Royal Bank of Scotland
Moderators: Sir Fred Goodwin, Fred Watt, Richard O'Connor
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09:30 BST

Operator: Good morning ladies and gentlemen, and welcome to today's Royal Bank of Scotland Conference Call. I would like to introduce the speakers for this call, Sir Fred Goodwin, Group Chief Executive; Fred Watt, Group Finance Director; and Richard O'Connor, Head of Investor Relations. I will now hand over to Sir Fred Goodwin who will be chairing the call. Please go ahead, Sir Fred.

Sir Fred Goodwin: Thanks. Thanks everyone for calling in this morning for a clearly somewhat longer than usual pre-close trading update package today. We've got quite a lot of information on IFRS. I know there's a lot there for you to digest and you won't have had a chance to go through it yet, so I'm happy to answer any questions you have in this morning's conference call. I guess over the coming days or so you will have other questions, and feel free to come back to us on those and we'll try and clear them up for you as much as we can.

That said, I don't think there's any particularly new news in IFRS. There's a lot of detail there to give you an understanding of what the numbers should look like. Similarly I think with the trading update itself, I don't think there's anything in there which should come as a great surprise. The business continues to perform well, we're seeing good overall income growth, a slight transition away from consumer unsecured lending growth, diminishing somewhat as we flagged I guess back in February, but given our limited dependency on that as part of our overall business mix, it's not really too much of a drag on the Group results overall. The integrations are all going well and underlying profit, i.e. profit excluding acquisitions and the effect of acquisitions remain broadly consistent with the comparable period last year.

I think it would be a shade too ambitious at this point to try and talk you through the IFRS numbers, so it's maybe better if I just cut short at this stage and go straight to questions, and Fred and Richard and I will try as best we can to answer them. So thank you for that, and who would like to go first? This would be a first. Any questions?

Operator: The question and answer session will be conducted electronically. If you would like to ask a question, please do so by pressing the * key followed by the digit 1 on your touchtone telephone. If you are using a phone with a mute function, please ensure your mute function is turned off to allow your signal to reach our equipment. We will proceed in the order that you signal us and we will take as many questions as time permits. Once again, please press *1 on your touchtone telephone to ask a question. If you find that your question has been answered, you may remove yourself by pressing *2. We will now pause for just a moment to give everyone an opportunity to signal for questions.

We will now take our first question from Simon Samuels of Citigroup. Please go ahead, sir.

Simon Samuels: Thanks very much. Good morning everybody, it's Simon Samuels here. A couple of questions, the first is just one to sort of…if you like, an on the record clarification. Your statement today talks about under profit growth expected to produce underlying growth in profit before tax broadly consistent with that reported for the comparable period last year. Would I be right in saying that that comparable period number is 12% and that the profit growth that you're referring to, the underlying growth for this year is the number excluding – as it was last year – is excluding both acquisition effects and also currency translation effects as well.

Sir Fred Goodwin: Correct. Correct on all counts.

Simon Samuels: Ok, thank you. The question was, well, two actually. First of all, I was wondering if you could just elaborate a bit more on your comments regarding the retail banking businesses, particularly in terms of growth rates within retail direct which has obviously been on an essentially different trajectory to the industry for a while now. You're signalling both that and retail banking to slow in terms of revenue growth. Can you give us some kind of greater sense of the speed of deceleration – as a reminder retail direct grew revenues last year 16% year on year in retail banking at [6%], so I was wondering if you can just try and flesh those expectations for '05 out on those two divisions.

Sir Fred Goodwin: I think you've correctly sensed Simon that both of those are slowing, albeit we're still growing so it's a question…we're debating here a slowdown in the rate of growth rather than businesses going backwards or whatever. The principle component of the story I guess is the consumer transitioning of unsecured lending – that is slowing the growth of unsecured lending down. But as you would remember from the presentation we gave last year, the retail directors from the mortgage business, there's a merchant acquiring business. Retail also includes the SME business, the money transmission business, so there's quite a lot of other businesses in there other than just consumer lending, so I wouldn't want you thinking or anyone thinking that the whole thing has come to a halt like that. That's not what we're signalling today at all, but it would be fair to say that the growth in unsecured lending has been a major component of our activity over the last few years has been slowing down. That's one of the reasons that I think everybody's pretty familiar with.

Simon Samuels: Ok, thank you, and if I can just ask one other thing on the comments on margins. If you go back to the full year results, your sort of margin sort of directional impact charts have showed a flat to slightly down, and you said at the time the prime driver of this would be the mix effect. Obviously in your statement today you're citing the growth in corporate and the relative slow down in the margin on secured – can you go a bit further than that in terms of…is it 100% a mix effect and the actual product margins themselves are stable or perhaps even rising, but that's been more than offset by the mix dynamics.

Sir Fred Goodwin: The mix dynamic is the main one as the comment says, and there's some mortgages on large corporates go on, and tend to go on in quite large lumps. Unsecured lending has been coming off as we describe, so you can work those all out. There are a lot of moving parts in the margin calculations, that's why it's primarily mixed rather than exclusively mixed. But in terms of the competitive aspect of margin movement, it's actually been reasonably stable of late, and certainly we're not feeling the need to go and play in any of the areas that are perhaps more silly, what we would consider to be silly margin behaviour. Competition is not a thing that leaps to the top of my mind as driving margins. There's plenty of competition out there, but in terms of intensifying in ways that are forcing us to cut margins for competitive reasons, no, I don't really feel in that place.

Simon Samuels: Thanks very much.

Operator: Our next question comes from John Paul Crutchley of Merrill Lynch. Please go ahead.

John-Paul Crutchley: Ok, it was two questions if I may. Firstly just on the growth of the business in terms of what you're signalling…if you can give us a steer, obviously the pre-tax line, and obviously there's been some movement when we go to [follow] our first transition from items from below the line on a preference share cost to above the line which obviously has some impact in terms of the two, comparing pre-tax and comparing earnings. I'm just wondering, if I look at what you're signalling in terms of the earnings hit under the full IFRS, it's about the same as the pre-tax. I'm just trying to get a feel for whether the rate of growth in the two is comparable to where you're signalling the pre-tax line, whether there will be a bit more pressure at the earnings line because of the funding from Charter One coming through below the line.

Sir Fred Goodwin: I'm going to get Fred to take a stab at that one, JP.

John-Paul Crutchley: Ok.

Fred Watt: The total move or preference charge up the line JP, we're narrow mind thinking pro forma here. So we're aligned for, when we make comments about underlying to adjust '04 on the same basis as we were adjusting '05 and things like putting preference shares further up the P&L. Yes, there were as you know last year some preference shares issued in the second half, and clearly that has an increased impact on overall preference dividend cost year on year. So there maybe is a marginal year on year impact of more preference shares than issue.

John-Paul Crutchley: Understood. The second question was just a quick one on the revenue recognition here of 932 million which is on page 46. I was just wondering if you could comment – does that do anything in terms of future revenue growth or is this something which is almost like a step down in terms of how revenue gets recognised and the group carries on from this level, or is that 932 million something which drives essentially higher revenue growth in future as it starts to get recognised back through the P&L.

Fred Watt: I think you'd be basing, JP, once you've kind of stepped down the list, you're then on a different measurement plane, if you like, and clearly if the Group is growing in the fee income related areas like that then IAS has an impact on that in terms of growth is muted more under IAS than it is under UK GAAP because of fees being spread forward, but by and large we are –

having restated for IFRS, we're not suggesting that you should be thinking any differently about, materially, about growth trajectory from here.

John-Paul Crutchley: Ok, that was it. Thank you.

Operator: Our next question comes from Michael Lever of Credit Suisse First Boston. Please go ahead.

Michael Lever: I just want to confirm that there's no change in your dividend profile as a result of the earnings adjustment in terms of dividend growth expectations. Secondly, I mean clearly the basis points adjustment to your tier one capital ratio was slightly larger, no great surprise there as it's slightly larger for all banks, but you're comfortable with your capital position given prospective capital generation? And the third one is just, you were quoted on the wires, I think this morning as saying you've got no acquisitions in contemplation for the US and Europe, which leaves obviously another area of the world which you didn't mention, namely Asia. I just wonder if you'd like to comment on that as well.

Sir Fred Goodwin: Okay, let me try and just make sure I pick those up as we go, Michael. The dividend growth, I mean we haven't said anything today about dividend growth, we're not trying to signal any philosophical change in dividend. I don't think the numbers, we can take you to a place to do that. So there are no discussions or thoughts to change our outlook on dividend. Tier one we'd be, the numbers where that sits comfortably in the range we've previously articulated, but we would have no plans particularly to change that range. Clearly we've got a bad '02 coming down in the pipeline and a forthcoming attraction. We'll revisit the whole subject then, no doubt, but there are no basic plans to review that.

I am correct as quoted in Europe and in relation to Europe and the United States that just reiterates what I said at the year end. We've never expressed any interest in making acquisitions in Asia. All we've ever said was we would explore the possibilities for some joint ventures and that is all we've ever done. There will be no announcements or things to tell you beyond what we said at February time in any respect.

Michael Lever: Fine, could I just come back just to clarify the capital, what you're saying on capital is that the range that you've previously identified for share buybacks is, as you previously given to the market, is not impacted by IFRS?

Sir Fred Goodwin: No.

Michael Lever: Ok, thank you very much.

Operator: Our next question comes from Nick Lord of Deutsche Bank. Please go ahead.

Nick Lord: Morning. It's Nick Lord from Deutsche Bank. I just wondered if you could give us a little bit more flavour on what's happening in CBFM. You seem to be talking about a relatively healthy income outlook and maybe if you could just give us a bit of guidance as to what's driving that? And secondly, just some of bad debts within the CBFM, again you seem to be talking about a very healthy sort of bad debt charge there. Is that benefiting from recoveries, I mean is this something you'd expect to move back up again in '06, just sort of whereabouts we are on the cycle there?

Sir Fred Goodwin: Yes, well CBFM more generally, I guess, has been having quite a good run of late. We're seeing a lot of activity amongst, and continuing activity amongst, the sort of mid-corporate companies, in other words those not in the FTSE or wherever, and it's not necessarily the household names but the kind of bread and butter companies throughout the country. That's been going well. Large corporate activity has picked up, financial markets activity continues on a steady fashion, I mean, dealing profits are up but it's not dealing profits that are driving the performance.

Europe and the United States: our businesses there, you know we've talked about these for a while, but I mean Europe is now getting, not only is it growing quickly, but it is getting towards a more meaningful scale. United States: [with gained] capital and you will remember last year when we talked about CBFM's results we highlighted that the cost growth was higher than was kind of representative of the business, because we're investing in a capital markets business there. Well, that is now coming through and paying dividends. So a number of different components contributing to CBFM, across the board really.

The bad debt situation, we're not, I think, at this stage seeing huge recovery. What we're seeing is that we're not incurring further charges, although the rate at which charges are being added is falling. We're not releasing provisions or reducing levels of provisions held as such. There'll be individual instances I'm sure where we are, but it's not, that's not where it's coming from, it's more just we're not adding new provisions at the sorts of rates we have been.

Nick Lord: So if there was no deterioration then that low level of corporate bad debts could be sustainable, if the economic situation remains as is at the moment.

Sir Fred Goodwin: Yes.

Nick Lord: Ok, thanks very much.

Operator: We will take our next question from Tom Rayner of Citigroup. Please go ahead.

Tom Rayner: Yes, good morning.

Sir Fred Goodwin: Hi Tom.

Tom Rayner: Hi, thanks. The guidance I think on first half numbers is very clear. I'm just trying to get a sense for how sustainable some of the trends are into the second half of the year. I think you've dealt with a couple of the obvious issues in response to Nick's question. I mean, I was looking at the higher dealing profits and the lower corporate provisions in the first half, but just in general I guess on the sustainability of the growth that we're seeing in the first half of the year.

Sir Fred Goodwin: Dealing with that, I don't think we're trying of signal anything in the second half that would be out of line with the first. I mean dealing profits are up, but as I was saying, as you picked up that they're not stellar; it's not a dealing profit story particularly that moves ahead. As you know our dealing profits are related very much to the business we do for customers, so they tend to be less volatile than some other peoples, so we don't make as much in the good times that we tend to have a more resilient performance when there's less activity in the market. So I wouldn't be signalling you to look for anything in the second half that's particularly different from the first.

Tom Rayner: Ok, and just quickly so I understand the comments on IFRS and the cost-income. Are we saying that if we were staying on UK GAAP you would still be expecting revenue growth ahead of cost growth this year, i.e. cost income on a downward trajectory, and its really only IFRS which is changing that?

Sir Fred Goodwin: Pretty much, I mean it's all, we're down to your very, very small movements now in the cost-income ratio, because you can imagine the sort of curve over the recent years as we've come down from a very high one, down to the level we're at. And we've indicated whether that was under GAAP, was going to take us through to a number beginning with a 3 by 2006. The shape of the line hasn't changed. I mean it varies from time to time with different business mix and so forth, but the shape of the line hasn't essentially changed, what you'd have to do is sort of move the whole line just up a shade to recognise that IFRS creates a structurally higher cost-income ratio for the same business. One business from 2004 not under IFRS would have a higher cost income ratio under IFRS, well I think for reasons you understand. I'm talking about sort of underlying here, Charter One obviously causes the kind of face cost-income ratio to go up a bit this year.

Tom Rayner: Sure. Sure.

Sir Fred Goodwin: Underlying it, I'm talking about.

Tom Rayner: Ok, thanks a lot.

Operator: Our next question comes from Peter Toeman of Morgan Stanley. Please go ahead.

Peter Toeman: Morning.

Speakers: Morning.

Peter Toeman: I want to ask you about the bad debt charge. I was a bit surprised that the bad debt charge was declining relative to total stock of lending. But I wonder to what extent that reflects the Charter One acquisition which wouldn't have been in the, sort of the '04 comparative – what the number would have looked like ex-Charter One.

Sir Fred Goodwin: Charter One isn't particularly driving it, so that would sort of take you away from that, with your line of thinking. Fred is there anything you want to add.

Fred Watt: No, I mean I think last when the lending growth ran ahead of the bad debt growth and that's what we're anticipating again this year.

Sir Fred Goodwin: [unclear] is that we have seen lending growth are not one to traditionally attractive, like mortgages and large corporates and so on.

Peter Toeman: I mean, is it possible you can put some more colour on that in terms of the sort of basis point deterioration and retail, relative to the basis point improvement on corporate.

Sir Fred Goodwin: No, but that's certainly outside results kind of questions.

Fred Watt: Directionally you're right, but I mean we'll cover the detail in [August].

Peter Toeman: Right, thanks.

Operator: We will take our next question from Ian Smillie of ABN Amro. Please go ahead.

Ian Smillie: Good morning. I have three related questions, please. Firstly, could you comment in terms of the operating EPS underlying growth rather than necessarily the operating profit, given the increase in shares outstanding? Secondly, is the rate of balance sheet growth higher or lower than it was this time last year? And thirdly, as a follow through from that, what is the trend in Group profitability relative to last year, please?

Sir Fred Goodwin: I'm going to pass to Fred on the first question and that might actually flow through into the second one.

Fred Watt: Yes, we haven't commented, as you said Ian, specifically on EPS at this point. I think as last year, I think EPS was trading slightly lower than an operating profit growth for tax reasons, for pref dividend reasons, so we'd expect something similar this year as well, so I think if we were to do the numbers with you now, EPS growth would be slightly lower than our operating profit growth again, but purely for sort of below-the-line reasons rather than operating profit reasons. And on the second point…

Sir Fred Goodwin: Yes, about the balance sheet growth.

Fred Watts: I mean, it varies by division, clearly, but overall probably not too far off in terms of overall growth with, as we've indicated, a slightly lower growth in unsecured, good growth in secured, and good growth again in corporate.

Sir Fred Goodwin: And I guess between the answer and EPS, my answer and cost-income ratio, that covers the profitability point.

Operator: We will take our next question from Michael Helsby of Fox-Pitt Kelton. Please go ahead, sir.

Michael Helsby: Yes, morning everyone.

Sir Fred Goodwin: Morning, Michael.

Michael Helsby: Just a couple of questions. Firstly, on the comments that you made on unsecured lending not being a major part of the Group in terms of income, can you give us a feel for how much it actually contributed to revenue growth in 2004, and also in profits for the retail divisions and for the Group?

Sir Fred Goodwin: Yes, I mean, we'll give you – there was a slide in year end pack which broke out the growth in unsecured… broke out the growth in consumer lending and split it between secured and secured, and split it between the UK and the US, and it split it between net interest income and non-interest income. We don't allocate cost factor in the sense you're looking for, so you could form your own views of it, of the profitability of it. I'm not being cute, and I don't have the slide in front of me, but it was round – I think the total of net interest income and non-interest income for unsecured consumer in the UK was 8% or 9%, something like that.

Michael Helsby: Ok, thanks. And just on a couple of the themes that are coming out is in terms of the credit quality that Barclays have been experiencing, and say for Lloyds TSB, for example, is actually the origination of in-franchise and out of franchise in terms of credit cards and personal loans. Could you give us a sense of where you've been originating the majority of your personal loans and credit cards for the last 12-18 months.

Sir Fred Goodwin: Not offhand, I mean there's generally speaking we have a lot that come out of the branch network, particularly in personal loans. We've got a good number of cards that come out of there, but we also have cards we've originated direct. I mean Mint was obviously a feature over the last 12 to 18 months which was not originated out of our own network. I think we would, generally speaking, go along with the notion that your stuff sourced from your own network tends to be more predictable, or predictable within a narrower and different range of outcomes than stuff you source elsewhere. But these are all pretty well recognised phenomena that have taken into account when you're actually promoting and pricing the product.

Michael Helsby: Ok. So no real steer in terms of percentages of origination?

Sir Fred Goodwin: No. Not offhand. And I'm not trying to be difficult, but I can't actually think of the figures, of having seen figures for the last 18 months split that way.

Michael Helsby: Ok.

Sir Fred Goodwin: But the rest of the point, the steer we are giving today is that where credit quality sits at the moment we'd be well within normal parameters for those products. What it has done, though, is it has changed from being at the very low end of the scale and has moved up, which I guess doesn't come as an enormous surprise.

Michael Helsby: Ok, and just finally, on clearly with the consumer and all the talk on the high street at the moment with the slowdown, in terms of SME lending are you experience any sort of deterioration there in terms of credit metrics or anything at all?

Sir Fred Goodwin: No. I mean I think it's interesting that the high street has been, does appear to be, a sort of epicentre for the slowdown at the moment. As we look across some of our merchant acquiring data and our ATM data and so on, I mean the consumer's still spending money, you know reasonably at a healthy rate. You can see a move away from some of the retail expenditure, but they're still spending a lot on services more generally, so there's not a slowdown in borrowing. There isn't such a slowdown in spending.

Michael Helsby: Ok, thank you.

Operator: Our next question comes from Robert Law of Lehman Brothers. Please go ahead.

Robert Law: Good morning.

Sir Fred Goodwin: Hi Robert.

Robert Law: Hi. Just one question, just to follow on the guidance you gave earlier on the cost-income ration. You've given out targets for '06 and I wondered, of the cost gains that you're targeting by that, I think from memory it was 400 million, how much have we seen in the first half of this year, do you think? And can you give us some indication of what that becomes under IFRS?

Sir Fred Goodwin: I don't think I ever gave an actual figure, Rob, in terms of the cost saving, but we just gave a steer in the rates, and other people have worked out sort of various recipes by which we could arrive at it. So you're right to highlight, it was not a trivial programme, but we never actually put a figure out, just to clarify on that point.

We're down to the final knockings of the programme and so, as I said earlier in the guidance, I don't expect the trajectory of the cost-income ratio to deviate, so the shape of the curve won't be different from what it would have been in old money. In new money, IFRS bumps the cost-income ratio up kind of in the 1% or 2% range. It's not a drastic move up, so I don't think it's pointing to a cost-income ratio that's going to be profoundly different from where it would have been otherwise. But it structurally higher, for the reasons that you know. I don't know, does that answer the question?

Robert Law: It does, yes, thank you. While I've got the mike, could I ask you to…

Sir Fred Goodwin: I say – sorry – I say 1 or 2%, I mean might add 1 or 2% to the cost-income ratios, not a 1 or 2%...

Robert Law: Yes. No, got that. Can I ask you to add to the comments you've given there in terms of Direct Line. How much of a pressure are you seeing on premium rates, and can I ask you to comment on what you're doing in response to that. So in particular, where are renewal rates going?

Sir Fred Goodwin: Yes, there's clearly a degree of commercial sensitivity around exactly what we're doing about it, Robert, but we're seeing pressure in the market but actually, compared to previous cycles, the pressure would appear to be a bit less intense. And I think, well, we'll see what happens in the market in the second half of the year, but there are signs of premiums starting to move up. And I don't think anyone – you know the interesting thing about the insurance market at the moment is that pretty much all of the players of any significance have the same business model and face the same kind of levels of scrutiny, transparency and sort of commercial pressure. So when you've got underlying claims costs going up, you can only sit on that for a certain amount of time. I don't think you'll be disappointed with RBS Insurance results when you see them, but it is worth noting that we're at a particular point in the cycle.

Robert Law: Thank you.

Operator: Our next question comes from James Eden of DrKW. Please go ahead.

James Eden: Good morning.

Sir Fred Goodwin: Hi James.

James Eden: Most people have been asking questions about the fundamentals underlying your business. But I'm really not sure that anybody cares about the operating outlook. I think if they did, you wouldn't be the cheapest bank in Europe. What's hurting your share price is the view that you're acquisition-crazy and the fact that you issued stock on 9 times to buy Charter One. And my question is: are you unhappy with the market's view, or do you just focus on running the business well and not worry about the share price?

Sir Fred Goodwin: Well, you know the answer to that question, James, but just for the record I'll go over it again. We do certainly concentrate on running the business as well as we can, because it seems to me that if we don't run the business well it can take quite a long time to fix that. Market sentiment, it would appear, can come and go on particular stocks, and can be influenced by a number of factors, not always necessarily related to the particular stock.

I certainly agree that our performance warrants a higher rating than it has at the moment, and I would look forward to that situation being restored. I think there have been a variety of rumours and concerns about what we may or may not be doing in relation to acquisitions and so forth, which I think we have sought to dispel, and we are happy to continue to seek to dispel those. The Charter One acquisition, we stand by as something to do. You know, the numbers that our Group are now generating are different from what they would have been without that Charter One acquisition, and by different I mean good different. We're seeking to run a – build a – business here, and deliver sustainable value over time, and I think the wisdom more you would suggest otherwise of making the Charter One acquisition last September can only really properly be judged certainly after, once we get past the kind of first anniversary of it, would that not be too much to ask?

James Eden: To ask how low the multiple would have to get before you consider more radical changes like – I don't know – getting a separate listing for your US business, maybe getting an ADR?

Sir Fred Goodwin: I don't actually know what an ADR would do to the multiple, to be honest. A significant proportion of our shareholding is already American institutions. So American institutions can gain access to our shares relatively readily, they're at it's about 19% or 20% of our shareholding is Americans. I don't think an ADR would particularly alter that.

James Eden: I think – it wouldn't help that much – but at margin it could only be positive. I was speaking to a US guy yesterday, who was saying that he loved Royal Bank of Scotland just like I do, but his problem was – I mean, he owned it in all the funds he could own it, but it one fund he could only invest in ADR's. Is that something [involved]. I don't know why.

Sir Fred Goodwin: Maybe an ADR will come someday. Clearly, if I thought an ADR was the answer to it we're in a position: (a) to have an ADR, because we have preference shares listed in the United States we meet all of the – we encounter – all of the joys of Sarbanes-Oxley and all the

SEC filings and so on, so it would be a relatively straightforward matter and you could take it from me that if I thought that would make a big difference to the share price we'd certainly give it some thought. But it's not, I don't think it's quite as straightforward as that, although I'd be happy if it was. I mean [unclear], I'm happy to carry on the conversation with you, but this is probably not the optimum…

James Eden: But I guess the main message is you do care, which is the message that I definitely want to hear.

Sir Fred Goodwin: I think people – I'm a big shareholder too – and it seems to me I'm a big shareholder, I care. I care about everything to do with the Royal Bank, and people can accuse me of many things, but not caring about the Royal Bank is something that I'm not often accused of.

James Eden: Thank you.

Operator: We will now take our next question from James Alexander of M&G. Please go ahead.

James Alexander: Yes, morning. I've got a couple of questions. One is just on the impact of acquisitions in the first half. I think when you gave your presentation this time last – in the first half last year – you said there was about 3% was the impact of acquisitions on the operating profit growth. You couldn't give a figure for what that might be…

Sir Fred Goodwin: I don't remember that one, James. That would seem like a rather against the run of play, if we'd given a figure like that.

Fred Watts: It would certainly have been that August time, James, not in June, but…

James Alexander: That's right. I mean, August. You gave 3% as the rough impact of the acquisitions that you've made.

Sir Fred Goodwin: Oh, you see in August, yes. When we put the results up you got a sense of what the acquisition element is.

James Alexander: Is it going to be like 10% this year, that's what I wanted…

Sir Fred Goodwin: Well, if I told you that I'd be telling you, wouldn't I?

James Alexander: Could you just outline what are the impacts? Is it just Charter One, or is there other things?

Sir Fred Goodwin: Basically, there are one or two odds and ends, but for all practical purposes it's mainly Charter One, yes.

James Alexander: Ok. Another point on IFRS, I'm just wondering – I mean, I'm not really singling out Royal Bank of Scotland here – but why it is that Royal Bank, Barclays and Lloyds didn't give a pro forma 2004 IFRS P&L. Because it does seem like you've wasted a bit of your own time and a bit of our time producing a detailed, audited, partial implementation of IFRS, and I'm just – I hope you haven't spent too much on the accountants to produce it, because people aren't really going to look at it in the future. They might look at it, at a pro forma one, but this one – it just seems a bit of a waste of time and that the pro forma would have been a lot more useful and the big three banks haven't produced one. And I just wondered why you came to that agreement with the other two, maybe three.

Sir Fred Goodwin: We came across a number of [unclear], and there's no coming to agreements with anyone, but what we did do – what we have done – in relation to 2004, we are required to do it. It was a non-optional basis, and a non-optional restatement. There are some option as to how much detail you go into in this thing, and we've tried to go into as much detail as we reasonably could. So you may consider it a waste of time, and I would maybe not entirely disagree with you, but we were required to do it. And that's why it's been done.

Fred Watts: And there were, as you know, James, some standards that were just not known about throughout 2004, which for a statutory basis makes it very, very difficult for large, sophisticated buying with, particularly, hedging operations and dealing operations and multi-national operations, to incorporate that on a statutory basis throughout the whole of the prior year. However, on a kind of pro forma basis then clearly we've already given you some guidance as to what that will mean, and I hope we can help you further on that in due course.

James Alexander: Thank you. Because we see it from HBSC and Standard Chartered and the smaller mortgage banks have produced a pro forma 2004…

Fred Watts: I think you've summed up why.

James Alexander: Ok. So you did – there was some agreement, it looks like, between Barclays and Lloyds that stopped you doing it.

Speakers: No, no.

Sir Fred Goodwin: No, but we've made it… These standards that put – the [protocol] prospective standards – the fact we are trying to apply them to 2004 at all to give you some steer, going above and beyond the call, as it were. There are some difficulties with that. It is a pro forma rather than a proper statutory basis. But I see the problem. I have some [back to the other], but this was in an attempt to be helpful.

James Alexander: Hopefully it didn't cost too much.

Sir Fred Goodwin: I'll tell you it cost a lot of time and effort to produce them, but the basis, the restated basis is the one that's prescribed and was not optional. So there was no sense of waste around all of that, but your view as to the usefulness of it would not be unique.

James Alexander: Ok, thanks.

Operator: We will now take our next question from John Kirk of Redburn. Please go ahead.

John Kirk: Good morning, everybody. Just a quick question, coming back to the fundamentals actually on the UK unsecured book again, and I'm interested in your thoughts, really, as to how much further deterioration in credit quality in that book can go. And I'm just thinking you know if there's any sort of comment with regards, if it's any particular vintage of credit cards that are going wrong now; whether you're seeing any sort of change in looking at indicators on credit cards or other forms of unsecured lending, and also if you have any comments about your provisioning rate in relation or in comparison rather with the other larger banks in the sector.

Sir Fred Goodwin: Well, let me try and pick those off. I think our provisioning rate had traditionally been sort of a bit less than some of the others in this area. It goes back to, I think, an observation that was made earlier or a question some one asked about the proportion that's originated from your own portfolio, from your own business rather than originating directly from the market. It's also impacted by the proportion of your business that relates to people who borrow on a credit card but repay it in full each month, of which we have a higher proportion than some of the other players, to do with how these things were marketed historically.

So there has been a long-standing difference, and I think that difference still remains, compared to the rest of the market. Also we don't do sub-prime, or aren't involved in the sub-prime market, in the way that some others are. I'm not being critical of them; it's not a type of business that we happen to be in. The trajectory going forward, as I say, I'm always loath to try and predict future events that are out of our control, but just looking at the numbers there's a sort of slowing down in the rate of increase, which you could interpret that as being: everybody's now come, those that have been caused pain by the latest interest rate rises have now sort of fed through and we've reached some stability.

I personally think it's rather early to be making that call at this point, but just for the information, your information, that that could be seen in the numbers. I would not make the call just now, but thinking through the overall underpinnings, if you like, for consumer credit, employment remains very strong in the UK, the prospects for employment remain good, and I think that is probably where you take most comfort. Getting into difficulty with debt is not a good place to be, but it's certainly not something you would do for fun.

John Kirk: Ok, thanks. I mean just in terms of sort of forward-looking indicators on the book itself, like minimum repayment activity on credit cards for example, would there be any obvious changes there?

Sir Fred Goodwin: Not without the general directional view we've given.

John Kirk: Ok, thanks.

Operator: Our next question comes from Derek Chambers of Standard & Poor's Equity. Please go ahead.

Derek Chambers: You've indicated an effective IFRS2 on the 2004 accounts of £36 million, but presumably, because you're only phasing this in for awards made from November '02, the impact will be greater in '05 and '06. Do you have any steer on the amount by which that might rise?

And secondly, on the pensions impact on capital ratios, I think in December you were indicating 10, which might have been rounded to 15 basis points impact, and now you're indicating 25 basis points. So I wonder what has changed.

Sir Fred Goodwin: Ok, I'll get Fred to tackle both of those.

Fred Watt: Yes, on the share option charge, if you like that we're now taking in through the profit, yes, you'll see a gradual increase but not a dramatic increase. We don't have that many options and issues of percentage of the total shares in issue and for us, I can't remember what percentage we'd now be at, at the full cost, but it's not like you're going to see a two or three times step up in the way that the charge has come through so far. So yes, you will see a gradual increase in that cost over the next 18 months to two years probably, but nothing out of line with what the rest of the Group profile will look like.

On pensions, again this kind of falls into the category of things that were still moving at the end of the year. And only in the last couple of months, in fact that it's still not absolutely clear on this, we've had further clarification from, in particular the FSA, on the treatment of regulatory deficits and indeed prepayments. So it's a combination of just new guidance and new interpretation that's combined to that adjustment being slightly higher than we had at the year end.

Derek Chambers: Thanks.

Operator: Our next question comes from Simon Willis of NCB Stockbrokers. Please go ahead.

Simon Willis: Good morning, it's Simon Willis here from NCB.

Sir Fred Goodwin: Good morning.

Simon Willis: Morning. My question relates again to the UK credit experience comments and relates to the unsecured personal loan book. Last year you flagged that you'd made some increase in the charge in relation to the old NatWest book, in anticipation of an increase in delinquency rates. Can you give some indication as to how the experience in that area has trended year to date, and how you see the picture looking ahead?

Sir Fred Goodwin: Yes, I mean think actually we gave the indication in 2003 for the first time, and it was in relation to actual deterioration at that, or seasoning as it was described at the time, in the loan book. Following the acquisition of NatWest, we've altered the lending strategy, if you like, for NatWest to bring into line with RBS. We saw, I think second half '03 and 2004 we saw what we were flagging as sort of unrepresentative, if you like, increases that were part of that seasoning. So there's nothing that we're looking at in it at this point is that is out of line with the trajectory in the RBS book going forward. We indicated that the seasoning process was coming to an end and that is the case.

Simon Willis: Thank you.

Operator: Our next question is a follow up question from Michael Lever of Credit Suisse First Boston. Please go ahead.

Michael Lever: Thank you. Hello again, I've just got a couple of questions really on Charter One. I wonder if you can give us some indication on how you're going in terms of increased product penetration on both sides of the balance sheet; and then a more general question on how you see Charter One faring going forward in the light of a probable slowdown in the consumer expenditure, and obviously rather stretched household balance sheets in the US?

Sir Fred Goodwin: Yes, ok. The integration is going well. We indicated in the release, a number of significant targets already being or achievements are already behind us. The results continue in line with our expectations. I mean, clearly part of the strategy for Charter One was to introduce, not so much, well I suppose they are new products, but it was into business areas which would actually take you away from or reduce the proportion of the business that related to consumer expenditure. And Charter One was originally a deposit-led institution and remains a deposit-led institution, as does Citizens.

A lot of our lending is SME's, which is an area where we've been stepping up activity and I think went through at the final year results the number of new relationship managers we're putting in. We're doing the same with mid-corporate and commercial, putting in new relationship managers, and those areas of the activity still looks quite attractive. But just as importantly, even if the market growth was to slow down, market shares are very small and there's a lot of fragmented players, who I think would be quite vulnerable to the approach that we're deploying which is to white-label some of our own corporate banking and financial market products, to enable the Citizens and Charter One guys to sell them, but to not to have to incur the cost of manufacturing. That's proving quite attractive. So we'll talk more about Charter One when we put the actual results out, Michael, but that's moving along in a most satisfactory fashion.

Michael Lever: Thank you.

Operator: Once again, ladies and gentlemen, if you would like to ask a question please do so by pressing *1 on your touchtone telephone. We will now take our next question from Simon Samuels of Citigroup. Please go ahead.

Simon Samuels: Yes, thanks very much it's Simon here again, Citigroup. I just wanted to go back to the question on dividend growth. I know your answer was essentially IFRS doesn't change the way you think about the dividend growth for the Group. My question wasn't so much as a result of IFRS, but just more generally. It's been, I think at least 10 years, I think slightly longer, where you have grown the dividend of 15% per annum, and just what I'm trying to get a sense is: what would be the circumstances under which you would consider changing that, and particularly accelerating the dividend growth as a sort of mechanism of returning some of the forthcoming surplus capital generation? I mean are you anywhere near thinking about a step in dividend growth rates.

Sir Fred Goodwin: Well, it's been 12 years that we've paid 15% or more, Simon. You know, the Board considers dividend each year. I don't want to end up giving a sort of theoretical lecture here, and the things you would consider in relation to dividend, but you know: capital position, earnings growth, etc. would all be considered – as you highlight – it would be a way of returning surplus capital to shareholders, and that will get consideration at such time as that situation arises. The Board would go beyond not thanking me for setting dividend policy in a phone call like this.

Simon Samuels: Sure, but actually what I'm trying to get a sense of is, is the environment going forward. Is potentially one of less balance sheet strain as asset growth is maybe just slower pace, you know whether your payout ratio, which is currently is any of the major banks in the UK the lowest, even including the preference burden, you know whether that coming together of less capital strain, you think, could be a recipe for an accelerated payout ratio.

Sir Fred Goodman: Well, it's certainly one of the possibilities, but I don't want to rush our fences here. The payout ratio is not that much less than the other banks, and if we carrying on growing it at this rate, that the gap, you would think, would start to close, or continue to close. So we'll see. But this is one of those conversations that creates hostages to fortune and just generally rushes fences, so we would not – as I've said before – we would not wish dividend policy to be matter at issue between ourselves and our shareholders. And I think the Board would always look to take a progressive line with dividend.

Simon Samuels: Ok, thank you.

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

Mark Thomas: Morning. Just a very quick IAS one: can you confirm that about 2% of the hit will drop off in 2006 around the software development amortisation?

Fred Watts: I think the bit that drops off in software, Mark, will be more to do on the integration cost line. Above the line, it really just depends on current spend versus the last two or three years' or four years' spend, so hard to predict that far ahead. But certainly in the integration line, you would see a dropoff.

Sir Fred Goodman: Because as you'll have obviously gathered, Mark, this kind of resurrects some of the NatWest stuff that was already written off.

Mark Thomas: Yes. But there is still a potential benefit once that amortisation stops, which will be 2005.

Sir Fred Goodman: Yes.

Mark Thomas: Great, thank you.

Operator: As there are no further questions, I will now turn the call back over to Sir Fred Goodman.

Sir Fred Goodwin: Thanks, everyone, for your patience and for the questions. As ever, it's kind of slightly unsatisfactory trying to talk about results and trends across the whole diversity of our business without actually putting hard numbers in front of you, so I look forward to seeing you in August, when we can put the numbers up and have a more substantial conversation. On the IFRS front, I realise there's a lot here to digest, and I'm sure as you make your way through all of this, there will be other questions. So please, take the opportunity to ask them, and we'll try to do what we can to help. But thanks for listening in this morning, and we'll catch you later.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. You may now disconnect.