Interim Results 2006

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 Friday 4th August 2006.

Top table:

SIR TOM McKILLOP (Chairman)

SIR FRED GOODWIN (Group Chief Executive)

MR. GUY WHITTAKER (Group Finance Director)

MR. LARRY FISH

MR. GORDON PELL

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THE CHAIRMAN: Good morning, ladies and gentlemen, and welcome to our 2006 Interim Results presentation. It is a special pleasure for me to welcome you today as this is our first set of results since my taking over as Chairman.

The past 9 months have been really fascinating for me personally as I have learnt about RBS and how it operates. What I found is a truly impressive company with a focus on creating opportunities for growth, then realising those opportunities through speed and excellence in execution. I believe today's results, based as they are purely on organic growth, amply demonstrate these fundamental strengths and the sustainability of the Group.

Guy and Fred will take you through the results in more detail, so I only have one slide summarising the headlines, in fact, you must all be suffering from ‘slide fatigue’ at the end of a long difficult week so we will try and move along smartly and get to the discussion as quickly as possible.

Total income for the first half rose by 10 per cent to £13.642 billion; coupled to significant productivity gains this resulted in Group operating profit rising by 15 per cent to over £4.6 billion, and adjusted earnings per share rising 10 per cent to 95.2p.

The financial strength of the Group has enabled the Board to continue its dividend policy of announcing an interim dividend of one-third of the previous year’s total resulting in a dividend of 24.2 pence, an increase of 25 per cent.

During the first 6 months, £200 million worth of shares were also repurchased and it is our intention to complete the remainder of the £1 billion repurchase announced earlier this year during the next period.

So, I will now hand over to Guy to take you through the results in more detail.

MR. GUY WHITTAKER (Group Finance Director): Thank you very much, Tom. Good morning and welcome. It is nice to see you all here. No doubt pretty much all of you in the audience by now will have seen the Company Announcement that we put out a little over two-and-a-half hours ago, and in that I think you will see what we consider to be an excellent set of results, with a strong performance across all of the Divisions of the Group.

What I would like to do over the next maybe 15 or 20 minutes is spend some time not just talking about the numbers but also just talking about the main themes that have come out of that for the Group as a whole, and also across our major operating Divisions, and then hand it over to Fred who will share with you some of his thoughts about the Company and its direction and what the outlook will be for the future.

As Tom has mentioned, a very good set of numbers led off by strong income growth up 10 per cent to £13.64 billion. Combined with good expense discipline and a very strong credit performance, we saw operating profit up 15 per cent or £603 million to £4.603 billion. After intangibles and integration costs and, of course, a sizeable tax bill our attributable profit to Shareholders was £2.978 billion, up 18 per cent over the prior year.

The basic EPS at 93.1p, up 17 per cent; adjusted up 10 per cent at 95.2p; our tier 1 capital stable in the mid-7s at 7.6 per cent, and return on equity 18.5 per cent, up from 18.2 per cent for the full year, 2005.

So income grew by just under £1.2 billion in the first half of 2006, but in that our UK businesses grew by £643 million, up 7 per cent over the prior year, and our International activities contributed 17 per cent growth or £545 million more than in the prior year.

Our net interest income grew 9 per cent to £5.19 billion, our net interest margin coming down just 5 basis points from the second half of last year to 2.45 per cent and very much in line with the guidance that we gave you at the Full Year Results and very much in line with our plans and expectations for the year. Net interest income was stable at 38 per cent of Group income.

Our non-interest income grew £780 million, or 10 per cent, to £8.448 billion, principally made up of fees, trading activities, operating leases, insurance gains and other. The proportion at 62 per cent, again the same as in 2005.

Our income grew by £1.88 billion it was supported on a cost base that only grew 8 per cent, or £463 million, allowing our cost:income ratio to fall from 42.2 per cent to 41.9 per cent. You will notice a big contributor to that was the Manufacturing costs which grew just 3 per cent, I think very much demonstrating the strength of the business model that we have.

In a departure at least from prior results, if you have had time to look at the Company Announcement, you will see that for the first time we have made some attribution of those Manufacturing costs into each of the Divisions, in part in a response to queries and questions that you have raised but also as a way of demonstrating I think the business model that we have more effectively.

The way we run the Company is unchanged. Each of the Divisions remains responsible for its income and its direct expenses but the shared costs of operations, technology, purchasing and property remain managed as a single number within Manufacturing.

I think it clearly demonstrates if you look at that 3 per cent rise, a contribution to 8 per cent cost growth, the benefits of having a scaleable platform and those productivity gains have allowed us to continue to make investments across all the Divisions in our service and customer-facing activities. Operating profit pre-impairment losses grew 13 per cent over the prior year.

The credit environment has been strong. We have a quality book, we have a very good risk and control environment. Our impairment losses grew 5 per cent over the prior year, or £40 million, up to £887 million. On a book of £352 billion sterling our risk elements in lending and potential problem loans were up just £449 million and now represent 1.64 per cent of the book, little changed from the same period last year when it was 1.63 per cent.

Our provision coverage at 63 per cent is very similar to the 65 per cent that it was at the end of last year and we are very pleased with the overall performance of our credit across the entire portfolio.

While it is a strong overall number there are sort of three distinct elements to the book. In the US our exposures are dominated by retail activities. There we participate in the prime segments only. I think we probably have the highest quality portfolio amongst the Top 20 US banking groups and we are seeing no stress appearing within those portfolios and impairments, up 11 per cent, are very much in line with underlying balance sheet growth.

The corporate sector is very benign, impairment losses actually fell from £185 million in the first half of 2005 to £97 million in the first half of 2006, a drop of 48 percentage points. The recovery number was broadly similar and it really does reflect the very benign corporate environment that we are currently experiencing, corporate cash flows remain strong and there are no emerging signs of stress at this point in time. The portfolio quality is broadly stable year over year and is well diversified by industry and by geography.

In the UK, you can see from our Retail Markets business our losses grew 19 per cent year over year. This is all driven by retail unsecured and I would just like to take a moment to talk about that.

UK unsecured lending, costs rose 20 per cent year over year. You can see from the left-hand side of that slide that the pace of those losses appears to have slowed at this point having risen 43 per cent in the first half of 2005, 47 per cent in the second half, the drop to 20 per cent in the first half of 2006 was very welcome.

There are two sorts of books within the unsecured portfolio, there is a cards book and a personal loans book, and there are slightly different patterns in each of those. Within the cards portfolio losses grew 14 per cent year over year and I think if you look at those top lines in the slide you can see us sort of divergent from the market but actually stable at this point in time.

We think if you look back the period covers May of 2005 up until May of this year, you can see that portfolio appears to have stabilised and I think presuming the macro-economic environment remains broadly where it is we think in the case of the cards book, which is about a third of the unsecured portfolios, the worst is at this stage behind us.

On the personal loans side, things feel a little better but it is probably too early at this point to declare complete victory. Our losses rose 22 per cent year over year and the bottom right-hand little graph on the slide there on personal loans really shows the flow of loans that are currently impaired versus the size of the portfolio 18 months' ago, and that is the sort of typical emergence period for problem loans in the personal sector.

It does show that arrears are still rising. It shows that pace of increase is moderating and, as I think Gordon maybe said about this time a year ago, he thought it was perhaps an 18 months to two year workout to get through this in the personal sector, and it feels sort of like that, was a very astute forward-looking comment, and that is broadly speaking where we feel we are at this point in time.

So if you add all of those things up, I think we are very pleased with the quality, we are very pleased with the depth of the earnings that we have achieved in the first half. We have positive growth across all parts of the Company, we have made very good franchise developments in each of our Divisions, we have got strong income, good expense control, good credit performance and a very pleasing operating profit, up

15 per cent, of which 43 per cent came from our International operations, up from 41 per cent this time a year ago.

I just want to spend a few minutes now running through the main Divisions. Corporate Markets - it is hard to imagine that it was established on 1st January this year - two Divisions: Global Banking & Markets, focusing on international financing and risk management to large top tier corporations and institutions around the world, and UK Corporate Banking, UKCB, the leading corporate bank in the United Kingdom.

Corporate Markets grew income £508 million in the first half of the year, expenses by just £220 million and saw operating profit with a favourable credit performance up 21 per cent to just over £2.7 billion. Within that, two sort of Divisions: GBM had a terrific first half, gained leadership positions in underwriting sterling bonds, was the leading underwriter of US mortgage-backed securities, was number two in asset-backed securities in the United States, and for the first time moved into the Top 5 globally in all bonds and loans underwritten.

Our European business grew 40 per cent, our fees grew 36 per cent, within that underwriting fees over 70 per cent, and operating profit up 24 per cent to just over £1.8 billion. Our income from trading activities - the stable and low VaR of £13 million - was up 15 per cent in the time period.

UK Corporate Banking: income up 9 per cent, credit again a positive story and operating profit up 14 per cent at £907 million, with good growth in loans and deposits, credit losses falling from £95 million to £78 million in the like period, and the quality and metrics of that portfolio also remaining strong.

In Retail Markets, income growth of 6 per cent, disciplined costs helping offset some of the rise in impairment losses from £570 million to £680 million, saw our operating profit growing by 6 per cent to £1.26 billion

For the first time in a long time our deposits actually outgrew our lending in the Retail Divisions and two things sort of drove that, firstly changing consumer behaviour, a greater propensity to save and a slightly lesser propensity to borrow, but also in part a conscious decision on our part to focus on assets that offered attractive risk return characteristics particularly when using the intermediary channels.

So our mortgages year over year grew 10 per cent but a larger part of that growth was in the second half of last year and we doweled back that in the first half of this year as pricing and risk return options look less attractive and we chose to focus our lending elsewhere. Our small business lending grew 10 per cent over the time period; our personal unsecured loans were pretty much flat.

Growth in current accounts and particularly in savings accounts where our deposit base rose 9 per cent, and the combination of that helped keep our net interest income margin stable at just a couple of basis points lower over the period. Sales in investment products were strong, our bancassurance APE up 88 per cent; we continue to make investments in financial planners and in business banking.

Our Wealth Management Division produced an operating profit of £179 million, up 27 per cent over the prior period, with the principal driver of that being strong investment management fee growth.

Now, Ulster Bank. I think the phrase is a buoyant economy and growing nicely in that buoyant environment, income up £63 million or 15 per cent. We continue to invest in expanding our branch distribution and our business centres. We are building our retail business particularly in the South of Ireland, in the Republic, and also investing heavily in our corporate banking business. Expenses up £23 million, or 18 per cent; credit costs very much in line with portfolio growth, up £7 million or 23 per cent; and the operating profit at £182 million, up 20 per cent over the prior year.

We are a long way through a major project to integrate the Ulster Bank operating platform into the Group IT technology programme. There have been some initial tests of that, that work is progressing well and that will deliver I think enhanced product capability and also productivity gains for the future when it is completed later this year.

Headline numbers for the Citizens Group were up 8 per cent over the prior year. For those watchers of foreign exchange markets, the half over half average FX rates 2005-2006 were 187 versus 179 this year, so in US dollar terms headline income grew 4 per cent, expenses grew 3 per cent, impairments as I said earlier very much in line with expectations, and operating profit overall up 4 per cent.

The customer side of our business continues to make extremely good progress: personal lending up 11 per cent period over period; business lending up 14 per cent and deposits up 5 per cent on an average basis, up 10 per cent on a spot basis over the middle of last year. Customer satisfaction numbers are up, attrition levels are down, but the environment remains challenging. It is a very, very competitive environment.

The rise in interest rates that has taken place since the middle of 2004 has introduced a much higher degree of sensitivity in our customers about deposit pricing, that aligned with the competitive situation means that there is significant margin compression that is taking place, particularly on the liability side of the balance sheet, and net interest income overall is flat on a year over year basis.

Our non-interest income in the period has grown 11 per cent, principally fuelled by corporate and retail fees, some gains, and also an increasing proportion of foreign exchange and interest rates derivative activity as well as a growing cash management function. The credit portfolio remains good, as I said earlier. It is a prime portfolio, FICO scores average 700 plus, 650 typically being the cusp point, so a very strong portfolio, 95 per cent of which is secured. We continue to manage the costs very aggressively.

We are investing in opportunities, particularly around growing some of our cards businesses, customer numbers up 25 per cent year over year; our merchant acquiring business, RBS Lynk, is up 17 per cent year over year; we continue to invest in business banking across the region from small business through to mid and top tier corporates, working very closely with RBS in New York and with our partners at Greenwich Capital.

In RBS Insurance, it is a tight market and in a tight market we grew income by 3 per cent, we kept expenses flat with productivity gains offsetting an increment in marketing expenditure. Again a little bit similar to the mortgage story, we are maintaining a very disciplined approach to pricing in the market place. We are focusing on areas and segments of the market that we find attractive.

We are working hard to mitigate the claims inflation by better risk profiling and by higher excesses, so claims inflation again up 5 per cent has outstripped growth in premium income, but with the measures we have taken we have contained our claims inflation to 3 percentage points.

Our combined operating ratio at 93.8 per cent remains the lowest in the industry although it is up slightly from the 93.3 per cent that we achieved in 2005. We are making good progress on our commercial and small business policies and we are very pleased with the 14 per cent growth that we have seen in Europe, contributing to a 17 per cent rise in income in Spain, Italy and Germany.

Finally amongst the Divisions, our Manufacturing Division. I think again a demonstrable strength of the business model of the Group, holding expenses growth to just 3 per cent. The three main areas here are technology, purchasing and property, and customer support.

Technology costs grew 1 per cent but within that our production support was down 2 per cent and we continued to invest in development which was up 3 per cent. Our property upgrades: we talked at the Full Year Results about a programme of city centre consolidation and continuous branch improvement; we continue to make those investments and property expenditure grew 11 per cent over the time period. But our core operations and customer support costs were flat.

Despite increasing volumes we put 10 per cent more cash through our ATMs, we have put 11 per cent more deposit accounts on the books, we made staggeringly over 1 billion BACS payments, up 7 per cent year over year, and all of those increased volumes fully funded through productivity gains, and you saw the power of that coming through into the growth in the operating profit earlier on

From a capital position, risk-weighted assets grew 5 per cent on a spot basis over the period, balance sheet emphasis very much on origination and also increasingly on distribution, and we kept our ratio stable at 7.6 per cent, flat to the year end. Total capital 11.9 per cent. For those of you who follow the core Tier 1 number, we achieved 5 per cent, up from 4 per cent in the prior period and 4.9 per cent at the end of the year.

First half capital generation supported balance sheet growth, it supported a final dividend payment of £1.7 billion and it also funded £200 million of our share buy-back programme. We announced a £1 billion programme at the Full Year Results, which the Chairman alluded to, and we remain on track to buy the balance of that, or £800 million, in the second half of the year.

With that, I will pass over to you, Fred, to make your remarks. Thank you.

SIR FRED GOODWIN (Group Chief Executive): Thanks, Guy, and good morning everyone. Hopefully from the Company Announcement and from Guy's presentation you would have got a pretty good sense for the numbers themselves. I think they are a particularly straightforward set of numbers, there are no new splits in terms of the Divisions, IFRS is in both periods, there are no legs of an acquisition one way or another, so as straightforward a set of results as we have issued probably for some time.

So, I don't propose to go over a lot of the ground which Guy covered but I am happy to go over anything in questions. What I would like to do is principally address myself to the topic of outlook, although before doing that there are just a couple of sort of almost housekeeping topics which if I could just briefly go through them.

Customarily at this point in proceedings I would give some sense of the Group strategy, what we are thinking and where we are going. I don't really feel a great need to do that at this point, I think it is very well understood. We circulated and we produced a slide here from last year: the key message I guess is that, that there is “no change” in what we are proposing to do.

If I pick out a couple of elements from the content of that slide, we do see the opportunity to evolve some of our strategic direction, for instance, in Global Banking & Markets. Some of the product areas we are in we would like to deepen our involvement, a little broadening here and there, but nothing drastic, nothing to write home about and certainly we have no plans for any large acquisitions. The main message is the two words at the bottom “no change” on strategic direction.

It is very much about leveraging the platform that we are on, which brings me neatly I think to the second point, and Guy has covered most of this, but again I would just like to emphasise it. A big feature of these results and a big feature of our results for some years now has been the Manufacturing platform. By virtue I guess of there not being any acquisitions involved this year and nothing on the accounting this is the first opportunity I think to see Manufacturing in-the-round.

We had an investor presentation a few years’ ago now which featured Manufacturing; I think some of you then began to see the potential for Manufacturing. I think the results we are presenting today let you see in full the reality of Manufacturing.

Costs up 3 per cent. If we were to take out some of the property costs associated with our expansion in Asia, for instance, and some of the expansion in the UK we have actually got flat technology costs and flat customer support costs against a backdrop where we grew our income by 10 per cent and in many of the volume areas, the day-to-day money transmission processing, for instance, volumes were up very significantly.

Whilst we can't guarantee for ever to keep these costs flat, in fact, we hopefully can guarantee not to keep them flat because the growth in the business would be too much, there are very significant 'jaws' here and this platform does give us a real competitive advantage.

One of the things we have done, and Guy touched on this as well, is we have allocated the costs. I know this is a subject that with many of you we have had dialogue about this over the years. I think two separate aspects to this. We do not allocate these costs internally. It is very important and it has been a big cultural step for us not to maintain and support the industry, which usually goes with cost allocation at detailed level, and not to support the sort of internecine warfare which often goes on within the organisation associated with arguments about that allocation.

So we are very comfortable with the culture and behaviours which are generated within the organisation and how we go about our day-to-day business of managing the cost base - and the responsibilities there are very clear and we are not signalling any change in that backdrop. However, it does clearly make life a little easier and, in fact to be selfish about it, it does help us to get the message across I think about the Manufacturing platform if we make an allocation.

I would stress that this is a top down allocation, it is an allocation which we think is reasonable. I have put the figures on this slide there, and you will all have worked these out already, but just in case anyone hasn't, you will see that the basis we have used in 2005 for the comparatives is the same as the basis we have used in 2006. They are reasonably round numbers here. It is not the only allocation you could come up with, it is probably not the only reasonable allocation, it is simply the allocation which we think is reasonable. I hope that it is helpful.

We have chosen to do this in a way which is transparent so you can see the Manufacturing costs allocation in the face of the Divisional P&L, so for those of you who preferred the old model it is still there for you to see, but for those who wanted an allocation it is there. I am sure it does facilitate comparison of our Divisions with other business units and our competitors.

Also, under the sort of miscellaneous business heading, just a brief update on China. I think you have all followed the success of the Bank of China IPO and I don't think there is anything else I need to say about that. There is nothing reflected in any of the P&L numbers that we have spoken about today or indeed it sort of washes through the balance sheet, it is not driving the capital ratios or anything else, but the figures are there for you to see.

On the business co-operation front things move along really quite well. We have issued about 450,000 or so credit cards now out of the joint venture, and corporate banking is moving ahead - we have done a number of deals together. It is very much essentially that once you have done one deal in a particular area like shipping or an aircraft it makes the next several deals considerably easier. So, good progress being made there.

With wealth management we would expect to have pilot sites open in Beijing and Shanghai very shortly, and insurance has started to pick up quite a lot of pace of late. As we signalled at the outset, we are providing quite a lot of support to Bank of China in risk management, IT, HR, etc., so it is all moving along well and I am sure it is a subject we will talk more about in future.

I said though that my principal objective today was to talk about outlook. I always find it very hard to talk about outlook or even to think about outlook without sort of conditioning it by some view of the economic outlook. This is not the time or the place and I am certainly not the person to present an economics lecture, it is not my thing, but I can’t really go on to talk about outlook for the business without sharing some sense of how we see the world.

I think our view of the world is fairly unremarkable and our view of the world would appear to be very similar to the views expressed by many of your own economists and analysts. The consensus figures we have got on the slide there I think are remarkable mainly in the sense that there is a very tight dispersal or dispersion of estimates around them. We would find ourselves very comfortable with those consensus numbers for 2006 and 2007.

But, of course, we are predicting future events here. We are trying to predict, to boil down, large economies into a single number. But in terms of setting an economic context all I would take away from that slide is that if we could buy those numbers just now I think we would buy them – that looks not an unsatisfactory economic outlook or backdrop at all – so we would feel it certainly is one which is positive for the business.

In the time-honoured fashion though, any economic outlook or any future prediction has to be hedged or couched around with some of the risks. On this slide these are only some of the risks. Again I would not presume to stand here today and tell what all of the risks are but these seem to be the obvious ones. Funnily enough, this slide was prepared before yesterday's rate announcement but clearly it is highly topical.

In looking at those risks I am struck by the following, that these are not new risks. If we were having a conversation about risks a year ago those would have been the risks, probably two years' ago we would have been talking about the same things. They are not new risks and actually all of those economies where I put up growth figures previously have come through this as not too badly so far, they have been pretty resilient, and the policymakers have built up something of a track record.

Now I know it is fashionable to highlight that Mr. Bernanke hasn't yet built up a track record, but he is not a one-man band there and I think the behaviour of the regulators and the policymakers has actually been quite reassuring, so not unbridled joy in the economic outlook front but I think there is a basis there for cautious optimism about the economic outlook in the near term.

So, what does that mean for RBS? Well, again to think about outlook I suppose you have got to work out were you are starting from. It is fairly simple to get a reminder and, on this slide, these are easy numbers to remember, but we have just delivered a 6 month period of purely organic growth:10 per cent income growth, operating profit up 10 per cent, EPS up 10 per cent.

What does that mean about our ability to prosper and grow against the economic backdrop that I have just described? Well, I think we still need a little bit more of a lens on that performance and the first lens I would offer is the track record, a track record of organic growth down at the bottom of that slide. Taking out all of the acquisitions, we have been delivering organic growth and income like this for the last five years – very, very consistent organic growth, leaving aside all of the acquisitions.

We have also been delivering strong operating profit growth, with this year's operating growth actually being at the stronger end of the range in terms of organic operating profit growth. So an organisation that is accustomed to driving organic growth out through economic circumstances, which if we cast our mind back to 2002 we have been up and down a few hills and dales since then.

Also those results did not all come from the same places, and a number of different stories in here, as shown on this slide, as to where that contribution growth came from. I am not proposing today again to go back through it all as a bit of a history lesson, but I stood at this podium and talked about business performance which has varied quite remarkably across these various Divisions during that period. But the Group has delivered very, very consistent performance or very consistent organic performance during that period.

You have heard me on this theme before, that is because our income streams and our businesses are pretty well diversified. None of us can predict future events, none of us really know what is going to happen in the future, but one of the best ways we believe that we can prepare ourselves for it is to give ourselves options, to give ourselves choices, and one of the best ways to do that we believe is to have diversity.

As you look down the chart there, you will see how our income is spread quite widely across differing ranges of activities. Most of our income is non-interest income; that percentage continues to grow. Of the net interest income significant uptake this time in the proportion which comes from deposits; customer behaviour has shifted. We are responding, we are growing our deposits strongly, and you will see that in the numbers and in the Company Announcement.

On the non-interest income front, I think we have some very good quality income streams in there. If I could pick up one in particular on this theme of quality I would pick up the income from trading activities down at the bottom of the slide there, which makes up round about 11 per cent of our income. I'll just have a look at the history there and where that has come from. Again you have heard me on this theme before, but it certainly stands repeating in the current context.

We do have income from trading activities, we are in businesses which generate income from trading activities, but we view them as businesses and we view them as businesses that we are building on a sustainable basis. The trading activities we are involved in are activities principally on behalf of customers, we have got a strong customer franchise behind the income which we generate from these businesses, and so we are very pleased and proud of the progress which has been achieved.

But it is not a one-off, it is not a sort of 'boom or bust', it has been a steady build across quite a wide range of activities. You will see down at the bottom of the slide there both that this has remained a pretty constant, a pretty steady and remarkably so – we hadn't set out to make it always this proportion of our total income! – but it is interesting I think that it bears a pretty constant relationship to our total income. As our business has grown, as our customer franchise has grown we do more of this business.

Also I think interesting is the bottom line figures, the VaR. VaR is not a perfect measure but, as a rule-of-thumb, as a sense of the amount of risk we are prepared to take, you will see that has remained pretty constant through all of this as well. Sometimes people when they look at this type of income stream they think that's not very good quality, it is not very sustainable. I put it to you that this is very high quality trading income and it has a good sustainability characteristic, as those figures show you.

Also I think our performance over the period and our ability going forward to generate strong growth is conditioned by the markets in which we do business. We have, as you know, been working to grow the proportion of our income which comes from outside of the United Kingdom, and again the results we are showing today demonstrate further progress on that front.

But to give a sense of the 'pie' and how it is changing shape, I would like to just give you a sense of what the growth rates are in each of those. This is now cutting across some of the Divisional analysis because clearly in Global Banking & Markets there is some activity in the United States and some of the other businesses have activity in the United States, it is not all about purely what goes on in Citizens.

You will see from that slide a very clear picture that actually we are growing much more strongly outside of the United Kingdom than we are inside, no where more so funnily enough than Europe, and I will come back to that in a moment.

Looking first at the United States, on this slide these are Citizens growth rates in local currency and Corporate Markets. Very strong growth in Corporate Markets, and whilst it is smaller than Citizens it is about half the size of Citizens now. This is a non-trivial business that we are building in the United States in Corporate Markets and it is a business that in conjunction with Citizens we anticipate getting meaningfully larger, but again through doing business with real customers and building a sustainable franchise. 17 per cent growth in Corporate Markets in dollars, round about 22 per cent that would translate into sterling.

In Europe, 40 per cent growth in our income in Corporate Markets, spread around in Europe quite well, but a business that we started off from practically nothing not so many years' ago now – very significant momentum.

Also, to pick up some of the others on the slide there, Guy covered off the Ulster Bank story, but RBS Insurance in Europe grew 17 per cent in the first half. Those are some of the quite small businesses that we have plugged away at for a while; well, they are not quite so small any more and they are starting to pick up momentum quite meaningfully. Also our consumer finance business in Europe, which is in Retail Markets, has started to pick up more strongly than it has for some time. So, a good picture emerging in Europe also.

Finally, Asia Pacific. The numbers are very small. The Corporate Markets number very much less than we would anticipate showing to you in due course in Asia Pacific. Asia Pacific is a very particular focus for Corporate Markets, so one to watch as we go forward. There has been very good progress in the Wealth Management business, but at this stage the numbers are quite modest in absolute terms.

So I think a picture of diversity, of growth, a track record of growth, a range of options going forward. It is all very well though just to talk in terms of income growth and profit but all of that has also enabled us to deliver earnings per share growth over a very long period now and we are well on track to continue that trend this year. So it is not just about profit and it is not just about income and it is not just about growth, it is about returns. Similarly, from the return on equity slide you will see our return on equity has moved ahead in the first half and we would anticipate that trend continuing also.

So it leaves me, well, I hope more importantly to leave you, with a sense that the outlook for the Group is a positive one. The economic outlook is net positive. Yes, there are risks out there, there are always risks out there. The risks which are out there funnily enough feel like lesser risks because they are recognised and they have been around for some time and they are on pretty much everyone's agenda. That, to my mind, helps diminish them and creates a greater likelihood that they will be managed through in a way which is sensible and constructive.

We have scale. We have the ability to grow our business at very attractive cost:income ratios, the Manufacturing platform amongst other things ensures that, and has got considerable scope to have on it far more transactions than it currently has without a corresponding step-up in cost; Ulster Bank moving on to that platform is the next imminent step in that process.

We have momentum. It is all very well having good metrics but you have got to be actually moving. It is all very well saying that organic income growth is important but you have to be able to deliver it and I think our track record shows that very clearly in the same way as these results show very clearly that we can deliver organic growth in challenging market conditions. You would again get a clear sense from Guy's slides that it was not all 'beer and skittles' out there in the first half.

We have diversified income streams - very important! The more options we have the greater the prospects of us delivering good growth and good organic growth. And, of course, the quality of those income streams. Yes, we are involved in trading activities, for example, but they are good quality, sustainable, repeatable income streams and that's important.

So, you will not be surprised to hear me conclude after all of that I hope that we do have options for growth and we feel that we are very well positioned to pursue them and the results we are presenting to you today are a very clear endorsement of all of that. Thank you very much

. Now is the opportunity for questions and we will be very happy to try and pick up any questions you have got and if we can't answer them here, or my colleagues who are coming up on to the platform to join us can't answer them, then we will try and get an answer for you. Thank you. (A pause)

MR. JAMES EDEN (Dresdner): Your Global Markets business managed 24 per cent profit growth, which is obviously good, but Barclays Capital managed 66 per cent. Now the most favourable interpretation would be that you are building a sustainable customer centric business model while they are punting it about, but I am not sure there is much evidence to support that view, and I wondered if you could try and build a business that looks a bit more like Bob Diamond's?

SIR FRED GOODWIN: I wouldn't for a moment, James, think of accusing Barclays of punting it about. But I think you have partly answered your own question, in the sense that where we are in similar businesses to BarCap then we are very happy with the metrics relative to BarCap. BarCap are in some businesses which are different from ours, they are businesses which we are not in them by accident, we have chosen not to be in them.

But I think Johnny would be far better placed than me to pick that up!

MR. JOHNNY CAMERON: The reaction you all gave to those results doesn't particularly encourage me to build a business like that would be one answer! (Laughter)

We could have taken a different path over the last five years but we took a path for sustainable growth. I am very, very comfortable and happy with the platform we have build in GBM. As I said at the presentation we made on Corporate Markets at the end of last year, we have built a global platform in most of the key products in all of the key areas. It is paying off very well. I think our results in GBM are absolutely first-class for the businesses we are in. I am very comfortable with where we are.

I really don't want to get into whether we could do better or differently and compare ourselves to what BarCap did, but I think the results speak for themselves and particularly the consistency of results over what effectively is 10 consecutive halves now also speaks for itself. But there are things we can do more and we will do more, that's part of the excitement we have, further things that we can grow and do more in, as Fred indicated.

THE CHAIRMAN: Okay. Oh, lot's of interest! Where will we go? We will go to the front here!

MR. SIMON SAMUELS (Citigroup): I have actually got three questions but the first two are just sort of housekeeping and there is a bigger one at the end.

Just on the housekeeping. First of all, in terms of the margin or the margin guidance, it has been a long week so my memory might be failing, but I seem to recall at the Full Year Results where you had a Group margin of 2.55 that you were sort of indicating low'ish double-digit basis point from the financial year number. But you now seem to be stressing your guidance is unchanged. So is it now sort of from that second half of 2005 number, because obviously the margin came down a lot during the course of the last year?

MR. WHITTAKER: 2.55 was the average for 2005, 260 first half, 250 second half. We talked about 10-15 basis points down over the year, 2005 to 2006.

MR. SAMUELS: But from which number?

MR. WHITTAKER: 2.55. So we thought in the 2.40 to 2.45 range on a full year average for 2006.

MR. SAMUELS: And that's unchanged?

MR. WHITTAKER: And we are 2.45 for the first half and we feel that is going to be still a pretty good forecast.

MR. SAMUELS: Okay. Thank you. The second question is - and probably you disclosed those but I can't find them - can you just quantify what you have done in the first half of the year by way of securitisation and maybe what your aspirations are for the second half?

MR. WHITTAKER: Yes, we did. We had a mortgage securitisation of around £4.7 billion and about £2.4 billion of risk asset reduction and a corporate securitisation for a little over £3 billion. I think absent those two you would have seen spot growing 7 per cent instead of 5 per cent, and obviously I think that securitisation is also very much part of our capital management programme now and going forward.

MR. SAMUELS: And any quantification of your plans for the second half for this year?

MR. WHITTAKER: We're not going to make any forward looking numbers but we have a number of deals in different asset classes that we are looking at, mortgages, cards and the like would be typical sorts of things to think about.

MR. SAMUELS: Okay, thank you. And the third one, which I guess is for Fred actually, is 2 per cent 'jaws'. It has been a while, I can't actually remember exactly how long it has been, but it has been a while I think since you have delivered kind of 2 per cent 'jaws' - I think it has probably been at least a couple of years. I guess the question is, is this a first half 2006 blip?

In the past you have tried to condition us away from expecting positive 'jaws' and saying it just better if the absolute revenue and cost growth is higher. So is this just a sort of a particularly good first half and there were things on the cost and revenue side that fell nicely or is positive 'jaws' now something that we should be expecting going forward?

SIR FRED GOODWIN: I am looking around for Robert Law here. This 'jaws' thing has now taken on, or has become, an industry standard measure. When I think about 'jaws' - you talk about 2 per cent 'jaws' - I talk about the gap because I am thinking of 'jaws' in terms of 60 per cent or getting on towards 60 per cent, in other words, the gap between a pound of income we generate and what it cost us to produce it.

Earlier on we picked up, there was a slide of £1.1 billion extra income at a cost of £460 million or thereby, those are the sort of 'jaws' that I think about and those feel like 'jaws' that are pretty wide open and, if you like, we are sailing through the world and hailing income up here *(indicating)* and only costing us distribution. They feel like wide enough open.

We could open a little bit further and indeed depending on which businesses we got involved in we could open them a lot further or close them. I think at this stage in proceedings we are at a point where we are looking to take the Group forward. We have got to select the businesses we are in based on the returns that they generate and the sort of risk-adjusted returns that they generate.

For instance, for many of Johnny's businesses we have a cost:income ratio attached to them that is higher than the overall Group cost:income ratio, so if we get into those businesses it would drive the cost:income ratio up. Actually we are in those businesses and I am very happy at the growth we are having in them. So, this is a long rambling way, Simon, of saying there is a mix element in here as well and I could easily see the mix changing and causing the thing to move around.

I am very happy with the improvement in the cost:income ratio in the first half. I don't view it as a blip but there are mix effects in here as well which we need to be cognisant of. Moving around a few basis points in the cost:income ratio one way or another I don't think we should read too much into it.

We go through life with our foot firmly on the throat of costs but at the same time recognising that to grow a business you need to spend more money. Zero per cent cost growth isn't something that we aspire to because it is difficult for it to come without a very low per cent income growth.

THE CHAIRMAN: Yes, I will take this one here!

MR. MARK THOMAS (Keefe, Bruyette & Woods Inc.): I have two questions, one of which will definitely be for Guy. In terms of the strategy one first, what do you see as being the synergies and the operational risk of integrating Citizens into Group Manufacturing?

SIR FRED GOODWIN: I think in the first instance, Mark, we are not planning to integrate it on a wholesale basis. What we would propose to do is to create something in the United States that's akin to Group Manufacturing. All of Larry's businesses are already on a single IT platform, and that has been one of the strengths of what we have always done, what our integration process has always entailed.

The GBM businesses in the United States are on a platform and it is a completely different platform. We would not be proposing to bring those sets of businesses together, so there is not a big IT integration in the offing which scores off one of the potential risks. It feels in fact more like an opportunity for us. We are into areas like how we manage our properties, how we go about procurement, although already quite a significant part of that procurement is brought through Group Purchasing, which comes under Mark.

I don't know, Mark, whether you want to say anything about that?

MR. MARK FISHER: Yes, it is about replicating the model I think rather than trying to share the underlying platform. The Citizens platform works very well for Citizens in its context, but working with Larry's people we are now starting to look at how we do share on the strategies.

On operational strategies, you saw the lean manufacturing referred in our results, which is starting to come through quite well, and Larry's people are starting to look at the same things, so it is much more at that level than it is about physical bringing together. There is no doubt that the distance makes that an operational risky thing to do, but not impossible. There are things where we can, global purchasing, IT architectures, IT security, and they are already done largely at a global level.

MR. THOMAS: Okay. And the one for Guy is, I still think a lot of us are still feeling our way round IAS accounting and I think it is very noticeable that yourself and Lloyds were the lowest nominal increase in retail charges, were the banks that had the highest unwind of discount in terms of last year. I am just wondering, has there been any change of volatility associated with the IAS accounting particularly in terms of how they discount, that would mean that the two of you would have a lower nominal increase in charge compared to the rest of the sector?

MR. WHITTAKER: No. The short answer to that is "no". They are comparable. We did have full IAS accounting at this time last year, so the period to period numbers are very comparable.

MR. THOMAS: And could you say whether the discount factor has actually changed materially? I mean in terms of were there nominal discounting effects more or less?

MR. WHITTAKER: Pretty unchanged

THE CHAIRMAN: One here, just behind

MR. JONATHAN PIERCE (Credit Suisse First Boston): I have got two actually. Can I ask Johnny a question which I asked at the Full Year stage actually on Other income within Global Banking & Markets? I think at the time, given the spike up in the 2005 figure to £744 million, I asked what a sustainable level might be and you guided us to the average of 2004 and 2005 which I think is about £550 million'ish.

In the first half of the year that has come in at slightly north of £400 million and I was wondering therefore could you give us a bit of flavour as to what's in there? I am not clear whether there is an element of 'Doncasters' in there, whether there is and how big that is? Also can you tell us whether the property gains, which are detailed later in the statement, are in that line as well?

MR. CAMERON: I think we talked about £500 million plus or minus and indeed quite a wide range about that number and I think we will come out at the top end for the full year, the top end of the sort of range I had in mind when I said that.

We have got an ongoing business that generates Other income. We take warrants in mezzanine, we do a number of transactions where we take on positions and then sell them pretty soon for capital gains, so there is a mix of long term gains and short term gains in that business and obviously I expect the short term gains, or the business that generates short term gains, to continue going forward.

The specific answer to your question is that there is a bit of Doncaster in there, there is a bit of Doncaster in the second half of 2005 as well because we have mark-to-market, as you know, those private equity investments and so there is a bit in the last half of last year and in the first half of this year. But we still have a book of both private equity investments, property investment and, as I say, the continuing business that generates these gains, so plus or minus it should continue.

MR. PIERCE: I'm sorry, were the property gains in there as well and, if they weren't, perhaps Guy could tell us where the property gains did fall? There was £100 million or so of property gains.

MR. CAMERON: I think they are in there.

MR. WHITTAKER: They are in that line.

MR. PIERCE: They are in that line! Okay. Thank you. The second question – sorry to keep going on about gains! – is on Citizens, noting the comments made and obviously the text in the release, I am just wondering how material and whether you can quantify the gains in the non-interest income line of Citizens?

MR. LARRY FISH: We have, like Johnny, a certain number of gains that are recurring. We have a venture capital subsidiary, we have a student loan business that produces gains, we have securitisation activities. But we did do one large transaction in the first half of the year which was a sale/leaseback of a couple hundred of our branches to bring the Charter One franchise in line with the Citizens ratio of properties that are owned and properties that are leased and it was very fortuitous. We took advantage of very high liquidity in the States and the transaction was enormously successful.

MR. WHITTAKER: If I add a little colour, in terms of the sequential year over year gains in Citizens it is about a £20 million difference. And then combined, if you add up all the pluses and minuses and ins and outs in that line, it is in the mid-20s.

THE CHAIRMAN: Yes, here

MR. IAN GORDON (Dresdner): Just a question on the dividend please. You are very clear, as always, in your announcement that the interim dividend is just an arithmetic consequence of the final year dividend, so there is no explicit guidance there. But what we are always encouraged to look at or what we are always told the Board looks at when setting dividend and distribution policy is current year performance and outlook and what we have today is strong performance, notwithstanding a challenged contribution from Citizens.

We see that story underpinned with costs falling on the back half of 2005 Manufacturing, we see a bad debt performance which is the envy of your UK peers, given all that on a consensus spreadsheet you are going to have surplus capital generation in 2007 and beyond of £3.5 billion to £4 billion, more than that on real numbers. Are you able to give us any steer now or do we have to wait until February for the good news in terms of dividend hikes and/or the rolling buy-back programme? Thank you.

THE CHAIRMAN: Well, I am pleased you've recognised the qualities of our performance and I am sure the Board will take all of these into consideration as we get to the end of the year. But we haven't done, we have followed strictly our policy, and that's something the Board will be dealing with at the end of the year. But I'm so happy! (Laughter)

Yes, just along here!

MR. TOM RAYNER (Citigroup): Two questions please. The first one comes all the way back to the very first question to Johnny inviting him to sort of compare GBM with BarCap. I am not going to ask you to do that, but I think one difference is where your competitor is perhaps very willing to talk up their future prospects; you guys seem to be far more conservative always. You have mentioned a deepening and a broadening of product range. Can you give us a bit more colour on that, where currently you feel your sub-scale to where you might be, given your infrastructure and your franchise?

MR. CAMERON: Well, I think we are making good progress in equity derivatives, for example, but there is still a long way to go. We have a nice but relatively small business there. We have definitely got plans to build that up and I think that was an important part of BarCap's results.

And in commodities as well we are sub-scale, we have a very modest business there, and again we are looking at ways that we might get into that although we are mindful that prices are high at the moment and so if we did do something we again would be taking a sensible approach as we always do. Those are just two off-the-cuff examples of products I would say.

Geographically, as Fred has already indicated, we are underweight in Asia and we have added people in Asia in the first half of this year. I am delighted to say that recruiting people to Global Banking & Markets while never easy and it is a very competitive market it is a place people want to come to, so we are getting some very good people.

MR. RAYNER: Okay. Thank you. My second question just refers to Note 8, on the litigation, which looks to me is a complete re-paste from what was said at the Full Year. There have been some concerns in the market this morning regarding the Enron settlement. Is there anything you can say this morning to update us and give us confidence there is nothing that has changed there regarding that situation?

SIR FRED GOODWIN: Note 8 is Note 8, Tom. That is all there is to it!

MR. RAYNER: Thank you.

THE CHAIRMAN: Yes!

MR. IAN SMILLIE (ABN AMRO): Four questions of detail, all on RBS Insurance please! (Laughter)

THE CHAIRMAN: Annette! (Laughter) Why don’t we bring you together? No, everybody wants to hear. Please, go ahead!

MR. SMILLIE: Firstly, could you just remind us of any seasonality that comes through there? Secondly, can you tell us what goes into the Other Income which seems to be the driver of the top line? Thirdly, can you tell us if there are any reserves releases coming through? And fourthly, could you give us an update on the outlook for pricing in the motor market, which you comment, “remains competitive”?

MS. ANNETTE COURT: Hello, Ian. If I can remember your questions! So seasonality; it is a seasonal business and it does depend on weather factors this business. Obviously people have more claims, more accidents in the winter period than they do in the summer period and so inevitably that does affect our results.

If you compare this half to last year’s first half, particularly on the household account, we have had a more benign year in that the weather, as you will have noticed, has been a lot better. But also, if you remember, at the first part of last year we did have some experience with some bad storms and floods, so those obviously impacted our result last year and we have not seen those this year. So, there is that effect on seasonality.

In terms of Other income and the sort of various lines that come through there in terms of our investment income, some of our investment portfolio, from other fees that we charge to customers that are not strictly premium and so on, so there are a sort of range of things that come into Other income, and obviously we have been enjoying some good results in that area.

The third one, reserve releases. In general our stance is that we ensure that our reserving is prudent and on an ongoing basis is consistent, and on a year on year basis if you look at our results then we have seen reserve releases. As I say, if you look historically we have seen reserve releases because of the prudent nature of our reserves; there is nothing specific to report in that area, to bring your attention to.

In terms of the outlook on pricing, as Guy has already mentioned we have seen claims inflation for motor insurance of around 5 per cent, which again is pretty much consistent to what we have seen in previous years, and we expect to continue within that a slight increase in terms of the percentage of bodily injury claims that are occurring although we have seen some drop-off in frequency; it is pretty flat or slightly falling in terms of frequency.

Pricing has been pretty flat. We are now in the fourth year where premiums have not risen as much as claims but we are seeing some green shoots in there. We have been posting price increases ahead of the market and, as I said, we are seeing flat pricing in general, although notably a change from previous insurance cycles is that we haven't seen price decreases, so we are continuing to take a prudent approach to what we are doing.

MR. SMILLIE: Thank you very much.

THE CHAIRMAN: Yes, at the back!

MR. DAVID WILLIAMS (Morgan Stanley): A follow up question for Johnny with relation to your comment that you are looking to build up equity derivatives and commodities. Nine months' ago when you held the CBFM Investor Day I think you said at the time that you were a corporate bank not an investment bank and that you actually had no interest in the equity products at all because of, I think the exact words you used were, "conflict of interest". Does this signal then a change in strategy of what CBFM wants to be and where it is going?

MR. CAMERON: No, absolutely not. I was explicitly referring to cash equities business and brokerage business which I have used as building a major equity business, underwriting new issues of equities and working with companies on their equity side, which we have absolutely no intention of getting into. Where equity derivatives is relevant is that our corporate customers, and importantly our retail customers, look for equity derivative products as I think everybody in the room will be aware, and that's the business we are looking to build up. It is absolutely equity derivatives, not a mainstream cash equity business.

MR. WILLIAMS: Thank you. Do you have a time-frame with which you …….

SIR FRED GOODWIN: One of the big challenges for Johnny and Brian Crowe and their colleagues is to build the business in a way that retains the culture that Johnny and the guys went on about at the Corporate Presentation and yet enables them to get into these markets. We don't want to get to a place where you go out and hire 1,000 people and then fire 1,000 people, so that introduces a considerable element of complexity in what you are trying to do.

MR. WILLIAMS: And time-frame for that, for building out the equity derivatives platform?

MR. CAMERON: I'm sorry, I didn't quite catch that?

MR. WILLIAMS: Time-frames for building out the equity platform?

MR. CAMERON: Well, we have an equity derivatives platform and it makes a significant sum of money. I don't want to underplay what we have already got and nor do I want to over-emphasise it. I was asked a question and I said these are two examples off-the-cuff.

I actually was just looking at a memo I wrote this morning where we have 12 significant projects that we are thinking about looking at, considering maybe we'll do them, maybe we won't, but there are lots of things still to do in GBM. We have come a long way, as I said earlier, and I will just repeat one thing Guy said, is that we were fifth in the league table for underwriting all bonds and all loans globally in the first half of this year and that is a great place to be. There are American banks and Deutsche ahead of us, it is a great company, and the really important point I would emphasise is that we have got the platform but there are still plenty of things to do, which I look on as good news.

MR. JAMES ALEXANDER (M&G Investment Management Ltd.): It is a question maybe for Sir Fred and Larry, it is about Citizens. It must be a bit disappointing for the Group as a whole that Citizens is not really showing much momentum. I have got a fall versus the second half in operating profit in the first half and this is at a time when you should, I would imagine, have been getting very strong growth from old Citizens, very strong growth that was seen at Charter One and then the synergies on top of that. So, this ALM stuff that is going on must be really viciously nasty to outweigh what should be really strong numbers coming through from Citizens?

SIR FRED GOODWIN: I will pass you to Larry in a minute, but I think you have summed the situation up really quite neatly, James. Charter One moves well, Citizens moves well, but as you look around the comparator banks in the US you are seeing a very strong effect. You will see in the Company Announcement reference to some of the growth in business activity that is going on and it is very strong but if we'd had last year's margin we would be sitting here having a celebration about Citizens results. We don't have last year's margin for the reasons you have described.

Larry, you have got all the granularity!

MR. FISH: James, I think that's very perceptive! The business is going well; deposits are up strongly; versus our principal competitors we are growing at almost twice their rate; loans are up strongly, especially corporate lending; expenses are under control; non-interest income and fees in many categories are growing very nicely; we have a flat to inverted yield curve and we have higher interest rates.

The effect is two-fold, one, you have customers both retail and commercial moving from lower cost deposits to higher cost deposits, and you have diminution of balances, customer moving into financial assets as opposed to safer and steady bank liabilities and that puts tremendous pressure on the margin in the short term. So I think our performance was quite solid and I am very pleased with the way the business is going and the curve will change – it always does!

I think the important thing is that we don't make any mistakes here. We are not in sub-prime lending, we don't do investment banking, we don't take big market positions. Many of you know Citizens for many, many years. It is a low risk business, in a flat yield curve at the moment, and we just have to make sure we continue to grow the business and eventually it will get better.

THE CHAIRMAN: Yes, at the back! In fact, there are two at the back. We will take this one and then the one along.

MR. ED FIRTH (SG Securities): I guess it is another question relating to Citizens and I guess it is largely a valuation question. But one of the mysteries I suppose of the Royal Bank share price is that if you look at US retail banks they all trade at a huge premium to UK banks and yet if you look at the Royal Bank premium you are trading at a discount, justified in part by some people on your US exposure. I guess my question is, how long are you comfortable letting that situation continue before you might be tempted to perhaps make steps to either realise part of that value and get a more direct comparison?

SIR FRED GOODWIN: Well, I think this is an old chestnut in that it goes round and round. Some of the valuation premiums you are seeing in the US retail banks are a reasonably transient phenomenon, as I hope is the valuation of RBS. But Citizens represents a very attractive return on the capital we have invested in it and opens up a significant range of options for us for growth in the United States as I have touched on, on previous occasions, and touched on briefly in my presentation earlier on. Citizens offers very attractive growth opportunities for us and attractive returns and those are things that we are in the market looking for.

The United States is a very attractive market, it is a very stable market, it is a very significant economy and it is one in which we are the sixth largest bank, in the United States. It opens up a huge range of options, not just for Larry's business but Larry's business in conjunction with Johnny's business, so P/E values on banks are transient phenomenon and it would I think be a key strategic mistake at this point to harbour any belief that we should not carry on with the strategy we have been on now since 1988 so successfully with Citizens.

THE CHAIRMAN: I mean what we could do is run the business very effectively and communicate accurately on the performance of the business. The market creates the valuation and over time if we deliver consistent high quality performance then the options for future growth that are clearly there in a business like Citizens should get factored in properly. I think it is very dangerous if you respond to any particular moment in time to a valuation question. You have got to run the business the best way you know possible and communicate accurately and let the market come to its view, and I believe it will come to a reliable view of that.

Oh sorry, I will take that one first and then come to you!

MR. MICHAEL HELSBY (Fox-Pitt, Kelton Ltd): It is just a question for Gordon really on the Retail Bank, just on the comment on mortgages. I see in the Direct Channel you were very, very aggressive last year with First Active. Your mortgage balances have actually dropped in the first half versus the second half of last year. I know you have moved away from unsecured last year, so I am just wondering the future direction in terms of near term strategy for the Retail Bank, where you see that moving? I know versus the second half of last year the revenue momentum is pretty much dried up within retail markets in general, so it is just a broader question on where you see the business going in the next 12-18 months?

MR. GORDON PELL: Sure! I think there are two questions lurking in there and if we deal with the mortgage one first. I said last year we saw mortgages as an interesting opportunity but I was not religious, it was not a market share grab, it was looking for profitable business. Last year a couple of the big boys more or less came out of the market which gave us an excellent opportunity to come in and take volume – maybe they had discussions with, you guys, I don't know!

But anyway, in the first quarter of this year we saw a couple of 'big gorillas out in the jungle'. When you have a 5 per cent market share you don't get caught in that meat grinder, so we stood back. We came back in, in May and June and we stayed in, in July, so last year we rather had a year of two halves - a very, very strong first half, stabilisation second half.

I think you might find this year looks a little bit like a negative of last year although that is all dependent again on - the fact of life there is a limited amount of unsecured lending available and those who are sort of land-locked strategically have got to go to the mortgage market, haven't they? So I am not going to get caught in that particular grip unless I can make money, but at the moment I am doing reasonable volumes and am very happy with the situation.

The second question there, the income growth has not dried up from the second half of last year. We had a very funny half year, a very funny year of two halves last year in the retail markets. In the first half profit growth was zero and in the second half it was 6 per cent, the average was 3 per cent and we have kicked off with 5 per cent into the first half of this year. I didn't really believe the zero, I didn't really believe the 6 per cent either; I think the nice base for last year would have been something like 4.5 per cent, so I am perfectly happy at 5 per cent.

There is plenty to go for in this business but actually market conditions are more challenging – I think you will have heard that from all our peers – so to have turned in 5 per cent - and actually now we are allocating Mark's costs too and actually it is 6 per cent on pure comparative … (Laughter) … I think Richard O'Connor allowed me to say best of the bunch, that was the agreed statement. I had something slightly more aggressive but he vetoed that one – I think it said something like twice everyone else, but he vetoed that one so I think that 6 per cent … (Laughter) … he vetoed that one and by that I have thrown in other people's private bankings into that, just in case anyone thinks they would like to discount Wealth.

Wealth is 70 per cent of banking business, it's mortgages, credit cards and loans to rich people, as any of you who bank at Coutts will know. It is not an investment-flogging business, so I regard Wealth as actually an integral part of the Retail Markets proposition. I regard 6 per cent profit growth as a very nice base and certainly nothing is drying up. But, you know, consumer credit markets are very tight and you have seen that in everyone else's figures. The beauty we have got is we are very diversified and have got plenty of other levers to pull.

MR. HELSBY: Can I just follow up on that? Can you talk a little bit more about what you are going to do in the savings franchise, bancassurance and on the deposit side?

MR. PELL: Yes. Well, what we have seen is obviously we have gone full reversal from asset growth of sort of 15 per cent a year and liability growth at 5 or 6 per cent. We have crossed to a situation where we are looking at liability growth and savings now in double-digits and the beauty about that is we are actually doing that at sensible margins. We are not out there with 10 basis point margins, this is convenience balances placed with us because we provide sensible rates and we provide the convenience of the money transmission.

We have been very careful over the last three years to protect our market share of money transmission. When I came here our market share of personal current accounts was 20 per cent and, being realistic, our market share of current accounts is still 20 per cent - there are not too many people who could actually say that! At that point we were 5 per cent below the leader; I would say we are now 5 basis points below the leader, so by protecting that market share of current accounts you maintain your premium for convenience on savings, so our margin has remained flat despite growing our savings by 11 per cent. Now that's the proposition as far as savings are concerned.

But looking at some of the other levers we've got, and I have made this point before, we have 29 per cent of AB's in this country compared to 20 per cent of our overall market share, and that shows particularly through in the strong growth we have seen in Coutts and our other private banks. There is a big lever there that we haven't really pulled in the Retail Bank and taking some of those skills, products and expertise and taking that down to the next level in a way that you can actually make money, and I am reasonably convinced we can do that, so watch this space on that!

On business banking, we've still maintained our market share at about 26 per cent despite endless attempts to come into this market. There is another lever there working with Johnny's people. We have taken some of Johnny's people, we have taken some of Johnny's systems, we are working now as a much more integrated operation and I think we have got great potential in business banking as well. Consumer credit is nice but being risky it is going to be a quiet few years - bank it, file it, move on, find something else to do!

MR. HELSBY: I'm sorry, can I just have one more? The unsecured slides that you put up in terms of the arrears rates, you put some market data on there. Where did you get that from? (Laughter)

MR. PELL: It comes from APAX. It is credit card data. It is freely available from APAX, so it is not some sort of survey of 10 people passing in the street stuff … (Laughter) … which I have seen in some of the other stuff.

Actually Fred's handed me a note and he said you weren't aggressive enough, Gordon, your pre-tax operating profit was actually in double-digits! (Laughter)

SIR FRED GOODWIN: Pre-impairment!

MR. PELL: I'm sorry, pre-impairment operating profit was actually in double-digits. Find me another one! (Laughter) Okay, is that all right?

MR. HELSBY: Thank you.

THE CHAIRMAN: Okay, we have time for one last question and we will take it here!

MR. PETER TOEMAN (HSBC): You have highlighted the shift in the business mix towards corporate lending and mortgages as a primary reason why the margin came down and also the US yield curve. It seems to me that both those factors are makeshift and the yield curve is going to be continuing, so I wondered why you are so confident the margin is going to stabilise in the second half?

SIR FRED GOODWIN: Guy, do you want to pick that up in the first instance?

MR. WHITTAKER: The margin is comprised of two parts, there is the asset side and the liability side, and certainly on the asset side an increasing mix of mortgages and corporates would bring that margin down. But increasingly, as we saw in Gordon's numbers, that being funded by customer deposits is obviously a more cost effective form of funding than going out into the wholesale unsecured markets. So I think looking at the stock of business we have and the expected flow of new business that will come on to that, we are very comfortable with this 10-15 sort of basis point year over year guidance that we gave at the Full Year and stand by that. (A pause)

THE CHAIRMAN: Well, thank you very much everyone for coming along this morning and for your questions. There will be coffee served outside and an opportunity to meet with colleagues. Thank you.

(The proceedings then terminated).