

Royal Bank of Scotland
Presenters: Sir Fred Goodwin, Guy Whittaker
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09h00 BST

Operator: Good morning ladies and gentlemen and welcome to today's Royal Bank of Scotland Conference Call. Your chairperson today will be Sir Fred Goodwin. Sir Fred Goodwin, please go ahead.

Sir Fred Goodwin: Good morning everyone, thank you for calling in. I'm sure you've all had a chance to look at the pre-close trading update, it's not a long document, it's hopefully very straightforward, there are not any hidden messages in there. We're pleased to be able to confirm that we anticipate our results for the first half will be slightly ahead of expectations. I know this is not new news as we confirmed that last week in the context of the ABN announcement that we made. Nevertheless it's a pleasure this morning to be able to present a little bit more granularity around those remarks. The first half of 2007 is very much a continuation of 2006, that's certainly the story within the business units, business metrics continue to be stable or improving and particularly in the area of credit, particularly in the area of unsecured credit where we see the quality as well as the quantum of the charge improving, and that's really it. I think business is travelling well and we anticipate delivering a strong set of results in the first half and for 2007 in total. So Guy and I are here to try and answer any questions you've got and probably the best use of time now is just to pass over to you and take your questions.

Operator: Ladies and gentlemen, to register for questions please press *1 on your touchtone keypad. If your question has been asked, press *2 to remove yourself from the Q&A list. We will pause for a moment while we wait for questions.

We will now take our first question from Mike Trippett with Oriel Securities. Please go ahead.

Mike Trippett: Hi Sir Fred, good morning. Two questions if I may, just on the first half against expectations, you are not in the statement today or indeed last week, it doesn't appear that you're attempting to actually talk up a full year consensus. I just wondered if you can confirm if that is the case, that you're simply saying there's a good first half at the moment but there isn't...

Sir Fred Goodwin: Can I take them one half at a time Mike, steady as we go and all that. We're ahead of expectations for the first half, I wouldn't want to spoil all your fun for the second half. I think if you read ahead of expectations in the first half with everything travelling forward on the same basis of last year, a reasonable person would draw a conclusion but I need to leave you guys to draw those conclusion for the second half through. We'll just confine ourselves to the first half today.

Mike Trippett: Ok, the second question, this is more about I suppose the broader market than specifically your first half trading but there's increasingly a lot of scaremongering stories on the quantum of lending by banks to non-bank financial institutions, be it private equity, be it hedge funds, comments today in the press about sort of covenant light lending. I just wondered if you could kind of just give a view as to how you see it from your perspective and the volume of lending to non-bank financial institutions in the first half?

Sir Fred Goodwin: I think there's nothing abnormal about loan growth in the first half, there has been good loan growth but nothing remarkable. Certainly there has been a debate going on for some time about covenant light, I'm conscious probably about this time last year actually there was a debate about covenant light and pressures on margins. I think in the numbers you saw today we were making some pretty unequivocal comments about credit quality and we have made some comments about group margin. There is in the market covenant light deals, I don't think it's a great turn of events. To my mind it may well be signifying we are coming towards the end of a

particular phase but they apply to a fairly narrow segment of the market that you're describing. The vast majority of our business is perhaps in some respects more mundane but for the areas that are affected but covenant light that are attracting all the attention are but a small part of our business. Nevertheless even in that small part of our business normal credit standards apply. We have been doing this for quite a long time now as a bank and we would like to think that we try and stick to our knitting when it comes to credit. The people that make decisions about credit are not the people who are interfacing with the customers, we have a completely independent credit process as we have spent many happy hours discussing over the years. Of course the other feature of the market at the moment is a huge proportion of those loans get redistributed anyway, so we are distributing 90-95% of the loans in the zone that you're talking about. But there is covenant light out there and there are those taking part in it. I think you wouldn't find many of the more seasoned players getting involved. I think we are happy with all the covenants we have got on the loans that we have advanced.

Operator: We will now take our next question from Mark Thomas with KBW. Please go ahead.

Mark Thomas: I just wanted to explore a bit more the improvement in the unsecured, I note your comment saying it's quality as well as quantum. Could you just perhaps elaborate a bit as to whether that's driven by the cautious approach to lending meaning perhaps that the book has shrunk so it's a sort of action by RBS? Do you see it as a market improvement? Is there any perhaps distortion around IAS volatility as the rate of deterioration has slowed? Just if we could get a little bit more colour and light on the improvement on the unsecured.

Sir Fred Goodwin: I will pass to Guy on the IAS aspect of it Mark but it's a combination of all the things you mentioned, the book has shrunk a little as it did in the second half of last year, the market is coming down as well. The mix or the quality of the credit within our book as you have heard me saying probably ad nauseam, we don't do sub-prime so we have not perhaps been exposed to some of the more boisterous elements of that market that others have. So

provisioning as a proportion of our book is coming down as well as the book coming down so to my mind that gets you to the remarks about quality and quantity. I will throw across to Guy on IAS.

Guy Whittaker: There's no change Mark on the IAS components of that so this is really as Fred said a function of there being slightly lower volumes in unsecured lending which reflects the cautious stance as well as throughout the duration of this whole episode. We have consistently tracked slightly ahead of the market in terms of timing and slightly lower than the market or in some cases considerably lower than the market in terms of absolute losses. I think this sort of just coming through, this likeness is consistent with those trends.

Mark Thomas: So you would say it is perhaps more weighted to Royal Bank action but the market as a whole has shown some improvement? Would that be a reasonable summary?

Sir Fred Goodwin: I think that's a pretty fair go I would say.

Mark Thomas: Thank you.

Operator: We will now take a question from Peter Toeman with HSBC. Please go ahead.

Peter Toeman : Morning. I just wanted to explore your commentary on the Corporate Markets division because you talk about the business performing well which perhaps sounds a little bit under enthusiastic but last year there were very strong realisation gains within CBFM, this other operating income line, but they came predominantly in the second half of the year. I wondered if you could give an indication of what the sort of realisation gains might have done in the first half and maybe that explains why the CBFM commentary seems rather moderate?

Sir Fred Goodwin: I'm sorry if it comes across like that Peter, we are not trying to be moderate or anything, we are just trying to be our usual modest self rather than moderate. The gains, we indicated last year that we thought that gains for this year would be at a slightly lower level but still making it into the four digit territory. First half we would anticipate being entirely consistent with the delivery of that. As I said there's nothing remarkable there to point out to you in the first half. I'm sorry you took that view about Corporate Markets, we are pretty pleased with the performance but we try and adopt a modest tone.

Peter Toeman : Right.

Sir Fred Goodwin: Are we ready for another question?

Operator: We will now take our next question from John-Paul Crutchley with Merrill Lynch. Please go ahead.

John-Paul Crutchley: Good morning all, it's JP here. A couple of questions if I can, the first on Corporate Markets, again I seem to recall that the first half of last year saw some strong recoveries as well and in terms of your phrasing on credit quality which is you're pointed to continuing good trends and general stability there, I'm just wondering whether we should be thinking about that in the context of the first or second half because there was a degree of variance reflected in a very strong first half recoveries. The second question was on the US margin where clearly you're now pointing to a more stable trend overall. I'm just wondering if we can now expect that to be sustained or are there other sort of issues associated with the yield curve or competitive issues that would give you some cause for concern thinking longer term?

Sir Fred Goodwin: To the recoveries point I think there was in fact one specific recovery of note in the first half of last year which is not likely to be repeated. Beyond that I am not sure that there is [anything].

John-Paul Crutchley: So when you talk in terms of the general stability, should we think about the charge for the last year as a whole as our base rather than the first half of last year that was clearly distorted?

Sir Fred Goodwin: It's still very low so it's a very good performance in the first half so I would be kind of blending your view a little bit. I'm not being entirely helpful but I'm just looking at the numbers. There's not a lot to call on it JP, it's pretty consistent with last year taking in the round, that's the best guidance I could give you. As far as the US margin is concerned it is looking more stable. That's not to say there is any shortage of competition out there but it seems to be less driven by...we have reached a degree of intensity of price competition which seems to be stabilising so the margin going forward has been pretty stable. We have still got some margin effect as the full decline in last year flows through but as you saw in second half of last year, the margin had pretty much flattened out and that's what we are seeing rolling forward into '07.

John-Paul Crutchley: Ok, thank you.

Operator: Our next question will come from Ian Smillie with ABN AMRO. Please go ahead.

Ian Smillie: Hello, good morning, it's Ian Smillie from ABN, a question on Retail Markets and on Citizens please. On retail markets, could you talk about any impact you might be seeing on the fee generation there and in particular with relation to any rise in the volume of refunds which you are having to offer to customers which is obviously something that one of your peers has talked about recently? Also in Retail Markets if you could talk about what's driving the strong wealth management performance, whether it's more about volume or pricing? An in Citizens if you could give us a little bit more detail about the non-interest income growth, last year it was much better than net interest income and whether that momentum has continued as the margin stabilises or whether that might be slowing down a little?

Sir Fred Goodwin: Ok, I'll get Guy to pick up the Citizens point, I'll just rattle through the Retail Markets one. The overdraft fees, there's been an uptake albeit it's reflected in the comments we're making about the numbers from the levels of refunds that were there in the second half of last year Ian. Numbers of complaints are moderating a bit now, I think from the outlook when we spoke last time I think it's been interesting to see the OFT's remarks that this whole area didn't look quite as straightforward as it first seemed and talking about now our review of the market going forward, a more rounded review involving not just these fees themselves. In recent weeks in a couple of cases which one of the banks has actually won in this area. So it's still an issue for us, it's still something that's attracting attention for the industry as a whole but it's not something that features particularly in a way that we've mentioned to you at this point in the first half numbers.

Wealth management, a number of different dimensions I guess, certainly growth in volume of activity, certainly growth of firmness in price but also a big part of it has been growth in our business in Asia. We're seeing very strong growth there and we're seeing good growth in income coming through, there's good shape of growth. I think yes to the two things you've said about profitability and volume, factor in the fact that our business is growing in the Asian market where we've been investing for some time as you know.

Guy Whittaker: Just to pick up the Citizens point Ian, no real big change in shape issues and the sort of general within Citizens the proportion of non-interest income and net interest income is stable really on a year over year basis H106 to H107.

Ian Smillie: That's great, thanks gentlemen.

Operator: Our next question will come from Jonathan Pierce with Credit Suisse. Please go ahead.

Jonathan Pierce : Good morning guys, I've got two if that's alright, the first is just on the tax charge, the tax charge fell quite notably in the second half of last year and we were guided that it would pick back up again from that base in 2007. Is that still the expectation?

Guy Whittaker: Perhaps I'll take that one. I think we sort of guided at the full year results that we thought our run rate was about 30% for the first half on an underlying basis, obviously we saw the change in corporate tax rates in the budget earlier this year and so the headline number reflects some of the benefits it came from, the deferred tax liability as a result of that. The underlying number is still guiding to about the 30%.

Jonathan Pierce : Right, but there will be a benefit to the 2007 tax charge at the budget comment?

Guy Whittaker: Yes, that's expected to be...I'm just trying to think of exactly what the number coming through, it will give a significant one time uptick. That's not reflected in the comments we've put out today, just for clarification purposes. We've tried to in the interests of consistency compare it to the underlying numbers rather than these one-off things which sort of come through from time to time.

Jonathan Pierce : Ok, thanks. The second question is on Citizens again. If we look at the quarterly filings from the States which I'll accept aren't perfect but they do show in trend terms that income and profits were quite weak in the first quarter of the year in dollar terms, with actually income going backwards and profits going backwards. Is there likely...understanding the comments you're making on margin but the balance sheet doesn't seem to be growing, is there likely therefore to be any income on profit growth in Citizens this year? Is that still the expectation for the year?

Sir Fred Goodwin: I think the quarterly filings as you've indicated Jonathan have got a number of things not to commend them, most notably they're not in IFRS and the US GAAP provisioning is

materially different from IFRS so that would be one observation to take you to Citizens for the full year. I don't recollect us giving a full year forecast for Citizens so again we'd leave you to your own devices there, but we are certainly signalling today that the business is seeing growth in a number of its activities, margins have stabilised, dollar weakness certainly doesn't help the US but the business is still absorbing some of the impact from last year's decline in margin but in local currency the business continues to move forward.

Jonathan Pierce : Ok, thank you.

Operator: As a reminder, please press *1 to ask a question. We will now move to Mamoun Tazi with Man Securities. Please go ahead.

Mamoun Tazi: Good morning, I have four questions if I may. The first two are about insurance, have the increases in insurance premiums been sticky so far? Also about the insurance claims, have you seen any moderation in the inflation rates? In terms of asset quality in UK retail, considering the fact that interest rates are rising, what do you think the impact of that would be on your provision charges? I know that the situation is improving but could we see some deterioration at least from a theoretical perspective? Then on the US, Citizens, I wanted to understand your exposure to the Alt-A mortgages and while you're not exposed to the sub-prime sector, could we see a contagion to the near prime decline considering the fact that the housing market is flowing, that interest rates are not coming down and that activities are slowing down altogether?

Sir Fred Goodwin: Premium inflation we've seen has been modest but sticky, yes, it's coming through and price increases are going through into the market so that's encouraging and hopefully something which will continue. Claims, we have seen a pretty good performance in claims, over the last couple of years we've been selecting risks very carefully. You can select your way out of some of the claims cost as well as managing your way out of it and we've been doing a bit of both, so I think the claims metrics are not so bad in the first half.

Mamoun Tazi: But in terms of the difference or the jaws between the premium inflation and the claim inflation, are the jaws widening enough or are they being stable?

Sir Fred Goodwin: Reasonably stable at this point. It takes a while remember for the premium increases to work their way through and to earn the premium, so it goes from written and then works its way through into earned. Rising interest rates and its impact on unsecured credit, bear in mind firstly that the unsecured credit that's on our books is largely at interest rates that are fixed. A significant proportion of the unsecured written and personal loans for instance have fixed rates on them so it doesn't directly impact on the rates that the customers are paying. There haven't been so many increased interest rises in the credit card interest rates which again doesn't pass on the interest rate rises directly to these customers at this point. I think my comments are not qualified by rising interest rates and where we would anticipate rates would rise to, I would not expect them to materially impact on the prospects of the book now as it rolls forward. Alt-A, we're not anticipating, we don't have a huge exposure to Alt-A but it's a very modest level of exposure but they're all very high FICO scores. I think one of the things when somebody comes to write the book about all of this in the United States is that the contagion from sub-prime is into other areas of sub-prime. I think what's happened over recent years and perhaps it's passed people by is the depth of the sub-prime sector is a lot greater than people thought. Where there's contagion it's up the food chain but still within the sub-prime area rather than making it across into any of the others, so we're not seeing any stress in our book against what little exposure there is to Alt-A.

Mamoun Tazi: Can you give us an idea of your overall exposure just to the Alt-A sector?

Sir Fred Goodwin: A few hundred million.

Mamoun Tazi: A few hundred million, ok. Thank you very much.

Sir Fred Goodwin: All in very good FICOs.

Mamoun Tazi: Thank you very much.

Sir Fred Goodwin: That was a few hundred million dollars by the way.

Operator: We will now take a question from Bruce Packard with Pali. Please go ahead.

Bruce Packard :Yes, it's Bruce Packard . I just thought it might be worth asking from a Royal Bank banking perspective for your thoughts on China given that Shanghai seems to be down 20% since 29th May?

Sir Fred Goodwin: Sorry, what do you see the banking read-across as being?

Bruce Packard :In terms of are you actually seeing anything from a banking perspective or do you just think this is a stock market issue that really has no impact at all?

Sir Fred Goodwin: I can't see any read across in the banking context. Shanghai went up a fair few notches as well, so it's in some respects quite healthy to see it coming down. We've seen sharp corrections in Shanghai before as things move on, but certainly to RBS I can't see any banking read-across.

Operator: We will now move to Sandy Chen with Panmure Gordon. Please go ahead.

Sandy Chen: It looks like there's still some pricing pressure for '07. Are you looking at better pricing environments for '08, that seems to be what the bulk of the motor insurers have been saying?

Sir Fred Goodwin: Sorry Sandy, I missed the start of your question. I don't know if you were on mute or something. You're talking about insurance?

Sandy Chen: Yes, my question was about RBS Insurance. It just seems that a lot of the motor insurers are saying that the pricing environment for '07 is still quite tough and they're looking forward to premium pricing, better pricing in '08. Is that similar to...that seems to be how the statement's reading on your trading update today. Do you share that?

Sir Fred Goodwin: People were saying that at the beginning of '06 as well Sandy, but I think we have seen some price increases go into the book and stick and they've been welcome. I think there was a sense around about this time last year that I think it was Norwich Union announced some pretty substantial price increases of double digits, so it's difficult to see those coming into the market at this point. There have been some price increases which have stuck, which differentiates the latter part of '06 and the early part of '07 from the year before. We still think the pricing pressure is upwards. We would expect to see pricings moving upwards, so I think '07, I certainly would hope that '07 is a year of transition rather than still looking forward to '08. I'd hope that in '08 the process would continue. I think the days where you could bang in huge price increases very quickly into the market are probably not there, but I think there is a steady upward pressure on prices and that's what we are doing and that's what we expect to see others doing.

Sandy Chen: Thanks very much.

Operator: We will now take a question from Michael Helsby with Fox Pitt Kelton. Please go ahead.

Michael Helsby: Thank you, morning. It's just another question really on the other operating income within the Corporate Markets business. I think last year your first half was about £410 million so I was just wondering if you could give us a better sense for what the run rate is in the first half of

'07 and also whether your...the three digit guidance that you're giving for the full year, whether that includes anything for Southern Water?

Sir Fred Goodwin: The guidance we gave for the full year was four digits.

Michael Helsby: Four digits, yes, sorry.

Guy Whittaker: The four digit number Michael, it's Guy here, we think it's probably been evenly paced throughout the year this year, so that would compare to last year's 400, 800, it feels like it's more balanced this year first half-second half although the timing of gains are difficult to predict. I hope that answers the first part of your question. On Southern Water I think we've just gone out and looked for assessing the situation at this point as reported in the weekend press, I think that included in the first half numbers, of course these valuation uplifts get recorded anyway through income these days as you well know, and so they were certainly part of last year's programme and valuations, if anything were to happen and it was different from the carrying value then obviously that would be reflected in the income statement at the time.

Michael Helsby: Ok, thank you very much.

Guy Whittaker: That was for the first half.

Operator: As we have no further questions I would like to turn the call back over to you Sir Fred Goodwin for any additional or closing remarks.

Sir Fred Goodwin: Thank you very much everyone for calling in. If there are any other questions during the course of the day, feel free to give us a call and we'll try and answer them for you. Again just to sum up, I think a fairly straightforward statement, a continuation of the trends we've seen in the business in '06. We anticipate coming in slightly ahead of expectations in the first half

of '07. So thank you for the questions, thank you for there being none about ABN, that was very welcome and we'll catch up with you later. Thank you very much. Bye bye.

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