Royal Bank of Scotland
Moderators: Sir Tom McKillop, Sir Fred Goodwin, Guy Whittaker
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Sir Tom McKillop: Good morning ladies and gentlemen and welcome to our Interim Results Presentation. This morning is very much about business as usual and here at RBS business is very good indeed. This morning we announced a very strong set of results with income up 8%, group operating profit up 11% and earnings per share up 21%. The board is pleased to continue its dividend policy with an interim dividend payment of 1/3 of prior year total. That equates to 10.1p per share, an increase of 25%. Our aim at RBS is sustained growth, the delivery of sustained growth and that sustainability comes through a diversified revenue stream, disciplined risk evaluation, and a relentless focus on efficiency in the interest of both our customers and our shareholders as you will hear from Fred and Guy in a moment. First I'll hand over to Guy to take you through the financial results in more detail. Guy?

Guy Whittaker: Thank you very much Tom and good morning ladies and gentlemen. I'd like to take the next few minutes to run through the financial results for what was a very good first half for the RBS Group. Income rose 8 percentage points to £14.7 billion. Operating profit rose 11%, profit attributable to shareholders who benefited from a £157 million reduction in our deferred tax liability rose 19% to £3.55 billion. Our adjusted earnings per share, which were benefited by a further 2% as a result of the buyback we undertook in 2006, rose 21% to 38.4p. Our returns on equity rose just over 1% to 19.6, our Tier I capital ratios were stable.

Income was up by just a little over £1 billion as I said at £14.7 billion. Net interest income rose 4% to £5.4 billion and non-interest income rose 10% to £9.3 billion. Our non-interest income now comprises 63% of group income up one percentage point from this time a year ago. Net interest margin declined three basis points from this time a year ago to 2.42%, slightly less than the guidance we've given when we announced the full year results at the beginning of March. In sterling terms Citizens was held back by the weak dollar. In local currency terms all of our businesses grew income and in constant FX terms our income rose by 10%. Top line income growth was complemented by costs contained to only 6% growth, we continue to see productivity gains coming through from our operating model which allowed further investment in our customer facing activities where expenses grew 7% as well as providing investment capabilities for our operating infrastructure on a net basis up 2% year over year. The cost income ratio for the group continues to show improvement and dropped a further 50 basis points to 41.4%.

The credit environment was positive, our credit metrics reflected that and duly improved. Loans and advances grew by 10% to £424 billion but our impairment losses fell by 2% to £871 million. Our risk elements in lending and potential problem loans declined as a proportion of the portfolio from 1.64% this time a year ago to 1.51% as at June 30th. It remains a very high quality portfolio, well diversified by industry and by geography. It was pleasing to see that our UK unsecured credit losses declined in the first half of the year and arrears are falling. The corporate environment remains benign and our US portfolios, a subject of much discussion at the moment are of a prime or super prime nature.

All in all it was a very strong first half, strong income growth notwithstanding the adverse currency move, good expense control, improving credit environment, adverse claims experience which we'll come on to talk about when we go through the divisions all added together to give double digit profit growth up 11% to £5.106 billion.

If I can just take a few minutes to run through each of the divisions now, it was another in a long series of record halves for our global banking and markets business, we grew income by 18%, profit by 19% at £2.17 billion. Our fees for arranging and structuring large scale financings, loans and bond issuance grew 25%. Our income from trading activities while maintaining our customary modest VaR profile of just £15.1 million grew by 18% led by strong performances in foreign exchange, interest rates, equity derivatives in our retail investor products. Markets as you know don't always move in straight lines, in North America we saw a decline in income of 6% in local currency terms, down 15% in sterling as a result of declining activities in our mortgage and CDO businesses but these were partially offset by good growth elsewhere particularly in North American trading. In Europe we saw income grow 33%, particularly strong performances in Germany, Italy, Spain and in the Nordic region and in Asia where there was still plenty of opportunity for growth we more than doubled, grew by 124% our income in the region. We continue to invest in people and in systems while maintaining an industry leading cost income ratio of 40.5% in this business. We continue to be efficient in our deployment of capital to this business, our returns on risk weighted assets rose by another 16 basis points to 3%.

In UK corporate banking where we have the industry leading position we saw another half of strong organic growth, income rose 10%, profits rose 12% to £981 million. We saw balanced balance sheet growth for loans and advances up 11% and deposits up 13% and net interest margin declining just 7 basis points to 2.81%. Our credit metrics are stable, the £21 million increase reflects an absence of prior year recoveries and some small latent provisioning, very strong credit portfolio overall. Direct expenses grew 9% as we continue to invest in this business, we added 600 relationship managers, we extended our 'Another Way of Banking' service model and we continue to roll out of e-banking platform connecting 37,000 of our 100,000 customers to that system.

In retail top line income growth of 3%, £3.87 billion was held back by cards and direct finance where income fell by 5%. It was a conscious decision to de-emphasise the intermediary and direct channels and concentrate on our franchise-led distribution as evidenced by branch lending sales volumes which grew by 19% in the half. Our costs in this business were held to 1% which also includes a £30 million restructuring charge we took in the first half and added to that our operating expenses declined by 2%. We saw the peak in impairment losses in the second half of

2006 and our credit costs year over year declined in this business by 7% and our arrears have fallen by 11%. We continue to make very good progress on the savings and investment side of retail with deposits growing 10% and savings balances up 12%. We continue to lead the UK in current accounts and in switches. Our bank assurance business APE grew 24% to £171 million and for the first time took us over 10% of the bank assurance market in the UK.

It was another strong half for the wealth management business firing on all cylinders, both banking and investments. Our loans grew 13%, deposits were up 16%, assets under management on a constant FX basis up 25%. Coutts in the UK had a record 7% increase in the number of clients which contributed to a 14% uplift in income. We added 85 private bankers around the world and now have over 400 people working for us in Asia where we saw a 46% increase in income. The metrics across this business were all as you can see very strong, 28% growth in profit year over year and great momentum for the future.

Also another strong half for Ulster Bank, another good performance around organic growth, income up 13%, profits up by 20%. The credit environment remains strong and impairments fell by 7 percentage points to £53 million. Expenses grew by 17% reflecting a programme of investment and expansions that we have across the island of Ireland in both people and in infrastructure. Our corporate lending business grew by 29% with a particularly strong performance in the north of Ireland. Our capital markets businesses are growing well with fees up 14% and in retail where we opened new branches and added 90,000 customers, also a very strong performance. In May we saw the launch of our new wealth management business for high net worth individuals which got off to a very dynamic start.

In Citizens after I think a protracted period of decline we saw margins on a year over year basis stabilise at 2.75%. On a sequential basis the second half of 2006, first half of 2007 we saw margins just increase slightly by 6 basis points, this helped lift total income 2% in US dollar terms to just over $3 billion. Our costs were held flat in what remains a challenging environment.

Impairments rose by just over £15 million to $163 million you see there allowing operating profit to grow by 2%. It remains quite a tough market for deposits and whilst spot balances were down by 5% our average balances were up by 1%. The business mix in Citizens is slowly changing, we've issued 20% more cards on a year over year basis, we added 8% more merchants to our merchant acquiring business, we continue to add corporate and commercial clients and overall customer numbers rose by 5%. Our commercial lending volumes grew by 12% with good growth in the ancillary fees and products that are sold with them. Credit metrics overall remain strong, the rise in impairments is very much in line with our expectations and reflects really the growth in the commercial book as that side of the business expands. Our risk elements in lending are very low at 35 basis points. We have just as a reminder no sub-prime exposure in the lending book at Citizens. Our FICO scores are over 700 and 96% of our lending to consumers is fully secured.

In insurance really the results that you can see are dominated by the floods in June which we estimate cost £125 million, rather frustrating that these one in 150 year events seem to come round slightly more frequently and we had a similar impact, we are expecting a similar impact from the floods that you will all have seen took place in July. The headline income for insurance was up 3%, expenses up 2%, claims were up 9% and operating profit overall down 27%. Underneath that excluding the extraordinary weather that we saw in June it was a very good performance and operating profit grew by 8%. Our own brands performed particularly well, we've refined our risk pricing putting pricing increases through on the higher risk segment. Income grew 7%, profits grew by 10%. In the partnerships business where we manage these relationships of profitability, we elected to exit a number of contracts. The impact you will see in the numbers is a 14% decline in partnership policy numbers, a 2% decline in partnership income but actually a 4% increase in profits from this activity. Finally underneath the floods a very good performance in insurance and signs that UK motor price rises are holding, the outlook there looking more promising.

In manufacturing a very good, a very now familiar story of the group operating model, a scaleable platform providing a basis for productivity gains across the company. Group technology costs were held flat on a year over year basis. Our property costs rose 4% which is a combination of both savings and new investment. Our customer support grew 2% as volume increases were largely offset by productivity gains and overall total costs in manufacturing grew just by 2% and really underpinned the group profitability metrics.

The balance sheet remains in good shape, risk weighted assets grew 9 percentage points, our capital ratios were stable in the middle of our 7-8% Tier I range. Our returns on equity were up 1% to 19.6 and our interim dividends as the chairman just said rose 25% to 10.1p, I think in the round a very good set of financial numbers and I'd now like to hand over to Fred to share a few thoughts about the outlook. Thank you very much.

Sir Fred Goodwin: Thanks Guy and good morning everyone. In approaching these presentations it always strikes me that there are two objectives. The first is to disclose and explain the actual performance of the business for the period which has just elapsed, but actually more importantly to give you a sense of what that means and what the outlook is of where the business is heading. Hopefully from the numbers that you've had a chance to look at and from Guy's presentation you will have a sense, I think the numbers are very reassuring in the first half. The trends that are there we think are good and strong and consistent with those that you've seen in the business now for some time and I think that's very relevant when you come to think about what that means going forward. I would like to give a short presentation, there's a few thoughts around outlook, probably with the obvious health warning at the start that I can't predict the future, it's something we have in common, none of us can predict the future. I have a sense that if we could predict the future with any accuracy we'd all be extremely wealthy and as much as I enjoy talking about RBS I suspect that on a sunny Friday afternoon in August I'd be tempted to be doing something else. But the fact of the matter is I can't predict the future with any accuracy, but what I'd like to do is share with you a few thoughts and pointers for the outlook at least as it applies to RBS.

In thinking about it we tend to think that our prospects going forward will be conditioned by really three things: firstly what's going on in the world, the economic climate, the market climate, whatever; the momentum within the business itself; and also where that momentum arises, what sort of momentum is it? Of whatever opportunities there are out there our ability to take advantage of them will be dependent on whether we have businesses to which they are relevant.

Let's look very briefly at each of these. I put this chart up quite frequently, I thought it would be interesting just to see how this sentiment has moved since February and quite interesting I think there's swings and roundabouts, ups and downs, some notable movements in relation to the Euro zone, with Asia Pacific. Again it's worth reminding ourselves that that's a region which has growing significance for the RBS Group. Once upon a time those figures were put on the slide almost for the sake of completeness, the growth prospects in Asia Pacific are increasingly relevant to our own business prospects now. In the United States things have moved back a little bit for '07 although I must say 2.1%, it's going to be a bit of a challenge to get down to 2.1% when we had 3.4% Q2 growth just last week. But for better or for worse I don't have any particular insight to throw on those other than that they're there and whichever way you want to look at it it suggests to us a positive environment for business around the world and indeed prospects for the world seem to have improved marginally for the rest of 2007.

The group's momentum, how is RBS facing into that? Well, I'm not a big fan of underlying figures, I think as you know the figures are the figures but in trying to get a sense of how the group is moving, how it's travelling I think there are one or two things that I would draw particularly to your attention, Guy has touched on some of them already but those are the numbers straight out of the reported numbers. I think we do need to just highlight a few things in getting ourselves to a sense of what's actually happening in the underlying business. I'm not putting currency up there, I think the ebbs and flows of currency are an integral part of our business, Guy mentioned some of those effects but I wouldn't cite them here. There are really three things which I think need to be taken into account to get a true and proper sense of the momentum in the underlying group: the overdraft key imbursements on a goodwill basis, in the first half they were £81 million as a result of the court action that we have brought, we the banks have brought against the OFT, there will be no more of these payments. The June floods, £125 million, an allegedly one in 150 year event; and the other one in 150 year event will be of similar magnitude again as Guy said. Also the tax effect here I think needs to reflect the fact that the adjustment in deferred tax as a result of the change to corporation tax rates bolsters the EPS numbers, I think we want to take that out as well albeit it brings you back to the same number.

So in terms of the…and as I say, I don't like underlying, I don't want to get into the underlying business but I think in looking at the momentum of the group these are better numbers to be using. If I slot them into a fairly simple time series, again I hope it gives you a sense of these are not numbers that come from nowhere, that come out of the blue, they're very consistent with a trend which has been evident and established now for a long time within the RBS Group. Going back to Tom's comments, this is what we're trying to do is deliver sustainable and consistent growth.

One of the things I'd like to do is to help you understand diversity a bit better is to do a reprise of some slides that I did back I think in 2005. I think it's all very well to talk about diversification in our income streams but I thought you might like to see some of the detail that lies behind that. You may remember the slides from 2005, obviously these are the figures updated for the first half of '07 just to give you a broad sense of where we derive our income from. I think interesting point number one is that the majority of our income still comes from doing business with individuals rather than doing business with companies and financial institutions, 52.2% plays 47.8%. The business side of it has grown a little since 2005 but not a great deal actually in relative terms.

Turning to look at a little bit of detail and don't worry, I'm not going to go through all of these figures. The message is that there are lots of these figures and they're relatively small, but adding up to the total but probably a couple on that slide just to draw your attention to particularly would be that the leveraged finance figure down at the bottom, the 2.1%, that's the proportion of our income which is derived from our activities in that area and you can see spread between the United Kingdom, the United States and Europe. A lot of our income comes from taking deposits but clearly dominated by lending in this particular facet of the business, but well spread, the tick is simply to highlight that we do business in those areas but it doesn't make it to the 0.1% of the overall group figure. As I say I'm not going to go through all of these individually, I'm happy to take any question on them later on after you have had a chance to digest them but the objective of this slide is just to give you a sense of how diverse our income actually is.

Looking beyond the deposits and lending I think another interesting figure is all of our activity in asset backed, related to US asset backed activity comes to about 1.6% of our total income, I'll show you a slide in a moment that highlights the point that Guy touched on earlier that the income in that area has reduced in the course of this year but it's a small part of the overall group's performance. Income from trading activities at 12.8%, roughly consistent, it's good growth in the underlying numbers but that's been a remarkably consistent percentage of the total group income over the last five or six years. We're not managing it to a particular figure but it tends to keep pace with growth in the group.

Turning to the personal side, a much bigger proportion of the income comes from deposits, I've not broken out deposits but all the usual suspects are represented there. On the lending side you'll see mortgages and home equity loans in the United States don't account for a big part of our business.

I mentioned the importance of insurance in the earnings and there's a big number from motor insurance predominantly in the United Kingdom, so hopefully that gives you a sense that by product and by geography our numbers are very diverse and so we don't have to keep doing any one thing to drive the group numbers forward. We have the opportunity to step back from activities when market or business or economic conditions are less favourable.

Looking geographically for a moment I think there's some interesting dimensions here too. The United Kingdom is ahead by 10%, the United States back by 1% at group level. I'll give you a sense of what was driving that. As Guy said earlier the corporate markets business has gone backwards 6% in dollars, 15% in sterling and still we delivered those results in corporate markets. The asset backed business, we stepped back from that activity and there was less of that activity to step back from was down 23% in local currency and still we delivered the numbers. You'll see the ever growing other corporate markets activity in the United States moved ahead strongly. There's a lot happening in the United States again demonstrating that there's more to our business there than simply asset backed securities and there's a lot more to our business there than Citizens. In Europe good progress pretty much across the board, wealth management actually surprisingly slow in Europe, I'll come back to that in the Asian context in a moment. Very strong corporate markets growth, good growth in insurance. Asia Pacific an increasingly important area for the group, over 1,000 added to the head count there in the first half of '07 coming on top of a very strong growth in head count last year also, very, very significant growth as the numbers show both in wealth and in corporate markets.

So very diversified income steams, those ingredients for growth then are…the economic climate is there and it's changing a little bit and some of the emphasis is changing but there's plenty of economic activity and plenty of growth to participate in. The group moves forward into that future with good momentum and with a very diversified range of businesses. China, China highly topical, always is, we've been there for some time now. A brief update on our joint ventures with Bank of China, credit cards having opened a million new cards during '06 we've already opened a million new cards year to date 30th June, good progress in the business, a lot of work still to do. Private banking, we have launched now our branches in Beijing and Shanghai with more coming up. Corporate banking, we did about 1.2 billion of business during the whole of 2006, we've done

850 million or so in the first half of 2007 and again that's moving forward very well. You can follow the market capitalisation of Bank of China for yourselves but the stake in Bank of China is now worth about $5.4 billion.

So conclusion, I think you'll have gathered what the conclusion is but nevertheless it's worth again just emphasising that we do operated within an economic environment that is positive and looks set to remain positive whoever's numbers you want to believe or prefer. We have real momentum across the group, the headwinds expression that we were using at the year end I think we talked then that we saw signs of head winds abating. I think today we can present you with and have presented you with actual numerical evidence of the head winds abating in insurance and in Citizens. We've got diversification, we're able to take part in a wide range of business activities, we have participated in economic growth in a variety of different ways but just as crucially we're able to step back from things if conditions are not right for us doing business and often that can be as important as being able to step in to doing new things. So net net we have many options for growth and we're well positioned to pursue them

On that note I'll stop and we'll move into what will hope will be the most valuable part of the morning for you which is the questions and answers. Thank you very much.

Sir Tom McKillop: So we're ready to take questions but can I remind people please to state their name and affiliation before placing their question. Yes?

Jonathan Pierce: Thanks a lot, it's Jonathan Pierce from Credit Suisse. I've got two actually, the first one is just on the gains in the corporate banking, global banking and markets. Can you give us a feel for how much of the 630 was property related versus private equity? Also in terms of H2 guidance at the pre-close you suggested there would be a better balance between H1 and H2 than there was last year, is that still the expectation?

Guy Whittaker: I'll take the second one, do you want to comment on the first one Johnny?

Johnny Cameron: About 50/50, maybe 2/3 private equity.

Guy Whittaker: The mix overall, I think we guided at the full year to a number over a billion probably in line with last year and last year you'll recall was the 1280 number, it feels like 50/50 is a better balance than last year's 1/3, 2/3.

Jonathan Pierce: Ok. For the second question, thank you very much for the income detail, the updating of that, that's very useful but can I perhaps invite Johnny to talk a little bit about trading performance in July and maybe if we can have a few extra figures if possible on the actual balance sheet exposure to some of these areas leveraged lending whether there's problems getting some of this stuff away and also perhaps a comment on exposure in the CDO market and equity bridges, all that sort of stuff.

Johnny Cameron: I'll answer as much of that as I can starting with the remark about July. First of all we've got momentum in GBM as well as in the group as a whole and I think it has actually underlined some things that Guy said, the growth in GBM is after taking the hit of -15% in sterling terms in GBM North America, so there's very good business being done in GBM and I'm particularly proud of the trading performance through the sort of quite volatile markets we've had. The answer is that has continued in July, July again we've had a good month, we're ahead of last year in July across GBM as a whole and again I think that's a tribute to our trading. Our FX volumes were fantastic last week, our FX volumes were three times the weeks we were having average weeks, three times average week. We were doing tickets of well over 100,000 tickets a day, I think our peak was Friday, 135,000 tickets in FX on Friday so we're seeing some very good business come out of the volatility and I'm very pleased with the way that our traders are taking advantage of that and working with our customers to generate good numbers.

In terms of answering the portfolio questions, our portfolio as I said at the full year results that our portfolios were modest, they've got much more modest since then but giving you actual numbers I think is misleading, it's better to look at the overall context and look at the results which I'm just quoting you for July. We have hedges in all sorts of places against the various portfolios so to pick one portfolio and say it's x billion then I have to give you the hedge, then I give you the hedge on the hedge and I think we end up in a difficult place. We've cut back a lot since the year end of '06 in our exposure to these sorts of markets and I told you then that they were very modest. We've taken no credit losses any more in the portfolio. Generally while volatility has made for some difficulties, it's made for some opportunities as well and I think that we will stabilise in due course, hopefully in September, August is pretty much a holiday for the markets anyway so I think August will be a very big holiday this year but coming back to September we see the business resuming. It's a good thing too, just to repeat something that others have said this week, it's a good thing to see this correction. A correction was overdue, I think all the commentators and indeed ourselves felt that a correction was overdue. I think the fear would be – talking leveraged finance here – the fear would be that a correction would come following a credit event – that is not the case. This is purely confined to the markets. We are very happy with the credit of the things in our portfolio, remain happy with that so while I'd rather that there wasn't volatility I suppose in some cases it's actually an opportunity in a lot of other cases.

Sir Tom McKillop: Thanks Johnny. Other questions? Yes, there's one over here.

Questioner: On the same point on page 34 of the release you give figures for the movement in available for sale reserves, a loss of about 825 million, a year ago a profit of about 3 billion. I wondered the extent to which capital markets and assets that are not mark to market where losses are only recognised on sale might be a factor in that 825 million negative?

Johnny Cameron: Could you just repeat the question actually?

Questioner: I wondered on the 825 million movement in reserves for available for sale assets the extent to which that might reflect the write-down of debt capital market assets?

Johnny Cameron: No, I don't have anything to do with that.

Guy Whittaker: I think it pertains to the reduction in the holdings in Citizens, we saw a significant reduction in the AFS portfolio. We'll pick that up and come back to you outside of the meeting.

James (DKW): Good morning, it's James here from Dresdner Kleinwort. I've got a question on RBS Insurance please. Does the fact that we've already had two one in 150 year events this year already affect your reinsurance going forward? So if we have another set of floods in September are you going to have as much cover as you've had from your reinsurance already this year?

Gordon Pell: The short answer is yes we will have the same cover. We are reinsured for not catastrophic events but actually at this level the reinsurance is not a huge offset to the losses and the pricing reinsurance means that you would actually over the period of time pay away the majority of your profits to the reinsurers. Clearly the frequency of these events is going to change the dynamics of reinsurance pricing. It's going to harden the pricing for home insurance and it's really going to make it absolutely crystal clear to a number of people who aren't insured or underinsured that that's a very dangerous thing, so it should also push the demand but it's clearly going to put upward pricing pressure into the market. Who knows that whether the metric of a 150 year event has really changed, obviously it could be statistically speaking that they are still one in 150 year events. I think all of us would intuitively feel it feels like something's changing there, so we will see those metrics change and reinsurance will clearly get more expensive.

James (DKW): Do you know if you're going to be looking to lay off more risk or less risk or it just depends on the pricing?

Gordon Pell: I think it will be the latter. It's always a business decision about the balance between the risk and the return that you forecast, so we'll have to see how the perceptions of risk change.

Sir Fred Goodwin: It's probably just worth observing that this point that all of these claims we're taking on the chin so there will be no reserve movements. The reserves do make provision if you forgive the pun for a rainy day – that has not been touched so these have just been taken on the chin.

Sandy Chen: It's Sandy Chen from Panmure Gordon. Just two questions maybe trying to follow up on the earlier question about mark to market, on just the corporate markets, that asset backed number of down 23% to 614, could you give a bit more colour on that in terms of is it mainly mark to market losses or what was driving that decline?

Johnny Cameron: It's a bit of both. Some securities have been mark to market but the main thing really is loss of volume, we've been originating a lot less during the first six months of this year in the residential area. It's worth noting that the commercial mortgage backed has carried on, it's been pretty good actually in the first six months.

Sandy Chen: Ok, so in terms of outlook into the second half, would you expect us to just draw the line carrying on downwards in terms of extending that volume assumption given that you've said you've done a very good July?

Johnny Cameron: I don't think we'll see volumes in the sub-prime space in particular recover any time soon.

Sandy Chen: Ok. Then just a balance sheet question, I notice that the derivatives long item on the asset side went from about 117 billion to 183 billion just on the face of the balance sheet. What explains that upward movement on…?

Guy Whittaker: It's a similar increase on the liability side as well so it's just the gross amount of revaluation gains and losses in the derivative books.

Johnny Cameron: Just to add to that you've seen quite a significant movement in interest rates and that's really what's driving it is the mark to market on interest rate swaps in particular. As Guy said it's balanced but it's bound to move.

Stephen Andrews: Good morning, it's Steven Andrews from UBS. A couple of questions for Gordon please, firstly can you just give us an outlook on how you characterise the outlook for UK retail banking revenues at the moment? The second question comes back to how you've been repositioning that retail bank. I think there's been a much greater emphasis on pushing product through the branches and de-emphasising direct channels over the past 6-12 months or so. Can you give us an update on how that repositioning is going and whether there's more appetite for direct channels going forward now?

Gordon Pell: Yes, that's fine. I think income has been tracking pretty much as it did in the second half of last year. The only two events we're having to deal with is obviously there's a continued regulatory effect, not obviously the refund effect but the effect of greater scrutiny on PPI and also greater awareness of paying overdraft administration fees anyway. I would say that's probably worth about 1% in income. The other effect has actually been the point you actually made yourself, re-positioning the business away towards franchise growth rather than direct growth and the rundown of that direct lending book has probably cost us another 1% in income which will actually annualise out towards the end of this year, so we're tracking perfectly sensibly I think and you can see the benefit of the policies we've put in place two years ago obviously in the impairment line. So as I said previously you can't necessarily have your cake and eat it. The good news I think is now that we really feel pretty confident on the impairment side, we saw it flat in the first half of last year. I think by December we were beginning to suspect we might actually see it turn down, that's obviously now come through. I feel the models are now quite well reset, so we've gone back into branch lending reasonably aggressively, branch lending in the first half of this year has been up about 19% in volume terms as part of a 22% increase in branch volumes generally. I think I'm also getting to a point where I actually feel confident enough now that we can start selectively going back into the direct markets. The models I think are reasonably stabilised. Impairment new flows are 14% down and bankruptcies and IVAs are both down in single digits, so I think I've got enough feeling of what's going on in the market to actually open up some of the taps in direct channel as well. It'll take time to flow through but I'm a lot more confident than I was a year ago.

Bruce Packard: I just wanted to ask about sale and leaseback gains in Citizens, I'm not sure you gave us a number for it last year but there were some in there last year, if there are any in there this year? Also just a second related question would be on the appetite for prime because it looks like although your margins were stable in the US business that the balances haven't really grown, the mortgage balances so is there a sort of reduced appetite for prime mortgages going forward?

Guy Whittaker: We didn't disclose a discreet gains number for Citizens last year and we're not intending to for this year. Actually the numbers are pretty similar, there's a $14 million difference between last year and this year and the level of gains that we see is sort of consistent with the sort of sustainable numbers that we see going forward.

Larry Fish: The appetite for business remains, the demand is weak so the slow down in the growth of balances is really a reflection of a very slow housing market in the United States. In some parts of the country you could almost describe it as recessionary, but there's no lack of appetite. Our models to qualify credit where we qualify it both on the consumer credit score, the loan to value of the property and the income of the borrower have proven very successful over time. We would do all the business we could if there was business to do.

Questioner: I wonder if you can comment, you gave us an indication that your income in GBM in July was above the same period last year. Could you please comment on your credit trading bar in that same way, qualitatively at what level it is at the end of July compared to where it was last year and particularly is it much above your maximum that you reported on page 47? Many thanks.

Johnny Cameron: Our credit trading bar like all our bars remains modest compared to our peer group, it's up about 10% year on year and didn't change that much in July.

Derek Chambers: Derek Chambers from Standard & Poor's Equity Research. Can I ask two questions about China? One is you mentioned the growth in head count in Asia Pacific and I wonder if you could say how much you've actually got for your direct operations in China and perhaps comment on whether that's in profit now or what's happening to the China operations? You've got some comments scattered through the report about the movement in the value of your stake in Bank of China which I suppose goes partly towards that AFS movement but I wonder if you could just clarify what part of that movement is for your own account and how much is for minorities?

Gordon Pell: The head count number I referred to is outside of China, not in China, Fred, if you want to pick up…

Sir Fred Goodwin: The head count in China has not gone up by a huge amount. We would have 60 or 70 people in China, so the bulk of the head count increase I referred to earlier was on our wholly owned businesses in Asia generally, not specifically in China. The activities are floating around the break even mark. As predicted with the joint ventures in China they'll take their time to come through. They'll certainly take a long time to become material to the results of the RBS Group, so the figures are de minimis around about the break even point. The final point was on the treatment of the value…

Derek Chambers: In the report you give some various comments about the change in the value of the stake in Bank of China and I just wondered if you could clarify how much of that is for your own account and how much is for…

Sir Fred Goodwin: The number I quoted on my slide is purely for our account, that's just our half of it.

Guy Whittaker: The gross value of our Bank of China stake in sterling terms fell by £825 million as referred to on page 34. Does that answer your question?

Derek Chambers: 825 is including minorities and the 300 is excluding? Is that the weighting?

Guy Whittaker: That's the gross and our share of that is 300.

Questioner: Thank you, good morning. I'd just like to follow up the earlier question on Citizens if I may. I understand there's a reduction in demand for prime mortgages in the US at the moment, that's perfectly understandable but it's also interesting that your customer deposits don't seem to be growing at all and margins are stable. It looks like this is a business essentially that you're harvesting and yet which is quite surprising. I thought this was a business that you really saw as having very good long term growth prospects, so perhaps I would just invite you to reassure us that you do see a lot of growth in that business and it's not just a business that you're just running for cash.

Larry Fish: I welcome your invitation. We're certainly not harvesting. The competitive environment for deposits in the States is very difficult. We have a flat to inverted yield curve. Until this more recent adjustment in the stock market financial assets have looked a lot better than bank deposits and with higher interest rates people are being much more careful with their money, so you have an environment where deposits are very competitive, both the volume isn't big and the pricing is very tough and it isn't at all…we're very pleased that we were able to grow them at all. A number of banks in the United States had negative growth in their deposits in the first six months and we continue day after day, week after week to do our very best to grow our deposit book. It continues to be a core part of our business. We're opening 60-70 new supermarket branches on long island, we're looking for new branch opportunities in key markets like Philadelphia and Chicago. We continue to invest very aggressively in the business. I hope that answers your question.

Questioner: It gives me some reassurance but I'm still thinking about what might we think in terms of dollar terms what the growth of this business might look like because it's clearly been flat over the last 12 months, albeit we know there's pressures in the housing market but it doesn't sound like they're going to abate very quickly so the structural headwinds that were referred to as being abating with Citizens, it doesn't sound to me like they are other than the yield curve effects?

Larry Fish: I think I'd answer your question that my belief is that the worst is over but the cat is not going to bounce off the floor to double digit growth I believe. It's going to take some time, it'll be gradual. I hope that's helpful.

Questioner: Ok, thank you.

Simon Willis: Thank you, it's Simon Willis from NCB. The question is still on the States to do with the prime mortgage market as well as the sub-prime, so it applies to Citizens but also to the markets business. Firstly in the prime mortgage area has there been any sense that competition has escalated as people have perhaps looking to tilt their books away from sub-prime and near prime more towards prime mortgages and if that hasn't happened yet, would you expect that that may happen on a 6-12 month view? Secondly I guess more from the market side volumes in the markets as you flagged for residential for RMBS in the States has fallen particularly in the sub-prime quite heavily. How long do you think it might be before we start to approach last year's levels for example? Could it be 6-12 months or could it be three years or never?

Larry Fish: On the prime market, the prime market for mortgages and second mortgages in the United States is much more relational than the sub-prime which is more transactional. The kind of people who do business with us in the prime space are…they're going to check a rate or two before they make a decision but they generally bring their business to their relationship bank. So I think what you're seeing is a firm like Credit Suisse or Bear Stearns going to be competitive in the prime market? I think it will be more difficult for them so while there's always competition I don't think it's going to be heightened by people effectively taking the sub-prime model and migrating it to the prime space because it's a different kind of banking. As far as sub-prime goes is that me or is Johnny going to handle that one?

Johnny Cameron: If I absolutely knew the answer to that Simon, I wouldn't be here, I'd be on a beach, but it's not going to come back in six months. It'll be after this year.

Simon Willis: Can I ask, I'm not sure who might wish to answer this but in terms of the restructuring of the industry which going back a few months was clearly involving regulators, politicians not surprisingly wanted to get involved and others, would you care to make a comment on how far you think we've moved down the path in terms of the regulators leaning on the banks who are directly involved in that market to sort out the issue? We've seen with one of your big competitors with a direct exposure there that they've clearly moved down the road some way but on a broader industry view do you think there's been a significant move in that respect or has that not even started yet?

Larry Fish: I think I can handle that Johnny. I sit on the National Commission of the Federal Deposit and Insurance Corporation, a national commission that was constituted before the sub-prime events began to happen and the Commission is around financial inclusion. We've met now a number of times. The Federal Reserve has powers, statutory powers, legislative a number of years ago by Congress that to take steps as it relates to mortgage lending and I suspect that there will be some changes, changes possibly around pre-payment penalties, changes that could…regulate might be too strong but certainly put more controls, more discipline around the players in that market than has been the case historically.

Johnny Cameron: I might just add to that, I think that markets will impose more discipline. At the end of the day lenders want to get their money back and the ultimate lenders here, the investors in the securities and so on, there will be renewed discipline around underwriting standards and those sorts of things people won't want to see some of the excesses of '05-'06 repeated. So there will be market discipline for that as well.

Simon Willis: If I could a one-liner just on GBM, the impairment charge just ticked up by a couple of million sterling. Were there any significant one-off releases of provisions that you might wish to…?

Johnny Cameron: Last year there were a couple of releases so that had an effect on the movement, but this is a rounding error.

Robert Sage: Thank you, it's Robert Sage from Bear Stearns. Just a question, we've had a couple of questions on the margin. I notice within your commentary within retail markets that you comment that the net interest margin was stable there and I was wondering whether you could comment in terms of whether this is an offset between possibly a sort of narrower asset spread and sort of improved deposit spread; and secondly possibly what your view would be going forwards into the second half of the year and if you could possibly extend those comments in terms of what the group margin outlook is? I seem to remember you saying the full year margin could be zero to 10 basis points down this year, whether that guidance still holds good?

Guy Whittaker: I think for group margin zero to 10 looks like it's going to come in the full year out term, yes. It was down three at the half year.

Presenter: Retail markets, I've always made it quite clear that as a matter of general policy holding our margin firm I always regard it as a good, safe haven in difficult times so we've obviously taken that policy quite clearly. There is clearly pressure on asset spreads, you can see that in the reports for various mortgage banks. On the margin in the intermediary market it's quite difficult to see where people are making money, I've had my usual quiet first half in the intermediary market. That must have set back into the mortgage margins and obviously personal loan margins have been affected by the rise in base rates, so yes, asset margins have been under pressure. In fact we've been growing our sales book very strongly ahead of the market now for two years, obviously it's come home to roost in the sense we've been able to widen the margins out and we've been able therefore to keep the sort of overall balance flat. I suspect those trends will continue into the second half of this year but I'd prefer to be coming off whatever the situation is for the margin I've got at the moment.

Sir Fred Goodwin: It comes back a bit to the diversification comments again, not having to pursue a particularly line of activity beyond irrational has had a step out of and perhaps back into direct. I think the margin has been one of the beneficiaries of that.

Anthony Broadbent: Good morning, it's Anthony Broadbent from Sandford Bernstein. Just coming back to the current turmoil in the capital markets and the possible impact. One of your competitors quite helpfully this week share the view with us of $80 billion of deals that they've done, only around 2% of currently stock on the balance sheet is deals that they can't get away. I was wondering if you could give us a similar feel for the order of magnitude of the size of the deal flow that has similarly impacted for you and also the bridging financing volumes that you've currently got out there?

Johnny Cameron: I don't actually think that is what my friendly competitor said, I think he said that they'd done $80 billion of deals over the last 10 years and 2% was currently in his portfolio which I took to mean the whole portfolio as opposed to what is his underwriting book which I don't think he gave a number on. Our whole portfolio has been coming down over the last three years, it's in the same sort of general ballpark of that, we've done slightly more deals, the portfolio is very slightly larger but our whole portfolio remains very modest. Our hold levels are on average at £32 million per deal. All banks active in this market have an underwriting portfolio that currently as I said earlier, there's a hiatus going on in the market, we expect to be looking to sell that in September. We're comfortable if we had to sell it today at the sort of prices we think were the clearing prices we'd sell it at a profit but I'm not in a hurry to sell, I'm very happy with the credits. We're going to sell down when the market has stabilised and when we've got prices that we think are the right prices to sell at.

Anthony Broadbent: Any comments on the bridging finance?

Johnny Cameron: I included that in those comments.

Sir Tom McKilliop: It looks as though that's the end of your questions. Thank you very much for those questions and good morning.