

Citizens

	2007 £m	2006 £m	2005 £m
Net interest income	1,975	2,085	2,122
Non-interest income	1,147	1,232	1,142
Total income	3,122	3,317	3,264
Direct expenses			
– staff costs	741	803	819
– other	717	751	739
	1,458	1,554	1,558
Contribution before impairment losses	1,664	1,763	1,706
Impairment losses	341	181	131
Operating profit	1,323	1,582	1,575
	US\$bn	US\$bn	US\$bn
Total assets	161.1	162.2	158.8
Loans and advances to customers – gross			
– mortgages	19.1	18.6	18.8
– home equity	35.9	34.5	31.8
– other consumer	21.7	23.2	24.8
– corporate and commercial	37.6	32.7	29.2
Customer deposits	115.0	106.8	106.3
Customer deposits (excluding wholesale funding)	105.0	101.8	105.2
Risk-weighted assets	114.4	113.1	106.4
Average exchange rate – US\$/£	2.001	1.844	1.820
Spot exchange rate – US\$/£	2.004	1.965	1.721

2007 compared with 2006

Against the background of weaker housing and credit market conditions, Citizens' franchise demonstrated resilience in 2007, with a particularly good performance in corporate and commercial banking. Modest growth in net interest margins and strong fee growth in several products lifted income by 2% to \$6,249 million which, coupled with tight cost control, resulted in contribution before impairment losses growing by 2% to \$3,329 million. However, impairment losses increased from 0.31% of loans and advances to 0.60%, resulting in a decrease in operating profit of 9% to \$2,647 million. In sterling terms, total income decreased by 6% to £3,122 million and operating profit fell by 16% to £1,323 million.

Net interest income rose by 3% to \$3,954 million. Average loans and advances to customers increased by 4%, with strong growth in corporate and commercial lending, up 13%, with close attention being paid to our risk appetite in light of prevailing market conditions. Average customer deposits increased by 1% but deposit margins narrowed as a result of deposit pricing competition and continued migration from low-cost checking accounts and liquid savings to higher-cost products. Notwithstanding this migration, Citizens' net interest margin increased slightly to 2.80% in 2007, compared with 2.72% in 2006, thanks in part to improved lending spreads in the latter part of the year.

Non-interest income rose by 1% to \$2,295 million. Business and corporate fees rose strongly, with good results especially

in foreign exchange, interest rate derivatives and cash management, driven by increasing cooperation with RBS Corporate Markets. Good progress was also made in credit card issuing, where we increased our customer base by 20%, and in merchant acquiring, where RBS Lynk achieved significant growth, processing 30% more transactions than in 2006 and expanding its merchant base by 5%.

In response to more difficult market conditions Citizens intensified cost discipline, with a reduction in headcount helping to limit total expense growth to 2%, despite enhancements to infrastructure and processes as well as continued investment in growth opportunities including mid-corporate banking, contactless debit cards and merchant acquiring.

Rising losses and increased provisions lifted impairment costs from \$333 million in 2006 to \$682 million in 2007. Against a background of weaker economic activity the Citizens portfolio is performing well, although we have experienced a reversion from the very low levels of impairment seen in recent years, reflecting both the planned expansion of our commercial loan book and the impact of a softer housing market. There has also been an increase in reserving. The average FICO scores on our consumer portfolios, including home equity lines of credit, remain in excess of 700, with 97% of lending secured. Average loan-to-value ratios at the end of 2007 were 58% on our residential mortgage book and 74% on our home equity book.

2006 compared with 2005

Citizens grew its total income by 3% to \$6,115 million and its operating profit by 2% to \$2,917 million. In sterling terms, Citizens total income increased by 2% to £3,317 million, while its operating profit rose slightly to £1,582 million.

We have achieved good growth in lending volumes, with average loans and advances to customers increasing by 10%. In business lending, average loans excluding finance leases increased by 15%, reflecting Citizens' success in adding new mid-corporate customers and increasing its total number of business customers by 4% to 467,000. In personal lending, Citizens increased average mortgage and home equity lending by 14%, though the mortgage market slowed in the second half. Average credit card receivables, while still relatively small, increased by 19%.

We increased average customer deposits by 4%, although spot balances at the end of 2006 were little changed from the end of 2005. As interest rates rose further and the US yield curve inverted, we saw migration from low-cost checking and liquid savings to higher-cost term and time deposits. This migration is a principal reason for the decline in Citizens' net interest margin to 2.72% in 2006, compared with 3.00% in 2005. The decline slowed over the course of the year, with net interest margin in the second half 6 basis points lower than in the first. Lower net interest margins more than offset the benefit of higher average loans and deposits, leaving net interest income marginally lower at \$3,844 million.

Non-interest income rose by 9% to \$2,271 million. Business and corporate fees rose strongly, with good results especially in foreign exchange, interest rate derivatives and cash management benefiting from increased activity with Corporate

Markets. There was good progress in debit cards, where issuance has been boosted by the launch in September of our "Everyday Rewards" programme. Citizens has also become the US's leading issuer of Paypass™ contactless debit cards, with 3.65 million cards issued. Our credit card customers increased by 20%, whilst RBS Lynk, our merchant acquiring business, also achieved significant growth, processing 40% more transactions than it did in 2005 and expanding its merchant base by 11%.

Tight cost control and a 5% reduction in headcount limited the increase in total expenses to only 1%, despite continued investment in growth opportunities such as mid-corporate banking, contactless debit cards, merchant acquiring and supermarket banking.

Citizens continued to expand its branch network. Our partnership with Stop & Shop Supermarkets has helped us to expand our supermarket banking franchise into New York, while in October we announced the purchase of GreatBanc, Inc., strengthening our position in the Chicago market and making us the 4th largest bank in the Chicago area, based on deposits. The acquisition was completed in February 2007.

Impairment losses totalled \$333 million, representing just 0.31% of loans and advances to customers and illustrating the prime quality of our portfolio. Underlying strong credit quality remained unchanged as our portfolio grew, with risk elements in lending and problem loans representing 0.32% of loans and advances, the same level as in 2005. Our consumer lending is to prime customers with average FICO scores on our portfolios, including home equity lines of credit, in excess of 700, and 95% of lending is secured.