RBS
Moderators: Sir George Mathewson, Sir Fred Goodwin, Guy Whittaker
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Sir George Mathewson: Good morning, ladies and gentlemen, and can I welcome you to our Annual Results Conference for 2005. Before we go on to the results I'd like to welcome several people who you're going to see more of for years to come. First I'd like to introduce Sir Tom McKillop. Tom takes over from me as Chairman on April 28th, the day of our Annual General Meeting. I'm sure I am looking forward to it just as much as he is, and Tom brings to this job several years of board experience at one of the biggest banks in the country, huge international experience and, what's important, in his last job as Chief Executive of AstraZeneca, large company experience, and I'm absolutely delighted, delighted, that Tom is going to succeed me and I think the Royal Bank has done very well to attract him.

Could I also introduce to you Guy Whittaker, our new Finance Director. Guy also comes to us with many years international and banking experience, and I think it says something for the calibre and reputation of the company that we can attract someone of his calibre. And – positively his last appearance and in a supporting role – I'd like Fred Ward to stand up, and I'd like to thank Fred for what he's done for the Royal Bank over the years in which he worked for us and you go out with all our best wishes, Fred. Thank you very much. Now can I ask Guy Whittaker to take us through the numbers?

Guy Whittaker: Good morning, everyone. George, thank you very much for that kind introduction. I'm absolutely delighted to be here and I appreciate every single one of the twenty days you have given me to prepare for this moment, in fact every hour of those twenty days to prepare for this moment.

I am delighted to report an excellent set of results for the Group this year. Income at £25.6 billion is up 14%; operating profit at £8.25 billion up 16%; and profit attributable to shareholders up 17% at almost £5.4 billion. Our basic earnings per share rose 13%, reflecting a 1.6% increase in the tax rate to 30% as well as the full year impact of prior share issuance. Subtracting one-time gains and integration cost of adjusted EPS is 175.9p up 8%. I'm particularly pleased to see with these strong earnings a disciplined balance sheet growth lifted our tier one ratio to 7.6% producing a very good return on equity of 18.2%.

All of our customer-facing businesses performed well in the context of the marketplace in which they operate. Highlighting the strength of the business model that we have and we'll go into each of the divisions later, as well as being diversified by customer we are clearly diversified by type of activity. Our net interest income from personal, business, loans and deposits, domestic and international rose 10% to £9.9 billion and non interest income also again from personal and business activity domestically and internationally rose 16% to £15.6 billion. Non-interest income now accounts for 61% of group income up 1% from 2004.

Our net interest margin, 39% of income, fell 26 basis points over the course of 2005, dropping from 2.81 to 2.55. As we indicated at the interims in the first half, the first half reduction was 20 basis points and in the second half we declined a further 10. Across a company as large and diverse as RBS, there are many moving elements to this but the key drivers have changed. While growing share of the UK mortgage market which while having a lower margin has a better risk adjusted return, a growing share of business deposits and long term savings, sometimes the stabilisation in margins particularly in the UK personal lending sector. On the other hand corporate markets and margins there remained quite tight. We continue to feel, as do many of our peers, the impact of the flatter curve across the United States and the sort of mix and underlying trends that we see here whilst moderating slightly show at least they'll point to the likely path we'll see in the early parts of 2006. In terms of operating efficiency, expenses rose 14% to £11.3 billion. Our headline cost-income ratio at 42.4 reflected the full year impact of Charter One and underlying expense control remains good as our flat operating efficiency 41.8.

We continue across the Group to look for efficiency gains, although I think at this stage we've accomplished an awful lot over the last five years or so and there's mainly just modest scope for improvement from these sort of levels next year.

Overall, the total loans and advances grew 16% across the company and impairment losses grew 7% to £1.7 billion. They experienced high losses in cards and retail and lower losses in the corporate sector where cash flows remained strong. Our risk elements in lending fell from 1.84% to 1.6% as a function of write offs and the higher proportion of secured lending that we're now doing and impairments overall as a the whole portfolio were 1 basis point better up 46 basis points. Our provisions coverage which is typically hovered around 70% fell from 70 to 65%, this again reflects the higher proportion of mortgage lending within the book as well as forth quarter actions to bring our write off policies inline with Basel II guidelines. Ex-mortgages, our provision ratios remained stable at 74% year-on-year, and the overall portfolio credit quality and metrics remained stable.

Across the Group, income rose £3 billion to 25.6, as I said; expenses up £1.4 billion to 11,298 million; and insurance claims are up 9% – or up £357 million or 9% broadly in line with volume growth; and impairments rose 117 million to the 1,707 number – resulting in an operating profit of £8,251 million, up 16%. And again a similar story to the income across the Group, each of the divisions making a very good contribution in the context of the market place or the geography in which they operate.

And I'd like to take a few moments now just to go through each of the divisions. Corporate Markets had an outstanding year. Corporate and institutional cash flows remained strong and the resulting positive credit environment is very good in terms of lower losses, in terms of higher recoveries, in terms of gains from prior work out situations as well gains on other investments. We maintained our market-leading position in the UK corporate and commercial markets and around the world. Underwriting volumes remain strong and we're pleased to be the fourth most active arranger of loan financing in the world. We also had a much greater focus on distribution, particularly in the second half of the year. So building a distribution and origination strategy allowed us to see risk weighted assets come down from the midyear spike to show just the 14% year-over-year growth with a 24% corresponding increase in contribution. We're particularly pleased to see over half of the income growth in Corporate Markets come from outside the UK, with Europe and RBS Greenwich Capital doing particularly well. Sales and trading were up 16% year over year with the Group trading bar remaining very modest at £13 million.

Across our Retail markets, I think there's a very pleasing result in a challenging market environment. Total income was up 7% on the year; tight cost control helping mitigate rising credit costs in cards and in the retail sector which reduces the bottom line contribution up 4%. RBS and NatWest are respectively the first and second brands in service quality in the UK Retail space based on customer feedback. And this is also evidenced by us gaining the largest share of net new accounts, switching amongst the UK banks. We're making excellent progress, highlighted at the interims in leveraging our branch distribution network. Taking increasing share in term savings products; in bank assurance where premium income has raised 25% to £171 million; in mortgages where our share of the UK mortgage market has now risen to 8%; and in cards where we originated 336,000 customers in the second half of the year up 60% from the prior period last year all through our branch channels.

Credit criteria, as you might expect, remain strict although there are some signs that margins are firming, but some of the stress that we saw around the turn of last year is beginning to abate. And our bias going forward is towards continued increase in our secured lending products.

Over in Ireland, Ulster Banks: a very good story, a strong growth contribution up 15%. We added 68,000 new customers, both business and personal, fuelling the rise in mortgage and business lending. Ulster Bank in the Republic of Ireland grew 9% benefiting from its easy switch account programme. In Northern Ireland we've significantly enhanced our personal account offering, First Active remains very well on track.

In the United States, our Citizens headline income grew 43% and our contribution was up 47% of this, they obviously reflect the full year impact of Charter One. Excluding Charter One, the Citizens business grew 10% points. On the current acquisition we talked about a number of revenue and expense synergies that we would try to pursue over the following three years. On the expense side of the equation, the systems infrastructure on operating efficiencies all remain on track. On the revenue side we're seeing good growth in terms of volumes with loans up 18% and deposits up 10%. What is irrefutable across the market place is the environment is a significantly tougher one than we saw two years ago.

The combined Citizens Group overall has good underlying growth. We're making excellent progress in cards, with RBS National showing balances up 9% to £2.5 billion; RBS Link, our merchant acquiring business adding 25% more customers over the year and our joint venture with progress to provide private label credit cards, going extremely well. Credit quality is good and the Group have minimal impact from the spike in the fourth quarter bankruptcies, due to the adoption of the Bankruptcy Laws in the US in the fourth quarter of 2005.

The flatter yield curve and the positive credit environment in the United States is making the Retail market place there extremely competitive and putting pressure on margins, with narrow spreads coming through in both loans and deposit. In that environment over time we will clearly learn to adapt and evolve our business model, as we do in fact in other markets where we operate with a flat yield curve. It offers no respite in the short term as it looks like this environment is most likely one we will continue to operate in over the course of 2006.

In our Insurance division, direct, intermediary and partnership motor insurance policies grew 4%, contributing to an income growth of 8% and bottom line contribution of 5% to £926 million. We have the industry leading combined ratio of 93.6%, just slightly up from 93.2% last year which reflects both the underlying operating efficiency of our business, along with continuing claims inflation. On the business development front, we added 14% more policies across Europe. We added 10% more policies in the small and medium sized enterprises through our NIG brand and the Churchill integration is now absolutely complete.

The size and scale of our Insurance business has allowed us to reduce our reinsurance cover in 2005 while continuing to maintain protection against catastrophic events. The resultant reduction in this quota share has manifest itself mainly on the expense line, due to the nature of the arrangement of re-insurers, showing a headline increase of 13%. Our underlying expense growth across the business is only 4% points.

Manufacturing, as you know, supports most of our client placing on many of our client placing businesses. We spent £945 million on technology costs last year, up 11% from 2004. The underlying growth in technology spend was up 2% with the adoption of IFRS on 1st January 2005. The resulting amortisation of software costs added 9% points to that headline number.

Our property and purchasing costs were £1.13 billion, up 9%. These reflect ongoing upgrades to our portfolio including the City Centre strategy across the UK. There's material improvements in Edinburgh, Birmingham, Manchester and Southend, along with extensive branch improvement programmes across the country.

Our customer support areas have spent £785 million, up 2% year-over-year, with increasing efficiency, obviously the result of prior year investments offsetting wage inflation and of course, significantly increased business volumes. For example, 10% growth in mortgages processed over the course of the year. Overall the core expenses, excluding the impact of IFRS grew 4% points.

Our central items grew £458 million over the course of the year. These reflected the full year funding costs of the Charter One acquisition, reflected increased pension costs and also reflected the hedge volatility that we record essentially for economic hedges which have accounting ineffectiveness and they also flow through the centre. It also affects a number of centrally managed initiatives from Group training and development programmes, from Group insurance policies, as well as the number of regulatory issues to see us compliant with Basel II, Sarbanes-Oxley and International Accounting Standards. We do not expect the same sort of jump to occur in 2006.

The balance sheet discipline was excellent. Overall assets grew 12%, risk rated assets grew 14%, while return on equities 18.2% on a constant capital basis 18.7% to help lift our tier one ratio from 6.7% to a very healthy 7.6% at the end of 2005 and allowed a number of the capital distribution initiatives that we announced this morning to begin.

So overall I think a very, very good year from the Group across all of our operating divisions, profits up 16%, diversified income across the group up 14%, demonstrable capital strength and efficiency, stable credit metrics and a company that is very well positioned for 2006. And with that I'll hand it over to Fred to make his comments. Thank you.

Sir Fred Goodwin: Thanks, Guy. Good morning, everyone. I think uniquely amongst this morning's presenters I am neither coming nor going. I'm just delighted to be here, as always. Building on the stream of good news this morning, also I just would like to intimate that I am only going to cover off in a short number of slides, just in a couple of quite important topics, in the hope we can leave more time for questions at the end.

The first topic I'd like to touch on obviously is capital. I think today does mark a milestone in the development of the Group's capital base and in the development of its capital strategy. I know you'll have a number of questions around this, and particularly around its context, and I'd like to begin by just touching on this. And as far as context is concerned, I would like to begin with what I'd remind you all of what I would consider to be the most significant milestone in the capital development policy prior to this, and to do that I have to take you back to the halcyon days of the summer 2003 when this chart first made its appearance, indicating for the first time our thinking around capital policy for the Group.

Interesting, I suppose, in a number of respects, firstly that we saw our capital being – flexibility in capital being delineated by our tier one ratio and where it fell, also indicating that there wasn't a precise science but there was a zone in which buybacks were unlikely, there was a zone in which returning capital to shareholders were very likely and what I know some of you found slightly unhelpful, a ‘maybe’ zone in the middle. But nevertheless this was the last major milestone and what we've been up to ever since have been moving down that path.

In simple terms we run the business by a very simple set of metrics and objectives. I mean, it may seem at some levels disarmingly simple, but trying to grow our income seems quite an important thing to do; if you're not able to grow your income, everything else starts to go backwards on you pretty quickly. Improving your income, but having the benefit go backwards because your efficiency is not improving is not a great place to be either, so improvement in efficiency is something which is important to us. Maintaining stable credit quality: always a good idea when you are a financial institution, but that was one of our key objectives and one our key metrics. And also generating appropriate returns on capital, there's no point in doing all of the above if our returns on capital are going down.

So how have we being doing against that? I don't propose to go through all of these figures in detail. You will be familiar with them yourselves; those are the headline figures over the period since the NatWest transactions. Good income growth, good growth in operating profit, impacted of course by acquisitions along the way. So let's have a look at the underlying, excluding acquisitions and at constant exchange rates. Again you will see a clear pattern emerging, evidencing the fact that we are growing income, we are maintaining and improving our efficiency and we are enjoying stable credit metrics through that time. Also, the picture is slightly confused by the interaction of IFRS, obviously, and by the fact that in the current year we have stepped up the capital base but strong returns on equity during that period.

Not surprisingly from those numbers, you will appreciate that we do generate a lot of capital in the business there. The reason for putting the slide up in 2003 was, I guess, that some of your minds and our minds were turning to the fact that post the AVS we announced at the time of NatWest, the Group’s capital generation was going to just arithmetically create a significant amount of capital generation.

At the same time, we can't grow without consuming capital, so out of that gross capital generation we have consumed some of it to support the growth in the business and support the growth in the balance sheet, and we have stepped up our dividend during that time as well. But as you can see, right at the bottom, we have generated quite a lot of “free” capital. We've also generated a number of uses for that capital up until now again. You're familiar with all of these, I don't propose to go into any detail but it is worth remembering that almost £3 billion which were returned as part of the AVS, and obviously the acquisitions which we made, which absorbed capital also.

Mapping that onto the skeleton or the framework which we presented in the summer of 2003, the following picture emerges. At the end of last year it was pretty clear to everyone that we were not in a position to return capital to shareholders. The priority remained funding organic growth and getting our capital ratio up to a level that we felt was sustainable. At the end of this year, to the end of 2005, I'm pleased to announce that we have reached that place. Our UK GAAP equivalent capital number would be up 7.8% or so, but it's very hard to make a precise comparison but under IFRS any feeling in all of this would be adjusted so I would put it to you that the equivalent of our 8% threshold in GAAP would map to about 7.7% under IFRS. It's not a precisely scientific movement, but just as a rule of thumb. So you will see that we are not only into the maybe zone but well through the maybe zone and given that we are already a couple of months into 2006 and remembering the previous slide about the amount of capital we generate, you can spot that we are well into the zone at which I have always signalled to you that we would wish to return capital to shareholders.

I think to allow some greater understanding around that and to give a sense of what our thinking going forward is, we do expect to continue generating capital, we expect that generation to remain strong. We have no plans for major acquisitions, as we've said before, no news there and no change there. We see, crucially though, we see many opportunities to generate profitable growth in the business and a good many of them not particularly capital intensive. You will have spotted in Guy’s slide, the fact that in US project and company announcement as well, that our non-interest income now represents over 60% of our total income, we’re using it because it tends not to tie up capital in the same way as the net interest income can.

You would have also have seen in the figures and in the progression of risk-weighted assets in the year, the fact that we have great capabilities, not just in originating but in distributing, and I think as we go forward in the business, that will become a more integral part of the model, not just in Corporate Markets but across our balance sheet more generally.

We will continue to evaluate opportunities; there are plenty of opportunities out there. I think it would be reckless of us not to. But we maintain, against everything that we do, whether they they've got to be acquisitions or whether they be business plans or enhancements of our business, strict investment criteria. And certainly we would expect to fund our future growth from our own resources.

All of that said we remain committed to capital efficiency. We don't like carrying more capital than we need to. You have heard me before on the subject of building up war chests and carrying, that's not the way we would wish to operate at all. Which brings us then to an almost, to an almost arithmetic conclusion rather than a strategic or emotional one, that we therefore expect that you know, that returning capital to shareholders is an integral part of our strategy going forward and something which will be determined by where our capital ratios fall relative to the metrics which I have shown you.

Having got to a place this year where there was clearly capacity to return capital to shareholders our first thought turned to dividend. We are very proud of our dividend track record and I will return to that a little bit later, but by the same token our payout ratio was starting to fall behind those of our peers and those of the market more generally. So our first thought turn to dividend and to increase going forward at payout ratio to something beginning with a four rather than something beginning with a three, hence the 29% increase in the final dividend this year, bringing the total dividend up by 25% and setting a new base for moving forward.

Thereafter, you would easily spot that the numbers still support a redistribution to a simple buyback, that we propose to do over the course of the next month, the next twelve months, starting from - that would be fun, no, no, put that thought to one side now. That said, we would view it as game on from noon today, that's not to say we're getting any hostage to fortune, we're going to go out and plan a new ending today; but from noon today we are in the buyback market, albeit you know, we've said, as you would appreciate, we're not rushing out to do anything that would create any distorting movements in the share price.

Also, going forward, we would aim to maintain our tier one ratios after a round at current level and I don't want to get locked in here to 7.6 but you know, in the mid seven's. There will be comings and goings as we go through in the normal course of business. I don't want to get too trapped. But just for guidance and for information, in the mid sort of sevens, is where we would, all other things being equal, expect to come out.

As I was going to say, in capital – I'm sure return to that in questions later – a very quick comment on China, not to make a big fuss out of China but I'm conscious that this is the first time that I've actually stood before you face to face since we announced the transaction in August. A lot has flowed under the bridge since then, but I thought I would just remind you of the salient features of our position in China and, again, happy to take any questions on this.

I think the notable points being the transaction completed just before the year end. We have no plans to increase our investment in China. We view this very much, the shareholding very much, as a ticket to the game to enable us to access the joint venture and business opportunities in China. This is not a take over of Bank of China by stealth or building up a strategic stake, this was the minimum stake that we felt that was consistent with the benefits that we've been able to secure. The IPO was planned for 2006, you've read all about that. One of the very encouraging things about progress so far, is that progress began and activity began on the ground last August and there wasn't a holding back until we got the deal signed so quite a lot of ground has already been covered, inevitably it's of a preparatory and preliminary nature. And it's been very encouraging and we're making progress now across quite a wide number of fronts in developing joint venture opportunities and in helping Bank of China to get itself ready for its IPO.

The outlook, always a topic I like to cover and it is important today as it ever is. Before diving in to talk about the economies we operate in I thought it was just worth reminding ourselves that it isn't just about the UK any more. There is always a temptation when we talk about outlook and economy to start talking about what's happening to the UK consumer and no doubt we will come back and talk about that but it's worth reminding ourselves that, you know, the significance of the UK is still considerable to our business but its considerably less than it has been historically. An interesting figure on here is underneath the European one. Clearly I was aware of the size of our European business, but a little metric that I hadn't picked up until we were putting the slides all together, is that we make the same amount of money in Europe now as we did in Citizens prior to the Charter One acquisition. So Europe has grown primarily organically to quite a significant part of our business now and continues to grow as strongly. But you'll gather from the slide that the economies I'm going to talk about this morning in terms of outlook are the UK, the US and Europe.

This is not an economics lecture incidentally, because I would not be very well equipped to deliver it but I thought I would just try and pick out some of the salient points as we see them. Firstly, I think it is worth observing that 2005, these economies really coped rather well with quite a number of shocks. In the US, we had the hurricanes and the high energy prices. We had the fed tightening by 200 or so basis points. In the UK we saw quite a marked slow down in growth and lead to the lowest growth we've had since 1992 albeit still at 1.8% which in terms of more growth in the UK doesn't feel so bad and, with a distinct sign of a pulse almost everywhere you looked in Europe which again, was progress.

Going forward in the UK, I think 2006 looks like being better than 2005. The housing market is back on the rails. Retail sales are recovering, not every retailer is doing well but I think that's got more to do in many instances with their positioning and strategy than it has to the attitudes and behaviour of the consumer. We've seen a small rise unemployment, we want to keep our eye on that but in the context of record low levels of unemployment and the actual size of the increase has been very modest indeed. One of the more interesting feature is the length time someone now tends to be unemployed for, the flexibility of our labour markets have improved markedly. So typically people are remaining unemployed for only about six months before moving into something else so I don't think unemployment is something we should be overly concerned about but it pays to keep an eye on it.

Also worth reminding ourselves I guess in relation to consumer lending that for unsecured consumer lending in the UK represents less than 7% of our total income, so it's not a big business activity for us. Corporate credit remains very benign. So 2006 in the UK looks like being an ok year and certainly better than 2005. You'll have your own views as to where the growth lies but it always, the estimates we've seen seem to fall somewhere between 2 - 2.5%.

The United States, the economy motoring along, they've had rather a few shocks during the course of the year: the hurricanes, the high oil price, fed tightening and the economy. There are also signs suggesting the economy is operating near to its capacity; unemployment below 5% which is probably as good as its going to get. Again, we're seeing a bit of a transition in consumer spending, we are starting to see companies coming to the fore now to increase capacity and behaviour. Credit quality: benign. We've been able, in particular in our business, to largely absorb the change in the bankruptcy laws in the United States without undue pain, rather against the run of play. Internationally those changes favour the banks but they just created something of a rush to become insolvent before the new laws came in but they managed to absorb the limited impact of that without difficulty. And we're expecting big growth in the United States, perhaps a little slower than this year but at between 3-4% that doesn't feel like a bad place to be.

Europe, I guess compared with the UK and compared with the United States doesn't seem all that exciting perhaps, but it is important to recognise that they're very skewed as to where we are in Europe. We're particularly exposed to the Irish economy, which amongst the European economies is one of the strongest. We're also particularly exposed to corporate activity in Europe, where we are seeing a lot of activity, a lot of transaction related activity so we would remain in a very positive frame of mind about Europe in 2006, certainly as it impacts on our businesses.

In summary then, I think the economic backdrop in 2006 will provide ongoing opportunities for business and for financial services business.

Crucially, our platform, our existing platform allows us to access them, it gives us the skills we need to be able to go in and compete from a position of advantage, a position of efficiency and underlying competitive advantage. We face the economy going forward in a position of strength. We have a strong balance sheet. We have strong credit ratings. We have good array of business. We have a good array of people and talent to go forward and develop the opportunities. We have diversity, which means that not everything hangs off of a single business initiative, or off of a single market or off of a single income stream – again, something which I think is important, not least because it does allow us to respond flexibly. The only thing that we know about the future for sure is that it will come out slightly differently fro how we imagine. And the diversity which we have in our business, does give us the flexibility to respond both to opportunities and to threats.

So all in all, I think it would be fair to say we face 2006 with a good degree of confidence in our ability to generate value for our shareholders going forward. At this point, I would normally stop the presentation, and move to questions, but there is just one other subject I would like to touch on and you've already had a clue what it is. And that is you'd have deduced from George's earlier remark this will be George's last appearance at these gatherings. Your views about that may be different from George's views about that. He has confided what his are, but I couldn't let this occasion go past without paying publicly, and I know I'll have many opportunities to do this at other gatherings going forward but nevertheless in front of all of you, to pay tribute to George, and to thank him, both personally and on behalf of all of his colleagues for everything that he has brought to the Royal Bank of Scotland Group.

I've always got on effortlessly and closely with George and I will miss him when he goes. It doesn't quite seem real yet, because it's still in April, but we'll get to April soon enough. Modesty, which is not a quality often associated with George but on this occasion prohibited George from putting this slide up earlier on, I'd like to put it up. Just a chart – George took over as Chief Executive of the Royal Bank in 1992, and there will be very few Chief Executives, George, who could, over that period of time, deliver those sorts of numbers, firstly as Chief Executive, and then as Chairman as you moved through. It's rather a pity the IFRS intervened, in my opinion, but the legal advisors prevented me adjusting those blue bars to where they possibly would have been under GAAP. But I think you get the general picture, ladies and gentlemen. Similarly, in terms of dividends per share, there will be few who have presided over such an achievement. There are a huge number of anecdotes and trials and tribulations in amongst all of that. I can attest to them personally from 1998 onwards. I fully intend to return to them, George, at your various retirement gatherings, but I'm conscious that today is a results presentation, and not a retirement party. So I'll stop this simply by again expressing my and our appreciation for everything that you've done for the group. Thank you very much. I'll invite George and my other colleagues up to join me in the panel and we'll be happy to try and answer any questions.

Sir George Mathewson: Okay, as usual, but for the last time, could you please give your name and organisation, and await the microphone.

Ian Smillie: Morning, I'm Ian Smillie from ABN- Amro. Can I ask two questions please, both on capital? The first one is the impact of the Bank of China transaction. I think at the time of the deal you guided to a ten basis point benefit on the tier one. By my account in the press release you made at the Bank of China deal, my calculations to me suggest it's like 40 basis points, the difference being the consolidation of 1.2 billions' worth of minority investments – effectively consolidating your partners' money into that deal. Can I just clarify that that is correct?

Sir Fred Goodwin: No, it's not correct, Ian. I think the number from the combined Bank of China plus disposal of SCH would be about 20 basis points.

Ian Smillie: So what's driving the 1.2 billion increase in minority investments, which appear to be coming from outside the group and being capitalised inside your tier one?

Sir Fred Goodwin: Some of it would be translation differences. There will be some in valuation and in the minority interest in Linea Directa.

Guy Whittaker: The Bank of China number, if I recall correctly is around £850 million, I think is the right number for that. So the 1.2 is not a number that I'm familiar with. So we'll have to look into that, or maybe just connect with you afterwards and see.

Ian Smillie: And the second question is can we look forward to at any stage to a return on capital by division, showing separately identified capital across each of the divisions that the group operate or should we continue to expect return on capital figures just to be provided at the group level and obviously the subtext is that there's something like 40% of your core equity tier one capital, which is being deducted from total regulatory capital. So there's a fair degree of double counting going on.

Sir Fred Goodwin: I'm not sure of that either Ian but I think the basic difficulty with that is the significant allocation of manufacturing costs to make that viable, which is not something that we propose to do. We take the view that capital is something we absorb as a group, and we deploy within the group to deliver a single return to our shareholders. So the single return in capital figures is a metric that we use, I think we provide and disclose around the business unit to allow you to understand the performance of those business units. So I don't think we plan to disclose it by division and the double counting point as you would expect we do refute.

Ian Smillie: Thank you.

Simon Samuels: Thanks, morning. It's Simon Samuels from Citigroup. Three questions actually, I was wondering first of all, can you just give some indication of, in your assessment what you think a kind of sustainable growth rate in risks assets going forward should be? Obviously you've done 14 for the year. It was a very unusual year, with the big number in the first half, and a much smaller second half. And I know there was some securitisation activity in that second half. So thinking going forward in terms of both the organic growth of the business and also scope for securitisation what you think are the RWA growth medium term should trend towards?

Sir Fred Goodwin: You know my great enthusiasm for giving forward looking statements Simon but the picture becomes more difficult than ever, I think because, as you partly suggested it in your question that the impact of securitisation has general ability to distribute what we originate, makes the picture more difficult. I'll pass along to Johnny to give you a sense of what's happening in the corporate markets, where the chunkier numbers would be and most of the distribution would be, and then I'll come back to try and address the situation more generally.

Johnny Cameron: I think – I don't want to put bounds on how much we can originate, but we will manage through the capital allocation from group so that we will manage at the back end, so to speak by distributing more and more. But we won't be bringing in our assets reigning in our efforts to originate.

Simon Samuels: Maybe if I can just rephrase the question to give you another way to answer it. Is 14%, which was the '05 performance – is that good/bad/average, in terms of when you do your medium term planning?

Sir Fred Goodwin: I'd say it's not too shabby, Simon. But I think that we don't go about the internal planning in that way. I think that we could originate – there are as many assets out there as you could possibly wish to have at the moment. The problem is the returns on them. And the problem in some instances is the degree to which people are prepared to compromise in credit to put those assets on. So neither of those – the profitability of the asset growth and the credit quality are sacrosanct as far as we are concerned. So we don't sort of set out in the beginning of the year saying you must deliver X amount of asset growth. As Johnny says, we don't set out at the start of the year to bound what the business does either. But there's a limited amount that it makes sense to us to put onto our balance sheet. The greater availability of mechanisms for offloading assets that we've originated give us a lot more flexibility in the area, so I'm not helping you here. I'm not trying not to help you. But it's just there's not a number that we focus on, let's go out and do this amount risk weighted asset growth and shape everything back around that. It demonstrates something of our product. As you saw at the half year, we had a great deal of risk weighted assets on the balance sheet which were something of a spike and we subsequently offloaded them. So that maybe gives you some insight into how we think around risk weighted assets.

Simon Samuels: The second question is, I guess for Larry, you know obviously the, I know the IT side the IT integration was completed last July on Charter One. I was wondering if you could just give a sense of how soon you think, and indeed want to start making some of the infill acquisitions in the Charter One footprint that I think most of us in this room are expecting at some point to be part of the US strategy.

Larry Fish: I think the answer to that Simon is when we begin to see a more realistic price that the smaller banks are trading at. Right now, I think there's too much optimism around what these franchises are worth. I was explaining to somebody earlier, there are still 403 banks in Chicago, so there's plenty to go for. But we should be careful not to race after the kind of valuations that are in the market at the moment. I think at some point, their ability to be competitive and also the relatively few number of buyers will put these valuations back in line and then there will be opportunities for us.

Tom Rayner: Thanks, it's Tom Rayner of Citigroup. Could I just ask two questions actually? The first, just a bit more colour on what was said on the margin outlook. I think it was the trends will sort of continue into the early part of 2006, but obviously there's many different trends across many of the different divisions. Could you just maybe add a bit more colour to those comments on the margin overall, please?

Guy Whittaker: Yes. I think what I was trying to indicate there is there are a number of different drivers. There are some widening margins in some products, as more sensible risk-based pricing is applied. There is also a change in our underlying business mix, where we are seeing a growing preponderance of mortgages, particularly in retail, which obviously have both the maybe lower margin characteristics but very good risk-adjusted returns. No, I think the spread pressures that we have seen in the US will continue and be contributory at least in the early part of 2006. And if you wanted to pin it down, a sort of lowish double-digit number I think is more likely on a sort of full-year horizon. I think we are sort of seeing some signs that the accelerating trends in 2004/early 2005 have started to abate, and that would be sort of my best estimate in order to narrow it down a bit further.

Tom Rayner: No, thank you, that's fine. Thanks very much. Just a second quick one on the capital. Fred sort of, you suggested the mid-sevens for the total tier one. Just looking at your slide on, I suppose, the free cash flow generation, I think you used a 5% ratio to apply to the risk-weighted assets. Is that suggesting a 5% equity tier one is pretty much there or thereabouts where you would be comfortable to – on an ongoing basis?

Sir Fred Goodwin: I mean, the equity component of it will move around within it as well. I think that it's something like 4.9% or so just now, equity tier one, so that's a sort of rule of thumb, Tom. It's not a precise science either, I would imagine around that level.

Tom Rayner: Ok, thanks a lot.

Sir Fred Goodwin: Ed?

Ed Firth: Thanks, it's Ed Firth from SocGen. Could I just ask you about the pensions deficit? I see that was up almost, what, 30% in the second half and is now, what, almost 15% of tier one equity, I guess. So I guess my two questions are: firstly, how do you look at that in terms of when you're assessing your capital requirement going forward; and secondly, you highlighted that some of the central costs included a big increase in the pension contribution. Should we expect that to continue, going forward? Is that how you're going to see this pension deficit come down, or…?

Sir Fred Goodwin: Yes, I think as to the pension deficit that you see in the numbers, it's driven, as you would have read about in a number of places, by the sort of bond yield more than anything else. That's caused the increase. That's not to say that there aren't underlying issues with pension costs which drive a deficit. We mentioned last year, you will remember, that we made a one-off contribution of 750 million towards the pension deficit post the actuarial valuation. The actuarial valuation is considerably less than the deficit calculated under the basis that you describe, and we also increased the contribution rate based on salaries, that we make into the pension fund, to eat into the deficit. So on an actuarial basis the picture is considerably different.

The way we look upon that deficit, I suppose in simple terms, there it's what, three months' or so profit, three or four months' profit. Of course, I'm not being at all flippant, but I think everyone understands why the numbers associated with pensions are quite large and quite volatile. Ours are no different. We are fortunate, I think, in that the numbers as a proportion of our capital base or market cap or profitability or any basis you want to look at it on are relatively small, but we have our eye on it. I think, as to how it will be treated going forward, by our regulator, then under Basel II there are still some vagaries around. But we are certainly looking at it. But the volatility is occasioned by the bond yield, which you would have known.

Ed Firth: And in terms of the P&L contribution, would you expect the costs associated with pension contributions to continue to rise, or have we seen a sort of one-off…?

Sir Fred Goodwin: You've seen a very big step up. I think we'd not anticipate them rising at this point, but you know the underlying dynamics as well as we do.

Ed Firth: Thanks.

Jonathan Pierce: Thanks. Hi there, it's Jonathan Pierce from Credit Suisse. I've got two. One's actually back on capital I'm afraid, the other's on the corporate bank. On capital, I mean, bearing in mind the hints, as discussed in a previous answer that 5% equity tier one looks to be about the right level. Fitch, I think recently as August, suggested that, I think they said that there was downside risk to both Barclays and RBS ratings, unless they fairly rapidly rebuilt, capital ratios following obviously ASBA in Barclays' case, but Charter One in your case. I'm wondering whether you've had time to discuss the planned dividend and capital programme today with the rating agencies, and what their position is?

Guy Whittaker: The answer is yes, we did. We've called the agencies as part of our decision-making process, and they all affirmed the financial strength and ratings of the company, and the outlook – that's prior to the announcement.

Jonathan Pierce: Thank you. On the corporate bank, and global banking specifically, there's quite a big increase in the sort of other non-interest income line, which we saw to an extent in the first half, but I think has accelerated in the second half. It's moved from over 300 million to just over 700 million in 2005 versus 2004. I was wondering if you could clarify what's in there, and what the big drivers of the growth have been..

Guy Whittaker: We had, as I said at the half year, I think, we've had a good year in our private equity portfolio, and also in some of the warrants and similar that we carry in our mezzanine portfolio. And I'm pleased to say we've still got a very significant portfolio going forward, but that's the main driver.

David Williams: Good morning, it's David Williams from Morgan Stanley. Two questions please: one on UK Retail and one on the Corporate Markets. On the UK Retail division, you say that you plan to refocus your strategy at gross sales, at deposit and bank assurance. Could you just expand on that, what you think the implications are, will it require cost investment? And also, is that a more pessimistic outlook on the direction of UK credit quality going forward? The second question: in the corporate market division of the mortgage-backed securities and asset-backed, two of your key product lines there, according to the Deal Logic data they've got off to a very weak start to the year. Could you say what implications that has for your business in '06 please?

Guy Whittaker: Yes, thank you. On the retail side, we said at the half-year that, being realistic, we were in for a two-year slog in the retail sector, and I think that just means less demand for unsecured credit, both from the customer and actually from our point of view in actually wanting to lend it as well. So bearing that in mind, we decided to refocus on the mortgage market itself, obviously, where we're relatively underweight, and have huge distribution capability; and also on savings and investment generally. Both areas where, historically I think, we've been underweight.

And then that investment that you're talking about has largely been made, the Bancassurance business has been largely rebuilt over the last two years, the sales force is now getting up to the sort of level where we're actually beginning to see critical mass coming through. But it's interesting enough we still have roughly 60% the number of financial planning consultants that say, HBOS has on a customer-base, which is not that dissimilar. So you can see that we could probably still significantly increase our sales force, and we've got a huge amount of room to go. I think on bank assurance, there's always been the sort of concept 'there is a glass ceiling', that the potential has never been quite realised, but from our point of view, I think we're still on sort of a glass doorstep, relative to that ceiling, so we've got several years of growth, where really, the only investment is sales people. The actual structures are there, and obviously joint ventures of either.

On deposits, obviously when you're looking at net interest margins, the more of your business you can obtain without lending, the happier you are. And that has come through really well in the last six months. Our new sales systems point our sellers straight to people's saving space, and they actually open accounts, which is something we've had to rely on the past on experience, and now it's automated, that has shown through. And we're – I wouldn't be at all surprised if next year we see deposit growth actually outrunning asset growth in the retail bank, and that's partly a change in our customers' own attitudes, but also our own inclination. I think that just shows that if consumer credits flow down, we've got plenty of other irons in this fire, hence the big pickup in performance in the second half of the year.

David Williams: Thank you.

Sir Fred Goodwin: I think it's quite – it's worth stating the obvious, it's sometimes difficult for us to refocus on things if it's not what our customers are doing. And I think the reality in the UK is that we have seen people becoming more conservative in a position, and that focus on deposits and savings has benefited the direction Gordon is going in.

Johnny Cameron: I'm going to make a couple of points. One is: I think you're particularly referring to the States there. We are actually number two in the world in securitisation, and that diversity is obviously beneficial. Secondly, I think to extrapolate from one month is a bit ambitious. I was interested in your report that you didn't focus on how well we did in '05 bbut picked on January, actually – but if it does turn down, if it were to turn down – and it may do one day – the real advantage is that we are now, with Greenwich, coming much closer to our branch in New York and having it all run under one hand. The benefits are flowing through strongly and using the Greenwich platform to build on our corporate banking relationships. So for example our derivative business in the States was up over 100% last year. So other things will come through. It can't go on growing forever, I do agree with that.

Simon Wallace: Thank you. Simon Wallace from NCB Stockbrokers, I have two questions. The first one on UK Retail and the mortgage market and the second one on the tax rate. On the mortgage bit, the growth was clearly very strong last year and probably surprised a lot of us relative to expectations twelve months ago. Can you give us some indication as to the scale of your ambitions for growth in that area this year relative to the likely overall growth in UK lending? And secondly, on the tax rate: is it fair to assume that it's likely to come down in '06 given the steer that I think you're giving us on the US and the likely pickup relatively in UK profits growth if we see a peak in the bad debts and arrears?

Gordon Pell: If you look at the results actually over the last two years, our share of net new lending has outgrown our share of stock by about 2%. I think that's a reasonable run-rate as long as margins in the market allow you to do that. We're not in the business just of taking on board assets, but the market is quite robust at the moment. The South is moving ahead quite rapidly and traditionally we're very strong in that area. The advantage we developed over last year, really apart from our strong branch franchise, we now have RBS for intermediaries which is a combined sales force selling all our products in the intermediary market and in that we now have the First Active brand which has really grown from nothing to quite a significant player in the last 18 months. And 35% of that business is actually directed to the consumer not via intermediaries. So we've now got a branch franchise, a direct consumer franchise and a pure intermediary franchise and to some extent I will take as much market share as I can make a sensible return on. It's good quality business, it plays to our core franchise and we will see how margins go. If anything margins have proved remarkably stable over the last year and that suited us fine.

Guy Whittaker: Actually the tax rate if anything is probably going to creep maybe slightly higher from these sorts of levels, reflecting obviously some of the international income that we generate. US tax rates particularly around 35 percentage points, obviously with New York operations that can creep up closer to 40 percentage points. So they sort of creep into the overall group numbers and I think the sort of move up from 28.4 to 30% reflected some of that. Looking forward into ’06, I think if anything, just sort of a few basis points higher from here.

Sir George Mathewson: Any other questions? Over here, Mark. Mark Thomas.

Mark Thomas: Morning, Sir. It’s Mark Thomas of Keefe Bruyette. Just a question on the insurance side, if I may. We seem to have seen IT developments where you can aggregate so the hassle of checking prices is an awful lot easier. Are you seeing that having the impact on the business to date and looking forward would you anticipate this having an impact?

Annette Court: Morning. We are seeing quite a lot of activity with aggregators. Obviously we’re in a position where we have several strong brands, Direct Line, Churchill, Privilege. They’re all performing extremely well on the internet. In fact that growth that we’re getting through the internet channel has been quite substantial over the last 12 months and continues to increase so obviously there is a lot of activity happening through that route but I think we’re still very well positioned as a result of the strength of our brand.

Sir George Mathewson: Thank you, Annette.

Peter Toeman: Peter Toeman from HSBC. Retail Direct and the Retail Bank saw comparable bad debt charges in H2 relative to H1 and that’s in contrast to what we’ve seen from other institutions, so I wondered, is that because you tightened credit criteria quicker or are there any other lessons you want to pass on to your competitors.

Gordon Pell: I know they're all buying me drinks at the moment. I think the issue is, actually I was talking about this outside, we have a slightly different customer base from the two main competitors. Our market share of current accounts in the UK is about 21%. Our market share of high earners, which is anything over sort of £50,000 is actually nearly 30%. We're very much a South East customer base at one extreme and the other extreme we're a Scottish customer base and those two customer bases tend to be relatively insulated from what's been going on over the last couple of years. We don't have the big C - D customer base of the Lloyds Business and we don't have the big Barclaycard base of people who have cards but don't have bank relationships with you. So it's nice to see that it's sort of perhaps playing out as you might have expected. But we've taken our share of the pain. I said at the half year we were stable and at the end of the year we're stable but we are fragile and if unemployment ticks up dramatically, as Fred was saying, all of us will take our fair share of the pain. But I think with our Southern customer base and our high earning customer base, by and large, I think we're probably better equipped to sail through this particular storm than some of our competitors.

Sir George Mathewson: Ok, anyone else before we…oh yes.

James Hamilton: Good morning, it's James Hamilton at WestLB. A couple if I may. Firstly the United States, obviously great that the integration is complete, how much scope do you see for additional product penetration now that you've finished sort of sorting the base level IT and training out, going forward? And the second question is for Johnny, I mean clearly credit quality in Corporate is fantastic at the moment. How long do you see this going on for and realistically what do you see as a more normal sort of charge? And a cheeky third one if I may, do you believe that as a group that loan growth will yet again outpace the growth in loan impairment charge?

Larry Fish: Yes James thank you, I've come all the way from Providence, I was hoping to get at least one question, so thank you very much for that. I think the opportunity on the revenue side continues to be exciting. Charter One did not have a small business banking program. We've hired, trained and deployed 175 plus business bankers that offer now a range of loan, deposit, credit card and merchant processing services. We've hired 50 middle market corporate bankers across the Midwest. They're selling RBS white label derivatives, foreign exchange products, Citizens cash management products. And we've introduced on the retail side our family of Circle and Circle Green checking account products. Charter One did not offer credit cards. Charter One did not offer the ability to do mortgages in its branches. So there's still an awful lot to go for.

Johnny Cameron: All I can say that is, the only inside information I have, so to speak, rather than looking forward 3, 4, 5, 6 years to the end of this benign environment is that in the metrics that we look closely at, the most important of which is cases moving into our work out unit, we see no sign of a change at all. The credit environment does remain benign and I've also been pleased that our disciplines have remained strong and in the few instances in the UK where there have been problems there I think we've had less than our fair share. So, touch wood, as far as how forward I can look, which isn't that far, we're comfortable.

Sir George Mathewson: One last question please.

Sandy Chen: Hi it's Sandy Chen from Collins Stewart. Another question for Larry actually to make your trip worth it. The credit quality, you say it's stable, and I noticed that foreign loans non accrual were down really quite sharply versus '04. What's your expectation in terms of a sustainable impairment charge on the US business? And particularly with an expansion into business banking and credit cards. And also in the US, the economic slide that was put up, and 90% of personal lending being secured, what's your expectation for volume growth in the US business?

Larry Fish: Two very good questions, thank you. The first one was the question about credit quality. 70% of what we do is consumer credit, 90% of that is secured. 30% therefore is commercial credit, 85-90% of that is secured. We rank either first or second in credit quality of the twenty largest banks in the United States. We've always had a history of being quite conservative on the assets side of the balance sheet and I expect that to continue. So the outlook from my point of view at the moment continues to be positive as it relates to credit. I think what's going to happen, just to add a bit with the yield curve, is that banks are going to be reaching on credit and I think one of the things that will be very important for us is that we continue to be discipline on that front and not let this cycle push us to do things we shouldn't do.

The second question – I think what's happening is that volume growth is going to slow somewhat. Home prices are coming down or at least levelling off and therefore individuals have less equity against which to borrow. Typically we've had the last four, five years of very robust increase in home valuations and that's given people the ability to dip into the equity in their homes and take some credit and be more dynamic in their spending. I think that's going to slow a bit.

Sandy Chen: Thank you.

Sir George Mathewson: Ok. Thank you very much, ladies and gentlemen.

Operator: Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation you may now disconnect.