The Royal Bank of Scotland Group

2008 Interim Results

P R O C E E D I N G S at an ANALYSTS PRESENTATION

of the Company held at 280 Bishopsgate

London EC2 on Friday 8th August 2008.

Top table:

SIR TOM McKILLOP (Chairman)

SIR FRED GOODWIN (Group Chief Executive)

MR. GUY WHITTAKER (Group Finance Director)

MR. GORDON PELL

MR. MARK FISHER

MR. JOHNNY CAMERON

SIR TOM McKILLOP (Chairman): Good morning, ladies and gentlemen, and welcome to our Interims Results Presentation for 2008. Before we begin, could I remind everyone to switch off their mobile phones and could I also draw your attention to the first slide in your pack covering the usual 'safe harbour' provision.

As you all know, this morning we announced a loss before tax of £691 million. We are all deeply disappointed to be announcing such results and apologise for the pain this has caused to our Shareholders.

We are determined, however, to do everything we can to ensure outstanding performances from our businesses going forward and to deliver results which will restore the Company's value as soon as possible. We are all absolutely focused on creating sustained Shareholder value.

The results we announced today were broadly expected following the previous announcements associated with the mark-downs and the rights issue, so in a sense there is no surprise. This morning, however, gives us a chance to set these results in context and to share with you our analysis and the reasons why we believe we are now well placed for the future.

Let's remember that in 2007 RBS delivered £10 billion of profit. Yes, we have taken major hits in the credit markets but, as you will see, the underlying earnings power of the Group remains strong even through these difficult markets.

In view of the deteriorating environment, in April the Board acted quickly and prudently to set out a new capital plan for the business, including significantly raised target capital ratios.

To us the balance of risks had changed for the worst in the early months of 2008 and it was the Board's view that they were likely to remain so. Against that backdrop we signalled that these conditions would lead us to take £5.9 billion of write-downs in our credit market exposures.

The next step in the new capital plan was the completion of a £12 billion Rights Issue and we are grateful that over 95% of our Shareholders supported the issue.

I am pleased to say we are also making good progress with the other elements of the plan and I have asked Fred to update you on the disposal programme and the steps already taken to improve the efficiency of our balance sheet. We are now in a position where we will only dispose of other assets if the valuation is attractive to us.

Turning to the headline results, I have already mentioned the pre-tax loss of £691 million, which resulted from the mark-downs, but as you can see from this slide the underlying earnings quality of the Group is satisfactory. Excluding write-offs and other one-off items, the business delivered an operating profit of £5.144 billion and adjusted earnings per share of 21.3 pence.

Guy will shortly review the contribution from our diversified businesses and I am sure highlight the excellent performances many of them achieved.

In the current climate, credit conditions are high on the agenda of the Board and of our investors and we have included significant additional disclosure in today's presentations.

Many of you are particularly interested in the UK economy where the consensus forecast and this week's IMF assessment still point to growth of around 1.5% in the next 18 months. We would bank that as an outturn today if we could but, in the meantime, we have conditioned our risk appetite for a tougher credit environment.

Indeed, disclosure is an important theme of these results. The Board is keen to ensure all of our stakeholders have access to the right information on the Company's performance and its balance sheet. We have listened to what investors and analysts have said and we are responding.

Another element of the Group's new capital plan relates to our dividend policy. As we announced in April, the Board believes it is prudent to issue new ordinary shares instead of paying an interim dividend. The Board agreed that the capitalisation issue would be calculated on the basis of the interim cash amount paid in 2007, which was £950 million.

We have therefore decided on a capitalisation issue of 1 new ordinary share for every 40 shares held. It remains our intention to pay the 2008 final dividend in cash.

The final important feature of today's presentations is the acquisition of parts of the ABN AMRO business for a net consideration of £10 billion.

The Board is fully engaged with the integration plan and in the delivery of the synergies. Fred's presentation will show we are on track to deliver the original promised synergies, and more.

But there is more to ABN than synergies. This acquisition accelerated our pre-existing strategy of earnings diversification and expansion into Asia. RBS now has well diversified product ranges in mature economies and exciting franchise opportunities in the fast growing economies. We are well positioned to thrive in the competitive landscape the current storm will leave behind.

But the Board is realistic about the challenges facing our sector. We face a set of financial and economic conditions whose eventual impact is hard to predict. We are determined to learn the lessons for risk management and capital adequacy stemming from this turbulent period. You will see evidence of this in today's presentations.

We have already taken tough decisions and made a good deal of progress but there is a lot still to do. I am confident we have an experienced management team who will continue to take the right actions in the interests of all our Shareholders.

Now I will hand over to Guy to take you through the results for the first half.

MR. GUY WHITTAKER (Group Finance Director): Thank you very much, Sir Tom, and good morning, ladies and gentlemen.

The results this morning, as you have heard from the Chairman, will and have been inevitably overshadowed by the credit market write-downs of £5.9 billion in line with estimates that we indicated back in April and resulted in the loss of £690 million, but underneath that I think these results will also illustrate a very strong underlying business performance and material progress towards our re-based capital targets.

Total income declined 1 percentage point, principally driven by weakness in financial markets; costs were reduced by £118 million, or 1%, down to just below £8.3 billion; our claims, recovering from the flood-affected 2007, fell £488 million; and pre-impairment profits rose 6 %to just over £6.6 billion.

Impairment costs rose by £540 million, operating profit from our Divisions was £5.1 billion, a decline of 3 percentage points over a record first half in 2007.

The impact of credit markets, which I will highlight in a couple of slides, was £5.9 billion, in line with estimates. Other items, including amortisation of intangibles, integration costs and the shared assets of ABN, were more than offset by £800 million gain on the fair value of our own debt, the combination of those items resulting in a loss before tax of £691 million.

On the important capital ratios, our core Tier 1 was up by 170 basis points to 5.7 per cent, Tier 1 at 8.6 per cent, total capital at 13.1 %on a proportionate 'look through' basis, well ahead of the estimates that we published back in April.

Just highlighting the credit market write-downs overall, they are in line with the Rights Issue announcements, the holdings and valuations of our sub-prime CDO exposures are in line and as we published them back in April.

Our US retail mortgage-backed securities, commercial mortgage-backed securities and leveraged finance exposures have all been reduced at prices and within marks above those estimated in April.

However, we have against our monoline exposure reserved an additional £300 million since April, recognising perceived deterioration in that sector. Overall the write-downs were £6.1 billion before hedges and £5.9 billion after hedge effects.

Just a brief word on monolines, our net exposure now has come down from £2.5 billion at the time of the Rights Issue to £2.4 billion of which £170 million remains to non-investment grade counter-parties.

We have reserves and hedges against 62% of our gross exposure, which totals £3.9 billion, and this is slightly more than the gross exposure that we have to our insured CDOs and retail mortgage-backed securities. The vast majority of our remaining net exposure is to the higher rated monoline counter-parties.

Across the board our exposure to credit markets has been reduced, obviously largely significant impacts of course because of the mark-downs but also some material disposals, notably a large reduction in our inventory of US mortgages and leveraged finance.

Leveraged finance has come down from year end £14.5 billion on a funded, and unfunded basis to £10.8 billion, at the end of June. As we stand here today, an additional further £1.3 billion at prices within the marks indicated was sold in July; our net exposure now stands at £9.5 billion.

Pre-credit markets, Divisional operating profit was £5.1 billion. Our growth outside GBM, which was heavily affected by levels of activity in financial markets, the growth there was 10 percentage points.

And I am now gong to run through very briefly each of the Divisions.

GBM income fell 10%, costs were held back and reduced by 14%, impairments rose £294 million from a negligible number in 2007 and were up about £178 million versus the second half of 2007.

We saw a notably strong performance in local markets, rates, currencies and commodities, up 87%, and a very good start to our joint venture with Sempra which closed on April 1st.

Credit markets remained weak with lower origination volumes, particularly securitisation and leveraged finance, and also some considerable costs in de-risking the balance sheet. These were partly offset by the sale of Angel Trains, with income overall in credit markets down 80%.

We made material progress in de-risking the balance sheet with over £100 billion of nominal of assets coming off the GBM balance sheet in the period and risk-weighted assets fell by 1%, including the acquisition of Sempra, and on a like-for-like basis we are down 10 percentage points.

By contrast, Global Transaction Services delivered much of what was hoped and expected at its formation. It is a highly complimentary customer product and revenue opportunity for the Group, and income rose 12 percentage points, profits rose 15%.

Average balances, an important driver of income, rose 13% over the time period and we saw particularly strong growth in our international activities with cash management up 21%, merchant acquiring up 14% and trade finance growing by 60%.

In our UK Retail & Commercial Banking business we saw strong performance across all of the major business lines, we saw steady growth in income and falling impairment costs. Retail impairment charges fell 8% or £50 million, largely on an improving unsecured loan book. These were partially offset by a £34 million increase in corporate provisions.

Our Retail Banking profits were up 9% in the first half of 2007, our Corporate & Commercial profits rose by 6% and our Private Banking businesses rose 14%. Good loan growth was complemented by a rise in average deposits of 10 percentage points.

In the United States, facing a tough economic climate, income grew by 2%, expenses grew by 1% and impairments rose markedly, leading to a 31% decline in contribution to just over $1 billion and a 41% decline in operating profit after the allocation of manufacturing costs.

Within the impairment rise it is important to know there are two main elements to this: there is the core Citizens portfolio, which I think has been recognised a long time as a high quality book of business, which continues to perform very well in its market place; and, as we have previously disclosed, a line of home equity business which was originated through broker distribution channels, know as the SBO portfolio, which continues to perform quite poorly, and I will just highlight a couple of those comments.

The core portfolio here, well diversified across consumer and corporate lending activities with charge off rates currently running at around 73 basis points on an annualised basis; the corporate commercial/uncommercial real estate books all performing well, charge offs at 80 basis points across those portfolios with reserves now standing at 1.6 times the non-performing loan amounts.

Our retail books, mostly the Citizens originated high quality credits; continue to perform well and certainly very well against their US peer group. The core home equity and mortgage books with a FICO score of 748 average and a Loan to Value of 64% continues to experience I think some industry-leading credit performance at this point.

Just for clarity, we have provided a little extra information here around the distribution of Loan to Value, which again continues to illustrate the overall strength of the main part of the book.

The SBO portfolio has been of greater problem. It is now closed to new business. It was closed last year and is in run off. Exposures there have come down from a nominal £9.3 billion in the middle of last year to now £7.7 billion as at June 30th. We have taken cumulative provisions of $675 million against this portfolio and our current reserves stand at $413 million or roughly 2.7 times the non-performing loan amount.

We remain cautious about its outlook, however, the delinquency graph which you can see there, is showing some signs of levelling and certainly at this stage the book of business is performing in line with the estimates that we announced at the time of the Rights Issue.

Within Europe and the Middle East, we saw a 13% growth in profits, principally as the benefits of a strong euro. In constant currency terms income rose 7%, costs rose 15%, largely reflecting the completion of the journey to one investment programme in Ulster Bank. Impairments rose £27 million from the run rate at second half of 2007, and in local currency terms profits declined by 1%.

Encouragingly we are seeing new business margins now rising, especially in Ireland, and I highlight at the bottom a bullet point in the Middle East, whilst still only a small part of this Division representing just 5% of Europe and the Middle East, we are very pleased to see an income growth there of 39% during the first half of the year.

In Asia, a very positive story. The regional commercial banking businesses moved into profit in 2008 with a 30% uplift in contribution and strong growth, as you can see, across all the areas of consumer finance, affluent banking, business banking and private banking. There is certainly an opportunity here for us to leverage the Group manufacturing support going forward and we would expect to see good profitable growth coming through in this Division.

RBS Insurance rebounded from the 2007 floodings with profits up at a headline number of 56%. We've continued with the theme of differentiation between our own brand distribution channels and our partnership channels, own brand income rising 3%, partnerships income fell 8% as we discontinued a number of relationships, but importantly the partnership contribution grew by 18% to the bottom line.

Net claims fell 13% to £1.86 billion on a headline basis and fell 6% on an underlying basis, adjusting for last year's flood effect, reflecting the de-risking of customer selection that has been progressing well over the last year or two. Underlying profits rose 5% and the combined operating ratio fell from 95.8 to 94.6%.

In Group Manufacturing we continued the theme of productivity gains, largely offsetting continued investment and business volume growth. Results there were impacted by foreign exchange rates and on a constant currency basis costs grew just 2 percentage points, and certainly contributed towards holding the cost:income ratio for the Group flat at 48.2% versus the first half of 2007 despite the slight headline decline in income across the Group.

Net interest income grew by 30% in the first half of 2007 to just over £7.5 billion and represented 45% of Group income. Business margins remained broadly stable in the first half, a mix effect, principally higher mortgage originations contributing to a decline in UK Retail & Commercial Banking.

Across all of our front books we are starting to see margins rising as the risk premium in the market place has been added to new business origination. Whilst we are still picking up some lag effect on back book pricing, more notably in Europe and the Middle East, underlying NIM for the Group was stable at around 2.02%.

Credit metrics remain stable in the first half of 2008. Whilst we are seeing some evidence of leading indicators flagging weakness ahead, certainly the first half results showed the strength and quality of the portfolio.

Our loans grew 7% during the period and non-performing loans by about the same amount, leaving our non-performing loans to loan ratio very similar to the levels at the end of last year.

Our impairment charge rose from 37 to 46 basis points, principally as a result of GBM and the US retail and commercial business. Our provision coverage declined slightly, reflecting charge offs, along with a higher proportion of the non-performing loan book being in well-secured assets where we have a reduced expectation of loss.

Finally, on a half that has been I think dominated by capital and discussions around capital, we've made substantial progress towards our re-based capital targets, obviously supported by the £12 billion Rights Issue the Chairman referred to, but coupled with very strong balance sheet control.

Risk-weighted assets across the Group were up by slightly less than 1%, we made material progress on de-risking the balance sheet, and our Core Tier 1 at 5.7% was well ahead of the 5% that we indicated at the time of the Rights Issue, and Tier 1 at 8.6%, and total capital of 13.1% on a proportionate basis already ahead of our revised targets. We are well on track to meet our Core Tier 1 target of being above 6% at the end of 2008.

On a consolidated basis, capital ratios - showing the strength and support from the rest of consortium - were 6.7% Core Tier 1 and 9% on a Tier 1 basis.

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

SIR FRED GOODWIN (Group Chief Executive): Thanks Guy. Good morning everyone.

I don't want to go back over all of the ground that has Guy has covered so what I will do is just pick out a couple of themes which I think are important, then address the outlook, and then we will be on to the opportunity to try and answer any of your questions. The themes I would like to talk about are ABN separation & integration, capital and outlook.

ABN AMRO: we tend to think of it in terms of integration but, of course, because of the way in which the business was acquired by the consortium there is actually quite a big task to go on out there of separating ABN AMRO into the parts which belong to each of the consortium members and transferring them to the consortium members, and that is going on in parallel with the integration of the business.

A quick reminder back to one of the slides we used last year. We were characterising what would happen in terms of separation out in two parts really. There was the sort of snipping off of the connections of some relatively discreet business units within ABN AMRO, and then the altogether more complicated separation of BU Netherlands, which was enmeshed with the part of the business at the centre which RBS was taking.

As we got into the business and formed our detailed plans that is precisely what has happened and how we are going about it, and that is precisely how things have progressed. The last piece in the equation to be separated will be BU Netherlands, although I think we are already moving up the timescale in that, to do that rather quicker than we first thought.

To give you a sense of how that all looks in terms of value, the overall transaction as you will well remember was in the region of €70 billion, but it is worth reminding yourself that our piece, down at the bottom, was only about €14 billion.

LaSalle is there in a slightly different colour, just to remind ourselves that by the time this deal completed we obtained the cash disposal proceeds of LaSalle rather than the LaSalle business, which obviously had found it way to, or at least had been sold to, Bank of America. The separation of LaSalle to Bank of America took place during our period of ownership.

Since then a lot has happened, broadly as follows: asset management was transferred to Fortis during the first half of this year; Banca Antonveneta was sold, as you know, which came out of

Santander's share; and in July, post-30th June but obviously an historic event now, Banco Real was transferred to Santander. So in terms of the whole businesses, Santander has pretty much already got all of its parts.

We have acquired the LaSalle cash, as you know, so we are left in a situation now where there is about €34 billion of the nominal €70 billion left, principally belonging to Fortis.

Two major parts of separating that now: BU Private Banking which will separate in the early part of 2009 and BU Netherlands which will separate some point during 2009, a date I think that is getting nearer rather than further away. It hangs on a piece of IT separation, which is well advanced at this point.

There are some shared assets in there; relatively small, again very good progress has been there. Some of the sundry stakes and individual bits and pieces have been transferred to their respective owners or sold. Business Unit Private Equity is about 75% complete. There are some very small rump positions now being disposed of.

The last remaining item of any substance is to sell the stake in Saudi Hollandi bank, the minority stake, and that process is pretty well advanced as we speak. So very good progress in separation, it is not finished yet, but we are now down to a discreet and small number of items.

In turning then from the separation aspect to the integration aspect, we set out in the original offer document some synergies of both cost and revenue and we revised those earlier this year to a rather higher figure.

I think we will stop talking about the synergies in euros now and just flip then into sterling: £1.15 billion cost savings, £500 million or thereby net revenue benefits, or what we plan now to deliver.

Just as a passing observation, that represents about 4 times the annual profit of the businesses which RBS acquired, about 4 times their annual profit in 2007, so it was a very material element of the transaction and the benefits which accrue to us.

How are we progressing? As you will have seen from the document, progressing well. Hopefully this is helpful information not just in terms of how we are doing but also in giving you a sense of how these benefits will flow through. Remember these are recurring annual benefits, so that is to say from 2010 onwards we would expect as a result just of the cost synergies to be delivering £1.15 billion incremental profit year in, year out.

The figures you see in the other columns are the annual profit impact, not the amount of synergies we have implemented, because obviously as you implement a synergy in a year you don't get the full year's benefit that year.

So I hope this is helpful to you, it is not information that you've had before – I know you probably take a swing at it! – but that gives you a sense of how we planned to – originally planned – to deliver.

You will see from the dark blue bar on the left-hand side that we got out-of-the blocks pretty quickly. We are materially ahead in terms of P&L effect which we have generated.

I am sorely tempted to suggest to you that will translate into higher benefits. I think in the interests of prudence at this point, we will just leave it that we are going to deliver the benefits faster so the value created during the integration period will be greater than simply adding the light blue bars together, but let's not rush our fences there. But we have got out-of-the-blocks very quickly and we feel good about the synergies and they are all now entrained.

There is always a sense when you have a plan, that's all very interesting, it's only when you start to roll it out that you start to get a sense of how deliverable that it. We would be pleased with those numbers and pleased with that progress.

Turning to the revenue side, the revenue synergies are always a much more difficult thing to get your mind around, a rather more nebulous sort of concept, if I could just take a moment to share with you our sort of thinking around revenues synergies.

These are synergies which come from specific things which we are doing, they are not intended as a proxy for growth in the business, so we would expect to be able to stand up in front of you and take our total income, deduct these amounts and answer to you in terms of the growth of the net figure as being respectable, having regard to what's being going on in the world and the businesses that we own.

So this is not a proxy for the growth we expect to see from the businesses, this is the incremental revenue, which we think we will get from specific revenue synergies.

The story is similar to that with costs, we got out-of-the-blocks pretty quickly here, the numbers are obviously smaller but again we are tracking well ahead. I'm tempted, less tempted than I am on costs but nevertheless tempted, to suggest that we will get more than this but for the moment I think we will settle for getting quicker delivery of these synergies.

A little flesh to go on the bones; what we have been doing behind the numbers. The new Group structure which we announced to you in February actually took quite a lot of engineering to get it into place with our people: management appointments have to be made, reporting lines have to change, not in of itself a huge exercise but as we are folding two organisations together it is of course of critical importance to make sure that we choose the best person, whether it be the so-called ABN person or the so-called RBS person – they are all RBS people now!

But we went through quite a convoluted process as part of that, involving third-part consultants to help us conduct interviews, because it is very important in the early days of integration not just to be fair but to be seen to be fair. We are through that now but it was a long process and it was tempting just to push on at times. But I think we got the right outcome, albeit it took a little bit of time.

Re-branding around the business: there are no two countries in which the story is the same in terms of what the regulator thinks, what the legal position is, what the practical position is, but we have now made significant inroads in all of the large jurisdictions to re-branding the business and making it look and feel more like RBS, which is an important part of the cultural shift in all of this.

We have had a very good reaction from customers in all of this. As we have written to customers to draw to their attention it will trading as RBS now rather than ABN AMRO, we have had a very good reaction and no negative reaction to speak of, so that's another important piece.

IT systems: we have been scaling the GBM systems to accept ABN AMRO. A huge proportion of the business is now conducted on a co-mingled basis. ABN AMRO numbers, as previously, don't exist. Various books and businesses have been folded in and are already being run on an integrated basis. There has been a lot of scaling up of our IT systems to enable that to happen.

And how we arrive at delivering the synergies ahead of plan? It ranges from the sublime to the sort of screamingly obvious I suppose, but the headcount reductions have been accelerated. There have been about 2,200 or so people have moved out in the first half of 2008 and there will be – it is never politic to describe what the number will be in the second half – but the process continues to move people out of the business as the synergies are being realised.

We have ramped down the ABN AMRO Head Office activities in the Netherlands rather quicker than we had first thought. And then we come to the other end of the spectrum, which just in buying things as mundane as stationery items for ABN AMRO we are achieving significant savings by putting them through the combined Group Purchasing processes.

Interesting I think as a commentary on the economic situation, the suppliers certainly have very sharp pencils at this moment in time when it comes to quoting for business on the scale of the business which we can offer up around the world, so those purchasing synergies are very encouraging.

So, separation and integration are both going well. I know it is a subject we will return to again, but off to a good start and the start is always the most difficult part just to go from a piece of paper with synergies on to actual delivered momentum.

As the Chairman mentioned earlier, we didn't buy the business for the synergies, we bought the business for the underlying businesses and again as we have taken ownership, brought these under control and started to move forward with the combined management teams in the new business structure, we have been running through and just validating the business rationale, the strategic rationale, that was in our mind at the time we took the businesses over - and so far, so good! What we thought was possible in those businesses still looks possible, we believe it will happen, it does move us forward in the way which we anticipated.

Clearly what's different though are the current trading prospects for some of the businesses – some but not all! A very crude assessment on the chart I grant you, but just to give a sense that the real areas, and they are not small areas, but the areas where current market conditions fall short of what we might have expected at the time we set off on the transaction.

Equities: a difficult equity market, not the end of the world, but more difficult than would have been ideal for the business. And in credit markets, I need hardly tell you what the markets have been like, and that's impacted on the RBS business and the pieces we have acquired from ABN AMRO.

We are by no means despondent about the prospects for credit markets going forward, but just as to how things currently trade against where we thought, those are really the areas of where it is pinching at this point. But the strategic rationale for the businesses and their acquisition remains intact.

Capital: Guy has already covered the ratios and I don't have anything additional to say in that respect. We are well ahead of where we expected to be at the half year and, as a consequence, we are much closer to the year end target of Core Tier 1; we are already through it in terms of the overall Tier 1 measure.

One of the features to talk about a little bit is disposals. Firstly, the disposals are on track. What does that mean? Well all of the things, which we had in mind to dispose of when we spoke about this April, have either been disposed of or are still entrain. Of course, a disposal entrain falls well short of a disposal completed and settled.

There are a number of material items out there. I know the one that will be the top of everyone's mind is RBS Insurance. We continue in discussions for RBS Insurance with interested parties. We have not concluded a deal obviously – we would have announced if we had concluded a deal – and until you sign a deal you haven't signed a deal!

So we continue with that process; it carries on. We have a figure in mind that we would expect to get for that business, it is a figure that I don't think you would view as unreasonable, but we are determined not to sell the business at an undervalue, and not to be a forced seller. This is not a trivial asset.

One of the benefits, I mean the capital ratios move on more quickly towards our target, is that pressure on disposals, there are more disposals out there being progressed than just RBS Insurance. Indeed, the Tesco Personal Finance disposal, which we announced recently, is not reflected in the figures and it alone would increase the Core Tier 1 ratio to 5.8%.

As you know, the business tends to generate more capital in the second half of the year and, as I will talk about in a moment, our de-leveraging activity continues into the second half of the year. So it feels like we have created some more flexibility in terms of the ways in which we can deliver that Core Tier 1 ratio.

But all of the businesses that were up for sale remain for sale and all of the process continues and as soon as we have got anything to announce we will announce it to you.

I'm sorry, the other throwaway on that slide – well, hardly a throwaway! – was that we are about 25% of the way through delivery of the £4 billion contribution to capital as a result of disposals that have already been contracted.

De-leveraging is an important theme as well. I think I mentioned to some of you, and certainly we have talked in the intervening period about the numbers at 31st December (2007) were pretty much bushed: two balance sheets, cross-cast, and that was it! We all knew it as part of integration and as part of bringing the two organisations under control. There is a lot of meshing together of balance sheets to be achieved and clearly as market conditions have changed a lot of de-leveraging to bring about.

The chart there gives you a sense for just one part of the business, clearly a rather important part, within GBM. These are nominal values rather than RWAs. Just to give you a sense of how it went, there is still momentum in the businesses through late 2007, but we saw the capital plan and the de-leveraging plan starting to bear fruit from February/March time, driving the numbers down.

There is a cost attached to this, there is an opportunity cost attached to this, but it is clearly the right thing to do for the business. And after initial squeals of pain from the customer-facing colleagues as we start down this path, actually we are managing down this now in a less painful manner and we will see these gains and improvements continuing into the second half as we further de-leverage the balance sheet.

The focus on improving the risk/return, there is nothing clever about this, we just want an improved risk/return metric as we go forward and generally a smaller balance sheet.

The outlook: I have put this slide up to start with. As you know, I am not an economist and as I know you are not here for an economics lecture, so I am not going to spend a lot of time going through this. I have put this up just because I tend to historically, sometimes for inspiration, as I start to think about outlook.

Picking up again a comment that the Chairman made, I think if we could get those July 2008 numbers and bank them we would. I found it interesting in looking at this actually how little the numbers had deteriorated from the start of the year through to now; it certainly feels as if things have deteriorated more than that. We shall see!

The numbers do still forecast growth in most of the major markets in which we operate and, as you can see, in Asia Pacific although the numbers are certainly coming down from this level they are still relatively high compared to the rest of the business we operate in. But, in truth, we tend not to see the world through the lens of forecasts like this; we see the world through the lens of the businesses that we operate and the customer franchise that we operate.

I am not going to go through all of this but just a sort of vignette, as it were, of some of the business strands, some of the facets, some of the elements of growth during the first half of the year, and whilst it's right that we focus on some of the areas that are particularly stressed it is worth noting there are some very, very strong rates of growth in parts of the business many of which are new parts of the business to RBS.

So with growth, there is a lot going on out there and you may be surprised to go around the Group to discover how busy people are in the customer-facing parts of the Group.

Also, in thinking about the outlook I thought it might be helpful to again have a split of our income within the business units. These are pretty big chunky business units. We have set out here but also in the Appendix, as I didn't want to trawl through them and waste time in this part of the presentation, but if you look in the Appendix we have given a breakdown within each of our operating businesses of their main income streams 2007 compared with 2008, just to giving you a sense of the moving parts.

I think even just to flick through those slides you would see quickly that by far the most volatile part of the business is GBM. You can see that from that slide, just looking at that, which is in fact total Global Markets, but the big gaps between light blue and dark blue bars in both directions highlight just how much volatility there has been within individual business lines. I think the stories behind each of them are pretty well known to you.

I would draw your attention to the fact that Global Markets are actually less than half of the Group in income terms. We are actually achieving very good growth over our customer franchise.

The new customer bases that we have accessed through the ABN AMRO transaction, the ability to bring RBS products to bear in there, has given us an important fillip at what is quite a difficult time in the market. Going to speak to customers about new products or going into new markets with new product is quite a good recipe for growth at times when economies are generally under downward pressure.

Also importantly, and I am sure this is a theme we will return to again in the course of the morning, is that margins are widening out. One of the positive aspects of the dislocation we have seen is that the risk premium has re-emerge and our margins are moving up, and you can see that in the Group margin and you can see that in individual product margins as you go through.

Another very significant part of this business is Global Transaction Services. As you saw in Guy's slides, just some of the very significant growth we are now achieving in international cash management, again a product we didn't really feature in before.

So, the diversified income streams in GBM is a very up and down story but we feel that we have opportunity for growth in the second half and beyond.

A similar run through regional markets: of course immediately you put the slide up you can see what we were meaning about the gaps between the light and dark blue bars – far steadier performance across the piece and as you go in and look at the individual components of this, whether it be the UK, the US, Europe or Asia, the picture is very similar, the bars are all up a little or stable, and that's very much the nature of this business.

It is about 40% of the Group income, the Group underlying income, and we are seeing good growth in here in the commercial segment as well as in personal. Private banking remains strong and it will be interesting to see how strong that remains as the economies slow down, but we shall see!

Personal business is growing despite difficult market conditions, and again in common with what I was saying about global markets, we are starting to see new business margins improving.

So in conclusion then, we are making good progress on ABN AMRO both in terms of the separation and in terms of the integration. The capital plan remains on track, we are ahead of target at the moment – it is where we expected to be at the end of June – and we have already completed the TPF disposal since which is about, as I say, 10 basis points into those numbers.

The outlook for the global economy is challenging for sure, you will all have your own views on that and I wouldn't necessarily disagree – I don't know what they all are but I think we are all in a place that expects the global economy to become more difficult going forward. It does feel as if we are better placed, it does feel that you would want to have a stronger capital base facing into this kind of environment.

It does feel good to have the opportunity to grow our income, not by doing more of the same old, same old, but to actually have new products to go to existing customers with and new markets to take new products into, and to be able to do it at a time when we expect to meaningful improve our efficiency by completing the integration of ABN AMRO, and realising the £1.1/1.2 billion of cost synergies feels like an important card to have in our hand at this time.

That was all I was proposing to say at this point. If I could invite my colleagues now to join me, we will be happy to try and answer any questions you have.

THE CHAIRMAN: Thank you, Sir Fred. Before we take the first question, could I just ask people to state their name and affiliation before they place their question? Lots! We will start up here and I'll kind of work my way around.

MR. LEIGH GOODWIN (Fox-Pitt Kelton): Good morning. Actually I have got a question just on the balance sheet and then a question on impairments, if I may.

Just on the balance sheet, I was interested in what's happening in terms of the customer deposits because it looks as if in the first half of this year customer deposits across the Group seem to have grown by only about 1% – I think it is £6 billion or so? When I look at loans we have grown by 7% at £45 billion.

So obviously that leads us to think, well where is it? Why is that happening? Is it because you are not wanting to compete as aggressively as maybe some of your competitors in that market? But how much longer might that sort of trend go on for and where does that take the loan to deposit ratio?

SIR FRED GOODWIN: You have partly answered the question, Leigh. But if I pass to both Gordon and Johnny to give you their respectives - there are similarities but differences between them.

MR. GORDON PELL: I suppose partly we are a taker and partly a giver from customers. I think you have clearly seen the personal sector I would say reducing liquidity actually available, several other banks have reported figures on current account balances.

We are not as bad as some of the figures which are shown, but I would certainly say flat is probably an average, and what you normally see at this point in the year, you normally see balances which have a peak, say, in last December then come down to March and then come up. So it wouldn't at all surprise me to see deposit balances actually showing a low'ish figure at this point in the year.

I would normally be expecting to see momentum going upwards just through natural activity and we are not seeing that at the moment, and I think most of our competitors have said something similar.

So I think you are seeing from 'available in the market' point of view there is less available and then there are people out there who are clearly – I will not use the word more desperate than us – but there are clearly rates out there which suggest people have a greater demand than us. That's something we are clearly going to have to look at in the second half of the year.

When you say lending growth, lending growth is essentially at the moment really mortgages, so to some extent that is discretionary. If we continue to get good margins in the mortgage market then clearly we will have to look at a way of funding that growth. Interestingly enough, in the last few weeks we actually seen some of those very strong new business margins already begin to tail-off, which suggest the banks are sort of already beginning to lose sense of reality perhaps!

But, you know, I think it is going to be an interesting challenge for the second half of the year. I think it is a market issue than our issue particularly. In the corporate market we are still seeing very strong opportunities for lending growth and deposit growth and if we want to do one we will have to find a way of doing the others, there is no question about that. Johnny!

MR. JOHNNY CAMERON: Well in GBM, not GTS, in GBM the distinction between customer deposits and money market deposits is somewhat artificial. There are a lot of strange things going on in the money markets, as you know, in the LIBOR and the LIBOR fixings and so on.

We have got absolutely no shortage of deposits at levels that we want them at, is a short answer, but everything we take tends to be at the money market rates; we are getting slightly better than most. So I don't think you should read anything into the trends in customer deposits in GBM, it is more a question of what we want to do and the price at which we want to do it.

MR. LEIGH GOODWIN: Okay. Thank you. If I may just have a second question on impairments? I am just interested in what's going on in GBM, there's a tick-up in impairments there? In addition, on the US SBO portfolio, I think going back to April you were guiding that there may be a provision of $1 billion you envisaged taking against that portfolio, and I wondered if you could just clarify please the amount you have shown for the first half, how that squares with the $1 billion you are envisaging for the year?

THE CHAIRMAN: Johnny!

MR. JOHNNY CAMERON: Without wishing to repeat myself again, it is quite difficult to talk about trends in GBM in the sense that provisions are somewhat lumpy, but there is a tick-up and I think that is surprising given the economic environment in which we find ourselves. I am not sure I can add anything beyond that.

THE CHAIRMAN: And the SBO, Guy?

MR. GUY WHITTAKER: Again for the purposes of capital planning, we estimated a charge of around $1 billion and, as I tried to illustrate in my slide, we have taken around $675 million of that. We have continued to manage it as a loan book in decline and so would expect to recognise those on a sort of 'as incurred' basis going forward. But I think that overall number still seems to be a good number.

MR. MICHAEL HELSBY (Morgan Stanley): There is clearly a lot of focus on bad debts at the moment. I'm actually very interested in the levers that you can pull. It is interesting, Sir Fred, you mentioned margins, how they have stabilised and look like they've reached an inflexion point. I was wondering if you could talk a little bit more that?

But also on costs, if I look outside of GBM, it looks like your costs on a Divisional basis are flat to down pretty much everywhere, so I was wondering clearly we know about the opportunity you have got in ABN, I was wondering what cost opportunity you have got in the old Royal Bank franchise? Thanks.

SIR FRED GOODWIN: If we start with levers we can pull on the credit front, there are still a variety. But the most effective lever you can pull is getting in early, getting hold of the customer early to start working things through, as opposed to waiting for the phone call to tell you that the receiver has been called.

One of the metrics that we look at quite closely is the flow of business into SLS and some of you, if you remember back to 2001/2002; we put slides up showing the movement of cases into SLS.

We operate on a basis with our relationship managers: basically there is an amnesty if they move the thing into SLS they are not to blame, whereas if it sits on their books and goes bad then it goes less well for them in terms of their budgets and their performance. The get immunised from it if it goes into the centre.

The flow of business into SLS is moving up. It has been moving up since early 2007, but the important thing in SLS, round about 60% of what goes in comes out back into the normal banking business having been through a period of intensive care.

So I don't know if you would call it a lever or not, Michael, but that's one of the tools that we use to get in early with these guys and, at that point, if they get in early enough, you can still sometimes give someone an opportunity to re-bank which is one lever we can pull. But getting in early is a simple key for all of that, is the best thing; of course we don't always, but that is the best thing there.

To the remainder of the business and costs, yes, there are cost opportunities and as we move forward with our scale it helps a lot. A lot of the scale benefits for costs though tend to come in Manufacturing. In Guy's slide he put up, the Manufacturing headline is up 5%; at constant currency though it is only up 2%, and if you take out the property element in that where we are increasing the number of properties we occupy to allow our growth to take place, our Manufacturing bears the cost of properties around the Group.

Our costs of actually supporting customers fell in constant currency, so that model, that continues, as we go forward. ABN had their own, they had got the Manufacturing concept, so a lot of progress had already been made in ABN AMRO. RBS has had the Manufacturing concept for a long time, and if you bring the two together we do see quite powerful opportunities to bring down costs.

The bit you see in the Divisions tends to be the very direct costs at the front-end - that relates to numbers of people out there doing business - so it tends to have less scope to come down. But insofar as there is variable remuneration, particularly in somewhere like GBM, if we aren't doing the business then you are not incurring that cost.

So sorry, it may have been a long-winded answer on costs, but there are plenty of levers, a lot of them though in Manufacturing more than in the individual businesses.

MR. HELSBY: And on the margins, sorry?

SIR FRED GOODWIN: Oh yes! I think, as I was trying to say, there are a lot of moving parts with margins but the fact of the matter is that the price has gone up. I had a customer in to see me on Monday, someone who if I mentioned his name you would all instantly know who it was and realise it was a very significant customer. He was in for chatting around a subject, which was just sounding us out whether we would be interested in something.

I said, 'Of course there is no question of us being interested in that other than at a materially higher price'. 'Oh, yeah, yeah, yeah!' Just everybody understands that the price of credit has gone up materially. It has to us; our funding costs have gone up too, so it's not all good news. But if we had been having that conversation not so long ago he would have been telling me the price or trying to tell me the price for the deal. That has now turned round quite a lot.

As you go through product by product, it is hard to see in products where the margin hasn't gone up. Deposits could be an exception because some people are pushing for more deposits for what I would consider to be strategic reasons or structural reasons. It feels quite good not to have that immediate need to do that, but if you look at mortgages, mortgage margins have gone up almost 100 basis points.

MR. GORDON PELL: Front book margins have basically doubled from the low, but even then I would argue only back to where we were in 2004, so I would say they actually ought to be going higher not going lower because the risk profile is considerably significantly worst than it was in 2004. So I would see more gravity in the upwards direction still to come in the mortgage market before I got too excited.

MR. MICHAEL TRIPPITT (Oriel Securities): Thanks. I have a couple of questions actually. Just on the increased synergies in ABN, it may sound like a slightly cynical question, but I was just wondering how much more costs would have come out anyway given the sort of de-leveraging that is going on in the markets business and just simply there is probably over the next year or so less business about anyway? I am trying to understand what costs would have come out from the two organisations naturally versus the increased synergies.

I have a second question on impairments.

SIR FRED GOODWIN: Okay. Well, I think to the RBS side of the question we ran the business fairly tightly, and you have seen how our cost base moved around over the piece. There may well have been costs that would have come out of ABN AMRO anyway; it wasn't a business that was normally associated with costs coming out, as we had observed.

The numbers we put up on the chart are numbers which we put up in – what, June or so of last year? - June and July time of last year, the starting point, so we had already identified synergies that weren't premised on a drop in activity anything like we are seeing just now, and we revised them upwards in February.

I don't think even then we would have necessarily forecast some of the activity falling away as much as we have, but also remember those two columns of ticks I put up there, that insofar as the business is doing less well or market conditions are less favourable it is really just in equities and credit markets, not small parts of the business and not unimportant parts of the business, but by no means in the whole business.

Maybe another way to come at your question though, Mike, is I would acknowledge that there would be some right sizing going on as well to reflect those businesses coming down, and we will also see costs coming down as variable remuneration costs come down. But the synergies, the savings, we are promising you up there are 2010 recurring synergies, so I would be disappointed to think that we are still seeing variable remuneration coming down in 2010. But I would acknowledge in the short term you'll see the variable remuneration element reducing.

MR. TRIPPITT: As I said, just a second question on the US impairments, outside of the SBO, which have also gone up quite significantly. I just wondered if you could give a feel of where we are in terms of impairments versus charge-offs and whether we are in sort of reserve building phase or whether impairments are in line with charge-offs? I am just trying to get a flavour of really where that goes in the next sort of couple of halves.

THE CHAIRMAN: A good question for Ellen Alemany, our CEO in North America!

MS. ELLEN ALEMANY: Outside of the SBO portfolio our impairments are roughly $388 million or about 70 basis points. Most of it has been in the retail sector, consumer originated, home equity, auto portfolios etc., and we feel we are performing much ahead of the rest of the other US banks in this sector and it just reflects the overall deterioration in the consumer segment. But it's a combination of reserves and provisions.

THE CHAIRMAN: Thanks Ellen. Could I just make a comment on the first part of your question on synergies? The Board sees every month an integration report and it is extremely detailed, made up of individual projects, so the numbers you are seeing here are all clearly identified projects and the delivery against those is tracked monthly and the Board sees that. This isn't some kind of rolling up of things that were happening anyway, these are all absolutely discreet projects.

MR. JONATHAN PIERCE (Credit Suisse): Thank you. I have got two questions. The first is just some disclosure on what the Angel Trains pre-tax gain was within these numbers? And then also if you can give us some idea, on page 52, as to what the fairly sizeable negative items are within the other income lines of non-interest income?

THE CHAIRMAN: That sounds like Guy!

MR. GUY WHITTAKER: If I take that! Page 52: around £570 million was the Angel gain, reflected in the rental assets line on page 52. Some of the other mark-downs relate to a number of valuation adjustments on carrying values of certain assets; some of those are mapped into the weak credit markets numbers which I highlighted as mark-downs on. There are certain assets, a function as part of the de-risking of the GBM balance sheet.

Overall across the GBM Division, other operating income came down from around I think it was about £950 million this time a year ago to around £675 million this year, and that would include the Angel gain of £570 million.

MR. PIERCE: Thank you. The second question is on risk-weighted asset progression in GBM again. I am interested really in the extent to which the reduction in credit exposures, some of the risks in credit exposures has assisted that, and in particular if I look at the LBO book, a sort of £3.5 billion to £4 billion reduction, I think those assets were risk-weighted at about 390 per cent odd.

So for that portfolio in its entirety, can you give us some feel as to how much of the decline in exposures contributed to the fall in risk-weighted assets in GBM and, perhaps more importantly, where you see the risk-weighted asset trend moving into the second half of the year?

THE CHAIRMAN: Johnny!

MR. JOHNNY CAMERON: I think I can give you some flavour around it, I am not sure I can specifically answer the question as phrased. There is a huge effort going on to manage risk-weighted assets in GBM. There are a number of initiatives that go into it, just naming a few. When we bring ABN and RBS together, if we are both lending to the same company, we don't tend to add one plus one to equal two; that would be a reduced exposure. That's one thing.

We are doing a number of treasury initiatives to manage RWAs, dealing with financial counter-parties, to pass the risk of certain assets to those counter-parties. That's a significant activity, always had been, in ABN and RBS and that continues.

What you say is true, but in terms of leverage finance reductions will have gone towards the reduction in RWAs but I don't think it is a really significant driver, if you like, there are so many other moving parts. There is the Basel II exercise - the switch from Basel I to Basel II - and the opportunities that gives, again around central management, and that's also shifted where RWAs are, if you see what I mean, into the lower end of the credit spectrum. So there are a great many moving parts.

I think the main thing to emphasise is that there is team absolutely focused on managing this, working with the front-end of the business, so we have a rigorous process to look at our deal pipeline and our incoming business, making decisions early about what sort of things we want to do, what sort of things we don't want to do. Then the team is also focused on, if you like, the back-end of managing what we do take in to make sure that we hit our risk-weighted assets targets - and it starts fundamentally with a target, what are we trying to achieve and working towards achieving that target.

MR. PIERCE: I am sure you won't answer this, but can you tell us what that RWA target is for the year? Will the RWAs stake plans fall again in H2?

MR. JOHNNY CAMERON: I can tell you what it was for June, which is to be where it is.

SIR FRED GOODWIN: Guy and I are involved in this process every week, so there are targets set to move us down the curve. To try and be helpful without answering your question, the moving parts were the meshing together of the businesses a lot of which took place in the first half. Also against that we had some draw-downs from customers, which that's happened now which we've hoovered up, and we continue to do customer business.

As we go into the second half I think you would not see the draw-down part, that's been contained, you won't see so much of the meshing part on the side of the equation but you will see, through the weekly process, a continuation of the downward momentum.

Guy, I don't know if you want to touch on any of that?

MR. GUY WHITTAKER: Well, just on Basel II there is a table on page 18, just to sort of highlight the change from Basel I to Basel II and the start points, which I am sure you have seen.

MR. PETER TOEMAN (HSBC): On the same point, is there a revenue penalty attached to the reduction in RWAs some of which might come through in a future accounting period? And secondly, when you talk about the £500 million of revenue synergies from ABN, is that after adjustment for potential revenue attrition, which is often a feature of investment banking mergers?

SIR FRED GOODWIN: That's a net number, Peter, on the synergy. On the revenue synergy question, there will be some revenue loss as a result of having a smaller balance sheet but relative to the cost of maintaining a larger balance sheet. It is not something, we don't believe, we are storing up an issue we are going to come and talk to you about. I think we prefer to have this smaller.

MR. JOHNNY CAMERON: Can I say the credit markets result within GBM does reflect a one-off cost of particularly reducing the riskier parts of the balance sheet, so some of that, the credit markets result, reflects the de-leveraging. There are some ongoing costs as well in terms of the hedging of risk-weighted assets, which is in these numbers too.

MR. JAMES INVINE (Dresdner Kleinwort): Sir Fred, could I just ask you to clarify a couple of your comments on the Insurance business please because I think clearly you have said that if you get a good price for it then you will sell it. But are you now saying that if actually somebody doesn't offer what you consider to be a sensible price then you wouldn't be too uncomfortable on the capital position to keep it?

SIR FRED GOODWIN: I am very anxious not to be a teaser on this, James, and RBS Insurance is up for sale – full stop! But I think there has been enough value destruction without compounding it by selling a business of that size and importance at a price that is not respectable or reasonable, however you want to put it.

We have a sense of what that would be and we have a belief that we can get to that place, but if we don't then I'd hate to be in a place of saying, 'Well guys, I've just sort of given away RBS Insurance'. And you would hopefully have got the sense from my remarks, that in terms of where we now sit relative to where we sat in April, the capital ratios have moved forward more quickly, the de-leveraging has gone well and will continue, and there have been a number of disposals.

There are a number of disposals out there still, not just RBS Insurance, which would leave us today sitting in a better place, to have confidence that we would be able to look ‘north’ of 6% without having to sell RBS Insurance. But it is not to tease about RBS Insurance, because whatever we think we have got a lot of people working in RBS Insurance and I don’t want to be playing with their emotions. The business is for sale and we will progress that and are progressing it.

THE CHAIRMAN: Just in front!

MR. INVINE: Can I just have one more on GBM costs as well? Is there an offset in the GBM cost line because of the credit write-downs? So basically what I am asking is that the £2,184 million, the adjusted GBM profit number, is that got the negative of write-downs stripped out but not the positive of any cost offset?

MR. JOHNNY CAMERON: The remuneration, the compensation number, for GBM is an accrual. The final determinant of what the variable compensation will be will not be taken until the end of the year, but the accrual is 25% down year on year and that obviously partly reflects the performance of the business net of write-downs.

MR. SIMON SAMUELS (Citigroup): It is quite reassuring actually that you seem to have as much trouble forecasting your capital ratios as we do, because I think you said you are well in excess of what you thought you would be back in April.

So I guess the question I am interested in is how much of being a long way different from what you expected – I assume most of that is not to do with higher earnings, it’s to do with faster balance sheet contraction – how much of that should we think of as kind of just bringing forward what you thought would have developed in the second half of the year, or do you think the capital ratios will now be meaningfully in excess of what you thought they would be at the end of the year back in April?

SIR FRED GOODWIN: First of all, Simon, I don’t think there was any bringing forward of the second half, so our view of the second half is that what will happen will happen.

But I guess when we were sitting back in sort of April time looking at a capital plan going forward we were very cautious. At that time the market wasn’t exactly what you would call liquid, and it is hardly liquid as we speak although it has improved, so in making assumptions about de-leveraging and so on we were pretty cautious. We were cautious about the earnings for the business; there are earnings in there and the business has performed better.

Also, perhaps one thing that has been brought forward slightly, is the degree to which we would have completed disposals in the first half. You will remember when Guy was quoting them we assumed there would be no disposals in the first half; we have achieved a little bit. In that respect there is possibly a bringing forward but only in relation to disposals.

It feels like we have got - there is a kind of mindset thing about de-leveraging a balance sheet- the business don't especially like it, and that's not to say they are resisting, but particularly when you go down to relationship manager level it is not the news they most want to hear!

But actually what we have experienced is that it is not as difficult as how you first thought. As with many things once you start it becomes easier, so there is a routine in process through the weekly meeting that Johnny and Brian and I have, and with Guy, and this has now become sort of industrialised.

MR. SAMUELS: When I look back at slide – what number is it? – 41 of yours, which was showing the £157 billion reduction in GBM assets since March, can you give us any sense - it is very difficult for us to forecast - but can you give us any sense of what kind of pace of decline in assets you think is reasonable for the second half or maybe into 2009? I don't know how you are going to answer that but in someway, are you a third of the way through the process or a quarter or a half or what?

THE CHAIRMAN: I think you are asking for a forecast!

SIR FRED GOODWIN: It is fair enough though!

MR. SAMUELS: Well yes, but it is a pretty dramatic step change from growth to shrinkage!

SIR FRED GOODWIN: I understand why you are asking, Simon. It is perfectly fair. I don't have an answer because the other slight uncertainty is about the growth in the business in terms of loans and advances and what the offset there is. We are certainly a big way through and that's why the thing to be thinking about is this meshing together of the ABN and RBS balance sheets, as Johnny mentioned, combining limits and, you know, one and one doesn't make two. We are well through that and that's a non-recurring element of it.

So I would not expect you'll be seeing the same sort of reduction in the second half as in the first half, but the process will continue. As far as 2009 is concerned, we do want to get to a place where the balance sheet is de-levered as far as it can sensibly be relatively quickly. I don't want this to be a long-running saga, we want to get down and then build the business forward from there.

So, I am looking at Johnny and I am looking at Guy for any more specificity we can give!

MR. JOHNNY CAMERON: If I might add a statement of the obvious, which is we are not heading for zero. I mean we have got a business and there is a sensible balance sheet that goes with that business, and that's where we are aiming to get it to. I think all banks all round the world in their wholesale activities had perhaps a bigger balance sheet than was needed to service the customers, but we want to keep the balance sheet that is appropriate to service our customers.

MR. TOM RAYNER (Citigroup): Thank you very much. Could I ask a more sort of conceptual question on your capital ratios, just looking on page 58, because I notice that both yourselves and I think Barclays yesterday don't make the sort of Tier 1 deductions from your measure of core capital ratios, and clearly you have indicated that a range of 6-7% is where you want to be. I think again in both cases if you were to make those deductions it would knock about 0.3% off.

Now I am really interested in what is the right way of thinking about those deductions because, if I understand them correctly, they largely represent the difference between what Basel II modelling will tell you the losses are likely to be and what IFRS accounting actually allows you to take as provisions to your balance sheet. I am just asking you if that is a correct interpretation and how you think about that in setting what is the right capital ratios for you to be managing the business towards?

MR. GUY WHITTAKER: I would concur with your analysis; first of all, I think that's entirely right. We do use the accounting definition of Core Tier 1, it is consistent with the 4% that we disclosed at the Full Year Results and the 170 basis point improvement is entirely on a like-for-like basis.

From a regulatory point of view some of the deductions that are mandated, and they are principally the expected loss deduction we have chosen to take out of the total Tier 1 perspective, then from capital point of view total Tier 1 is total Tier 1. So the targets we have set have been based off the accounting definition.

SIR FRED GOODWIN: I think the important thing also, Tom, is this adds to consistency and transparency, and they seem to me the most important parts of it, what's in Core Tier 1 versus total Tier 1? As long as we are consistent in setting our targets - and in articulating them to you we have been consistent in this.

MR. RAYNER: Okay. Could I have a quick follow-up just on the de-leveraging question? I am just trying to get a sense of what's really driving it. Do you think at the end of the day it is going to improve your Return on Equity (ROE) because you are going to get rid of a lot of low margin maybe inefficient assets or is it really about helping reach the capital ratios you want to get to?

SIR FRED GOODWIN: It feels to me that it's about good business. The balance sheet was too big as a result of putting ABN and ourselves together, also in the context of the world changing the balance sheet was too big, so that's first and foremost.

But clearly it does play through into capital ratios and it will also play through into Return on Equity. Our cash earnings on cash equity are pretty respectable figures in the first place but there would be no harm in improving them. But first and foremost we start almost from a prudential point of saying the balance sheet is not as you would want it to be for the current climate so let's move through that. It does impact on capital and it does impact on ROE as well.

MR. JONATHAN KIRK (Redburn Partners): Thank you. I'm sorry to carry on, on the issue of leverage, but I guess I am interested in whether you can give us an indication of how much actual risk has been removed from the GBM business because the risk-weighted assets are broadly flat on the year and the trading value-at-risk has gone up quite a lot? I know there are probably some ABN AMRO positions missing from the number given for the second half of 2007 but it has still gone up an awful lot between now and then. So how much risk has actually gone?

SIR FRED GOODWIN: I think the moving part that's probably just worth identifying in there, John, is Sempra. Sempra came in, in April, and Sempra would be about £20 billion of risk-weighted assets. So if you took that out the GBM RWAs are down about £10 billion from a Basel II start to a Basel II half year and the VaR is similarly impacted by the inclusion of not just ABN AMRO but the Sempra VaR into. So it is not meant to be a change to the risk-taking stance, but it mechanically goes up when you include a business like Sempra.

MR. KIRK: Fair enough, but I guess the position is still the same though, isn't it? That there is as much risk, probably if not slightly more in that business now than there was last year, or am I misinterpreting the numbers?

MR. JOHNNY CAMERON: I think one of the lessons of the last 12 months is there is no one ideal measure of risk, there are lots and lots of measures of risk. You comment on VaR, there is also the market risk input to risk-weighted assets. Actually the market risk input to risk-weighted assets has not gone up by anything like the increase in VaR, the market risk RWAs is driven by a number of things not just by VaR.

To answer the question how much risk has been taken out of the balance sheet is sort of how long is a piece of string question? We definitely have de-risked it. You would have a sort of dashboard of measures and look at them all and take a sort of holistic view to say, 'I can't say it's down 10% or 11.3%; it is not a question to answer in those terms. But we have de-risked undoubtedly and the RWA has been flat, notwithstanding the growth in loans and advances to customers, I think is the best combination of facts to dwell on.

Ms. ASHEEFA SARANGI (Societe Generale): I only have two questions. The first question relates to the unrealised losses of £750 million within the AFS that was driven by ABN assets, but I'm just wanting for a bit of more 'colour' as to which securities drove that?

Secondly, if you could comment on the €2.5 billion payment that Fortis has flagged as part of its re-capitalisation plan that it says is owned by yourselves and Santander, as to how much of that €2.5 billion is your share and when you expect to pay it?

MR. GUY WHITTAKER: The AFS adjustments I think total around £1.3 billion of which something like £400 million or so related to changing value of the Bank of China investment; of the balance about half of that related to ABN conduit business; no sort of impairments to flag there; there is change in the carrying value of those assets reflected through reserves.

SIR FRED GOODWIN: And on the Fortis side?

MR. GUY WHITTAKER: On the Forties piece, on the €2.5 billion it was always envisaged in part of our capital plans, as part of the separation plan, that we would be both ourselves and Santander providing some additional capital over and above the tangible equity they acquired with their businesses at the time of the acquisition and that was, as they indicated, around the €2.5 billion.

There is a plan to do that, by way of a preference share in the second half of this year, and we estimate the impact on our capital ratios will be around 3 basis points and that's taken into the plans that we have.

MR. SANDY CHEN (Panmure Gordon): Good morning. I am trying to carry on the risk-weighted asset discussion I think between Jonathan (Pierce) and Johnny (Cameron). I notice on page 60, on the credit derivatives line item, just on the face of the balance sheet there has been a big increase both on the asset and liability side in credit derivatives, from about £34 billion at the end of last year to about £63 billion on the asset side at the end of June. Now I think Johnny talked about using risk transfer to sort of mitigate any increases in risk weightings.

My question really is, given what some others have been taking in terms of CDS write-downs related to counter-party risks, is there a risk that, one, do you see any counter-party risks in that CDS position, especially keeping in mind that the notional contracts have probably grown from the £2.4 trillion that it was at, at year end, and would there be an associated risk weighting in that as well?

MR. GUY WHITTAKER: The short answer is "yes". The size of those exposures is a function both of nominal contracts outstanding as well as volatility in the underlying asset class. But, as we do with all derivative contracts, we provide a credit valuation reserve against the size of that exposure, and if the exposure has increased, to whatever counter-party it is, then we will be providing and depending on the underlying financial strength of that counter-party, a larger or smaller reserve. Yes, those are taken into consideration in computing our risk-weighted assets.

MR. CHEN: And is there a way of building in potential counter-party risks into the market risk assessment or anything in the RWA calculation or will that just have to wait until a counter-party?

MR. GUY WHITTAKER: Obviously the more riskier the counter-party is, as we have sort of demonstrated for instance with monolines, the greater reserve you put up there, but if you have highly-rated financial institutions and banking groups as your counter-parties you would have a correspondingly smaller number.

MR. CHEN: Thanks.

SIR FRED GOODWIN: That's happening as we go, Sandy.

MR. GUY WHITTAKER: Yes, it happens dynamically.

MR. ROBERT LAW (Lehman Brothers): Guy, I have got three points but I promise to keep them brief. You have in the past given the size of your investment portfolio. Could you update us on where that is now?

MR. GUY WHITTAKER: £12 billion I think it is, off the top of my head!

MR. JOHNNY CAMERON: Sorry, but it is a very different sort of portfolio these days. That £12 billion is mostly made up of the ABN assets which are typically fixed income assets; £4 billion of it is rental assets, and they have got some equity upside, but £8 billion is much more debt securities type assets, so don't think we have got £12 billion of equity.

MR. LAW: Secondly, on the risk-weighted assets question, could I ask you to comment on the effects of pro-cyclicality in Basel II in the second half?

MR. GUY WHITTAKER: I guess that will depend on sort of ratings migration over the course of the second half and the path of how things go. I think we mentioned at the time of the Rights Issue, we estimated the sort of Year 1 impact of a 1990 star recession as being in the sort of 30-50 basis point range – you could probably narrow that down to something like to 40-50 basis point range that had been talked about – and that remains our estimate.

MR. LAW: Thanks. And finally, could I ask you to give some more 'colour' on the increase in impairment charges in GBM up to the £300 million? Is there any particular region there, is there any particular type of loan or particular size of loan that has caused that because I don't see other banks are seeing that at this point?

MR. JOHNNY CAMERON: Honestly not really, Robert (Law). There are half-a-dozen of sort of 30-odd type numbers and there is no common feature to about half-a-dozen, so I don't think it is useful to try and generalise.

MR. GUY WHITTAKER: That £294 million does include just over £100 million of an impairment recorded against an AFS security, again as part of the de-risking exercise.

MR. JAMES ALEXANDER (M&G Investment Management): It is a question about impairments again. I'm a bit surprised by the small growth in the problem loans and non-performing loans in GBM, given your well-known appetite for rather risky leveraged property transactions around Europe.

A German bank did announce a rather large provision a couple of days ago for I think a transaction that you were co-leading with them in. They announced €250 million and you don't seem to have announced anything of that size. I am just wondering what's going on with the Spanish property lending and the German property lending that you have been doing?

MR. JOHNNY CAMERON: Well, the answer to the first part is, first of all, I don't accept the premise about we are only doing all the risky lending Europe, if I can just park that point!

Secondly, the definition of non-performing loans and potential problem loans is run by risk they bring forward, and that's the number and that is the trend. Again, it might reflect the de-risking point. I don't know whether that is why it hasn't gone up as much as you would expect, but that is the number produced by the independent risk department.

And thirdly Spanish property: yes, a difficult market. We are working with some of our customers there; we are appropriately provisioned today and very comfortable with that, but who knows looking forward!

SIR FRED GOODWIN: The property exposure in Spain is about 3 in total.

THE CHAIRMAN: Okay, well …

MR. ALEXANDER: But I am just wondering what is it looking like today? It can't be that good - can it? - given the number of bankruptcies going on in Spanish property developers and you have been very active in lending to property developers, so I am wondering how you are not seeing more?

MR. JOHNNY CAMERON: We tend to be very much at the larger end, the high quality end. We haven't got a big property developer book. We have got two or three or maybe four or five names and they are pretty good names, notwithstanding the comments you made about the German bank and our shared exposure there. By and large, we are in with the better quality names. Obviously we are all watching that closely and are working with our customers to see it through, but we are provisioned appropriately as of 30th June.