The Royal Bank of Scotland Group

Interim Results 2004

P R O C E E D I N G S at an **ANALYSTS CONFERENCE** of the Company held at 280 Bishopsgate London EC2 on Tuesday 3rd August 2004

Top table:

SIR GEORGE MATHEWSON (Chairman)
SIR FRED GOODWIN (Group Chief Executive)
MR. FRED WATT (Group Finance Director)
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THE CHAIRMAN: Good morning and welcome once again to this presentation of our Interim Results for 2004. I hope you will already have seen all the main aspects of our Interim Results in the Company Announcement. I should emphasise these results are built on the progress we have made in recent years in growing income, improving efficiency and completing acquisitions which improve the market positions and future earnings potential of our businesses.

In the first half of 2004 we increased our income by 20 per cent to £10,940 million. Our Group operating profit was up 12 per cent to £3,851 million and our profit before tax was up by 17 per cent to £3,381 million.

Our basic earnings per ordinary were up by 17 per cent to 69.9 pence per share and our adjusted earnings per ordinary share were up by 10 per cent to 84.4 pence per share.

In line with the policy which we have followed over recent years we have announced an interim dividend equivalent to one-third of last year’s total dividend, so our interim dividend will be 16.8 pence per share which represents an increase of 15 per cent over last year’s interim dividend.

Now, not surprising our agenda follows the usual pattern. Fred Watt will comment on our Group results and the results from each of our Divisions, then Sir Fred Goodwin will review our performance and look to the future. Fred!

MR. FRED WATT (Group Finance Director): Thank you, George. As George has already mentioned, Group operating profit is up 12 per cent and profit before tax is up 17 per cent. I think just for completeness, to what you feel is the difference between the two, you will remember that after Group operating profit we have goodwill charged and we have integration costs.

Taking the first of those, goodwill charge is slightly up on last year reflecting acquisitions since the beginning of 2003 and, more importantly, the bigger difference between our operating profit and PBT numbers is the much lower integration cost charges this year.

It is hard to be believe but true, given everything else we have been doing, that at this time last year we were finalising the integration of NatWest and completing that. In the first half of last year we actually had a £140 million charge for the final completion of the NatWest integration. As I say, it is hard to believe that was just over a year ago given everything else we have been doing.

But, there you go, that is the story year on year on integration costs, down causing PBT to be up by 17 per cent against our operating profit up by 12 per cent.

Focusing as ever on the operating profit number, up 12 per cent, and looking at the analysis of how we get there, and looking at it by line at the overall Group level first of all, we see income up strongly at 20 per cent, almost £2 billion income growth in 6 months - that is up 20 per cent year on year - and costs held to an increase of 14 per cent against that, with the difference obviously “jaws” having an effect on cost:income ratio, as we will see later.

Net insurance claims obviously hugely impacted here by the acquisition of Churchill but, as again we will see later when we look at that Division, insurance claims are up basically in line with insurance premium increase.

Lastly on this slide provisions, very flat year on year and whilst we have obviously been growing the balance sheet strongly in that period that flatness represents an improved credit quality position for the Group as a whole. Overall, all of that together producing operating profit up £400 million in the period or 12 per cent.

Looking firstly at that income growth line, that 20 per cent growth number, where does that come from? Well, as ever we see it nicely spread right across the Group, we are seeing some strong growth in all of our Divisions.

As we begin to look at the Divisional numbers we see some impact coming from foreign exchange, noticeably the Citizens number reflects obviously a decline in the US dollar year on year, the dollar is down about 13 per cent year on year remember, and obviously CBFM slightly impacted by the decline in the dollar also, and also two Divisions here, or mainly two Divisions, affected by acquisitions in the year.

You see that RBS Insurance is showing income growth up 89 per cent but that includes Churchill for the first time for a 6 months period. Churchill, you will recall, was acquired last September so this is the first half we have Churchill in, in full. The other Division that is impacted by acquisitions in the first half to any material extent is Ulster Bank. We are showing here on this slide Ulster Bank's income up 25 per cent, but again you will recall we acquire First Active for Ulster Bank in January 2004.

Overall, as I said, a very good spread of income growth right across the piece, some impact by FX on the negative side, some impact by acquisitions.

Just looking then at that overall Group number, the 20 per cent, how does that relate to an underlying rate? Well, with the 20 per cent the first thing we would do is add back the currency impact which cost us about £200 million in income terms year on year, just translating the results of our US businesses into sterling, otherwise income would have been up about 23 per cent year on year.

That 23 per cent then splits roughly 50-50 between acquisitions impact, the biggest part being Churchill coming in for the first time in the first half, and organic growth still representing a very strong 11 per cent income growth, so stripping out FX and acquisitions impact.

That 11 per cent organic growth in income is very consistent with what we have been producing over the last, certainly two half periods, the same number actually as the first half of last year organically, and the second half of last year a very similar picture indeed.

Looking at net interest margin briefly just now, and we will touch more on this later, but overall at the headline level a few basis points down, as we said. Half of the 4 basis points reduction in net interest margin comes from the inclusion of First Active for the first time. First Active is principally a mortgage business which obviously is at finer margins overall, that has 2 basis points impact on the overall Group margin.

Two basis point down elsewhere in the Group, again we will cover this in detail, but effectively it is caused by the mix of the business we do, with strong growth in mortgages across the rest of the book in particular, again more on that later, but in line with what we said and down only 4 points overall.

Looking briefly at expenses, we will touch on this in more detail as we go through each Division. Again a number of Divisions' distortions caused by foreign exchange and particularly by acquisitions, clearly RBS Insurance and Ulster Bank again impacted by expense growth in the acquired companies. I will go through each of the expense lines in detail as we go through each Division.

Overall, as I said, with income growing by 20 per cent and expenses growing by 14 per cent we see another step forward for the Group in terms of cost:income ratio. Overall a good cost:income ratio, down from 43 per cent at this time last year to 40.5 per cent now. Even if you take out the acquisitions, again the main one impacted these numbers being Churchill, an improvement in the Group cost:income ratio from 43 per cent to 42.5 per cent.

Again we will go through it with you later, but there have been a number of investment initiatives borne in these numbers, in other words, reflected even in that cost:income improvement which obviously have an initial negative impact on cost:income but, nonetheless, it is very pleasing to see an overall improvement in cost:income even after these investment initiatives.

Turning to provisions, as I said there has been broad stability in our provisioning charge not just on the first half of last year but also on the second half, so a £750 million total provisions charge in the P&L is almost identical to the charge we showed in the second half and the first half of last year.

More importantly, that charge represents now a considerably smaller proportion of the book and this is really where the underlying credit metrics begin to show through. This time last year the charge represented some 59 basis points of the book, we are now down to around 51 basis points, so a lower percentage overall representing that improvement overall in the book.

Another way of looking at provisions is, as you know, we focus on balance sheet coverage and balance sheet provisioning. Overall provisions are still slightly up year on year but risk elements in lending showing a decrease. From this time last year risk elements in lending and potential problem loans were just over £6 billion, they are now down to just over £5.6 billion, so again down from June last year and down from December.

Here again, demonstrating as a percentage of the book, risk elements in lending and potential problem loans are down from some 2.4 per cent this time last year to under 2 per cent, down at 1.92 per cent now reported. Overall, with that decline in risk elements and lending and with a small increase in our overall provisioning we are carrying in the balance sheet, we are seeing coverage actually improve significantly from last year, from 65 per cent up to 71 per cent now. So, a strong and improving position on credit quality.

Just re-capping on overall profitability then before we look at each Division, as I said earlier, income up 20 per cent, operating expenses up 14 per cent, provisions flat and profit up 12 per cent.

Turning now, first of all, to Corporate Banking and Financial Markets, here again we see a very strong performance from CBFM, income up 12 per cent - that would have been around 14 per cent at constant currencies - and profit up 17 per cent - that would have been 20 per cent at constant exchange rates. A very, very strong performance from CBFM.

Within these numbers, net interest income up strongly, even after the increased cost of funding rental assets, so net interest income before rental asset growth would actually have been up 10 per cent year on year. Non-interest income is up strongly also, up 14 per cent. Within that the rental income I have just referred to, obviously showing through as non-interest income, strong year on year growth there, and equally strong year on year growth in fees and commissions.

Well spread dealing revenues, dealing revenues up about 10 per cent year on year within this Division, strong and well spread across foreign exchange, across capital market related activities and across Greenwich. A very good position and good growth right across the board in dealing revenues which, as you know, are customer driven revenues rather than proprietary trading. A very good and solid performance there and strong customer momentum generally in that dealing profit line, increasing penetration of our customer base, increasing our capability of products in that area.

Expenses growing by 15 per cent; within that some operating lease depreciation growth. Stripping that out we see expense growth of about 14 per cent in the Division, and that reflects strong growth in some of our businesses which have inherently higher cost:income ratio than the Division as a whole. As you know, the Division as a whole has a relatively low cost:income ratio, in the low 30s. Some of our businesses have been growing very strongly, such as capital markets and our overseas businesses which have an inherently higher cost:income ratio than the Division as a whole.

In addition to that, we have been investing in some new business areas for us, in particular - and we will touch on later - our debt capital markets capability not just in Europe which, as you know, we have been extending in the last few years but now into the United States. These numbers reflect some of that initial investment spend towards growing these very good businesses for us.

Overall, a very strong performance even before provisions. Provisions down year on year, as we have seen, the credit metrics continues to improve in the corporate world and the contribution, as I said, very strong, up 17 per cent.

Turning to Retail Banking, again very good income growth coming through Retail Banking, income overall up 8 per cent, and particularly strong in mortgages in this first half. Obviously mortgage growth means the overall margin is down slightly given the finer margins you receive on lower risk mortgages, but overall income very strong, up 8 per cent. Costs are up just 5 per cent in the Division.

Provisions, as you will remember from last year, have been growing in this Division principally as a result of growth in the NatWest book over the last three years since acquisition. Like last year - you will recall provisions were up about 30 per cent - provisions are up a little bit more than that, slightly more than the 30 per cent, principally a small increase due to fraud but, by and large, in line with what we were saying we would see for a further period as a result of the growth in the NatWest book. The contribution overall from Retail up a very good 6 per cent.

Retail Direct, another strong period from our non-branch based businesses both in the UK but increasingly, as you will have seen, in Europe where we have been expanding and more recently in the United States. So good growth in income across the Board, good growth in cards, good growth in merchant acquiring, good growth in Tesco Personal Finance and good growth in the One Account mortgage business which is still growing strongly.

We also very successfully introduced a new brand to the business in January called MINT which has been extremely successful. Obviously coming with that some short term margin effect, but nonetheless a very, very successful launch of a new brand to replace the previous RBS Advanta brand. We are very pleased with the way that is going. Some small individual contributions so far from the People's Bank acquisition we announced back in January. Overall, as I said, the card businesses throughout the business going very strongly. It is a very good profit growth overall, up 17 per cent.

Turning to Manufacturing, you see here on this slide we have actually included and re-stated some of the numbers for Manufacturing to move into, as we said we would, certainly the operations from the insurance business. So Manufacturing now provides the platform for day-to-day processing of the insurance activities and that obviously now includes Churchill.

I think an easier way of looking at Manufacturing is possibly on the next slide where I break down for you the overall increase in Manufacturing costs. Headlines costs are up 17 per cent but that includes for the first time - where we say acquisitions here it is Churchill - Churchill’s processing costs, which are coming in for the first time to Manufacturing. Remember they were not in last year’s numbers at all at this stage. It adds about £50 million to Manufacturing’s cost base and takes it out of the Churchill base.

Cost growth, excluding that, is about 11 per cent. Within that, you will recall us discussing with you at the Manufacturing Presentation last October and also in February the Group Efficiency Programme that we kicked off last year, and that has some initial costs upfront related to that, principally in Manufacturing. They in this period amount to about an incremental £40 million in the 6 months.

Underlying cost growth in Manufacturing is about 7 per cent, and even within that there has been some investment spend, particularly in properties, upgrading properties for our people around the United Kingdom. Underlying cost growth here is probably closer to 5 per cent supporting double-digit volume growth in the UK.

Turning to Wealth Management, you will recall from the second half of last year that we begun to see some recovery in income with the recovery in the markets last year in Wealth Management. It is very pleasing to report that recovery has continued through strongly into the first half of this year, particularly in fee related businesses, particularly in those that are market related, and also net interest income where we have grown our business strongly. There was a small single digit contribution for the first time from Bank von Ernst, but even taking that out a very, very strong underlying position from Wealth Management.

There is some currency impact here as well, we do have overseas businesses which are either dollar or euro related and the underlying contribution would actually have been higher than this stripping these back out. So overall a very good and a very welcome return to profitable growth from Wealth Management.

RBS Insurance, as I said earlier, clearly impacted by Churchill. Therefore, probably the next slide is of more relevance as I take Churchill out for you, so excluding Churchill RBS Insurance still showed very good income growth, overall income growth up 17 per cent, expenses up 4 per cent and contribution up 13 per cent. Claims are virtually in line with premium income here, some effect by mix of the business rather than anything else.

Looking at these two slides back to back, you would deduce just from these two slides that Churchill contributed over £100 million in the 6 months, but remember the £50 million we are now taking Manufacturing. Nonetheless, a first time contribution from Churchill of some £57 million with most of the integration benefits still to come. So a very, very good performance from both old Direct Line and new Churchill, the combined RBS Insurance going well.

Turning to Ulster Bank, as with RBS Insurance impacted by acquisitions. First Active was acquired in January, also we disposed of last year you might remember a business called NCB Stockbrokers, a stockbroking business, and that is mainly on the non-interest income line you will see that move happening.

Again stripping out both First Active and NCB, we see income up a good 9 per cent and profit up 12 per cent in this Division. Both of these numbers would be higher by about 1 per cent, or 1 and a bit per cent, again caused by the decline in the euro year on year. Again a very good performance from Ulster Bank and First Active making a good first contribution.

Turning lastly to Citizens, unusually no material impact in this period from acquisitions for Citizens, a couple of very small ones completing but no material impact on the numbers overall. But clearly impacted by, as I said earlier, the decline of the US dollar.

As ever, stripping the Citizens' numbers back to dollars for you, we see very good income growth again from Citizens, up 11 per cent. Within that, you may recall last year in the first half in non-interest income there were higher than usual securities gains in the first half of last year. Taking that out, underlying non-interest income growth still very strong year on year and overall contribution of a very good 13 per cent in dollars.

Like income, when we look at profit split by Division you see a very well spread picture, all Divisions contributing to our overall Group profit growth. There was some impact from FX, some from acquisitions.

But overall this next slide really captures the essence of what is happening to Group profit. We see reported growth of £400 million, up 12 per cent. Currency impact is some £120 million in the period year on year, up 3 per cent, in other words, profit at like-for-like currencies would have been up £520 million or 15 per cent. Within there acquisitions net of funding costs add only 3 per cent, and very strong organic growth in profitability, over £400 million, up 12 per cent.

Turning briefly to earnings per share, as with profit before tax there is a difference between basic earnings per share and adjusted for goodwill and integration costs. The difference is narrowing clearly as integration costs have declined. The dividend is up 15 per cent, earnings up 10 per cent, and that clearly creates a very small decrease in the dividend cover but still a very healthy almost 5 times covered at the half year stage.

Finally, on capital. Clearly capital ratios are ahead of our target ranges - that is given the placing we did earlier this year in anticipation of the Charter One - so target ranges exceeded this at the half year stage as a result of that. Normal service will be resumed shortly with the completion hopefully of Charter One by the end of Q4!

That is all I have to say. I will now hand you over to Sir Fred Goodwin!

SIR FRED GOODWIN (Group Chief Executive): Good morning, everyone. Fred has gone through the results in some detail Division by Division and there is a whole lot more material obviously in the Company Announcement providing back-up to that, so what I thought I would like to do is just try and provide some of the strategic context of what we have been doing, what we are trying to do and hopefully give some sense of direction.

In terms of strategic context, there is nothing more important to my mind than what we are doing with income. Our strategy does revolve around the development and growth of our income, there are other elements about cost which I will talk about too, but really income growth is it, and so you can see our strategy most clearly I think through what has been happening to our income.

It is up 20 per cent, as Fred mentioned, and Fred has given some analysis between acquisition effect and Divisional effect, but I thought another lens through which we should look at this and a lens which is progressively more and more conditioning our strategic thinking is income growth by region.

You will see here on this slide the analysis of the 20 per cent. It might not seem too impressive to be up only 6 per cent in the US and down 10 per cent in the Rest of the World, but if I put things into local currency I think you will get a better sense of what is happening on the ground and in the strategic context.

Here on this slide you can see the particularly strong growth we have been achieving in Europe and in the United States and, as ever, remember these figures exclude Charter One. Stripping out the acquisition effect, you still see pretty much the same picture - strong underlying business growth continuing in the huge businesses we own in the United Kingdom but getting progressively stronger in the many regions where we are now represented outside the United Kingdom.

Income growth is one thing, it is always important to cross-check it with reality, you know, are we actually increasing the number of people we are doing business with because that is where the income comes from? Again, on this slide these are not the complete figures for each of the Divisions but these are representative figures for the Divisions. Compared to where we were this time last year there are between 7¾-8 million more customers with whom we do business and have business relationships.

Stripping out the acquisition effect, we end up with again strong growth across all of our businesses, nearly 430,000 more customers in the Retail Bank - I will talk a little bit more about what we are up to in Retail later on - so I take comfort from the fact that not only is the income growing, the geographic diversity growing, but at its most basic level we are adding significant numbers of new customers. These are net new customers and not all the customers we have added ignoring any customers we may have lost. These are net new!

Another dimension I guess on what we are doing to the business is what is happening to the balance sheet - where is the growth coming from? You get a sense there, from the slide, of a strong growth in mortgages this year. We have always said and maintained that we felt able to grow mortgages; we felt able but not willing to grow mortgages.

I think circumstances have changed somewhat, partly through the acquisition of First Active and some of the capabilities which come from there, partly because the interest rates have now started to go back up which I think will condition the duration of mortgages, which is in turn important for the amortisation and economics of the acquisition costs which we incur, and also I think we have seen more rational competition in the mortgage market place over the last 6-9 months than we have seen for some time.

So strong growth in that area and again reinforcing the message that we are not just growing our income in different regions with more customers but we are actually adding balances to the balance sheet. The same figures are on this next slide but excluding acquisitions.

Looking at the interest margin, another key indicator of health I think in the business. Fred has taken you through the bald figures, the 2 basis point reduction as a result of the inclusion of First Active for the first time, which I think everyone had factored in, and a further 2 basis point reduction as a result of other business activities.

I thought it might be helpful for you to see, if you like, my ‘road map’ through all of this, how I reconcile in my mind what is happening to the margin.

Firstly, the accounting treatment for rental assets causes the more rental business we do the more the margin is depressed. I don’t view that as real depression, if you like, of margin or loss of margin, but in terms of how it is accounted for it does have that effect. The mortgage growth has driven the numbers down by the inherent nature of mortgages being lower margin, albeit considerably lower risk.

MINT: this is a kind of one-off and reversible effect. We have not had any income from the MINT balances so far because it has begun within the last 9 months and there is 9 months interest free in MINT. So come what may in MINT either the balances stay with us and pay interest or a degree of them will leave, either way the margin impact of MINT reverses as we go forward.

Corporate Banking: as a result of the rather more subdued activity in large corporates being replaced by the really quite strong activity in mid-corporate and commercial that brings with it a margin benefit, as indeed do increasing interest rates. As we have said all along, increasing interest rates quite suit us.

So net-net, 2 basis points down to First Active, 2 basis points down to the rest, with the rest including a dramatic increase in our mortgage business and a pretty dramatic increase in our credit card business with the launch of MINT. I think it is a very robust performance on the margin front.

As ever, that is now history as of today - what is happening to margins going forward? Well, higher interest rates are a reality, I think it is inevitable here and in the United States. That said, I don't think any of scenarios that have been spoken about are particularly threatening or cause for concern in the bad debt sense, so we do expect to see those higher interest rates feeding through into improvement in margin.

In terms of our business mix, a number of effects. Our rental business continues to grow, our leasing business continues to grow, so we would expect that effect to continue. The mortgage business is growing very strongly, a very good quality business, and we would expect to see a continuing pressure from that area. The MINT effect I spoke about a moment ago, we expect to see that reversing. Mid-corporate versus large corporate, it does rather depend on what happens with large corporates but I would expect that to be very much at worst flat. Acquisitions, Charter One I think is pretty much margin neutral as it comes in. Net-net, flat to possibly slightly down, but nothing dramatic.

Looking at the diversity of income through another lens, we have done geographic diversity, but just looking by business activity. We have increased again the proportion of our income which comes from non-interest income up to 60 per cent.

Looking at the main ingredients of that, you will get a sense of the main contributors, net fees and commissions 20 per cent of it, general insurance about 22 per cent, dealing profits - again remember before the cost of generating those dealing profits - about 10 per cent.

This slide gives a bit more analysis on dealing profits, where they come from. Greenwich Capital is about 4 per cent of our total income. The "normal", inverted commas, business we do for our customers relating to foreign exchange, interest protection and so on is the major component of the dealing profit.

As we look at it by proportion of income over the years you will see it is very stable. I think importantly the bullet points at the bottom of the slide are key to understanding our dealing profits. We do not to any serious amount and by matter of policy get involve in proprietary trading so there is a difference between the dealing profits we generate and those that are generated by many of our peers and competitors

Also the point at the bottom of the slide, we have not generated these dealing profits by moving further up the risk curve, in fact, the average bar for the year is rather lower than it was last year. I think Treasury and Trading VaR together on average is about £15 million, so very low and has actually declined over the last compared with the previous half year. So, I think good quality dealing profits driven by business that we do for our customers.

Looking at the net interest income, it is a pretty well balance portfolio of interest streams.

Looking in a little bit more detail at the ever topical personal lending and the proportion that consumer lending represents of our total, I have introduced another column on the slide here just because some of you were interested to know this - we disclosed the shape at the Full Year Results. The 2 per cent represents the other income we make in relation to consumer lending. That tells you in total we earn 10 per cent of our income from consumer lending, in grand total, that is world-wide, and of that about 8 or 9 per cent - it is not as much as 9 per cent! - comes from the UK. Mortgages, as you can see, is still a very low proportion of our total income.

I think the outlook for income growth is good. There is a strong organic income momentum across the Group, you will see that from the figures, but even more importantly I think is the fact that they are diversified income streams. If any of these particular business activities run into the sand we are not overly depended on any one individual activity. I think that diversity has served us well over recent years and is part of the reason why our results have continued at such a smooth progression.

A theme which I would now like to turn to a little bit more is there is a lot going on here within the business that has not yet flowed through fully into the results. There are a lot of acquisitions which are part way through, there are a lot of synergy benefits still to be delivered, and there are quite a number of strategic initiatives taking place within our businesses which are only just beginning to show through into the numbers.

There is a sense following the NatWest acquisition which so much in everyone's mind represented a huge non business as usual activity, that somehow with that behind us it is all business as usual now. It does not feel that way within the business, there is really quite a large amount going on, and let me try and give you some sense of that.

That said, first of all, looking at improving efficiency, the cost:income ratio, a subject as you know dear to my heart. Fred covered the outline figures earlier on. The Group is down to 40.5 per cent; even taking out the acquisition benefit we are down to 42.5 per cent

Giving a sense of how we came to be in that position, clearly the fact that our income is growing at a faster rate than our costs reduces our cost:income ratio. The fact that we are actually spending money on things to increase further growth, and I will come on to some of the specifics of this in a minute, drives our cost:income ratio up.

The things that we are specifically doing. The Group Efficiency Programme that we referred to at the last two of our announcements is driving the cost:income ratio up as we speak, and the acquisition of Churchill helped the drive the cost:income ratio down, so a number of different moving parts here.

The Group Efficiency Programme though is one of the most important things which is going on at the moment and one about which you probably have least visibility. I put up the time-table at the Full Year Results, and that remains unchanged. I emphasised, and I would again emphasise, that there are no below-the-line costs being charged for this, the full costs of this programme are being taken above-the-line.

I reconfirm the fact that from the starting point we were at, this would have taken our cost:income ratio down below 40 per cent. Clearly as we move through with acquisitions that reference point becomes more difficult to see, but our cost:income ratio will begin with a “3” - and I don’t mean 39.99! - before the end of this programme.

To give you some sense of this and before you wince, this is not another of my sort of handmade graphs - I can see why you might think it is! - the almost horizontal line with RBS on it is our actual cost:income ratio over the last three half years. The other line is the actual cost:income impact of the Group Efficiency Programme, albeit these are not to scale.

Clearly the Group results are very large, the amounts being spent in the Group Efficiency Programme are less during the early period. The purpose of the graph is to highlight that through until the end of 2004 the Group Efficiency Programme is pushing our cost:income ratio up. Although it is giving a positive contribution to profit it is putting upward pressure on our cost:income ratio.

From the end of 2004 it starts to create downward pressure and the scale moves up quite markedly, so the size of this project is building as we go and the size of the benefits build as we go until we get to a point where we stop spending on it, and as well as generating income benefits the cost savings we generate from the programme are greater than the ongoing running costs of the income benefits we generate. This is a highly beneficial programme and narrows the trajectory of how the benefits will flow through.

I am not going to go through all the details here on this slide, but just to highlight this is not rocket science. The things we are doing to drive out these efficiency savings are astonishingly mundane. If I pick out just the one down at the bottom, by printing our branch reports to screen we are savings 18 miles of paper every night. Now leaving aside the environmental benefits of that, actually getting the stuff, printing the stuff and getting it out to branches was a monstrous undertaking, so even something as seemingly mundane as that brings quite a worthwhile cost saving, not to mention labour saving, in the branches themselves.

There are heaps of things like this which we are still doing and I take great comfort from this because even when the Group Efficiency Programme is finished I think it will be some time yet before we run out of 'silly things' to stop doing.

On this slide, these are just some more but quite important ones. Image and workflow is quite important for us, that is now being actively rolled out, and that does alter the way we do work and does alter the ability to absorb further operations as we go forward.

It is also worth remembering in the context of efficiency, and is a point I would make, there are a number of integrations still to be completed and in the course of completion, obviously Charter One being a significant one but which is still subject to approval.

The outlook then. As we bring Charter One on board it will cause the Group cost:income ratio to go up initially, it has a higher cost:income ratio than the Group and it will take us a little time to feed the synergies through, so initially it will push the cost:income ratio up. As I pointed out earlier, the Efficiency Programme itself has a positive impact from the end of 2004. And the various integrations, just completing them in line with the expectations we have already created will further drive cost:income ratio down.

Actually in truth getting below 40 per cent does not look as ambitious now as it looked at the time we made the announcement because there is quite a number of things already happening, so the prospects for the Group Efficiency Programme or the target cost:income ratio now are better than they have ever been.

So, where does that leave strategy? I know everyone knows and loves these charts, or maybe like me you are getting slightly tired of them, but every time we try to think of another way to present or give a sense of what we are thinking about we keep coming back to something that looks a bit like these. Nothing new then in the United Kingdom and Ireland, nothing new to say on the outlook. As I said, it is just worth reminding ourselves that we did make one of the tactical acquisitions that we have talked about as a possibility.

If we look at Continental Europe there is a change here, and I want to choose my words very carefully because I don't want to set any hares running, but over the piece we have always talked about cross-border transactions in Europe as being something which is really just 'a bridge too far'. I have always tempered my remarks with the comment that someday they will happen, or someday the timing will be right to make them happen, but it is not within the foreseeable future.

Well, I have cause to re-visit that of late. I do think that the climate is changing a little bit in Europe, not necessarily conditioned by good logic in every case but there are macro factors now which as you talk to other Chief Executives around Europe you get a sense, that any time that Sandy Weill comes to Europe there is a sort of panic which flows around the country because.....(Laughter).....what are Citigroup going to buy? You will remember his visit to Germany earlier in the year and the amount of column inches which it filled!

I think people are beginning to spoor at a macro level now, that there is a certain size you need to be if you want to play, and there are not many people in Europe of that size. The conversion has changed. I think we were amongst the first to say that we did not think cross-border deals made sense, when we said it; we may now be amongst the first to say we think the horizon has possibly come a little bit closer or at least we are able now to see over the horizon far enough.

I don't think any deals are imminent. I am not conditioning you to expect us to do anything. I am not sure the economic logic has changed so much, but I do now want to place on record my altered view that some of the macro pressures now are causing people to think about this in a way that they did not think about it before.

I know it is perhaps not helpful to move away from ticks and crosses and dashes, but I think a question mark was the best I could think of to keep the ambiguity going. That has changed a little bit from when we last spoke and I will be interested during questions or afterwards to get your own thoughts on it, but there is some palpable evidence that has moved.

For our own part, we have been plodding away against the areas we said were opportunities. The relationship we have built up with Tchibo, I mentioned it last time, it was in pilot mode, and that is now going out to a full scale roll-out. The pilot was extremely successful in selling financial services products through Tchibo outlets in Germany. You either will or will not know about Tchibo - it is kind of difficult to explain shorthand - but it is an extraordinarily effective retailer. It is something of a phenomenon in the countries in which it operates and it is proving to be a very effective channel through which to distribute financial services.

Bibit is strictly for the anoraks of merchant acquiring and Internet merchant acquiring, but gives us important strategic capabilities and market position in Europe, albeit I would not necessarily expect you ever to have heard of it before or indeed perhaps ever to hear of it again.....(Laughter) .....other than in the results that come through in Retail Direct.

In the United States, again just highlighting a change. I think we are quite happy with the extended market, post Charter One. It gives us an enormous footprint, a footprint which is full of opportunity both in terms of acquisition and organic growth, so I think for the time-being we probably just 'parking' market extension ambitions in the United States. The market we have got is more than plenty to be getting on with.

That said, we have been very busy in the United States since we last spoke. Charter One you know all about, and I will say a few words about Charter One in a moment; Larry bought another small bank which you heard about earlier in the year. I really want to focus for a minute on the other items up here on the slide, Kroger, People's Bank, and Lynk Systems which we announced this moment. These represent significant enhancement of our business capability within Retail Direct.

We are one of the largest card issuers on the planet and we are one of the largest merchant acquirers on the planet and we had no capability in either of these areas within the United States. Since the beginning of this year we have addressed that. The People's Bank credit card business which we bought at the start of the year gave us national manufacturing capability, it gave us a prime and super prime book to start with, and it gave us a business which was already experienced in manufacturing and providing credit cards for third parties.

As I said when we were last out, we are aiming to expand that business by building relationships with retailers, and we have done that with our relationship with Kroger. Kroger is the second largest supermarket business in the United States, that operates through 3,500-4,000 different outlets, not all branded Kroger, and we will be selling initially credit cards through that channel and which we are quite excited about.

Lynk Systems, which we announced today, gives us merchant acquiring capability in the United States. Lynk itself is I think ninth in terms of overall card acquiring capability within the United States and we aim to put some real energy behind that business. It already has a national salesforce and, of course, one of the beauties of the Charter One acquisition and the Citizens business that we already own is that cards are a largely unploughed furrow in both of those businesses and they will be moving their business into the capabilities which we have acquired this year.

So, quite a significant strategic step change in the United States, done at low cost and with a low risk profile.

A new slide again, simply to highlight the fact that we have been in Asia for a very long time, the business continues to go from strength to strength, and just to highlight that we are putting resource into that. I suspect it will be a while before - when I put up the Rest of the World income analysis - we are seeing huge income from this area.

But again to give you a sense that we are active now in these areas. We are actively deploying further resource into Corporate Banking and Financial Markets, Wealth Management, in Tokyo, Hong Kong, Singapore, all of which places we have been for sometime, and Australia where we have moved recently particularly in the area of project finance, and in China.

To try and put a bit more ‘flesh on the bones’, rather than ticks and crosses which can only take you so far, I thought I might have a very quick run through what we might call the Divisional dance card, what the Divisions are actually up to of note. I am not going to bother talking about organic income growth as usual since that is the ‘ticket to the game’ and the guys are all permanently fully engaged in that. I just want to pick out one or two things that we are doing which I think are out of the ordinary and alter our income generating capability.

We moving our Financial Markets business in the United States from New York to the responsibility of Greenwich Capital. It might sound as something of relevance to furniture removers than anything else but this is quite a significant up-tiering of what we are able to do. The Greenwich platform gives us a significant opportunity to perform just at a different level. You will also seen that there is recruiting of quite a number of capital market specialists in the United States. We are making quite a significant further investment in that business, and I know Johnny will be happy to fill in any of the details on that later on.

The Retail Bank: it might all sound terribly mundane just putting another 1,000 people into the branches and expanding our direct sales capability but, guess what, the big issue in Retail Banking or in our branches is still queuing, and has the customers grown and will continue to grow? We have become more and more committed to the model that allows people to actually speak to us face to face or to speak directly to an individual of their choice.

It is helping the income along quite wonderfully at the moment. It always somehow sounds mundane to be saying this, but a lot of these mortgage sales, for example, were achieved by people through the branch. When we set that channel to a task it goes about it and is an extremely effective way of distributing financial services.

Retail Direct: I have covered a lot of this already and so I will not dwell on this but if you take it together with MINT, together with Tchibo, the Bibit acquisition, the Lynk acquisition, the Kroger joint venture, the People’s card, a huge repositioning of that business against a backdrop where it is currently delivering very strong financial performance.

Wealth Management: again there are two extremes here, the acquisition of Bank von Ernst and getting it fully integrated is occupying minds, and going back to real basics and putting private bankers out into the regions so that they can actually go and speak to wealthy customers - it is about as low tech as it gets in Wealth Management but, guess what, it is extremely effective in terms of picking up business. We are taking Coutts back into commercial banking an area where it got out of before; there is quite a strong lead across between commercial banking and wealth management for a limited number of customers.

RBS Insurance: this again might sound relatively mundane. It is just completing the IT conversion and the integration of Churchill, but there is a huge amount of energy being deployed within RBS Insurance at the moment on the integration task. Annette and her colleagues have already got to a situation where if you buy something with a red phone on it and a dog on it then it is on the Direct Line platform. A huge proportion of the IT integration is already complete but there is still quite a bit to do in some of the peripheral areas and, of course, in driving out the revenue and cost synergies in full.

Some of you may have seen the Joanna Lumley ads last night which are the initial salvo in the relaunch of Privilege into the market, to reposition that brand and to give us a further active business development channel.

Ulster Bank: as well as being engaged in its IT integration and the general integration of the business, a non trivial activity - we have also launched the First Active brand in the United Kingdom as a direct channel for mortgage acquisition. We will be rolling out quite a number of new products through the First Active branches over the next 6 months or so, and I know Cormac will be happy to pick up any questions on that later.

Citizens: Charter One is pretty much the complete focus at the moment. We are enjoying very good co-operation with Charter One, there is a lot happening on the ground notwithstanding that transaction has not yet had regulatory or shareholder approval, albeit those are on track.

I thought I might just have a word or two on Charter One. Most of you or all of you will have seen its first half results. Just to pick a couple of points out of that, strong income growth, the *de nouveau* branch openings are going extremely well. We are picking up - they are I should say to be technically correct! - picking up a lot of new customers. The business which has put on a 53 per cent increase in operating profit, excluding securities gains and so, demonstrates that the business we have really bought in there is performing very well.

It is also worth highlighting here that they are actively de-risking the business as they go, so before anything comes round to us the mortgage-back securities, for instance, available for sale have been reduced dramatically from where they were this time last year. Again to re-emphasise the point we made at the time of the announcement, we will be moving this business to have a positive bias towards rising rates as part of the acquisition process.

Capital: Fred picked up on the numbers and I don’t really want to add very much here other than to remind people that capital generation remains strong and is getting stronger. We work comfortably within our target range, post the acquisition of Charter One, and all the previous guidance on use of capital and deployment of capital stands. I am not proposing to go back through it all again today, I think we have covered it *ad nauseam*, but if anyone has any questions then obviously we would be very happy to cover those.

So, income momentum is continuing. We are seeing very strong income momentum across all of our businesses, efficiency is improving and continues to improves and I think we are feeling more positive about that than we have felt - that is not quite right, we have always felt very positive and I have always felt very positive about that - but the goal of getting below 40 per cent no longer seems all that challenging, it is just a question of how far below 40 per cent we get rather than if we get below.

We have achieved a significant strategic enhancement of the business outside the UK. If the Charter One acquisition completes, fully a third of our income, of our profit before tax, will come from outside the United Kingdom.

There are a great many benefits still to flow through. We are not in business as usual mode at the moment, the business is quite energised, absorbing a number of new initiatives and acquisitions and the benefits of those are still flowing through into our numbers. We are set to benefit from rising rates and we do believe we are well positioned for the future.

On that note, thank you very much, and we will be happy to take any questions.

THE CHAIRMAN: Thank you, Fred. Could I now take questions with the usual caveats, there will be a microphone available and could you please identify yourself. Peter!

MR. PETER TOEMAN (Morgan Stanley): Fred, I think you are quoted on the newswires as saying your views on Abbey National have not changed, but I wonder if your views on 'mercy killings' might have changed? (Laughter)

SIR FRED GOODWIN: Again I think we are steering well clear of the Abbey subject for the very obvious reason I do not want to spend half of my life in front of the Panel explaining what we have or have not said.

But, on mercy killings, I think it is a question of priorities, Peter. Even a mercy killing absorbs capital and absorbs time and as I look across the options and the opportunities that are available to the Group at the moment I wonder whether a mercy killing would be best use of that capital or that time. I also wonder what strategic or even tactical capabilities a mercy killing would bring us.

Most of the mercy killings that people assumed we were talking about involved building societies, or at least mortgage capability. I think the numbers we have seen in the first half demonstrate that when the circumstances are right we can add mortgage balances in fairly dramatic amounts. I have no doubt we can add mortgage balances pretty much at will depending if we are prepared to take the margin consequences or the financial consequences, which are the moment are not as drastic as they would have been.

Mercy killings are probably still out there, but in terms of priorities for the Royal Bank Group right now they feel like something that isn't a priority.

THE CHAIRMAN: Ed!

MR. ED FIRTH (SG Securities): I have two questions. The first question was on consumer provisions in the Retail Bank, clearly they were up well ahead of balance sheet growth, and I guess that is doubly surprising given that mortgages was where the stronger growth was coming through so you would have expected the mix to benefited you and not hindered you.

You referred to fraud. Can you give us an indication of roughly how much the fraud was, but also give some sort of sense of what the underlying picture was excluding the fraud and how you see the outlook?

SIR FRED GOODWIN: I will get Fred to kick off and then Benny may want to chip in on the fraud piece!

MR. WATT: Clearly you referred to mortgage growth and that is in this period. What we have been seeing over the last few years is the growth in the unsecured book over the last three or four years with NatWest, so your mortgage point may be more relevant going forward but not necessarily relevant for this period's chart. But, Benny, why don't you comment?

MR BENNY HIGGINS: I would just remind you of the guidance I gave at the year end which was precisely that this year would be the year in which, if you like, the overrun of provision growth versus asset growth would in fact peak and going into 2005 the growth of provisions would be in line with the growth in assets. I would stick by that guidance. I don't think anything has changed on that front.

The only modest change to that has been the fraud. First party fraud, which appears in the provisions line, was a little higher than we expected but the path and trajectory of provisions is exactly where I suggested it would be at the year end.

MR. FIRTH: Okay, thank you. I just have one other question which is perhaps a somewhat tricky issue. Just talking about litigation risk, I saw you put in a note in the Accounts but obviously in the second quarter we saw some quite big charges from I think JP Morgan and Citigroup in respect of US business. Obviously I suspect you are somewhat limited in what you can say, but if you can give us some sort of 'compare and contract', your position versus theirs, and perhaps if possible give us some sort of an idea of a worst case scenario?

SIR FRED GOODWIN: Well, you will immediately understand, Ed, why we cannot do any of the above.....(Laughter).....but I would draw your attention to the note that appears in the Company Announcement we have made today which is identical to the note we put into the Accounts and represents our complete view of the position.

THE CHAIRMAN: Okay, Simon!

MR. SIMON SAMUELS (Citigroup Smith Barney): I have two questions, one is strategic and one is just on the operations. The operation one is, the Group cost:income ratio excluding acquisitions, the 42.5 per cent from 43 per cent prior year, roughly looks like it was the same as it was in the second half of last year - and you obviously indicated that the Efficiency Programme has the net benefit next year rather than this year. I just wanted to see whether you would be prepared to confirm that you would expect the cost:income ratio excluding acquisitions to continue to improve essentially in the second half of the current year?

SIR FRED GOODWIN: Yes.

MR. SAMUELS: Thank you. On the strategic question, obviously you have invited a question on the acquisition of a universal bank in Europe. I was wondering if you would be prepared to - well obviously! - talk a little bit more specifics about countries because there are lots of different countries in Europe.....(Laughter).....and also when you describe a sort of deal as not imminent is that not imminent because you are preoccupied with Charter One or not imminent because you don't see the other parties as being prepared to see you as a merger or as an acquirer?

SIR FRED GOODWIN: I think you have probably confirmed my worst fears, Simon, that the hare is already some way down the path here, therefore, I would decline to discuss any specific countries. In the context of the debate we have been trying to have, or the dialogue we have been try to have, through these ticks and crosses - I accept it is not the most sophisticated tool or technique - it was just to try and condition your understanding of how we see world.

I do think how we would look at the world in Europe has changed a little since we were last together. I am not encouraging anyone to think we are going to go out and do something or there is something about to happen, but I do think that the climate has changed a little bit. I am going to be interested in the views you guys would have as well, but it is a conversation which comes up more rather than less and, to my mind, that increase is significant.

I do not have a shopping list, whether it be in old Europe or new Europe, of deals we are wanting to go out and do, but I think there is a frame of mind out there which is different. I think that is the first sign of the change because once people are willing to think about it then you get further down the path; previously, people were not even willing to dream about it let alone think about it!

MR. SIMON MAUGHAN (Dresdner Kleinwort Wasserstein): I have two questions, if I may. First of all, could you expand upon the investment in CBFM and particularly in the US? Perhaps if you can give us an idea of the scale and the timing of the payback of that investment?

My second question concerns MINT. Perhaps you could just explain to us the rationale for the launch of that separate brand and what benefits it brings to the Group beyond starting to receive interest income?

SIR FRED GOODWIN: Johnny and then Chris!

MR. JOHNNY CAMERON: The scale of the investment in the context of CBFM as a whole is not large but it inevitably gets more comment than most things - capital markets tend to be our shop window, if you will. But we have just started to do it. We are talking 40 people, that sort of thing, in the States. The significant thing I think is that they would not have joined us if we had not had the Greenwich platform in both senses of the word, platform in terms of the trading floor and a platform in terms of a very, very loyal US investor base. I think we have an opportunity to do something there that many other banks would not have.

The impact is a little like the graph that Fred put up about the cost:income ratio. We are certainly in negative territory at the moment, i.e., costs exceed income, but I am hoping that we will be break-even next year and move towards a move sensible cost:income ratio over the two or three years after that. But, the numbers in the CBFM context as a whole are not huge.

THE CHAIRMAN: Christ!

MR. CHRIS SULLIVAN: A couple of reasons. I think the view on our Advanta brand was that it was a little tired and we had seen significant attrition within the base of the credit card business under the Advanta brand. In addition to that, we had a licence agreement with Advanta to use the name for a certain period of time.

We took the view at that time, at the end of last year, that probably it was time for something new, something if you will excuse the expression, a little bit fresh, and we came up with the view of MINT. It has been very positive for us. We achieved significant new customer growth in the first three months, way ahead of what we planned.

Some of the interesting aspects, and Fred has alluded to the fact that it affected the Group NIM to a certain degree because we obviously had to fund a significant amount of new balances, what I think was more significant was the credit card that people have taken off of us is being used more than other credit cards, so we had a very positive effect on fee income in the first half and that gives us a lot of positive views on what is going to happen with that credit card as we go forward when it re-prices.

Some other interesting aspects about the card itself and the customer base it has attracted, we were particularly looking at the sort of 20-50 year old range of customers, and that is exactly the customer base that has been attracted, a significant number of more Internet applications that we normally would have expected, and a higher quality of credit as well. So, lots of advantages and we envisage expanding the brand there into other products.

SIR FRED GOODWIN: And perfectly low acquisition costs as well. The only paying element of MINT is really just in the NIM.

THE CHAIRMAN: A question here!

MR. NICK LORD (Deutsche Bank): I just wonder if I could come back on the comments you made about European universal bank and your thoughts there. First of all, I just wondered if there is any change in your thoughts on the industrial logic of such a deal and what the industrial logic of such a deal would be?

And secondly, if what you are highlighting to us here is just that CEOs across Europe are talking more about this, or has something changed in regulatory structures or technology that would make the industrial logic of two universal banks in Europe merging more concrete?

SIR FRED GOODWIN: Not a huge amount of change, Nick, in the industrial logic. It is more of the fact that the unthinkable is now being thought about, which is some respects is a more profound or a more difficult aspect of change. If you want to make some change the industrial logic is still not overwhelming to my mind, and it is more often unattractive rather than attractive, but the fact that people are thinking about it and it has been conditioned by macro factors I think is interesting and is a change.

I am already deeply regretting ever mentioning this - maybe the plethora of dialogue is too subtle altogether! (Laughter)

THE CHAIRMAN: Tom and then Mike!

MR. TOM RAYNER (Citigroup Smith Barney): Can I just come back to the consumer provisions and forward issue that was asked about before. I think the guidance is very clear, provisions growing in line with assets from next year, but I guess we have already heard that mortgages are growing faster, so this I take it implies some deterioration in non-mortgage provisioning. I just wondered if you could clarify that?

The second thing, on the forward costs obviously the first party costs you say are going through bad debts, but how significant are third party forward costs which I guess are going through the cost line? Could you comment on that as well, please? Thank you.

SIR FRED GOODWIN: Benny or Fred, who wants to pick that up?

MR. HIGGINS: First of all, I think Fred already made the allusion that the mortgage business we are doing today has no impact whatsoever on the provisions line today, even in consumer lending there is technically an 18 month lag between selling business and the peak of provisioning against that business. So the guidance is very much accurate in that what we were talking about is the unsecured lending book in NatWest, which started when we acquired NatWest with the very low starting point in terms of provisions, and also we re-invigorated the salesforce and modified the risk appetite to be in line with RBS.

Exactly what we said at the year end has happened, that the growth we saw last year, which was in excess of asset growth, would continue into this year but then moderate as go into the back end of this year, and into next year it would be in line with asset growth.

So that part is exactly what we said would happen but clearly again, as Fred Watt alluded to, the fact that we have grown the mortgage book strongly this year is a sign of growing very good quality assets where provisions are likely to be very low with respect to that book of assets.

As far as the fraud line is concerned, clearly it is an industry issue and the third party fraud costs are a cost as opposed to a provision, the first party are in the provisions line. Neither are hugely material in terms of our P&L but they certainly have been higher than expected.

MR. WATT: To put it into context, within the provisions growth of around £50 million there is probably £10/12/15 million of fraud-related without which we are bang in line with where we said we would be. We are not talking big numbers here but obviously it is a very low base to compare the number with.

MR. RAYNER: Thank you.

THE CHAIRMAN: Michael!

MR. MICHAEL LEVER (CSFB): I have two questions, one on the US and one on the UK. On the US, although you have not acquired Charter One yet, I wonder if you could give us a little bit more of your thoughts in terms of the future development of the mortgage market trends in the US? Clearly there has been some concern expressed in local bank prices about what is likely to happen to the mortgage market.

The UK question is quite different. It relates to reports I read recently about the Government yet again putting its oar in, in train leasing, intervening in the pricing decisions, and I wondered if you could give some comment on that and whether the Government's intervention is likely to spread to potentially other areas?

SIR FRED GOODWIN: I will take the first one, then Johnny will take the train leasing one, and I can do the Government in more general.

On mortgages, it is interesting in the US just now and I think it is, as you say, Michael, starting to flow through into the valuations of some of the other banks. There are many people who have just become 'one-trick ponies', organisations who have been able to - inflate may be too strong a word to use, but not far off! - their financial performance by diving into mortgage-backed securities and building a business out of it which is now turning to dust before their eyes.

We were certainly very clear of that for our book, it was less clear or visible in pricing at the time we did Charter One but it has become I think much clearer since. We take great comfort from the Charter One core business, which I put some figures up about earlier, that it does not apply there. By the time we get around to looking for any more in-fill acquisitions, which will be sometime on, I think it will be entirely transparent as to who has a real business and whose business was just puffed up out of not quite thin air but getting on for it.

Johnny!

MR. CAMERON: On the railway business, obviously it is a pretty political subject and there has been a lot going on there. I think the vast majority of participants would say the train leasing companies are the one bit of the railway system that is clearly not broken, and that is the common view in the industry. There was a recent article in the Sunday papers, which you were referring to I think, that is the only snippet I have seen around this topic, so I am not particularly concerned by it.

But having said that, it is worth noting that our fleet is one bit of our business which has very long contractual terms - the vast majority of our leasing fleet is contracted out for really a very long time indeed - so even in the very, very worst scenario which I do not expect to occur, it is a long way off.

SIR FRED GOODWIN: I think on Government in general your guess is as good as mind, Michael!

MR. LEVER: Thank you very much.

THE CHAIRMAN: Mike next!

MR. MIKE TRIPPETT (HSBC): Good morning. I have a question on the CBFM bad debt charge which has come down at a time when you are still getting good asset growth. I just wonder if you could give a bit more background as to what is happening there in terms of the impact of any releases and recoveries or have we seen the sort of fixed asset write-offs dry up? I am really just trying to get an idea of the kind of run rate in CBFM bad debt charge going forward.

SIR FRED GOODWIN: Johnny!

MR. CAMERON: What you see is what you get here! That is, the figures are a very accurate reflection of how it feels, which I think is your question. The bad debt rises over previous years tend to be rather lumpy, large names in the large corporate arena. Our mid-market business has been steady throughout or slightly improved, but it has been very steady throughout the period of the last three years. So, what you see if what you get - the provision charge is down and that reflects improving metrics across the board.

MR. TRIPPETT: Can I just follow up then, just to be a bit more specific? The gross and new specifics within CBFM, is that coming down?

MR. CAMERON: The gross?

MR. TRIPPETT: The gross and new specific charges within CBFM.

MR. CAMERON: That is what that is. It is not a question of recoveries, it is fundamentally new specifics coming down.

MR. TRIPPETT: Okay. Thank you.

THE CHAIRMAN: You have a go on the right!

MR. MARK THOMAS (Keefe Bryette Woods): Thank you. I notice the pick up in term of pension charge. Does that fully reflect what you are expecting in terms of the triennial review?

Secondly, the Government is trying to introduce volatility in short term UK money markets. Will that have any impact in terms of income going forward?

Finally, could I request that the domestic disclosure on sectorial break-down of loans and provisions be reinstated in the 20F? Thank you.

SIR FRED GOODWIN: Fred, do you want to do pensions and the 20F point and we will get Johnny to do the other!

MR. WATT: The triennial review is due with us in about September time, so it is not meant to be there as a kind of guess forward. It reflects a whole host of pension schemes we have around the Group and there is generally, as you know, a pick up in pension costs as a result of running pension schemes, so no surprise there!

SIR FRED GOODWIN: And if you could take the 20F point!

MR. WATT: Yes, 20F point. Clearly the 20F is a full year disclosure and we will be looking at that separately. We are giving you I think very full disclosure, as we do, but anything that can help you we will clearly look at. Yes, I am happy to do that.

MR. CAMERON: On the money line side, our friends at the Bank of England have been working on this since the third quarter of last year I think, tightening up conditions in the overnight market, and the great bulk of the effect is already in the numbers. We have had some impact, but that is in our numbers for the first half of this year. We do not expect it to get any worst.

THE CHAIRMAN: We move along to here!

MR. RICHARD STAITE (SG Securities): Can I get you to comment on the UK credit card market. Do you think pricing is rational at the moment? Is it more competitive now than it was a year or 18 months ago? I am just wondering if you are being a bit optimistic in thinking that your customers are going to stay with you after 9 months. Are they not going to simply transfer to another very long interest-free period?

SIR FRED GOODWIN: I will pass on to Chris for the general one, but I don’t think we have evidenced any opinion at the moment other than the fact that even if they go that helps margin, so it is binary as far as margin is concerned. I think the margin effect will come about one way or another. But, Chris, as to the generality!

MR. SULLIVAN: I will just reiterate what I said before, there are certain behavioural characteristics within the credit card user that are an indication of how likely they are to stay with you and the credit card characteristics evidenced within the MINT base are very positive indeed.

SIR FRED GOODWIN: As to the general state of the market, is it more competitive or less competitive?

MR. SULLIVAN: It is very competitive!

SIR FRED GOODWIN: It is very competitive, but is it more competitive than a year ago?

MR. SULLIVAN: I'm not sure.

SIR FRED GOODWIN: I think pricing is realistic. I think you will see people start to move up. I suspect part of the question was that, Richard, is why are we not seeing base rate increases come through into pricing? I think historically the card market has been very slow to follow base rates in either direction, but I expect you will see people following it.

THE CHAIRMAN: I think we will go to Martin!

MR. MARTIN CROSS (Teather & Greenwood): Thank you. There has not been a question about interest margin yet which is surprising, I think every other bank gets asked about it, so I will ask it! I want to tie it in with your summary slide which said you saw the Group as a beneficiary of the rising interest rate environment.

On page 26 of the release, in the discussion of the net interest margin movements, it would appear that the benefit of rising UK rates has been offset by decreased volumes presumably of current accounts, but the benefit to the margin from rising interest rates has come in the overseas margin. Could I ask you, when you refer to the Group being a beneficiary of interest rate movements going forward are you thinking primary of the UK, the higher rate environment there feeding through, or are you thinking of dollar interest rates?

SIR FRED GOODWIN: I am thinking generally, Martin. We would expect the rate to go up in the US and in the UK and in both instances we think in the general that would be a positive impact for our business. You will remember that in recent years we spoke as interest rates were coming down of the floor effect and the compression effect on our margins. Well, the simple removal of that creates benefit for us.

I would not necessarily leap to the conclusions you have leapt to off of page 26 - I find page 26 quite difficult to tie up sometimes to the underlying dynamics within the business! But we are not trying to be clever about the wording, I think we would generally consider ourselves to be beneficiaries and have positioned ourselves to be beneficiaries of rising rates.

MR. CROSS: Am I entitle to conclude that unlike some other banks you don't have hedges against, or not to the same extent, against rising interest rates?

SIR FRED GOODWIN: Not hedges that create the comment, if you follow. There are hedges around but the comment arises from the basic impact on rates we set for our customers.

MR. JAMES HAMILTON (West LB): Good morning. If I could lead you down the hypothetical path for a moment, if we assume that the Competition Commission will not permit a large UK bank acquiring Abbey and we therefore assume a foreign buyers acquires it, what scope do you think there is for a domestic player to form a joint venture with the foreign buyer?

THE CHAIRMAN: I think we are in the areas of assumptions, aren't we?

SIR FRED GOODWIN: It is extremely hypothetical, isn't it?

THE CHAIRMAN: Exactly!

SIR FRED GOODWIN: I guess it would depend on who the hypothetical parties for the hypothetical asset would be.....(Laughter).....and the terms of any hypothetical joint venture. But to be crystal clear, we have no agreements, contracts, understandings or anything else with the hypothetical parties that I think you are thinking about! (Laughter)

THE CHAIRMAN: Okay, one last question!

MR. JONATHAN PIERCE (CSFB): I have two very quick questions, if that is all right, on Retail. The net credit card accounts ex-acquisitions went up 480,000 in one of the slides we were shown, but the MINT cards themselves added 560,000, so I was wondering what is going on in the NatWest and the Royal Bank of Scotland higher spread back books on credit cards?

SIR FRED GOODWIN: I am sorry, Jonathan, but there is a quick answer to that one. That was the existing Advanta cards that were there to start with, they were rebranded as MINT, so the total number of MINT cards at the end of the year were not all new, new to the Group. They are all new to MINT but the net increase to the Group is less because some of them were transferred across from Advanta.

MR. PIERCE: Okay. So the other brand cards were also going up in numbers?

MR. SULLIVAN: In January we purged a number of dormant accounts out of the NatWest and MINT cards as well. There were about 300,000 cards which we purged out which have actually reduced the number of cards in that arena. We are now starting to put more energy in particular into the NatWest brand where we do have some significant opportunities we think. In the Advanta book, actually the advent of MINT has already begun to increase the numbers of old Advanta customers that are using their cards and also the number of people within that particular sector.

MR. PIERCE: Okay. Secondly, quickly on mortgages, the net share in the first half from what I can tell from the balance sheet and other information looks to be 'north' of 10 per cent. I am just wondering whether moving forwards, it is well above your share of stock, that will continue and consequently whether that 4 basis point impact on the margin is likely to continue?

SIR FRED GOODWIN: As was indicated in the chart, there is certainly a negative effective going forward which I think will continue. As to precisely where we will pitch it, as ever it will depend on market responses, and we are not hell-bent on growing mortgage market share at any cost.

We have been very conservative in recent years around mortgages, we remain inherently conservative around mortgages, so I would expect there will continue to be a negative effect on margin from growing mortgages, albeit on profit there is a perfectly satisfactory effect. But as to whether it will be staying at the current levels or not we shall see. (A pause)

THE CHAIRMAN: Okay, thank you very much, ladies and gentlemen.

(The proceedings then terminated).