**334**	267	260	236	217
Provisions for bad and doubtful debts	**(11)**	**(11)**	(76)	(76)	(9)	(9)
Amounts written off fixed asset investments	**(26)**	**(26)**	(30)	(30)	(30)	(30)
Income from associated undertakings	**5**	**5**	(9)	(9)	–	–
Profit before disposals	**310**	**302**	152	145	197	178
Profit on disposal of businesses	**50**	**–**	41	–	–	–
Profit before tax	**360**	**302**	193	145	197	178
Tax	**(105)**	**(101)**	(91)	(84)	(64)	(61)
Profit after tax	**255**	**201**	102	61	133	117
Cost: income ratio	**66.3%**	**66.4%**	72.3%	71.4%	73.5%	73.5%
Post-tax return on average equity[2]	**18.9%**	**13.7%**	5.9%	1.0%	10.5%	9.8%
Average interest-earning assets	**£6.6bn**		£8.3bn		£8.3bn	
Net interest margin[3]	**4.40%**		3.15%		2.90%	
Weighted risk assets	**£4.4bn**	**£4.4bn**	£4.7bn	£4.6bn	£5.1bn	£5.0bn

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
3 Calculated after the elimination of intra-Group assets.

Profit before tax increased by £167m, 87%, to £360m. The rise primarily reflected improvements in Coutts NW from higher income, lower provisions for bad and doubtful debts and profits on the sale of businesses. Operating income was up £52m, 5%, to £1,016m. Operating expenses fell £23m, 3%, to £674m. Provisions for bad and doubtful debts decreased by £65m, 86%, to £11m.

Profit on disposal of businesses was £50m, comprising gains on the sales of Coutts Bahamas and the Coutts Institutional Trust businesses, and deferred consideration in respect of a Gartmore disposal in 1997. In 1997 profit of £41m was realised on Gartmore's investment management operations in Canada, Australia and France.

The tax charge for the year at £105m, represented 29% of pre-tax profit. The effective rate for the year to 31 December 1997 was 47% as no tax relief was available for the losses of certain overseas operations.

NatWest Wealth Management continued

Profit before tax in 1997 was £193m, down £4m, 2%, on 1996. A sharp rise in provisions for bad and doubtful debts at Coutts NW was partially offset by net gains realised on the disposal of subsidiaries. Operating income rose £75m, 8%, to £964m. Net interest income increased by £21m, 9%, to £262m, mainly in Coutts NW which benefited from growth in deposit volumes and wider margins. Net fees and commissions increased by £24m, 5%, to £461m largely reflecting the inclusion of Gartmore for a full year. The rise in other operating income of £22m reflects an increase in embedded value profits in NWLIS of £32m, 59%, to £86m, partially offset by a fall in realisation profits in NatWest Equity Partners down £7m, 7%, to £89m and lower gains on sales of securities in Coutts NW. Operating expenses rose £44m, 7%, to £697m mainly due to the inclusion of Gartmore for a full year, restructuring costs relating to the closure of the majority of Coutts NW's operations in the US and increased headcount in Coutts NW and NWLIS.

Ongoing Business

	1998 Wealth Management Ongoing Business			1997 Wealth Management Ongoing Business			1996 Wealth Management Ongoing Business		
	Coutts NW £m	**Other businesses £m**	**Total £m**	Coutts NW £m	Other businesses £m	Total £m	Coutts NW £m	Other businesses £m	Total £m
Net interest income	**277**	**5**	**282**	258	(6)	252	238	(8)	230
Non-interest income	**306**	**405**	**711**	282	376	658	270	320	590
Operating income	**583**	**410**	**993**	540	370	910	508	312	820
Operating expenses	**(380)**	**(279)**	**(659)**	(396)	(254)	(650)	(368)	(235)	(603)
Trading surplus	**203**	**131**	**334**	144	116	260	140	77	217
Provisions for bad and doubtful debts	**(11)**	**–**	**(11)**	(76)	–	(76)	(9)	–	(9)
Amounts written off fixed asset investments	**–**	**(26)**	**(26)**	–	(30)	(30)	–	(30)	(30)
Income from associated undertakings	**–**	**5**	**5**	(11)	2	(9)	–	–	–
Profit from ongoing business	**192**	**110**	**302**	57	88	145	131	47	178
Profit before tax including exited businesses and profit on disposals	**244**	**116**	**360**	68	125	193	148	49	197

Comparative figures have been restated to reflect the transfer of NatWest Investments and NatWest Stockbrokers to Coutts NW from NWLIS with effect from 1 January 1998. Coutts NW income and expenses for 1997 have been increased by £123m and £83m respectively, with a corresponding reduction in Other Businesses (1996 income £117m; expenses £73m). The total figures are unaffected.

Profit before tax increased by £157m to £302m. This was due principally to higher income in Coutts NW and NatWest Equity Partners and a reduction in provisions for bad and doubtful debts, partially offset by cost increases to support business growth and performance related rewards.

Net interest income rose by £30m, 12%, to £282m, mainly in Coutts NW. Net fees and commissions grew by £41m, 10%, to £459m, reflecting higher stock market levels in 1998. Dealing profits were down £1m, 4%, to £25m. Other operating income increased by £22m, 12%, to £213m due to higher investment realisation profits in NatWest Equity Partners, up £32m, 36%, to £121m partially offset by reduced embedded value profits, down £4m, 5%, to £82m.

Operating expenses were up £9m, 1%, to £659m. Increased costs to support business growth and implement change initiatives, together with higher performance related rewards, were only partially offset by savings following the closure of the majority of Coutts NW US operations in 1997.

Coutts NW

Profit before tax for the ongoing business of £192m was £135m higher. Operating income was up £43m, 8%, to £583m. Net interest income increased by £19m, 7%, to £277m largely as a result of growth in client deposit volumes in the UK and Offshore Business. Net fees and commissions increased £26m, 10%, to £274m largely due to strong growth in brokerage, investment management and other advisory fees in the UK.

Operating expenses, including restructuring costs of £13m (1997 £25m), fell by £16m, 4% to £380m. Cost savings following the closure of the majority of the operations in the US in 1997 and the absence of associated restructuring costs were partially offset by increases in staff and other costs to support business growth particularly in NatWest Stockbrokers and NatWest Offshore.

Provisions for bad and doubtful debts at £11m were £65m lower than last year when there were significant provisions on a small number of loans in the US.

Share of losses from associated undertakings in 1997 reflected the impairment of a property.

NatWest Wealth Management continued

Other businesses

Profit before tax was up £22m, 25%, to £110m. Operating income was up £40m, 11%, to £410m. Operating expenses were up £25m, 10% to £279m, reflecting higher performance related costs and implementation of change initiatives to improve administrative efficiency and strengthen systems. These included specific projects relating to euro conversion and Year 2000.

NatWest Equity Partners' ('NWEP') income rose by £33m, 28%, to £150m with increased profits from the disposal of portfolio investments, up £32m, 36%, to £121m reflecting a receptive market for realisations during the first half of 1998. The valuation of the portfolio at 31 December 1998 exceeded book value by £182m (31 December 1997 £216m). Despite intensive competition in the private equity market, the level of new investments remained satisfactory; 30 new transactions with a total value of £382m were completed during the year (1997 29 transactions, £233m) on behalf of the Group and other managed funds, all of which were as lead/joint equity provider.

NWEP is in the process of raising a Fund for investment throughout Europe. While the Fund is not yet closed, NWEP has succeeded in gaining commitments in excess of £900m.

Gartmore's income rose by £13m, 10%, to £146m benefiting from the impact of higher average market levels.

Funds under management at 31 December 1998 were down £1bn, 2%, to £50bn. Beneficial market movements and gains in retail, up £1bn to £14bn, were more than offset by a net loss of institutional funds.

The growth in retail business reflected strong sales of unit trusts and PEPs, both of which were at record levels. Gartmore was ranked second highest net seller of retail unit trusts in 1998.

Gartmore gained a number of new specialist and passive mandates, but these were not enough to compensate for a substantial withdrawal of UK balanced pension fund mandates, due principally to disappointing historic investment performance, particularly in 1997. In 1998, Gartmore's UK balanced investment performance has improved to a top quartile ranking following the successful implementation of a major project to refine and enhance Gartmore's investment philosophy and process.

NatWest Life and Investment Services' income was down £6m, 5%, to £114m mainly due to a decline in embedded value profits which at £82m were £4m, 5%, lower. This arose principally from reduced contribution from new business income. Benefits from a change in actuarial assumptions of £14m, which included a revision of the risk discount rate to 11.5%, were partially offset by the adverse effects of amendments to UK Corporation Tax concerning timing of payments which necessitated an additional charge in 1998.

Global Financial Markets

	Year ended 31 December		
	1998 £m	1997[1] £m	1996[1] £m
Net interest income	**243**	239	301
Net fees and commissions	**(39)**	(37)	(37)
Dealing profits	**432**	263	173
Other operating income	**6**	2	1
Non-interest income	**399**	228	137
Operating income	**642**	467	438
Staff costs	**(166)**	(119)	(78)
Other administrative expenses	**(47)**	(98)	(99)
Depreciation and amortisation	**(8)**	(1)	(2)
Other operating charges	**(21)**	(7)	(7)
Operating expenses	**(242)**	(225)	(186)
Trading surplus	**400**	242	252
Provisions for bad and doubtful debts	**(8)**	–	–
Income from associated undertakings	**1**	2	–
Profit before tax	**393**	244	252
Tax	**(133)**	(84)	(87)
Profit after tax	**260**	160	165
Cost: income ratio	**37.7%**	48.2%	42.5%
Post-tax return on average equity[2]	**40.3%**	27.2%	28.2%
Average interest-earning assets of banking business	**£27.7bn**	£27.9bn	£27.0bn
Net interest margin of banking business[3]	**0.88%**	0.86%	1.12%
Weighted risk assets	**£9.6bn**	£8.6bn	£9.2bn

1 From 1 January 1998, the basis of remunerating NatWest UK for business introduced to GFM was revised and comparative figures have been restated. The effect has been to decrease 1998 operating income by £62m (1997 £50m; 1996 £50m).
2 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
3 Calculated after the elimination of intra-Group assets.

Profit before tax was £393m, up £149m, an increase of 61%. Operating income increased by £175m, 37%, to £642m, principally due to significantly higher dealing profits. Operating expenses increased by £17m, 8%, to £242m.

Net interest income rose £4m, 2%, to £243m. Margins were maintained with the benefit of declining interest rates in the second half compensating for narrower spreads following a cautious approach to issuer and counterparty credit quality.

Net fees and commissions payable were up £2m, 5%, to £39m, as a result of increased trading volumes.

	1998 £m	1997 £m	1996 £m
Foreign exchange	**317**	239	149
Debt securities	**7**	1	(3)
Interest rate derivatives	**108**	23	27
Dealing profits	**432**	263	173

Dealing profits increased by £169m, 64%, to £432m reflecting strong performances across all trading areas. Currency and interest rate volatility provided significant trading opportunities in the second half of the year, which produced dealing profits of £287m, up from £145m in the first half of the year. Foreign exchange trading profits were up £78m, 33%, to £317m, with currency derivatives, spot and forward trading all showing improved results on 1997. Second half foreign exchange trading profits were £182m, up £47m, 35%, on the first half of the year. Interest rate derivatives trading profits were up £85m to £108m: most of the increase arose in the second half of the year from interest rate positioning opportunities taken primarily in anticipation of falling and converging interest rates in the run up to the introduction of the euro.

Global Financial Markets continued

Staff costs were up £47m, 39%, to £166m, reflecting higher performance related remuneration and an increase in headcount. Staff numbers increased by 300 during the year to 1,100 following the transfer of certain support staff to GFM after the restructuring of NatWest Markets. However, there was an offsetting decrease in other administrative expenses, depreciation and other operating charges, down £30m, 28%, to £76m in aggregate. Reductions in costs, due to the curtailment of activities overseas, were offset by increased expenditure on information technology to secure long term operational efficiencies, to convert systems for the introduction of the euro and in preparation for Year 2000.

Provisions for bad and doubtful debts of £8m were made in 1998 (1997 £nil) in respect of two counterparties in Asia.

The tax charge at 34% was higher than the standard UK rate due to overseas profits being taxed at higher rates.

Profit before tax in 1997 at £244m, was down £8m, 3%, on 1996. Operating income rose £29m, 7%, to £467m, as strong dealing profits more than offset lower money market earnings. Operating expenses grew by £39m, 21%, to £225m, reflecting higher performance related remuneration, business expansion and strengthening of infrastructure and controls.

Greenwich NatWest

	1998 Total £m	1998 Ongoing business £m	1997[1] Total £m	1997[1] Ongoing business £m	1996[1] Total £m	1996[1] Ongoing business £m
Year ended 31 December						
Net interest income excluding adjustment for finance leases	**90**	**89**	89	78	71	61
Adjustment for finance leases [2]	**(45)**	**(45)**	(80)	(80)	–	–
Net interest income	**45**	**44**	9	(2)	71	61
Dividend income	**1**	**1**	–	–	1	1
Net fees and commissions	**152**	**86**	318	63	344	106
Dealing profits	**344**	**367**	202	228	318	215
Other operating income	**5**	**(2)**	49	17	36	28
Non-interest income	**502**	**452**	569	308	699	350
Operating income	**547**	**496**	578	306	770	411
Staff costs	**(427)**	**(378)**	(667)	(418)	(522)	(312)
Other administrative expenses	**(64)**	**(17)**	(197)	4	(93)	23
Depreciation and amortisation						
Tangible fixed assets	**(34)**	**(34)**	(41)	(34)	(36)	(25)
Goodwill	**(18)**	**(16)**	(23)	(16)	(9)	(3)
	(52)	**(50)**	(64)	(50)	(45)	(28)
Other operating charges	**(44)**	**(35)**	(66)	(50)	(44)	(21)
Operating expenses	**(587)**	**(480)**	(994)	(514)	(704)	(338)
Trading (loss)/surplus	**(40)**	**16**	(416)	(208)	66	73
Provisions for bad and doubtful debts	**(79)**	**(79)**	9	9	(22)	(11)
Provisions for contingent liabilities and commitments	**–**	**–**	(1)	(1)	–	–
Amounts written off fixed asset investments	**(1)**	**(1)**	–	–	(2)	(2)
Income from associated undertakings	**3**	**3**	4	4	(9)	(9)
Disposal of tangible fixed assets	**–**	**–**	2	2	1	1
(Loss)/profit before termination and disposal of businesses	**(117)**	**(61)**	(402)	(194)	34	52
Losses on termination of Equities operations	**–**	**–**	(287)	–	–	–
Profit on disposal of businesses	**19**	**–**	2	–	–	–
(Loss)/profit before tax	**(98)**	**(61)**	(687)	(194)	34	52
Tax	**162**	**134**	205	131	26	8
Profit/(loss) after tax	**64**	**73**	(482)	(63)	60	60
Cost: income ratio	**107.3%**	**96.8%**	172.0%	168.0%	91.4%	82.2%
Cost: income ratio excluding finance lease adjustment	**99.2%**	**88.7%**	151.1%	133.2%	91.4%	82.2%
Post-tax return on average equity [3]	**3.0%**	**3.8%**	(22.1)%	(5.2)%	2.3%	2.5%
Average interest-earning assets of banking business	**£10.4bn**		£14.0bn		£15.8bn	
Net interest margin of banking business [4]	**0.86%**		0.64%		0.45%	
Weighted risk assets	**£14.5bn**	**£13.1bn**	£22.6bn	£16.1bn	£28.8bn	£23.8bn

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79) and the transfer of Corporate Advisory to Other Businesses.
2 See note 2 on page 3.
3 Average equity is attributed relative to weighted risk assets, adjusted for goodwill and other local regulatory/business needs. Corresponding adjustments are made to earnings.
4 Calculated after the elimination of intra-Group assets and excluding the finance lease adjustment.

Greenwich NatWest continued

The results shown are made up of the Greenwich NatWest ongoing business; the Global Equities losses up until the date of sale; results of our Australian trading operations and our Canadian subsidiary until the date of sale; and profits and losses on disposal of businesses. The Corporate Advisory businesses (Hawkpoint Partners and UK Acquisition Finance) are now shown in Other Businesses. The ongoing business comprises two segments. The first is the trading and capital markets business in London, Greenwich (Connecticut) and Tokyo, where the main activities are: global interest rate derivatives trading; securitisation origination and trading; securities/credit trading; futures brokerage and project and structured trade finance origination. The second is the Portfolio Management Group ('PMG') which was formed to manage down the banking book activities: corporate lending; debt structuring; and finance leases. The remaining (third party) assets of PMG amounting to £4.3bn (Weighted Risk Assets, WRAs', £3.4bn) were transferred to Corporate Banking Services on 1 January 1999.

The overall loss before tax was £98m, compared with a loss of £687m in 1997 which included a £287m provision for the termination of Equities operations. Operating income at £547m was £31m, 5% lower. Operating expenses fell by £407m, 41%, to £587m. Provisions for bad and doubtful debts were up £88m from a net recovery of £9m in 1997 to a charge of £79m in 1998.

The loss before tax in 1997 was £687m. Operating income was down £192m, 25%, to £578m, principally due to the £80m adjustment for finance leases and the £85m charge in respect of options mispricing. Operating expenses increased by £290m, 41%, to £994m, largely due to the full year impact of acquisitions made in 1996, costs associated with restructuring of the business, growth in Equities and strengthening of infrastructure and controls. Losses on termination of Equities operations were £287m, representing provisions in respect of severance and other staff related costs, premises, fixed asset write downs and the estimated costs to exit the businesses not being sold.

	1998		1997[1]		1996[1]	
	Total £m	**Ongoing business £m**	Total £m	Ongoing business £m	Total £m	Ongoing business £m
(Loss)/profit before tax by business						
Greenwich NatWest - ongoing business	**(16)**	**(16)**	(114)	(114)	52	52
Global Equities	**(52)**	**–**	(221)	–	(26)	–
Other exited businesses	**(4)**	**–**	13	–	8	–
	(72)	**(16)**	(322)	(114)	34	52
Adjustment for finance leases [2]	**(45)**	**(45)**	(80)	(80)	–	–
Profit/(loss) on disposal/termination of businesses	**19**	**–**	(285)	–	–	–
(Loss)/profit before tax	**(98)**	**(61)**	(687)	(194)	34	52

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79) and the transfer of Corporate Advisory to Other Businesses.
2 See note 2 on page 3.

Ongoing business

The loss before tax of the ongoing business, before the adjustment for finance leases in both years, was £16m, compared with a loss in 1997 of £114m. The 1998 loss was struck after a charge for bad and doubtful debts of £79m (a £9m recovery in 1997). This charge, £70m of which arose in the second half of the year, resulted principally from specific provisions in the banking book for loans to corporate customers in Indonesia and Thailand (£37m) and to banks in Russia (£31m).

The profit after tax was £73m, an increase of £136m on the 1997 result. In 1998, the tax credit of £134m reflects the release of £45m (1997 £80m) of deferred tax following the change in the rate of UK Corporation Tax, utilisation of prior year tax losses, overseas profits taxed at lower rates and benefits arising from structured transactions. This is partially offset by overseas profits taxed at higher rates and other items, such as goodwill amortisation, which are not deductible for tax purposes.

Net interest income of the banking book, before the adjustment for finance leases of £45m (1997 £80m), increased by £11m, 14%, to £89m. The rise reflected the sale of low margin assets, including finance leases, and interest recoveries from corporate loans classified as non-performing in 1997. Partially offsetting this was a reduction in the average interest earning assets of the banking business due to the securitisation of assets in late 1997 and a £2.5bn reduction in average loans resulting from the transfer of loans to NatWest UK.

Ongoing business continued

Net fees and commissions in the ongoing business rose £23m, 37%, to £86m. A reduced level of assets generated lower banking fees, but the trading and capital markets business in winning a number of significant securitisation mandates and in expanding futures brokerage revenues has more than offset this fall.

Dealing profits	1998 Total £m	1998 Ongoing business £m	1997 Total £m	1997 Ongoing business £m	1996 Total £m	1996 Ongoing business £m
Foreign exchange	**–**	**–**	(3)	–	(6)	–
Securities						
Debt	**242**	**242**	192	213	72	138
Equities	**(25)**	**–**	(2)	–	169	–
Interest rate derivatives	**127**	**125**	100	100	83	77
Mispricing of interest rate options and swaptions	**–**	**–**	(85)	(85)	–	–
Dealing profits	**344**	**367**	202	228	318	215

Dealing profits in the ongoing business increased £54m, 17%, to £367m (excluding the options mispricing). Debt securities income increased by £29m, 14%, to £242m, despite the difficult trading conditions in the second half of 1998. Interest rate derivatives income at £125m was £25m, 25%, higher, with improvements in sterling and US dollar activities.

Other operating income fell by £19m. The prior year benefited from a successful legal action and the current year included profits and losses arising on the disposal of leasing receivables and other banking book assets.

Operating expenses fell by £34m, 7%, to £480m. Staff costs decreased by £40m, 10%, to £378m. Lower overhead support costs reflected a reduction in employee numbers, in part due to transfers to GFM and the absence of restructuring costs which were charged in 1997. Higher bonus costs in 1998 following improved performance in the trading and capital markets business partially offset these reductions. However, despite lower restructuring costs in 1998, there was an offsetting increase in other costs which rose £6m, 6%, to £102m in aggregate.

Global Equities

Sales of substantially all of the cash business and the majority of the derivatives activities of Global Equities were completed on 27 April and 3 March respectively. The profit on these disposals of £37m is consistent with expectations, announced in December 1997, apart from the effect of the change in the accounting policy relating to goodwill. For the businesses sold, pre-tax losses of £52m arose from trading up to their respective dates of disposal. Revenues and costs associated with residual positions are being charged against the provision taken in the second half of 1997 to cover the cost of exiting the remaining equities business.

Other exited businesses

The Australian and New Zealand investment banking operations were sold with effect from 1 January 1998. The residual Australian business has been substantially wound down incurring a pre-tax loss of £4m. NatWest Bank of Canada, which was sold on 1 May 1998, recorded neither profit nor loss in the four months prior to sale.

The sale of the Australian operations and the Canadian subsidiary resulted in an aggregate pre-tax loss on disposal of £18m. The £40m loss reported in the interim results has been reduced by additional consideration of £22m, based upon the profits of the businesses sold, which has now been received.

Capital employed

WRAs have reduced since the end of 1997 by £8.1bn, 36%, to £14.5bn. Of this, £5.1bn was due to the disposal and termination of Global Equities and other businesses, and £0.6bn to the transfer of assets and loan commitments to Corporate Banking Services in NatWest UK during 1998. The remaining reduction mainly includes the effect of selling leasing receivables (£0.8bn) and the managing down of other banking book assets.

Other Businesses

	Year ended 31 December		
	1998 £m	1997[1] £m	1996[1] £m
Net interest income	**20**	12	9
Dividend income	**1**	–	–
Net fees and commissions	**114**	121	109
Dealing profits	**5**	6	3
Other operating income	**10**	16	7
Non-interest income	**130**	143	119
Operating income	**150**	155	128
Staff costs	**(84)**	(89)	(47)
Other administrative expenses	**(27)**	(25)	(12)
Depreciation and amortisation			
Tangible fixed assets	**(1)**	(4)	(4)
Goodwill	**(38)**	(41)	(33)
	(39)	(45)	(37)
Other operating charges	**(11)**	(14)	(17)
Operating expenses	**(161)**	(173)	(113)
Trading (loss)/surplus	**(11)**	(18)	15
Provisions for bad and doubtful debts	**(68)**	(35)	(37)
Provisions for contingent liabilities and commitments	**–**	(1)	–
Income from associated undertakings	**–**	(1)	1
Disposal of tangible fixed assets	**–**	2	–
Loss before tax	**(79)**	(53)	(21)
Tax	**(4)**	(10)	(14)
Loss after tax	**(83)**	(63)	(35)
Average interest-earning assets	**£1.9bn**	£1.9bn	£2.3bn
Weighted risk assets	**£1.3bn**	£1.4bn	£1.7bn

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79) and the transfer of Corporate Advisory from GNW.

'Other Businesses' comprise the Group's Corporate Advisory businesses (Hawkpoint Partners and UK Acquisition Finance), commercial banking operations in Germany and Greece, together with assets retained following the disposal or termination of retail operations in Australia, Spain and the US.

Net interest income rose by £8m, 67%, to £20m largely reflecting lower funding costs of operations as they are wound down. Net fees and commissions fell by £7m, 6%, to £114m primarily as a result of decreased fee income in the Corporate Advisory businesses. Other operating income at £10m was £6m, 38%, lower than in 1997 which included a gain of £7m on the sale of an investment in the residual US business. Operating expenses at £161m were down £12m, 7%, on 1997 primarily reflecting lower staff and other costs in Corporate Advisory. Provisions for bad and doubtful debts rose £33m, 94%, to £68m, with increased provisions in Acquisition Finance and in residual businesses in Australia and Spain.

The 1997 loss before tax was £53m, an increase of £32m over 1996. Operating income increased by £27m, 21%, to £155m, largely due to higher fee income at Gleacher NatWest and the sale of an investment in the residual US business. Operating expenses rose by £60m, 53%, to £173m, principally due to the full year impact of the Hambro Magan (now part of Hawkpoint Partners) acquisition in 1996 and growth at Gleacher NatWest.

Head Office costs and central items

Head Office costs and central items at £102m were down £47m on 1997. These included a £30m provision for rationalisation of central London office accommodation (operating expenses £21m and loss on disposal of fixed assets £9m).

Head Office costs and other central items in 1997 include an £80m general provision for bad and doubtful debts in respect of South East Asia and South Korea which was held centrally.

Operating and financial review – Looking forward

The Group produced a strong improvement in performance for 1998 with profit before tax at £2,142m, up from £975m. We continue to deliver on our primary objectives: we have made good progress in the building of our new retail bank, our wholesale markets businesses have been tightly managed. The return on equity at 20% was significantly above the 17.5% target we set last year.

We have made further progress in rationalising our activities. The disposal of most of the Equities business took place in the early part of the year and, in the second half, the sale of significant elements of Lombard and Coutts NW businesses continued the process of strategic simplification.

Our strategy to build and develop the NatWest UK franchise was first outlined in 1996. Considerable progress has been made. Fifty two new operating centres were open by the end of 1998 and we have reached our target size for the branch network having reduced the number of branches by 496 since the end of 1995. The new centres now employ approximately 6,000 people and handle 42% of our processing work. Some 70% of the work should have been transferred by the end of 1999.

Designing and installing the computer software applications for the new systems is complex and we have experienced delays with this aspect of the programme. We believe the key issues are being successfully addressed. We have also decided to take a prudent approach to the millennium and will not be making any system changes from October 1999 to February 2000. These factors will put back the implementation of some parts of the programme. Revenue investment will continue as we develop more efficient internal infrastructure and new delivery channels as well as investing for growth in areas such as cards, electronic commerce and wealth management.

At the end of 1996 we highlighted our concerns that the UK economy would slow significantly following a short period of strong growth. As a result, we have been more selective in our lending to certain high risk areas. However, we are not immune to the economic cycle.

GFM delivered another strong performance despite operating against a background of turbulent market conditions. GFM – centred around the Group's business and commercial franchise – has been a consistent contributor to shareholder value.

The Wealth Management businesses are core to our growth ambitions. Our strategy is to deliver the full range of financial services more efficiently to our customer base. We continue to concentrate on developing Coutts NW into a pre-eminent private bank. Gartmore's poor investment performance for UK balanced pension funds, particularly in 1997, led to significant client losses. Performance was much improved in 1998. On the retail side of this business there was, once again, excellent progress as sales benefited from ever closer integration with NatWest UK's retail operations.
The problems of the pension and life industry have tempered market activity in this area. We are investing in our sales force, new distribution channels and products for both individuals and business customers.

GNW, by carefully selecting its areas of business, avoided many of the worst effects of instability and crisis in world financial markets. The ongoing business of GNW achieved a profit after tax of £73m in 1998 and the WRAs in this business were reduced.

Electronic commerce and new delivery channels are growing in importance to our customers. We have become the largest supplier of electronic payment services to shops and small businesses handling a wider range of cards than any other system. We are also building alliances with technology companies to provide electronic commerce and digital information security over the Internet. We expect the rate of change in systems development and technology to increase during 1999.

The Group has made considerable progress in 1998. We have great strengths and many good businesses. We are determined to reduce unit costs and enhance our customer service right across the Group. The economic environment for many of our customers is already showing signs of being more difficult and we expect this to continue through 1999. But we remain confident that we are well positioned to meet the challenges of the years ahead and to grasp the opportunities that the rapidly changing times will offer.

The preceding paragraphs contain a number of forward-looking statements. No assurances can be given that the Group's actual future results will not differ materially from the results targeted in such statements. For a further discussion of forward-looking statements see page 135.

Operating and financial review – Summary balance sheet

	At 31 December	
	1998 **£m**	1997[1] £m
Cash and balances at central banks and items in the course of collection	**3,488**	3,504
Treasury and other eligible bills	**5,859**	6,246
Loans and advances to banks	**32,369**	32,016
Loans and advances to customers	**78,962**	84,475
Operating lease assets	**1,308**	1,703
Debt securities	**37,563**	30,411
Equity shares	**333**	4,350
Other assets	**26,111**	22,789
Total assets	**185,993**	185,494
Deposits by banks and items in the course of transmission	**27,830**	29,422
Customer accounts	**96,294**	89,888
Debt securities in issue	**15,555**	17,797
Subordinated liabilities	**5,162**	5,145
Other liabilities	**32,651**	35,255
Shareholders' funds	**8,501**	7,987
Total liabilities and reserves	**185,993**	185,494
Contingent liabilities and commitments	**58,949**	63,909
Reverse repurchase agreements and stock borrowing		
Loans and advances to banks	**10,501**	6,567
Loans and advances to customers	**5,144**	8,489
	15,645	15,056
Repurchase agreements and stock lending		
Deposits by banks	**5,692**	5,866
Customer accounts	**11,510**	9,229
	17,202	15,095

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Total assets were £0.5bn, 0.3%, higher than 31 December 1997, at £186.0bn. The termination and disposal of Global Equities and other businesses in GNW led to a reduction of approximately £12.0bn in assets and the disposals in Lombard reduced assets by a further £5.5bn. These reductions were offset by increases in debt securities held, lending to customers and banks by ongoing businesses, mark-to-market value of derivatives and long-term assurance assets attributable to policyholders.

Treasury and other eligible bills fell by £0.4bn, 6%, to £5.9bn following a move to holdings of certificates of deposit ('CDs') due to their more competitive yields.

Loans and advances to banks increased by £0.4bn, 1%, to £32.4bn reflecting increases in reverse repurchase agreements of £4.5bn largely offset by lower bank placements and a reduction in stock borrowing collateral of £0.5bn in Global Equities.

Loans and advances to customers fell by £5.5bn, 7%, to £79.0bn. Reverse repurchase agreements fell by £0.5bn, and stock borrowing collateral in Global Equities was down £2.8bn. Other loans and advances to customers fell due to disposals of £4.3bn in Lombard, sales of leasing receivables in GNW of £2.5bn, and reductions from the sale and termination of Global Equities and other GNW businesses of £0.4bn. Excluding these items, lending grew by £5.0bn, 7%. NatWest UK saw continuing strong demand for mortgages, up £1.0bn, 7%, and other lending growth of £3.0bn, 10%, principally in corporate and card lending. Lending in Ulster Bank was up £0.8bn, 17%.

Operating lease assets were down by £0.4bn, 23%, at £1.3bn following the disposal of Lex Vehicle Leasing by Lombard, £0.8bn, partly offset by business growth in Lombard Business Finance.

Debt securities rose by £7.2bn, 24%, to £37.6bn. Increased holdings in GFM, up £4.4bn, were largely as a result of growth in CDs purchased due to their competitive yield. GNW was up £3.0bn due to increased trading portfolios and development of the credit trading business. These increases were offset by a reduction of £0.2bn in Coutts NW.

Equity shares fell by £4.0bn, 92%, to £0.3bn following the sale and termination of Global Equities.

Other assets were up £3.3bn, 15%, at £26.1bn, despite reductions of £2.1bn relating to Global Equities and other GNW businesses exited and sold and £0.2bn relating to the Lombard disposals. In the ongoing business, settlement balances were up £0.2bn, mark-to-market value of derivatives up £1.5bn, and other items up £0.7bn, partially offset by property disposals of £0.4bn. Long-term assurance assets attributable to policyholders increased by £3.6bn.

Deposits by banks and items in the course of transmission decreased by £1.6bn, 5%, to £27.8bn, including a decrease in repurchase agreements and stock lending of £0.2bn, reflecting lower funding requirements.

Customer accounts were up £6.4bn, 7%, to £96.3bn, with increased repo activity in GNW contributing £2.5bn. Time and demand deposits and savings accounts increased in NatWest UK, up £3.2bn, Ulster Bank, up £1.4bn, and Coutts NW, up £0.5bn, and a reduction of £0.3bn resulted from Lombard disposals. The transfer of Gartmore's institutional custody business to a third party supplier reduced customer accounts by £0.6bn.

Debt securities in issue fell by £2.2bn, 13%, to £15.6bn reflecting reduced funding requirements.

Other liabilities were down £2.6bn, 7%, to £32.7bn with a reduction of £5.9bn arising from the sale and termination of Global Equities and other GNW businesses, and £0.3bn relating to Lombard disposals. Deferred tax balances were £0.7bn lower as a result of Lombard disposals and sale of GNW leasing receivables. In the ongoing business, increases in the mark-to-market value of derivatives, up £1.6bn, long-term assurance liabilities attributable to policyholders, up £3.6bn, and other items, up £0.9bn, were partially offset by falls in settlement balances, down £0.1bn, and short positions, down £1.7bn.

Operating and financial review – Average balance sheet and interest rates

The following table shows average balances, interest and interest rates for the past three years. In this table and elsewhere in this report, unless otherwise stated, average balances are calculated from a combination of daily, monthly and quarterly data and management believe that the trends shown by the tables would not be materially different if daily data were used for all balances.

	1998			1997			1996		
Assets	**Average balance £m**	**Interest receivable £m**	**Average rate %**	Average balance £m	Interest receivable £m	Average rate %	Average balance £m	Interest receivable £m	Average rate %
Interest-earning assets									
Loans and advances to banks [1,2]									
Domestic	**4,594**	**337**	**7.34**	4,357	299	6.86	2,450	150	6.12
International	**17,231**	**1,010**	**5.86**	20,905	1,137	5.44	24,724	1,455	5.88
Loans and advances to customers [2,3] (includes operating lease assets)									
Domestic	**63,273**	**5,939**	**9.39**	60,704	5,498	9.06	57,527	5,025	8.74
International	**16,393**	**1,197**	**7.30**	15,958	1,193	7.48	22,682	1,711	7.54
Treasury and other eligible bills									
International	**511**	**18**	**3.52**	611	37	6.06	1,206	63	5.22
Debt securities									
Domestic	**7,083**	**532**	**7.51**	6,195	414	6.68	4,383	285	6.50
International	**8,656**	**514**	**5.94**	6,954	450	6.47	6,700	418	6.24
Total interest-earning assets of banking business	**117,741**	**9,547**	**8.11**	115,684	9,028	7.80	119,672	9,107	7.61
Total interest-earning assets of trading business	**45,062**	**2,700**	**5.99**	47,501	3,033	6.39	24,173	1,584	6.55
Total interest-earning assets	**162,803**	**12,247**	**7.52**	163,185	12,061	7.39	143,845	10,691	7.43
Allowance for bad and doubtful debts	**(1,388)**			(1,412)			(1,495)		
Equity shares	**2,235**			7,428			4,137		
Other non-interest earning assets[4]	**32,876**			37,907			28,403		
Total assets	**196,526**			207,108			174,890		
Percentage of assets applicable to international operations	**49.4%**			49.4%			49.1%		

1 These are primarily funds placed with institutions for maturities not exceeding six months.
2 Loans and advances to banks and to customers are stated net of unearned income and before deduction of the allowance for bad and doubtful debts. Non-accrual loans have been included in the average balances. Interest income on non-accrual loans has been included to the extent that cash payments have been received.
3 Excluding adjustment for finance leases.
4 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Liabilities	1998 Average balance £m	1998 Interest payable £m	1998 Average rate %	1997 Average balance £m	1997 Interest payable £m	1997 Average rate %	1996 Average balance £m	1996 Interest payable £m	1996 Average rate %
Interest-bearing liabilities									
Deposits by banks									
Domestic	**1,641**	**104**	**6.34**	2,174	128	5.89	3,778	228	6.03
International	**18,726**	**993**	**5.30**	23,300	1,216	5.22	25,085	1,451	5.78
Customer accounts									
Demand deposits									
Domestic	**23,913**	**1,014**	**4.24**	22,300	812	3.64	18,557	553	2.98
International	**2,704**	**108**	**3.99**	2,266	96	4.24	2,713	92	3.39
Savings deposits									
Domestic	**11,267**	**678**	**6.02**	11,472	622	5.42	12,031	561	4.66
International	**133**	**7**	**5.26**	110	6	5.45	1,741	43	2.47
Time deposits									
Domestic	**20,446**	**1,376**	**6.73**	19,050	1,192	6.26	17,949	1,114	6.21
International	**14,205**	**744**	**5.24**	13,706	760	5.55	16,852	912	5.41
Debt securities in issue									
Domestic	**8,021**	**601**	**7.49**	9,580	622	6.49	8,922	538	6.03
International	**8,394**	**447**	**5.33**	8,280	484	5.85	5,499	317	5.76
Subordinated liabilities									
Domestic	**3,910**	**292**	**7.47**	3,324	248	7.46	2,968	212	7.14
International	**1,110**	**89**	**8.02**	1,566	127	8.11	1,684	133	7.90
Internal funding of trading business									
Domestic	**(7,539)**	**(454)**	**6.02**	(10,199)	(578)	5.67	(7,381)	(501)	6.79
International	**(6,090)**	**(318)**	**5.22**	(7,930)	(477)	6.02	(7,584)	(395)	5.21
Total interest-bearing liabilities of banking business	**100,841**	**5,681**	**5.63**	98,999	5,258	5.31	102,814	5,258	5.11
Total interest-bearing liabilities of trading business	**44,062**	**2,428**	**5.51**	46,372	3,020	6.51	25,984	1,659	6.38
Total interest-bearing liabilities	**144,903**	**8,109**	**5.60**	145,371	8,278	5.69	128,798	6,917	5.37
Non-interest bearing deposits	**14,466**			14,260			14,425		
Other non-interest bearing liabilities	**28,758**			39,314			23,738		
Total liabilities	**188,127**			198,945			166,961		
Shareholders' equity [1]	**8,399**			8,163			7,929		
Total liabilities and shareholders' equity	**196,526**			207,108			174,890		
Percentage of liabilities applicable to international operations	**47.4%**			48.3%			45.4%		

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

The following table shows the interest spread and net interest margin of the Group's banking business and certain benchmark interest rates for the past three years.

	1998 Average rate %	1997 Average rate %	1996 Average rate %
Interest spread [1, 2]			
Domestic	**3.22**	3.44	3.72
International	**1.12**	0.98	1.04
Group	**2.48**	2.49	2.50
Net interest margin [1, 3]			
Domestic	**4.27**	4.44	4.28
International	**1.56**	1.36	1.98
Group	**3.28**	3.26	3.22
Bank's sterling base loan rate	**7.2**	6.6	6.0
3 month sterling LIBOR	**7.4**	6.9	6.1
Dollar prime rate	**8.3**	8.4	8.3
3 month dollar LIBOR	**5.5**	5.7	5.5

1 Excluding adjustment for finance leases.
2 Interest spread represents the difference between the rate of interest earned on average total interest-earning assets of banking business and the rate of interest paid on average total interest-bearing liabilities of banking business.
3 Net interest margin is net interest income of banking business, expressed as a percentage of average total interest-earning assets of banking business.

Analysis of changes in net interest income

The following table allocates changes in net interest income between volume and rate for 1998 compared with 1997 and for 1997 compared with 1996. Changes due to a combination of volume and rate are allocated to volume and rate on the same proportionate basis as changes due to each of volume and rate.

	1998 over 1997			1997 over 1996		
	Increase/(decrease) due to changes in			Increase/(decrease) due to changes in		
	Average volume £m	**Average rate £m**	**Net change £m**	Average volume £m	Average rate £m	Net change £m
Interest-earning assets [1]						
Loans and advances to banks [2]						
Domestic	**17**	**21**	**38**	129	20	149
International	**(210)**	**83**	**(127)**	(214)	(104)	(318)
Loans and advances to customers [2]						
Domestic	**237**	**204**	**441**	284	189	473
International	**33**	**(29)**	**4**	(504)	(14)	(518)
Treasury and other eligible bills						
International	**(5)**	**(14)**	**(19)**	(35)	9	(26)
Debt securities						
Domestic	**63**	**55**	**118**	121	8	129
International	**103**	**(39)**	**64**	16	16	32
	238	**281**	**519**	(203)	124	(79)
Interest receivable of banking business [1]						
Domestic	**317**	**280**	**597**	534	217	751
International	**(79)**	**1**	**(78)**	(737)	(93)	(830)
Total interest receivable of banking business[1]	**238**	**281**	**519**	(203)	124	(79)
Total interest receivable of trading business	**(142)**	**(191)**	**(333)**	1,533	(84)	1,449
Total interest receivable	**96**	**90**	**186**	1,330	40	1,370

1 See note 3 on page 37.
2 See note 2 on page 37.

Analysis of changes in net interest income continued

	1998 over 1997			1997 over 1996		
	Increase/(decrease) due to changes in			Increase/(decrease) due to changes in		
	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m
Interest-bearing liabilities						
Deposits by banks						
Domestic	**(33)**	**9**	**(24)**	(95)	(5)	(100)
International	**(241)**	**18**	**(223)**	(100)	(135)	(235)
Customer accounts						
Demand deposits						
Domestic	**62**	**140**	**202**	123	136	259
International	**18**	**(6)**	**12**	(17)	21	4
Savings deposits						
Domestic	**(11)**	**67**	**56**	(27)	88	61
International	**1**	**–**	**1**	(62)	25	(37)
Time deposits						
Domestic	**91**	**93**	**184**	69	9	78
International	**27**	**(43)**	**(16)**	(175)	23	(152)
Debt securities in issue						
Domestic	**(109)**	**88**	**(21)**	41	43	84
International	**7**	**(44)**	**(37)**	162	5	167
Subordinated liabilities						
Domestic	**44**	**–**	**44**	26	10	36
International	**(37)**	**(1)**	**(38)**	(9)	3	(6)
Internal funding of trading business						
Domestic	**158**	**(34)**	**124**	(169)	92	(77)
International	**101**	**58**	**159**	(19)	(63)	(82)
	78	**345**	**423**	(252)	252	–
Interest payable of banking business						
Domestic	**202**	**363**	**565**	(32)	373	341
International	**(124)**	**(18)**	**(142)**	(220)	(121)	(341)
Total interest payable of banking business	**78**	**345**	**423**	(252)	252	–
Total interest payable of trading business	**(110)**	**(482)**	**(592)**	1,361	–	1,361
Total interest payable	**(32)**	**(137)**	**(169)**	1,109	252	1,361
Movement in net interest income						
Increase in total interest receivable	**96**	**90**	**186**	1,330	40	1,370
Decrease/(increase) in total interest payable	**32**	**137**	**169**	(1,109)	(252)	(1,361)
	128	**227**	**355**	221	(212)	9
Adjustment for finance leases [1]	**–**	**51**	**51**	–	(106)	(106)
Net interest income	**128**	**278**	**406**	221	(318)	(97)

1 See note 2 on page 3.

Shareholders' funds

Retention for the year of £953m, adjusted for the repurchase of ordinary shares of £375m and the redemption of preference shares of £147m as well as £42m from the issue of ordinary shares in connection with various staff share option schemes, were the main factors contributing to the £514m increase in shareholders' funds to £8,501m at 31 December 1998. A reconciliation of the movements in consolidated shareholders' funds is given on page 75.

Dividend policy and earnings per ordinary share

The Group's objective is to deliver real growth in dividends. Absolute levels are set with reference to current and prospective performance whilst ensuring an adequate level of retentions to fund business growth in attractive markets. Dividends for 1998 increased by 11.8% to 36.0p from 32.2p per ordinary share, compared with a rise in the annual average of the all-items retail price index ('RPI') for the year of 3.4%. 1997 dividends grew by 11.0% over 1996 (RPI 3.1%).

Earnings per ordinary share are calculated by dividing the Group profit for the financial year of £1,566m, after preference share dividends of £51m (1997 £591m after preference share dividends of £45m; 1996 £617m after preference share dividends of £37m) by the weighted average number of ordinary shares in issue during the year of 1,717m (1997 1,716m; 1996 1,747m). Earnings per ordinary share were 91.2p, up 164% on 34.5p in 1997, which was itself 2% lower than the 35.3p in 1996.

Diluted earnings per share, calculated to give effect to potential ordinary shares (such as share options) outstanding during the period, were 90.1p, up 166% on 33.9p in 1997, which was itself 3% lower than the 34.9p in 1996.

Headline earnings, as defined by the Institute of Investment Management and Research ('IIMR'), are calculated by adjusting the profit for the financial year, after preference share dividends, for the after-tax profits or losses on disposals or terminations of businesses and tangible fixed assets, permanent diminution in value of tangible fixed assets and goodwill amortisation. This gives headline earnings per ordinary share in 1998 of 78.1p, up 67% on 46.9p in 1997, which was 30% lower than 1996's 66.6p (see note 15 to the accounts on page 85).

IIMR is a professional body for members of the investment community which was founded in 1955. Its definition of headline earnings is widely accepted in the UK as a standard measure of earnings to supplement that required under UK GAAP.

Total return to shareholders

Total return to shareholders encompasses both dividend payments and changes in share price. For the 5 year period 1994 to 1998, the cumulative total return to shareholders of the Bank was 137% compared with a return on the Financial Times Stock Exchange 100 ('FT-SE 100') share index of 108% – the Bank has outperformed the FT-SE 100 share index by 14%.

The major risks associated with the Group's businesses are market risk, liquidity risk, credit risk and operational risk. The Group has established a comprehensive framework for managing these risks which is continually evolving as the Group's business activities change in response to market, credit, product and other developments.

The Group Market Risk Committee oversees the management of the market risk in the Group's trading portfolios. The Group Asset and Liability Management Committee sets and regularly reviews policies for the management of the Group's operational liquidity and the structural interest rate and foreign exchange rate exposures arising from non-trading activities. Each major business unit has its own asset and liability management committee which operates within the framework of the Group's policies. The Group Credit Risk Committee establishes and reviews policies for the management of credit risk associated with all loans, securities, derivatives and other financial instruments that expose the Group to credit risk. The Group Operational Risk Committee is responsible for the establishment and monitoring of operational risk policy, standards and control processes. It oversees the implementation of the Group Operational Risk Framework across the Group's businesses.

Market risk

Market risk is the risk that changes in interest rates, foreign exchange rates, equity prices and other rates, prices, volatilities, correlations or other market conditions, such as liquidity, will have an adverse impact on the Group's financial condition or results.

The principal market risks to which the Group is exposed are interest rate risk, foreign exchange risk and equity price risk. Activity in debt securities, interest-rate derivatives and money-market instruments is the primary source of interest rate risk in the Group's dealing, money-market and debt investment portfolios. Mismatches between the repricing dates of the Group's assets and liabilities account for most of the interest rate risk associated with its commercial banking activities. In the first half of 1998, the Group disposed of much of its equities trading business. The residual portfolios continue to be managed down. The Group's venture capital portfolio accounts for most of its non-trading equity price risk.

For a discussion of the Group's accounting policies for, and information with respect to its exposures to, derivative financial instruments, see notes 1xiii and 44 to the Group's consolidated accounts on pages 80 and 110 to 112 respectively.

Trading

The Group's dealing, money-market and debt investment portfolios comprise derivative financial instruments (futures, forwards, swaps and options), debt and equity securities, loans, deposits and other debt obligations. So as to be able to meet customer demand, the Group carries portfolios of cash, marketable financial instruments and derivative instruments, and, by continuously quoting bid and offer prices, maintains access to market liquidity. Its proprietary activities involve taking positions as principal in the interest rate, exchange rate and securities markets to take advantage of anticipated market conditions.

The Group manages the market risk in these portfolios through position and sensitivity limits as well as value-at-risk ('VaR') limits. The VaR limits are approved by the board. The Group supplements its daily VaR calculations with stress testing which measures the impact of abnormal changes in market rates and prices on the fair value of the Group's trading portfolios. The portfolios are also subject to scenario analyses. Option risk is modelled using simulation and revaluation of the variables determining the option's value and further analyses are performed on instruments with discontinuous payoffs.

VaR is a technique that produces a single estimate of the potential negative change in the market value of a portfolio over a specified time horizon at a given confidence level. The Group's VaR assumes a time horizon of one day and a confidence level of 95%. In other words, the Group expects to suffer a one-day loss greater than VaR only 5% of the time, i.e. one day in twenty. The Group has made use of both variance/covariance and historical simulation models for its VaR assessment.

Variance/covariance VaR models assume that changes in market risk factors have a normal distribution and that the parameters of this joint distribution (in particular the standard deviations of risk factor changes and the correlations between them) have been estimated accurately. Historical simulation models assume that risk factor changes observed in the past are a good estimate of those likely to occur in the future. Hence both methods are limited by the relevance of the historical data used. The Group typically uses the last two years of market data. The independent market risk function will modify the historically derived estimates of likely risk factor changes to reflect prevailing market conditions. These modified estimates use other market information e.g. the implied volatility of traded options. The method of aggregation used assumes that the profit and loss of each sub-portfolio is normally distributed and that the exposures of each sub-portfolio is independent of the others.

Trading continued

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

i Changes in risk factors may not have a normal distribution. In particular such an assumption may underestimate the probability of extreme market movements.

ii Historical data used to estimate parameters in the variance/covariance method and used directly in the historical simulation method may not provide the best estimate of the joint distribution of risk factor changes in the future, and any modifications to these data may be inadequate. In particular VaR using only two years of historical data may fail to capture the risk of possible extreme adverse market movements.

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

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

v At present the Group only computes the VaR of trading portfolios at the close of business and positions may change substantially during the course of the trading day. Controls are in place to limit the Group's intra-day exposure but it does not yet compute VaR intra-day.

VaR should, therefore, not be viewed as a guarantee of the Group's ability to limit its market risk. The Group cannot be certain that losses will not exceed the VaR amounts indicated nor that losses in excess of the VaR amounts will not occur more frequently than once in 20 trading days.

The VaR for the Group's dealing, money-market and debt investment portfolios, using the same methodology as for 1997, segregated by type of market risk exposure, is presented in the table below.

		1998			
Market risk	**31 December 1998 £m**	**Maximum £m**	**Minimum £m**	**Average £m**	31 December 1997 £m
Interest rate	**13.1**	**14.6**	**11.0**	**13.1**	10.3
Currency	**3.3**	**6.2**	**2.4**	**4.1**	3.3
Equity	**0.5**	**3.0**	**0.2**	**0.7**	2.6

The Group's dealing, money-market and debt investment activities are conducted principally by GFM and GNW. During 1998, for all their portfolios carried at fair value, average daily VaR (assuming zero correlation between product groups) was £9.7m[1] (1997 £7.4m). Maximum and minimum VaR were £12.2m[1] and £7.5m[1] respectively (1997 £12.7m and £5.6m). In the same period, the average daily profit including net interest for these books was £3.2m[1] (1997, excluding the option losses, £2.0m); the maximum loss on any one day did not exceed £16m[1] (1997, excluding the option losses, £9m); and the standard deviation of profits was less than £5.0m[1] (1997, excluding the option losses, less than £3.4m). During 1998, VaR for GFM's money-market and debt portfolios, which are accounted for on the accruals basis, averaged £7.9m (1997 £6.4m). Maximum VaR was £11.2m and minimum £3.8m (1997 £7.9m and £4.7m).

Late in 1998, the Group introduced a new Group-wide market risk analysis system, 'UniVaR', to assess the VaR of its trading portfolios. UniVaR is based upon historical simulation techniques and has been developed to provide a consistent Group-wide assessment of risk. UniVaR measures VaR on a Group-wide portfolio basis and as such it is no longer necessary to rely on zero correlation assumptions.

Non-trading

The Group's portfolios of non-trading financial instruments principally comprise loans (including finance leases), debt securities, deposits, certificates of deposit and other debt securities issued, loan capital and derivatives (mainly interest rate swaps). The Group's long-term assurance assets and liabilities attributable to policyholders have been excluded from these market risk disclosures.

Interest rate risk

Structural interest rate risk arises where assets and liabilities in the Group's commercial banking activities have different repricing dates. Group policy requires all material non-trading interest rate risk to be transferred to units whose market risks are included within trading above. Non-trading interest rate risk is measured using VaR and its potential effect on short-term earnings. Risk transfers to the trading units are arranged through arm's length cash transactions and derivatives, principally interest rate swaps.

1 Excluding Global Equities; comparatives have not been restated.

Interest rate risk continued

The VaR of any non-trading interest rate exposures that are not so transferred is measured using the same methodology that is used for trading portfolios. VaR for the Group's commercial banking activities is calculated quarterly. At 31 December 1998, it was estimated to be £2.1m (1997 £0.9m) with the primary risk being to changes in longer term sterling interest rates. This was also the maximum value for 1998; the minimum was £0.7m and the average £1.4m.

In computing the VaR, all on-balance sheet assets and liabilities (other than those which are match funded and therefore have no interest rate risk) and off-balance sheet derivatives products in each of the non-trading businesses are categorised by product or asset/liability type and included in an interest rate ladder at the appropriate maturity band. The maturity bands are monthly for the first 24 months, quarterly from 24 months to 72 months and annually thereafter.

For the principal non-trading business units, when the actual interest rate repricing characteristics differ from the contractual maturity (e.g. for managed rate products), the repricing maturity is determined by the market interest rate most closely correlated to the historical behaviour of the product interest rate. Non interest bearing current accounts are behaviourised on the basis of their inherent stability and fixed rate characteristics and included at the corresponding maturity in the gap report. The Group policy is also to include non-financial assets and liabilities, principally tangible fixed assets of £2.5bn (1997 £2.8bn) and the Group's capital and reserves of £8.5bn (1997 £8.0bn) using medium term maturity conventions. The product maturity conventions used by each sector are reviewed by the asset and liability committee of each business unit.

Principal amounts only are included. Average balances are used for products where this is considered to provide a more accurate representation of the exposure. A separate ladder is produced for each material currency. Interest rate movements between currencies are assumed to be zero-correlated.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities. It arises where businesses undertake to provide funding to, or to accept deposits from, customers at a future date at a pre-determined fixed interest rate. Derivatives are used to manage the risk of interest rate movements from the date a commitment is made to a customer to the date the transaction closes. Option risk also arises where customers can repay fixed rate loans or withdraw fixed rate deposits prior to their maturity. In managing this risk, historic early repayment rates are taken into account. The Group generally seeks to protect itself from early repayment risk through the imposition of market based penalties.

Interest rate repricing table

The table on page 45 is management's estimate of the interest rate sensitivity gap for the Group at 31 December 1998. It is not necessarily indicative of the positions at other times. It reflects the aggregation of both non-trading and trading account positions in all currencies. The actual interest rate sensitivity of the Group's earnings will be determined by the currency and contractual or behavioural profile of assets and liabilities, in addition to the size and timing of interest rate movements. The table does not indicate the effect of interest rate options used by the Group to hedge its own positions. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. Variations in interest rate sensitivity may exist within repricing periods and among the currencies in which the Group has positions. As this table uses actual maturities, it is prepared on a different basis from the VaR for non-trading interest rate risk (see page 43).

Interest rate repricing table at 31 December 1998

	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non interest-bearing funds £m	Total £m
Assets							
Loans and advances to banks	25,303	4,518	2,059	139	27	323	32,369
Loans and advances to customers	50,881	3,439	2,853	15,512	5,789	488	78,962
Treasury and other eligible bills	5,235	224	267	119	13	1	5,859
Debt and equity securities	10,146	2,998	2,854	7,721	13,842	335	37,896
Other assets	424	138	253	691	–	29,401	30,907
Total assets	91,989	11,317	8,286	24,182	19,671	30,548	185,993
Liabilities							
Deposits by banks	24,412	832	393	198	10	717	26,562
Customer accounts	76,924	1,875	867	2,269	422	13,937	96,294
Debt securities in issue	12,189	1,808	1,198	304	54	2	15,555
Subordinated liabilities	1,964	556	–	1,157	1,485	–	5,162
Other liabilities	899	146	380	2,524	2,128	27,842	33,919
Shareholders' funds	–	–	–	–	–	8,501	8,501
Total liabilities	116,388	5,217	2,838	6,452	4,099	50,999	185,993
Off-balance sheet items	(2,603)	9,367	(759)	(2,148)	(3,857)	–	
Interest rate sensitivity gap	(27,002)	15,467	4,689	15,582	11,715	(20,451)	
Cumulative interest rate sensitivity gap	(27,002)	(11,535)	(6,846)	8,736	20,451		

Currency risk
The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in overseas subsidiary and associated undertakings and their currency funding. The Group's policy is normally to match the initial net foreign currency investment with borrowings in the same currency. Exposures arising from changes in net foreign currency investments are subject to regular review by the Group Asset and Liability Management Committee. Changes in foreign exchange rates affect the Group's earnings and equity through differences on the retranslation of the net assets and related funding of overseas subsidiaries and associates from the local functional currency to sterling. Gains or losses on foreign currency investments in subsidiary and associated undertakings, net of any losses or gains on related foreign currency funding, are recognised in reserves. The principal currencies of the Group's investments in overseas subsidiary and associated undertakings are the US dollar, Irish pound, and Swiss franc. In 1998, exchange losses of £3m were charged to reserves.

Equity risk
The Group holds, principally in its venture capital portfolios, equity shares in mainly unlisted companies. These interests are included in the balance sheet at cost less provision for any impairment. At the year end, the directors' valuation of this portfolio was £461m and its carrying value £268m (1997 £524m and £311m respectively).

Liquidity risk

The liquidity standard introduced in January 1996 by the Bank of England for sterling operations requires the Group to maintain at all times sufficient high-quality liquid assets to cover the net sterling cash outflow from the Bank and its UK banking subsidiaries over the next five business days.

The Group's liquidity policy covers both sterling and currency activities. A portfolio of liquid assets is held against the Group's currency obligations, in addition to those required by the Bank of England for sterling. The policy also requires expected cash outflows for both sterling and currency to be managed within prescribed limits for the next working day, week and thirty days.

Sterling and foreign currency retail deposits (principally current accounts and savings deposits repayable on demand or at short notice) form an important part of the Group's liability base. These deposits represent a stable source of funding due to the number and diversity of depositors. Liquidity is actively managed through dealings in the major world markets, in which the Group is a significant participant, thereby enabling ready access to wholesale funding. Time deposits obtained in inter-bank financial markets represented 16.4% of average total interest-bearing deposits in 1998 compared with 24.8% in 1997 and 25.0% in 1996.

Credit risk

Credit risk is the risk that companies, financial institutions, individuals and other counterparties will be unable to meet their obligations to the Group. Credit risk arises principally from the Group's lending activities but also from other transactions involving on and off balance sheet instruments.

Group Risk has specific responsibility for establishing the Group's credit risk principles and for the implementation of Group credit policy for all activities (including securities transactions and derivatives), for monitoring geographic, product and market sector concentrations within the Group's portfolio of credit risks and for managing the Group's most significant credit risk exposures and special situations. Day-to-day credit management is conducted by dedicated teams in each business unit, where there are continual reviews of the effectiveness of credit control practices and procedures. Particular attention is paid to the manner in which new risks are assumed, on-going management and monitoring of credit risks within the book, the early detection of loan quality deterioration and the structure and composition of the credit portfolio in relation to market opportunities, the competitive environment and economic projections.

In estimating the provision for bad and doubtful debts, the Group analyses its loan portfolio into segments by internal risk classification and by type of loan. Exposures identified as impaired are evaluated for provision individually except for products such as mortgages, leases, credit cards and other personal loans where a portfolio approach is used.
For exposures that are individually assessed, the specific provision is determined from a review of the financial condition of the counterparty and any guarantor and takes into account the value of any security. For those portfolios where specific provisions are established on a portfolio basis, the provision depends on historical loss experience and the level of arrears.

A general provision is made in respect of impaired loans which have not been individually identified as such, but which are known from experience to be present in any portfolio of bank advances. The general provision is assessed in the light of general economic conditions, the size and diversity of the Group's portfolio and a review of internal risk classifications.

Bad debts are written down to their estimated net realisable value at the point in time at which the normal banking relationship with the customer has ceased and the debt becomes subject to recovery procedures. The decision to commence recovery procedures is a matter of judgement exercised by lending centres, regional management and departments specialising in the recovery of debt and depends upon the circumstances of the individual situation.
During the recovery process, the Bank's estimate of the net realisable value is reviewed and additional provision raised or provision recovered to ensure that the net provision raised (and subsequently written off) equate to the actual loss incurred.

Management believes that the allowance for bad and doubtful debts at £1,372m adequately covers the identified and latent losses within the Group's lending portfolio. For further comments on bad and doubtful debts see pages 16 and 17.

Operational risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, fraud or inadequate internal controls and procedures. The Group manages this risk through systems and procedures to monitor transactions and positions, the documentation of transactions and periodic review by internal audit. The Group also maintains contingency facilities to support operations in the event of disasters.

Group Risk is developing a comprehensive framework and methodology which will enable businesses to identify and control operational risks leading to a consistent and consolidated overview of exposures across the Group.

Operating and financial review – Cash flow

	Year ended 31 December		
	1998 £m	1997 £m	1996 £m
Net cash inflow/(outflow) from operating activities	**5,221**	(320)	10,241
Interest paid on subordinated liabilities	**(386)**	(379)	(345)
Dividends paid less received (excluding equity dividends paid)	**(88)**	(75)	(29)
Taxation	**(314)**	(288)	(314)
Purchase, sale and maturity of investment securities (net)	**(4,016)**	687	(5,592)
Purchase and sale of tangible fixed assets (net)	**(5)**	(364)	(330)
Purchase and sale of operating lease assets (net)	**(772)**	(744)	(457)
Purchase and sale of businesses (net)	**1,825**	141	(338)
Equity dividends paid	**(575)**	(488)	(444)
Share capital (redemptions)/proceeds (net)	**(480)**	233	(428)
Subordinated liabilities raised/(redeemed) and minority interests (net)	**61**	485	112
Increase/(decrease) in cash	**471**	(1,112)	2,076

Increases in customer accounts and decreases in loans to customers have exceeded decreases in other liabilities and debt securities in issue, causing a net cash inflow of £5,221m from operating activities in 1998.

Interest paid on termination of floating rate notes caused the rise of £7m to £386m in interest paid on subordinated liabilities. New issues in 1997 led to an increase of £34m.

Higher preference share dividends paid largely caused the £13m increase in dividends paid less received.

Increased acquisitions of certificates of deposits led to the net cash outflow of £4,016m in the purchase, sale and maturity of investment securities. In 1997, a reduction in holdings led to a net cash inflow of £687m.

Sales of tangible fixed assets, largely freehold land and buildings and computer and other equipment, offset by acquisitions of computer and other equipment and freehold land and buildings, led to a net cash outflow of £5m in 1998. In 1997, investment in computer and other equipment led to a net cash outflow of £364m.

Continued growth in the leasing business caused an increase of £28m in the outflow on operating lease assets. In 1997, the increase was £287m.

The net cash inflow of £1,825m from the purchase and sale of businesses was due to the proceeds of disposals of businesses, principally the Lombard point of sale businesses, Lex Vehicle Leasing, Cash and Equity Derivatives businesses, Coutts Bahamas and Coutts Institutional Trust and Custody businesses. A further £84m of deferred consideration (net) was received in respect of the 1996 sale of Bancorp. The 1997 net cash inflow of £141m comprised £79m of deferred consideration (net) received from the sale of Bancorp and the proceeds from the disposal of businesses in Australia and Canada.

Share capital redemptions, net of proceeds, led to an outflow of £480m, due largely to the repurchase of ordinary shares of the Bank at a cost of £375m and the redemption of $250m non-cumulative dollar preference shares, Series A, at a cost of £147m. This was offset by £42m from the issue of ordinary shares upon the exercise of options granted under the Bank's various schemes for staff. In 1997, proceeds from the issue of shares were £233m, comprising £178m from the issue of $300m non-cumulative dollar preference shares, Series C, and £55m from the issue of ordinary shares upon the exercise of options granted under the Bank's various schemes for staff.

There was a net cash inflow of £61m from subordinated liabilities raised less redeemed and minority interests. The raising of £300m 6.5% subordinated notes resulted in an inflow of £294m after issue expenses. Offsetting this were redemptions in loan capital totalling £270m. In 1997, the cash inflow from the raising of subordinated loans was £598m, partially offset by a cash outflow from the redemption of subordinated loans of £125.

As a result of the above, net cash held by the Group increased by £471m, compared with a decrease of £1,112m in 1997.

Loan portfolio

In the UK, the Group offers loans, including overdrafts and leasing facilities, to all categories of personal and corporate customers. By virtue of its size and countrywide representation, the Group is a significant provider of credit to all major industries in the UK and, as a result, its domestic loan portfolio is broadly diversified.

The Group extends to customers overdrafts, instalment loans and loans repayable on a specified date or in specified circumstances. A substantial proportion of the Group's loans and advances to customers is by way of overdraft which is a line of credit established through the customer's current account. It is generally expected that the customer will make deposits into the account from time to time with the result that the balance can fluctuate between debit and credit positions. Interest rates on overdrafts are variable and are usually quoted in relation to the sterling base lending rate, which is a published rate that generally moves with market rates in the UK. Interest on an overdraft is normally debited directly to the customer's account, thereby increasing any debit balance or reducing any credit balance. Overdraft facilities are subject to annual review although typically they are renewed for subsequent periods. The Group does not consider overdrafts suitable for medium or long-term financing, which it prefers to provide through loans with fixed repayment schedules.

An overdraft is not subject to a repayment schedule and, under English law, is repayable on demand unless the customer and the bank have agreed upon a different contractual basis. However, as a matter of normal banking practice, demand is made only if the customer fails to honour the conditions on which the overdraft was granted or if the customer's financial position has so deteriorated that it is necessary to take protective action. In respect of a significant portion of overdraft facilities granted to individuals and partnerships which are regulated by the UK Consumer Credit Act 1974, a bank can demand repayment only by giving seven days' prior notice.

The Group's international lending is principally to multinational and other large corporations with headquarters in the major industrialised countries which are members of the Organisation for Economic Co-operation and Development ('OECD') and to OECD governments and their agencies.

Provisions for bad and doubtful debts

The tables on pages 49 and 50 show details of the movements in the Group's provisions for bad and doubtful debts for loans and advances to banks and customers by location of office for each of the past five years. Percentages are expressed in relation to total Group loans and advances to customers at each year end.

Provisions for bad and doubtful debts continued	**1998**		1997		1996		1995		1994	
	£m	**%**	£m	%	£m	%	£m	%	£m	%
Provisions at 1 January										
Domestic	**763**		770		791		885		1,062	
International	**639**		700		921		941		1,080	
Total	**1,402**		1,470		1,712		1,826		2,142	
Specific new and additional provisions										
Domestic	**609**		668		737		738		802	
International	**198**		170		164		332		335	
Total	**807**		838		901		1,070		1,137	
Specific releases and recoveries										
Domestic	**(288)**		(305)		(305)		(362)		(322)	
International	**(31)**		(68)		(71)		(119)		(135)	
Total	**(319)**		(373)		(376)		(481)		(457)	
General provision										
Domestic	**7**		8		47		48		(1)	
International	**4**		89		2		2		(63)	
Total	**11**		97		49		50		(64)	
Charge against profit										
Domestic	**328**	**0.57**	371	0.59	479	0.78	424	0.76	479	0.93
International	**171**	**0.75**	191	0.83	95	0.44	215	0.64	137	0.45
Total	**499**	**0.62**	562	0.65	574	0.69	639	0.72	616	0.75
Exchange and other movements	**–**		(17)		(41)		23		(10)	
Subsidiary undertakings acquired	**–**		–		–		11		41	
Disposal of subsidiary undertakings	**(109)**		–		(145)		–		(48)	
Amounts written off										
Domestic	**(528)**	**0.92**	(591)	0.94	(685)	1.12	(696)	1.25	(874)	1.70
International	**(98)**	**0.43**	(249)	1.09	(154)	0.72	(334)	1.00	(295)	0.97
Total	**(626)**	**0.78**	(840)	0.98	(839)	1.01	(1,030)	1.16	(1,169)	1.42
Recoveries										
Domestic	**198**	**0.34**	213	0.34	186	0.30	191	0.34	219	0.43
International	**8**	**0.04**	14	0.06	23	0.11	52	0.16	35	0.11
Total	**206**	**0.26**	227	0.26	209	0.25	243	0.27	254	0.31
Net write offs	**(420)**	**0.52**	(613)	0.71	(630)	0.76	(787)	0.88	(915)	1.12
Provisions at 31 December										
Domestic	**660**		763		770		791		885	
International	**712**		639		700		921		941	
Total	**1,372**		1,402		1,470		1,712		1,826	

Provisions for bad and doubtful debts continued	**1998**		1997		1996		1995		1994	
	£m	**%**	£m	%	£m	%	£m	%	£m	%
Average loans and advances to customers (net of unearned income)	**86,804**		87,303		84,550		87,440		83,761	
Ratio of net write offs to average loans and advances to customers (net of unearned income)		**0.48**		0.70		0.75		0.90		1.09
Specific provisions at 31 December										
Domestic	**385**	**0.67**	496	0.79	511	0.83	580	1.04	722	1.40
International	**580**	**2.54**	509	2.22	659	3.07	729	2.19	764	2.50
Total	**965**	**1.20**	1,005	1.17	1,170	1.42	1,309	1.47	1,486	1.81
General provision at 31 December										
Domestic	**275**	**0.48**	267	0.42	259	0.42	211	0.38	163	0.32
International	**132**	**0.58**	130	0.57	41	0.19	192	0.58	177	0.58
Total	**407**	**0.51**	397	0.46	300	0.36	403	0.45	340	0.42
Total provisions	**1,372**	**1.71**	1,402	1.63	1,470	1.78	1,712	1.92	1,826	2.23
Closing provisions										
Banks	**41**		7		14		60		70	
Customers	**1,331**		1,395		1,456		1,652		1,756	
Total provisions	**1,372**		1,402		1,470		1,712		1,826	
Loans and advances to customers: closing provisions as a % of gross lending										
Domestic		**1.15**		1.21		1.26		1.42		1.72
International		**2.94**		2.76		3.19		2.58		2.85
Total		**1.66**		1.62		1.76		1.85		2.14
Loans and advances to customers: charge against profit as a % of gross lending										
Domestic		**0.57**		0.59		0.78		0.75		0.93
International		**0.58**		0.85		0.50		0.67		0.33
Total		**0.57**		0.66		0.71		0.72		0.71

As at 31 December 1998 the total provisions for bad and doubtful debts held amounted to £1,372m, £30m, 2%, lower than as at 31 December 1997. The total provisions included £965m (1997 £1,005m) of specific provisions and £407m (1997 £397m) of general provisions.

The overall reduction in the level of specific provisions reflects a combination of lower levels of problem loans within NatWest UK, the sale of the point of sale finance and other businesses by Lombard and an overall net increase in the levels of problem loans in other businesses. Further details on the levels of problem loans (or risk elements in lendings) and provision coverage are given below.

The increase in the level of general provisions reflected management's assessment that the level of latent losses had increased in Card Services, NatWest Mortgage Services, Ulster Bank and Coutts NW.

During 1998, no changes were made to provision calculation methodologies that had a material impact on the levels of provisions held and there were no material reallocations of provisions between different elements.

In 1997 the Group established a general provision of £80m in respect of credit exposures to counterparties in South East Asia and South Korea, reflecting the deterioration in the economic environment in that region. This general provision was reviewed as at 31 December 1998 and was considered adequate to cover latent losses not only in South East Asia and South Korea but also in Russia and Latin America. Details of the Group's outstandings to sub-investment grade countries are set out on page 52.

A breakdown of the loans written off by each category of customer over the last five years is set out on page 130.

Risk elements

Non-accrual, past due 90 days and troubled debt restructuring loans

The following table presents details of risk elements (non-accrual loans, loans past due 90 days and troubled debt restructurings) in lendings, based on guidelines established by the SEC. It should be noted that the Group makes provisions for bad and doubtful debts in accordance with the method described on page 46 under credit risk.

The Group's loan control and review procedures generally do not include the classification of loans as non-accrual, past due 90 days, troubled debt restructurings and potential problem loans ('PPLs'), as defined by the SEC. Moreover, because overdrafts are not subject to a repayment schedule, the Group cannot, in respect of much of its loan portfolio, produce statistics on loans contractually past due 90 days or more. However, management has estimated, without giving effect to available security or related provisions, the amount of the loans which would have been so reported had the SEC's classification been employed.

	At 31 December				
	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Non-accrual loans					
Loans accounted for on a non-accrual basis [1]					
Domestic [2]	**1,188**	1,399	1,605	2,022	2,258
International	**686**	878	1,035	1,349	1,293
Total	**1,874**	2,277	2,640	3,371	3,551
Past due 90 days					
Accruing loans which are contractually past due 90 days or more as to principal or interest payments [3]					
Domestic	**263**	241	291	361	363
International	**15**	31	21	107	69
Total	**278**	272	312	468	432
Troubled debt restructurings					
Loans not included above which are 'troubled debt restructurings'					
Domestic	**24**	28	27	76	74
International	**253**	93	158	246	189
Total	**277**	121	185	322	263
Total risk elements – banks and customers	**2,429**	2,670	3,137	4,161	4,246
Total risk elements as a % of gross loans and advances to customers	**3.03%**	3.11%	3.79%	4.67%	5.17%
Total risk elements as a % of gross loans and advances to customers excluding reverse repurchase agreements and stock borrowing [4]	**3.23%**	3.45%	4.23%	4.82%	
Allowances for bad and doubtful debts as a % of total risk elements	**56.48%**	52.51%	46.86%	41.14%	43.01%

1 The Bank and its UK banking subsidiary undertakings account for loans on a non-accrual basis only from the point in time at which the collectibility of interest is in significant doubt.
2 NatWest Mortgage Services includes in this category the total value of loans which are subject to claims under Mortgage Guarantee Insurance policies in force.
3 Overdrafts generally have no fixed repayment schedule and consequently are not included in this category.
4 Information for 1994 is not available.

Non-accrual loans have fallen by £403m since 31 December 1997, partially due to the transfer of one large loan to troubled debt restructurings. Interest income which would have been recognised in 1998 under the original terms of the non-accrual and restructured loans amounted to an estimated £237m (1997 £272m) from domestic loans and an estimated £53m (1997 £80m) from international loans; interest income of approximately £56m (1997 £49m) from such domestic loans and approximately £28m (1997 £17m) from such international loans was recognised in 1998.

Potential problem loans

At 31 December 1998, the Group had loans (including overdrafts) amounting to £0.78bn (1997 £0.8bn) not included in non-accrual, past due 90 days and restructured loans but where information about the possible credit problems of borrowers caused management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms. Of this amount, some £0.67bn (1997 £0.61bn) related to domestic loans and £0.11bn (1997 £0.19bn) to international loans. The Bank holds substantial security in respect of PPLs and appropriate provisions have been made for shortfalls between the face value of loans and their estimated realisable value.

Selected Country Exposure

Set out below are the outstandings and off-balance sheet commitments to countries which are rated as sub-investment grade by at least one of the leading rating agencies.

	Governments, banks and financial institutions		Commercial industrial and other private sector		Off-balance sheet commitments		Total exposure	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Argentina	**75**	75	**25**	5	**17**	18	**117**	98
Brazil	**184**	169	**47**	40	**5**	100	**236**	309
India	**10**	65	**40**	51	**5**	5	**55**	121
Indonesia	**42**	99	**142**	103	**3**	39	**187**	241
Mexico	**121**	121	**49**	54	**39**	94	**209**	269
Panama	**–**	–	**69**	48	**13**	10	**82**	58
Russia	**58**	33	**42**	66	**–**	89	**100**	188
South Africa	**116**	102	**8**	10	**36**	136	**160**	248
South Korea	**668**	731	**91**	310	**7**	40	**766**	1,081
Thailand	**6**	169	**136**	57	**2**	11	**144**	237
Turkey	**87**	96	**15**	24	**4**	28	**106**	148
	1,367	1,660	**664**	768	**131**	570	**2,162**	2,998
Outstanding to 18 (1997: 22) other countries each below £50m	**59**	157	**104**	108	**62**	23	**225**	288
	1,426	1,817	**768**	876	**193**	593	**2,387**	3,286
Less specific provisions								
Indonesia	**(5)**	–	**(39)**	(10)	**–**	–	**(44)**	(10)
Russia	**(35)**	–	–	–	**–**	–	**(35)**	–
Thailand	**–**	–	**(17)**	(7)	**–**	–	**(17)**	(7)
	(40)	–	**(56)**	(17)	**–**	–	**(96)**	(17)
	1,386	1,817	**712**	859	**193**	593	**2,291**	3,269
Total general provision							**(80)**	(80)
							2,211	3,189
Of which non-performing loans	**55**	2	**98**	114	**–**	–	**153**	116

A general provision of £80m was raised in 1997 against exposures in South Korea, Indonesia and Thailand. The Group's exposure to these three countries has been reduced significantly. In addition, specific provisions of £44m were raised in 1998 in respect of counterparties there. However, due to the recent economic downturn it is considered that latent losses in exposures to counterparties in emerging markets generally has increased. Accordingly, the £80m general provision raised last year has been retained to cover this wider group of exposures.

Investment debt and equity securities

Information on the Group's investment debt and equity securities is shown in notes 22 and 23 to the accounts on pages 92 to 95 and in note 50(f) to the accounts on page 126.

Deposits of banking business

The aggregate average balance of all the Group's interest-bearing (demand, savings and time) deposits increased by 2.4% to £115.8bn (1997 £113.1bn, a rise of 7.1% on 1996). Rates paid reflect market conditions. The effect on net interest income depends upon competitive pricing and the level of interest receivable which can be generated through the use of the funds.

In the UK, approximately 70% of the Group's domestic customer accounts were derived from the branch network (1997 71%). These provide a stable deposit base, reducing reliance upon generally more expensive and potentially volatile wholesale funding. Time deposits are the principal source of funds in international offices, representing 80% of customer account deposits in 1998 (1997 79%). Deposits by banks are primarily time deposits, the majority of which are raised by the Bank's UK based money market operations in the world's major financial markets. Securities and bills sold under agreements to repurchase are included within deposits by banks and customer accounts (see Short-term Borrowings on page 133).

Certificates of deposit are 70% of debt securities in issue (1997 75%). These instruments are issued as a part of liquidity management with maturities generally of three months or less (see also table on page 54).

The table on page 53 shows details of the Group's average balances on customer accounts, deposits by banks and debt securities in issue together with the average interest rates paid thereon for each of the past three years.

Deposits of banking business continued

	1998		1997		1996	
	Average balance £m	**Average rate paid %**	Average balance £m	Average rate paid %	Average balance £m	Average rate paid %
Customer accounts						
Domestic offices						
Demand – interest free	**12,436**		12,457		11,741	
– interest bearing	**23,913**	**4.2**	22,300	3.6	18,557	3.0
Savings	**11,267**	**6.0**	11,472	5.4	12,031	4.7
Time	**20,446**	**6.7**	19,050	6.3	17,949	6.2
Total domestic offices	**68,062**		65,279		60,278	
International offices – United States						
Demand – interest free	**34**		32		953	
– interest bearing	**–**	**–**	10	4.0	433	1.4
Savings	**37**	**1.9**	27	2.2	1,433	2.1
Time	**2,106**	**2.7**	1,549	5.8	2,896	6.1
	2,177		1,618		5,715	
International offices – other						
Demand – interest free	**652**		1,171		1,165	
– interest bearing	**2,704**	**4.0**	2,256	4.2	2,280	3.8
Savings	**96**	**6.6**	83	6.0	307	4.1
Time	**12,099**	**5.7**	12,157	5.5	13,956	5.3
Total international offices	**17,728**		17,285		23,423	
Total customer accounts						
Banking business	**85,790**		82,564		83,701	
Trading business	**13,272**		8,555		2,485	
Total customer accounts	**99,062**		91,119		86,186	
Deposits by banks						
Domestic offices						
Interest free	**280**		201		242	
Interest bearing	**1,641**	**6.4**	2,174	5.9	3,778	6.0
International offices						
Interest free	**411**		376		277	
Interest bearing	**18,726**	**5.3**	23,300	5.2	25,085	5.8
Total deposits by banks						
Banking business	**21,058**		26,051		29,382	
Trading business	**9,503**		10,166		4,386	
Total deposits by banks	**30,561**		36,217		33,768	
Debt securities in issue						
Domestic offices						
Certificates of deposit	**6,497**	**7.4**	8,381	6.5	7,804	6.1
Other	**1,524**	**7.8**	1,199	6.4	1,118	6.0
Total domestic offices	**8,021**		9,580		8,922	
International offices – United States						
Certificates of deposit	**4,120**	**5.5**	3,494	5.8	2,929	6.2
Commercial paper	**–**	**–**	–	–	175	5.8
	4,120		3,494		3,104	
International offices – other						
Certificates of deposit	**899**	**2.7**	1,560	5.6	1,666	5.7
Commercial paper	**1,868**	**5.7**	1,529	5.5	105	5.5
Other	**1,507**	**5.9**	1,697	6.0	624	3.8
Total international offices	**8,394**		8,280		5,499	
Total debt securities in issue						
Banking business	**16,415**		17,860		14,421	
Trading business	**83**		526		568	
Total debt securities in issue	**16,498**		18,386		14,989	

Deposits of banking business continued

The following table shows details of the Group's certificates of deposit and other large deposits by time remaining until maturity; domestic sterling deposits shown are generally those of £50,000 and over; international deposits are those of $100,000 and over or the equivalent in other currencies.

		At 31 December 1998			
		3 months or less £m	After 3 months but within 6 months £m	After 6 months but within 12 months £m	After 12 months £m
Domestic offices					
Certificates of deposit		5,221	906	–	–
Other time deposits	– banks	425	1	1	–
	– customers	14,025	447	391	786
Total domestic office deposits		19,671	1,354	392	786
International offices – UK					
Certificates of deposit		158	–	38	–
Other time deposits	– banks	7,488	401	226	14
	– customers	3,324	130	59	5
		10,970	531	323	19
International offices – United States					
Certificates of deposit		2,148	1,934	–	–
Other time deposits	– banks	905	54	67	148
	– customers	558	55	53	141
		3,611	2,043	120	289
International offices – other					
Certificates of deposit		2	–	–	–
Other time deposits	– banks	2,599	175	43	–
	– customers	2,891	157	41	131
		5,492	332	84	131
Total international office deposits		20,073	2,906	527	439
Total		39,744	4,260	919	1,225
Banking business		39,744	4,260	919	1,172
Trading business		–	–	–	53
		39,744	4,260	919	1,225

The following table shows the distribution of all deposits and debt securities in issue by sterling and other currencies at 31 December for the past three years.

	At 31 December		
	1998 £m	1997 £m	1996 £m
Analysis by currency			
Deposits by banks			
Sterling	4,363	4,627	4,068
Other currencies	22,199	23,475	32,250
Customer accounts			
Sterling	69,650	67,000	62,390
Other currencies	26,644	22,888	21,801
Debt securities in issue			
Sterling	8,968	9,595	11,316
Other currencies	6,587	8,202	7,098
Total	138,411	135,787	138,923

Capital structure

The Group's policy is to diversify its sources of capital, to allocate capital within the Group efficiently and to maintain a prudent relationship between capital resources and the risks of its underlying business.

Capital resources

	As at 31 December		
	1998 **£m**	1997[1] £m	1996[1] £m
Ordinary shares	**1,705**	1,731	1,709
Retained earnings and other reserves	**6,324**	5,633	5,583
Preference shares	**472**	623	434
Minority interests	**147**	175	176
Subordinated liabilities	**5,162**	5,145	4,607
Total capital resources	**13,810**	13,307	12,509

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Total capital resources increased during 1998 by £503m. Retention for the year was £953m. The issue of shares in connection with various staff share option schemes added £42m.

During 1998, the Group completed a share repurchase programme to acquire ordinary shares of the Bank at an average price of 1007p, resulting in a reduction to capital resources of £375m.

Preference shares decreased by £151m largely as a result of the redemption of $250m (£147m) non-cumulative dollar preference shares, Series A. Subordinated liabilities rose £17m.The issue of £300m 6.5% subordinated notes 2021 (£294m after issue expenses) was offset by the redemption and maturity of loan capital totalling £270m and a reduction of £7m resulting from the strengthening of sterling against a largely dollar denominated loan capital.

Group capital ratios

The Group has to comply with the conditions in the Banking Act 1987. The risk-based capital ratios presented below exceed the international standards determined by the Basle Committee on Banking Regulations and Supervisory Practices (the Basle Accord) and the requirements of the Financial Services Authority which has responsibility for administering the Banking Act 1987.

	As at 31 December		
	1998 %	1997 %	1996 %
Group capital ratios			
Tier 1	**8.3**	7.2	6.7
Total	**13.2**	11.7	10.8

	£m	£m	£m
Adjusted capital			
Tier 1			
Ordinary shareholders' funds[1]	**8,006**	7,364	7,292
Preference shares	**472**	623	434
Minority interests	**210**	215	188
Less intangible fixed assets[1]	**(640)**	(739)	(898)
Total tier 1 capital	**8,048**	7,463	7,016
Tier 2			
Loan capital	**4,804**	4,752	4,388
General provision	**407**	397	300
Other	**33**	7	8
Total tier 2 capital	**5,244**	5,156	4,696
Supervisory deductions	**(605)**	(556)	(400)
Total regulatory capital	**12,687**	12,063	11,312

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

	£bn	£bn	£bn
Weighted risk assets			
NatWest UK	**50.4**	46.2	42.0
Lombard	**9.8**	14.1	12.9
Ulster Bank	**6.4**	5.6	5.0
NatWest Wealth Management	**4.4**	4.7	5.1
Global Financial Markets	**9.6**	8.6	9.2
Greenwich NatWest	**14.5**	22.6	28.8
Other Businesses	**1.3**	1.4	1.7
Total	**96.4**	103.2	104.7
Banking book			
– on-balance sheet	**74.2**	77.7	77.2
– off-balance sheet	**9.2**	9.4	11.1
Trading book	**13.0**	16.1	16.4
Total	**96.4**	103.2	104.7

Tier 1 capital increased by £585m to £8,048m due mainly to retained profits of £953m offset by equity repurchases of £375m and the redemption of US$250m (£147m) of preference shares. The issue of ordinary shares added £42m. The deduction for capitalised goodwill declined by £99m due to amortisation and elimination relating to disposals.

Tier 2 capital increased by £88m. The issue of 6.5% subordinated notes in the second half of 1998 raised £294m (after issue expenses); this was substantially offset by the redemption of four subordinated loans and amortisation of lower tier 2 debt approaching maturity in accordance with regulatory rules. The net increase in fixed asset revaluation reserves, general provision and minority interests amounted to £36m.

Supervisory deductions increased by £49m to £605m due to an increase in the investment in unconsolidated subsidiaries and associates.

WRAs were down by £6.8bn, 7%, to £96.4bn. The decrease primarily reflects the sale of Global Equities and other businesses and assets.

Board of Directors
at 22 February 1999

Lord Alexander of Weedon QC (62)
Chairman.
Director, Total S.A.
After a distinguished career as a Barrister, Lord Alexander became Chairman of the Bar Council in 1985. From 1987 to 1989 he chaired the Panel on Takeovers and Mergers. In 1989 he was appointed a director and then Chairman of NatWest. He served as a director of The RTZ Corporation and as a director and Deputy Chairman of the Securities and Investments Board until 1996. Lord Alexander will be retiring as a director and Chairman at the Annual General Meeting ('AGM') in April.

* **Sir Sydney Lipworth QC (67)**
Deputy Chairman.
Senior Independent Non-Executive Director.
Chairman, Zeneca Group. Chairman, Financial Reporting Council. Director, Carlton Communications.
Sir Sydney qualified as a Solicitor and a Barrister in Johannesburg where he was also a director and co-founder of Liberty Life Association of South Africa. From 1970 to 1988 he held senior posts in Allied Dunbar Assurance (of which he was a co-founder) as well as in other financial services companies. He served as Chairman of the Monopolies and Mergers Commission from 1988 to 1993, having previously been a part-time member from 1981. In 1993 Sir Sydney became Chairman of the Financial Reporting Council and joined NatWest as a director and Deputy Chairman. In 1995 he became Chairman of Zeneca Group.

* **Sir David Rowland (65)**
Deputy Chairman.
President, Templeton College, Oxford.
Sir David joined insurance brokers, Matthews Wrightson in 1956 becoming Chairman of Stewart Wrightson Holdings in 1981. Following a merger with Willis Faber in 1987 he was appointed Deputy Chairman of Willis Faber. In 1988 he left Willis Faber to join Sedgwick Group as Chief Executive, serving as Chairman from 1989 to 1992. In 1993 Sir David was elected Chairman of Lloyd's, retiring at the end of 1997. Sir David was appointed to the NatWest Board in April 1998, becoming a Deputy Chairman in September 1998. At the AGM in April 1999, following Lord Alexander's retirement, Sir David will become Chairman of NatWest.

* **Sir Michael Angus (68)**
Chairman, Whitbread. Deputy Chairman, The Boots Company. Deputy Chairman, British Airways.
Sir Michael joined Unilever in 1954 and held various posts including that of Chairman and Chief Executive, Unilever United States. He became Chairman of Unilever in 1986 and held that post until 1992. Sir Michael was appointed a director of NatWest in 1991.

* **Professor Sue Birley (55)**
Professor of Entrepreneurship at the Management School, Imperial College of Science, Technology and Medicine, London. Director, Imperial College Innovations.
Professor Birley has lectured for a number of years on entrepreneurship and strategy including appointments at London Business School, University of Notre Dame, USA and Cranfield Institute of Technology. From 1988 to 1991 she was Academic Director, European Foundation for Entrepreneurship Research. From 1988 to 1994 she was a member of the Northern Ireland Economic Council, and is currently a member of the Technology Foresight Steering Group. Professor Birley was appointed to the NatWest Board in 1996.

* **Lord Blyth of Rowington (58)**
Executive Chairman, The Boots Company. Director, Anixter. Director, Diageo.
Lord Blyth, after gaining experience in marketing both consumer and high technology products, became a director of Joseph Lucas and General Manager of Lucas Aerospace before moving to the Ministry of Defence as Head of Defence Sales in 1981. Thereafter he was Chief Executive of the Plessey Company. From 1991 to 1997 Lord Blyth served as Chairman of the Prime Minister's Advisory Panel on the Citizen's Charter. He was a Governor of the London Business School from 1987 until 1996, becoming an Honorary Fellow in 1997. He has served as a director of the Imperial Group, Cadbury Schweppes and British Aerospace. Lord Blyth was appointed to the NatWest Board in April 1998.

Richard Delbridge (56)
Group Chief Financial Officer.
Member, Financial Reporting Review Panel.
Mr Delbridge, who is a Chartered Accountant, was a Partner of Arthur Andersen & Co from 1974 to 1976. He then held various posts in London and New York for J P Morgan & Co before becoming Managing Director and General Manager for the UK from 1987 to 1989. He then joined Midland Bank as Director, Group Finance and later took on the role of Group Finance Director, HSBC Holdings. Mr Delbridge was appointed to his present post and the NatWest Board in 1996.

*** Sir Richard Evans CBE (56)**
Executive Chairman, British Aerospace. Director, United Utilities.
Member, Supervisory Board of Airbus Industrie.
Sir Richard spent the early part of his career with the Ministry of Transport and Aviation, Ferranti and the Ministry of Technology before joining the British Aircraft Corporation, later British Aerospace, in 1969. He has held a variety of posts in British Aerospace, including Chairman of the British Aerospace Defence Companies from 1988 to 1990 and Chief Executive of British Aerospace from 1990 to 1998. He took on his current role as Executive Chairman of British Aerospace in 1998. Sir Richard was appointed to the NatWest Board in October 1998.

H Martin V Gray (52)
Executive Director, Retail and Commercial Businesses.
Mr Gray joined the NatWest Group in 1963 and has held various posts including Head of Group Planning from 1986 to 1988, Assistant General Manager, Group Development from 1988 to 1989 and General Manager, UK Branch Business from 1990 to 1992. He joined the NatWest Board in 1993.

*** Anthony J Habgood (52)**
Executive Chairman, Bunzl. Director, PowerGen. Director, Schroder Ventures International Investment Trust.
Mr Habgood joined the Boston Consulting Group in 1970 and was a director from 1977 to 1986. He was appointed a director of Tootal Group in 1986 and served as their Chief Executive until their takeover in 1991. He was appointed a director of NatWest in April 1998.

Bernard P Horn (52)
Executive Director, Group Operations.
Mr Horn joined the Group in 1965 and spent the early part of his career in retail banking. He then held a number of posts in the Group and in 1989 was appointed General Manager in the Group Chief Executive's Office. In 1990 he was appointed General Manager, Group Strategy and Communications and in 1991 he became Chief Executive, International Businesses. Mr Horn joined the NatWest Board in 1995 and took on his present responsibilities in 1996.

*** Rt Hon Lord Hurd of Westwell CH CBE (68)**
Deputy Chairman, Coutts & Co.
Lord Hurd served in The Diplomatic Service from 1952 to 1966 before commencing his career in politics. He became a Member of Parliament in 1974 and held ministerial posts in the Foreign and Commonwealth Office and the Home Office. From 1984 to 1985 he was Secretary of State for Northern Ireland and from 1985 to 1989 he was Secretary of State for the Home Department. He served as Foreign Secretary from 1989 to 1995. Lord Hurd joined the NatWest Board in 1995.

*** Pen H Kent CBE (61)**
Member, Commonwealth Development Corporation.
Mr Kent joined the Bank of England in 1961 where he undertook a number of key roles including Private Secretary to the Governor, UK Alternate Executive Director, International Monetary Fund, Head of Information Division, Head of International Division and Associate Director, Finance and Industry. He was Executive Director of the Bank of England from 1993 until his retirement in 1997. He was a member of the Technology Foresight Steering Group and the Private Finance Panel. He is Chairman and Trustee of Blind in Business and Chairman of the City Arts Festival. Mr Kent joined the NatWest Board in September 1997.

Paul Myners (50)
Executive Director, Wealth Management Businesses.
Director, English & Scottish Investors. Director, Orange. Member, Financial Reporting Council.
Mr Myners held various posts at N. M. Rothschild & Sons between 1974 and 1985 becoming a director in 1979. He was appointed Chief Executive, Gartmore in 1985 becoming Chairman in 1987. He was appointed to his current post and a director of NatWest in 1997.

*** Sir Charles Powell KCMG (57)**
Director, Jardine Matheson Holdings. Director, Louis Vuitton – Moët Hennessy.
Director, Arjo Wiggins Appleton.
Sir Charles served in various posts in The Diplomatic Service from 1963 to 1983 before becoming Private Secretary to the Prime Minister, first Baroness Thatcher and later John Major, from 1984 to 1991. He joined the NatWest Board in 1991.

*** Sir George Quigley CB (69)**
Chairman, Ulster Bank.
Chairman, NatWest Pension Trustees.
Sir George joined the Northern Ireland Civil Service in 1955 and held senior positions in the departments responsible for Manpower Services, Commerce and Finance until his retirement in 1988. He was appointed Chairman of Ulster Bank in 1989 and a director of NatWest in 1990.

*** Martin G Taylor CBE (64)**
Chairman, National Westminster Life Assurance.
Deputy Chairman, Charter. Director, Vickers. Director, Millennium Chemicals.
Mr Taylor, who is a Chartered Accountant, joined Dow Chemical (UK) as Company Secretary in 1963. In 1969 he moved to Hanson and became a director in 1976 and Vice Chairman in 1988, a post he held until his retirement in 1995. Mr Taylor has been a director of NatWest since 1990.

Derek Wanless (51)
Group Chief Executive.
Mr Wanless joined NatWest in 1970 and his appointments within the Group include Area Director, North East from 1982 to 1985 and Area Director, West Yorkshire 1985 to 1986. In 1986 he became Director of Personal Banking and in 1989 he was appointed General Manager, UK Branch Business. In 1990 he took on the role of Chief Executive, UK Financial Services. Mr Wanless was appointed a director of NatWest in 1991 and became Group Chief Executive in 1992.

* Independent non-executive director.

General Counsel
Christopher F FitzGerald

Company Secretary
Peter J S Hammonds FCIS

Committees of the Board

Audit and Compliance Committee
Sir Sydney Lipworth (Chairman)
Professor Sue Birley
Pen H Kent
Sir George Quigley
Martin G Taylor

Remuneration Committee
Martin G Taylor (Chairman)
Sir Michael Angus
Professor Sue Birley
Sir Sydney Lipworth
Sir Charles Powell

Nomination Committee
Lord Alexander (Chairman)
Sir Michael Angus
Lord Blyth
Sir Sydney Lipworth
Sir Charles Powell
Sir David Rowland
Derek Wanless

Executive officers
at 22 February 1999

Name	Position	Appointed
Guy V Barker (48)	Managing Director, NatWest Life & Investment Services, NatWest Wealth Management	May 1998
Lord Blackwell (46)	Director of Group Development	August 1997
Patrick J Boylan (57)	Managing Director, Card Services, NatWest UK	March 1995
Andrew J Brown (54)	Joint Chief Executive, Gartmore Investment Management, NatWest Wealth Management	February 1997
Howard R Brown (53)	Group Financial Controller	September 1997
Terrence I Collis (45)	Director of Corporate Affairs	January 1997
Christopher F FitzGerald (53)	General Counsel	May 1995
Peter J S Hammonds (45)	Company Secretary	June 1991
Stephan L Harris (52)	Chief Executive, Global Financial Markets	February 1994
Gary F Holloway (47)	Co-Chief Executive, Greenwich NatWest	August 1997
Alton F Irby (58)	Chief Executive, Corporate Advisory	August 1997
Glyn P Jones (46)	Chief Executive, Coutts NatWest Group, NatWest Wealth Management	November 1997
Timothy L Jones (43)	Managing Director, Retail Banking Services, NatWest UK	September 1996
Rajan Kapoor (46)	Group Chief Accountant	March 1993
Konrad R Kruger (46)	Co-Chief Executive, Greenwich NatWest	August 1997
Simon P G Lee (37)	Director of Wholesale Markets	October 1998
James S Mann (52)	Director of Group Operations and Technology	July 1998
William W Martin (42)	Director of Group Risk	March 1998
David B Maycock (55)	Director of Group Compliance	March 1995
Michael D Newens (49)	Managing Director, Group Property and Security	January 1996
David V Paige (47)	Director of Group Audit	February 1997
Achi Racov (54)	Chief Information Technology Officer	December 1996
David R Shaw (50)	Managing Director, NatWest Equity Partners, NatWest Wealth Management	May 1989
H Anthony Shaw (56)	Managing Director, Corporate Banking Services, NatWest UK	January 1995
J Christopher Wathen (53)	Director of Group Human Resources	June 1994
David W Watts (49)	Joint Chief Executive, Gartmore Investment Management, NatWest Wealth Management	February 1997
Stephen J S Wells (50)	Managing Director, NatWest Insurance Services, NatWest UK	January 1995
Martin J Wilson (48)	Chief Executive, Ulster Bank Ltd	April 1998
George J Wise (55)	Managing Director, NatWest Mortgage Services, NatWest UK	February 1995

The Group has employment contracts with the executive officers listed on page 60. The majority of these contracts provide for a term of service expiring at the end of a 12 month period or on the individual's 60th birthday, if earlier. The notice periods within these contracts are normally 12 months.

Remuneration of directors and officers

The total remuneration for the year ended 31 December 1998 of all directors and officers (52 persons) amounted to £21,733,000. This sum includes £206,000 in respect of services as directors and includes amounts paid under the Bank's profit sharing schemes, which are described in note 5 to the accounts on page 81.

The following table shows the aggregate shareholdings, as at 31 December 1998, of the directors and officers.

Title of class	Owner	Number owned	Percentage of class
Ordinary shares of £1 each	Directors and officers of the Bank (47 persons)	329,047	0.02%

At 31 December 1998, executive officers held options under the Bank's 1981 Savings Related Share Option Scheme relating to a total of 23,388 shares. At the same date, executive officers held options under the Executive Share Option Scheme relating to a total of 776,251 shares.

Further details of directors' remuneration and interests in shares are given in the Report of the directors on pages 66 to 71.

Report of the directors

Results for the year

Profit on ordinary activities before taxation was £2,142m compared with £975m for the previous year. This profit has been dealt with as shown in the Consolidated Profit and Loss Account on page 74.

The taxation charge for the year amounted to £501m as against £309m for 1997. After minority interests of £24m and preference share dividends of £51m, the profit attributable to ordinary shareholders of the Bank was £1,566m (1997 £591m).

Dividends

The final dividend for 1998 of 24.2p per ordinary share (1997 21.6p), together with the interim dividend of 11.8p (1997 10.6p), makes a total distribution to the ordinary shareholders for the year of 36.0p per ordinary share, compared with 32.2p for 1997. With the related tax credit at current rates, this represents a gross distribution of 41.6p per ordinary share (1997 40.3p). The final dividend will be paid on 4 May 1999 to shareholders registered at the close of business on 5 March 1999.

Activities

The Bank and its subsidiary undertakings which form the Group provide an extensive range of banking and financial services through offices and branches in the UK and overseas. A detailed description of the businesses of the Group is given on pages 4 to 6. The principal subsidiary undertakings, together with an indication of the nature of their businesses, are set out in note 25 to the accounts on page 96.

The operating and financial review on pages 10 to 56, which is adopted as part of this Report, contains a discussion and analysis of the performance of the businesses and the factors underlying their results, financial position and future prospects. Further commentary on the development of the businesses during the year and an indication of likely future developments in the Group are contained in the Annual Review for 1998 which will be sent to all shareholders.

Corporate governance

The Board

The most important factors in ensuring that the Group is headed by an effective Board which can lead and control the NatWest Group are the quality, integrity and experience of directors. The Board has established a Nomination Committee (see list of members on page 59) which meets at least once a year to discuss the make-up of our Board and Committees. The Nomination Committee recommends potential new directors to the Board.

Currently, new non-executive directors are appointed to the Board for three years. At the end of that time the Nomination Committee considers whether that director should continue on the Board for a further period which would not usually exceed three years. In addition to this, all directors stand for re-election by shareholders at least every three years. As shown on pages 57 to 59 the NatWest Board comprises, at present, a full-time Chairman, Lord Alexander, twelve independent non-executive directors and five executive directors including the Group Chief Executive, Derek Wanless. The composition and balance of the Board is appropriate for the needs of our business at the present time. However, the Board, with the advice of the Nomination Committee, regularly reviews the composition of the Board to ensure that it has the range of skills and experience to provide effective leadership for the NatWest Group. The Board provides leadership by setting the Group's strategy and plans, monitoring financial and business performance and ensuring that the Group's control framework is effective.

The distinct roles of the Chairman and Group Chief Executive have been clearly documented to ensure that there is no uncertainty about their respective roles and duties.

On appointment, all non-executive directors go through an induction programme to allow them to make an effective contribution to the Board's work as quickly as possible. Non-executive directors also receive ongoing training on new developments in the Group's businesses. Clear guidelines are in place on the format, content and presentation of reports to the Board to make sure that the Board receives reports in a timely manner that are appropriate for the needs of the Board and to initiate challenging debates. Sir Sydney Lipworth, one of the Deputy Chairmen, who has served on the Board since 1993, has been nominated by the Board as Senior Independent Non-Executive Director, as recommended by the Combined Code of the Committee on Corporate Governance issued by the London Stock Exchange ('the Combined Code').

Directors' remuneration

The Board's report on Directors' remuneration appears on pages 66 to 71. The Remuneration Committee, which consists entirely of independent non-executive directors, sets the pay and benefits of the Chairman, Sir David Rowland, Lord Hurd and the executive directors. None of these directors is involved in setting their own remuneration.

Relations with shareholders

The Group has a well developed and structured communications programme with its institutional shareholders which is led by the Group Chief Executive and the Group Chief Financial Officer.

The Board makes every effort to maximise the value of the AGM to private shareholders and the Group. In addition to the routine business of the meeting, additional briefings are provided by the Group Chief Executive and other executives on areas of particular concern or interest to shareholders. As well as the briefings provided during the main part of the meeting, information stands on particular business areas or issues are available for shareholders at every meeting. Shareholders who are unable to attend the AGM are also invited to submit their questions and they are provided with a written reply.

Accountability and audit
The Board has established an Audit and Compliance Committee which is made up of non-executive directors (see list of members on page 59). The committee considers, in detail, the Group's principal accounting policies and approves any changes. It also reviews the effectiveness of the Group's systems of internal financial controls and receives regular reports from executives responsible for finance, internal audit, compliance with the Financial Services Act and risk management. It also receives reports from our auditors, KPMG Audit Plc.

With the help of the Audit and Compliance Committee, the Board strives always to present a balanced and understandable assessment of the Group's financial position and prospects.

A key objective of the Audit and Compliance Committee is to ensure that the Group's auditors, both internal and external, retain their independence. The Committee monitors fees paid to the external auditors both for audit and for non-audit work.

The Combined Code
Throughout the year ended 31 December 1998 the Bank has complied with the Code Provisions set out in Section 1 of the Combined Code, except for the following:

– The Bank has not, in the past, announced the number of proxy votes cast on resolutions at General Meetings which were not the subject of a poll vote. We shall do so in future.

– The Chairman, Sir David Rowland and the executive directors each have service agreements which, in normal circumstances, provide for a 12 month notice period. However, if there was a change in control of the Bank the agreements (except for those with the Chairman, Paul Myners and Sir David Rowland) provided for a 36 month notice period to apply. Since the end of the year, this arrangement has been withdrawn.

– The Board nominated Sir Sydney Lipworth as Senior Independent Non-Executive Director in December 1998 as recommended by the Code.

As permitted by the London Stock Exchange, the Group has complied with Code provision D.2.1. on internal control (in the Directors' Responsibility Statement on page 72) by reporting on internal financial control in accordance with the guidance for directors on internal control and financial reporting that was issued in December 1994.

Going concern
In accordance with the Combined Code, the directors confirm that they are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future. It is, therefore, appropriate to continue to adopt the going concern basis in preparing the accounts.

Capital
During 1998, 7.7m ordinary shares were issued to the Group's Qualifying Employee Share Ownership Trust ('QUEST') at an issue price of 922.5p to enable the QUEST to satisfy options exercised under the Bank's Savings Related Share Option Scheme. In addition, 0.3m ordinary shares were issued directly to staff on the exercise of options under the Savings Related Share Option Scheme at subscription prices between 196p and 634p per ordinary share. A further 2.7m ordinary shares were issued following exercise of options under the Bank's 1986 and 1994 Executive Share Option Schemes at subscription prices between 278p and 1101p per ordinary share.

During the year the Bank purchased 37.2m (2.2% of the issued ordinary shares at 31 December 1998) of its ordinary shares of £1 each in the market for cancellation at a cost of £375m plus expenses. In addition to the longer-term benefits of achieving a more efficient capital structure, the purchase was in the Bank's and shareholders' best interests because it enhances earnings per share.

In September, the Bank issued £300m (£294m after issue expenses) 6.5% subordinated notes due to mature in 2021. In October, the Bank redeemed $250m of Non-Cumulative Dollar Preference Shares, Series A, at a premium of $0.90 per share. In February, the Bank redeemed at par $95m variable rate notes due to mature in February 2000. In April, DM300m 6% subordinated notes matured. In August, $135m variable rate notes matured. In October, the Bank repaid the third $50m instalment of variable rate notes maturing in October 2000.

The effect of the transactions referred to above on the ordinary share capital, reserves and subordinated liabilities of the Bank is detailed in notes 39 to 41 to the accounts on pages 105 to 109.

The Bank's AGM in April 1998 renewed an authority to purchase up to 100m ordinary shares (6% of its then issued ordinary share capital). Having purchased 37.2m ordinary shares since this authority was given the Bank may, under this existing authority, purchase up to 62.8m ordinary shares before the AGM for 1999. A resolution will be put to the Bank's AGM on 20 April 1999 to obtain an authority to purchase up to 200m ordinary shares (12% of its current issued ordinary share capital) for the period to the AGM in 2000 or to 20 July 2000, whichever is the earlier.

Substantial shareholdings

At the date of this report, the Bank did not know, and had not been notified, of any interest in its shares which would need to be disclosed to the Bank under Part VI of the Companies Act 1985. The Bank is not aware of any person who owns 10% or more of its ordinary shares.

Directors

The current members of the board are shown on pages 57 to 59.

Sir Desmond Pitcher resigned as a director in February 1998 and Sir John Banham retired as a director at the AGM in April 1998.

Lord Blyth, Anthony Habgood and Sir David Rowland were appointed directors in April 1998. Since the last AGM, Sir Richard Evans has been appointed a director with effect from October 1998 and he will offer himself for election at the forthcoming AGM.

The directors retiring by rotation at the AGM, in accordance with the Articles of Association, are Lord Alexander, Professor Sue Birley, Sir Sydney Lipworth, Bernard Horn, Lord Hurd and Sir George Quigley. Lord Alexander, Sir George Quigley and Lord Hurd do not intend to offer themselves for re-election, but each of the other directors named above shall be standing for re-election.

Contracts

None of the directors had a material interest at any time during the year in any contract of significance in relation to the Bank's business.

Employees

NatWest Group is committed to equality of opportunity and the creation of an environment in which individuals can feel valued and develop their potential without the barrier of discrimination.

In line with the Group's commitment to the Opportunity 2000 Campaign, 28% of the management team are female. Employees from ethnic minorities represent over 3% of the management team across the Group.

NatWest takes every reasonable step to facilitate the employment, training, career development and promotion of disabled individuals, adopting a flexible approach to roles and surroundings to allow staff to fulfil their duties.

Employee participation

The methods used by the Bank to communicate directly with staff during 1998 included circulars and other information sheets, leaflets, videos, telephone hotlines and in-house magazines. Comprehensive staff attitude surveys were regularly used to seek feedback on key issues. NatWest UK's units held regular communication meetings to enable a two-way flow of information.

The Bank remains committed to providing opportunities for staff to acquire shares as a means of encouraging employee participation and, in 1998, over 41,000 staff (around two-thirds of those eligible) subscribed to an offer under the Bank's ShareSave '98 Scheme. In addition, staff may elect to receive shares instead of cash under the Staff Profit Sharing Share Scheme.

As part of the Bank's overall reward package, all staff are eligible to earn performance-based bonuses.

The Bank continues to consult and negotiate on a regular basis with the NatWest Staff Association and the Banking Insurance and Finance Union. The NatWest Staff Council, which is another avenue for communication and consultation across the Group as a whole, held its third meeting in March 1998. Developed in conjunction with staff representatives, it has 52 members reflecting the views of staff around the world.

Suppliers

The Group's suppliers are vital to its success and it is committed to establishing mutually beneficial relationships with them, based on the same high ethical standards that apply to all dealings. It is the Group's policy:

- wherever appropriate, to settle the terms of payment when agreeing each transaction;
- to ensure the supplier is aware of the terms; and
- to abide by them.

In all other circumstances, the Group is committed to paying suppliers within 30 days of receipt of a valid invoice.

At 31 December 1998, the amount owed to trade creditors by the Bank and the Group, expressed as a proportion of the amounts invoiced by suppliers during the year then ended, was 22 and 21 days' worth respectively.

NatWest and the environment

NatWest Group is committed to achieving environmental best practice throughout its business activities, wherever this is practicable. NatWest started its environmental responsibility programme, based on continuous improvement, nine years ago, concentrating on three main areas:

- reducing our effect on the environment;
- improving the way we measure environmental risk; and
- developing the new business opportunities that improve environmental protection.

In April 1999 the Group will be publishing its first Social Impact Review which will look at the Group's progress in addressing environmental, community and social issues. Copies of the Review can be obtained by telephoning the Shareholders' Helpline on 0117 930 6566.

Premises

At 31 December 1998, the Group had approximately 2,400 branches, representative and similar offices worldwide of which approximately 2,255, principally branch offices, were located in the UK. Of the total net book value of Group properties, over 90% is owned or held under long-term leases. There are no material encumbrances to the Group's properties.

During the year, the Group sold two major properties – The International Financial Centre and No 1 St James's Square, with an aggregate book value of £320m.

The Group's freehold properties were valued at the end of 1998 by its internal and external qualified valuers on the basis of existing use value or, in the case of specialised properties, on a depreciated replacement cost basis. Surplus and investment properties were valued on the basis of open market value. The resulting revaluation surplus of £40m was credited to the revaluation reserve.

Contributions

During the year, the Group made donations amounting to £2.5m to UK charitable organisations. No contributions were made by the Group to any UK political party.

Annual General Meeting

The AGM for 1999 will be held on 20 April 1999. The Notice of Meeting will be sent to all shareholders. Copies of the Notice can be obtained by writing to the Registrar for NatWest Group, Freepost (BS2282), PO Box 82, Bristol BS99 7ZZ or by telephoning our Shareholders' Helpline on 0117 930 6566.

Auditors

KPMG Audit Plc have signified their willingness to continue in office and a resolution re-appointing them as auditors and authorising the directors to set their remuneration will be proposed at the AGM.

Report on Directors' Remuneration

The Remuneration Committee
The Board has appointed a Remuneration Committee ('the Committee'), which consists entirely of independent non-executive directors, whose names are shown on page 59. Martin Taylor CBE was appointed Chairman of the Committee with effect from April 1998.

The Committee:
- advises the Board on the Group's policy for executive remuneration;
- determines the remuneration for Lord Alexander, Sir David Rowland, Lord Hurd, the executive directors and other key Group executives; and
- considers the Group's compliance with recommended best practice for executive remuneration.

It does not set fees for any members of the Committee or other non-executive directors. These are recommended to the Board by the Chairman and the Group Chief Executive and determined by the Board. Full details of individual directors' emoluments are given on page 69.

Remuneration policy
The Board's policy on executive directors' remuneration is designed to ensure that the Group delivers improved shareholder value through the achievement of its strategic objectives by:

- attracting and retaining individuals of the highest calibre; and
- encouraging them to perform to their utmost capability.

In this context, the Committee aims to:

- pay market competitive salaries and associated benefits;
- reward individual performance through appropriate annual bonuses; and
- award medium-term incentives to provide a check and balance against the short-term perspective of the annual bonus and to align the interests of executives and shareholders.

The Committee considers each element of the reward package to ensure that it remains relevant and stretching and that the overall reward package is not excessive.

The Committee also seeks to encourage executive directors to retain a significant stake in the Group's shares, to align their interests with those of our shareholders. The Committee has thus introduced a personal shareholding policy for the Group's key executives, under which executive directors are encouraged to build and retain a holding in the company's shares with a value equivalent to at least one times salary (as defined at 31 December 1998). Personal beneficial shareholdings and shares gained through Group employee share schemes count towards target shareholdings. At least 60% of shares vesting from awards under the Group's Executive Share Option Scheme ('ESOS') and Medium Term Equity Plan ('MTEP') are to be retained in order to achieve target shareholdings.

Remuneration arrangements
Salaries
The Committee reviews salaries annually taking into account market data and independent, external advice on pay for similar roles. The Committee also considers the Group's performance compared with other companies and pay increases to the Bank's employees generally.

Annual bonuses
The Committee determines annual bonus payments after considering the performance of each individual director against both their personal and corporate strategic objectives. The maximum bonus that can normally be paid is 60% of salary. There is no upper limit on bonus payments for Derek Wanless and Paul Myners. The Deputy Chairmen and other non-executive directors do not receive an annual bonus.

Medium term incentive schemes
In 1994, the Group established a MTEP for those executives who are best placed to maximise shareholder value. This is an employee share ownership plan, under which participants are conditionally awarded a potential maximum number of shares. The Committee determines individual participation in the plan. In 1998, Lord Alexander and the executive directors' awards were equivalent to 100% of salary. The Deputy Chairmen and other non-executive directors do not participate in the plan.

For the 1998 award, the actual number of shares that participants may eventually acquire is dependent on the Group's total return to shareholders ('TRS') relative to other companies in the FT-SE 100 index over the three year performance period, 1998-2000, as follows:

- 100% of shares if NatWest is ranked in the top 12 positions;
- between 98% and 25% of shares if ranked between 13th and 50th positions; and
- no shares if NatWest is ranked below 50th position.

The Committee must also be satisfied that there has been an improvement in the underlying financial position of the Group before it agrees that the performance conditions have been met.

The Committee has confirmed that the Group Return on Equity ('RoE') performance condition for the 1996 MTEP award has not been met over the financial years 1996-1998 and, as stated in the Committee's 1997 report, the performance period for this award will be remeasured over the financial years 1998-2000. The Committee determined that the 1996 Trading Return on Capital Employed performance condition relating to the Retail and Commercial Businesses that formerly comprised NatWest UK has been met over the financial years 1996-1998. 70% of Martin Gray's 1996 MTEP award will thus vest in March 1999.

The Committee has decided that in order to reinforce the emphasis on performance-based reward and the importance of alignment with shareholders' interests, the executive directors' awards in future will be equivalent to 125% of salary. The performance condition for grants to be made in the 1999 award will be the Group's total return to shareholders relative to other companies in the FT-SE 100 index over the three year performance period, 1999-2001. The actual number of shares that executive directors may eventually acquire in 2002 will be determined as follows:

- 100% of shares if NatWest is ranked in the top 10 positions;
- between 98% and 20% of shares if ranked between 11th and 50th positions; and
- no shares if NatWest is ranked below 50th position.

Business incentive schemes

Paul Myners is the only director to participate in a business incentive scheme. As Chairman of Gartmore he continues to receive awards under those Gartmore incentive schemes that were introduced in 1996 to retain and motivate key executives in the combined Gartmore and NatWest Investment Management business.

Payments to Paul Myners under the Gartmore Short Term Retention Plan are shown on page 69. Paul Myners' awards under the Gartmore Interim Incentive Plan and the Gartmore Long Term Incentive Plan are expressed as a percentage of a plan pool. The monetary values of awards are defined when they become exercisable. The 1996 Interim Incentive Plan award is dependent upon Gartmore's profitability in 1997 and 1998 and will become exercisable in April 2000. The 1997 Long Term Incentive Plan award is dependent upon growth in Gartmore's profitability between 1997 and 2000 and will become exercisable in April 2001.

Group-wide employee schemes

Executive directors are eligible to participate, on the same terms as most other employees, in the Group's profit sharing, ShareSave and profit related pay schemes. The Chairman, Deputy Chairmen and other non-executive directors do not participate in any of these schemes. Paul Myners does not participate in the Group profit sharing scheme. The Group also operates a discretionary executive share option scheme. Since 1994, executive share options have not been granted to the Chairman, executive directors or other executives who participate in the MTEP. Options granted prior to 1994 have met their performance conditions and remain exercisable. Options granted in 1994, 1995 and those granted in 1996 with Group RoE performance conditions are not currently exercisable. The Group's performance for these options will be measured again over the financial years 1997-1999.

Other benefits

Lord Alexander and the executive directors may also receive benefits in kind, such as a car (or a car allowance) and private health insurance. Sir George Quigley is the only non-executive director to receive a benefit in kind. As Chairman of Ulster Bank, he has the use of a Bank car.

Pensions

Executive directors are entitled to pensions based on salary and length of service with the Group. These pensions will be provided by Inland Revenue approved pension schemes funded by the Bank. These schemes provide:

- a pension on retirement of up to two thirds of pensionable emoluments; and
- dependants' benefits in the event of the member's death before or after retirement.

Pensionable emoluments include salaries and part of the annual bonus, up to a maximum of 20% of salary. The Committee is aware that it is not general practice for part of the annual bonus to be pensionable but believes that as a significant proportion of directors' remuneration is performance-related, it is consistent that their pension should reflect this arrangement. As part of its approach to determining overall remuneration, the Committee considers the pension implications of its decisions on individual salary and bonus.

Under the Gartmore Pension Scheme, of which Paul Myners is a member, his pensionable emoluments do not include a proportion of bonus.

Benefits for directors who joined after May 1989 under the Bank's pension schemes are subject to the Inland Revenue earnings cap. Richard Delbridge will receive a pension from one of the Bank's pension schemes up to the level of the earnings cap. The remainder of his pension will be provided by the Bank. The additional cost of this has been provided for in the accounts of the Bank.

The Chairman will not receive a pension under the Bank's pension schemes. Instead the Bank paid £98,000 in 1998 (£77,000 in 1997) towards the Chairman's personal pension arrangements. The Chairman's and Sir David Rowland's dependants would receive a lump sum payment of four times their basic salary in the event of death whilst in the service of the Bank.

Sir Sydney Lipworth, Lord Hurd and other non-executive directors are not members of any Group pension scheme.

Details of the pension benefits earned by executive directors during 1998 are summarised in the table below.

The third column shows the annual pension that each director would receive at normal retirement age, were he to have left the Bank's service at the end of the year. The pension figure shown is based on completed service and actual earnings at the end of the year.

The fourth column shows the increase in each director's accrued pension during 1998, after adjustment for inflation. The pension figure reflects the completion of additional pensionable service and any increase in salary in 1998.

The final column shows the transfer value at 31 December 1998 of the additional accrual of pension over 1998. This does not represent any pension sum paid or due to each individual director.

	Normal retirement age	Accrued annual pension at year end		Increase in accrued benefit over the year		Transfer value of increase in accrued pension
		1998 £pa	1997 £pa	1998 £pa	1997 £pa	1998 £
R Delbridge	60	13,400	6,600	6,600	5,100	100,000
H M V Gray	60	192,200	179,800	5,900	18,100	75,800
B P Horn	60	181,300	169,200	6,000	19,000	77,600
P Myners[1]	62	82,800	73,100	11,200	4,600	140,900
D Wanless	60	272,400	252,200	11,100	30,600	133,900

1 The 1997 figures shown for Paul Myners cover the period 5 August 1997, his date of appointment to the Board, to 31 December 1997.

Service agreements

The service agreements between the Bank and the Chairman, Sir David Rowland and the executive directors provide for a 12 month notice period. The previous arrangement in respect of four executive directors, which provided for a 36 month notice period to apply in the event of a change of control of the Bank, has been withdrawn.

Having had regard to the Combined Code recommendations, and to provide further clarity to all interested parties on compensation in the event of departure, the Committee has determined that, should the Bank breach an executive director's service agreement, the executive director will be entitled to receive liquidated damages from the Bank, equivalent to 12 months' salary and benefits, which will include an average of the previous three years' annual bonuses.

Of the directors offering themselves for re-election at the Annual General Meeting, Bernard Horn has a service agreement with the Bank which may be terminated upon 12 months' notice. None of the other directors seeking re-election has a service agreement with the Bank or any of its subsidiary undertakings.

Non-executive directors

Most non-executive directors sit on one or more of the Group Audit and Compliance Committee, the Nomination Committee, the Remuneration Committee and the Boards of certain subsidiary companies. Details of some of these responsibilities are shown on page 59.

Individual directors' remuneration

	Salary and fees £000	Performance related bonuses £000	Profit sharing £000	Benefits £000	Total 1998 £000	Total 1997 £000	Potential pre-tax gain on exercise of options in 1998 £000	Transfer value of increase in accrued pension 1998 £000
Lord Alexander (Chairman)	456	250	–	14	720	434[2]	90	–
Sir Sydney Lipworth (Deputy Chairman)	200	–	–	–	200	183	–	–
Sir David Rowland (appointed director April 1998 and Deputy Chairman September 1998)	74	–	–	–	74	–	–	–
R Delbridge (Group Chief Financial Officer)	318	195	21	1	535	478	–	100
H M V Gray (Executive Director, Retail and Commercial Businesses)	271	145	16	16	448	405	3	76
B P Horn (Executive Director, Group Operations)	283	175	19	1	478	366	3	78
Lord Hurd (Deputy Chairman, Coutts & Co)	250	–	–	–	250	250	–	–
P Myners (Executive Director, Wealth Management Businesses, appointed a director August 1997)	256	190	–	11	457[1]	109[2]	–	141
Dr J M Owen (resigned June 1997 as Chief Executive, NatWest Markets)	–	–	–	–	–	198[3]	–	–
D Wanless (Group Chief Executive)	435	350	30	17	832	450[2]	3	134
					3,994	2,873		
Potential pre-tax gains on exercise of options					**99**	125		
Amounts received under long term incentive schemes					**358**[1]	333		
1996 bonus waived by Dr J M Owen					**–**	(200)		
Total					**4,451**	3,131		

1 Paul Myners exercised the interim part of his 1996 grant under the Gartmore Short Term Retention Plan to the value of £333,333 in March 1998. £24,224, representing 7.27% interest on this sum was also paid at that time.
2 In light of the 1997 Group results, Lord Alexander and Derek Wanless indicated that they did not wish to be considered for an annual bonus. Paul Myners similarly took no bonus in view of Gartmore's investment performance at that time. The total remuneration figures for 1997 reflect these decisions.
3 Dr Owen's salary and fees for 1997 include an ex-gratia payment of £35,000 relating to his departure and a payment of £12,000 in respect of outplacement consultancy.

	Board fee £000	Board committee fees £000	Salaries and fees from subsidiary undertakings £000	Benefits £000	Total 1998 £000	Total 1997 £000
Sir Michael Angus	24	7	–	–	31	31
Sir John Banham (retired April 1998)	7	7	–	–	14	45
Professor Sue Birley	24	19	–	–	43	35
Lord Blyth (appointed April 1998)	18	1	–	–	19	–
Sir Richard Evans (appointed October 1998)	6	–	–	–	6	–
A J Habgood (appointed April 1998)	18	–	–	–	18	–
P H Kent (appointed September 1997)	24	14	–	–	38	10
Lord MacLaurin (resigned February 1997)	–	–	–	–	–	5
J W Melbourn (retired October 1997)	–	–	–	–	–	64[1]
Sir Desmond Pitcher (resigned February 1998)	3	1	–	–	4	26
Sir Charles Powell	24	29	–	–	53	49
Sir George Quigley	24	12	49	13	98	86
M G Taylor	24	24	27	–	75	67
Total	196	114	76	13	399	418

1 The potential pre-tax gain on the exercise of options in 1997 by Mr Melbourn was £399,000.

Directors' interests in shares

The interests, all beneficial (see note 5 on page 71), of those who were directors at 31 December 1998 in the ordinary shares of the Bank are shown in the following table.

Ordinary shares of £1 each

	Beneficially owned		Medium Term Equity Plan			
	As at 1 January 1998 or date of appointment if later	As at 31 December 1998	Total as at 1 January 1998	Granted in 1998	Lapsed in 1998	Total as at 31 December 1998
Lord Alexander	55,979	40,000	124,771	32,713	43,944	113,540
Sir David Rowland	500	5,000	–	–	–	–
Sir Sydney Lipworth	6,000	20,192	–	–	–	–
Sir Michael Angus	3,428	3,440	–	–	–	–
Professor Sue Birley	609	991	–	–	–	–
Lord Blyth	5,000	5,000	–	–	–	–
R Delbridge	5,000	5,731	68,795	27,586	–	96,381
Sir Richard Evans	6,631	6,631	–	–	–	–
H M V Gray	45,834	46,882	92,254	24,773	31,803	85,224
A J Habgood	2,000	2,000	–	–	–	–
B P Horn	15,790	17,361	89,362	24,773	28,911	85,224
Lord Hurd	284	284	–	–	–	–
P H Kent	2,000	2,000	–	–	–	–
P Myners	5,000	15,000	–	23,367	–	23,367
Sir Charles Powell	–	–	–	–	–	–
Sir George Quigley	3,800	4,173	–	–	–	–
M G Taylor	2,000	2,000	–	–	–	–
D Wanless	84,453	88,421	146,326	39,746	50,593	135,479

Directors' interests in shares continued

Share Options

	As at 1 January 1998 or date of appointment if later	Options granted in 1998 Options	Options granted in 1998 Price pence	Options exercised in 1998 Options	Options exercised in 1998 Price pence	Options exercised in 1998 Market price at date of exercise pence	As at 31 December 1998	Weighted average exercise price of options at 31 December 1998 pence
Lord Alexander	115,594	–	–	16,455	503	1052	99,139	501
R Delbridge	–	207	941	–	–	–	207	941
H M V Gray	127,105	366	941	518	399	990	126,953	500
B P Horn	111,702	207	941	518	399	990	111,391	500
P Myners	705	366	941	–	–	–	1,071	708
D Wanless	202,803	366	941	518	399	990	202,651	500

1 The Register of Directors' Interests in Shares contains full details of directors' options to subscribe for shares in the Bank. The Register is available for inspection by any shareholder at the Bank's Registered Office, during normal business hours.

2 None of the directors had any interest during the year in the preference shares or loan capital of the Bank or in the share or loan capital of the Bank's subsidiary undertakings. The Register of Directors' Interests maintained by the Bank in accordance with Section 325 of the Companies Act 1985 does not:

i record any director as being interested in any debentures of the Bank or any other Group company as at 31 December 1998; or

ii show any member of the immediate family of any director as having been granted or having exercised any rights to subscribe for shares of the Bank or other members of the Group.

3 The market value of the Bank's Ordinary Shares of £1 at 31 December 1998 exceeded the subscription price per share of those options granted under the Executive Share Option Scheme in 1993. These are the only grant of options which are currently exercisable and remain outstanding. The middle market price of the Bank's Ordinary Shares of £1 each as at 31 December 1998 was 1159p per share. During the year, the price of the Bank's Ordinary Shares has ranged from a low of 702p to a high of 1222p.

4 As at 31 December 1998, 1,487,592 (1997 1,411,552) shares were held by the independent trustees of the MTEP and in the terms of the trust deed setting up the plan, all employees and directors are deemed to have an interest as potential discretionary beneficiaries in those ordinary shares.

5 The Bank has established a Qualifying Employee Share Ownership Trust ('QUEST') to operate in connection with the Bank's Savings Related Share Option Scheme. The trustee of the QUEST is NatWest QUEST Limited, a wholly-owned subsidiary of the Bank. As at 31 December 1998, 488,197 (1997 1,566,065) ordinary shares were held by the trustee. Under the terms of the QUEST trust deed, all employees and executive directors are deemed to have an interest as potential discretionary beneficiaries in those ordinary shares. As at the date of this report the number of ordinary shares held by the trustee was 122,057.
Richard Delbridge is a director of NatWest QUEST Limited and therefore additionally has a non-beneficial interest in the shares held in the QUEST.

6 Details of the conditions relating to 1998 MTEP awards are shown on pages 66 and 67.

7 There have been no changes in the interests of the directors of the Bank between 31 December 1998 and the date of this report.

On behalf of the board

Peter J S Hammonds FCIS
Company Secretary

Registered Office
41 Lothbury, London EC2P 2BP
22 February 1999

Directors' responsibility for financial reporting

The following statement, which should be read in conjunction with the Report of the Auditors on page 73, is made to enable shareholders to distinguish the respective responsibilities of the directors and of the auditors in relation to the accounts.

The directors are required by the Companies Act 1985 to prepare, for each financial year, accounts which give a true and fair view of the state of affairs of the Bank and the Group as at the end of the financial year and of the profit for that financial year. The Bank also presents additional information for US shareholders. Accordingly, these accounts are framed to meet both UK and US requirements, including those of the SEC, to give a consistent picture to all shareholders.

The directors consider that, in preparing these accounts, the Bank has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all applicable accounting standards have been followed.

The directors have responsibility for ensuring that the Bank keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Bank and which enable them to prepare accounts that comply with the Companies Act 1985.

The board of directors is responsible for maintaining a comprehensive system of internal financial controls, which is designed to provide reasonable, but not absolute, assurance

– as to the reliability and integrity of the accounts;
– that assets are safeguarded and only authorised transactions are entered into; and
– that fraud and other irregularities are prevented and detected.

The day-to-day operation of the system of internal financial controls is delegated to executive management. The system includes physical controls; procedures for the segregation of duties; credit, trading and other authorisation limits; extensive financial and operating policies; and a comprehensive financial reporting and planning system. It is documented through Group policies and procedures that are communicated to employees. In devising internal financial controls, the Group has regard to the materiality of the risk, the likelihood of it crystallising and the costs of controls. It is, however, possible for internal financial controls to be circumvented or overridden.

The system of internal financial controls is subject to scrutiny by management and internal audit. The Audit and Compliance Committee (the 'Committee') of the board, all of whose members are non-executive directors, meets periodically with internal audit to discuss the nature, scope and results of its work. The Committee has reviewed the effectiveness of the Group's system of internal financial controls that operated during 1998.

The Bank and certain of its United Kingdom subsidiary undertakings are subject to the requirements of the Financial Services Authority in respect of internal financial controls. The Banking Act 1987 provides for the appointment of Reporting Accountants to review selected aspects of accounting records and other internal financial control systems. The scope of such reviews is determined by the Financial Services Authority. Executive management and the directors consider the Reporting Accountants' reports and discuss them with the Financial Services Authority.

KPMG Audit Plc, the independent auditors appointed by the ordinary shareholders of the Bank to audit the accounts, have full and unrestricted access to the Committee to discuss their audit and related findings as to the integrity of the Group's financial reporting and the adequacy of the system of internal financial controls. Both the internal auditors and KPMG Audit Plc have access to the Committee at any time to discuss matters they believe may be of significance. The Committee meets privately with representatives of KPMG Audit Plc at least once a year.

On behalf of the board

Robert Alexander
Chairman

Derek Wanless
Group Chief Executive

Richard Delbridge
Group Chief Financial Officer

22 February 1999

Report of the auditors to the members of National Westminster Bank Plc

To the members of National Westminster Bank Plc
We have audited the accounts on pages 74 to 127.

Respective responsibilities of directors and auditors
The directors are responsible for preparing the accounts as described on page 72. Our responsibilities, as independent auditors, are established by statute, Auditing Standards generally accepted in the United Kingdom and the United States, the Listing Rules of the London Stock Exchange, the United States Securities and Exchange Commission and by our profession's ethical guidance.

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

We review whether the statement on page 63 reflects the Bank's compliance with those provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Bank's corporate governance procedures or its internal controls.

We read the other information contained in the Annual Report and Accounts, including the corporate governance statement, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the accounts.

Basis of opinion
We conducted our audit in accordance with auditing standards generally accepted in the United Kingdom and the United States. An audit includes examination, on a test basis, of evidence relevant to amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

United Kingdom opinion
In our opinion, the accounts give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 1998 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

United States opinion
In our opinion, the accounts present fairly, in all material respects, the financial position of the Group at 31 December 1998 and 1997 and the results of its operations and cash flows for each of the years in the three year period ended 31 December 1998 in conformity with generally accepted accounting principles in the United Kingdom.

Generally accepted accounting principles in the United Kingdom vary in certain significant respects from generally accepted accounting principles in the United States. Application of the generally accepted accounting principles in the United States would have affected consolidated net income for each of the years in the three-year period ended 31 December 1998 and consolidated shareholders' equity at 31 December 1998, 1997 and 1996 to the extent summarised in note 50 to the accounts on page 121.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London, England

22 February 1999

Consolidated profit and loss account
for the year ended 31 December 1998

	Notes	Continuing operations			Discontinued operations			Total		
		1998 £m	1997[1] £m	1996[1] £m	1998 £m	1997 £m	1996[1] £m	1998 £m	1997[1] £m	1996[1] £m
Interest receivable and similar income arising from debt securities		**1,046**	864	660	**–**	–	43	**1,046**	864	703
Other interest receivable and similar income	2	**8,501**	8,164	7,915	**–**	–	489	**8,501**	8,164	8,404
Interest receivable		**9,547**	9,028	8,575	**–**	–	532	**9,547**	9,028	9,107
Interest payable		**(5,681)**	(5,258)	(4,998)	**–**	–	(260)	**(5,681)**	(5,258)	(5,258)
Adjustment for finance leases		**(55)**	(106)	–	**–**	–	–	**(55)**	(106)	–
Net interest income		**3,811**	3,664	3,577	**–**	–	272	**3,811**	3,664	3,849
Dividend income	3	**18**	25	21	**–**	–	1	**18**	25	22
Fees and commissions receivable		**2,745**	2,883	2,822	**–**	–	101	**2,745**	2,883	2,923
Fees and commissions payable		**(563)**	(576)	(491)	**–**	–	(8)	**(563)**	(576)	(499)
Dealing profits	4	**848**	444	500	**–**	–	6	**848**	444	506
Other operating income		**508**	534	456	**–**	–	14	**508**	534	470
Non-interest income		**3,556**	3,310	3,308	**–**	–	114	**3,556**	3,310	3,422
Operating income		**7,367**	6,974	6,885	**–**	–	386	**7,367**	6,974	7,271
Administration expenses	5	**(3,949)**	(4,249)	(3,709)	**–**	–	(202)	**(3,949)**	(4,249)	(3,911)
Depreciation and amortisation	26/27	**(361)**	(359)	(305)	**–**	–	(32)	**(361)**	(359)	(337)
Other operating charges		**(745)**	(666)	(710)	**–**	–	(34)	**(745)**	(666)	(744)
Operating expenses		**(5,055)**	(5,274)	(4,724)	**–**	–	(268)	**(5,055)**	(5,274)	(4,992)
Trading surplus		**2,312**	1,700	2,161	**–**	–	118	**2,312**	1,700	2,279
Provisions for bad and doubtful debts	19	**(499)**	(562)	(549)	**–**	–	(25)	**(499)**	(562)	(574)
Provisions for contingent liabilities and commitments		**–**	(5)	(10)	**–**	–	–	**–**	(5)	(10)
Amounts written off fixed asset investments	6	**(28)**	(31)	(32)	**–**	–	–	**(28)**	(31)	(32)
Operating profit		**1,785**	1,102	1,570	**–**	–	93	**1,785**	1,102	1,663
Income from associated undertakings		**29**	13	23	**–**	–	–	**29**	13	23
Disposal of tangible fixed assets	7	**(21)**	25	(125)	**–**	–	–	**(21)**	25	(125)
Losses on termination of Equities operations	8	**–**	(287)	–	**–**	–	–	**–**	(287)	–
Profit/(loss) on disposal of businesses	9	**265**	43	224	**84**	79	(448)	**349**	122	(224)
Profit/(loss) on ordinary activities before tax	10	**2,058**	896	1,692	**84**	79	(355)	**2,142**	975	1,337
Tax on profit on ordinary activities	12							**(501)**	(309)	(653)
Profit on ordinary activities after tax								**1,641**	666	684
Minority interests – equity								**(24)**	(30)	(30)
Profit for the financial year	13							**1,617**	636	654
Preference dividends – non-equity	14							**(51)**	(45)	(37)
Ordinary dividends	14							**(613)**	(557)	(495)
								(664)	(602)	(532)
Retention for the year	41							**953**	34	122
Per ordinary share								**pence**	pence	pence
Dividends – net	14							**36.0**	32.2	29.0
Earnings – basic	15							**91.2**	34.5	35.3
– diluted	15							**90.1**	33.9	34.9
– headline	15							**78.1**	46.9	66.6

Movements in profit and loss account reserves are shown in note 41.
1 Restated (see page 79).

Statement of consolidated total recognised gains and losses
for the year ended 31 December 1998

	1998 £m	1997[1] £m	1996[1] £m
Profit for the financial year	**1,617**	636	654
Other recognised gains and (losses)			
Revaluation of freehold properties	**40**	32	15
Exchange and other movements	**5**	(67)	3
	45	(35)	18
Total recognised gains for the year	**1,662**	601	672
Prior year adjustment – cumulative goodwill amortisation	**(188)**		
Total recognised gains since 31 December 1997	**1,474**		

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Note of consolidated historical cost profits and losses
for the year ended 31 December 1998

	1998 £m	1997[1] £m	1996[1] £m
Profit on ordinary activities before tax	**2,142**	975	1,337
Realised property revaluation (deficit)/surplus	**(38)**	2	(128)
Historical cost profit on ordinary activities before tax	**2,104**	977	1,209
Retention for the year on an historical cost basis	**915**	36	(6)

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Reconciliation of movements in consolidated shareholders' funds
for the year ended 31 December 1998

	1998 £m	1997[1] £m	1996[1] £m
The Group			
Profit for the financial year	**1,617**	636	654
Dividends	**(664)**	(602)	(532)
Retention for the year	**953**	34	122
Other recognised gains and (losses)	**45**	(35)	18
Issue of ordinary shares in relation to share option schemes for staff	**42**	55	23
Shares issued in lieu of cash dividends	**–**	24	20
Repurchase of ordinary shares	**(375)**	–	(451)
Issue of preference shares	**–**	184	–
Preference share issue expenses	**–**	(6)	–
Redemption of preference shares	**(147)**	–	–
Exchange movement on preference shares	**(4)**	5	(30)
Net increase in shareholders' funds	**514**	261	(298)
Opening shareholders' funds as previously reported	**7,897**	7,552	7,213
Prior year adjustment	**90**	174	811
Opening shareholders' funds – as restated	**7,987**	7,726	8,024
Closing shareholders' funds			
Equity interests	**8,029**	7,364	7,292
Non-equity interests	**472**	623	434
	8,501	7,987	7,726

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

	1998 £m	1997 £m	1996 £m
The Bank			
The split between equity and non-equity interests of the Bank's shareholders' funds is as follows.			
Equity interests	**7,390**	6,625	6,394
Non-equity interests	**472**	623	434
	7,862	7,248	6,828

Consolidated balance sheet of the NatWest Group

at 31 December 1998

	Notes	1998 £m	1997[1] £m
Assets			
Cash and balances at central banks		**1,055**	905
Items in the course of collection from other banks		**2,433**	2,599
Treasury and other eligible bills	16	**5,859**	6,246
Loans and advances to banks	17	**32,369**	32,016
Loans and advances to customers		**79,448**	85,232
less: non-returnable finance		**(486)**	(757)
	18	**78,962**	84,475
Operating lease assets	21	**1,308**	1,703
Debt securities	22	**37,563**	30,411
Equity shares	23	**333**	4,350
Interests in associated undertakings	24	**93**	67
Intangible fixed assets	26	**639**	739
Tangible fixed assets	27	**2,454**	2,761
Other assets	29	**13,736**	13,633
Prepayments and accrued income		**1,970**	1,989
		178,774	181,894
Long-term assurance assets attributable to policyholders	31	**7,219**	3,600
Total assets		**185,993**	185,494
Liabilities			
Items in the course of transmission to other banks		**1,268**	1,320
Deposits by banks	32	**26,562**	28,102
Customer accounts	33	**96,294**	89,888
Debt securities in issue	34	**15,555**	17,797
Other liabilities	36	**21,948**	27,090
Accruals and deferred income		**2,659**	2,882
Provisions for liabilities and charges			
Deferred taxation	37	**578**	1,264
Other provisions for liabilities and charges	38	**100**	244
		678	1,508
Subordinated liabilities			
Undated loan capital including convertible debt	39	**2,356**	2,360
Dated loan capital	39	**2,806**	2,785
		5,162	5,145
Minority interests including non-equity interests		**147**	175
Called up share capital			
Ordinary shares	40	**1,705**	1,731
Preference shares	40	**472**	623
		2,177	2,354
Share premium account	41	**1,181**	1,105
Other reserves	41	**259**	75
Revaluation reserve	41	**23**	(56)
Profit and loss account	41	**4,861**	4,509
Shareholders' funds including non-equity interests		**8,501**	7,987
		178,774	181,894
Long-term assurance liabilities attributable to policyholders		**7,219**	3,600
Total liabilities		**185,993**	185,494
Memorandum items			
Contingent liabilities			
Acceptances and endorsements	43	**731**	858
Guarantees and assets pledged as collateral security	43	**10,054**	9,718
		10,785	10,576
Commitments			
Other commitments	43	**48,164**	53,333

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

These accounts were approved by the Board of Directors on 22 February 1999 and signed on its behalf by

Robert Alexander
Chairman

Derek Wanless
Group Chief Executive

Richard Delbridge
Group Chief Financial Officer

Balance sheet of National Westminster Bank Plc

at 31 December 1998

	Notes	1998 £m	1997 £m
Assets			
Cash and balances at central banks		**746**	763
Items in the course of collection from other banks		**2,299**	2,474
Treasury and other eligible bills	16	**5,272**	5,393
Loans and advances to banks	17	**32,478**	30,453
Loans and advances to customers		**58,799**	64,999
less: non-returnable finance		**(346)**	(589)
	18	**58,453**	64,410
Debt securities	22	**21,785**	15,256
Equity shares	23	**38**	119
Participating interests – associated undertakings	24	**6**	18
Shares in Group undertakings	25	**7,710**	8,018
Tangible fixed assets	27	**1,894**	2,208
Other assets	29	**9,907**	8,480
Prepayments and accrued income		**1,552**	1,412
Total assets		**142,140**	139,004
Liabilities			
Items in the course of transmission to other banks		**1,249**	1,298
Deposits by banks	32	**33,254**	32,148
Customer accounts	33	**65,560**	64,095
Debt securities in issue	34	**14,128**	15,531
Other liabilities	36	**13,287**	11,740
Accruals and deferred income		**1,634**	1,710
Provisions for liabilities and charges			
Other provisions for liabilities and charges	38	**77**	162
Subordinated liabilities			
Undated loan capital including convertible debt	39	**2,356**	2,360
Dated loan capital	39	**2,733**	2,712
		5,089	5,072
Called up share capital			
Ordinary shares	40	**1,705**	1,731
Preference shares	40	**472**	623
		2,177	2,354
Share premium account	41	**1,181**	1,105
Other reserves	41	**256**	72
Revaluation reserve	41	**973**	1,568
Profit and loss account	41	**3,275**	2,149
Shareholders' funds including non-equity interests		**7,862**	7,248
Total liabilities		**142,140**	139,004
Memorandum items			
Contingent liabilities			
Acceptances and endorsements	43	**716**	775
Guarantees and assets pledged as collateral security	43	**13,519**	14,731
		14,235	15,506
Commitments			
Other commitments	43	**54,727**	59,803

These accounts were approved by the Board of Directors on 22 February 1999 and signed on its behalf by

Robert Alexander
Chairman

Derek Wanless
Group Chief Executive

Richard Delbridge
Group Chief Financial Officer

Consolidated cash flow statement

for the year ended 31 December 1998

	Notes	1998 £m	1997 £m	1996 £m
Net cash inflow/(outflow) from operating activities	46i	**5,221**	(320)	10,241
Dividends received from associated undertakings		**6**	7	16
Returns on investments and servicing of finance				
Preference share dividends paid		**(53)**	(43)	(37)
Dividends paid to minority shareholders in subsidiary undertakings		**(41)**	(39)	(8)
Interest paid on subordinated liabilities		**(386)**	(379)	(345)
Net cash outflow from returns on investments and servicing of finance		**(480)**	(461)	(390)
Taxation		**(314)**	(288)	(314)
Capital expenditure and financial investment				
Purchase of investment securities		**(26,457)**	(35,255)	(29,930)
Sale and maturity of investment securities		**22,441**	35,942	24,338
Purchase of tangible fixed assets		**(574)**	(619)	(620)
Sale of tangible fixed assets		**569**	255	290
Purchase of operating lease assets		**(1,603)**	(1,047)	(727)
Sale of operating lease assets		**831**	303	270
Net cash outflow from capital expenditure and financial investment		**(4,793)**	(421)	(6,379)
		(360)	(1,483)	3,174
Acquisitions and disposals				
Net cash outflow from the purchase of businesses	46iii	**(11)**	(5)	(815)
Net cash inflow from the disposal of businesses	46v	**1,843**	155	479
Investments in associated undertakings		**(7)**	(9)	(2)
Net cash inflow/(outflow) from acquisitions and disposals		**1,825**	141	(338)
Equity dividends paid				
Ordinary share dividends paid		**(575)**	(488)	(444)
		890	(1,830)	2,392
Financing				
Proceeds from issue of ordinary share capital net of £45m contribution to the Qualifying Employee Share Ownership Trust (1997 £105m; 1996 £nil)	46vii	**42**	55	23
Repurchase of ordinary share capital		**(375)**	–	(451)
Proceeds from issue of preference share capital	46vii	**–**	184	–
Redemption of preference share capital	46vii	**(147)**	–	–
Net proceeds from issue of subordinated liabilities	46vii	**294**	598	297
Repayment of subordinated liabilities	46vii	**(270)**	(125)	(188)
Increase in minority interests		**37**	12	3
Share issue expenses	46vii	**–**	(6)	–
Net cash (outflow)/inflow from financing		**(419)**	718	(316)
Increase/(decrease) in cash	46viii	**471**	(1,112)	2,076

1 Principal accounting policies

Change of accounting policy and presentation

The Group's accounting policy for goodwill has been changed in line with FRS 10 'Goodwill and Intangible Assets'. Purchased goodwill is capitalised, classified as an asset and amortised over its useful economic life. The gain or loss on the disposal of a subsidiary or associated undertaking is calculated by comparing the carrying value of the net assets sold (including any unamortised goodwill) with the proceeds received. Previously the Group's policy was for goodwill to be either deducted from profit and loss account reserves or capitalised. Goodwill eliminated from reserves in prior periods has been reinstated by means of a prior year adjustment and comparatives restated. The effects of this change of policy on the Group's profit and loss account and balance sheet are set out in note 26 on page 97.

The trading revenues of the Group's banking business, principally from currency transactions, have been reclassified as fees and commissions receivable to reflect the retail nature of these units' operations. This change has reduced dealing profits by £66m (1997 £56m; 1996 £55m) with a corresponding increase in fees and commissions receivable.

i Accounting convention

The accounts have been prepared under the historical cost convention modified by the inclusion of the revaluation of freehold properties and certain investments and in compliance with Part VII of the Companies Act 1985 and in accordance with applicable accounting standards. In preparing the accounts, reasonable and prudent judgements and estimates have been made that affect the reported amounts of certain assets, liabilities, memorandum items, income and expenditure. Actual outcomes may differ from these estimates.

The effect on the Group's consolidated net income and ordinary shareholders' equity had US Generally Accepted Accounting Principles ('GAAP') been applied in the preparation of these accounts is set out in note 50 commencing on page 120.

ii Basis of consolidation

To avoid undue delay in the presentation of the Group's accounts, the accounts of certain subsidiary undertakings have been made up to 30 November. There have been no changes in respect of these subsidiary undertakings, in the period from their balance sheet dates to 31 December, that materially affect the view given by the Group's accounts. Details of principal subsidiary undertakings are given in note 25. The long-term assurance assets and liabilities attributable to policyholders are separately disclosed on the consolidated balance sheet in view of their distinct characteristics.

During 1996, Bancorp was sold and, following sale of 80% of the Group's interest, BNWE ceased to be a subsidiary undertaking. Their results are reported as discontinued operations in the consolidated profit and loss account. However, the consolidated cash flow statement for 1996 includes the cash flows of these businesses for the period up to their disposal.

iii Goodwill

The excess of the cost of shares in subsidiary and associated undertakings over the fair value of underlying separable net assets at the date of acquisition and other purchased goodwill are capitalised as intangible assets and amortised over their useful economic lives. The gain or loss on the disposal of a subsidiary or associated undertaking is calculated by comparing the carrying value of the net assets sold and any unamortised purchased goodwill with the proceeds received. Capitalised goodwill is amortised over periods of up to 20 years.

iv Fees receivable

Fees receivable that represent a return for services provided are brought into profit when the related service is performed. Certain front-end fees relating to loans and advances are, subject to yield criteria, taken to profit over the period of the loan.

v Pension costs

The pension costs relating to UK schemes are assessed in accordance with the advice of independent qualified actuaries to recognise the cost of pensions on a systematic basis over employees' service lives. The costs of certain overseas schemes are calculated in accordance with local law and best practice.

vi Foreign currencies

Assets and liabilities denominated in foreign currencies are translated to sterling at rates current on 31 December. The results of overseas subsidiary and associated undertakings are translated at average rates of exchange for the year. Exchange differences arising from translation of opening net assets of overseas subsidiary and associated undertakings and from the restatement of their results from average to year-end rates are taken to reserves together with exchange differences arising on related foreign currency borrowings. All other exchange differences are included in operating profit.

vii Provisions for bad and doubtful debts

Provisions for bad and doubtful debts are made as considered necessary having regard to both specific and general factors. The general element arises in relation to existing losses which, although not separately identified, are known from experience to be present in any portfolio of bank advances. Provisions made (less amounts released) during the year are charged against profits. Advances are written down to estimated realisable value when the normal banking relationship with the borrower has ceased. Where the collection of interest is in significant doubt it is credited to a suspense account. Suspended interest is written off when there is no longer any realistic prospect of it being recovered.

1 **Principal accounting policies** continued

viii Leases and hire purchase contracts

Income from leases and hire purchase contracts is credited to the profit and loss account in proportion to the funds invested. Finance lease receivables and amounts due under hire purchase contracts are included under 'Loans and advances to banks' and 'Loans and advances to customers' as appropriate.

ix Securities (treasury and other eligible bills, debt securities and equity shares)

Securities intended for use on a continuing basis in the Group's activities are classified as investment securities and are stated at cost less provision for any permanent diminution in value. The carrying value of dated investment securities is adjusted over the period to maturity to allow for the amortisation of premiums or discounts. Such amortisation is included in interest receivable. Securities maintained for the purpose of hedging are carried at a value which reflects the accounting treatment of the items hedged. Other securities are carried at market value. The difference between the cost of such securities and market value where the market value is higher than the cost is not disclosed as its determination is not practicable. Short positions in securities are carried at market value.

x Sale and repurchase transactions

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

xi Interests in Group undertakings

The Bank's shares in Group undertakings are included in the balance sheet at its share of net tangible assets.

xii Depreciation

Land is not depreciated. It is the Group's policy to maintain its properties in a state of good repair. The directors' assessment of the residual values (based on values prevailing at acquisition or subsequent valuation) and useful economic lives of freehold and long leasehold properties is such that the charge for depreciation would not be significant; consequently these properties are not depreciated. Depreciation of other fixed assets is provided on a straight-line basis over estimated useful lives generally as follows:

Short leasehold property (leases of less than 50 years unexpired)	Unexpired periods
Property adaptation costs	10 years
Computers	Up to 5 years
Motor vehicles	5 years
Other plant and equipment (including fixed plant in buildings)	10-15 years

xiii Forward foreign exchange contracts and other derivatives

Derivatives, including swaps, futures and forward contracts, options and similar contracts, used in trading activities are carried at their fair values. Fair values are based on quoted market prices when available. If no quoted price exists for a particular instrument, fair value is determined from market prices for its components using appropriate models. Changes in the fair value of trading derivatives are included in 'Dealing profits'. Positive and negative fair values of trading derivatives are set off where the contracts have been entered into under master netting agreements or other arrangements that give a legally enforceable right of set-off. Derivatives used to hedge exposures to (a) changes in fair value of assets and liabilities measured on the accruals basis; and (b) variability in expected future cash flows from assets and liabilities (both recognised and forecast) measured on the accruals basis are classified as non-trading. Such derivatives, which must match or eliminate the exposure being hedged, are accounted for on an equivalent basis to the item being hedged. Amounts payable or receivable on interest rate swaps, forwards and options are included in the profit and loss account so as to match the interest receivable or payable on the hedged item. Discounts or premiums on non-trading forward foreign exchange contracts are amortised to net interest over the life of the contract. Any profit or loss on the early termination of a hedge is amortised to interest receivable or payable over the remaining life of the item being hedged. If a hedged item is derecognised or a forecast transaction is no longer expected to occur, the related hedge is remeasured at fair value and the resulting gain or loss taken to the profit and loss account.

xiv Long-term assurance business

The value placed on the shareholders' interest in the Group's long-term assurance business is a prudent estimate, based on the advice of a qualified actuary, of the net present value of the cash flows inherent in the policies in force, together with the net assets of the business. The change in this value, grossed up at the underlying rate of UK corporation taxation, is included in 'Other operating income'.

xv Deferred taxation

Tax deferred or accelerated by timing differences is accounted for to the extent that it is probable that a liability or asset will arise. It is calculated at rates expected to be applicable when the liabilities or assets are expected to crystallise.

2 Other interest receivable and similar income

	1998 £m	1997 £m	1996 £m
Other interest receivable and similar income includes			
Operating lease rentals	**546**	501	417
Depreciation (note 21)	**(366)**	(336)	(269)
	180	165	148

3 Dividend income

	1998 £m	1997 £m	1996 £m
Income from equity shares	**18**	25	22

4 Dealing profits

	1998 £m	1997[1] £m	1996[1] £m
Foreign exchange	**363**	276	183
Securities			
Debt	**258**	204	83
Equities	**(19)**	(87)	114
Interest rate derivatives	**246**	136	126
Mispricing of interest rate options and swaptions	**–**	(85)	–
	848	444	506

1 Restated (see page 79).

5 Administrative expenses

	1998 £m	1997 £m	1996 £m
Wages and salaries	**2,557**	2,660	2,489
Social security costs	**154**	159	154
Other pension costs (note 11)			
Pensions	**27**	75	111
Other post-retirement benefits	**–**	–	2
	27	75	113
Staff costs	**2,738**	2,894	2,756
Other administrative expenses	**1,211**	1,355	1,155
	3,949	4,249	3,911

Under the rules governing the staff profit sharing schemes, provided the Group's profit on ordinary activities before taxation and profit sharing exceeds £600m, a sum equal to 3% of profits up to £1,200m and 5% of profits in excess of £1,200m, adjusted to disregard the proportionate profit contribution made by units who do not participate in the scheme, is made available for distribution to qualifying members. For 1996, the directors decided to make an ex-gratia payment to neutralise the effect of the net loss on disposal of subsidiary and associated undertakings on the amount available for distribution to staff. In addition, several business units have introduced schemes linked to their profits, as distinct from Group profits. In aggregate, the total profit sharing related payments to staff in respect of 1998 amount to £91m (1997 £88m; 1996 £69m).

Number of employees

The average number of persons, including part-time staff, employed by the Group during the year was made up as follows.

	1998	1997	1996
Managers	**11,900**	12,400	11,900
Clerical staff	**62,400**	63,800	66,200
Others	**600**	800	1,000
	74,900	77,000	79,100
Full-time equivalent at 31 December	**64,400**	70,000	71,000

6 Amounts written off fixed asset investments

	1998 £m	1997 £m	1996 £m
Investment debt securities (note 22)	**14**	9	11
Investment equity shares (note 23)	**14**	22	21
	28	31	32

7 Disposal of tangible fixed assets

	1998 £m	1997 £m	1996 £m
Profit on sale of properties	**30**	27	11
Loss on sale of properties	**(34)**	(3)	(4)
Net (loss)/profit on sale of properties	**(4)**	24	7
Profit on sale of equipment	**3**	9	7
Loss on sale of equipment	**(11)**	(8)	(11)
Net (loss)/profit on sale of equipment	**(8)**	1	(4)
Write down of properties to be disposed of	**(9)**	–	(128)
	(21)	25	(125)

The tax charge on the disposal of tangible fixed assets was £9m (1997 £nil; 1996 £nil).

8 Losses on termination of Equities operations

Losses on termination of the Equities operations in 1997 include £33m of goodwill at termination date and £25m relating to the permanent impairment of goodwill capitalised on the acquisition of Hambro Magan in 1996. The balance, £229m, represents provisions in respect of severance and other staff related costs, premises, fixed asset write-downs and the estimated costs to exit the business not being sold. (Tax credit – £23m).

9 Profit/(loss) on disposal of businesses

	1998 £m	1997 [1] £m	1996 [1] £m
Profit arising on disposals in the year[2] (tax charge – £12m, 1997 £4m)	**265**	43	–
Additional consideration received relating to the disposal of Bancorp, a subsidiary undertaking, in 1996[3] (tax charge – £2m, 1997 £nil)	**84**	79	–
Loss arising on disposal of Bancorp, a subsidiary undertaking (tax charge – £57m)	**–**	–	(431)
Loss arising on disposal of 80% of the Group's interest in BNWE, a subsidiary undertaking (tax charge – £nil)	**–**	–	(17)
Profit arising on disposal of investment in 3i Group plc, an associated undertaking (tax charge – £56m)	**–**	–	224
	349	122	(224)

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).
2 Principally profits on disposal of Lombard point of sale businesses, Lex Vehicle Leasing, Cash and Equity Derivatives businesses, Coutts Bahamas and Coutts Institutional Trust and Custody businesses offset by losses on disposal of the Australian trading operations in 1998. These businesses contributed £16m to Group profit before tax for 1998 up to their disposal. In 1997, the principal components of the profit on disposal were County NatWest Investment Management Australia Limited and McLean, Budden Limited of Canada.
3 The1996 loss on disposal of Bancorp excluded the contingent consideration of up to $560m of which $128m was received in 1997 and $142m was received in 1998.

10 Profit on ordinary activities before tax

	1998 £m	1997 £m	1996 £m
Is stated after			
a Income			
i Profits less losses on disposal of investment securities	**123**	103	110
b Expenditure			
i Charges incurred with respect to subordinated liabilities	**386**	379	346
ii Finance charges in respect of finance leases	**23**	17	21
iii Operating lease rentals			
Hire of computers and equipment	**15**	29	43
Property rentals	**144**	153	161
iv Pensions mis-selling provision	**100**	–	–
v Auditors' remuneration			
The Group	**4.3**	5.2	4.5
The Bank	**1.1**	0.9	0.7
vi Fees paid to auditors and their associates for non-audit work [1]			
UK	**18.0**	10.4	6.1
Overseas	**2.0**	3.1	5.3
	20.0	13.5	11.4

1 Comprise £13.5m (1997 £5.5m; 1996 £3.0m) for management consulting services and £6.5m (1997 £8.0m; 1996 £8.4m) for regulatory, tax, debt investigation, staff secondments and other advisory services.

11 Other pension costs

The Group operates a number of pension schemes throughout the world. The major schemes, which cover 96% of the Group's employees, are defined-benefit schemes whose assets are independent of the Group's finances. The total pension cost for the Group was £27m (1997 £75m; 1996 £111m). This includes £4m (1997 £13m; 1996 £14m) relating to foreign schemes of which £1m (1997 £3m; 1996 £6m) has been determined in accordance with generally accepted accounting principles in the US. At 31 December 1998, there was a pension cost prepayment of £56m (1997 £36m; 1996 £4m). The reduction in total pension cost to £27m from £75m is principally due to the results of a valuation of the major UK scheme as at 31 March 1998.

At 31 March 1998, the date of the latest valuation of the major UK scheme, the National Westminster Bank Pension Fund, the market value of its assets was £9,501m and the actuarial value was sufficient to cover 118% of the future benefits that had accrued to members after allowing for expected increases in earnings. The valuation was carried out using the projected unit method; any imbalance between assets and liabilities is adjusted over the average future service life of members of the scheme. The assumptions, determined in consultation with the scheme's actuaries, which have the most significant effect on the results of the valuation are those relating to the rate of return on new investments and the rates of increases in salaries, pensions and dividends. It has been assumed that over the long term the rate of return on new investments will be 7.25% (1997 8.25%) per annum, the rate of general salary increases will be 4.5% (1997 6%) per annum, the rate of increase in pensions in payment will be 3% (1997 4%) per annum, the rate of dividend increases will be 4% (1997 4.5%) per annum and price inflation will be 3% (1997 4%) per annum.

12 Tax on profit on ordinary activities

	1998 £m	1997 £m	1996 £m
United Kingdom corporation tax	**406**	155	249
Relief for double taxation	**(29)**	(87)	(42)
	377	68	207
Tax credit on franked investment income	**5**	14	29
Deferred taxation	**50**	214	246
Overseas taxes	**123**	126	164
	555	422	646
Share of associated undertakings' taxation	**5**	8	7
	560	430	653
Effect of change in the UK corporation tax rate from 31% to 30% (1997 33% to 31%)			
Adjustment for finance leases	**(55)**	(106)	–
Other	**(4)**	(8)	–
	501	316	653
Overprovisions in previous years	**–**	(7)	–
	501	309	653

The tax charge for the year at £501m, equivalent to 23.4% of pre-tax profit, benefited from a release of deferred tax of £59m, resulting from the reduction in the rate of corporation tax from 31% to 30% enacted by the Finance Act 1998 with effect from 1 April 1999. Primarily, utilisation of capital losses and rollover relief led to only a small tax charge on disposal of subsidiaries, including the second tranche of the additional consideration received on the sale of Bancorp. Excluding these items, the underlying tax rate was 29.5% (1997 35.5%; 1996 31.4%). This was lower than the 1998 effective UK corporation tax rate of 31%, largely due to non-taxable income and overseas income taxed at lower rates being only partially offset by overseas losses for which no relief is currently available, overseas profits taxed at higher rates and other items, mainly goodwill amortisation, which are not allowable for tax purposes.

The UK corporation tax charge includes notional tax of £23m (1997 £25m; 1996 £18m) on the shareholders' interest in the increase in value of the Group's long-term assurance business.

13 Profit dealt with in the accounts of the Bank

Of the profit for the financial year, £2,118m (1997 £827m; 1996 £1,158m) has been dealt with in the accounts of the Bank. As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Bank has not been presented separately.

14 Dividends

	1998 pence per share	1998 £m	1997 pence per share	1997 £m	1996 pence per share	1996 £m
Ordinary shares						
Interim (paid)	**11.8**	**201**	10.6	181	9.6	164
Final	**24.2**	**412**	21.6	376	19.4	331
	36.0	**613**	32.2	557	29.0	495
Total ordinary share dividends including related tax credit [1]	**41.64**		40.25		36.25	
Preference shares – non-equity						
9% non-cumulative sterling preference shares, Series A	**9.00**	**12**	9.00	12	9.00	12
	cents per share [2]		cents per share [2]		cents per share [2]	
Non-cumulative dollar preference shares, Series A	**170.24**	**10**	212.80	13	212.80	14
Premium on redemption		**5**		–		–
Non-cumulative dollar preference shares, Series B	**175.00**	**11**	175.00	11	175.00	11
Non-cumulative dollar preference shares, Series C	**172.50**	**13**	133.22	9	–	–
		51		45		37

1 The current tax credit is 20%. From 6 April 1999 this will reduce to 10% and this lower rate has been applied to the final 1998 dividend to be paid on 4 May.
2 The cents per share data are shown net of tax credit.

The non-cumulative dollar preference shares, Series A, were redeemed on 16 October 1998 and had carried dividends equal to a gross rate of 10.64%. The non-cumulative dollar preference shares, Series B and Series C, carry dividends equal to a gross rate of 8.75% and 8.625% per annum respectively inclusive of any associated tax credit.

15 Earnings per ordinary share

Basic earnings per ordinary share are calculated by dividing the profit for the financial year of £1,566m, after preference share dividends of £51m (1997 £591m after preference share dividends of £45m; 1996 £617m after preference share dividends of £37m), by the weighted average number of ordinary shares in issue during the year of 1,717m (1997 1,716m; 1996 1,747m). Net income per ordinary share and diluted net income per ordinary share under US GAAP are detailed in note 50 on page 121.

Diluted earnings per share are calculated by adjusting the weighted average number of shares to take account of potential ordinary shares outstanding in the period as follows.

Ordinary shares	1998	Number of shares (millions) 1997	1996
Average number of shares in issue during the year	**1,717**	1,716	1,747
Effect of dilutive securities			
Executive Share Option Scheme	**3**	1	1
Savings Related Share Option Scheme	**19**	24	21
Average number of shares in issue during the year assuming dilution	**1,739**	1,741	1,769

Dilutive securities have no effect on earnings.

Headline earnings per ordinary share are calculated in accordance with the definition in the Institute of Investment Management and Research ('IIMR') Statement of Investment Practice No 1, 'The Definition of IIMR Headline Earnings', as follows.

	1998 pence	1997 [1] pence	1996 [1] pence
Basic earnings per ordinary share	**91.2**	34.5	35.3
Losses on termination of Equities operations	**–**	15.4	–
Loss on disposal of Bancorp and BNWE	**–**	–	28.9
Additional consideration received relating to the disposal of Bancorp	**(4.8)**	(4.6)	–
Profit on sale of investment in 3i Group plc	**–**	–	(9.6)
Profit on disposal of businesses	**(14.7)**	(2.3)	–
Disposal of tangible fixed assets	**1.7**	(1.5)	7.2
Impairment of properties	**–**	0.5	0.7
Goodwill amortisation	**4.7**	5.1	4.3
Other	**–**	(0.2)	(0.2)
Headline earnings per ordinary share	**78.1**	46.9	66.6

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

16 Treasury and other eligible bills

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Treasury and similar securities	**1,770**	1,338	**1,211**	516
Other eligible bills	**4,089**	4,908	**4,061**	4,877
	5,859	6,246	**5,272**	5,393
Banking business	**1,049**	466	**920**	382
Trading business	**4,810**	5,780	**4,352**	5,011
	5,859	6,246	**5,272**	5,393

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

17 Loans and advances to banks

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Repayable on demand	**3,805**	3,484	**6,273**	2,397
Other loans and advances – remaining maturity				
3 months or less	**21,386**	20,790	**17,720**	18,444
1 year or less but over 3 months	**6,560**	7,069	**7,638**	8,636
5 years or less but over 1 year	**606**	489	**647**	688
Over 5 years	**53**	191	**240**	294
Specific bad and doubtful debt provisions (note 19)	**(41)**	(7)	**(40)**	(6)
	32,369	32,016	**32,478**	30,453
Banking business	**20,580**	24,629	**21,402**	26,406
Trading business	**11,789**	7,387	**11,076**	4,047
	32,369	32,016	**32,478**	30,453
Amounts include				
Subordinated – third party	**5**	1	**–**	–
Due from subsidiary undertakings				
Subordinated			**231**	183
Unsubordinated			**7,503**	8,941
			7,734	9,124
Loans and advances to banks on which interest is being placed in suspense				
Gross loans and advances	**50**	–	**50**	–
Provisions	**(9)**	–	**(9)**	–
	41	–	**41**	–

18 Loans and advances to customers

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Remaining maturity				
On demand or short notice	**11,591**	13,458	**15,636**	18,381
3 months or less but not on demand or short notice	**12,364**	13,717	**8,806**	17,686
1 year or less but over 3 months	**9,167**	10,630	**7,052**	6,531
5 years or less but over 1 year	**21,801**	20,145	**18,884**	12,857
Over 5 years	**25,370**	27,920	**9,017**	9,880
General and specific bad and doubtful debt provisions (note 19)	**(1,331)**	(1,395)	**(942)**	(925)
	78,962	84,475	**58,453**	64,410
Banking business	**72,583**	74,955	**57,004**	62,230
Trading business	**6,379**	9,520	**1,449**	2,180
	78,962	84,475	**58,453**	64,410
Amounts include				
Subordinated – third party	**21**	22	**–**	–
Due from subsidiary undertakings				
Subordinated			**270**	683
Unsubordinated			**18,757**	26,104
			19,027	26,787
Due from associated undertakings				
Subordinated	**15**	14	**–**	–
Unsubordinated	**241**	236	**–**	–
	256	250	**–**	–
Finance lease receivables	**3,954**	7,308	**–**	–
Hire purchase and conditional sale agreements	**2,953**	4,555	**–**	–
Loans and advances to customers on which interest is being placed in suspense				
Gross loans and advances	**1,061**	1,288	**559**	790
Provisions	**(507)**	(479)	**(317)**	(328)
	554	809	**242**	462
Due from subsidiary and associated undertakings sold during the year	**1,353**	43	**706**	43

18 Loans and advances to customers continued

Analysis by category of borrower	1998 The Group £m	1997 The Group £m
By domestic offices		
Agriculture, forestry and fishing	**1,531**	1,486
Manufacturing and other production	**3,997**	3,855
Construction	**1,580**	1,341
Distribution, transport and hotels	**7,455**	7,199
Financial and other	**6,507**	7,814
Property companies	**3,886**	3,468
Personal – mortgage	**17,794**	16,867
– other	**7,101**	6,597
Instalment	**4,135**	7,329
Lease financing	**3,503**	6,983
Total domestic offices	**57,489**	62,939
By international offices		
United States	**5,636**	6,413
United Kingdom		
Residents	**6,390**	6,382
Non-residents	**3,124**	3,571
	9,514	9,953
Other European Union	**5,589**	4,533
Rest of the World	**2,065**	2,032
Total international offices	**22,804**	22,931
Total gross loans and advances to customers	**80,293**	85,870
Provisions for bad and doubtful debts	**(1,331)**	(1,395)
Total net loans and advances to customers	**78,962**	84,475

The geographical analysis of lendings is based on the location of office from which the loans are made.

Securitisations

The Group has securitised certain loans and revolving credits, using special purpose companies funded primarily through the issue of floating rate notes ('FRNs'). The Group is entitled to substantially all of the proceeds of the assets after the claims of the FRN holders have been met. In each securitisation the offering circular stated that the FRNs are the obligations solely of the issuer and not guaranteed by, or the responsibility of, any other party. The Group is not obliged to support any losses incurred by FRN holders and does not intend to do so.

Special purpose company	Type of asset	Net income recognised by the Group[1]		
		1998 £m	1997 £m	1996 £m
Lothbury Funding No 1 Plc (Lothbury)[2]	Mortgage loans	**2**	2	2
ROSE Funding No 1 Ltd (ROSE 1)[3]	Corporate loans and revolving credits	**–**	–	–
ROSE Funding No 2 Ltd (ROSE 2)[3, 4]	Corporate loans and revolving credits	**1**	(1)	–
		3	1	2

1 Net income comprised interest receivable and other income of £312m (1997 £226m; 1996 £31m) less interest payable and other expenses of £309m (1997 £225m; 1996 £29m).
2 Lothbury is owned by Sarfu Ltd which is in turn owned by Royal Exchange Trust Company Ltd. Lothbury has entered into an interest rate swap with the Bank under which Lothbury pays average building society mortgage rates and receives interest at a rate linked to 3 month LIBOR. Lothbury has also entered into a fixed/floating rate swap with Rabobank Nederland NV under which Lothbury pays the weighted average interest rate on its fixed rate mortgages and receives a rate linked to 3 month LIBOR. The Bank has entered into a corresponding swap with Rabobank Nederland NV.
3 ROSE 1 and ROSE 2 are owned by ROSE Holdings Ltd which is in turn owned by Queensgate Bank & Trust Co and have entered into interest rate swaps with the Bank under which they pay a floating interest rate based on interest received on their assets and receive an interest rate linked to 3 month LIBOR.
4 The Group has the option to transfer further loans to ROSE 2.

19 Provisions for bad and doubtful debts

The Group

	1998 Specific £m	1998 General £m	1998 Total £m	1997 Specific £m	1997 General £m	1997 Total £m
At 1 January	**1,005**	**397**	**1,402**	1,170	300	1,470
New and additional provisions						
Domestic	**609**			668		
International	**198**			170		
Releases and recoveries						
Domestic	**(288)**			(305)		
International	**(31)**			(68)		
Charge against profit						
Domestic	**321**	**7**	**328**	363	8	371
International	**167**	**4**	**171**	102	89	191
	488	**11**	**499**	465	97	562
Exchange and other adjustments	**(1)**	**1**	**–**	(17)	–	(17)
Disposal of businesses	**(107)**	**(2)**	**(109)**	–	–	–
Amounts written off						
Domestic	**(528)**		**(528)**	(591)		(591)
International	**(98)**		**(98)**	(249)		(249)
	(626)		**(626)**	(840)		(840)
Recoveries						
Domestic	**198**		**198**	213		213
International	**8**		**8**	14		14
	206		**206**	227		227
At 31 December						
Domestic	**385**	**275**	**660**	496	267	763
International	**580**	**132**	**712**	509	130	639
	965	**407**	**1,372**	1,005	397	1,402
At 31 December						
Loans and advances to banks – international	**41**	**–**	**41**	7	–	7
Loans and advances to customers						
Domestic	**385**	**275**	**660**	495	267	762
International	**539**	**132**	**671**	503	130	633
	924	**407**	**1,331**	998	397	1,395
	965	**407**	**1,372**	1,005	397	1,402

19 Provisions for bad and doubtful debts continued

The Bank

	1998			1997		
	Specific £m	General £m	Total £m	Specific £m	General £m	Total £m
At 1 January	**571**	**360**	**931**	720	277	997
New and additional provisions						
Domestic	**329**			377		
International	**159**			70		
Releases and recoveries						
Domestic	**(218)**			(206)		
International	**(18)**			(39)		
Charge against profit						
Domestic	**111**	**2**	**113**	171	1	172
International	**141**	**–**	**141**	31	81	112
	252	**2**	**254**	202	82	284
Exchange and other adjustments	**8**	**–**	**8**	(6)	1	(5)
Transfer to subsidiary undertakings	**(3)**	**(1)**	**(4)**	–	–	–
Amounts written off						
Domestic	**(311)**		**(311)**	(361)		(361)
International	**(57)**		**(57)**	(150)		(150)
	(368)		**(368)**	(511)		(511)
Recoveries						
Domestic	**159**		**159**	161		161
International	**2**		**2**	5		5
	161		**161**	166		166
At 31 December						
Domestic	**189**	**245**	**434**	232	244	476
International	**432**	**116**	**548**	339	116	455
	621	**361**	**982**	571	360	931
At 31 December						
Loans and advances to banks – international	**40**	**–**	**40**	6	–	6
Loans and advances to customers						
Domestic	**189**	**245**	**434**	232	244	476
International	**392**	**116**	**508**	333	116	449
	581	**361**	**942**	565	360	925
	621	**361**	**982**	571	360	931

19 Provisions for bad and doubtful debts continued

The breakdown of the Group's specific bad and doubtful debt provisions against loans and advances to customers by category and domestic and international offices is set out in the following table.

	1998 The Group £m	1997 The Group £m
Specific bad and doubtful debt provisions		
By domestic offices		
Agriculture, forestry and fishing	**10**	6
Manufacturing and other production	**28**	23
Construction	**16**	13
Distribution, transport and hotels	**48**	55
Financial and other	**39**	49
Property companies	**8**	26
Personal – mortgage	**13**	14
– other	**89**	115
Instalment	**102**	152
Lease financing	**32**	42
Total domestic offices	**385**	495
By international offices		
United States	**25**	83
United Kingdom	**309**	287
Other European Union	**59**	66
Rest of the World	**146**	67
Total international offices	**539**	503
Total domestic and international offices	**924**	998

20 Interest in suspense

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
At 1 January	**339**	330	**197**	190
Net interest suspended in the year	**79**	73	**63**	48
Interest written off	**(27)**	(45)	**(18)**	(31)
Exchange and other adjustments	**–**	(19)	**–**	(10)
At 31 December	**391**	339	**242**	197

21 Operating lease assets

The Group	Cost £m	Accumulated depreciation £m	Carrying value £m
At 1 January 1998	**2,350**	**(647)**	**1,703**
Additions	**1,603**	**–**	**1,603**
Disposals	**(991)**	**160**	**(831)**
Disposal of businesses	**(1,288)**	**487**	**(801)**
Charge for the year	**–**	**(366)**	**(366)**
At 31 December 1998	**1,674**	**(366)**	**1,308**

22 Debt securities

The Group	1998 Balance sheet £m	1998 Gross unrecognised gains £m	1998 Gross unrecognised losses £m	1998 Market value £m	1997 Balance sheet £m	1997 Gross unrecognised gains £m	1997 Gross unrecognised losses £m	1997 Market value £m
Investment securities								
Issued by public bodies								
Debt securities of, or guaranteed by, the UK government	**1,197**	**33**	**–**	**1,230**	1,235	9	–	1,244
Debt securities issued by the US treasury and other US government corporations and agencies	**136**	**1**	**–**	**137**	186	1	–	187
Debt securities issued by other foreign governments	**2,469**	**133**	**–**	**2,602**	1,348	49	(3)	1,394
Government securities	**3,802**	**167**	**–**	**3,969**	2,769	59	(3)	2,825
Debt securities issued by other public sector issuers other than states of the United States and political subdivisions of the states	**545**	**5**	**(1)**	**549**	506	3	–	509
	4,347	**172**	**(1)**	**4,518**	3,275	62	(3)	3,334
Other issuers								
Bank and building society certificates of deposit	**8,292**	**30**	**(2)**	**8,320**	5,939	5	(1)	5,943
Corporate debt securities	**3,057**	**164**	**(9)**	**3,212**	2,526	31	(8)	2,549
Mortgage-backed securities	**80**	**–**	**–**	**80**	97	–	–	97
Other	**960**	**18**	**(1)**	**977**	765	12	(1)	776
	12,389	**212**	**(12)**	**12,589**	9,327	48	(10)	9,365
Total investment securities	**16,736**	**384**	**(13)**	**17,107**	12,602	110	(13)	12,699
Other debt securities								
Issued by public bodies								
Government securities	**13,555**				11,085			
Other public sector securities	**172**				226			
	13,727				11,311			
Other issuers								
Bank and building society certificates of deposit	**326**				517			
Other	**6,774**				5,981			
	20,827				17,809			
Total debt securities	**37,563**				30,411			
Investment securities								
Listed	**3,862**			**4,013**	4,210			4,286
Unlisted	**12,874**			**13,094**	8,392			8,413
	16,736			**17,107**	12,602			12,699
Other debt securities								
Listed	**3,280**				5,814			
Unlisted	**17,547**				11,995			
	20,827				17,809			
Total debt securities	**37,563**				30,411			
Due within one year	**11,138**				10,572			
Due one year and over	**26,425**				19,839			
Total debt securities	**37,563**				30,411			
Net unamortised discounts/(premiums) on investment securities	**(62)**				327			
Amounts include								
Subordinated debt securities	**335**				37			

22 Debt securities continued

The Group	Cost £m	Amortised discounts/ (premiums) £m	Provisions £m	Carrying value £m
Investment securities				
At 1 January 1998	**12,211**	**414**	**(23)**	**12,602**
Exchange and other movements	**121**	**(2)**	**–**	**119**
Acquisitions	**26,356**	**–**	**–**	**26,356**
Securities sold	**(964)**	**(542)**	**–**	**(1,506)**
Disposal of businesses	**(49)**	**–**	**–**	**(49)**
Transfer to other debt securities	**(118)**	**–**	**–**	**(118)**
Transfer to equity shares	**(5)**	**–**	**5**	**–**
Securities matured	**(20,688)**	**8**	**–**	**(20,680)**
Written off	**(4)**	**–**	**4**	**–**
Amortisation of discounts and premiums	**–**	**26**	**–**	**26**
Provisions made	**–**	**–**	**(14)**	**(14)**
At 31 December 1998	**16,860**	**(96)**	**(28)**	**16,736**

The Bank	1998 Balance sheet £m	1998 Market value £m	1997 Balance sheet £m	1997 Market value £m
Investment securities				
Issued by public bodies				
Government securities	**3,301**	**3,437**	2,249	2,291
Other public sector securities	**545**	**549**	448	450
	3,846	**3,986**	2,697	2,741
Other issuers				
Bank and building society certificates of deposit	**8,290**	**8,318**	5,729	5,732
Other	**2,530**	**2,559**	1,945	1,957
Total investment securities	**14,666**	**14,863**	10,371	10,430
Other debt securities				
Issued by public bodies				
Government securities	**2,070**		1,703	
Other public sector securities	**125**		112	
	2,195		1,815	
Other issuers				
Bank and building society certificates of deposit	**1**		2	
Other	**4,923**		3,068	
	7,119		4,885	
Total debt securities	**21,785**		15,256	
Investment securities				
Listed	**2,975**	**3,079**	2,900	2,939
Unlisted	**11,691**	**11,784**	7,471	7,491
	14,666	**14,863**	10,371	10,430
Other debt securities				
Listed	**2,361**		3,544	
Unlisted	**4,758**		1,341	
	7,119		4,885	
Total debt securities	**21,785**		15,256	
Due within one year	**10,185**		7,571	
Due one year and over	**11,600**		7,685	
	21,785		15,256	
Net unamortised premiums on investment securities	**(52)**		(37)	
Amounts include				
Subordinated debt securities	**329**		31	

22 Debt securities continued

The Bank	Cost £m	Amortised discounts/ (premiums) £m	Provisions £m	Carrying value £m
Investment securities				
At 1 January 1998	**10,396**	**(17)**	**(8)**	**10,371**
Exchange and other movements	**93**	**(1)**	**–**	**92**
Acquisitions	**25,670**	**–**	**–**	**25,670**
Securities sold	**(938)**	**1**	**–**	**(937)**
Transfer to other debt securities	**(118)**	**–**	**–**	**(118)**
Transfer to equity shares	**(5)**	**–**	**5**	**–**
Securities matured	**(20,405)**	**4**	**–**	**(20,401)**
Securities written off	**(3)**	**–**	**3**	**–**
Amortisation of discounts and premiums	**–**	**(10)**	**–**	**(10)**
Provisions made	**–**	**–**	**(1)**	**(1)**
At 31 December 1998	**14,690**	**(23)**	**(1)**	**14,666**

Market value for investment securities is the market price for quoted securities and directors' estimate for unquoted securities.

23 Equity shares

The Group	1998 Balance sheet £m	1998 Gross unrecognised gains £m	1998 Gross unrecognised losses £m	1998 Market value £m	1997 Balance sheet £m	1997 Gross unrecognised gains £m	1997 Gross unrecognised losses £m	1997 Market value £m
Investment securities								
Listed	**57**	**30**	**–**	**87**	20	39	(7)	52
Unlisted	**211**	**163**	**–**	**374**	291	182	(1)	472
	268	**193**	**–**	**461**	311	221	(8)	524
Other securities								
Listed	**55**				4,039			
Unlisted	**10**				–			
	65				4,039			
Total equity shares	**333**				4,350			

	Cost £m	Provisions £m	Carrying value £m
Investment securities			
At 1 January 1998	**377**	**(66)**	**311**
Exchange and other movements	**5**	**(3)**	**2**
Acquisitions	**101**	**–**	**101**
Transfer from debt securities	**5**	**(5)**	**–**
Disposals	**(132)**	**–**	**(132)**
Written off	**(9)**	**9**	**–**
Provisions made	**–**	**(14)**	**(14)**
At 31 December 1998	**347**	**(79)**	**268**

23 Equity shares continued

The Bank	1998 Balance sheet £m	1998 Market value £m	1997 Balance sheet £m	1997 Market value £m
Investment securities				
Listed	**1**	**1**	11	4
Unlisted	**27**	**27**	43	45
	28	**28**	54	49
Other securities				
Listed	**–**		65	
Unlisted	**10**		–	
Total equity shares	**38**		119	

	Cost £m	Provisions £m	Carrying value £m
Investment securities			
At 1 January 1998	**54**	**–**	**54**
Exchange and other movements	**2**	**(2)**	**–**
Acquisitions	**7**	**–**	**7**
Transfer from debt securities	**5**	**(5)**	**–**
Disposals	**(32)**	**–**	**(32)**
Written off	**(1)**	**1**	**–**
Provisions made	**–**	**(1)**	**(1)**
At 31 December 1998	**35**	**(7)**	**28**

Market value for investment securities is the market price for quoted securities and directors' estimate for unquoted securities.

24 Interests in associated undertakings

Share of net assets	The Group £m	The Bank £m
At 1 January 1998	**67**	**18**
Acquisitions	**7**	**–**
Intra-Group transfer	**–**	**(11)**
Change in status of subsidiary undertaking	**19**	**–**
Disposals	**(18)**	**–**
Retentions	**18**	**–**
Revaluation	**–**	**(1)**
At 31 December 1998	**93**	**6**

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Banks	**12**	11	**–**	11
Others	**81**	56	**6**	7
Total (all unlisted)	**93**	67	**6**	18

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

	1998 The Bank £m	1997 The Bank £m
Cost	**3**	11
Provisions	**(1)**	(1)
Net book value	**2**	10

25 Shares in Group undertakings

The Bank	Share of net tangible assets £m
At 1 January 1998	**8,018**
Exchange adjustments	**28**
Investments	**1,825**
Divestments	**(1,776)**
Impairment	**(4)**
Revaluation	**(381)**
At 31 December 1998	**7,710**

	1998 £m	1997 £m
Banks	**2,977**	2,384
Other	**4,733**	5,634
Total (all unlisted)	**7,710**	8,018

On the historical cost basis, shares in Group undertakings would have been included as follows.

	1998 £m	1997 £m
Cost	**6,976**	6,614
Provisions	**(259)**	(248)
Net book value	**6,717**	6,366

The principal subsidiary undertakings of the Bank are:

	Nature of business	Country of incorporation and principal area of operation	Notes
Coutts & Co	Banking	Great Britain	1, 2
Coutts Bank (Switzerland) Limited	Banking	Switzerland	1
Coutts Trust Holdings Limited	Holding company	Bahamas	1, 3
Gartmore Investment Management plc	Fund management	Great Britain	1
Greenwich Capital Markets Inc	Broker dealer	United States	1
NatWest Offshore Limited	Banking	Isle of Man	1
Lombard North Central PLC	Banking, credit finance and leasing	Great Britain	
National Westminster Home Loans Limited	Home mortgage finance	Great Britain	
National Westminster Insurance Services Limited	Insurance intermediary	Great Britain	
National Westminster Life Assurance Limited	Life assurance	Great Britain	
NatWest Equity Partners Limited	Venture capital	Great Britain	1
Ulster Bank Limited	Banking	Northern Ireland	4

1 Shares are not directly held by the Bank.
2 Coutts & Co is incorporated with unlimited liability.
3 Coutts Trust Holdings Limited and its subsidiary undertakings operate worldwide and provide trust, banking and investment services.
4 Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

At 31 December 1998, the Bank held, either directly or indirectly, 100% of the equity share capital and voting rights of the principal subsidiary undertakings. All the above subsidiary undertakings are included in the Group's accounts and have an accounting reference date of 31 December.

26 Intangible fixed assets

Goodwill	1998 The Group £m	1997[1] The Group £m
Cost		
As previously reported	**740**	744
Prior year adjustment	**278**	326
At 1 January, restated	**1,018**	1,070
Arising on acquisitions during the year	**11**	3
Disposal of businesses and termination of operations	**(110)**	(55)
At 31 December	**919**	1,018
Amortisation		
As previously reported	**91**	20
Prior year adjustment	**188**	152
At 1 January, restated	**279**	172
Charge for the year	**80**	88
Disposal of businesses and termination of operations	**(79)**	(6)
Provision for permanent impairment	**–**	25
At 31 December	**280**	279
Net book value at 31 December	**639**	739

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (See page 79).

Effect of change of accounting policy for goodwill

	Year ended 31 December		
	1998 £m	1997 £m	1996 £m
Profit and loss account			
Profit before tax on previous basis	**2,113**	1,011	1,122
Additional goodwill amortisation	**(32)**	(42)	(56)
Decrease in loss on disposal or termination of businesses	**61**	6	271
Profit before tax on new basis	**2,142**	975	1,337

	At 31 December		
	1998 £m	1997 £m	1996 £m
Balance sheet			
Increase in intangible fixed assets and shareholders' funds.	**38**	90	174

27 Tangible fixed assets

	Freehold land and buildings [1] £m	Leases of 50 years or more unexpired [1] £m	Leases of less than 50 years unexpired £m	Computer and other equipment £m	Total £m
The Group					
Cost or valuation					
At 1 January 1998	**1,997**	**237**	**312**	**2,190**	**4,736**
Exchange and other movements	**(3)**	**1**	**1**	**3**	**2**
Reclassifications	**(16)**	**(17)**	**33**	**–**	**–**
Additions	**150**	**20**	**31**	**373**	**574**
Disposals	**(527)**	**(18)**	**(88)**	**(393)**	**(1,026)**
Disposal of businesses	**(7)**	**(3)**	**(6)**	**(93)**	**(109)**
Revaluation	**40**	**–**	**–**	**–**	**40**
At 31 December 1998	**1,634**	**220**	**283**	**2,080**	**4,217**
Accumulated provisions for depreciation and impairment					
At 1 January 1998	**415**	**67**	**178**	**1,315**	**1,975**
Exchange and other movements	**(1)**	**1**	**1**	**(2)**	**(1)**
Disposals	**(125)**	**(6)**	**(76)**	**(238)**	**(445)**
Charge for the year	**18**	**6**	**16**	**241**	**281**
Disposal of businesses	**–**	**(1)**	**(2)**	**(53)**	**(56)**
Write down of properties to be disposed of	**4**	**–**	**5**	**–**	**9**
At 31 December 1998	**311**	**67**	**122**	**1,263**	**1,763**
Net book value at 31 December 1998	**1,323**	**153**	**161**	**817**	**2,454**
Net book value at 31 December 1997	1,582	170	134	875	2,761
The Bank					
Cost or valuation					
At 1 January 1998	**1,788**	**175**	**247**	**1,575**	**3,785**
Exchange and other adjustments	**–**	**(1)**	**1**	**(1)**	**(1)**
Reclassifications	**(16)**	**(17)**	**33**	**–**	**–**
Transfer to subsidiary undertakings	**(14)**	**–**	**(4)**	**(2)**	**(20)**
Additions	**127**	**8**	**27**	**187**	**349**
Disposals	**(521)**	**(18)**	**(76)**	**(223)**	**(838)**
Disposal of businesses	**–**	**–**	**(2)**	**(33)**	**(35)**
Revaluation	**28**	**–**	**–**	**–**	**28**
At 31 December 1998	**1,392**	**147**	**226**	**1,503**	**3,268**
Accumulated provisions for depreciation and impairment					
At 1 January 1998	**410**	**52**	**145**	**970**	**1,577**
Exchange and other movements	**–**	**1**	**–**	**–**	**1**
Transfer to subsidiary undertakings	**(1)**	**–**	**(1)**	**(1)**	**(3)**
Disposals	**(125)**	**(6)**	**(66)**	**(193)**	**(390)**
Disposal of businesses	**–**	**–**	**–**	**(15)**	**(15)**
Charge for the year	**18**	**4**	**12**	**161**	**195**
Write down of properties to be disposed of	**4**	**–**	**5**	**–**	**9**
At 31 December 1998	**306**	**51**	**95**	**922**	**1,374**
Net book value at 31 December 1998	**1,086**	**96**	**131**	**581**	**1,894**
Net book value at 31 December 1997	1,378	123	102	605	2,208

1 Including depreciable amounts comprising fixed plant with cost of £308m (1997 £451m) in the Group and £296m (1997 £440m) in the Bank together with costs of £264m (1997 £219m) in the Group and £235m (1997 £206m) in the Bank for adapting properties to meet business needs.

At the end of 1998, the Group's freehold land and buildings were valued by internal and external qualified valuers who are members of the Royal Institution of Chartered Surveyors ('RICS') or, in the case of some overseas properties, by local qualified valuers. Properties were valued in accordance with the 'RICS Appraisal and Valuation Manual' and if occupied by the Group, on the basis of existing use value or, in the case of specialised properties, on a depreciated replacement cost basis. Surplus and investment properties were valued on the basis of open market value.

27 Tangible fixed assets continued

Cost or valuation of freehold land and buildings	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
At 1998 valuation	**1,158**	–	**929**	–
At 1997 valuation	**–**	1,444	**–**	1,242
Adaptation costs at cost less depreciation	**165**	138	**157**	136
Net book value at 31 December	**1,323**	1,582	**1,086**	1,378
On the historical cost basis, freehold land and buildings would have been included as follows.				
Cost	**1,172**	1,453	**977**	1,280
Accumulated provisions for depreciation and impairment	**(311)**	(415)	**(306)**	(410)
Net book value at 31 December	**861**	1,038	**671**	870
Land and buildings				
Occupied for own use	**1,448**	1,443	**1,165**	1,201
Investment properties	**48**	44	**7**	4
Properties under development	**100**	345	**100**	345
Properties to be disposed of	**41**	54	**41**	53
Net book value at 31 December	**1,637**	1,886	**1,313**	1,603
Net book value of tangible fixed assets held under finance leases	**27**	33	**28**	31
Depreciation for the period in respect of assets held under finance leases	**1**	2	**1**	1
Future capital expenditure				
Contracted but not provided in the accounts	**143**	139	**134**	108

28 Lease commitments

At the year end, annual commitments under non-cancellable operating leases relating to land and buildings expiring in the following periods were:

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Within 1 year	**7**	3	**2**	1
Between 1 and 5 years	**25**	16	**10**	9
In 5 years or more	**109**	93	**70**	66
	141	112	**82**	76

Net obligations under finance leases at the year end were payable

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Within 1 year	**70**	32	**56**	2
Between 1 and 5 years	**120**	155	**97**	10
In 5 years or more	**1**	53	**7**	19
	191	240	**160**	31

29 Other assets

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Derivatives (note 44)	**8,871**	8,186	**7,656**	6,310
Settlement balances	**2,458**	3,537	**148**	546
Deferred taxation (note 37)	**–**	–	**37**	45
Other	**2,407**	1,910	**2,066**	1,579
	13,736	13,633	**9,907**	8,480

30 Assets subject to sale and repurchase transactions

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Treasury and other eligible bills	**462**	684	**–**	–
Debt securities	**18,199**	15,322	**5,120**	4,210
	18,661	16,006	**5,120**	4,210

31 Long-term assurance business

The long-term assurance assets attributable to policyholders comprise

	1998 The Group £m	1997 The Group £m
Investments	**7,214**	3,627
Value of in-force policies	**228**	189
Computer and other equipment	**7**	9
Net current assets	**159**	105
	7,608	3,930
Long-term assurance business attributable to shareholders	**(389)**	(330)
	7,219	3,600

The increase in value of the Group's long-term assurance business included in the profit and loss account amounted to £82m before tax (1997 £86m) and £59m after tax (1997 £61m).

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

	1998	1997
The key assumptions used are		
Risk discount rate – net of tax	**11.5%pa**	12.5%pa
Economic assumptions		
Growth of unit-linked funds – gross of tax	**8.5% pa**	9.5%pa
Growth of non-linked funds – gross of tax	**7% pa**	7%pa
Basic tax rate	**23%**	23%
Shareholder taxation – life	**28%**	29%
Expense inflation	**5% pa**	5% pa

32 Deposits by banks

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Repayable on demand	**4,752**	4,471	**4,774**	5,231
With agreed maturity dates or periods of notice – remaining maturity				
3 months or less but not repayable on demand	**20,434**	21,056	**27,147**	24,385
1 year or less but over 3 months	**1,089**	2,225	**1,291**	2,206
5 years or less but over 1 year	**287**	314	**42**	291
Over 5 years	–	36	**–**	35
	26,562	28,102	**33,254**	32,148
Banking business	**20,089**	21,956	**29,783**	28,581
Trading business	**6,473**	6,146	**3,471**	3,567
	26,562	28,102	**33,254**	32,148
Amounts include				
Due to subsidiary undertakings			**11,326**	8,278
Due to associated undertakings	**30**	12	**30**	12

The breakdown of deposits by banks between domestic and international offices of the Group is set out below.

	1998 The Group £m	1997 The Group £m
In domestic offices		
Non interest-bearing	**176**	120
Interest-bearing	**2,292**	1,168
Total domestic offices	**2,468**	1,288
In international offices		
United States		
Non interest-bearing	**23**	25
Interest-bearing	**4,974**	5,795
Total United States offices	**4,997**	5,820
Other international offices		
Non interest-bearing	**518**	553
Interest-bearing	**18,579**	20,441
Total international offices	**24,094**	26,814
Total domestic and international offices	**26,562**	28,102

33 Customer accounts

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Repayable on demand	**45,388**	42,137	**37,974**	34,243
With agreed maturity dates or periods of notice – remaining maturity				
3 months or less but not repayable on demand	**42,317**	41,706	**21,983**	26,395
1 year or less but over 3 months	**4,197**	3,412	**2,094**	1,796
5 years or less but over 1 year	**3,861**	1,810	**3,393**	1,489
Over 5 years	**531**	823	**116**	172
	96,294	89,888	**65,560**	64,095
Banking business	**84,223**	80,404	**62,357**	61,147
Trading business	**12,071**	9,484	**3,203**	2,948
	96,294	89,888	**65,560**	64,095
Amounts include				
Due to subsidiary undertakings			**2,265**	1,280
Due to associated undertakings	**4**	60	**4**	60

The breakdown of customer accounts between domestic and international offices of the Group is set out below.

	1998 The Group £m	1997 The Group £m
In domestic offices		
Non interest-bearing	**12,519**	12,772
Interest-bearing	**56,504**	53,729
Total domestic offices	**69,023**	66,501
In international offices		
United States		
Non interest-bearing	**38**	36
Interest-bearing	**11,071**	8,432
Total United States offices	**11,109**	8,468
Other international offices		
Non interest-bearing	**1,380**	1,173
Interest-bearing	**14,782**	13,746
Total international offices	**27,271**	23,387
Total domestic and international offices	**96,294**	89,888

34 Debt securities in issue

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Bonds and medium term notes – remaining maturity				
1 year or less	**148**	166	**85**	124
2 years or less but over 1 year	**157**	171	**98**	74
5 years or less but over 2 years	**1,992**	1,890	**1,992**	1,769
Over 5 years	**54**	147	**54**	126
	2,351	2,374	**2,229**	2,093
Other debt securities in issue – remaining maturity				
3 months or less	**9,087**	12,990	**8,974**	11,050
1 year or less but over 3 months	**4,117**	2,433	**2,925**	2,388
	13,204	15,423	**11,899**	13,438
	15,555	17,797	**14,128**	15,531
Banking business	**15,518**	17,547	**14,128**	15,531
Trading business	**37**	250	**–**	–
	15,555	17,797	**14,128**	15,531
Amounts include				
Due to subsidiary undertakings			**24**	106

35 Short-term borrowings

Included within the balance sheet captions 'Deposits by banks', 'Customer accounts' and 'Debt securities in issue' are the following short-term borrowings.

	1998 The Group £m	1997 The Group £m
Federal funds purchased	**1,191**	990
Securities and bills sold under agreements to repurchase	**17,201**	14,886
Commercial paper	**1,532**	2,618
Other short-term borrowings	**1,687**	840
	21,611	19,334
Banking business	**3,599**	4,908
Trading business	**18,012**	14,426
	21,611	19,334

36 Other liabilities

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Derivatives (note 44)	**9,344**	8,865	**8,358**	6,828
Settlement balances	**1,994**	3,112	**306**	547
Short positions in securities				
Debt securities				
Government securities	**7,073**	9,171	**2,450**	2,558
Other	**854**	912	**434**	199
Equity shares	**3**	2,774	**–**	–
Taxation	**492**	310	**31**	14
Dividends	**420**	384	**420**	384
Other liabilities	**1,768**	1,562	**1,288**	1,210
	21,948	27,090	**13,287**	11,740

37 Deferred taxation

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Capital allowances and depreciation	**666**	1,318	**23**	67
Advance corporation tax carried forward	**–**	(45)	**–**	(45)
Other timing differences (net)	**(88)**	(9)	**(60)**	(67)
	578	1,264	**(37)**	(45)
At 1 January	**1,264**	1,236	**(45)**	(5)
Exchange adjustments	**–**	(6)	**–**	–
Arising during the year	**50**	214	**15**	24
Adjustment arising from change in the rate of corporation tax	**(59)**	(114)	**–**	–
Advance corporation tax carried forward	**45**	(45)	**45**	(45)
Disposal of leasing receivables	**(556)**	–	**–**	–
Disposal of businesses	**(120)**	–	**–**	–
Other movements	**(46)**	(21)	**(52)**	(19)
At 31 December	**578**	1,264	**(37)**	(45)

The Bank's net deferred tax asset is included in 'Other assets'.

Provision for UK deferred taxation relating to capital allowances has been made at 30% (1997 31%) being the rate of corporation tax at which the liability is expected to crystallise. Unprovided deferred taxation liabilities, all of which relate to capital allowances, amounted to £105m (1997 £133m) for the Group and £48m (1997 £74m) for the Bank.

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

i Group properties being realised at balance sheet values. Most of these properties are occupied for the purposes of the Group's trade and any gains arising on disposal are normally rolled-over pursuant to the Taxation of Chargeable Gains Act 1992 Section 152. The directors are, therefore, of the opinion that the likelihood of any material liability arising in this respect is remote and, in view of the large number of properties, no useful purpose would be served by quantifying the potential liability.

ii Subsidiary and associated undertakings being disposed of at their balance sheet amounts.

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

38 Other provisions for liabilities and charges

	Termination of Equities operations £m	Provision for branch closures commitments £m	Unfunded post-retirement benefits £m	Other £m	Total £m
The Group					
At 1 January 1998	**161**	**60**	**7**	**16**	**244**
Exchange and other movements	**1**	**–**	**–**	**–**	**1**
Charge for the year	**–**	**–**	**2**	**8**	**10**
Provisions utilised	**(139)**	**(5)**	**(1)**	**(10)**	**(155)**
At 31 December 1998	**23**	**55**	**8**	**14**	**100**
The Bank					
At 1 January 1998	**100**	**60**	**2**	**–**	**162**
Exchange and other movements	**–**	**–**	**–**	**–**	**–**
Charge for the year	**(61)**	**–**	**2**	**2**	**(57)**
Provisions utilised	**(22)**	**(5)**	**(1)**	**–**	**(28)**
At 31 December 1998	**17**	**55**	**3**	**2**	**77**

39 Subordinated liabilities

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Undated loan capital including convertible debt				
Sterling	**550**	550	**550**	550
US dollars	**1,806**	1,810	**1,806**	1,810
	2,356	2,360	**2,356**	2,360

Undated loan capital includes $1,000m (£603m) primary capital FRNs, Series A & B. The FRNs have no final maturity but may be redeemed at the option of the Bank at their principal amount. Interest on the FRNs is payable semi-annually at a rate of 0.25% per annum over the mean of the London interbank bid and offer quotations for six-month dollar deposits. The FRNs are subordinated to the claims of depositors and other unsubordinated creditors of the Bank and those subordinated creditors whose claims are expressed to be senior to the claims of the noteholders.

£200m 11.5% undated subordinated notes, issued in 1992, are convertible at the Bank's option into 200m 8.392% non-cumulative preference shares of £1 each at any time. The notes are redeemable at par on or after 17 December 2052. Between 17 December 2022 and 16 December 2052 inclusive the notes may be redeemed at par, or if higher, the price calculated according to a set formula.

$500m (£301m) 7.875% exchangeable capital securities, Series A, issued in 1993, may be exchanged at the Bank's option for 20m non-cumulative dollar preference shares of $25 each at any time or redeemed at par at the option of the Bank on or after 16 January 2004.

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Dated loan capital				
Sterling	**1,388**	1,094	**1,388**	1,094
US dollars	**1,405**	1,577	**1,345**	1,517
Other currencies	**13**	114	**–**	101
	2,806	2,785	**2,733**	2,712

On 27 February 1998, the Bank redeemed at par $95m variable rate notes due to mature in February 2000.

On 27 April 1998, DM300m 6% subordinated notes matured.

On 26 August 1998, $135m variable rate notes matured.

On 7 September 1998, the Bank issued £300m 6.5% subordinated notes due to mature in 2021. Net proceeds of the issue were £294m.

On 31 October 1998, the Bank repaid the third $50m instalment of variable rate notes maturing 31 October 2000.

Group and Bank include $750m (£452m) 9.45% subordinated notes maturing in 2001. These notes are not redeemable prior to maturity except in the event that payments thereunder become subject to certain taxes. The notes are subordinated to the claims of depositors and other creditors of the Bank except for claims which by their terms rank equally with or are subordinated to the notes.

Claims in respect of the Group's other loan capital are subordinated to the claims of other creditors. None of the Group's loan capital is secured.

The Bank's US dollar dated loan capital includes £410m (1997 £550m) of amounts due to subsidiary undertakings in respect of issues made by them and on-lent to the Bank on a subordinated basis. They have been guaranteed on a subordinated basis by the Bank as to the payment of principal and interest.

Interest payable on Group floating rate issues totalling £2,509m (1997 £2,683m) is at a margin over London interbank rates. Interest is payable at various fixed rates on £2,653m (1997 £2,462m); the range of applicable rates is as follows.

Sterling	6.5% - 12.5%
US dollars	7.75%- 9.45%
Other currencies	6.0% - 6.25%

Interest on £1,000m and $1,750m of fixed rate issues is swapped into floating rates at a margin over London interbank rates.

39 Subordinated liabilities continued

Dated loan capital is repayable, in certain cases at a premium, as follows.	1998 Fixed rate loan capital £m	1998 Floating rate loan capital £m	1998 Total £m	1997 Total £m
The Group and the Bank				
Due in				
1998	–	–	–	131
1999	–	30	30	30
2000	–	32	32	33
2001	552	–	552	553
2003 to 2007	100	567	667	667
2008 to 2012	297	156	453	453
2015	295	–	295	295
2021	294	–	294	–
	1,538	785	2,323	2,162
Due to subsidiary undertakings				
Due in				
1998	–	–	–	82
2000	–	109	109	166
2003 to 2007	301	–	301	302
	301	109	410	550
Bank dated loan capital	1,839	894	2,733	2,712
Subsidiary undertakings				
Due in				
1999	13	–	13	13
2000	–	60	60	60
Group dated loan capital	1,852	954	2,806	2,785

40 Called up share capital

	The Group and The Bank		
	1998 £m	1997 £m	1996 £m
Ordinary shares of £1 each			
Authorised	**2,250**	2,250	2,250
Allotted, called up and fully paid			
At 1 January	**1,731**	1,709	1,771
Issued in relation to share option schemes for staff	**11**	19	7
Issued in lieu of cash dividends	**–**	3	3
Shares repurchased	**(37)**	–	(72)
At 31 December	**1,705**	1,731	1,709
	1998 $m	1997 $m	1996 $m
Non-cumulative preference shares of $25 each			
Authorised	**2,000**	2,000	2,000
Allotted, called up and fully paid			
At 1 January	**800**	500	500
Issued during the year	**–**	300	–
Redeemed during the year	**(250)**	–	–
At 31 December	**550**	800	500
At 31 December (£m)	**332**	483	294
	1998 £m	1997 £m	1996 £m
Non-cumulative preference shares of £1 each			
Authorised	**1,000**	1,000	1,000
Allotted, called up and fully paid			
At 1 January and 31 December	**140**	140	140
Total preference share capital – non-equity shares	**472**	623	434

On 8 October 1998, the Group completed a share repurchase programme to acquire 37,210,320 ordinary shares in the Bank at an average price of 1007p per share, resulting in a cost of £375m.

Under the terms of the executive and savings related share option schemes, options have been granted to eligible directors and other members of staff enabling them to subscribe for 52m (1997 53m; 1996 61m) ordinary shares between 1999 and 2008 at various prices between 196p and 1101p.

It is not possible to quantify the number of ordinary shares that will be issued in 1999 under profit sharing schemes in respect of profits arising in 1998.

The Bank redeemed the 10,000,000 non-cumulative dollar preference shares, Series A, of $25 each on 16 October 1998.

The non-cumulative dollar preference shares, Series B, which carry a gross dividend of 8.75% inclusive of associated tax credit, are redeemable at the option of the Bank exercisable to 9 June 2003, at a premium per share of $1.20 in 1999 reducing by $0.30 in each successive year. There is no redemption premium if the date of redemption falls after 9 June 2003.

The non-cumulative dollar preference shares, Series C, of $25 each carry a gross dividend of 8.625% inclusive of associated tax credit. They are redeemable at the option of the Bank from 9 April 2002 to 8 April 2003 inclusive, at a premium per share of $1.50 in 2002 reducing by $0.30 in each successive year. There is no redemption premium if the date of redemption falls after 8 April 2007.

The 9% non-cumulative sterling preference shares, Series A, of £1 each are non-redeemable.

The holders of sterling and dollar preference shares are entitled, on the winding-up of the Bank, to priority over the ordinary shareholders as regards payment of capital. Otherwise the holders of preference shares are not entitled to any further participation in the profits or assets of the Bank and accordingly these shares are classified as non-equity shares.

The holders of sterling and dollar preference shares are not entitled to receive notice of, attend, or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the Bank or the sale of the whole of the business of the Bank or any resolution directly affecting any of the special rights or privileges attached to any of the classes of preference shares.

41 Reserves

	1998 The Group £m	1997[1] The Group £m	1996[1] The Group £m	1998 The Bank £m
Share premium account				
At 1 January	**1,105**	973	960	**1,105**
Premium on ordinary shares issued in relation to share option schemes for staff	**76**	141	16	**76**
Preference share issue expenses	**–**	(6)	–	**–**
Ordinary shares issued in lieu of cash dividends	**–**	(3)	(3)	**–**
At 31 December	**1,181**	1,105	973	**1,181**
Other reserves				
At 1 January	**75**	75	–	**72**
Ordinary shares repurchased	**37**	–	72	**37**
Redemption of preference shares	**147**	–	–	**147**
Redemption of preference shares of a subsidiary held by third parties	–	**–**	3	–
At 31 December	**259**	75	75	**256**
Revaluation reserve				
At 1 January	**(56)**	(79)	(221)	**1,568**
Exchange and other movements	**1**	(7)	(1)	**(2)**
Revaluation	**40**	32	15	**(354)**
Transfer from/(to) profit and loss account	**38**	(2)	128	**(239)**
At 31 December	**23**	(56)	(79)	**973**
Profit and loss account				
As previously reported	**4,419**	4,440	4,239	**2,149**
Prior year adjustment	**90**	174	811	
At 1 January, restated	**4,509**	4,614	5,050	
Exchange and other movements	**4**	(60)	1	**–**
Retention for the year	**953**	34	122	**1,454**
Ordinary shares issued in lieu of cash dividends	**–**	24	20	**–**
Ordinary shares repurchased	**(375)**	–	(451)	**(375)**
Redemption of preference shares	**(147)**	–	–	**(147)**
Transfer (to)/from revaluation reserve	**(38)**	2	(128)	**239**
Reduction in reserves resulting from shares issued to the QUEST in relation to share option schemes for staff (see below)	**(45)**	(105)	–	**(45)**
At 31 December	**4,861**	4,509	4,614	**3,275**

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets' (see page 79).

Exchange losses of £27m (1997 gains £28m; 1996 gains £138m) arising on foreign currency borrowings have been offset in the Group's profit and loss account reserves against differences on retranslating the net investment in overseas subsidiary and associated undertakings financed by these borrowings.

The tax effect of gains and losses taken directly to reserves was £nil, (1997 £nil; 1996 £12m credit).

Included in the closing balances of the Group's revaluation reserve and profit and loss account at 31 December 1998 are cumulative net losses of £35m (1997 losses of £32m; 1996 gains £35m), relating to the retranslation of opening net assets of overseas subsidiary and associated undertakings offset by foreign currency borrowings.

In 1997, the Group established a Qualifying Employee Share Ownership Trust ('QUEST') for the purposes of share option schemes for staff. During 1998, contributions of £45m and loans of £35m have been made to the QUEST and used by the QUEST to apply for 7,700,000 new ordinary shares of £1 each in the Bank (1997 – contributions of £105m and loans of £37m, 15,347,334 new shares). Under the provisions of FRS 5 'Reporting the Substance of Transactions', the assets and liabilities of the QUEST are recognised as assets and liabilities of the Bank. The effect of the above transactions has been to reduce profit and loss account reserves in 1998 by £45m with a corresponding increase in share premium account (1997 £105m). In 1998, 8,777,868 (1997 – 13,781,269) of the ordinary shares of £1 each held by the QUEST were transferred to option holders exercising options under the Staff Savings Related Share Option Scheme and the option exercise money received by the QUEST used to repay part of the loans. The remaining 488,197 ordinary shares of £1 each held by the QUEST at 31 December 1998 are included in other assets at an amount of £2m, reflecting the exercise price of the options the shares are expected to be used to satisfy. (1997 – 1,566,065 shares, £5m). Surplus funds of £9m (1997 nil) held by the QUEST are deposited with the Group.

41 Reserves continued

The Group's profit and loss account reserves include its share of reserves of associated undertakings as shown below.

	1998 £m	1997 £m	1996 £m
Profit and loss account			
At 1 January	**32**	36	213
Exchange and other movements	**(2)**	–	(2)
Retention for the year	**18**	(2)	–
Transfer to subsidiary undertaking	**–**	–	26
Disposal of interests in associated undertakings	**1**	(2)	(201)
At 31 December	**49**	32	36

42 Assets and liabilities denominated in foreign currency

	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Denominated in sterling	**112,495**	107,805	**93,417**	90,029
Denominated in other currencies	**73,498**	77,689	**48,723**	48,975
Total assets	**185,993**	185,494	**142,140**	139,004
Denominated in sterling	**113,833**	108,174	**95,325**	90,600
Denominated in other currencies	**72,160**	77,320	**46,815**	48,404
Total liabilities	**185,993**	185,494	**142,140**	139,004

43 Memorandum items

	Contract amount			
	1998 The Group £m	1997 The Group £m	1998 The Bank £m	1997 The Bank £m
Contingent liabilities				
Acceptances and endorsements	**731**	858	**716**	775
Guarantees and assets pledged as collateral security	**10,054**	9,718	**13,519**	14,731
	10,785	10,576	**14,235**	15,506
Commitments – other commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend				
1 year and over	**11,413**	12,883	**21,029**	22,342
Less than 1 year	**35,816**	35,184	**32,934**	32,505
Other (including documentary credits)	**935**	5,266	**764**	4,956
	48,164	53,333	**54,727**	59,803
Incurred on behalf of subsidiary undertakings (included above)				
Contingent liabilities			**4,276**	5,800
Commitments			**10,098**	10,528
	£bn	£bn	**£bn**	£bn
Derivatives				
Exchange rate related contracts	**672.0**	679.0	**658.0**	668.1
Interest rate related contracts	**2,135.2**	1,472.8	**2,073.8**	1,398.0
Equity and commodity related contracts	**8.0**	43.7	**–**	0.9

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

43 Memorandum items continued

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

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

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

Exchange rate, interest rate and equity and commodity related contracts comprise all such contracts with third parties, both trading and non-trading (see note 44).

Assets charged as security for liabilities

Assets under the following headings have been pledged to secure liabilities and potential liabilities.

	1998 The Group £m	1997 The Group £m	**1998 The Bank £m**	1997 The Bank £m
Debt securities	**1,052**	846	**766**	533
Other assets	**383**	752	**265**	268
	1,435	1,598	**1,031**	801

Included above are assets pledged with overseas government agencies and banks, and margins placed with futures exchanges.

Other contingent liabilities

i Litigation

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

ii General

Additional contingent liabilities arise in the normal course of business. It is not anticipated that any material loss will arise from these transactions.

44 Derivatives

Companies in the Group enter into various off-balance sheet financial instruments (derivatives) as principal either as a trading activity or to manage balance sheet foreign exchange rate risk and interest rate risk (non-trading).

Exchange rate related contracts include currency swaps, forwards and options. Currency swap transactions generally involve the exchange of interest payment obligations relating to assets or liabilities denominated in different currencies; the exchange of principal can be notional or actual. Forward foreign exchange contracts are contracts for delayed delivery of currency at a specified future date.

Interest rate related contracts include swaps, forward rate agreements and options. Interest rate swap transactions generally involve the exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts. 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 settlement date; there is no exchange of principal.

Foreign exchange rate and interest rate options are contracts that allow the holder of the option to purchase or sell a financial instrument at a specified price and within a specified period of time. As a writer of options, the Group receives a premium and then bears the risk of an unfavourable change in the price of the financial instrument underlying the option.

44 Derivatives continued

Derivatives held for trading purposes

At 31 December 1998 and 31 December 1997, the notional principal amounts and fair values (which, after netting, are the carrying values) of trading instruments entered into with third parties were as follows.

The Group	1998 Notional principal amount £bn	1998 Fair values Asset £m	1998 Fair values Liability £m	1997 Notional principal amount £bn	1997 Fair values Asset £m	1997 Fair values Liability £m
Exchange rate related contracts						
Spot, forwards and futures	**394.3**	**5,344**	**5,424**	384.6	5,621	5,296
Currency swaps	**32.9**	**1,054**	**1,268**	26.8	951	1,268
Options purchased	**125.5**	**2,248**	**–**	143.1	2,456	–
Options written	**118.9**	**–**	**2,462**	124.1	–	2,748
	671.6	**8,646**	**9,154**	678.6	9,028	9,312
Interest rate related contracts						
Interest rate swaps	**1,090.8**	**19,985**	**20,206**	712.9	10,058	10,411
Options purchased	**171.6**	**2,291**	**–**	157.8	1,303	–
Options written	**168.9**	**–**	**2,246**	143.7	–	1,223
Futures and forwards	**667.2**	**420**	**365**	423.5	191	198
	2,098.5	**22,696**	**22,817**	1,437.9	11,552	11,832
Equity and commodity related contracts	**8.0**	**653**	**497**	43.7	1,084	1,199
Effect of netting		**(23,124)**	**(23,124)**		(13,478)	(13,478)
		8,871	**9,344**		8,186	8,865
Average fair values (before netting)						
Exchange rate related contracts		**8,663**	**9,048**		8,605	8,866
Interest rate related contracts		**15,289**	**14,881**		10,904	11,163
Equity and commodity related contracts		**699**	**724**		659	875
		24,651	**24,653**		20,168	20,904

Averages are calculated from a combination of monthly and quarterly balances.

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

Maturity of notional principal amounts of trading contracts	1 year or less £bn	2 years or less but over 1 year £bn	5 years or less but over 2 years £bn	Over 5 years £bn	Total £bn
Exchange rate related contracts					
Spot, forwards and futures	**390.6**	**3.0**	**0.7**	**–**	**394.3**
Currency swaps	**7.9**	**5.7**	**11.5**	**7.8**	**32.9**
Options purchased	**124.2**	**1.0**	**0.2**	**0.1**	**125.5**
Options written	**117.6**	**1.0**	**0.2**	**0.1**	**118.9**
At 31 December 1998	**640.3**	**10.7**	**12.6**	**8.0**	**671.6**
At 31 December 1997	645.8	15.4	11.5	5.9	678.6
Interest rate related contracts					
Interest rate swaps	**434.0**	**216.1**	**275.7**	**165.0**	**1,090.8**
Options purchased	**58.9**	**24.7**	**45.1**	**42.9**	**171.6**
Options written	**81.2**	**18.3**	**38.1**	**31.3**	**168.9**
Futures and forwards	**562.0**	**81.3**	**23.9**	**–**	**667.2**
At 31 December 1998	**1,136.1**	**340.4**	**382.8**	**239.2**	**2,098.5**
At 31 December 1997	743.9	257.0	270.7	166.3	1,437.9
Equity and commodity related contracts					
At 31 December 1998	**3.5**	**1.2**	**3.1**	**0.2**	**8.0**
At 31 December 1997	32.2	2.7	8.4	0.4	43.7

44 Derivatives continued

Non-trading derivatives

The Group uses derivatives to manage specified interest rate positions relating to assets and liabilities and to hedge foreign exchange exposures. The Group establishes non-trading derivatives positions with third parties and through intra-company and intra-Group transactions with the Group's independent trading operations. At the year end, the notional principal amounts, by maturity, of the Group's non-trading derivatives (third party, intra-company and intra-Group) were as follows.

Notional principal amounts [1]	1 year or less £bn	2 years or less but over 1 year £bn	5 years or less but over 2 years £bn	Over 5 years £bn	Total £bn
Exchange rate related contracts					
Spot, forwards and futures	**19.6**	**–**	**–**	**–**	**19.6**
Currency swaps and options	**0.6**	**0.6**	**0.9**	**0.5**	**2.6**
At 31 December 1998	**20.2**	**0.6**	**0.9**	**0.5**	**22.2**
At 31 December 1997	14.5	0.5	1.0	0.3	16.3
Interest rate related contracts					
Interest rate swaps	**28.2**	**12.0**	**16.6**	**7.6**	**64.4**
Futures, forwards and options	**11.4**	**0.1**	**0.2**	**0.1**	**11.8**
At 31 December 1998	**39.6**	**12.1**	**16.8**	**7.7**	**76.2**
At 31 December 1997	30.3	14.1	18.1	7.1	69.6

1 Includes contracts with third parties with notional principal amounts of £0.4bn (1997 £0.4bn) (exchange rate related) and £36.7bn (1997 £34.9bn) (interest rate related) and positive fair values of £11m (1997 £18m) and £560m (1997 £316m) respectively.

Maturity of replacement cost of over the counter contracts (trading and non-trading)

	1 year or less £m	2 years or less but over 1 year £m	5 years or less but over 2 years £m	Over 5 years £m	1998 Total £m	1997 Total £m
Before netting						
Exchange rate related contracts	**7,665**	**279**	**303**	**410**	**8,657**	9,046
Interest rate related contracts	**4,285**	**2,825**	**7,395**	**8,740**	**23,245**	11,855
Equity and commodity related contracts	**275**	**99**	**266**	**13**	**653**	835
	12,225	**3,203**	**7,964**	**9,163**	**32,555**	21,736
Banks and investment firms					**29,232**	18,935
Others					**3,323**	2,801
					32,555	21,736
After netting						
Banks and investment firms					**7,346**	6,208
Others					**2,085**	2,050
					9,431	8,258

45 Segmental information

	1998 £m	1997[1] £m	1996[1] £m
Geographical segments [2]			
Gross income			
Interest receivable			
Domestic	**6,808**	6,211	5,460
International – UK	**1,262**	1,209	1,564
– US	**386**	398	411
Rest of the World	**1,091**	1,210	1,140
Continuing operations	**9,547**	9,028	8,575
Discontinued operations	**–**	–	532
Total	**9,547**	9,028	9,107
Dividend income			
Domestic	**15**	23	16
International – UK	**1**	1	4
– US	**1**	–	–
Rest of the World	**1**	1	1
Continuing operations	**18**	25	21
Discontinued operations	**–**	–	1
Total	**18**	25	22
Fees and commissions receivable			
Domestic	**2,209**	2,184	2,172
International – UK	**215**	127	175
– US	**114**	267	192
Rest of the World	**207**	305	283
Continuing operations	**2,745**	2,883	2,822
Discontinued operations	**–**	–	101
Total	**2,745**	2,883	2,923
Dealing profits			
Domestic	**44**	(67)	124
International – UK	**479**	258	283
– US	**213**	93	(15)
Rest of the World	**112**	160	108
Continuing operations	**848**	444	500
Discontinued operations	**–**	–	6
Total	**848**	444	506
Other operating income			
Domestic	**517**	480	382
International – UK	**(31)**	6	21
– US	**4**	7	4
Rest of the World	**18**	41	49
Continuing operations	**508**	534	456
Discontinued operations	**–**	–	14
Total	**508**	534	470

45 Segmental information continued

	1998 £m	1997[1] £m	1996[1] £m
Profit/(loss) on ordinary activities before tax			
Domestic	**1,399**	890	1,434
International – UK	**476**	137	158
– US	**(13)**	(142)	(5)
Rest of the World	**196**	11	105
Continuing operations	**2,058**	896	1,692
Discontinued operations	**84**	79	(355)
Total	**2,142**	975	1,337
Profit/(loss) on ordinary activities after tax			
Domestic	**1,058**	666	949
International – UK	**403**	112	143
– US	**(52)**	(167)	(30)
Rest of the World	**150**	(24)	63
Continuing operations	**1,559**	587	1,125
Discontinued operations	**82**	79	(441)
Total	**1,641**	666	684
Net assets [3]			
Domestic	**4,554**	3,744	3,552
International – UK	**2,138**	2,439	2,458
– US	**539**	562	662
Rest of the World	**1,270**	1,242	1,054
Total	**8,501**	7,987	7,726
Total assets [3]			
Domestic	**99,106**	96,384	97,544
International – UK	**39,616**	37,330	38,366
– US	**26,790**	28,878	24,983
Rest of the World	**20,481**	22,902	24,617
Total	**185,993**	185,494	185,510
Average total assets [4]			
Domestic	**99,470**	104,840	89,023
International – UK	**35,397**	41,640	42,357
– US	**31,898**	33,583	9,003
Rest of the World	**29,761**	27,045	27,169
Continuing operations	**196,526**	207,108	167,552
Discontinued operations	**–**	–	7,338
Total	**196,526**	207,108	174,890

45 Segmental information continued

Profit/(loss) on ordinary activities	Net interest income £m	Non-interest income £m	Deprecia-tion and amortisa-tion £m	Other operating charges £m	Provisions for bad and doubtful debts £m	Other income and expenses £m	Profit/(loss) on ordinary activities before tax £m	Tax on profit on ordinary activities £m	Profit/(loss) on ordinary activities after tax £m
Classes of business [5, 6]									
1998									
NatWest UK	**2,266**	**1,489**	**(166)**	**(2,394)**	**(123)**	**(14)**	**1,058**	**(314)**	**744**
Lombard	**700**	**198**	**(18)**	**(533)**	**(194)**	**219**	**372**	**(65)**	**307**
Ulster Bank	**256**	**135**	**(21)**	**(199)**	**(16)**	**–**	**155**	**(42)**	**113**
NatWest Wealth Management	**290**	**726**	**(45)**	**(629)**	**(11)**	**29**	**360**	**(105)**	**255**
Global Financial Markets	**243**	**399**	**(8)**	**(234)**	**(8)**	**1**	**393**	**(133)**	**260**
Greenwich NatWest	**45**	**502**	**(52)**	**(535)**	**(79)**	**21**	**(98)**	**162**	**64**
Other Businesses	**20**	**130**	**(39)**	**(122)**	**(68)**	**–**	**(79)**	**(4)**	**(83)**
Head Office costs and other central items	**(9)**	**(23)**	**(12)**	**(48)**	**–**	**(11)**	**(103)**	**2**	**(101)**
Continuing operations	**3,811**	**3,556**	**(361)**	**(4,694)**	**(499)**	**245**	**2,058**	**(499)**	**1,559**
Discontinued operations	**–**	**–**	**–**	**–**	**–**	**84**	**84**	**(2)**	**82**
Total	**3,811**	**3,556**	**(361)**	**(4,694)**	**(499)**	**329**	**2,142**	**(501)**	**1,641**
1997 [1]									
NatWest UK	2,107	1,475	(154)	(2,245)	(189)	18	1,012	(276)	736
Lombard	702	206	(25)	(529)	(179)	17	192	(33)	159
Ulster Bank	243	126	(20)	(193)	(12)	–	144	(37)	107
NatWest Wealth Management	262	702	(47)	(650)	(76)	2	193	(91)	102
Global Financial Markets	239	228	(1)	(224)	–	2	244	(84)	160
Greenwich NatWest	9	569	(64)	(930)	9	(280)	(687)	205	(482)
Other Businesses	12	143	(45)	(128)	(35)	–	(53)	(10)	(63)
Head Office costs and other central items	90	(139)	(3)	(16)	(80)	(1)	(149)	17	(132)
Continuing operations	3,664	3,310	(359)	(4,915)	(562)	(242)	896	(309)	587
Discontinued operations	–	–	–	–	–	79	79	–	79
Total	3,664	3,310	(359)	(4,915)	(562)	(163)	975	(309)	666
1996 [1]									
NatWest UK	1,999	1,484	(146)	(2,182)	(332)	(122)	701	(276)	425
Lombard	663	194	(19)	(494)	(141)	15	218	(71)	147
Ulster Bank	229	121	(20)	(187)	(8)	–	135	(41)	94
NatWest Wealth Management	241	648	(42)	(611)	(9)	(30)	197	(64)	133
Global Financial Markets	301	137	(2)	(184)	–	–	252	(87)	165
Greenwich NatWest	71	699	(45)	(659)	(22)	(10)	34	26	60
Other Businesses	9	119	(37)	(76)	(37)	1	(21)	(14)	(35)
Head Office costs and other central items	64	(94)	6	(26)	–	2	(48)	16	(32)
Profit on disposal of investment in 3i Group plc	–	–	–	–	–	224	224	(56)	168
Continuing operations	3,577	3,308	(305)	(4,419)	(549)	80	1,692	(567)	1,125
Discontinued operations	272	114	(32)	(236)	(25)	(448)	(355)	(86)	(441)
Total	3,849	3,422	(337)	(4,655)	(574)	(368)	1,337	(653)	684

45 Segmental information continued

	1998 £m	1997[1] £m	1996[1] £m
Net assets [3]			
NatWest UK	**2,430**	1,876	1,419
Lombard	**1,122**	1,029	922
Ulster Bank	**627**	549	506
NatWest Wealth Management	**851**	841	918
Global Financial Markets	**558**	474	437
Greenwich NatWest	**2,170**	2,638	3,156
Other Businesses	**403**	352	288
Head Office and other central items	**340**	228	80
Total	**8,501**	7,987	7,726
Total assets [3]			
NatWest UK	**56,859**	52,336	48,605
Lombard	**9,804**	13,617	12,321
Ulster Bank	**9,472**	8,646	7,958
NatWest Wealth Management	**25,129**	21,201	19,054
Global Financial Markets	**43,903**	43,443	57,034
Greenwich NatWest	**49,538**	60,607	62,387
Other Businesses	**1,995**	2,039	2,446
Head Office and other central items	**(10,707)**	(16,395)	(24,295)
Total	**185,993**	185,494	185,510
Average total assets [4]			
NatWest UK	**55,572**	49,543	47,810
Lombard	**13,943**	12,974	11,283
Ulster Bank	**9,184**	8,647	7,587
NatWest Wealth Management	**13,084**	12,680	11,770
Global Financial Markets	**40,377**	41,260	38,112
Greenwich NatWest	**60,790**	80,542	49,545
Other Businesses	**2,580**	2,595	2,603
Head Office and other central items	**996**	(1,133)	(1,158)
Continuing operations	**196,526**	207,108	167,552
Discontinued operations	**–**	–	7,338
Total	**196,526**	207,108	174,890

1 Restated, see note 1 on page 79.
2 Domestic operations consist of the 'UK' domestic transactions of the Bank and its UK subsidiary undertakings (but exclude the Republic of Ireland transactions of Ulster Bank Limited). International operations consist of the Group's transactions through offices outside the UK, including the Republic of Ireland transactions of Ulster Bank Limited. International – UK includes the business of those offices in the UK specifically organised to service international banking transactions. US-based business recorded in the Bahamas is included in International – US.
3 Total assets are disclosed additionally as they are considered to be more meaningful than the segmental analyses of net assets required under SSAP25 'Segmental reporting'. In banking, liabilities, which mainly constitute the source of funds, are generally fungible in nature and some subjective allocations are necessary to provide segmental information on net assets.
4 Average total assets attributed to segments represent third-party assets only and are derived from a combination of daily, monthly and quarterly balances.
5 From 1 January 1998, the basis of remunerating NatWest UK for business introduced to GFM was revised and comparative figures have been restated. The effect has been to increase 1998 operating income by £62m (1997 £50m; 1996 £50m).
6 Classes of business comprise the Group's principal businesses, Other Businesses and Head Office costs and other central items. Corporate Advisory has been transferred from GNW to Other Businesses and comparative figures have been restated. The Group sold Bancorp, its US retail and commercial banking operations, on 1 May 1996 and 80% of its investment in BNWE, its retail and commercial bank in Spain, on 30 September 1996 and they are classified as discontinued operations.

46 Consolidated cash flow statement

	1998 £m	1997[1] £m	1996[1] £m
i Reconciliation of operating profit to net cash inflow/(outflow) from operating activities			
Operating profit	**1,785**	1,102	1,663
(Increase)/decrease in accrued income	**(153)**	18	(147)
Interest on subordinated liabilities	**386**	379	346
(Decrease)/increase in accruals and deferred income	**(7)**	413	267
Amortisation of and provisions against investment securities	**2**	(14)	(5)
Provisions for bad and doubtful debts	**499**	562	574
Loans and advances written off net of recoveries	**(420)**	(613)	(630)
Profit on sale of investment securities	**(123)**	(103)	(110)
Provisions for liabilities and charges	**10**	9	107
Provisions utilised	**(155)**	(104)	(11)
Depreciation and amortisation of tangible and intangible fixed assets	**361**	359	337
Depreciation of operating lease assets	**366**	336	269
Permanent diminution in value of freehold and leasehold properties	**–**	8	12
Increase in value of long-term assurance business	**(82)**	(86)	(54)
Net cash inflow from trading activities	**2,469**	2,266	2,618
Decrease/(increase) in items in the course of collection	**166**	213	(137)
Decrease/(increase) in treasury and other eligible bills	**327**	(1,201)	3,478
(Increase)/decrease in loans and advances to banks	**(1,473)**	2,153	6,686
Decrease/(increase) in loans and advances to customers	**1,503**	(3,129)	(5,074)
(Increase)/decrease in securities	**(1,940)**	1,615	(1,584)
Increase in other assets	**(273)**	(145)	(1,834)
Decrease/(increase) in prepayments	**48**	(46)	(379)
(Decrease)/increase in items in the course of transmission	**(52)**	(354)	395
Increase/(decrease) in deposits by banks	**2,027**	(8,215)	(10,167)
Increase in customer accounts	**6,960**	5,742	7,433
(Decrease)/increase in debt securities in issue	**(2,129)**	(617)	4,845
(Decrease)/increase in other liabilities	**(2,277)**	1,182	3,883
Effect of other accruals/deferrals and other non-cash movements	**(135)**	216	78
Net cash inflow/(outflow) from operating activities	**5,221**	(320)	10,241
ii Purchase of interests in subsidiary undertakings			
Net assets acquired	**–**	2	217
Goodwill	**11**	3	776
	11	5	993
Satisfied by			
Cash and acquisition costs	**11**	5	899
Deferred consideration	**–**	–	15
Loan stock issued	**–**	–	79
	11	5	993

Acquisitions did not have a material impact on the items prescribed by FRS 1 (Revised 1996) 'Cash Flow Statements' for inclusion in the consolidated cashflow.

	1998 £m	1997[1] £m	1996[1] £m
iii Analysis of net outflow of cash from the purchase of interests in subsidiary undertakings			
Cash consideration	**11**	5	899
Cash acquired	**–**	–	(84)
Net cash outflow	**11**	5	815
iv Disposal of businesses			
Net assets disposed of	**1,498**	33	2,331
Profit/(loss) on disposal	**349**	122	(224)
Satisfied by cash	**1,847**	155	2,107

1 Restated following implementation of FRS 10 'Goodwill and Intangible Assets'. (see page 79)

46 Consolidated cash flow statement continued

	1998 £m	1997 £m	1996 £m
v Analysis of net inflow/(outflow) of cash from the disposal of businesses			
Cash consideration	**1,847**	155	2,107
Cash disposed of	**(4)**	–	(1,628)
Net cash inflow	**1,843**	155	479
vi Discontinued operations			
Cash flows from discontinued operations during 1996 were as follows.			
Net cash inflow from operating activities			63
Taxation			(1)
Net cash inflow from capital expenditure and financial investment			663
Increase in cash			725

vii Analysis of changes in financing during the year

	Share capital (including share premium account)			Subordinated liabilities		
	1998 £m	1997 £m	1996 £m	1998 £m	1997 £m	1996 £m
At 1 January	**3,459**	3,116	3,195	**5,145**	4,607	4,792
Effect of foreign exchange differences	**(4)**	5	(30)	**(7)**	65	(358)
Repayments in the year	**–**	–	–	**(270)**	(125)	(188)
Issues in the year						
Ordinary share capital	**87**	160	23	**–**	–	–
Preference share capital	**–**	184	–	**–**	–	–
Subordinated liabilities	**–**	–	–	**294**	598	297
Share issue expenses	**–**	(6)	–	**–**	–	–
Ordinary shares repurchased	**(37)**	–	(72)	**–**	–	–
Redemption of preference shares	**(147)**	–	–	**–**	–	–
Acquisition of subsidiary undertaking	**–**	–	–	**–**	–	64
At 31 December	**3,358**	3,459	3,116	**5,162**	5,145	4,607

viii Analysis of the balances of cash as shown in the balance sheet	1998 £m	1997 £m	1996 £m
a Cash and balances at central banks			
At 1 January	**905**	902	1,583
Cash flow	**150**	3	(681)
At 31 December	**1,055**	905	902
b Loans and advances to other banks repayable on demand			
At 1 January	**3,484**	4,599	1,842
Cash flow	**321**	(1,115)	2,757
At 31 December	**3,805**	3,484	4,599
c Total			
At 1 January	**4,389**	5,501	3,425
Cash flow	**471**	(1,112)	2,076
At 31 December	**4,860**	4,389	5,501

The Group is required to maintain interest-free deposits with the Bank of England. At 31 December 1998, these deposits amounted to £108m (1997 £236m; 1996 £232m). The total amount required to be maintained both with the Bank of England and State banks abroad was £188m (1997 £362m; 1996 £327m).

The Group is also required to maintain reserve balances with the Federal Reserve Bank in the United States. The average amount of these reserve balances for the year ended 31 December 1998 was £2m (1997 £3m; 1996 £49m).

47 General

i Management and agency services

The Group undertakes investment management, insurance broking and stockbroking business.

ii Investment funds

Certain investment funds which the Group manages and invests in are, by virtue of the definition contained in the Companies Act 1985 and FRS 2 'Accounting for Subsidiary Undertakings', subsidiary undertakings of the Group and are, therefore, required to be included in the consolidated financial statements. However, the directors believe that full consolidation of these funds, which are in substance collective investment schemes managed by the Group, would not present a true and fair view. To reflect the true commercial effect of the funds, only the Group's share of their results and underlying investments have been included in the consolidated financial statements. The effect on the Group's balance sheet at 31 December 1998 of consolidating these funds would be to increase loans and advances to customers by £30m (1997 £nil), investment debt securities by £290m (1997 £77m), investment equity shares by £314m (1997 £123m), other liabilities by £31m (1997 £nil) and minority interests by £622m (1997 £200m) and to reduce customer accounts by £19m (1997 £nil). Group profit on ordinary activities before tax would be £27m (1997 £21m) higher with a corresponding increase in minority interest. Profit for the financial year and shareholders' funds would be unaffected.

iii Lease and similar finance arrangements

Amounts financed during the year under finance leases were £1,764m (1997 £2,906m; 1996 £2,994m) and under hire purchase and conditional sale agreements were £4,093m (1997 £4,271m; 1996 £3,839m). Aggregate amounts receivable, including capital repayments, under finance leases, hire purchase and conditional sale contracts were £4,405m (1997 £4,518m; 1996 £3,920m).

iv Related undertakings

As permitted by Section 231 of the Companies Act 1985, the information required by Schedule 5 of the Act is given only for those undertakings whose results or financial position principally affect the figures shown in the accounts (note 24). Full information will be annexed to the Bank's next annual return.

v Investments in partnerships and unlimited companies

Interests of the Group in qualifying partnerships and unlimited companies have been incorporated in the accounts of the Group either by the equity method or proportional consolidation, thereby exempting it from the requirements of The Partnerships and Unlimited Companies (Accounts) Regulations 1993.

vi Pension funds

The Group provides banking and other services to Group pension funds. These are not material to the Group.

48 Emoluments of directors

	1998 £000	1997 £000
Aggregate emoluments of directors who served during the year	**4,393**	3,291
Aggregate amount of gains made by directors on exercise of share options	**99**	524
Aggregate amount received by directors under long term incentive schemes	**358**	333
	4,850	4,148
1996 bonus waived by Dr J M Owen	**–**	(200)
Pensions paid to former directors and their dependants	**255**	244
	5,105	4,192

5 directors (1997 5) are accruing retirement benefits under defined benefit pension schemes of the Group.

The total emoluments of the highest paid director in the UK, Derek Wanless, were £835,000 (1997 £465,000). The 1998 amount includes a potential gain on an option exercised under the Group's ShareSave Scheme of £3,000 (1997 £15,000). The highest paid director in 1997, Lord Alexander, received emoluments of £518,000 for that year. That amount included a potential gain on the exercise of an option made under the Group's Executive Share Option Scheme of £84,000.

49 Transactions with directors and executive officers

i The aggregate amounts outstanding at 31 December 1998 under transactions, arrangements and agreements made by institutions authorised under the Banking Act 1987 within the Group for persons who are, or were, directors of the Bank during the year and their connected persons, and with executive officers listed on page 60 and their connected persons comprised the following.

	Number of directors/ officers	Number of connected persons	Aggregate amount £000
Directors and their connected persons			
Loans and credit card transactions	**5**	**8**	**61**
Other executive officers			
Loans and credit card transactions	**19**	**5**	**904**

ii Mr B P Horn, a director, and his wife have entered into two three year agreements with subsidiary undertakings of the Bank for the lease of cars. The combined annual rentals will amount to £10,186. Both agreements are on usual commercial terms.

iii Mr R Delbridge, a director, has entered into a 3 year agreement with a subsidiary undertaking of the Bank for the lease of a car. The annual rental amounts to £6,380. This agreement is on usual commercial terms.

iv As at 31 December 1998, National Westminster Home Loans Limited, which is not an authorised institution under the Banking Act 1987, had made available mortgage finance which amounted to £1,450,006 to 8 other executive officers and one member of the close family of a director. All transactions were at normal commercial rates and terms.

50 Differences between UK and US accounting principles

The consolidated accounts of the Group are prepared in accordance with UK GAAP which differs in certain respects from US GAAP. The following is a summary of the significant differences.

- Freehold property may be revalued and the surplus or deficit arising on such revaluation is included in the Group's reserves which form part of ordinary shareholders' equity. Revaluation of freehold property is not permitted under US GAAP.
- It is the Group's policy to maintain its properties in a state of good repair. The directors' assessment of the residual values (based on values prevailing at acquisition or subsequent revaluation) and useful economic lives of freehold and long leasehold properties is such that the charge for depreciation would not be significant; consequently, these properties are not depreciated. Under US GAAP, depreciation must be charged.
- Ordinary share dividends are provided in the financial year in respect of which they are declared by the board of directors. Under US GAAP, such dividends are not provided for until the date declared.
- Deferred taxation is provided only where it is probable that a taxation liability will crystallise. Under US GAAP, full provision must generally be made for all potential taxation liabilities.
- Certain loan fees are recognised when received. Under US GAAP, all loan fees and certain direct costs are deferred and recognised as an adjustment to the yield on the related loan or facility.
- Pension costs, based on actuarial assumptions and methods, are charged in the accounts so as to allocate the cost of providing benefits over the service lives of employees in a consistent manner approved by the actuary. US GAAP prescribes the method of actuarial valuation and also requires assets to be assessed at fair value and the assessment of liabilities to be based on current interest rates.
- The shareholders' interest in the long-term assurance fund is valued as the discounted value of the cash flows expected to be generated from in-force policies together with the net assets in excess of the statutory liabilities. Under US GAAP, premiums are recognised as revenue when due from policyholders. The costs of claims are recognised when insured events occur. For traditional business, the present value of estimated future policy benefits is accrued when premium revenue is recognised. Acquisition costs are capitalised and charged to expense in proportion to premium revenue recognised. For unit-linked business, acquisition costs are amortised over the life of the contracts at a constant rate based on the present value of estimated gross profits. Initial income in respect of future services is not earned in the period assessed but recognised as income over the same amortisation period and using the same amortisation schedule as for acquisition costs.
- Total gross earnings under a finance (capital) lease under UK GAAP are allocated to accounting periods to give a constant periodic rate of return on the lessor's net cash investment in the lease, including the effects of taxation. Under US GAAP, taxation is excluded from the calculation of net cash investment in the lease and the actuarial method before tax is used to calculate the income element of the lease rental.

50 Differences between UK and US accounting principles continued

– Provision was made in 1997 under UK GAAP for losses on the termination of the Group's Equities operations. This provision included certain charges, principally severance and other staff related costs and certain exit costs, which did not meet the US GAAP criteria for recognition in that year. These costs are being charged to US GAAP net income in subsequent periods when the criteria are met.

– Acceptances and the related customer liabilities are reported in memorandum items on the consolidated balance sheet whereas in the US they would be reflected by banks in assets and liabilities.

– Where the Group has entered into reverse repurchase agreements accounted for as secured lending, the securities received are treated as collateral held and are not recorded on the Group's balance sheet. Under US GAAP, where such securities are under the Group's control, as defined in SFAS No 125 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities', they are included on the balance sheet as securities held with a corresponding liability reflecting the obligation to return the securities.

– Under UK GAAP, debt and equity securities intended for continuing use in the Group's activities are classified as investment securities and stated at cost less provision for any permanent diminution in value. Premiums and discounts on dated securities are amortised to interest income over the period to maturity. Under US GAAP, the Group's investment debt securities and marketable investment equity shares are classified as available-for-sale securities with unrealised gains and losses recorded in shareholders' equity together with unrealised gains and losses on related derivatives.

Following the change in accounting policy for goodwill under UK GAAP to comply with FRS 10 'Goodwill and Intangible Assets', the UK to US net income and shareholders' equity reconciliations have been restated as there is no longer a significant difference between the two sets of accounting principles in respect of goodwill.

Reconciliation between UK and US GAAP	**1998 £m**	1997 £m	1996 £m
Consolidated statement of income – Net income			
Profit for the financial year – UK GAAP	**1,617**	636	654
Adjustments in respect of			
Depreciation of property	**(16)**	(17)	(18)
Pension costs (note c)	**86**	40	5
Long-term assurance policies	**(38)**	(51)	(38)
Deferred taxation	**28**	1	(12)
Deferral of loan fees and costs	**(13)**	11	5
Leasing	**(18)**	26	(14)
Loss on disposal of businesses	**–**	–	(6)
Property disposals	**98**	3	4
Losses on termination of Equities operations	**(66)**	95	–
Net income – US GAAP	**1,678**	744	580
Preference dividends	**(51)**	(45)	(37)
Net income available for ordinary shareholders – US GAAP	**1,627**	699	543
Equivalent to	**$2,699m**	$1,157m	$923m
Net income per ordinary share – US GAAP	**£0.95**	£0.41	£0.31
Diluted net income per ordinary share – US GAAP	**£0.94**	£0.40	£0.31
Consolidated shareholders' equity – 31 December			
Ordinary share capital	**1,705**	1,731	1,709
Reserves	**6,324**	5,633	5,583
Ordinary shareholders' equity – UK GAAP	**8,029**	7,364	7,292
Adjustments in respect of			
Elimination of revaluation surplus on properties	**(459)**	(505)	(478)
Ordinary share dividends	**412**	376	331
Depreciation of property	**(215)**	(210)	(195)
Pension costs (note c)	**(68)**	(154)	(194)
Long-term assurance policies	**(266)**	(228)	(177)
Deferred taxation	**(105)**	(133)	(134)
Deferral of loan fees and costs	**(95)**	(82)	(93)
Leasing	**(85)**	(67)	(93)
Losses on termination of Equities operations	**29**	95	–
Net unrealised gains on available-for-sale securities	**118**	41	46
Ordinary shareholders' equity – US GAAP	**7,295**	6,497	6,305
Preference share capital	**472**	623	434
Total shareholders' equity – US GAAP	**7,767**	7,120	6,739
Ordinary shareholders' equity – US GAAP – equivalent to	**$12,102m**	$10,753m	$10,719m
Year end exchange rate £1=$	**1.659**	1.655	1.700

50 Differences between UK and US accounting principles continued

Reconciliation between UK and US GAAP continued

Note a – Net income from continuing operations

	1998 £m	1997 £m	1996 £m
Income			
Net income available for ordinary shareholders	**1,627**	699	543
Adjustment for discontinued operations	**(82)**	(79)	455
Net income from continuing operations	**1,545**	620	998
Net income from continuing operations per ordinary share	**£0.90**	£0.36	£0.57
Diluted net income from continuing operations per ordinary share	**£0.89**	£0.36	£0.56

The effect of dilutive securities on the average number of ordinary shares in issue during the year is shown in note 15 on page 85. Dilutive securities have no effect on net income from continuing operations.

At 31 December 1998 there were 9.9m options outstanding that were not included in the computation of diluted earnings per share because they were anti-dilutive or contingent on conditions not satisfied at that date, exercisable at prices between 493p and 1101p (1997 10.0m options exercisable between 493p and 1030p; 1996 11.4m options exercisable between 493p and 672p).

Note b – Income taxes

i Disclosures under SFAS 109, additional to notes 12 and 37 to the accounts published under UK GAAP, are set out below.

ii Income tax expense attributable to discontinued operations is £2m (1997 £nil; 1996 £29m).

iii The significant components of income tax expense attributable to continuing operations are as follows.

	1998 £m	1997 £m	1996 £m
Current tax expense excluding benefits of operating losses brought forward	**508**	215	344
Benefits of operating losses brought forward	**–**	(6)	(11)
Deferred tax expense	**50**	214	234
Effect of change in corporation tax from 31% to 30% (1997 33% to 31%)			
Adjustment for finance leases	**(55)**	(106)	–
Other	**(4)**	(8)	–
	499	309	567

iv A reconciliation of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying the standard UK corporation tax rate to profit before tax from continuing operations is given below.

	1998 £m	1997 £m	1996 £m
United Kingdom corporation tax expense at 31% (1997 31.5%; 1996 33%)	**638**	282	558
Adjustments for prior years	**–**	(7)	–
Overseas losses for which relief is currently not available	**17**	51	30
Effect of changes in corporation tax rate	**(42)**	(81)	–
Losses on termination of Equities operations for which full tax relief has not been assumed	**–**	69	–
Profit on disposals taxed at lower rates	**(70)**	–	–
Provisions relating to the redesign of the retail bank for which full tax relief has not been assumed	**–**	–	52
General provision for bad and doubtful debts not allowable for tax	**3**	30	16
Dividends taxed at lower rates	**(2)**	(31)	(54)
Tax relief on payments made to employee share option plans	**(14)**	(33)	–
Other	**(31)**	29	(35)
Tax expense provided on continuing operations	**499**	309	567

50 Differences between UK and US accounting principles continued

Note b – Income taxes continued

v The tax effects of the principal components of deferred tax liabilities and deferred tax assets are as follows.

	1998 £m	1997 £m
Deferred tax liabilities		
Capital allowances and depreciation	**666**	1,318
Accrued interest and other items	**36**	126
Gross deferred tax liabilities	**702**	1,444
Deferred tax assets		
Provisions and other items	**(124)**	(180)
Gross deferred tax assets	**(124)**	(180)
Net deferred tax liabilities	**578**	1,264

Note c – Pension costs

The provisions of SFAS No 87, 'Employers' Accounting for Pensions' have been applied only to the Group's main plan which represents 89% of the assets and actuarial liabilities of all Group plans. Pension benefits are based on years of credited service and the employee's compensation in the final year before retirement. Annual contributions are made equal to the cost of accruing benefits calculated in accordance with the advice of actuaries to the plan, adjusted appropriately to amortise any past service surpluses or deficiencies in respect of the liabilities accrued at the valuation date. The majority of plan assets comprise direct and indirect holdings in listed shares, fixed income securities and property.

Under US GAAP, changes in the benefit obligation, fair value of fund assets, accrued pension credit and net periodic pension cost of the main plan are set out below.

	1998 £m	1997 £m	1996 £m
Benefit obligation at beginning of year	**6,671**	6,245	6,015
Service cost	**156**	175	180
Interest cost	**455**	517	498
Net actuarial loss/(gain)	**586**	67	(134)
Benefits paid	**(327)**	(333)	(314)
Benefit obligation at end of year	**7,541**	6,671	6,245
Fair value of fund assets at beginning of year	**8,936**	7,657	6,869
Actual return on fund assets	**(89)**	1,471	1,088
Employer contribution	**15**	141	14
Benefits paid	**(327)**	(333)	(314)
Fair value of fund assets at end of year	**8,535**	8,936	7,657
Funded status	**994**	2,265	1,412
Unrecognised net actuarial gain	**(1,117)**	(2,546)	(1,791)
Unrecognised prior service cost	**6**	6	7
Unrecognised transition obligation	**72**	82	92
Accrued pension credit	**(45)**	(193)	(280)
Service cost	**156**	175	180
Interest cost	**455**	517	498
Expected return on assets	**(658)**	(678)	(607)
Amortisaton of the net obligation at transition	**10**	10	10
Amortisation of prior service costs	**1**	1	1
Amortisation of gain	**(98)**	(60)	(31)
Net periodic pension (credit)/cost	**(134)**	(35)	51

50 Differences between UK and US accounting principles continued

Note c – Pension costs continued

Weighted average assumptions used at 30 September, the measurement date.

	1998 % per annum	1997 % per annum	1996 % per annum
Discount rate	**6.00**	7.00	8.50
Salary increases	**4.00**	5.00	6.50
Long-term rate of return on assets	**6.75**	7.50	9.00
Inflation rate	**2.50**	3.00	4.50

The US GAAP pension credit for the main plan of £134m (1997 £35m credit; 1996 £51m expense) compares with a UK GAAP credit for the main plan of £9m (1997 £23m expense; 1996 £59m expense), giving an increase to net income of £86m (1997 £40m; 1996 £5m).

Note d – Cash flow

The Group prepares its cash flow statement in accordance with Financial Reporting Standard 1 (Revised 1996), 'Cash Flow Statements' ('FRS 1'). Its objective and principles are similar to those set out in SFAS No 95, 'Statement of Cash Flows' ('SFAS 95'). The principal difference between the standards relates to classification. Under FRS 1, the Group presents its cash flows for (a) operating activities; (b) returns on investments and servicing of finance; (c) taxation; (d) capital expenditure and financial investment; (e) acquisitions and disposals; (f) equity dividends paid; and (g) financing. SFAS 95 requires only three categories of cash flow activity being (a) operating; (b) investing; and (c) financing.

The classification of cash flows under FRS 1 differs from that under SFAS 95 as follows: (a) returns on investments and servicing of finance and taxation would be included as operating activities; (b) capital expenditure and financial investment, acquisitions and disposals and management of liquid resources would be included as investing activities; and (c) equity dividends paid would be included as a financing activity.

Note e – Disclosure of information about the fair value of financial instruments

SFAS No 107 'Disclosures about Fair Value of Financial Instruments' ('SFAS 107') requires disclosure of the estimated fair value of the Group's financial instruments. SFAS 107 defines fair value as the amount at which an instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. Most of the Group's assets and liabilities are considered to be financial instruments. Many of these do not trade regularly and no market for them exists. Where quoted market prices are not available, fair values have been estimated based on discounted anticipated cash flows and other valuation techniques. The fair values estimated are influenced by the valuation method chosen from the options available under SFAS 107 and reflect the underlying subjective assumptions made about the discount rate and estimates of the amount and timing of anticipated future cash flows. Changes in these assumptions would significantly affect estimated fair values.

SFAS 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. The following table sets forth estimated fair values of the Group's financial instruments as at 31 December 1998 and 1997. The valuations are presented at a specific date and the estimated fair values of these financial instruments at other times may therefore be different from the amounts reported. In many cases, the estimated fair values could not be realised immediately. As a result, the aggregate fair value amounts disclosed do not represent the underlying value of the Group or the amounts which will actually be paid or realised on settlement or maturity.

	1998		1997	
Assets	**Carrying amount £m**	**Fair value £m**	Carrying amount £m	Fair value £m
Assets carried at fair value				
Treasury and other eligible bills	**5,859**	**5,859**	6,246	6,246
Debt securities	**20,827**	**20,827**	17,809	17,809
Equity shares	**65**	**65**	4,039	4,039
Derivatives	**8,871**	**8,871**	8,186	8,186
Other assets				
Cash and balances at central banks	**1,055**	**1,055**	905	905
Items in the course of collection from other banks	**2,433**	**2,433**	2,599	2,599
Loans and advances to banks and customers	**111,331**	**112,047**	116,491	116,215
Investment debt and equity securities	**17,004**	**17,568**	12,913	13,223
Non-trading derivatives – net	**155**	**(504)**	157	(273)

50 Differences between UK and US accounting principles continued

Note e – Disclosure of information about the fair value of financial instruments continued

Liabilities	1998 Carrying amount £m	1998 Fair value £m	1997 Carrying amount £m	1997 Fair value £m
Liabilities carried at fair value				
Short positions in debt securities	**7,927**	**7,927**	10,083	10,083
Short positions in equity shares	**3**	**3**	2,774	2,774
Derivatives	**9,344**	**9,344**	8,865	8,865
Other liabilities				
Items in the course of transmission to other banks	**1,268**	**1,268**	1,320	1,320
Deposits by banks and customer accounts	**122,856**	**122,963**	117,990	118,010
Debt securities in issue	**15,555**	**15,560**	17,797	17,868
Subordinated loan capital	**5,162**	**5,354**	5,145	5,321

Derivatives and securities (both long and short positions) held for trading purposes are included in the balance sheet at fair value.

Assets

Cash and balances at central banks and items in the course of collection from other banks: the carrying amount is a reasonable estimate of fair value.

Loans and advances to banks and customers: for loans that reprice frequently, and with no significant change in credit risk since inception of the loan, carrying amounts represent a reasonable estimate of fair value. The fair values of other loans are estimated by discounting anticipated future cash flows, using interest rates currently being offered for loans with the same terms to borrowers of similar credit quality. The value of non-performing loans has been estimated by discounting the expected cash flows for recoveries. In accordance with SFAS 107, fair values are not estimated for lease receivables.

Debt securities and equity shares: fair values of marketable securities are based on quoted market prices. Where these are not available, fair values are based on the quoted market prices of comparable securities or, where these are unavailable, are estimated by discounting anticipated future cash flows or using other valuation techniques.

Liabilities

Items in the course of transmission to other banks: the carrying amount is a reasonable estimate of fair value.

Deposits by banks and customer accounts: the fair value of demand deposits, savings accounts and certain variable-rate money market deposits is the amount payable on demand on 31 December. SFAS 107 requires deposit liabilities with no stated maturity to be reported at their carrying value and does not allow for the recognition of the interest funding value of these instruments. The directors believe that significant value exists in this funding source. The carrying amounts of borrowings under repurchase agreements and other short-term borrowings approximate to their fair value. The fair value of fixed-rate term deposits is estimated by discounting anticipated future cash flows using the rates currently offered for deposits of similar maturities.

Debt securities in issue: the carrying amounts of short-term debt securities in issue approximate to their fair values. Fair values of other debt securities in issue are based on quoted prices where available, otherwise by discounting anticipated future cash flows.

Subordinated loan capital: the fair value of quoted loan capital equates to the offer price. For unquoted loan capital, fair values have been estimated based on rates currently available to the Bank for loan capital with similar terms and conditions.

Financial commitments and contingent liabilities: the directors believe that the diversity of the fee structures, the lack of an established market and the difficulty of separating the value of the instruments from the value of the overall relationship involve such uncertainty that it is not meaningful to provide an estimate of fair value for these instruments. (The principal amounts of financial commitments and contingencies are given in note 43).

Derivatives

Fair values of derivatives are the amounts estimated to be payable or receivable by the Group at the balance sheet date to replace outstanding contracts. These are based on market prices where available. Otherwise, fair value is estimated based on current market data using appropriate valuation models.

50 Differences between UK and US accounting principles continued

Note f – Investment debt and equity securities

The following table analyses by maturity the book value and fair value of the Group's holdings of securities classified as available for sale as at 31 December 1998 and gives the weighted average yield on the book value for each category within each maturity range.

	1 year or less		After 1 year but within 5 years		After 5 years but within 10 years		After 10 years		Total	
	£m	Yield %	£m	Yield %	£m	Yield %	£m	Yield %	£m	Yield %
Available for sale										
Debt securities of, or guaranteed by, the UK government	208	5.0	965	6.5	1	6.7	23	8.0	1,197	6.3
Debt securities issued by the US treasury and other US government corporations and agencies	108	6.2	28	6.1	–	–	–	–	136	6.2
Debt securities issued by other foreign governments	220	8.5	1,991	7.2	258	7.3	–	–	2,469	7.3
Corporate debt securities	432	5.6	2,482	6.5	60	8.4	83	3.9	3,057	6.4
Mortgage-backed securities	–	–	–	–	11	3.5	69	6.8	80	6.4
Certificates of deposit	7,829	6.9	463	7.1	–	–	–	–	8,292	6.9
Other debt securities	269	5.5	1,198	6.4	36	6.4	2	3.8	1,505	6.2
Equity securities	–	–	–	–	–	–	268	–	268	–
Total book value	9,066	6.8	7,127	6.7	366	7.3	445	5.6	17,004	6.8
Total fair value	9,099		7,480		375		614		17,568	

Proceeds from the sale of available for sale investment securities were £1,751m (1997 £2,214m; 1996 £5,899m). Gross realised gains of £131m (1997 £103m; 1996 £110m) and gross realised losses of £8m (1997 £nil; 1996 £nil) were recorded on those sales.

	At 31 December		
	1998 £m	1997 £m	1996 £m
Book value			
Debt securities of, or guaranteed by, the UK government	1,197	1,235	1,687
Debt securities issued by the US treasury and other US government corporations and agencies	136	186	125
Debt securities issued by other foreign governments	2,469	1,348	881
Corporate debt securities	3,057	2,526	2,389
Mortgage-backed securities	80	97	159
Certificates of deposit	8,292	5,939	6,560
Other debt securities	1,505	1,271	1,797
Equity securities	268	311	317
Total investment securities	17,004	12,913	13,915

All investment securities are classified as 'available for sale'.

Further information on the Group's investment debt and equity securities is shown in notes 22 and 23 to the accounts published under UK GAAP.

50 **Differences between UK and US accounting principles** continued

Note g

SFAS No 114, 'Accounting by Creditors for Impairment of a Loan' ('SFAS 114') as amended by SFAS No 118, 'Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures' ('SFAS 118') addresses accounting by creditors for impairment of a loan by specifying how allowances for credit losses for certain loans should be determined. A loan is impaired when it is probable that the creditor will be unable to collect all amounts in accordance with the contractual terms of the loan agreement. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective rate or, as an expedient, at the fair value of the loan's collateral.
Debt securities, leases and smaller-balance homogeneous loans and debt securities are excluded from the scope of SFAS 114.

At 31 December 1998, 1997 and 1996 the Group estimated that the difference between the carrying value of its loan portfolio on the basis of SFAS 114 and its value in the Group's UK GAAP accounts was such that no adjustment to net income or consolidated ordinary shareholders' equity was required.

At 31 December 1998, the Group's net investment in non-accrual loans and troubled debt restructurings was £1,432m (1997 £1,707m; 1996 £2,050m) of which £1,245m (1997 £1,498m; 1996 £1,730m) was after specific provisions of £719m (1997 £690m; 1996 £775m). The average investment during 1998 in such loans was £1,411m (1997 £1,848m; 1996 £2,406m). Interest credited to interest receivable on these loans in 1998 amounted to £84m (1997 £65m; 1996 £68m).

Note h

The American Institute of Certified Public Accountants issued in March 1998 Statement of Position 98-1 'Accounting for the Costs of Computer Software Developed or Obtained for Internal Use'. This statement, which requires the capitalisation of certain costs of developing software for internal use, will be applicable to the Group's 1999 accounts.
In June 1998, the Financial Accounting Standards Board ('FASB') published SFAS No 133 'Accounting for Derivative Instruments and Hedging Activities' effective for accounting periods beginning after 15 June 1999. This statement requires all derivatives to be measured at fair value and sets out specific requirements for the accounting treatment of derivatives that are designated as hedges. In October 1998, FASB published SFAS No 134 'Accounting for Mortgage-Backed Securities Retained after the Securitisation of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise – an amendment of FASB Statement No 65'. The Group is reviewing these three statements to determine their effect on its US GAAP reporting.

Loans and advances to customers

This section should be read in conjunction with (i) the tables of average balance sheets and interest rates on pages 37 to 40 and (ii) the discussion of provisions for bad and doubtful debts beginning on page 48.

Net loans and advances to customers [1, 2, 3]

At 31 December

	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
By domestic offices					
Agriculture, forestry and fishing	**1,531**	1,486	1,398	1,378	1,331
Manufacturing and other production	**3,997**	3,855	3,960	3,786	3,822
Construction	**1,580**	1,341	1,241	1,453	1,420
Distribution, transport and hotels	**7,455**	7,199	6,548	6,588	6,168
Financial and other	**6,507**	7,814	10,211	8,090	6,466
Property companies	**3,886**	3,468	2,842	2,714	2,342
Personal – mortgage	**17,794**	16,867	15,570	15,031	14,388
– other [4]	**7,101**	6,597	6,284	6,014	5,930
Instalment	**4,135**	7,329	6,540	5,402	4,550
Lease financing	**3,503**	6,983	6,673	5,262	4,881
Loans guaranteed by UK government agencies	**–**	–	–	–	195
Total domestic offices	**57,489**	62,939	61,267	55,718	51,493
By international offices					
United States	**5,636**	6,413	4,957	15,355	12,895
United Kingdom [5]					
Residents	**6,390**	6,382	6,886	7,002	6,684
Non-residents	**3,124**	3,571	2,906	2,907	3,296
	9,514	9,953	9,792	9,909	9,980
Other European Union	**5,589**	4,533	4,473	5,382	4,529
Rest of the World	**2,065**	2,032	2,253	2,706	3,157
Total international offices	**22,804**	22,931	21,475	33,352	30,561
Total gross loans and advances to customers	**80,293**	85,870	82,742	89,070	82,054
Provisions for bad and doubtful debts	**(1,331)**	(1,395)	(1,456)	(1,652)	(1,756)
Total net loans and advances to customers	**78,962**	84,475	81,286	87,418	80,298
Total net loans and advances to customers banking business [6]	**72,583**	74,955	72,519	84,138	
Total net loans and advances to customers trading business [6]	**6,379**	9,520	8,767	3,280	
Total net loans and advances to customers	**78,962**	84,475	81,286	87,418	

1 In the opinion of management, the Group was not exposed at 31 December 1998 to any significant loan concentrations that are not disclosed above.
2 Unearned income of £2,140m (1997 £5,739m; 1996 £5,305m; 1995 £4,602m; 1994 £4,093m) is excluded from the above.
3 The geographical analysis of lendings is based on the location of office from which the loans are made.
4 'Personal – other' comprises the Group's non-mortgage consumer credit portfolio, including credit cards, overdrafts and term loans but excluding leases and hire purchase agreements.
5 Includes loans guaranteed by UK government agencies of £137m (1997 £181m; 1996 £184m; 1995 £377m; 1994 £205m).
6 1994 has not been restated to show the trading business separately.

Loans and advances to customers continued

The following table analyses lending by time remaining until maturity and interest rate sensitivity by maturity as at 31 December 1998.

	1 year or less £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
By domestic offices				
Agriculture, forestry and fishing	931	290	310	1,531
Manufacturing and other production	2,739	773	485	3,997
Construction	1,142	300	138	1,580
Distribution, transport and hotels	4,123	1,863	1,469	7,455
Financial and other	3,899	1,247	1,361	6,507
Property companies	1,559	1,000	1,327	3,886
Personal – mortgage	588	1,749	15,457	17,794
– other	3,461	3,149	491	7,101
Instalment	1,629	2,399	107	4,135
Lease financing	821	1,346	1,336	3,503
Total domestic offices	20,892	14,116	22,481	57,489
By international offices				
United States	3,980	641	1,015	5,636
United Kingdom	4,560	4,159	795	9,514
Other European Union	2,328	2,354	907	5,589
Rest of the World	1,363	530	172	2,065
Total international offices	12,231	7,684	2,889	22,804
Total by maturity	33,123	21,800	25,370	80,293
Interest rate sensitivity of loans and advances to customers by maturity				
Variable interest rate	21,066	15,985	21,713	58,764
Fixed interest rate	12,057	5,815	3,657	21,529
Total by maturity	33,123	21,800	25,370	80,293

The portfolio of loans and advances to customers is diversified by borrower, industry and geographic region and totalled £80,293m at 31 December 1998 compared with £85,870m at the end of the previous year. Loans and advances to customers averaged £86,804m during the year (1997 £87,303m). All figures are before provisions for bad and doubtful debts.

The maturity composition of the loan portfolio has remained generally consistent with prior years. Some 41% of total loans mature within one year (mainly overdrafts which are typically renewed) and over two-thirds within five years. At 31 December 1998, over 90% of the loan portfolio was from UK and US offices, and more than 73% was subject to variable interest rates.

Provisions for bad and doubtful debts

The breakdown of the Group's write offs, recoveries and specific bad and doubtful debt provisions against loans and advances to customers by each category of customer is set out in the following tables. Percentages are expressed in relation to gross loans and advances to customers at each year end. These tables should be read in conjunction with the analysis of net loans and advances to customers shown on page 128.

Loans written off	1998		1997		1996		1995		1994	
	£m	%	£m	%	£m	%	£m	%	£m	%
By domestic offices										
Agriculture, forestry and fishing	**5**		4		7		8		14	
Manufacturing and other production	**27**		48		65		65		74	
Construction	**20**		23		49		64		55	
Distribution, transport and hotels	**67**		77		111		118		170	
Financial and other	**43**		88		108		91		124	
Property companies	**20**		17		23		31		48	
Personal – mortgage	**6**		12		23		19		19	
– other	**152**		127		167		166		242	
Instalment	**173**		181		119		117		101	
Lease financing	**15**		13		13		12		27	
Total domestic offices	**528**	**0.92**	590	0.94	685	1.12	691	1.24	874	1.70
By international offices										
United States	**19**		34		35		171		186	
United Kingdom	**42**		138		18		25		18	
Other European Union	**32**		65		50		81		27	
Rest of the World	**1**		10		18		55		39	
Total international offices	**94**	**0.41**	247	1.08	121	0.56	332	1.00	270	0.88
Total	**622**	**0.77**	837	0.97	806	0.97	1,023	1.15	1,144	1.39

Recoveries	1998		1997		1996		1995		1994	
	£m	%	£m	%	£m	%	£m	%	£m	%
By domestic offices										
Agriculture, forestry and fishing	**3**		4		5		5		5	
Manufacturing and other production	**13**		15		17		17		34	
Construction	**13**		17		16		14		16	
Distribution, transport and hotels	**34**		39		32		32		34	
Financial and other	**25**		28		30		30		34	
Property companies	**15**		11		13		15		18	
Personal – mortgage	**–**		–		–		1		1	
– other	**63**		52		39		40		40	
Instalment	**29**		46		33		33		33	
Lease financing	**2**		1		1		4		4	
Total domestic offices	**197**	**0.34**	213	0.34	186	0.30	191	0.34	219	0.43
By international offices										
United States	**1**		1		8		30		29	
United Kingdom	**–**		2		8		7		1	
Other European Union	**6**		10		6		13		5	
Rest of the World	**1**		1		1		2		–	
Total international offices	**8**	**0.04**	14	0.06	23	0.11	52	0.16	35	0.11
Total	**205**	**0.26**	227	0.26	209	0.25	243	0.27	254	0.31

Provisions for bad and doubtful debts continued

Specific bad and doubtful debt provisions

	1998 £m	1998 %[1]	1997 £m	1997 %[1]	1996 £m	1996 %[1]	1995 £m	1995 %[1]	1994 £m	1994 %[1]
By domestic offices										
Agriculture, forestry and fishing	**10**	**1.9**	6	1.7	5	1.7	12	1.5	10	1.6
Manufacturing and other production	**28**	**5.0**	23	4.5	42	4.8	48	4.3	87	4.7
Construction	**16**	**2.0**	13	1.6	14	1.5	38	1.6	39	1.7
Distribution, transport and hotels	**48**	**9.3**	55	8.4	53	7.9	87	7.4	110	7.5
Financial and other	**39**	**8.1**	49	9.1	78	12.3	108	9.1	113	7.9
Property companies	**8**	**4.8**	26	4.0	33	3.4	40	3.0	52	2.9
Personal – mortgage	**13**	**22.2**	14	19.6	20	18.8	34	16.9	35	17.5
– other	**89**	**8.8**	115	7.7	98	7.6	78	6.8	132	7.2
Instalment	**102**	**5.1**	152	8.5	131	7.9	99	6.1	102	5.6
Lease financing	**32**	**4.4**	42	8.1	37	8.1	36	5.9	42	6.0
Loans guaranteed by UK government agencies	**–**	**–**	–	–	–	–	–	–	–	0.2
Total domestic offices	**385**	**71.6**	495	73.2	511	74.0	580	62.6	722	62.8
Percentage of gross loans and advances to customers	**0.67%**		0.79%		0.83%		1.04%		1.40%	
By international offices										
United States	**25**	**7.0**	83	7.5	84	6.0	74	17.2	136	15.7
United Kingdom	**309**	**11.8**	287	11.6	408	11.9	405	11.1	298	12.2
Other European Union	**59**	**7.0**	66	5.3	106	5.4	164	6.1	185	5.5
Rest of the World	**146**	**2.6**	67	2.4	47	2.7	26	3.0	75	3.8
Total international offices	**539**	**28.4**	503	26.8	645	26.0	669	37.4	694	37.2
Percentage of gross loans and advances to customers	**2.36%**		2.19%		3.00%		2.01%		2.27%	
Total	**924**	**100.0**	998	100.0	1,156	100.0	1,249	100.0	1,416	100.0
Percentage of gross loans and advances to customers	**1.15%**		1.16%		1.40%		1.40%		1.73%	

1 These percentages represent the loans in each category as a percentage of the total gross loans and advances to customers.

Distribution of outstandings and foreign country related assets

Outstandings comprise total loans and advances to customers and banks, amounts receivable under finance (capital) leases, acceptances and other monetary assets, primarily bills discounted and certificates of deposit. At 31 December 1998, outstandings were £184,873m (1997 £184,153m; 1996 £184,218m). Outstandings, based on the country of domicile of the ultimate obligor and after recognising any transfer of risk resulting from guarantees, are analysed below.

At 31 December	1998 %	1997 %	1996 %
United Kingdom	**52**	50	51
Other European Union	**20**	16	17
North America	**20**	21	19
Rest of the World	**8**	13	13
Total	**100**	100	100

No country accounted for more than 5% of total Group outstandings other than the UK, the US (17.8%) and Germany (5.1%). The Group's international business is concentrated in OECD countries. Exposure to countries experiencing repayment difficulties was 1.29% of total outstandings. The Group's exposures to various countries which are rated as sub-investment grade by leading rating agencies are set out on page 52.

The table on page 132 sets out the Group's cross-border outstandings, by borrower category, to countries for which outstandings individually represented in excess of 1% of Group total assets (including acceptances) at 31 December in each of the past three years. None has experienced repayment difficulties which have required refinancing of outstanding debt.

Countries with cross-border outstandings in excess of 1% of Group total assets (including acceptances)

	Banks and other financial institutions £m	Governments and official institutions £m	Other (primarily commercial and industrial) £m	Total £m
				At 31 December 1998
Germany	**5,962**	**6**	**276**	**6,244**
France	**5,134**	**54**	**344**	**5,532**
United States	**3,207**	**2**	**1,105**	**4,314**
Netherlands	**2,126**	**–**	**753**	**2,879**
Italy	**2,472**	**116**	**64**	**2,652**
Canada	**2,070**	**184**	**327**	**2,581**
Japan	**2,122**	**–**	**281**	**2,403**
				At 31 December 1997
Japan	9,774	–	406	10,180
United States	3,425	7	1,506	4,938
Germany	3,200	69	608	3,877
France	3,157	84	435	3,676
Canada	1,830	85	358	2,273
Netherlands	1,439	1	712	2,152
Italy	1,363	151	405	1,919
				At 31 December 1996
Japan	8,823	1	457	9,281
United States	4,676	16	3,239	7,931
France	3,289	1	267	3,557
Germany	3,018	–	144	3,162
Netherlands	1,696	3	345	2,044
Italy	1,740	120	75	1,935

At 31 December 1998 Switzerland (£1,643m) was the only country that had cross-border outstandings of between 0.75% and 1% of Group total assets (including acceptances).

At 31 December 1997, no countries had cross-border outstandings of between 0.75% and 1% of Group total assets (including acceptances).

At 31 December 1996, Canada (£1,621m) was the only country that had cross-border outstandings of between 0.75% and 1% of Group total assets (including acceptances).

Short-term borrowings

Short-term borrowings are included within the balance sheet captions ‘Deposits by banks’, ‘Customer accounts’ and ‘Debt securities in issue’.

The short-term borrowings of the Group consist of federal funds purchased, securities and bills sold under agreements to repurchase, commercial paper issued in the US, and other, primarily bank, borrowings of subsidiary undertakings. Generally, original maturities of federal funds purchased and securities and bills sold under repurchase agreements are less than six months, commercial paper less than nine months and other short-term borrowings one year or less.

The following table shows details of the Group’s short-term borrowings for each of the past three years.

	1998 £m	1997 £m	1996 £m
Federal funds purchased			
Outstanding at 31 December	**1,191**	990	522
Maximum amount outstanding at any month end during the year	**1,191**	1,626	1,342
Approximate average amount outstanding during the year	**623**	1,020	657
Approximate weighted average interest rate during the year	**3.4%**	5.1%	5.2%
Approximate weighted average interest rate at year end	**2.6%**	5.5%	6.4%
Securities and bills sold under agreements to repurchase			
Outstanding at 31 December	**17,201**	14,886	13,951
Maximum amount outstanding at any month end during the year	**20,917**	23,460	16,466
Approximate average amount outstanding during the year	**17,082**	20,207	8,622
Approximate weighted average interest rate during the year	**4.7%**	5.4%	7.1%
Approximate weighted average interest rate at year end	**4.6%**	6.1%	6.3%
Commercial paper			
Outstanding at 31 December	**1,532**	2,618	1,659
Maximum amount outstanding at any month end during the year	**2,163**	2,700	1,659
Approximate average amount outstanding during the year	**1,840**	1,691	552
Approximate weighted average interest rate during the year	**5.7%**	6.2%	5.2%
Approximate weighted average interest rate at year end	**5.1%**	6.0%	5.8%
Other short-term borrowings			
Outstanding at 31 December	**1,687**	840	1,026
Maximum amount outstanding at any month end during the year	**1,817**	2,944	1,438
Approximate average amount outstanding during the year	**849**	757	1,163
Approximate weighted average interest rate during the year	**5.5%**	7.7%	5.9%
Approximate weighted average interest rate at year end	**4.5%**	6.0%	5.5%

Short-term borrowings remain important to the overall market operations of the Group. Average short-term borrowings in 1998 amounted to £20.4bn (1997 £23.7bn) or approximately 10% (1997 11%) of average total liabilities and shareholders’ equity.

Supervision and regulation

The Banking Act 1987 sets out the functions and duties of the Bank of England as the UK banking supervisory authority and gives it wide discretionary powers in relation to banks authorised by it to carry on banking business (‘authorised institutions’). These responsibilities were transferred to the Financial Services Authority (FSA) by the Bank of England Act 1998.

In June 1998 the FSA issued its Guide to Banking Supervisory Policy for the banks under its supervision. Each bank submits regular reports to the FSA which provide material for supervisory assessment. The Group’s senior executives meet regularly with the FSA to discuss key topics relating to the Group’s businesses, such as risk control, loan portfolio composition, profitability, capital adequacy and liquidity, organisational changes and operating practices. Supervision has become increasingly formalised with the introduction of guidelines, drawn up by the FSA in consultation with the banks, relating to, among other things, liquidity, large exposures to related borrowers, the adequacy of accounting and other records and internal control systems, money laundering (through the Joint Money Laundering Steering Group), loan transfers and securitisation of loans, advertising and the FSA’s relationship with a bank’s external auditors.

Supervision and regulation continued

The Arthur Andersen review of Supervision and Surveillance, commissioned by the Bank of England in 1995, was published in July 1996. Amongst the proposals accepted by the Bank of England was the development of a formal risk assessment model, now known as Risk Assessment, Tools of Supervision, Evaluation ('RATE'), and applied to the Group in 1997 as part of a voluntary prototyping exercise. Risk based supervision is now applied to all UK banks in 1998 by the FSA on the basis of the revised Statement of Principles issued under the Banking Act 1987 issued in June 1998.

UK banks are required to maintain, in interest free accounts at the Bank of England, a cash balance, which is based on eligible liabilities (primarily sterling deposits less amounts on loan to other monetary institutions). Such balances count towards the liquidity requirements for the Real Time Gross Settlement System introduced in the UK during 1996. Otherwise, these balances are regarded as non-operational and do not count towards overall liquidity requirements. Cash Ratio Deposits became statutory under the Bank of England Act 1998. The current ratio is 0.15% of eligible liabilities. The liquidity standard for sterling introduced in January 1996 requires the maintenance of sufficient holdings of liquid assets to cover potential cash outflows over the next five business days. This policy, known as sterling stock liquidity, applies to Group UK-based sterling operations.

Regulations were introduced in the UK in 1995 to implement the European Deposit Guarantee Schemes Directive. The percentage of depositors' funds covered is 90% subject to a maximum aggregate payment to any one individual of £18,000. In addition, the scheme covers all European Economic Area currencies and the European Union ('EU') and established a minimum level of deposit protection of ECU 20,000 (approximately £14,100 or $23,400 at 31 December 1998), although the level will remain at euro 15,000 until the end of 1999 in some member states.

A number of directives have been adopted by the EU in pursuit of the 1985 single market programme. Some deal with the provision of banking services in member states and allow EU banks to provide similar services throughout the EU. The single market programme for banking was completed when the Capital Adequacy Directive ('CAD') was implemented in the UK with effect from 1 January 1996. The CAD introduced, inter alia, a new requirement for banks to provide capital for market risk. The Investment Services Directive also came into force at the beginning of 1996 and introduced a similar capital regime for investment firms. The EU Commission unveiled proposals in December 1997 to simplify financial services legislation by replacing 19 directives with one codified version. During the year, the Group made a submission to the EU Commission's strategic review of financial services.

The Basle Committee on Banking Regulations and Supervisory Practices issued a capital accord in 1988 (the 'Basle Accord') creating a framework for measuring the capital adequacy of international banking organisations and establishing a risk asset ratio relating a bank's capital to its assets and off-balance sheet exposures, weighted according to broad categories of risk, primarily credit. The Basle Accord sets minimum capital adequacy ratios, but local banking regulators are permitted to set higher standards. A comprehensive review of the Basle Accord was announced in September 1998 and is expected to produce findings by 2000.

Capital adequacy issues were also addressed by the Own Funds and Solvency Ratio directives of the EU. The Bank of England brought these directives into effect in the UK on 1 January 1991. However, the requirements of the Basle Accord and the two EC directives are broadly comparable and there were no significant changes in the calculation of the risk asset ratios as a result of the directives.

'The Basle Amendment to the Capital Accord to Incorporate Market Risks' ('Basle') was issued in January 1996. The FSA introduced a new market risk regime as from 1 October 1998 for implementation of its policy based on Basle and the parallel EU market risk directive, known as CAD2. Both Basle and CAD2 enable banks to use internal value-at-risk models to calculate capital charges for market risks. It will not be possible to determine the impact on capital arising from CAD2 until the FSA has completed its work on model recognition. Also introduced by the EU in October 1998 was the expanded matrix directive which enables the Group to net counterparty risk in OTC derivatives.

The Group's investment business in the UK is regulated by the Financial Services Act 1986 ('the Act') which established a framework for strengthening investor protection by the regulation of investment business and markets. The provisions of the Act (as amended) give principal authority for such regulation to HM Treasury, which has delegated certain powers to the FSA (formerly these powers were vested in the Securities and Investment Board ('SIB')). The regulatory scope of the FSA has been extended. The aim is to create a single financial regulator for the UK with wide and flexible powers.

Supervision and regulation continued

The SIB issued guidance in October 1994 following its review of the financial services industry's past business conduct in relation to personal pension transfers and non-joiners and opt-outs of occupational pension schemes. Under this, and subsequent regulatory guidance, the financial services industry was required to carry out a review of past business in this area. The Bank has set up a specialist unit to carry out this work and the review has been completed within the time frame set by the regulators (Phase I). During the course of 1998 the FSA issued further guidance regarding the second stage of the review (known as Phase II). This part of the task will start in January 1999 with a major media campaign orchestrated by the FSA to encourage policy holders to respond to a mass-market mailing by the financial services industry of customers encouraging them to seek a review of their pensions business if they fall within the scope of Phase II. The Group made provisions of £32m and £30m in 1994 and 1995, respectively, and a further provision of £100m has been charged in 1998.

The Bank maintains a branch in the US and consequently its operations are subject to the US International Banking Act of 1978 and the Bank Holding Company Act of 1956 ('the BHCA'). The Bank is required to file certain reports with, and is subject to examination by, the Board of Governors of the Federal Reserve System ('the Board'). The Bank's US branches and agencies are subject to the reserve requirements established by the Board. With respect to non-banking activities, the BHCA generally prohibits the Bank from acquiring, directly or indirectly, more than 5% of the voting shares of any company engaged in non-banking activities in the US unless the Board has determined, by order or regulation, that such proposed activities are so closely related to banking or managing or controlling banks as to be a proper incident thereto. With respect to acquisitions of banks, the BHCA requires the Bank to obtain the prior approval of the Board before acquiring, directly or indirectly, the ownership or control of more than 5% of the voting shares of any US bank. Federal law imposes limitations on the ability of the Bank to engage in certain aspects of the securities business in the US, and extensions of credit and other transactions between the Bank and its US securities affiliates are subject to various restrictions such as quantitative limitations and collateral requirements.

Elsewhere, the Group's operations are subject to regulation and control by local central banks and monetary authorities.

Effect of exchange rate fluctuations

As a significant proportion of the assets, liabilities, income and expenses of the Group is denominated in currencies other than sterling, fluctuations in exchange rates affect the balance sheet and profit and loss account. The principal foreign currency affecting the Group's accounts is the dollar. Over the year to 31 December 1998, it depreciated by less than 1% against sterling, compared with an appreciation of 3% in 1997 and a depreciation of 9% in 1996.

Monetary policy

The earnings of the Group are affected by the economic policies of the UK government and by regulatory and other monetary authorities, particularly the Bank of England. The latter has, since 6 May 1997, had full independent responsibility for setting interest rates. It influences conditions in the money and credit markets which can affect exchange rates, the growth and distribution of lending among various industry sectors and the growth and mix of deposits. Similarly, the operations and profitability of the Group are also affected by the monetary policies of governments and monetary authorities in other countries. The Group cannot predict the future effect of such policies on lending volumes or earnings.

Forward-looking information

Certain statements in this document may be considered to be 'forward-looking statements' as that term is defined in the US Private Securities Litigation Reform Act of 1995, such as statements that include the words 'target', 'goal', 'objective', 'expect', 'estimate', 'project', 'anticipate', 'should', 'intend', 'probability', 'risk', 'VaR' 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 equity price risk. See 'Risk Management' commencing on page 42. By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual future gains and losses could materially differ 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; the monetary and interest rate policies of the Bank of England and other G-7 central banks; inflation; deflation; unanticipated turbulence in interest rates, foreign currency exchange rates, and equity prices; the effects of non-linear market behaviour that cannot be captured by linear statistical models such as the VaR model used by the Group; changes in UK and foreign laws, regulations and taxes; changes in competition and pricing environments; natural disasters; the inability to hedge certain risks economically; the adequacy of loss reserves; acquisitions or restructurings; technological changes; changes in consumer spending and saving habits; and the success of the Group in managing the risks involved in the foregoing. The forward-looking statements contained in this document speak only as of the date of this document, 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.

Five year summary

Amounts in accordance with UK GAAP [1, 2]

	1998 $m	1998 £m	1997[3] £m	1996[3] £m	1995[3] £m	1994[3] £m
Consolidated profit and loss account data						
Continuing operations						
Net interest income	**6,322**	**3,811**	3,664	3,577	3,202	3,030
Non-interest income	**5,900**	**3,556**	3,310	3,308	2,955	2,949
Operating income	**12,222**	**7,367**	6,974	6,885	6,157	5,979
Operating expenses	**(8,386)**	**(5,055)**	(5,274)	(4,724)	(4,304)	(4,170)
Trading surplus	**3,836**	**2,312**	1,700	2,161	1,853	1,809
Provisions for bad and doubtful debts	**(828)**	**(499)**	(562)	(549)	(571)	(549)
Disposal of tangible fixed assets	**(35)**	**(21)**	25	(125)	7	7
Other items	**2**	**1**	(23)	(19)	59	30
Profit before disposal of businesses – continuing operations	**2,975**	**1,793**	1,140	1,468	1,348	1,297
Losses on the termination of Equities operations	**–**	**–**	(287)	–	–	–
Profit on disposal of businesses	**439**	**265**	43	224	–	46
Profit before tax – continuing operations	**3,414**	**2,058**	896	1,692	1,348	1,343
Discontinued operations	**–**	**–**	–	93	348	216
Profit/(loss) on disposal of interests in discontinued operations	**140**	**84**	79	(448)	–	–
Profit on ordinary activities before tax	**3,554**	**2,142**	975	1,337	1,696	1,559
Profit on ordinary activities after tax	**2,722**	**1,641**	666	684	1,183	1,100
Profit attributable to ordinary shareholders [4]	**2,598**	**1,566**	591	617	1,120	1,022
Retention for the year	**1,581**	**953**	34	122	674	651
Consolidated balance sheet data [5, 6]						
Treasury and other eligible bills	**9,720**	**5,859**	6,246	5,046	9,649	8,918
Loans and advances to banks	**53,700**	**32,369**	32,016	35,332	28,775	32,045
Loans and advances to customers	**130,998**	**78,962**	84,475	81,286	87,418	80,298
Debt securities and equity shares	**62,869**	**37,896**	34,761	37,160	18,419	15,333
Other assets	**51,275**	**30,907**	27,996	26,686	24,822	22,095
Total assets	**308,562**	**185,993**	185,494	185,510	169,083	158,689
Deposits by banks	**44,066**	**26,562**	28,102	36,318	32,111	33,101
Customer accounts	**159,752**	**96,294**	89,888	84,191	88,387	84,001
Other liabilities	**81,833**	**49,327**	54,197	52,492	35,594	29,160
Subordinated liabilities	**8,564**	**5,162**	5,145	4,607	4,792	5,199
Minority interests	**244**	**147**	175	176	175	164
Preference shares	**783**	**472**	623	434	464	460
Ordinary shareholders' equity	**13,320**	**8,029**	7,364	7,292	7,560	6,604
Total liabilities	**308,562**	**185,993**	185,494	185,510	169,083	158,689
Average balances [6, 7]						
Total assets	**326,037**	**196,526**	207,108	174,890	173,988	161,572
Ordinary shareholders' equity	**12,958**	**7,811**	7,611	7,471	7,073	6,131

	1998	1998	1997[3]	1996[3]	1995[3]	1994[3]
Selected financial statistics [6]						
Average ordinary shares of £1 each outstanding		**1,717m**	1,716m	1,747m	1,741m	1,676m
Earnings per ordinary share	**$1.51**	**£0.91**	£0.35	£0.35	£0.64	£0.61
Diluted earnings per ordinary share	**$1.49**	**£0.90**	£0.34	£0.35	£0.63	£0.60
Earnings from continuing operations per ordinary share	**$1.43**	**£0.86**	£0.30	£0.61	£0.52	£0.51
Dividends per ordinary share [8]	**$0.68**	**£0.42**	£0.40	£0.36	£0.32	£0.27
Dividend payout ratio [8]		**39%**	94%	80%	40%	36%
Earnings per ADS [9]	**$9.08**	**£5.47**	£2.07	£2.12	£3.86	£3.66
Diluted earnings per ADS [9]	**$8.96**	**£5.40**	£2.04	£2.09	£3.80	£3.60
Earnings from continuing operations per ADS [9]	**$8.60**	**£5.19**	£1.79	£3.63	£3.09	£3.05
Dividends per ADS [8, 9]	**$4.06**	**£2.50**	£2.42	£2.18	£1.90	£1.62
Net asset value per ADS [9]	**$46.87**	**£28.25**	£25.53	£25.60	£25.61	£23.09
Post-tax return on average total assets		**0.80%**	0.29%	0.35%	0.64%	0.63%
Post-tax return on ordinary shareholders' average equity		**20.0%**	7.77%	8.26%	15.83%	16.67%
Ordinary shareholders' average equity to average total assets		**3.97%**	3.67%	4.27%	4.07%	3.79%
Ratio of earnings to combined fixed charges and preference share dividends [10]						
Excluding interest on deposits		**2.16x**	1.52x	2.02x	2.46x	2.54x
Including interest on deposits		**1.28x**	1.13x	1.19x	1.23x	1.26x

Amounts in accordance with US GAAP [1,2]

	1998 $m	1998 £m	1997 [3] £m	1996 [3] £m	1995 [3] £m	1994 [3] £m
Consolidated income statement data						
Continuing operations						
Net interest income	**6,475**	**3,903**	3,806	3,742	3,363	3,213
Non-interest income	**5,634**	**3,396**	3,198	3,175	2,875	2,817
Operating expenses	**(8,307)**	**(5,007)**	(5,347)	(4,882)	(4,487)	(4,510)
Losses on termination of Equities operations	**–**	**–**	(180)	–	–	–
Income on ordinary activities before tax						
– continuing operations	**3,419**	**2,061**	981	1,583	1,187	1,024
Discontinued operations	**–**	**–**	–	89	339	208
Profit/(loss) on disposal of interests in discontinued operations	**140**	**84**	79	(458)	–	–
Income on ordinary activities before tax	**3,559**	**2,145**	1,060	1,214	1,526	1,232
Consolidated net income from continuing operations	**2,563**	**1,545**	620	998	809	670
Net income available for ordinary shareholders [4]	**2,699**	**1,627**	699	543	1,023	831
Consolidated balance sheet data [5,6]						
Total assets	**321,338**	**193,694**	185,417	185,457	169,172	158,860
Ordinary shareholders' equity	**12,102**	**7,295**	6,497	6,305	6,585	5,679
Average balances [6,7]						
Total assets	**334,114**	**201,395**	206,990	174,855	174,093	161,890
Ordinary shareholders' equity	**10,934**	**6,591**	6,456	6,238	5,893	5,123

	1998	1998	1997 [3]	1996 [3]	1995 [3]	1994 [3]
Selected financial statistics [6]						
Average ordinary shares of £1 each outstanding		**1,717m**	1,716m	1,747m	1,741m	1,676m
Net income per ordinary share	**$1.57**	**£0.95**	£0.41	£0.31	£0.59	£0.50
Net income from continuing operations per ordinary share	**$1.49**	**£0.90**	£0.36	£0.57	£0.46	£0.40
Dividends per ordinary share [8]	**$0.69**	**£0.42**	£0.38	£0.33	£0.28	£0.24
Dividend payout ratio [8]		**35%**	73%	85%	39%	39%
Net income per ADS [9]	**$9.43**	**£5.69**	£2.44	£1.86	£3.53	£2.97
Net income from continuing operations per ADS [9]	**$8.96**	**£5.40**	£2.17	£3.43	£2.79	£2.40
Dividends per ADS [8,9]	**$4.16**	**£2.51**	£2.25	£1.99	£1.70	£1.46
Net asset value per ADS [9]	**$42.59**	**£25.67**	£22.52	£22.14	£22.31	£19.86
Post-tax return on average total assets		**0.81%**	0.34%	0.31%	0.59%	0.51%
Post-tax return on ordinary shareholders' average equity		**24.69%**	10.83%	8.70%	17.36%	16.22%
Ordinary shareholders' average equity to average total assets		**3.27%**	3.12%	3.57%	3.38%	3.16%
Ratio of earnings to combined fixed charges and preference share dividends [10]						
Excluding interest on deposits		**2.18x**	1.53x	1.96x	2.35x	2.27x
Including interest on deposits		**1.29x**	1.13x	1.18x	1.21x	1.21x

Notes to five year summary

1 The Bank publishes its accounts in sterling. The dollar exchange rates used by the Bank in preparing such accounts are shown on page 2.

2 The Bank's consolidated accounts are prepared in accordance with generally accepted accounting principles in the United Kingdom ('UK GAAP') which differ in certain significant respects from generally accepted accounting principles in the United States ('US GAAP'). For a discussion of such differences and a reconciliation of UK and US GAAP amounts, see note 50 to the accounts starting on page 120. Amounts in accordance with US GAAP have been shown only where they differ materially from those shown under UK GAAP.

3 Restated following implementation of FRS 10 'Goodwill and Intangible Assets'. Amounts under US GAAP have also been restated following the implementation of FRS 10 as there is no longer a significant difference between the two sets of accounting principles in respect of goodwill.

4 The Group has reported profit attributable to ordinary shareholders under UK GAAP of £1,566m for the year ended 31 December 1998 compared with net income available for ordinary shareholders of £1,627m under US GAAP. A reconciliation is provided in note 50 to the accounts on page 121.

5 At year end.

6 Continuing and discontinued operations except as noted.

7 Average balances are calculated from a combination of daily, monthly and quarterly balances. All balances are considered to represent fairly the operations of the Group.

8 Dividend data include the dividends proposed or declared by the Bank plus any related UK Advance Corporation Tax credit (gross dividend). The dividend payout ratio has been calculated using the net dividend payable (gross dividend less UK Advance Corporation Tax). Dividend data under US GAAP are based on dividends declared in the financial period; UK GAAP requires recognition of dividends in the period to which they relate.

9 Each American Depositary Share ('ADS') represents six ordinary shares of £1 each.

10 For the purpose of calculating the ratios of earnings to combined fixed charges and preference share dividends, earnings consist of profit before tax and minority interests, less the unremitted income of associated undertakings, plus fixed charges. Fixed charges consist of total net interest expense, including or excluding interest on deposits, as appropriate, and the proportion of rental expense deemed representative of the interest factor.

Shareholder information

Holders of ordinary shares

Analyses of ordinary shareholders of National Westminster Bank Plc as at 31 December 1998

	Number of shareholders	Percentage of total shareholders	Number of shares held	Percentage of issued shares held
Class of shareholder				
Individuals	**112,478**	**87.74**	**168,181,649**	**9.87**
Nominee companies	**13,196**	**10.29**	**1,436,327,588**	**84.25**
Banks (including bank trust companies)	**872**	**0.68**	**5,680,143**	**0.33**
Universities, schools and other corporate bodies	**800**	**0.62**	**47,473,934**	**2.78**
Other limited companies	**777**	**0.61**	**13,821,556**	**0.81**
Pension funds	**42**	**0.03**	**19,384,297**	**1.14**
Insurance companies	**35**	**0.03**	**13,996,519**	**0.82**
	128,200	**100.00**	**1,704,865,686**	**100.00**

	Number of shareholders	Percentage of total shareholders	Number of shares held	Percentage of issued shares held
Shareholding range				
1 – 100	**14,525**	**11.33**	**487,684**	**0.03**
101 – 250	**13,615**	**10.62**	**2,418,278**	**0.14**
251 – 500	**19,406**	**15.14**	**7,297,471**	**0.43**
501 – 1,000	**27,721**	**21.62**	**20,274,429**	**1.19**
1,001 – 5,000	**43,046**	**33.58**	**94,709,602**	**5.56**
5,001 – 10,000	**5,738**	**4.48**	**39,603,914**	**2.32**
10,001 – 25,000	**2,159**	**1.68**	**31,953,465**	**1.87**
25,001 – 50,000	**555**	**0.43**	**19,903,329**	**1.17**
50,001 and above	**1,435**	**1.12**	**1,488,217,514**	**87.29**
	128,200	**100.00**	**1,704,865,686**	**100.00**

Nature of trading market

The principal listing of the Bank's ordinary shares is on the London Stock Exchange with additional listings on the Frankfurt Stock Exchange, the Düsseldorf Stock Exchange and the Tokyo Stock Exchange. American Depositary Shares ('ADSs'), each representing six ordinary shares, for which Morgan Guaranty Trust Company of New York is the Depositary, have been listed on the New York Stock Exchange since October 1986. The ADSs are evidenced by American Depositary Receipts ('ADRs') and are traded on the New York Stock Exchange under the symbol 'NW'.

The table below sets forth, for the calendar quarters indicated, the reported high and low middle market quotations in pence for the Bank's ordinary shares on the London Stock Exchange based on its Daily Official List.

	Pence per ordinary share	
	High	Low
1998		
Fourth quarter	**1201**	**702**
Third quarter	**1218**	**790**
Second quarter	**1222**	**1070**
First quarter	**1195**	**977**
1997		
Fourth quarter	1072	850
Third quarter	944	782
Second quarter	825	670
First quarter	835	677

At 31 December 1998, a total of 33,665,092 ordinary shares (including ordinary shares denoted by ADSs), representing 2.0% of 1,704,865,686 total outstanding ordinary shares, were held of record in the US by 2,656 record holders. Since certain of such ordinary shares are held by nominees, the number of record holders may not be representative of the number of beneficial holders. At 31 December 1998, there was a total of 128,200 record holders of the Bank's ordinary shares.

Nature of trading market continued

At 31 December 1998, there were 5,128,446 ADSs outstanding, representing 30,770,676 ordinary shares. The ADSs are traded on the New York Stock Exchange; the daily average volume traded during 1998 was 7,052.

The Bank had outstanding at 31 December 1998 $250m of its non-cumulative dollar preference shares, Series B, of $25 each ('Series B dollar preference shares') and $300m of its non-cumulative dollar preference shares, Series C, of $25 each ('Series C dollar preference shares') issued June 1993 and April 1997, respectively. The Series B dollar preference shares are listed on the London Stock Exchange and the New York Stock Exchange. The Series C dollar preference shares are listed on the New York Stock Exchange. The trading market for the Series B dollar preference shares and the Series C dollar preference shares is the New York Stock Exchange only. The listings on the New York Stock Exchange are in the form of ADSs ('Series B ADSs' and 'Series C ADSs'), each representing one Series B dollar preference share and one Series C dollar preference share, respectively, for which Morgan Guaranty Trust Company of New York is the Depositary. The ADSs are evidenced by Series B ADRs and Series C ADRs.

At 31 December 1998, there were 10,000,000 Series B ADSs outstanding representing 10,000,000 Series B dollar preference shares held of record by 684 record holders and 12,000,000 Series C ADSs outstanding representing 12,000,000 Series C dollar preference shares held of record by 154 record holders. Since certain of such Series B ADSs and Series C ADSs are held by nominees, the number of record holders may not be representative of the number of beneficial holders. The Series B ADSs and Series C ADSs are traded on the New York Stock Exchange and the daily average volumes traded during 1998 were 9,354 and 25,856 respectively.

On 16 October 1998, the Bank repurchased its $250m non-cumulative dollar preference shares, Series A, of $25 each.

At 31 December 1998, the Bank had outstanding $500m aggregate principal amount of 7.875% exchangeable capital securities, $25 each, ('Capital Securities') which are listed and traded on the New York Stock Exchange and listed on the London Stock Exchange. The Capital Securities were issued in their entirety to, and subsequently deposited with, The Depository Trust Company in bearer form. It is not possible to advise the number of record holders. The daily average volume traded during 1998 was 22,798.

The following table sets forth the high and low sales prices of the ADSs, the Series B ADSs, the Series C ADSs, and the Capital Securities, as reported by the New York Stock Exchange.

	ADSs		Series A ADSs		Series B ADSs		Series C ADSs		Capital Securities	
	High $	Low $	High $	Low $	High $	Low $	High $	Low $	High $	Low $
1998										
Fourth quarter	**120.50**	**69.50**	**–**	**–**	**26.38**	**25.00**	**27.19**	**25.25**	**79.50**	**77.19**
Third quarter	**120.25**	**77.75**	**26.75**	**26.25**	**26.50**	**24.88**	**27.00**	**25.75**	**52.06**	**50.56**
Second quarter	**122.50**	**104.00**	**27.00**	**26.25**	**26.88**	**26.00**	**27.00**	**26.14**	**77.94**	**76.00**
First quarter	**117.50**	**94.00**	**27.31**	**26.25**	**27.00**	**25.88**	**27.75**	**26.13**	**78.75**	**77.38**
1997										
Fourth quarter	105.00	85.88	27.00	26.25	26.19	25.56	26.31	25.69	26.38	24.44
Third quarter	90.31	75.81	27.00	26.31	26.13	25.00	27.75	24.94	26.19	25.00
Second quarter	82.88	65.62	27.25	26.38	25.13	24.38	25.13	24.13	25.62	23.75
First quarter	81.38	65.62	27.50	26.53	26.38	24.88	–	–	25.62	24.25

Exchange controls and other limitations affecting security holders

At present, there are no UK foreign exchange control restrictions on payments of dividends on the ordinary shares or dollar preference shares or interest on securities of the Bank or on the conduct of the Bank's operations.

The Banking Act 1987 as amended by the Bank of England Act 1998 (the '1998 Act'), the Companies Act 1985 and the Bank's Articles of Association may delay, prevent or make more costly, a change in control of the Bank or a takeover attempt that the Bank's shareholders might consider to be in their best interest.

The 1998 Act provides the FSA with statutory powers to object to persons who intend to acquire 10% or more of the voting rights of an authorised institution on prudential grounds or, by direction of HM Treasury, on grounds of lack of reciprocity. There are no other limitations under the laws of the UK or the terms of the Memorandum and Articles of Association of the Bank concerning the right of non-residents to hold or vote their securities.

Exchange controls and other limitations affecting security holders continued

The Companies Act 1985 confers upon a public company the power to require persons whom it knows or reasonably believes to have, or to have had, interests in its voting shares (of whatever size or nature) to provide information regarding those interests and other interests in the same shares of which such persons may be aware. Failure to provide such information within the time specified entitles the company to apply to the court for an order imposing restrictions on, among other things, the transfer of such shares, the exercise of voting rights and the receipt of distributions. In addition, in such circumstances, the Bank is currently entitled under its Articles of Association, without application to the court, to prohibit the exercise of voting rights in respect of such shares, to refuse to register any transfer of such shares and to retain any dividend or other money held by the Bank in respect of such shares.

Dividends

Ordinary shares

The table below sets out the amounts of interim, final and total dividends paid and proposed on each ordinary share in respect of each financial year indicated, increased by the associated tax credit referred to in the section on Taxation commencing below. It also sets forth the equivalent amounts per ADS in respect of the same financial years, translated into dollars at the Noon Buying Rate on each of the respective payment dates for interim and final dividends, other than for the 1998 final dividend which is translated at $1.624, the Noon Buying Rate on 22 February 1999.

	Pence per ordinary share			Translated into dollars per ADS		
	Interim	Final	Total	Interim	Final	Total
1998	**14.75**	**26.89**	**41.64**	**1.50**	**2.62**	**4.12**
1997	13.25	27.00	40.25	1.28	2.67	3.95
1996	12.00	24.25	36.25	1.12	2.36	3.48
1995	10.50	21.13	31.63	0.99	1.90	2.89
1994	9.13	17.87	27.00	0.86	1.70	2.56

The final dividend will be paid to ADR holders whose names are registered with the Depositary on 5 March 1999. As noted in the section on taxation below, from 6 April 1999, no refund of the associate tax credit will accrue to US resident individuals and corporations. The declared dividend will be converted into dollars using the market rate in effect when the dividend on the shares is paid by the Bank to the Depositary on 4 May 1999. The dividend will be sent to individual ADR holders on 11 May 1999.

Series B and Series C dollar preference shares

Series B and Series C dollar preference shares carry a dividend equal to a gross rate of 8.75% and 8.625%, respectively, per annum, inclusive of any associated tax credit. As for ordinary shares (above) from 6 April 1999, no refund of the associate tax credit will accrue to US resident individuals and corporations.

Taxation

The following is a summary of certain tax consequences for US Holders (as defined below) of the acquisition, ownership and disposition of ADSs, Series B ADSs and Series C ADSs (all referred to as 'ADSs'), ordinary shares, Series B dollar preference shares and Series C dollar preference shares (all referred to as 'Shares'), Guaranteed Capital Notes and Capital Securities. The tax comments do not represent a complete technical analysis or listing of all potential tax effects. Investors are advised to consult tax advisors on the tax implications of their own holdings.

Unless otherwise noted the statements set out below are based on the laws in force as at the date of this report and are subject to any changes in law or in any double taxation convention between the US and the UK.

For the purposes of the current US-UK double tax conventions, which are currently the subject of re-negotiation, relating to income tax and capital gains (the 'Income Tax Convention') and estate and gift tax (the 'Estate Tax Convention') and for the purposes of the US Internal Revenue Code of 1986, as amended (the 'Code'), the holders of American Depositary Receipts ('ADRs') are treated as owners of the underlying ordinary shares or preference shares, as the case may be.

The term 'US Holder' means a beneficial owner of ADSs, Shares, Capital Notes and Capital Securities, and of the dividends and interest paid thereon, who is an individual, a corporation, a partnership, a trust or an estate resident in the US for purposes of the Income Tax Convention and in the case of a corporation not also resident in the UK for UK tax purposes.

Ordinary shares and preference shares

An Eligible US Holder (as defined below) is entitled to a repayment from the UK Inland Revenue of the tax credit to which a UK resident individual would have been entitled in respect of a dividend less a withholding of 15% of the sum of the dividend and associated tax credit (subject to a maximum withholding equal to the associated tax credit). The current tax credit rate is 20/80ths, although from 6 April 1999 this will reduce to 10/90ths, resulting in no refund.

Taxation continued

Ordinary shares and preference shares continued

An 'Eligible US Holder' is a US Holder (i) that is an individual or corporation, (ii) whose holding is not effectively connected with (a) a permanent establishment through which the US Holder carries on business in the UK or (b) a fixed base regularly available and situated in the UK from which the US Holder performs independent personal services, (iii) under certain circumstances, that is not an investment or holding company 25% of the capital of which is owned, directly or indirectly, by one or more persons that are not individuals resident in, and are not nationals of, the US and (iv) under certain circumstances, that is not exempt from federal income tax on dividend income in the US. Special rules apply in the case of certain partnerships, trusts and estates and may apply if the US Holder is a corporation which owns 10% or more of the class of shares in respect of which the dividend is paid.

US Holders of ADRs generally may receive payment of the refund together with, and at the same time as, the associated dividend. A US Holder who does not receive a refund to which they are entitled must, in order to obtain it, file a claim for payment in the manner and at the time specified by procedures established by the UK Inland Revenue.

The gross dividend (the sum of the dividend plus any related tax credit), including the amount withheld, paid to a US Holder will be included in gross income and treated as foreign source dividend income for US federal income tax purposes. Subject to certain limitations and restrictions, UK tax withheld from payments will be available as a credit against US federal income tax.

Taxation of capital gains

US Holders will not generally be subject to UK tax on capital gains on the disposal of ADSs or Shares unless such persons carry on a trade, profession or vocation in the UK through a UK branch or agency in connection with which the ADSs or Shares are held.

Stamp duty

No UK stamp duty is payable on the acquisition of ADRs or on any subsequent transfer of an ADR, provided that the ADR (and any subsequent instrument of transfer) remains at all times outside the UK and that the instrument of transfer is not executed in or brought into the UK.

Inheritance tax

Under the Estate Tax Convention, a US Holder generally is not subject to UK inheritance tax.

Guaranteed capital notes

Under English and Dutch law, no UK or Dutch deductions, taxes, levies, imports, charges or withholdings would be applicable to any payment to a US Holder (i) by National Westminster Finance BV of principal of, or interest on, the 12⅛% guaranteed capital notes due 15 November 2003 (each a 'Capital Note') or (ii) by the Bank pursuant to its guarantees in respect of those notes.

Capital Securities

Interest Payments of interest on any series of Capital Securities, including the 7¾% Reset Subordinated Notes issued in April 1997 which constitute a series of Capital Securities ('Payments') will not be subject to withholding or deduction for or on account of UK taxation as long as the Capital Securities of such series are issued, and remain at all times, in bearer form quoted on the New York Stock Exchange or some other stock exchange recognised by the UK Inland Revenue and the Payments are made by or through a paying agent outside the UK.

As Payments will have a UK source, they will be chargeable to UK tax by direct assessment. Where the Payments are made without withholding or deduction, the interest will not be assessed to UK tax in the hands of the holders of the Capital Securities who are not resident in the UK, except where such persons carry on a trade, profession or vocation in the UK through a UK branch or agency in connection with which the interest is received or to which the Capital Securities are attributable, in which case (subject to exemptions for interest received by certain categories of agent) tax may be levied on the UK branch or agency.

A collecting agent in the UK receiving or obtaining Payments on the Capital Securities of any series, whether in the UK or elsewhere, on behalf of a US Holder (in circumstances where no withholding tax or deduction for or on account of UK taxation has been made by the person making the Payment) must withhold or deduct income tax at the lower rate (currently 20%) unless it is proved, on a claim made in advance to the satisfaction of the UK Inland Revenue, that the US Holder is beneficially entitled to the Capital Securities of such series and to the Payments and is not resident in the UK.

Taxation continued

Capital Securities continued

The UK Inland Revenue has confirmed that Payments will not be treated as distributions for UK tax purposes (i) by reason of the fact that Payments may be deferred under the terms of issue or (ii) by reason of the undated nature of the Capital Securities, provided that at the time a Payment is made, the Capital Securities are not held by a company which is 'associated' with the Bank or by a 'funded company'. A company will be associated with the Bank if, broadly speaking, it is in the same group as the Bank. A company will be a 'funded company' for these purposes if there are arrangements involving the company being put in funds (directly or indirectly) by the Bank or a company associated with the Bank. In this respect, the Inland Revenue has confirmed that a company holding an interest in Capital Securities which incidentally has banking facilities with the Bank will not be a 'funded company' by virtue of such facilities.

Inheritance tax As long as the Capital Securities are physically held outside the UK, Capital Securities will not be subject to UK inheritance tax in respect of a lifetime transfer by or the death of a US Holder who is not domiciled in the UK for inheritance tax purposes. US Holders may be entitled to exemption from or a reduction of any UK inheritance tax liability under the Estate Tax Convention.

Stamp duty and stamp duty reserve tax No UK stamp duty or stamp duty reserve tax ('SDRT') will be payable in respect of a transfer of Capital Securities through a clearing system or by delivery or on redemption or exchange for dollar preference shares.

Once converted, the dollar preference shares will not be subject to UK stamp duty on any subsequent transfer, provided that the ADR (and any subsequent instrument of transfer) remains outside the UK, as described above.

Disposal (including redemption) A disposal (including redemption) of a Capital Security of any series by a US Holder will not give rise to any liability to UK taxation on capital gains unless the US Holder carries on a trade (which for this purpose includes a profession or vocation) in the UK through a branch or agency and the Capital Security is, or has been, used, held or acquired for the purposes of that trade or branch or agency. The exchange by such a US Holder of a Capital Security for dollar preference shares pursuant to the Bank's exercise of its exchange right will not be treated as a taxable disposal for the purposes of UK tax on capital gains, and so no liability to UK taxation on capital gains should arise.

A transfer of Capital Securities by a US Holder will not give rise to a UK tax charge on accrued but unpaid Payments unless the US Holder carries on a trade in the UK through a branch or agency to which the Capital Security is attributable.

Group structure

Group Head Office

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B P Horn Executive Director, Group Operations

R Delbridge Group Chief Financial Officer

C F FitzGerald General Counsel

Lord Blackwell Director of Group Development

H R Brown Group Financial Controller

T I Collis Director of Corporate Affairs

P J S Hammonds Company Secretary

J S Mann Director of Group Operations and Technology

W W Martin Director of Group Risk

D B Maycock Director of Group Compliance

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D V Paige Director of Group Audit

A Racov Chief Information Technology Officer

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P J Boylan Managing Director

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H A Shaw Managing Director

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2 *Including from 1 January 1999*
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S L Harris Chief Executive and Group Treasurer

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K R Kruger Co-Chief Executive

G F Holloway Co-Chief Executive

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A F Irby Chief Executive

SEC Form 20-F cross reference guide

Form 20-F item number Page reference in this document

To the extent referenced in this SEC Form 20-F cross reference guide, the information contained in the Annual Report and Accounts comprises the Annual Report on Form 20-F of National Westminster Bank Plc for the year ended 31 December 1998 (the '1998 Form 20-F'). Portions of the Annual Report and Accounts are not required to be included in the 1998 Form 20-F and any portion of the Annual Report and Accounts that is not referenced in this SEC Form 20-F cross reference guide is not filed as part of the 1998 Form 20-F. The 1998 Form 20-F has not been approved or disapproved by the SEC nor has the SEC passed upon the accuracy or adequacy of the 1998 Form 20-F.

Other information

Addresses and telephone numbers

The Registrar for NatWest Group
Freepost (BS2282), PO Box No 82, Bristol BS99 7ZZ

Shareholders' Helpline
0117 930 6566

Depositary for American Depositary Receipts
Morgan Guaranty Trust Company of New York, PO Box 8205, Boston, MA 02266-8205
Toll free telephone number for ADR (symbol 'NW') holders 800 459 0905

Financial calendar

The ordinary shares will be marked ex-dividend	1 March 1999
The dividend will be recorded	5 March 1999
Annual General Meeting	20 April 1999
Cash dividend to be paid	4 May 1999
Announcement of the interim dividend for 1999	3 August 1999
Payment of interim dividend for 1999	October 1999
Announcement of the final dividend for 1999	February 2000
Annual General Meeting 2000	April 2000

Notes

Registered number 929027 England