The Royal Bank of Scotland Group

Annual 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 Thursday 1st March 2007.

Top table:

SIR TOM McKILLOP (Chairman)
SIR FRED GOODWIN (Group Chief Executive)
MR. GUY WHITTAKER (Group Finance Director)
MR. LARRY FISH
MR. GORDON PELL
MR. MARK FISHER
MR. JOHNNY CAMERON

Supplied by:

Mercury Reporting Services
32 Melville Heath
South Woodham Ferrers
Essex, CM3 5FT

Tel/Fax: 01245 323 867
e.mail: k.mercury@which.net

THE CHAIRMAN: Good morning, ladies and gentlemen, and welcome to our Results Conference. Now, as many of you will know, this is for me the first Annual Results Presentation as Chairman of RBS, so I am particularly pleased it is a very strong set of results. These results, these very strong figures, they come on the back of a whole series of strong results from RBS, so I think it is fair to say the business is in very good heart.

Group operating profit increased by 14 per cent to £9,414 billion and adjusted earnings per share also up 14 per cent to 200 pence. The Board also are recommending an increase of 25 per cent in the dividend and this follows a 25 per cent increase in dividend last year, indeed it comes on the back of many years of very strong dividend increases and, if approved, this will mean 14 consecutive years of an increase in dividend of 15 per cent or more.

In reaching their recommendation the Board took account of a number of factors, obviously the strong capital generative nature of our business, and importantly the opportunities for growth in our businesses. We also consider our target pay-out ratio of around 45 per cent to be appropriate, and that's up from 41 per cent last year.

We also listened carefully to what our Shareholders were saying and their preference was for a progressive sustained increase in dividend and we have reflected that in our recommendation. The Board will continue to review regularly these and other elements in reaching our recommendations on use of capital.

I should also draw your attention to the announcement today of a bonus issue of 2 new shares for each share held.

But let's get on to the main event this morning. Guy is going to take you through the results, then Fred will conclude with his observations before we take your questions. So Guy!

MR. GUY WHITTAKER (Group Finance Director): Thank you very much, Tom, and good morning everybody and welcome to the 2006 Annual Results Presentation. I am sure by now you will all have had a chance to take a good look at the Company Announcements. What I would like to do is just share with you some of the financial highlights.

Our income rose from just over £25.5 billion to just over £28 billion, a rise of 10 per cent over the course of the year. Operating profit, as you've just heard, rose by £1.15 billion to £9.4 billion which after a tax rate of 29.3 per cent, and deductions for integration and one or two amortisations, we generated £6.2 billion of profit attributable to our Shareholders.

At £2 a share EPS grew 14 per cent, in line with our operating profit; we've kept our Tier 1 ratio in the middle of the 7-8 per cent range that we had talked about; and our return on equity rose from 18.2 per cent to 19 per cent reflecting strong profit generation and capital efficiency.

Income grew 10 per cent. All of our Divisions contributed to this and once again we saw faster growth internationally, up 11 per cent. Our net interest income rose by 7 per cent to £10.6 billion, our non-interest income up 11 per cent to £17.4 billion. Non-interest income now accounts for 62 per cent of Group income, up a percentage point from this time last year, and our net interest margin at 2.47 per cent was slightly better than expectations and is a combination of both mix and market.

With income up 10 per cent we held our costs growth to just 8 per cent. Our direct expense growth in those customer-facing Divisions was skewed towards those with strong income growth and we continue to invest in our client-facing businesses around the world. We see plenty of opportunities for growth here and abroad.

We enjoy the benefits of a scaleable platform and our base case manufacturing costs fell 1 per cent, which allowed for continuing investments in both IT and infrastructure of an incremental 4 per cent but containing overall manufacturing cost growth of 3 per cent as we share the benefits of process improvement and productivity gains.

Our cost:income ratio in the Group continued to improve, falling from 42.4 per cent to 42.1 per cent.

At the December trading statement we talked about our credit metrics remaining stable. We have a high quality well diversified portfolio, well diversified by counter-party, by sector and by geography, and our charge-off rate at 46 basis points was stable, over the year losses broadly rising in line with loans. The corporate environment remains benign.

In the UK, we saw the benefits of conservative credit selection criteria in our unsecured book and the levels of loss within that we highlighted at the Interims and we talked about at that stage our arrears were levelling. Well, I am happy to report this morning in the second half of 2006 our arrears levelled and were flat versus 2005 and whilst impairments in 2006 rose unless there is some significant change this is no longer a cause for concerns.

In the US, where there has been some market turbulence and much comment over the last days and weeks, we have prime quality portfolios both at Citizens where we do not do sub-prime lending, nor in our Global Banking & Markets business where our role as an intermediary between originators and investors leaves us both well protected and with limited risk.

Our risk elements in lending fell from 1.6 per cent to 1.57 per cent, our provision coverage ratio from 65 per cent to 62 per cent reflecting both mix and quality across the portfolio.

So, in summary, Group operating profit up 14 per cent, good organic growth, I think positive franchise developments across all of our businesses. You'll see the Citizens number there reflects the strong year end foreign exchange rate against sterling; in dollar terms the business grew 2 percentage points. International activities now contribute 42 per cent of Group profits.

In our Global Banking & Markets Division income rose 22 per cent, the credit environment remained favourable allowing operating profit to grow by 25 percentage points. We have good growth and momentum in the business here and around the world. In the US our income was up 18 per cent, in Europe we grew 26 per cent, in Asia we grew 35 per cent.

Our fees up 26 per cent reflect our strength in arranging and structuring public and private financings and what also has been noticeable is a sustained and continuing rise across many of the debt capital market league tables pointing to our growing distribution capabilities.

Non-interest income grew 27 per cent with income from trading activities up 15 per cent, complemented by a strong performance in both our asset rental and principal investment businesses. Our cost:income ratio at 39.6 per cent is amongst the lowest in our peers whilst our return on risk-weighted assets, up 30 basis points, amongst the highest.

In UK Corporate Banking it is a very good story, income up 9 per cent, profits up 12 per cent and good growth in both loans and deposits. We are the market leader in the UK and we are growing market share with 2 percentage points gains in our commercial business and 1 per cent in our corporate activity.

We continue to invest in both people and technology and we continue to leverage product capabilities across the Group with a very pleasing 39 per cent rise in sales of risk management products originated in our GBM business. The credit environment remains benign.

In Retail income grew 4 per cent, costs were held flat, impairment losses rose 15 per cent and operating profit rose 2 per cent. It was a very good performance and I think reflective of customer behaviour. We saw strong growth in savings and investment products and unsecured loans flat to slightly down. Our bancassurance sales rose 56 per cent and our share of this business rose from 6.5 per cent to 9 per cent in the UK.

Our leading service proposition saw us head the big bank switches and took us to joint number one in UK current accounts with slightly favourable or more favourable economics in the second half of the year. Out net new business in mortgages rose 7 per cent.

We continue to reap the benefits of combining our retail banking and direct channels business holding costs flat. On the old basis, which is included for you for the last time in the Company Announcement, our retail banking business grew 5 per cent whilst our direct channels business would have fallen by 6 per cent.

As I said, impairment losses rose 15 per cent to £1.3 billion. It was a 18 per cent rise in the first half of 2006 and a 11 per cent rise in the second half of 2006 and if you extrapolate the fact it was a single digit rise in the fourth quarter with the arrears numbers I think pointing to this issue increasingly being behind us.

Wealth Management was another strong year, income grew 15 per cent, profits grew 30 per cent with a good balance of banking and investment income. On a constant currency basis our assets under management grew 17 per cent, our income from these investments grew 23 per cent. We expanded our market-leading position in the UK with a 9 per cent growth in our client base. We saw good growth in Asia with customers up 13 per cent and income rising 24 per cent.

In Ulster Bank, a continuing familiar story now of good strong growth across-the-board. Income rose 15 per cent, impairments 22 per cent but somewhat slower than growth in the loan book, and profits rose 20 per cent, a particularly strong performance in the corporate sector but all parts of the business are performing well. We are in the midst of a significant investment programme to build out both our branch distribution capabilities as well as investing heavily in people and the business continues to reap the benefits of working closely with the Group.

Our branch improvement programme is 70 per cent completed, we added 100,000 new retail customers in Northern Ireland and across the Republic, and an important milestone was reached when the Ulster Bank group was successfully migrated to the Group operating platform which will help bring both product capabilities and benefits of scale in the future.

At Citizens - these numbers are reported in US dollars – our income grew 3 per cent, expenses grew 1 per cent, our operating profit up 2 per cent; the results very much reflect the current dynamics of the market. A slower growth in deposits, our average deposits grew 4 per cent, our customers migrating to more rate-sensitive products. It is a function of the yield curve and it has been impacting our margin, however, the franchise now has considerably more breath to it.

We saw good growth in personal lending, up 9 per cent, good growth in business lending, up 15 per cent, reflecting our expansion into the mid-corporate market place. Increasingly this business works closely with our Global Banking & Markets business providing risk management products to our Citizens customers.

In a period of declining margins it was important to manage costs carefully whilst allowing for continued investments in our supermarket branch distribution, in our credit card acquiring business and in our mid-corporate activities. Larry showed you a slide I think at the Investor Day back in November which talked about the pattern of margin and I am happy to report this morning that in the second half margins in the US only fell by some 6 basis points.

Our credit quality is very strong on a $100 billion portfolio. Impairments rose by $90 million from a very low base. This result really reflects the changing business mix and the increasing proportion of corporate lending in our book and one single corporate loss. The retail portfolio is in great shape and impairments across the whole book are only 31 basis points.

In RBS Insurance our profits grew by 3 per cent, income was up 3 per cent, expenses up 2 per cent, claims rose 4 per cent and, as I say, overall operating profit rose by 3 per cent.

Across the market the motor claims inflation remains stubbornly stuck at around 5 per cent. There were positive signs starting to emerge in the fourth quarter of the year around movements in motor market prices, those prices are rising and the price rises appear to be sticking, and we are doing our best to take full advantage of that opportunity although I am sure you will appreciate, given the nature of that business, these increases take time to feed through into bottom line performance.

We have maintained a tight focus on costs, controlling expenses to just up 2 per cent, we continue to leverage the Group's well renowned purchasing capabilities to keep our claims, up 4 per cent, below the industry inflation and our combined ratio rose just over 1 per cent to 94.6 per cent, which was also impacted by discontinuation of some partnerships business.

Our international activities continued to grow very well in Spain, Germany and Italy, with policies up 14 per cent and our SME business grows nicely with policies up by 10 per cent.

Underpinning much of our activities is our Manufacturing Division. Cost growth here was contained, as I mentioned earlier, to 3 per cent with the base case down and continued investments in both property and IT. Our IT in fact shows up 1 per cent but we initiated projects, investment projects, with an increase of 11 per cent, but these were largely offset by reduced production costs and production support costs elsewhere.

Property costs on a base case were flat. We do continue to invest in our branch improvement programme in our UK City Centre strategy, a number of growing Divisional requirements, all of which combined to contribute to an overall 9 per cent uplift in property expenditure. Our central support costs, processing, telephony and the like rose just £5 million to £976 million with productivity gains largely offsetting volume growth and inflation.

In 2006, we generated $6.2 billion of attributable profit, we funded organic balance sheet growth of 8 per cent, we've paid dividends both common and preferred of £2.7 billion, we've repurchased 54 million shares at a cost of £1 billion. We reduced our preferred share component of Tier 1 from 35.5 per cent to 32.5 per cent and maintained stable Tier 1 ratios in the mid-7s. Our returns, as I mentioned earlier, rose from 18.2 per cent to 19 per cent. Our capital guidance for 2007 remains unchanged and we are expecting a very smooth transition to Basel II, our preparations for which are very well underway.

And with that I will hand over to Fred! Thank you.

SIR FRED GOODWIN (Group Chief Executive): Thanks, Guy, and good morning everyone. I would like to carry on what I hope you will agree is a theme of good news this morning and begin by saying I'm not going to speak for very long at all.

I would like to only cover one subject with you this morning, it is a subject which is very important to us and I know is very important to you also, and the subject of course is growth. I don't want to talk about growth that has happened or historic growth, I would like to talk about the prospects for growth going forward and to share with you why we feel as confident as we do about the prospects for the Group and the growth in the immediate period ahead.

Of course, the trouble with doing that is that growth is in the future and predicting the future is always a challenging occupation, so what I would like to do today is just draw together some information and some markers and pointers which I think contribute to and give us confidence and form the basis for our confidence in the Group's future prospects.

As you know I am not an economist, as you know I am sort of famously adverse to making predictions of the future especially when they involve numbers and in the near term, so I put this slide up and I'll move off of it very quickly. I would just draw two observations out of it though. Firstly, in recent years a consistent pattern has emerged that forecasts of economic growth at the start of the year have been exceeded. I don't know if that's just to do with how economists come up with forecasts but it is a fact.

And secondly, whether you believe the 2007 numbers or not, whether they are your consensus numbers or not, the picture they portray is one of growth and we take from that – we are not wedded to any one of those individual numbers, they do move around a bit, they are moving around as we speak, - but the backdrop that they portray and paint certainly as far as the economies in which we operate is one of an environment in which growth opportunities will be available, certainly to an organisation such as RBS. Our view of the economic backdrop is positive.

So much for the economic backdrop: how do we face into that? Now today the 2006 numbers are in a special place. It is the first time that you have had the opportunity to see them and it is probably the day or the point at which we as the business sever the umbilical with these numbers.

These have been around for a long time as far as we are concerned: they began as an ambition, they turned into a budget, they have been a benchmark against which we have measured ourselves during the year, but they are already disappearing into the rear view mirror as far as the people who actually run the business are concerned, the people at the front line.

Guy has covered some of the important themes and we will take questions later. I only put them up here to highlight a couple of points, and that is we enter into 2007 in good shape. We are delivering good results from our business but we are doing it without knocking lumps out of the balance sheet or without overstretching the risk envelope at all.

Trading VAR has moved on a little. We are growing deposits strongly as well as we are growing risk-weighted assets. We are improving our return on equity. So the results don't in any sense come from "the elastic being stretched", and I think that's also important in getting a sense for our growth prospects in 2007.

Having said that I didn't want to go into ancient history, I am not going to spend long on this slide either, but just to take you down to the bottom two lines there to highlight that this organic growth thing has been around in RBS for a very long time. We have been consistently driving out double-digit income growth and doing it in a way which flows through to the profit line.

Growth doesn't happen by accident and existing growth is usually a precursor for ongoing growth and I think in that sense these numbers also give you an insight into one of the bases for the confidence we have in our future growth prospects.

This slide too you have seen before; it is updated obviously for the 2006 numbers. A particularly important aspect in this slide is that it goes to the diversity of our income, the diversity of our earnings. The results, which you saw today, don't represent the Group firing on all 12 cylinders. Guy covered, we have certainly covered in the past and I am sure we will touch on again, some of the individual circumstances affecting some of the businesses in there.

You have heard us talking about the headwinds which Citizens face, the headwinds that Insurance and Retail face – it's coming out of what has been a challenging time for UK Retail – all of the performances of those businesses I would put it to you stand up very well in comparison with our peers, but it would be fair to say that they have been facing into headwinds.

One of the key issues going forward though is that those headwinds have at least abated, and in some cases have done more than that, and so the prospects for the Group going forward should be viewed in the context of business units which have been facing headwinds facing let's say rather lower headwinds in the future.

The income which we have generated doesn't come from one source, it doesn't come from one geography either. I am not today going to go through the prospects for growth in the United Kingdom. I think we have a number of very substantial businesses here that are pretty well understood by all of you – we're very happy to take questions - and Guy touched on a number of the key features already.

What I want to do is take you through some of the overseas geographies and give you a sense of what's happening because there is a lot going on not just in our business-as-usual mode but in the sense of the businesses, us investing in those businesses and taking steps into new areas and new activities.

If I look at the United States, again just to give you a bit of granularity about what went to make up that total number, we have talked a little bit about Citizens and I have got a few more things to say in a moment.

But I think an important point to highlight is the Corporate Markets business in the United States, in which we have been investing significantly in recent years, has continued to move ahead very strongly, impacted yes by what happened in the asset-backed securitisation market – not that we have taken divots, quite the reverse! – but simply the volume of business has been less. So in a relatively flat performance there you will see the Other Corporate Markets activity growing by 35 per cent, a very powerful performance and one that comes off the back of significant investment in that business.

Looking at Citizens itself, once upon a time in talking about Citizens we would have tended to talk just about the top line on that chart, deposits. It was in every sense a deposit-led business. Deposits are still important to us and deposits have been a difficult "gig" during the course of 2006, as you well know.

But I think it is worth noting just how much the Citizens product range has been expanded in recent years, again not by accident but through investment. The credit card accounts, Lynk, merchant acquiring business, the treasury sales through Greenwich, and Corporate Markets, capital markets products, treasury products through the Citizens franchise have all moved ahead significantly during that time.

Interestingly and almost a throwaway observation, if we applied the end of 2005 margin to the Citizens business last year our profits would be up 16 per cent, so just again to get a sense of a lot of activity going on in this business, a lot of progress in the business, diminished by the margin impact of the yield curve which we have talked about before.

I'm a bit cynical about league tables, I know many of you are too, and I think that is probably well founded. For a change with this league table I'm not putting it up for bragging rights on the right-hand side of that chart, I would just draw your eye briefly to the left-hand side just again to give you a sense of momentum for what's happening in our business.

Yes, in some instances we are growing our business from a low base but we are making serious impacts in the market place. This is just a measure of loan markets. There are a number of other league tables I could put up, I'm not going to, I am not going to regal you with league tables, but just give a sense that this is what momentum looks like in the real sense.

Moving into Europe, quite a distribution of individual businesses, individual activities in the European market. This is Ulster Bank – just the Republic of Ireland part of Ulster Bank leaving the North to one side – strong double-digit growth you'll see across the waterfront. A little bit of granularity behind that, in Ulster Bank the benefits of the First Active acquisition to give us critical mass in deposits and mortgages has given us a platform which we are able to grow very strongly.

In corporate banking a significant investment in uptiering the Ulster Bank corporate banking business which was perhaps, to be kind, moribund for a number of years. It is no longer moribund, as you can see from those figures, as we've moved forward to putting in new personnel and to bring a lot of products from GBM into the Irish market place. We are getting very strong results in that business and we are very encouraged by the near term opportunities in corporate lending in Ireland.

In Insurance, we have been ploughing this furrow for a long time, we have crossed the 2 million policy mark now in Continental Europe, and it feels to us like we are getting real critical mass now in some of those markets.

Retail markets, making progress. Our consumer finance businesses in Europe though have got a way to go and that will put up a focal point for investment in the coming year.

The same caveats about the league table, let's not bother with the right-hand side of the chart, let's just have a thought for a moment over in the left-hand side and look at the progress that's made as we have been pouring investment into that business. Again there are metrics other than loan markets we can look at but it gives you a sense of what the momentum has been as we have moved up the league tables – and it is not because these other guys aren't trying, as you can see from the names that appear on that list!

Asia Pacific, relatively new. Perhaps we have been there for a long time but we have been there in what I would suggest was a very traditional almost colonial sense for n years. We decided that should change and a couple of years ago started to invest very significantly in our businesses in Asia Pacific. I think to some extent what's been going on in China has stolen some of the limelight from this business but I would like to remedy that today.

You can see from the slide there the growth that has been achieved. The focus of what we are doing in Asia Pacific is around Wealth Management and Corporate Markets.

Headcount is not a perfect number but again just to give you a sense that there are real things happening in Asia, and whereabouts in Asia it is happening as Asia Pacific is a big place. A lot of people going in. In the case of Singapore, we have moved the GBM Global Operations Centre to Singapore, we have also moved the headquarters of our Offshore Wealth Management business from Zurich to Singapore. A lot happening there, a lot more to happen!

The Asia Pacific Wealth Management business, again some metrics, there are others, and we would expect to see this sort of performance continuing as we go forward. A lot of business to be done in Asia Pacific and we start from a good place.

On this slide another league table, again please ignore – well, don't ignore! - but let's just concentrate on the left-hand side of the chart. We have moved up from 45th to 13th. We grew by 35 per cent last year. If we grew by 35 per cent again where would that move us in those rankings? I think an interesting thought but quite far up and quite challenging into some very established players in that Asian market place. The Asian market place feels very open to us at this point in time, so again momentum in our business.

Another important backdrop or element which is necessary for growth is the have the capital to support the growth and I would like to just walk through the capital outlook as we see it. The year end ratios, as you know, 7.5 per cent Tier 1, 11.7 per cent total, and you have had a sense from us before and Guy confirmed again today, that's pretty much where … we're happy to be there, we are not planning to markedly change those capital ratios.

A very important warning popped up in very small print at the bottom of this screen there … (Laughter)…..and by the way, ladies and gentlemen, these lines are not necessary to scale just in case anyone wants to go and measure this slide up later on. But we continue to be profitable and we continue to generate a lot of capital and that growth you are seeing continues to come through in cash form. So we start from a good place, we are filling the tank up at quite a rate.

But, of course, a lot of that growth comes at a cost, it comes with the need to put capital up behind it – nothing new there! What is not so much new but an area where we have made considerable progress in recent years is in our ability to distribute much of that growth to continue to participate in the economic benefit, but to be able to grow our business without the same pressure, putting the same pressure on our own balance sheet, and that's an important tool in a business sense. It is also an important tool in a capital sense.

We do plan to continue investing in our business. We have been investing in recent years and we continue to invest in new products, new premises, more people, and that will very much be a theme of 2007; it is already a theme of 2007. We are very active across, as you would gather from what I said a moment ago, a number of geographies and a number of businesses in that respect.

Basel II: Guy touched on this. The truth is none of us precisely know at this point. Pillar 1 is pretty much clear and looks marginally positive for us; Pillar 2 we are in deep discussions with the regulator just now and until we know the answer to that we don't know the answer, not does anyone else of our size know the answer to Basel II, but a pretty safe assumption would be line ball at that point. But it is one of the moving parts in the capital equation for this year.

Preference shares: as you know, we are stepping down, as I would describe it, towards "cruising altitude" on the proportion of preference shares. We get there during 2007 but that too has an impact on the capital equation as we move through.

And then the final component in the equation, is that anything that's left over as surplus goes back to our Shareholders. As Tom outlined earlier, the current steer from our Shareholders is very clear. They want us or the first priority is to invest in profitable growth in the business and that is the first call on capital. We happily agree with that. And our Shareholders have indicated a preference for receiving returns in the form of dividends at this point, a very strong, a very clear preference, and one again it is easy to go along with.

Whichever means we use to return the capital the model and the guidance remains unchanged, that we will return any capital because where we are trying to get to remains the same place at the end. We can cover off any questions on capital in a moment but that's how we see it, and I emphasise again these lines on the slide are not to scale!

So to conclude, a very simple conclusion and I hope a very clear conclusion. The economic backdrop, there will be ups and downs and these forecasts will change and the reality, of course, will be different from the forecasts but it looks like a backdrop that supports growth.

We do very much feel that we have the scale and diversity which gives us many opportunities for growth across the waterfront of our operations and across all of the geographies in which we operate.

We do feel able to respond to these opportunities. There is one thing to be in a market and to see things happening, it is quite another to be able to respond to it, and we feel better placed than we ever have to respond to the opportunities that confront us pretty much everywhere we look. And you will have gathered then that we face 2007 with confidence.

Having promised a short presentation from me, that is it and I think if we could now – I will invite my colleagues to join me – we will try and answer any questions that you might have. Thank you very much. (A pause)

THE CHAIRMAN: Could I remind people please to state their name and affiliation before they put their questions? Yes, I will take the one in the middle here!

MR. IAN GORDON (Dresdner Kleinwort (UK)): I have three quick questions, if I may. On slide 28, I think you gave us a clue in terms of your expectation of how you will deal with any possible headwind in the US Corporate Markets business. Clearly you told us that asset-backed securitisation growth was only 4 per cent in 2006, Other Corporate Markets earnings up 35 per cent. Presumably you would expect that headwind to continue into 2007? Can you just provide a little bit of colour as to how you see the overall move forward within that geography?

The second question is on Retail impairments. Yet again today we have seen your positively differentiated Retail credit experience and your positively differentiated Retail credit outlook. In terms of the drivers of that, do you see the key driver as being your timing in terms of ratcheting back your unsecured appetite or the choices you made by channel, for example closing down your direct brands, or do you just regard it as a fortunate consequence of the shape of your customer base?

And the third question, EPS, clearly you have done 200p today; consensus at 6.59 this morning seemed to be forecasting 6 per cent growth for 2007. Now clearly that number is wrong and it is going to move up, but no doubt we will be sat here in August and once again analysts will be carping and wailing about poor guidance leading to yet another earnings beat.

In terms of where the market is getting your numbers wrong, do you think it is mainly under-estimating your existing business lines or are we failing to fully appreciate the opportunities in small but growing areas, for example the 86 EV basis improvement in bancassurance, the growth in Asia which is currently very small, or indeed some of the elements within Corporate Markets where you still clearly sub-scale?

THE CHAIRMAN: Well, if that's an example of a quick, short, simple question we're in for an excellent morning! (Laughter) We'll do our best I am sure to reply to those. Johnny, are you going to start on the US Corporate Markets?

MR. JOHNNY CAMERON (Chief Executive, Corporate Markets): Yes. We've made a good start to the year in Corporate Markets in North America; I think there are still lots to go for. The successes have been two forms of integration: one, is bringing together the GBM businesses in the shape of Greenwich and what was traditionally the New York branch; those two coming together, that's really one of the things that drove the 35 per cent that you saw in Fred's slide. The other synergy that's happening is the coming together of GBM and Citizens, where again you have seen considerable growth and I think there is lots more to go for there.

More importantly, I think the market in America, as I have said before, is open to the emergence of another large-scale corporate bank. America is a very big country, there are only three really significant corporate banks there. We have a clear ambition to be up there in the top five and if we got anywhere near there that will be further growth, so lots still to do but lots of momentum.

THE CHAIRMAN: Gordon – oh sorry, I'm looking at the wrong side - retail impairments!

MR. GORDON PELL (Chief Executive, Retail Markets): Yes. I think you did a very excellent analysis which was based pretty much on what I said at the last Half Year. If we go back to June 2005, I said we were in for a two year slog, so I think you still owe me four months yet before I feel this is clearly behind us, but it is all looking reasonably positive. We were very early in, we were quite aggressively in as well. I don't think you can deal with the historic problem and pretend you can still pump in new business or even sub-prime business while you are at it, you actually have to sort of take the pain and get on with it.

That shows very clearly in the results in Retail Direct this year where basically we withdrew from the direct channel market. I mean, there is really toxic waste in this sort of environment if you are not very careful.

I would refer you to the BBC website actually in terms of our customer base. There is a very nice map up there which plots delinquencies across the country by geography. You will find there is a 100 per cent negative correlation between where all the problems are and where our big market shares are. It was nice of them to arrange that for me, but especially for you!

And the other one was the fact of life, as I said before. We have got 27 per cent of the ABs in the country with earnings of over £50,000, so while that is a customer base that is a delight to deal with in all sorts of other ways it doesn't tend to go bad on you in terms of bad debts.

The only bit you are missing from your analysis might actually be the quality of my management team … (Laughter) … but I wouldn't want to float that one to you obviously. But I think to be honest it does require a degree of discipline when you see this coming at you. Bankers have a natural unwillingness to admit there is a problem and hope it will go away; I think we did sort of grip it early and we are getting the returns from that, but at the end of the day we are dealing with a superb customer base.

THE CHAIRMAN: And, Fred, if I paraphrase the third part of the question: why do these guys get it wrong all the time? (Laughter)

SIR FRED GOODWIN: It's not an invitation I've had often … (Laughter) … but I will take it in the spirit in which it was given! I don't know, Ian. I think if you can go back through your models and all of the benefits of having the results out here. It is always a bit difficult to talk to the market through trading statements, it's all smoking mirrors, but we have got the numbers on the table today.

I think we do present the numbers in a pretty consistent format. There are no changes to accounting policies, there are no inorganic aspects to look at in these results, so it probably isn't too hard for people to go through their particular models and see the bit they may have got wrong. Inevitably going forward there will always be things – you are trying to predict the future, we are trying to deliver the future – and things can drift about.

The EPS one did seem a big gap to me. Some got the EPS closer than others but I guess it is for individuals to do that in their model. I think the most important part is that the results are now out there for people to understand the quality of our results and the bit I would like the market to get right now is the valuation rather than the model! (Laughter)

THE CHAIRMAN: Maybe I could just add, it is certainly not chance. These guys do a great job!

Yes, I will take this question here. There are a load of hands up; we'll get to you all, don't worry, or at least we will do our best.

MR. TOM RAYNER (Citigroup): Could I be the first person to ask a question on slide 38, please? I am guessing the investment part of that can include acquisitions – if so be it! I would just seek confirmation on that? But I would just like to question you on what you are hearing from your Shareholders because clearly there has been a preference for higher dividends? I am wondering if this is more to do though with the fact that it is maybe harder to reverse the increase in the pay-out ratio than it would be to not renew the share buy-back programme?

And, again, choosing between the dividend and the buy-back if you do believe the shares are undervalued, which I guess you do given the rating, possibly a buy-back is more in the interests of Shareholders than they realise and maybe you should save them from themselves and consider giving them one whether they want it or not? (Laughter)

THE CHAIRMAN: Fred, go ahead!

SIR FRED GOODWIN: I will deal with that last point first, Tom, I think. It is not for us to save Shareholders from themselves or anyone else, the Shareholders own our business and we do take their views into account. The beauty of where we are though - nothing is forever!

The dividend is what Shareholders want just now and I don't think their views are in any way confined to RBS, there seems to be a very general sentiment shift away from buy-backs towards dividend. It is something we can easily accommodate within our numbers; it brings out our pay-out ratio too. We are not in a dramatic place with the pay-out ratio but we are in a better place with the pay-out ratio, so it doesn't feel to me like an extreme.

I would not rule buy-backs out going forward, but I think the most important part is generating the surplus capital so we have got the choice and listening to what Shareholders are saying. Those would be the driving aspects. Views change, so it may well be by the time we get to the end of 2007 that Shareholder views have changed, in which case we will be listening just as hard as we are listening just now and have listened in the past.

Acquisitions: no change in the guidance there. We have got no plans to make any large acquisitions. We made a little acquisition in Citizens last year, GreatBanc, and there may be other things of that ilk but not things I think are customarily on people's radar screens.

MR. RAYNER: Could I just have a second question for Johnny because clearly in your rear view mirror you are seeing a fairly healthy second half in terms of some of the revenue items in your business. I just wondered if you could update us on what you are seeing so far this year in some of those areas, which look fairly big relative to the first half of the year on the revenue side?

MR. CAMERON: Are you thinking of anything in particular?

MR. RAYNER: Well, I haven't gone through all the breakdown and detail, but there are some where I think, some of the realisations, possibly in Global Banking & Markets looked reasonably high second half versus first.

MR. CAMERON: I assumed that was what you were asking; I just wanted to clarify. The Other Operating Income number, I think Fred and Guy made an important point there. We have got two businesses, and I emphasise the word "businesses" that contribute to that.

One is the physical ownership of assets such as ships, property and aircraft. We characterise them as rental asset businesses, which create rental income and capital gains. Those businesses have got some very strong positions in real estate in the UK, we are now expanding that into Europe, we've always had a strong business there in America. In aircraft, we are one of the major players in that market in the world. And they are businesses which I expect to sustain continued earnings.

In principal investments which is the other sort of area there, where we have made investments, I think the only thing I would emphasise is the portfolio churns. We have bought things, we have sold things during the year - quite significant moves in the portfolio! The portfolio of those two things taken together, started the year around £7 billion, finished the year around £7 billion, there is plenty left to go, and I expect those business to continue to contribute.

MR. RAYNER: Thank you.

THE CHAIRMAN: I will go over here now!

MR. MARK THOMAS (Keefe, Bruyette & Woods (UK)): A couple of questions around some of the higher risk elements in the US, if I may. If we look at the Fed. returns historically Citizens second year end write-off was about a fiftieth of HSBC …

MR. LARRY FISH (Chief Executive, Citizens): I can't hear you, I'm sorry! *(Microphone adjustment)*

MR. THOMAS: Talking about second year end write-offs in the US. You were running about a fiftieth of HSBC up until the third quarter and then charge or ratio rose to about 6 per cent of HSBC, so I am just wondering if you can give us a feel as to whether there was something funny in the third quarter numbers or whether or not you feel your risk profile relative to HSBC has actually gone up?

MR. FISH: You know, I left Boston last night and I thought to myself, gosh, I hope somebody asks me about credit! (Laughter) We had one large charge-off in the third quarter, a commercial credit in Rhode Island, the first commercial credit of any significance we had charged-off in 14 years.

We don't do sub-prime, we have never done sub-prime, we have no plans to do sub-prime – sub-prime brings with it operational risks, regulatory risks and, of course, credit risks – and our entire residential portfolio which I think you understand includes both first mortgages and what are called equity lines and equity loans is a little over $50 billion of outstandings and in 2006 we charged-off $18 million.

MR. THOMAS: Okay. Perhaps on Johnny's side then? Can you actually in terms of the revenue say how many dollars, millions of pounds, millions, was made in trading sub-prime mortgage-backed? And secondly, could you give us an indication of credit lines extended to originators of sub-prime? Thank you.

MR. CAMERON: That's asking for quite a lot of detail, some of which I think more commercially sensitive than I would like to discuss with this audience. But what I will say is that we had a small decline, and Fred laid it out in our asset-backed business last year, which basically reflected the residential side of asset-backed. The other parts of asset-backed had a good year last year. As it happens, we made a really very good start to this year as well both in residential and in asset-backed more generally. Where's that market going? It is in a bad state just at this moment but markets recover and we will have to wait and see.

But in terms of trading, we made no significant trading losses of any sort. Fred's very keen I use the phrase "we have taken no divots" – I am concerned you will think that's about my golf! (Laughter) But it is also true, we have taken no divots.

MR. THOMAS: I'm sorry, credit lines to sub-prime lenders, the originators?

MR. CAMERON: Yes. Greenwich has been in this business a long time and I think it is worth recalling that they started rather like a partnership and like a small partnership they have always been very risk adverse. We have got credit lines to originators like everyone in the street in this business but we have been highly selective; we have obviously had a further review during the last few weeks. We are very comfortable with what we have done, it is highly over-collateralised, the mark-to-markets are fine, we've got no concerns with our alliance to the originators.

THE CHAIRMAN: Yes, there was one here!

MR. MICHAEL HELSBY (Fox-Pitt Kelton Ltd. UK): Just to answer Ian actually, the reason why we got the numbers wrong is we didn't have the £870 million of increase on the Other Income line that Johnny was talking about in the numbers. And I think, Fred, at the Conference Call in December when you talked about the increase in consensus that you were signalling then you talked about it being a lot more broad-based.

So I was wondering, the first thing, I think Johnny mentioned the two business lines, principal investments and the assets. Could you tell us, of the £870 million in the second half what the mix is in terms of principal investments and other assets? Clearly there has been a big jump up, you have been helpful in telling us of the £7 billion, but what type of annual return should we expect on this £7 billion book? It feels like 2006 was a very big number.

And I have got a follow on question for Johnny as well, if that's all right.

SIR FRED GOODWIN: Okay. I think the principal finance number is shown separately as you go back into the 'meat' of the pack – I cannot remember offhand where it is, Michael, so I am not trying to be clever about it - but it is disclosed I think back in the later analysis of …

MR. WHITTAKER: Just under £800 million. That's for investments. About £250 million in the principal investments line.

SIR FRED GOODWIN: To the comments you've made, it is broadly-based, it goes across a number of different asset types. There are a number of businesses in there, as Johnny described in his answer, so there is nothing remarkable about it. None of them are new businesses that we are in, they are not businesses we haven't been in for some time.

MR. HELSBY: So it is a sustainable level?

SIR FRED GOODWIN: I think some of the guidance we've been looking to, is that 2006 was a very good year for a variety of different reasons. I would be very disappointed if the business did not generate something coming up towards the numbers we have pulled out this year as I think we were looking at a number that moved up from - what was it, Guy? - £780 million up to £1,280 million.

MR. WHITTAKER: £750 million to £1,280 million.

SIR FRED GOODWIN: It would be disappointing if we didn't get into something with four digits in it going forward, so it feels sustainable. But I would be the first to acknowledge that 2006 has seen a very good performance, which the business will do well to repeat, but I would not rule out repeating it.

THE CHAIRMAN: And you had a supplementary I think?

MR. HELSBY: Yes. I was just wondering, following on from Mark Thomas' question on the mortgage-backs, at the moment or just before it started to blow up, what's the warehousing exposure you've got in the mortgage-backed and also your retained interest in the securitisations?

THE CHAIRMAN: Johnny!

MR. CAMERON: Well, there are different forms of warehousing but we have – let's give you the exact numbers! We have around $4 billion of collateralised lending and $2 billion of warehouse. These are very round numbers. The amount of sub-prime, sub-investment grade exposure, we have across both the warehouses and collateralised lending and residual interests, whichever way you look at it, is really very, very, very small. A miniscule amount of that or a minimal amount of that, of those totals.

MR. HELSBY: Thank you very much.

THE CHAIRMAN: Okay. There was a question over here!

MR. ROBERT LAW (Lehman Brothers (UK)): Could I press you for a bit more clarity on some of the capital and distribution comments you've given please? The 45 per cent pay-out ratio, is that now a target we should be expecting going forward?

On the capital position, I think in the statement you referred to raising the level of ordinary equity as a proportion of the total and you referred to I think "cruising altitude". Could you give us some confirmation as what you regard as "cruising altitude" please?

And, why the change to move towards a lower level of equity leverage?

THE CHAIRMAN: Can I just say that I said in my introductory comments the Board will keep revisiting this. The 45 per cent pay-out ratio is broadly where we are at the moment. We will keep reviewing all of these things, so we are not locking in and I think it would be quite wrong for any Board to lock in its capital policy one time for ever.

MR. LAW: Perhaps I could expand on that, and the reason I ask the question, a bit better is that I think you accepted the level of pay-out ratio in the past was too low. You have now raised it to 45 per cent …

THE CHAIRMAN: Indeed!

MR. LAW: … and my question is, is that done now? Or?

THE CHAIRMAN: We were targeting raising it up to about this kind of level and we are very comfortable with that at the moment, but we will continue to review and take the views of Shareholders into account.

Fred!

SIR FRED GOODWIN: On the other side of the house, Robert, I was talking about preference shares and I would want to emphasise there is nothing new in what we said. I think you have heard me before talking about the sort of normal state ceiling on preference content was about 30 per cent - we went higher than that for the NatWest deal, we went higher than that for the Charter One deal – and we have been sort of working our way down as a proportion both by some repaying but also just keeping it flat as the rest of the capital base has grown. I think Guy has touched on it in the past.

My comments about coming down to “cruising attitude” is getting down to 30 per cent, which is the level of leverage we would expect to see on an ongoing steady state basis. We were at 32.5 per cent I think at the year end so as we go forward there is another de-leveraging, if you like, of the capital base which is germane to that line I was putting up, but it is certainly not intended as a change of strategy or policy, it is something we have been aiming at for a while.

MR. LAW: On the second half loans, could I just ask you to clarify what your position is on the guidance on the UK personal unsecured credit outlook? I think you have referred to the issue being behind you, or a two year period or whatever. There has been a range of guidance given by banks in the last couple of weeks. Do you think your charge is going to go up, do you think you think it’s flat or where do you think you are at this point for 2007?

THE CHAIRMAN: Gordon, do you want to comment?

MR. PELL: Preferably not! (Laughter) It would be the obvious question. I think in looking at bad debts you are going to have to look at a range of likely outcomes, aren’t you?

I don’t know what’s going to happen in the economy over the next 6 months, but Fred showed you those slides which showed a reasonably benevolent economy and if that emerges then if you had asked me a year ago would your bad debts be flat or coming down fall around a range of likely outcomes, I would have happily told you I would need a pair of binoculars to see them. If you told me now, will my bad debts be flat next year? It was in the range of likely outcomes. I would have to say, yes, even I would have to agree – if it was Fred – that probably that might be do-able.

I think we are in a different place to where we were 12 months ago and having looked at the others' figures I would probably say we are about at least a year ahead unless there is something I am missing. We do reach an inflexion point where obviously this becomes my biggest profit centre and it is very nice for Guy to tell me that it is actually behind him, but it isn't behind me! (Laughter) Because £1 billion is still a lot of money, and when we reach that inflexion point we start creating a lot of Shareholder value quite quickly, so the sooner we get there the happier I shall be.

THE CHAIRMAN: A question here and then I go over there next!

MR. SIMON SAMUELS (Citigroup): I've virtually got three questions as well. First, on the margins, and I guess it is for Guy really. It looks like your margin expanded about 4 basis points or so in the second half compared to the first half. The question is, is that the end of that long sort of decline from 3 per cent margin to 2.5 per cent, was it just flat line here or is it going up again or was there something unusual in the second half?

MR. WHITTAKER: I will take that now. It is really reflecting the mix across the portfolio and, as Fred alluded to, there are many moving part in the sort of mix of corporate and personal lending activities as well as on the liability side of what we are doing. We thought about a 10 basis point reduction. I think guided over the course of the year 10-15 per cent, it came out at 8 down.

I think the competitive pressures are still there but certainly in some of the markets appear to be abating, so I would say sort of level to slightly down. I don't know whether you quantify that in some way, but sort of level to 10 down feels like the sort of range that we want to think about as a base case going into this year.

MR. SAMUELS: Thank you. The second question – and I guess it is the last time we can ask it as well! - is about the direct channels business, because obviously you do give us still a bit of disclose although I know even that has been restated from previously. But it looks like, if I just look back at the half year stage, the contribution before manufacturing costs allocation from the direct channels I think rose about 4 or 5 per cent and for the full year it is down 6 per cent, so obviously in the second half it must have fallen about 15 per cent year on year. Can you just talk a bit more around that business in terms of what's kind of gone wrong there really?

MR. PELL: Sure! It's not so much what's gone wrong, it is what we decided to do in terms of changing its priorities. It really came through very clearly in the second half of last year because it is in the second half of the year before where we actually made the changes. We more or less pulled out of most of our direct channel lending, which was a significant chunk of that business, which was still moving along at a reasonable pace at this time last year.

That is now operating in a very small gear and obviously that has resulted in a fall in volume, also a matching fall in PPI which you could argue is not a bad place to be actually because I don't think historic levels of income in that area are going to be with us in the future.

You saw one of my colleagues described it as going "cold turkey", which I thought was a bit inelegant, but there is actually an element of truth in that. We were coming off perhaps an over excessive reliance on direct channel lending, with PPI. The good news is you sort of reach a base in that position and I think we are at that base figure now.

Our priority in the coming year is to concentrate on unsecured lending through our organic branch channels, and bearing in mind what I've just said about our underlying retail asset quality, I feel we are in quite a good position now to actually move forward.

MR. SAMUELS: Thank you. The third question, which I am sure is for Fred, is kind of another invitation to say where are we going wrong or what are we missing here? In 2006, you did a £1 billion buy-back and raised the dividend 25 per cent and you are obviously inviting us to think about the current level of profitability as being sustainable.

Your risk assets grew 9 or 10 per cent and I guess with more securitisation they are not going to really accelerate much from here. You've said you don't want to do major acquisitions and you've told us where the Tier 1 is going to end up the year at, at the mid point, or basically where it is now. So last year you had to do a £1 billion buy-back to stop the Tier 1 going up and an extra 10 per cent and the dividend only consumes an extra £150 million to £200 million in capital.

My question is, kind of what gives on all of those maths? Is it that we are too low on our RWA forecasts - I guess you don't think we are over-estimating profits – or could you see that pay-out ratio step up further even if it was just a creaming off the top of surplus capital generation?

SIR FRED GOODWIN: I will again resist the temptation, or the kind invitation, Simon, but to answer maybe the core or the kernel of the question. Yes, I think that we will end up still with surplus capital. It feels like quite a good problem to have and again, as Tom mentioned and I agree, it would be better not to rush our fences on that.

But we have no plans to hold it; the capital guidance remains unchanged. We don't want a "war chest", we don't want it to build up, it goes back to the Shareholders. At this point the dividend is the priority and we have made that decision and as we go forward if surplus capital starts to build up there is a range of options that we will consider in the light of what the Shareholders have to say.

MR. SAMUELS: Thank you.

SIR FRED GOODWIN: But you are right in your kind of arithmetic!

MR. IAN SMILLIE(ABN Amro): Two questions please, both on investment. The first one is, you have clearly set out your confidence for this year. Could I ask you to clarify how we should be thinking about positive operating leverage or the cost:income ratio? And at what stage there must be a temptation for you to accelerates some of those investments in order to capture future revenue growth please?

SIR FRED GOODWIN: I think it is important, Ian, that we go about it in a manner that doesn't cause alarm. One of the benefits of the position we are in at the moment is that we always invested in our business, so even in this year's P&L, the numbers you are looking at today, have got the cost of all those headcount increases and so on that you saw out in Asia Pacific, in the United States and in Europe. The IT investments and so on in Ulster Bank more or less are in there. We have got, if you like, a stake in the ground already in the numbers that allows us, now we have finished doing the IT piece in the Ulster Bank for the time-being, we can switch elsewhere.

So I would not be conditioning anyone to expect any reversals of general direction in terms of cost:income ratio. I think you can see it this year in GBM where costs went up a little bit more than income, but I wouldn't condition anyone to expect anything drastic or unpleasant. It is important I think in how we run the business that do temper the rate of growth with its impact on the P&L. That doesn't feel like a constraint at the moment, but it is discipline rather than a constraint.

MR. SMILLIE: Thank you. The second question I wouldn't normally ask but, as the analyst at ABN Amro, could I invite you to share your thoughts on larger scale M&A … (Laughter) … in the bank sector this year? And you have been very clear!

SIR FRED GOODWIN: I'll tell Rijkman on you! – not that I am in contact with him, I should add! (Laughter)

I think Tom gave me an invitation earlier to make a comment on that, and I made it. I will say it again, we have no plans for any large scale. I don't think Rijkman does either as I read the press! (Laughter)

THE CHAIRMAN: Yes, we have a question here!

MR. PETER TOEMAN (HSBC): I would like to ask Simon's question in a different way, which is to say there is about £5 billion of preference capital within Tier 1, the retentions for the Group only run at about £3 billion a year net of dividends, and I wonder if actually the missing capital is sort of repaying the preference dividend with equity and might that act as a constraint on dividend going forward?

SIR FRED GOODWIN: No. The short answer is “no”.

THE CHAIRMAN: We don’t think those numbers add up. Guy!

MR. WHITTAKER: The short answer to that one would be “no” I think. We don’t see it as a constraint. You can see our preference share dividends I think represented £200 million of the £2.7 billion of dividends that I put up in my slides, I think we will continue to be significantly capital generative and we will continue to have choices about the level of common dividends going forward. So I don’t think in our plans we see it as constraining.

MR. TOEMAN: Well, I was thinking more about the £5 billion stock of preference capital within Tier 1; the stock in relation to the £3 billion of retentions. (A pause)

As a supplementary, I think a few years ago you used to talk about an optimum level of capital for the Group which entailed a level of leverage within Tier 1, which was much higher than other banks and clearly you have changed your view on that, and I wondered what has been the factor behind that change?

SIR FRED GOODWIN: That’s not right, Peter. Our view hasn’t changed on the prefs., 25 to 30 per cent was the guidance we gave historically, and in fact we are aiming now, our “cruising altitude” we would see as being around about 30 per cent, so at the top end of that range. But in exceptional circumstances such as NatWest we ran it up to 40 per cent and Charter One we ran it up to the thick end of 40 per cent, but if you go back and look at what we said, we would bring that back down, that’s what we have done.

We are at 32.5 per cent now. But there is no change in our thinking around the attractiveness of prefs. as an element of gearing. I think if anything, as you look at practice now around the world amongst the banks, people are moving in that direction, it is a very effective form of leverage without placing any real constraints on our ability to run the business or indeed to place any threat on our ability to pay out dividend. The pref. dividend is *de minimis* in the whole scheme of it.

I don't know, Guy, if there is anything you want to add?

MR. WHITTAKER: I think we have had a good discussion around that, and I think certainly a level of gearing that would not be construed as being too aggressive, nor would it be construed as being a particularly conservative level of gearing either. I think it is one that, given our mix of businesses and the overall risk profile of the Group, we feel very comfortable with.

THE CHAIRMAN: Okay. A question here!

MR. JONATHAN PIERCE (Credit Suisse): Two quick questions, probably for Guy. The first is on the tax charge and why it was so low in the second half of 2006, and if you can give us any guidance on 2007 for the Group tax charge? And secondly, would you be willing to give us the reserve release number in RBS Insurance rather than having to wait for the Annual Report? Thank you.

MR. WHITTAKER: On the tax line, 29.3 per cent, a little better than expected. A number of moving parts in that: one, the weaker dollar, so higher tax jurisdictions in the US and that had some impact; secondly, was some recoveries that were earlier; and third, is that some of the principal investments which Johnny referred to have a tax positive consequence to them, they are low tax gains, and so the combination of those things and a number of other smaller moving parts contributed to about the sort of 1 percentage point or so benefit that we saw. If you add that sort of percentage point back on, 30.5 per cent, feels like a good planning number for 2007.

MR. PIERCE: And on the reserve releases?

MR. WHITTAKER: On the reserve releases, again no change to our policies there. We continue to provision on a prudent basis. Reserve releases in 2006 in fact were slightly lower than reserve releases in 2005 to the tune of I think £60 million to £70 million and we will continue to take a prudent reserving policy going forward. So, I think net-net, no change!

THE CHAIRMAN: A question here!

MR. DANIEL DAVIES (Exane BNP Paribas): Can I ask a question about the rental assets within CBFM because looking on page 44 there is about £2,100 of rental and other income, and then on page 13 it seems to being made on a portfolio of £13.9 billion of rental assets. Even if I subtract £700 million-odd of operating lease depreciation from that it still looks like a sort of 10 per cent rental yield. Is there some more of the depreciation somewhere in the cost lines or are there some other rental assets that's being made on or is it just a very high-yielding portfolio?

MR. CAMERON: The rental assets number! The rental assets that generate the gains as opposed to the rental assets that generate rent is a much lower number actually. There are a number of things in the £13.9 billion that are "vanilla rental", if you like. You are right that you have obviously got the gross up for operating lease and funding costs for the numbers on page 44. That's the other, for gross up. Does that help?

MR. DAVIES: Maybe I can ask it in a different way? What is the sort of average kind of realised yields on the rental portfolio, either on the £13.9 billion or on the kind of smaller number?

MR. CAMERON: Certainly on operating lease portfolios we are looking to have 2-3 per cent over cost of funds, as a sort of running yield.

THE CHAIRMAN: Yes! Quick questions now I think. One here and then one just behind!

MR. MICHAEL HELSBY (Fox-Pitt Kelton Ltd. UK): Johnny, can I just follow up on the realisations? You've changed the disclosure for the full year versus the half year so we don't actually have the principal investments number or the other sort of disposal gains that you were talking about at the Half Year to work out the split. So if you could just help us out on what the second half mix was please?

MR. CAMERON: Do you want to start on that, Guy?

THE CHAIRMAN: Maybe you will respond to that or I think it would be better to come back to you on that?

MR. WHITTAKER: Half on half on that level to give you the right guidance. We will take it up outside.

MR. HELSBY: Okay. And then …

MR. CAMERON: I'm sorry about that but we were trying to be helpful and we thought we were giving you more disclosure in the full year! (Laughter)

THE CHAIRMAN: Yes, and maybe Richard can pick that up with you afterwards.

MR. HELSBY: Okay. And then just a quick question; it is related. If I look at the revenue growth, even if I assume sort a £900 million/£1 billion ongoing, basis then the revenue growth was 14 per cent in Global Markets and the cost growth was 23 per cent. Clearly you are investing in that business but, if we assume that line doesn't grow, what "jaws" should we think about in 2007?

SIR FRED GOODWIN: Well, I wouldn't assume this would all come without costs so I wouldn't necessarily make that comparison. That would be my first point. And the "jaws" going forward, I wouldn't give you a number for that and, again, I guess it is for you guys to work out for yourself. But I think the comments I made earlier, I think it was in response to Ian's question about going forward, we will invest in the business but not in a way that is going to cause drama. I don't think actually given what has been achieved in GBM over the piece that a 23 per cent increase in cost is anything other than remarkable.

MR. CAMERON: Perhaps I might add to that? I can assure you that the sort of "jaws" you implied wouldn't work with Fred. That's not going to happen and without giving you any more guidance! (Laughter) So you are not right there.

The other thing I would make a point of is emphasising this, that it is of course convenient that at a time when we are investing in a lot of new products and new markets these gains are there. The fact that we are wresting new products and markets I do expect to come through in the bottom line in the near future when we have seen good growth.

MR. HELSBY: Okay. Thank you.

THE CHAIRMAN: There was a question just behind!

MR. MICHAEL TRIPPITT (Oriel Securities Ltd): Back on the Retail Bank, I just wanted to get an idea of the sort of likely income/cost trends going forward? Direct costs were held flat and I just wonder if that is a sustainable performance going forward?

And given the comments about starting to do unsecured lending through the branches, shall we be looking at a meaningful pick-up in unsecured balances or would you say that is just sort of maintaining balances where they are for the time-being? I am trying to get an idea of what this sort of change of distribution does to the cost:income ratio of the Retail Bank going forward?

MR. PELL: Okay. What was interesting actually, when I was getting ready for this, I went back to the slides I used in June 2005 just in case any of you had read them and were going to ask some difficult questions off them. I think what was interesting is the way the shape of the business has changed.

To use the analogy of a boxer, in June 2005 we were very heavily down on our asset foot, that's where a lot of our income was coming from; we were a bit overweight around the middle in the sense that our cost growth was at 4 per cent and, quite frankly, we didn't know which way the impairments were going because we had seen it in the personal market but I think the industry didn't know how bad that was going to get and whether it was going to spread to the other sectors.

Wind on from two years I think there has been a hell of a change. The weight is off. We are now running at a level of flat costs. The headcount figure you see is actually a bit deceptive. I think it shows 300 for the year, but the fact of life is we still grew the headcount in the first half of the year and in the second half we actually shed 800 people, and at a time when we were still investing in private bankers, in financial planning managers in the bancassurance business.

So this business is now getting pretty nimble in terms of costs and I have absolutely no intention of changing that because I think you are into a single digit income growth environment and I think you should plan for that: the good ones will be at the higher end of that and the bad ones will be very much at the lower end of it.

But the other issue is also the impairment issue. It is now I would say not behind us but again firmly balanced and, going back to the analogy of a boxer, I think we are now pretty light on our feet, we can be pretty nimble, and then as we have shown in things like market share we can also sting like a bee! (Laughter)

SIR FRED GOODWIN: Okay, enough of the boxer analogy! (Laughter)

THE CHAIRMAN: I think we are probably all done at this point? (A pause) In which case, thank you very much. There should be coffee outside.

(The proceedings then terminated).