The Royal Bank of Scotland Group plc

Pre-close Trading Update

The Royal Bank of Scotland Group (RBS) will be holding discussions with analysts and investors ahead of its close period for the year ending 31 December 2004. This statement sets out the information that will be covered in those discussions.

RBS has continued to make good progress in 2004. Key features of its annual results, which will be released on 24 February 2005, are expected to include strong income growth (both organic and from acquisitions) across a broad mix of businesses, improved efficiency and continued improvements in credit metrics. Consequently, the Group is confident of meeting market expectations.

Income and Margins

RBS has maintained strong momentum in organic income growth in the second half of the year, supported by continued good growth in loans and deposits, stable interest margins and good growth in non-interest income. Strong growth in income has been achieved despite the impact of US dollar weakness.

The Group has continued to achieve good growth in assets, including a sustained strong performance in small and mid-corporate loans, some recovery in demand for large corporate loans and continued growth in consumer lending, particularly mortgages. In UK consumer lending, there have been some signs of a modest easing in the rate of growth in unsecured lending and, more recently, in mortgages. UK consumer lending accounts for only 10% of Group income, so any slowdown would have minimal impact on our overall income.

Deposit balances have continued to grow across the Group, with particularly good growth in corporate volumes.

Margins are expected to be in line with guidance given in August. As previously indicated, the Group net interest margin is expected to be a few basis points lower than last year as a result of the inclusion of First Active and the business mix impact of particularly strong growth in mortgages and rental assets.

Non-interest income has continued to reflect strong growth across all our activities, including credit cards, general insurance and money transmission. Dealing profits continue to show positive momentum, reflecting higher customer volumes, but, as in the first half, their growth is expected to be less than for income growth across the Group as a whole.

Expenses

The Group remains focused on improving its efficiency. Expenses have increased to support higher business volumes, and the Group continues to invest in initiatives that will enhance its customer service capabilities and improve efficiency in the future. Excluding acquisitions, the Group is on track to achieve a small improvement in the cost:income ratio in the second half of 2004 compared to the first half, with a further improvement anticipated in 2005 as the Group's efficiency programme begins to have a positive impact on the cost:income ratio.

Credit Quality and Provisions

Credit quality remains strong. Credit metrics continue to improve overall, due principally to further improvements in Corporate Banking. Retail Banking provisions are expected to reflect the seasoning of the NatWest loan portfolio which we anticipated in our interim results presentation.

Acquisitions and Disposals

The performance of the businesses which we acquired in 2003 and 2004 continues to be good. They are contributing to the overall growth of the Group, and all integrations are fully on track.

The acquisition of Charter One Financial Inc, announced on 4 May 2004, was completed on 31 August 2004. The performance of the business continues to be good. The integration of Charter One, and the expansion of the franchise into the small business and mid-corporate sectors, are both progressing well. The balance sheet repositioning of Charter One to reduce interest rate risk has been successfully implemented, in line with the plans outlined at the time of the announcement of the acquisition.

Change of Accounting Policy

The Group plans to adopt Financial Reporting Standard 17 'Retirement Benefits' ('FRS 17') – the standard that replaces SSAP24 'Pension costs' ('SSAP24') – for its 2004 results. As the measurement principles in FRS 17 are similar to those in the equivalent international accounting standard (IAS 19 'Employee Benefits') the change in policy means that we will reflect the cost of pensions in 2004 on a basis that is consistent with the treatment to be applied from 1 January 2005 under International Financial Reporting Standards.

The effect on comparative periods of adopting FRS 17 is shown in Appendix 1. The charge for pension costs in the first half of 2004 was comparable to the charge that results from the adoption of FRS 17. Consequently there is no change to the reported profit before tax for that period. Although shareholders' funds are reduced, the adoption of FRS 17 has no effect on the Group's regulatory capital.

International Financial Reporting Standards (IFRS)

The Group's annual and interim accounts for 2005 will be prepared in accordance with IFRS. The Group's conversion project has progressed well and the Group is planning to issue its 2004 results restated to IFRS in the second quarter of 2005.

The precise effect of the application of IFRS to the 2004 results will depend on the full year figures and the balance sheet position at the end of the year. In addition, due to the delay in the issuance of IAS 39, uncertainties remain as to its detailed interpretation and implementation.

We have, however, attempted to quantify the impact of the move to IFRS as applied to our 2004 results and currently estimate that it will lead to a small reduction (of between 2% and 3%) in the Group's adjusted earnings per share (before goodwill amortisation and integration costs) for the year. Basic earnings per share are estimated to increase by more than 10%, principally as a result of goodwill no longer being amortised.

An analysis of the indicative effect of IFRS on earnings is shown in Appendix 2.

Capital

Capital ratios remain strong. Our Tier 1 capital ratio at 31 December 2004 is expected to be towards the top end of our target range of 6.5% to 7.0%.

The adoption of FRS 17 has no effect on the Group's regulatory capital.

The move to IFRS is expected to lead to a small reduction (currently expected to be in the range of 10 to 20 basis points) in the Group's Tier 1 capital ratio at 31 December 2004.

An analysis of the indicative effect of IFRS on Tier 1 capital ratio is shown in Appendix 3.

Sir Fred Goodwin, Group Chief Executive, commented:

"It is pleasing that our results continue to show good momentum across our broad range of businesses, driven both organically and through acquisitions. Our results are expected to show a picture of financial strength across all our businesses, whether reported under UK GAAP or following the application of International Financial Reporting Standards."

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Appendix 1
Impact of implementation of FRS 17 (pension costs)

	H1 2004 £ m	H1 2003 £ m	FY 2003 £ m
Income (Note 1)			
as previously reported	10,940	9,080	19,229
as restated	10,964	9,106	19,281
Change	24	26	52
Pension costs			
as previously reported	185	134	273
as restated	209	202	408
Change	(24)	(68)	(135)
Profit before tax			
as previously reported	3,381	2,896	6,159
as restated	3,381	2,854	6,076
Change	-	(42)	(83)
Shareholders' funds			
as previously reported	32,408	28,614	28,099
as restated	30,407	26,605	26,098
Change (Note 2)	(2,001)	(2,009)	(2,001)

Notes:

1. Under FRS 17 the expected return on pension scheme assets less the interest on scheme liabilities is credited to other finance income.
2. The change in shareholders’ funds is consistent with disclosures relating to FRS 17 previously included in our Report & Accounts for 2003 and for 2002.
3. Changes shown above as a result of implementing FRS 17 will be reported in Central Items in our restated results.

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Appendix 2
IFRS - Indicative Impact on 2004 Earnings

The following table sets out the Group's estimates of the effect of IFRS as applied to its 2004 earnings. All amounts are indicative.

	Capital instruments Note 2 £m	Goodwill Note 3 £m	Software capitalisation Note 4 £m	All other adjustments Note 5 £m	Total £m
Income	(400)	-	-	(100)	
Expenses	-	-	-	(150)	
Operating profit	(400)	-	-	(250)	
Integration costs	-	-	(250)	-	
Goodwill	-	900	-	-	
Profit before tax	(400)	900	(250)	(250)	
Tax	50	-	100	100	
Preference dividends and minorities	350	-	-	-	
Basic earnings	-	900	(150)	(150)	600
Adjusted earnings (before goodwill and integration costs)	-	-		(150)	(150)

Notes:

1. Amounts shown are indicative only at this stage and are rounded to the nearest £50m. They include the estimated effect of applying IAS 32 and IAS 39 even though these standards are effective only for 2005 and there is no requirement to show comparative information.

2. Under IFRS (IAS 32), certain capital instruments that are classified as preference shares or non-equity minority interests under UK GAAP will be classified as debt. Their coupons will be included in interest payable. There is no effect on their regulatory capital treatment.

3. Under UK GAAP the Group currently amortises goodwill over its estimated useful economic life. IFRS 3 'Business Combinations' does not permit amortisation of acquired goodwill. It must be measured at cost less any impairment losses and tested at least annually for impairment.

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Appendix 2
IFRS - Indicative Impact on 2004 Earnings

4. Under UK GAAP software development costs relating to the NatWest integration were written off as incurred and included in integration costs. Under IFRS these costs are capitalised and amortised over their useful life, typically 3 years. As the software will substantially be written off by the end of 2005, its amortisation will be negligible thereafter.

5. Other adjustments are principally: effective interest rate (IAS 39), leasing (IAS 17), loan impairment (IAS 39), and share-based payments (IFRS 2).

6. The table above does not include the grossing-up of life assurance income, expenses and claims which under current GAAP are reported as a single item in income. The grossing-up, which has no impact on profit before tax and regulatory capital, will be reflected in our 2005 accounts.

7. The introduction of IFRS will have a significant effect on the Group's balance sheet mainly through a gross-up of assets and liabilities on application of the stricter netting criteria in IAS 32 and additional assets and liabilities from the consolidation of certain SPVs, principally the group commercial paper conduits. This is likely to result in an increase in balance sheet footings of around £100bn. This change will have no impact on the Group's capital ratios.

8. IFRS will also result in equity volatility that does not arise under current GAAP as unrealised gains and losses on available-for-sale securities and derivatives in cash flow hedges are taken directly to reserves. Regulatory capital will be unaffected by such gains and losses (except those arising on any available-for-sale equity shares).

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Appendix 3
IFRS – Indicative Effect on Tier 1 Capital Ratio

The estimated effect of implementation of IFRS on our Tier 1 capital ratio at 31 December 2004 can be summarised as follows:

	Effect on Tier 1 capital ratio (basis points)
Final dividend (Note 1)	30
IFRS transition adjustments	(30) - (40)
Pension scheme deficit	(10)
Overall effect on Tier 1 capital	(10) - (20)

Notes:

1. Based on the final dividend for 2003