The Royal Bank of Scotland Group

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Annual Results 2004

P R O C E E D I N G S at an **ANALYST CONFERENCE** of the Company held at 280 Bishopsgate London EC2 on Thursday 24th February 2005.

Top table:

SIR GEORGE MATHEWSON (Chairman)
SIR FRED GOODWIN (Group Chief Executive)
MR. FRED WATT (Group Finance Director)
MR. LARRY FISH
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THE CHAIRMAN: Good morning, ladies and gentlemen, and welcome once again to this presentation of our results for 2004.

As you will have already seen from our Company Announcement, 2004 represented a continuation of established themes within our results: strong income growth, improving efficiency and good credit quality. In 2004, we increased our total income by 18 per cent to £22,754 million. Our Group operating profit was up by 15 per cent to £8,101 million and our profit before tax was up by 14 per cent to £6,917 million.

Our basic earnings per share were up by 79 per cent to 138 pence per share and our adjusted earnings per share were up by 10 per cent to 172.5 pence per share.

To no-one’s surprise, the Directors have recommended a final dividend of 41.2 pence per share which, when added to the interim dividend of 16.8 pence per share, makes a total of 58 pence per share for the year, an increase of 15 per cent over the dividend of 50.3 pence per share for 2003.

This slide updates a chart which I have shown previously. It shows the strong and stable growth in our earnings per share. In each of these 11 years the Royal Bank Group achieved record profits.

This chart shows the growth in our dividend per share; AVS dividends are excluded. This is the 12th consecutive year in which we have increased our dividend by 15 per cent.

Our agenda today follows the usual pattern: Fred Watt will review our Group results and the results from each of our Divisions; then Fred Goodwin will review our performance and look to the future. Thank you. Fred!

MR. FRED WATT (Group Finance Director): Thank you, George, and good morning all. My task, as ever, is to hopefully walk you through the results of the Group, Division by Division, and take you through the numbers.

As George has said, profit before tax up to £6.9 billion and obviously behind that we have a series of numbers to get there. The first one, of course, is operating profit, £8.1 billion up 15 per cent on last year’s £7.1 billion. This year there are very few restatements in terms of profit. We announced clearly in December we were adopting FRS 17 for pension costs - that is principally a balance sheet restatement with a very small adjustment to last year’s profit number - so fairly clear and fairly easy to follow I hope as I take you through the year on year numbers Division by Division.

After operating profit, goodwill amortisation up on prior year, principally obviously the acquisitions we have made not just this year but towards the end of the previous year, Churchill, First Active, Charter One, contributing to that increase in goodwill. Integration costs up a little bit on last year, components slightly different. Last year you will remember, was the tail-end of the NatWest integration as well as the beginning of Churchill; this year we have got Churchill, a bit of First Active, and towards the end of the year some integration costs relating to Charter One. Profit before tax after all of that is up 14 per cent.

Obviously these numbers are affected by acquisitions and these numbers are impacted also by exchange movements; currency movements have gone against us in the year in terms of the dollar exchange rate principally. Hopefully as I take you through the slides I will point out where I can the underlying numbers excluding both acquisitions and currency impact.

Looking behind that £8.1 billion of operating profit, how has it come about? Clearly we have strong income growth again, up almost £3.5 billion year on year, so income growth up 18 per cent. Cost growth up 13 per cent, just over £1.1 billion, so contribution after expenses up £2.3 billion, or up 22 per cent on last year. Claims growth up 59 per cent as we see, or will see later when we look at insurance, that is in line with insurance premium increase, so nothing untoward there. Provisions basically flat year on year, and we will come on to that in more detail later also. So, Group operating profit after all of that up 15 per cent.

Turning, first of all, to income. Income is up strongly, as I said, 18 per cent up. Very similar overall growth in income to the first half and also not just at an overall level but very consistent growth by Division. If you go down the Divisions here you will see very consistent patterns of growth for the full year to the first half. Obviously many of these numbers are impacted by acquisitions and foreign currency but a story of consistency more than anything else and obviously some very large percentage growths year on year in many of our Divisions.

Tackling, first of all, the impact of currency and acquisitions at a total level, reported income growth up 18 per cent, currency impacted our results by 2 per cent, so income before currency or at constant currency year on year would have been up 20 per cent, almost £4 billion, and that splits roughly 50-50.

We have got about £1.9 billion of income contribution from acquisitions and just over £2 billion contribution from organic growth. That 11 per cent income growth organically is exactly the same number as you saw in the first half and also the same number you saw in last year on the same basis. We are seeing consistency on the organic level overlaid with the benefit of acquisitions now coming through.

As ever, have we achieved that income growth at the expense of interest margin? The answer in short is "no". We have seen at the full year the same interest margin that we reported at the half year. Clearly year on year that is down slightly, principally as a result of mix - the next slide probably takes you through that better - but basically at the year end the same margin as in the first half.

The next slide really begins to drill down into the moving parts within the margin, and clearly there are a number of moving parts around the Group. In short, you could say that the funding of rental assets - remember of course as we grow our leasing business we have the funding costs in interest income and the income from that in non-interest income - so the funding of rental assets impacted margin by 3 basis points. The impact of First Active, which we acquired at the beginning of the year, a mortgage business - the average margin is lower in that business - that is 2 basis points. In short, you could say that was the overall margin movement.

Within the other net zero movement, clearly we have got on the one hand the impact of mortgage growth, obviously lower margin mortgage business takes margin down slightly overall. On the other hand, we have got Corporate Bank mix, we have got very strong growth in Mid-Market business in the year and, as we said at the half year, the average margin on that business is slightly higher than the overall mix of business. So mix almost offsetting there, with organic mortgage growth going one way and Corporate Banking growth going the other.

We then have the environment that we are in, in terms of interest rates moving, and that has clearly had an impact on levels of not just borrowings in consumer but a small impact also on margin in consumer lending, offset by an improved margin spread on deposits as a result of the higher rate movement. So many moving parts, but broadly margins the same as the half year and overall any margin movement really caused by mix.

In terms of looking forward on margin, this is a very similar slide to the one we showed at the half year, when we said that broadly margins were looking to be flat or down, and the level of down being really depended on the mix of business more than anything. Again, as we look forward, really the determinant of margin going forward will more than anything be the business mix impact of mortgage growth on the one hand, large corporate growth is coming back so that could have an impact on business mix going forward, but the our outlook really is very similar to the first half, so broadly flat to down a bit.

Turning next to expenses, just like income you will have seen, if you compare this slide with the half year slide, very consistent expense growth numbers across the whole Group. Slightly slower expense growth in the second half overall, so expenses up for the year 13 per cent; at the first half it was 14 per cent. At the Divisional level, however, very consistent, and we will go through each Division one at a time. But again, another story of consistency here with, if anything, expense growth slightly slower at the total level.

Doing the same for expense as I have done for income, stripping out the currency impact, expenses would have been 15 per cent higher at constant currencies. Again looking at the impact of acquisitions and organic, acquisitions have contributed about 6 per cent of that 15 per cent, organic or underlying businesses grew expenses by 9 per cent, again a consistent number with the first half.

You will not be surprised to see on the next slide that with income growing ahead of expense growth we are again seeing an improvement in cost:income ratio. I have laid out on this slide two changes since the first half for you.

At the headline level reported cost:income ratio would have been 40.4 per cent. We have clearly adopted FRS 17 since then which has a grossing up effect on income and costs, and that adds a couple of points to the cost:income ratio.

Charter One then coming in from 1st September. Charter One has a cost:income ratio of a little over 50 per cent at the moment and clearly that on average brings the overall cost:income ratio up by also a couple of points. So overall reported cost:income ratio now of 40.8 per cent, down from 42.6 per cent a year ago.

Turning next to provisions. Provisions, as I have said, broadly flat year on year and that belies the fact that our balance sheet has also grown at the same point in time, so our charge for provisions as a percentage of the book has gone down from, on this basis, 64 points to 51 points, really reflecting an improvement in the corporate world and also coupled with some strong growth in lower risk business, for example, in mortgages which obviously pushes up the overall balance sheet number. So overall an improving charge as a percentage of the book for provisions.

Underpinning that, asset quality is strong. A small increase in overall NPLs and PPLs mainly as a result of acquisitions, so incorporating them for the first time. Overall provisions slightly up, general provision broadly unchanged year on year; overall provision coverage increased from 68 per cent this time last year to 73 per cent, so stronger provision coverage being maintained on our balance sheet.

To re-cap, before we go into the Divisions: income up 18 per cent; costs up 13 per cent; and importantly at this point, where we are seeing other banks release a lot of provisions, we are seeing profit before provisions up 12 per cent, then flat provisions broadly below that; and overall profit up 15 per cent.

Turning then to the Divisions. First of all, Corporate Banking and Financial Markets. Total income is up 12 per cent for the year, again consistent with the first half; the first half was also 12 per cent. Net interest income up 10 per cent, even after the funding cost of rental assets, so excluding that net interest income slightly ahead of asset growth, again reflecting the business mix of mid-market business growth in there.

Expenses up 15 per cent - 14 per cent if you exclude operating lease depreciation, and of that 14 per cent we are seeing again as we saw in the first half about 2 per cent relating to the investment we are making in the US debt capital market business. They are not big numbers, it is about £40 million odd in the full year, but that is enough to throw the expense growth up from, say, 12 per cent to 14 per cent.

Overall numbers, very strong profit before provisions, up 11 per cent, and obviously a decline in the provision level from last year, giving an overall contribution up 18 per cent. There are many great success stories in CBFM this year. As I said earlier, continued strong growth in mid-corporate. We are now seeing some recovery in large corporate for the first time in probably three halves, good growth in dealing revenues but not out of proportion with the percentage you would expect dealing profits to contribute to the Division, and some early successes already in the US debt capital market expansion.

The next slide possibly could be accused of being over-simplistic, but the purpose was really to show what is driving the CBFM profit growth. It is just to demonstrate that it is not dealing revenue that is driving the overall profit growth. As I said already, the dealing profits are roughly up in line with their natural share of this business, dealing revenues are about 25 per cent of CBFM, and the contribution to the growth in the business is about the same. It is not driven by release of bad debt provisions. The contribution before bad debts, we see income up £800 million and profit from that income up £470 million, a very strong story and one that we are extremely proud of.

In Retail Banking, again reasonably good income growth, up 6 per cent and strong asset growth underlying that, albeit slowing slightly towards the end of the second half. There are some margin issues in terms of mix of margin - I've mentioned mortgages earlier and I will show you in a second that the mortgage mix is actually very strong in these numbers.

Overall income growth slightly slower than it was in the first half, again reflecting some evidence of slowdown we are seeing in consumer borrowing, but overall income up 6 per cent, expenses held to 4 per cent growth, so again contribution before provisions up a healthy 7 per cent.

The provision line up, consistent with the rate of growth in the first half, and in line with anticipation in terms of our description to you before of the catch up of NatWest over the years in terms of its growth since we acquired it; NatWest's experience now broadly in line with RBS, as we anticipated.

The next slide just demonstrates the balance sheet mix of this business and also highlights the relatively small level of consumer lending contribution to the numbers, albeit up reasonably healthy in prior years. We can see here mortgages up by £7½ billion. We think that in an environment where interest rates are actually going up, the economics of mortgages are actually slightly more favourable than they have been in the past.

Rising rates should lead to slightly longer average lengths of mortgage periods which is better from an economic return basis, provided you are not lending on any basis that works against you in terms of credit. I think some of the statistics we have got here prove that our lending criteria on mortgages are robust and we have got very conservative lending measures and loan to value.

So overall in the mix of business, clearly mortgage is a strong contributor. Small business lending, which appears in Retail, that is typically businesses with less than £1 million turnover, also growing reasonably well. Consumer lending, a smallish number overall now in the scheme of things but growing not too bad in that period.

Retail Direct: again another period of strong income for Retail Direct with good underlying performances from our cards businesses, from our acquiring business, from Tesco Personal Finance and from the One Account mortgage business. Significant enhancement in this Division from acquisitions we have made into the US and Europe over the last 12 months, also some partnerships we have entered into in both Europe and the United States. Underlying income growth and profit growth, even excluding these items however, are a very strong number.

There has been some up-tick in provisioning charge towards the end of the year, a little bit of uptake in the arrears levels that we were seeing in the book, not hugely impacting here in terms of overall numbers however. So another good and very strong performance from Retail Direct with overall profit up 18 per cent.

Manufacturing: Manufacturing is now supporting more parts of the Group than ever. It now supports in an IT and property sense both Ulster Bank and Insurance, and prior year numbers have been restated to account for some of that, but also supports within these numbers of growth new acquisitions we have made in the period.

The 15 per cent growth is 11 per cent stripping out the impact of taking on for the first time First Active and taking on a full year of Churchill compared to only four months last year. Of that 11 per cent, a lot of volume growth, as we are seeing elsewhere in the Divisions, being supported by

Manufacturing, very strong balance growth, very strong customer transaction growth. The underlying percentage cost growth is less than 11 per cent, but obviously we are still supporting here many Group efficiency initiatives and also enhancement of property facilities, particularly around the UK.

Turning to Wealth, income up a strong 17 per cent, stronger than the first half. We are seeing again improved market conditions coming through to support this business, also supported by some very strong customer growth in Wealth. Altogether a very good all round story, supplemented by Bank von Ernst which is now coming in - and some very good results coming through from there.

Wealth, up 16 per cent in profit. It probably would have been higher by a couple of points were it not for again currency impact. Remember, many of the funds under management here are in dollars and that does have an impact on profit year on year but, nonetheless, a very good all round story from Wealth Management with profit up 16 per cent.

Turning to Insurance, obviously impacted by Churchill. Churchill was acquired in September 2003, so this year twelve months, prior year just four months. Overall income up very strongly and profit up very strongly. It is easier obviously to look at this stripping out Churchill and then looking at the Churchill contribution separately.

Doing just that, excluding Churchill, we are still seeing some very strong income growth. Good volume growth in the underlying business in a market where insurance premiums are growing more slowly than they were in prior years, but good volume growth nonetheless. Income up 17 per cent here but cost growth less than that, so operating ratio improvements here in terms of cost efficiency. Claims running really in line with income and business mix. Profit up 13 per cent, again a number consistent with the first half of the year.

Turning briefly then to Churchill, because Churchill now appears both in Insurance and in Manufacturing costs, just to show you the actual contribution from Churchill in the year. Within Insurance we show the Churchill profit before the element of Manufacturing costs of £234 million - the IT and property cost now being picked up in Manufacturing of £96 million - with a net contribution from Churchill in the year of £138 million.

Moving on to Ulster Bank, again a Division where we have made an acquisition during the period. First Active came into the Group in January, so almost 12 months of First Active in these numbers. Overall, very strong profit growth, very strong income growth. Again stripping out First Active, and you may recall in 2003 we sold a small stockbroker business in Ulster Bank, like-for-like Ulster Bank income growth up 11 per cent and contribution growth up 12 per cent.

That income growth is a stronger number in the second half than the first, momentum is improving in Ulster Bank. These numbers again are slightly impacted by negative currency on the euro, the underlying contribution would have been slightly higher than the 12 per cent reported, so a very strong period for Ulster Bank and integration of First Active going well.

Moving on to Citizens, obviously in pounds impacted by both the dollar movement and by acquisitions. Headline reported contribution of Citizens is now over £1 billion, up 21 per cent.

It is easier to look at this in dollars, so the next slide takes it back into US dollars: Citizens contributed $1.9 billion in the year, so in local currency income up 31 per cent and profit up 36 per cent. It clearly does include acquisitions, Charter One came in for four months in that period, so excluding acquisitions, taking it in dollars and excluding acquisitions the underlying Citizens' business continued to do extremely well.

There was some very good asset growth again in these numbers, a little bit of margin decline year on year, partly because of the continued lower interest rates, but nonetheless a good income performance from Citizens. A good profit before provisions, up 10 per cent - provisions reflecting stable to improving credit metrics in the United States - and overall contribution up 13 per cent.

Looking down the Divisions then in terms of operating profit, as with income and as with expenses a story of consistency, a story of good diversity right across the Group with many of the Divisions contributing very strongly, all contributing well year on year, and that good spread really coming through Division by Division.

For completeness, I have mentioned the income and expense impact of currencies and acquisitions - on this slide is just the impact at the overall operating level - so, as I said already, income excluding acquisitions and excluding currency up 11 per cent, expenses up 9 per cent, and overall profit up 14 per cent. In the first half that number was 12 per cent, so overall underlying profit on constant currency and excluding acquisitions slightly ahead of that reported in the first half.

Earnings per share: obviously there is still a difference between basic earnings per share and adjusted earnings per share but that difference is now narrowing given the final AVS payment that was made towards the end of 2003. So basic earnings per share in the period up 79 per cent, but principally reflecting the fact that the AVS dividend last year was the equivalent of 49.9p of earnings per share; on an adjusted or underlying basis earnings per share up 10 per cent to 172.5p.

The tax charge in arriving at these numbers is very consistent with last year. The tax charge on the operating profit level a little over 28 per cent; going forward, I would see that being 29 per cent, given the mix of business in the United States that we now have and elsewhere; overseas tax generally a little bit higher than the UK.

Lastly on capital. Tier 1 capital at end of the year 7 per cent and total capital 11.7 per cent. Last year, you will recall, the 7.4 per cent we reported for Tier 1 was slightly ahead of what it would normally have been at that point. You will remember that we completed the acquisition of First Active very early into 2004. Excluding First Active, which is a January completion, Tier 1 last year was 7.1 per cent, so broadly consistent with last year, reflecting again some strong capital generation, obviously some capital raising during the year and the funding of acquisitions, but leaving us with a broadly similar position to the prior year.

That is all I have to say. I will now hand you over to Fred Goodwin!

SIR FRED GOODWIN (Group Chief Executive): Thank you, Fred. Good morning, everyone. I guess in the kind of time-honoured way, what I am going to try and do is pick off a couple of subjects which I think are of topical interest and then move on more generally to our own thoughts around strategy specific to RBS and some general thoughts on economic outlook. As ever, anything we don't cover I am happy to try and cover in questions later, or indeed any questions about what we do cover I am happy to try and answer.

Charter One update I thought would be timely. It is coming up for six months now since we acquired Charter One and I thought we would give you some insight into what has been going on now that the dust has begun to settle and the hard work has - well, it has not just begun, it is well under way!

A quick resume of Charter One. A great fit with Citizens geographically, only three branch overlaps. There is a danger though of being seduced purely by the map. There are a great many of the States in the United States which would pass as largely unoccupied and so it is not all about getting colours on the map. Fortunately though the States which we are moving into in no way, shape or form conform to that description.

One of the important attractions to us of Charter One was the markets it has given us access to, and in terms of scale of market they are very much larger than the markets we were already in, in New England and in Mid Atlantic. On this slide, you see there the number of households which I think is a pretty good proxy for relative size of market.

Also important, I guess, is to recognise that we are not everywhere in those States, we do tend to be concentrated. The Charter One franchise tends to be concentrated around the large metropolitan areas. This slide shows some of the key metropolitan centres in their market place, just to give you a sense of the size of the market place and just as importantly the rate at which it is growing. So in every way, shape and form we are attracted to the market place which Charter One is in.

Another one of the attractions, I guess, is just that those markets are largely unconsolidated. You see on those slides slightly highlighted our actual market shares in those States. Our shares in the actual cities there are higher than that but it gives you a sense of how unconsolidated the market place is and I would view that as an opportunity both organically to move up those rankings but also, of course, in due course it should present acquisition opportunities - I think we are still counting something like 3,000 banks in the area that we are operating in!

What has Charter One been up to? Well, as you know, there has been a variety of themes to the story. One of the very important ones, and again one of the attractive ones for us, was the growth in its branch network which had been going on in recent years both in terms of traditional branches but also instore branches. That process continues and it is one which we have embraced and, by and large, are continuing it apace in line with Charter One's own original plans.

Something that is perhaps less clear to you though is, what exactly is it that Charter One does? How does it compare with Citizens? I thought what I would do is, starting with what Citizens does - which I think over time we have all become familiar and comfortable with - and then contrast Charter One to it to highlight the differences and I think more obviously the many similarities.

On this slide, that is Citizens' income broken out by source - fairly simplistic categorisations! On the next slide is Charter One overlaid on that distribution. A couple of things pop out instantly. The one, and most importantly in fact, I think is the commercial banking difference. You will remember at the time of the acquisition we highlighted that commercial banking and small business banking were very important synergies as far as we could see, an opportunity to continue the process which had been begun by Charter One, but we still needed stepping up in terms of more people and more product into that very important and attractive market area.

The graph makes very clearly I think the point of the difference in the commercial banking activity in Citizens versus Charter One, and I will come back to some figures later on. I was going to say if anything, but no, absolutely our sense of the size of that opportunity has grown significantly as we have become closer to the Charter One opportunity.

During the course of the year there has been some excitement in the US market around certain types of mortgage activity, particularly origination and servicing, and with the interest rate movements there have been and the slowing off in some of the mortgage activity there have been some unpleasant surprises coming out from some of the players.

At the time the bad news was coming out, from some of the names that are on the screen there, there was a sense that Charter One would somehow be embroiled or caught up in all of this. Again, I want to just try and dispel that by giving you a sense of insofar as we are in those activities at all they are thoroughly and entirely peripheral to the business we are doing, and indeed are rather of a legacy nature rather than an ongoing nature, so you shouldn't be losing sleep over us in connection with those types of activity.

What is the business doing? To give you a sense of it, what I have prepared here is a slide, first of all, that shows you the pro forma UK gap actuals for Charter One, the new business if you like, the continuing businesses of Charter One, the businesses we view as ongoing for that period. Operating profit of $285 million in that period; there are no "funnies" in there, no one-offs in there, negligible synergies or integration benefits in there. Annualising them clearly gets you to a figure - on the other side, the right-hand column on the slide - of about $855 million. That would be the annualised results of the business as it stands today.

Underlying that, the income growth would have been about 12 per cent during 2004. There is some granularity beneath that, to just give you a sense of how some of the balance sheet headings have been moving. I will not go through each line on the slide there, but I think it is fairly clear. If you look at the commercial loans piece, very strong progress there already and that process is being ramped up. Just moving on to the deposits side, our move out of the more expensive CDs into more attractive current accounts and savings products, and good deposit growth accompanying the good asset growth.

Transaction benefits: these are exactly as posted at the time we announced the acquisition. Today I am confirming these, we will deliver these numbers. It is kind of early days to be revising things upwards, but we are confirming delivery of those numbers today and we will come back to you in due course if there is any deviation from that.

Just for the sake of completeness again, to remind you that the model we are building in the United States now bears more than a passing similarity to the model that we have in the rest of the Group: so centralised manufacturing and shared corporate functions are an essential and key ingredient of what we are doing; maintaining three distinct elements of the business which face into the customer.

It is worth remembering too that in the Midwest we are retaining the Charter One brand, so there will be a slight departure from the tried and tested Citizens model, brought about largely by the fact there are already some Citizens banks in the Midwest - who seem quite attached to being the only Citizens banks there for the time being! We are prevented from rebranding in the Midwest but we will be rebranding in Mid Atlantic and in the New England parts of the business, all to Citizens.

A quick run through of this slide; I am not going to go through every single one of these "clocks", but one of the very important things we talked a lot about at the time of the acquisition was the need to reposition the Charter One balance sheet. It was not, and had not for some years, been particularly well positioned in the context of rising interest rates - which I think everyone and their uncle believe what we are seeing and what we are going to see in the United States! - and we undertook to reposition the balance sheet to remove that, what we saw as a structural weakness. That has been done. The Charter One balance sheet will now benefit from rising interest rates in the United States, so that part has been completed.

Restructuring the executive management: it is an important part of our philosophy around integration. It is to get in and make the people changes quickly so that people are not standing around the coffee machine wondering who is going to be in charge of things when they are meant to be out there driving the business forward and driving integration forward. That has been successfully completed.

We had great co-operation from Charter One in the lead-up to the deal, so we were able to have people, senior executives, relocated before the beginning of September, so we did get off to a flying start there.

Combining the central functions is also well advanced. That said, certain elements of it are contingent on IT integration and so we have not quite finished there yet.

On this slide, and as I promised not to go through all of these, so I will not. But just to remind you, at the top, we are continuing with the branch opening programmes. The figures I showed you earlier for the Charter One expenses in the last four months include the *de novo* branch opening drag, so I would not see that rate of expense growth has being representative of the underlying.

Citizens very successful sales and incentives processes have launched. As ever, these things take a little while to build up to full effectiveness but that is moving ahead well.

One of the challenges we mentioned at the time of the acquisition was that we needed to recruit - we felt 150 additional small business bankers. That is now complete, in fact, we have recruited 185. It is relatively straightforward - well, compared to getting commercial bankers it is relatively straightforward to add people because they go in and they are absorbed almost into the branch network - so it easier to absorb large numbers of small business bankers quicker and we have succeeded in doing that.

Centralising the underwriting of all the small business loans in Providence: important both as a synergy but also important clearly from a risk management perspective. We want to be exactly clear about what business we are writing and we are in that place.

In terms of getting penetration of small business product and so on, that will take a little while to build as we would expect.

In the mid-corporate side, we have recruited key mid-corporate bankers in each of the States. It is very important. There is much more visibility of leadership in this part of the business and the State appointments are key. We were looking to recruit 295 additional corporate bankers, we have recruited 64 or 65 I think at the last count and in line with where we expected to be at this stage. As I say, you just can't go and hire hundreds of these people and throw them in. Picking them is very important because they tend to bring customers with them, so it is not just getting any old 295 corporate bankers, we do want to select quite carefully, as you would understand.

Getting the products, Citizens and RBS products, in there: that is progressing well but still a lot of work to do. Some of that is IT dependent as well.

Technology integration fully planned. The branch conversions: we have already converted the New England branches into Citizens. That wasn't a big deal but it was something to get done and out of the way. All of the auto loan processing has been converted. IT conversion moves along well but it is a big programme and it has got everyone's complete attention at the moment to make sure that goes well.

In summary then on Charter One, the initial performance of the business has been good and at least in line with expectations; integration is fully on track; we have had no negative surprises; and so far, so good. It is worth just remembering we are six months into a three year project here but so far, so good.

On integrations more generally, all of the IT integrations, it is worth not forgetting about First Active and Churchill. I know Fred touched on them, but they are still ongoing, well advanced and going well, and in terms of all the benefits coming out of them they are going well.

Fred put up a slide earlier on which showed the contribution from Churchill. It is worth remembering at the time of the integration, in giving you a sense of what we felt the Churchill opportunity was, we said that we figured that by the end of integration when taking into account the integration benefits we would pretty much have doubled Churchill's profit as it was at that point. Well, those of you who were looking at the figures would probably have worked out that we will double Churchill's initial profit sometime during this year, so that is certainly within two years of the acquisition. Churchill is going well and has been a great acquisition for us in every sense. And the underlying performance of these businesses is strong.

Capital, another topical subject and one I know we have covered before. I am not about to say anything that should come as a surprise to anyone, but this is clearly a key area to you and it is a key area to us, and I want to make sure we are always as clear as we can be about what we are thinking about, and I know you always take the opportunity to be as clear as you can be about what you are thinking about. We value the interchange on this subject and I want, as I say, to be as crystal clear as I can today.

Returning capital to Shareholders is really what we are talking about. This is not abstract debate about capital and theories of capital, this is about returning capital to Shareholders. I guess if I make some obvious observations here: our business generates capital, in fact, it generates quite a lot of capital. That is actually I think a good thing, in fact, I am sure it is a good thing, but it does I guess make this debate more pressing than it might be in some other companies, but I think nevertheless net-net that is good place to be.

We are committed to capital efficiency. We have demonstrated I think a long term commitment to capital efficiency. We do not believe in having our balance sheet full of surplus capital or having a ratio that is slack. We do believe in making your equity work and leveraging it in the business and that commitment is crystal clear in any scenario going forward.

There is no intellectual, practical, philosophical, strategic, cultural or any other form of objection to returning capital to Shareholders, indeed the AVSs I would have thought demonstrate that, quite a substantial return of capital to Shareholders in living memory. For all practical purposes, £3 billion has been returned during the last five years, so there is no difficulty here with the principle and I am happy to state that as often as you would like to hear to it.

We do actively consider share buy-backs. They are one of the things that features on the radar screen as much as acquisitions but I guess, and I am kind of stating the obvious here, all of our considerations in this area are conditioned by a couple of elements: one, what is the strategic position of the business and of the constituent parts of the business?

We are for better or for worse running the business on the basis of producing long term sustainable profitability and value for our Shareholders. That is what we are trying to do by way of strategy, and I will come on to talk about strategy a little bit more in a moment. That is what we are about doing, so in delivering against that objective acquisitions play a part and get a consideration. That is one element of the consideration of buy-backs.

The other element, of course, is what is our actual capital position at any given moment in time? That clearly conditions thinking and probably in the immediate sense conditions it more than anything else. To that end, here is a slightly amended version of a familiar, or hopefully familiar, chart. In the background you see the lines and the Tier 1 ratios. Tier 1, I think really is the determining factor for us of what to do in terms of returning capital to Shareholders. The lines, the "probably" and "unlikely" lines, are drawn at the same place as they were before, we have not moved those, they will still strike as a sort of zone we would be in.

I would recognise if we were above 8 per cent Tier 1, I think we are into the "probably" in terms of a buy-back. If we are below 7 per cent I think we are definitely into the "unlikely" zone, and in between - I acknowledge perhaps slightly unhelpfully described as "maybe" zone - is where some careful thought is always required.

On the chart, the blue bars you would have spotted, that is where we are at the moment. I have highlighted in the 2003 bar the fact that although it looked as if we were at 7.4 per cent in December 2003, and indeed we were at 7.4 per cent in December 2003 we had kind of "spent" - in inverted commas - a chunk of that on First Active which we handed over on 3rd or 4th of January in 2004, so the underlying rate was really about 7.1 per cent.

We exit 2004 in pretty much the same place as we entered 2004 at around about the border line between "unlikely" and "maybe". Without getting into estimates and profit forecast and all the rest of it for the coming year, if you do the maths yourself, you would have to reckon that we will remain in the "unlikely" end of the "maybe" spectrum during the course of 2004.

Strategy: in talking about strategy every now and again it is probably worth just a pause to make sure that, hang on, is what we have been saying is our strategy, does it in fact bear any resemblance to what actually has been happening in the business? And, by the way, does what has been happening in the business bear any resemblance to the kind of strategic objectives that we set ourselves?

It is coming up to five years now since we took over NatWest, in fact, I am trying to remember which traumatic event took place on 24th February in 2000, but there was something so traumatic that it is in a place in my memory where I cannot access it! But, on the 6th March we got the keys in 2000 for NatWest and at that time we shared these slides with you. At the end of 2000 that was the kind of "state of the nation" at that point in time.

It was the first time we inflicted on you the "ticks, crosses and dashes", which was a bit of an experiment at the time, but it strangely did seem to convey at least a sense of what we were thinking and bit more granularity than just words, and we have soldiered on with that to varying degrees of success ever since.

I am not going to trawl back through all of those ticks and crosses again, although if anyone wants to we can do that afterwards, but what was clear from them and certainly what our intent in producing a pattern of ticks and crosses of that shape was it was very clear to us that delivering organic income growth was pivotal. Acquisitions are fine, but you need to get into a mode where you are delivering organic growth going forward, and so we knew our strategy had to focus on that.

It also struck us as being important to try and diversify our income both by type of income and by geography, and again as you look back at the ticks and crosses I think it is self-evident how we were trying to do that. And improving efficiency struck us as quite a good idea as well; there is no point in making life more difficult for yourself by piling on more income that had a cost structure with it which affected the ultimate profitability of the business and in turn the value that you were generating for your Shareholders.

Given that it is five years on, it probably is worth just a moment to reflect, well, have we done that? Well, as to income growth, we have basically - well, not basically - in fact we have more than doubled our income since 1999. So what, you might add? - if there were any cynics in the room and I know there aren't! (Laughter) I guess to really to be able to appreciate that number you need to see some contextual information.

Looking at the other banks of global comparison - HSBC has not reported yet, HSBC has had a strong income growth over that period - but you get a sense that doubling your income during that period is not a bad outcome. Barclays who aren't on the slide, but Barclays have achieved 66 per cent or so growth over the equivalent period.

As important as causing the growth to happen I think is the shape of how it happens and the pattern or consistency over which it happens. You have seen that chart before. That has been updated to reflect the most recent results from all of those organisations. 'Big deal', you say, 'because that is your total income and that includes all the acquisitions you have made. Of course you have grown your income faster because you have made lots of acquisitions and all these other people haven't made any acquisitions over the last five years'.

No! Again, I know we are the ones that get accused of making all the acquisitions and spending all the money on acquisitions, but we come out quite well down that table - not quite well down that table but very well down that table - both in terms of number of acquisitions and amounts spent on acquisitions. So it is not just acquisitions that are putting RBS at the top of that chart.

Looking at the income growth to try and dig into the acquisition question, there are some clear constituent elements of the income growth we have achieved. There on the slide are the now long forgotten about NatWest transaction benefits and the acquisitions themselves of just under £4 billion. But organic growth during that period is 60 per cent of the total income we have achieved - £6.9 billion of organic growth since the start of 2000! To put that in context, that is about NatWest's total income at the time we bought it, so we have grown by NatWest since the end of 1999.

Looking at income by type, clearly that sort of income has altered the shape, the proportion of non-interest income to the total has increased markedly from 52 per cent to 60 per cent where it stands today. Within that there are some important shifts. Clearly Insurance has grown in significance within the business now, it represents about 22 per cent of our non-interest income. As Fred mentioned earlier, dealing profits have hardly flickered during that period in terms of the proportion of our total income, but they have grown in proportion to our business over that time and, in fact VAR is practically the same as it was back then. There is very little movement in it.

Net interest income has shrunk as a proportion of the whole, but the broad shape within there is the same, the balance is still there. We don't derive too much of our income from any individual activity. It remains the case that total exposure to consumer lending in the UK in all of its forms, including mortgages and so on, is around about 10 per cent of our income, so it is not a big proportion. I think maintaining that diversity is important.

Geographically things have moved on somewhat as well during that time. Looking at the individual countries, on this slide, those are the figures in pounds. I think for the purposes of examining our record of growth it is better to look at them in local currencies, and this is just the growth in the last 12 months. I think going back to 1999 it starts to lose a bit of relevance as between the various countries in here.

One of the challenges we have had in altering the shape of the geographic distribution is the fact that we have continued to grow the UK as strongly as we have. But you can see in there very clear changes in the proportion of our income which comes from overseas, driven in a number of instances by acquisitions, as you know.

Improving efficiency: I have gone on about this at great length, as you know. We remain, just for the record, committed to delivering a cost:income ratio that begins with a "3", and 2006 was the deadline we gave for that. Who knows whether it will be achieved before that or not? I will leave you to think about that!

What I think is interesting though or what I want to take away from this slide to be is the kind of validation of the Manufacturing model. We have added £11.7 billion worth of income at a cost of

£3.1 billion. I would like to do those kinds of economics for a long time, but leveraging this common platform does give us real scale benefits going forward and the creation of an equivalent platform in the United States is a big opportunity for us.

You will be astonished to learn that we would give ourselves a “tick”, that a strategy we embarked on in 2000 has delivered to a pretty reasonable degree against each of the themes or objectives that we set for it. So, some staggering conclusions here: it has produced results. It has had to evolve. The ticks and crosses did change during the course of that - and they evolved. There were no wholesale changes but you will remember a number of changes that we pointed out to you. It continues to produce results and I think the results for 2004 show that.

What is also clear to us is that it needs to continue to evolve and what I would like to do now is take you through some of evolutions that we think apply at this juncture. The usual “health warnings” about the ticks. I am not going to go through these, you know them, but we have not yet had to go back and rely on the health warnings but it is nevertheless in the interests of completeness as well to have them there. The world can change and these are options and not promises.

The first thing I would draw your attention to I guess, and Fred touched on it in his presentation, is what’s happening with the consumer. The consumer is transitioning in the UK away from a phase of very strong credit led growth into something else. I am not exactly sure what the something else is yet, lending is still growing, mortgages are still growing, property prices are still going up, but it is at a lower rate and we would anticipate going forward that the rate of growth slows down. I think it is overdue, I think it is welcomed, and I think it is for the good of the economy and for the consumers and, as a consequence, for our business.

The prognosis for the economy in the UK is very good, and I am just talking about the UK here. The prognosis for the economy is very good, so I think it is a transition of consumer behaviour away from borrowings, and one school of thought is we start to move up the savings and longer term investment curve which would suit us fine, or we maybe just have a pause and let the money sit in our current account and then go back to borrowing again. I don’t know, it is too early to call, but there is a transition there.

What I am trying to indicate here is that for the second tick in Retail Banking and the second tick in Retail Direct has got a sort of “watch this space” around it. I am not removing the tick, I am not downbeat, but it is just worth thinking about where we are going with consumer lending. Everything else on that slide there, as is!

Europe: where angels fear to tread! It is probably the most painful thing we have ever done in terms of ticks and crosses, and certainly from my point of view was the question mark we put there last time. That took a lot of work to get the genie back in the bottle; I think we have got it back in the bottle. I wasn't trying to say we were going to go out and do anything mad in Europe, I was trying to signal an underlying change in mindset.

I would suggest that events since I said this have been supportive rather than non-supportive of that thought, but it remains the case we are not rushing out to do anything silly or major in Europe. I am too frightened now to change the question mark so we are just going to leave it as a question mark! (Laughter)

United States: we are adding a tick here. That commercial banking opportunity I talked about earlier, which is an area where we are at the top end of that opportunity, there is a significant opportunity for CBFM in the United States to work more closely together with Citizens. That is a big opportunity and we are gearing up for that opportunity, so I am adding a tick there in terms of our ability to grow lending to not the biggest corporates in America but the sort of mid-corporate and commercial market place we are very familiar with.

Something I should have done last time - I think I actually left it as a dash - was the market extension piece. The "dance card" is pretty full at the moment getting Charter One absorbed. We have also got the People's Bank business, the credit card business we bought in the United States, and the Lynk merchant acquiring business we bought. We are fully and very productively engaged in their integrations. The Kroger joint venture we announced is progressing extremely well. So there is a lot on in the United States just now.

The notion that we might try ... we always have been against buying something out of market, a bank in Texas or Florida or California or something like that, that never made sense to us, but insofar as Charter One was a market extension for the time being we have got plenty to be going on with and we have no immediate plans for market extension. When I went back and looked at the slides last time I think everybody was so obsessed with the question mark in Europe that you didn't pick me up on it, but I should really have made that an X last time and so that is, if you like, a delayed X from August. Out of market has been an X, as I say, for some time.

Asia, we flagged up the last time and there is no change to that slide.

As ever, having a strategy is one thing but we are impacted by the big bad world out there and what is going on. That said, as these charts go and I was digging back through some of the old ones yesterday, this is probably as positive as it has been for a while.

Interest rates are going up I think - and the views on that subject can change pretty quickly - but I don't think they are going up drastically, I don't think they are going up painfully or to any levels that should induce panic or distress, in fact, we have seen them going up in a manner which is particularly controlled, measured and reasoned in terms of controlling the economy. We are okay with interest rates going up; the Group is well positioned for interest rates going up.

Economic growth: I think we are set for economic growth, even in Europe. 2004 I think turned out better than many people thought. If we were having this conversion this time last year I suspect we would have more than happily swapped for the actual figures that we have achieved against our estimates at that time. 2005 feels as if it might be a little bit less in terms of growth than last year but still pretty attractive rates of growth.

Sentiment: improving a little in Europe, but that is not saying much; everywhere else relatively stable. But sentiment is the most fickle of things and one thing that is subject to sudden change - we can see what happens and how oil prices affect sentiment as a topical example - so I put that up on the slide as today's view on sentiment, and that is clearly capable of changing pretty quickly.

Net-net in all of that, I think we are in a good place. I think the economic outlook for 2005 is essentially benign, there are banana skins out there as always but the sense of them is no greater than before, and it is an okay economic outlook.

Our own results then for 2004 were characterised by a strong and well diversified income growth consistent with prior years; we have delivered increased contributions from all of our Divisions; we are looking to achieve further improvements in efficiency and we have delivered further improvements in efficiency in 2004 and we are looking to deliver more; the acquisitions we have made are performing well and are still very much in build-up phase, there are some material acquisitions out there which are not yet fully integrated, as we have touched on; the integrations of them are going well as is their underlying performance; and net-net I think we are well positioned to participate in the growth which is occurring and looks set to occur in all of the market places in which we are operating.

Thank you very much for listening. I think we now move on to any questions you might have. Thank you.

THE CHAIRMAN: Thank you, Fred. Ladies and gentlemen, could we now have any questions? Could I remind you there will be a microphone available and if you could identify yourself and your organisation? Peter Toeman!

MR. PETER TOEMAN (Morgan Stanley): It seems one of the themes of the results is that CBFM has seen an improvement in credit quality which more or less offsets a deterioration in the

Retail Bank and Retail Direct. I wondered if you would explain what sort of trends you are expecting next year?

SIR FRED GOODWIN: If I start off; Peter, Fred, Johnny, or Benny for that matter, will add anything. I think you are right, we have seen an improvement in CBFM. That was pretty well trailed earlier in the year and I think it has evolved in line with what we saw in the first half.

Similarly though in Retail. The story of Retail was more to do with the seasoning of the NatWest personal loan portfolio which we took on and grew after the acquisition, that coming through. Clearly when your bad debt cost goes up it is hard to say it is not due to underlying deterioration in credit quality but it is not the kind of deterioration in credit quality that I think you are getting at. It was moving up to a level of performance which is actually very similar to the Royal Bank personal loan book, so it would be of a different nature than what you are driving at.

I don't know if Fred or Benny want to add anything?

MR. WATT: That is absolutely right. I have nothing really to add to that, to be honest.

MR. BENNY HIGGINS: Perhaps if I could just add that it is in line with the guidance given this time last year and again at the Interims. We would now expect the provisions to grow broadly in line with asset growth.

MR. TOEMAN: But that would be in the CBFM as well as the Retail?

MR. HIGGINS: That is Retail I am talking about.

THE CHAIRMAN: Johnny Cameron!

MR. JOHNNY CAMERON: I have nothing much to add. The trends have improved certainly through the last 12 months and go on. Unlike some, I think we have got some room for further improvement in that provision line.

THE CHAIRMAN: Okay. Yes!

MR. NICK LORD (Deutsche Bank): A couple of questions on the unsecured book. First of all, just in Retail Direct it looks as if your unsecured or your non-mortgage balances have gone down at the full year stage versus the first half. I just wonder if you could give us some 'colour' on that?

Secondly, you make a comment on the Retail Bank about unsecured margins coming down. I wonder if you could just comment on whether that is sort of back book or new business pricing and whether you have seen an acceleration of that in the second half?

SIR FRED GOODWIN: Okay, let me bounce it across to Chris for the first piece and then over to Benny for the second!

MR. CHRIS SULLIVAN: We have definitely seen more growth in the mortgage book in Retail Direct than we have in the unsecured side, but unsecured balances in the credit card business have gone up during the year ahead of market.

MR. WATT: One issue in the second half of the year was MINT, for example. That was a very strong launch in the first half and we did expect some of that to run off in the second half, and that is in line with expectations.

SIR FRED GOODWIN: The interest free period from when MINT was launched through until when the interest free period ended took us through until I think the late August/September time before the first tranche came to an end, so that brought a bit of a drop into it, Nick. So that was the first bit!

THE CHAIRMAN: Benny!

MR. HIGGINS: Well, the margin on the book is clearly the kind of arithmetic consequence of what rolls off and what rolls on. If you look at the market place you will see for yourself that margins are thinner than they were. But the biggest issue on margin overall is the mix which Fred Watt referred to in terms of the volume on the mortgage business being done.

MR. LORD: And just on the unsecured loans within that, were you seeing that rolling off more quickly in the second half than in the first half?

MR. HIGGINS: Yes, that is right.

THE CHAIRMAN: Ian!

MR. IAN SMILLIE (ABN Amro): I have two question please, one operational and one strategic.

The operational one: inside CBFM, the very strong performance, could you give us a little bit of detail into the geographic contributions UK versus non-UK and how you might see that going forward in 2005 in terms of the investment in the franchise?

SIR FRED GOODWIN: Okay. Johnny!

MR. CAMERON: Our ambition is always to try and grow in the UK in high single digits, in fact, we just outperformed that, we were at very low double-digits. In the US and in Europe we aim to grow a great deal faster than that, and again we were right on target, 30/40 per cent in Europe and US in local currency.

MR. SMILLIE: Thank you. Strategically, if you look back over the last 10-15 years, Direct Line and Retail Direct both came out of identifying trends early. You have steered us today that loan growth in the UK is going to slow down and that the UK consumer is changing; Wealth Management is only 6 per cent of Group profit. Are you telling us that there is something of a bigger picture to come here? I am not thinking certainly in terms of acquisitions but just in terms of changing the shape of how the Group is positioned to try and capture that?

SIR FRED GOODWIN: Not really, Ian. The Wealth Management, as we have it structured, we only ever deal with a sort of relatively thin set of the population. You will see Wealth Management's performance has rebounded very strongly as the markets have come back and Gordon has got the reshaping of that business to where we want it to be now, which is more back to being a private bank.

So, as we sit, if we were to see the consumer moving across to anything else it would be within Retail where we have got bancassurance in the first instance and we have also got inbrand private banking for higher net worth individuals inside of Retail, so I am not signalling anything structurally.

I think I am just pointing to what at one level I suppose is blindingly obvious - the consumers cannot carry on borrowing at the rate, and we would certainly not want to lend to them going much beyond the levels of that just now. So that is coming back. I am not trying to signal anything drastic or structural here. We are reading every day of signals of it happening; all I am trying to do is just confirm to you we see that happening as well. I am not trying to signal anything drastic or any acquisitions coming up or anything else.

We participate in income in our Retail business from consumers across a wide range of other aspects of their finances, it is not just lending. Consumer lending, including mortgages, only comes to about, what, 10 per cent or so of our total income.

THE CHAIRMAN: Mark!

MR. MARK THOMAS (Keefe, Bruyette & Wood, Inc.): I have two unrelated questions.

First, within the capital structure what is the maximum amount of gearing you would be happy with in terms of the Tier 1?

Secondly, I think most people would probably suggest that 'bidder's curse' is the reason you might be trading at a discount to the peers. If we look at Citizens, you are saying an annualised profit of $855 million, if we stick on $400 million of synergies it takes us to $1.2 billion pre-tax, and tax it down, it suggests a return of 7/8 per cent which is certainly below your hurdle rate and some would argue below your cost of capital. So, first of all, where am I wrong in terms of the Citizens calculation that gets you to cost of capital and given that experience how are you going to get rid of the bidder's curse? Thank you.

SIR FRED GOODWIN: Thank you, Mark. There are certainly times I would acknowledge that it feels like there is bidder's curse but hopefully the time we start to get rid of it is when people, insofar as it applies, see the results coming through as a result of the deploying of a strategy here, which I think is transforming our business in terms of the diversity of income streams that we have, not just in terms of by type but also in terms of geography. It does give us a capability as economies change, as the market place changes, to deliver consistent results and consistently improving returns for our Shareholders. We are hoping to get our rewards 'long before heaven' and I think there are signs that will happen.

If I pick up in the first instance the maximum gearing in Tier 1, in terms of the preference shares, it would depend I guess what had happened, Mark. Our views as to maximum gearing after a large transaction like Charter One or indeed like NatWest itself would be different from our views on an ongoing steady state basis. On an ongoing steady state basis, we have said in the past between 25-30% of prefs. would be at a level that we would be perfectly comfortable with, and indeed the ratings agencies would be perfectly comfortable with it.

In a post-transactional stage I think we all can see the benefits of gearing up on prefs. rather than issuing more ordinary equity, and I know you understand the mathematics of that. Higher figures would be feasible, and indeed we are running at a higher level just now, to the satisfaction of ourselves and the ratings agencies.

Fred, I don't know if there is anything else you want to add on that?

MR. WATT: Only that the capital generation is such, as you have seen, post-NatWest that at the moment we are sitting at about 36 per cent pref. content in Tier 1; the transition from that downwards will be quite rapid given the capital generation.

SIR FRED GOODWIN: I am getting too old and too wise to try and do these things 'on-the-hoof', Mark, but we will be happy to go through the calculations with you. Our calculations tell us that Citizens is adding a lot of value to the Group. A lot of the capital that sits in Citizens doesn't move to

Citizens would be one kind of point I would make, but we would be happy to go through your calculations with you and try and do it.

MR. WATT: One aspect you haven't mentioned there, Mark, is that Charter One is a fast growing franchise and has all the elements in place to continue growth at levels that we have seen recently - and that is without synergy benefits on top!

SIR FRED GOODWIN: There is a significant strategic aspect to Charter One as well, and Citizens more particularly. Since we have got Larry with us today, it might be ideal just to get Larry's thoughts on that?

MR. LARRY FISH: I think that the Charter One transaction has to be put in the context of what has been happening in the United States in banking and what is going to be the end game, because we are very close now to the final picture.

If you took the 50 largest banks in the United States in 1985, there are something like 11 that are left. The 20 largest banks in the United States now control around 60 per cent of the deposits in the country. Those 20 banks will become 7 or 8 and those 7 or 8 banks will dominate, will overwhelm, the national deposit market in America.

SIR FRED GOODWIN: He means dominate in a nice way! (Laughter)

MR. FISH: Well, well within anti-trust rules, let's put it that way! (Laughter)

We now, with Charter One - it is a transformational transaction - we will be one of those 6 or 7 or 8 banks that will have a meaningful share of the deposits in America. It is little understood that Citizens today now has, with Charter One, somewhere between 1½ per cent and 2 per cent of all the deposits in America.

As I said, there will be 7 or 8 banks - you know who they are: they are Wells Fargo, JP Morgan, Chase Bank One, Bank of America - and Citizens Charter One will be one of those banks. So you have to put it in that context, and then appreciate there will still be 6,000 or 7,000 or 8,000 total banks, but only 7 or 8 will really command an important two-thirds, roughly, of the deposits in the country.

THE CHAIRMAN: Tom!

MR. TOM RAYNER (Citigroup Smith Barney): I have got a couple of questions. One actually was on Charter One, so I think I will start with that one. I think there has been some concern about the sort of costs of repositioning the balance sheet. I just wanted to confirm that will be part of the internal rate of return calculation and I guess a fairly immaterial part of it? That was just the first quick question.

SIR FRED GOODWIN: "Yes" to the second part!

MR. WATT: Yes absolutely, Tom, and it is in line with what we said at the time. I think the very first thing this morning I heard someone looking at what we paid for it as being $10.1 billion, for example, and coming up with a slightly different expectation of the goodwill number and fair value. Of course, that £10.1 billion excludes the £500 million, or thereabouts, of stock option, settlement, and every other item that went into that overall $10.6 billion acquisition price. So you might well find that having looked at it that way that you go back to the numbers you were first thinking of!

MR. RAYNER: Okay. Thank you. The second question was just on the Retail Bank. I see you have given us some greater disclosure on the breakdown of the loan book. I just wondered if you could give the provisions on the same breakdown or at least an indication of the relative importance of the provisions in the three categories you now report the loan book?

MR. HIGGINS: That is something that maybe I can come to you with the details. I don't have them off the top of my head, but I can get the numbers.

SIR FRED GOODWIN: Were you driving at something in particular, Tom, or not?

MR. RAYNER: Well, I am particularly interested in the actual level of provisioning on the unsecured, and I see you have split out SME from the unsecured, so I would just like to get a feel.

SIR FRED GOODWIN: Okay. There is very little provision on the mortgage part of it, as you would expect, and so it is on the other two categories. We will have a look at it.

MR. WATT: The larger part being the unsecured!

SIR FRED GOODWIN: Yes.

MR. HIGGINS: As we said earlier, the NatWest provisioning level is now at the same level of RBS, both stable and good quality.

MR. RAYNER: Thank you.

THE CHAIRMAN: Simon!

MR. SIMON SAMUELS (Citigroup Smith Barney): I have got two questions actually on Retail Direct as well. The first is, I just wanted to basically repeat Nick's question because I don't think it was answered, which is why the non-mortgage loan book of Retail Direct has shrunk in the second half of the year? This is a loan book that has been growing at sort of 25-30 per cent per annum; it was £16.4 billion of outstanding balances in June of 2004 and it was £16 billion at December.

SIR FRED GOODWIN: That was the MINT answer, was it not?

MR. SAMUELS: So that is purely MINT?

SIR FRED GOODWIN: Well, yes, that is the big part of it. MINT had got to the roll off point at the end of the free period.

MR. SAMUELS: Okay. And if you were to take that out of it, is the growth rate consistent with the first half or slowing down?

MR. SULLIVAN: It is roughly consistent with the first half.

MR. SAMUELS: Okay. The second question which is really just a clarification of something Benny said, is in terms of the credit costs within - well, I wasn't sure whether you were answering as Retail Direct or within the Retail Banking Division in talking about credit costs in 2005 growing with the loan book? What I was interested in ... I'm sorry!

MR. HIGGINS: It is Retail Banking, as classified in the results.

MR. SAMUELS: Then maybe if you could just comment about credit quality expectations for 2005 within the Retail Direct business, because you obviously make the comment in here about the early signs of deterioration in the card business towards the end of the year?

MR. SULLIVAN: The majority of the increase in bad debt for this year came from acquisitions in particular, and obviously the growth of the book in the credit card side. What we have seen just in the last few months is a small deterioration - and I have to highlight that point, it is a very small deterioration - in the trends of the defaulters.

SIR FRED GOODWIN: It is back to the reality again, Simon. That we have seen a unprecedented period of extremely good credit quality. There is something there which is marginally less good than that, it is not something that is causing any angst, but it is there.

MR. SAMUELS: Would you expect credit cards in Retail Direct to grow faster than the loan book growth in 2005 then?

MR. SULLIVAN: Credit cards in Retail Direct to grow faster than the overall credit quality?

MR. SAMUELS: The bad debt charge.

MR. SULLIVAN: The bad debt charge for cards against the loans - of Retail or Retail Direct?

MR. SAMUELS: Retail Direct.

MR. SULLIVAN: Of Retail Direct! At roughly similar levels I would think; maybe slightly more in the credit side but nothing much.

SIR FRED GOODWIN: The picture is masked slightly by the fact that there is a lot of the mortgage business in Retail Direct as well, Simon, and so we wouldn't expect to see credit costs going up in that part - if you want to take that out of any picture of growth.

There is somebody up at the back. I cannot see who it is but I can see a hand!

MR. JAMES EDEN (DrKW): Barclays tells us that any acquisition they do has to be better than the alternative uses to which that capital could be put, which includes share buy-backs, and we can argue about whether they have managed that in practice, but at least they pay 'lip service' to the idea. When considering the merits of a deal, do you compare it with the alternative of a buy-back and do you think Charter One would pass that test, which given where your shares are trading would be somewhat tougher than your internal rate of return hurdle?

SIR FRED GOODWIN: I was certainly trying to answer that question in the presentation, and I am conscious of answering it the last time. I am happy to answer it again, which is that we do weigh it up - there is no question of the fact of weighing it up - but when you talk about it in the terms you do it kind of infers this is a highly scientific process that can be determined today with absolute certainty.

By definition and the distinction you are making, in comparing a share buy-back with an acquisition, you are looking at the returns you generate from the acquisition and the likely impact on the valuation of the business versus the returns you generate or the cost of the share buy-back versus the impact of that on the share price going forward. Both of these valuations involve highly subjective and highly judgmental ingredients. The only thing that makes the share buy-back piece look slightly more certain is you know today's share price, or at least today's share price before you start trying to do the buy-back.

This is a highly judgmental area. We do evaluate it. I am very happy, if we were to take the specific instance of the Charter One acquisition that you mentioned, to repeat again that the Charter One acquisition exceeded our hurdle rate, which I have said on several occasions now - and that is not taking into account any valuation on the sort of factors that Larry described a moment ago about the strategic significance of Charter One in terms of the opportunity it gives the business going forward.

But to the core of the question, yes, we actively consider buy-backs versus acquisitions. You made a remark about Barclays performance, and that is for you to make. I would point you to the actual acquisitions we have made in the business and the value they have generated for Shareholders, to suggest that those were better acquisitions for us to make than share buy-backs on the days in question.

MR. EDEN: Would you agree that share buy-backs could be not just earnings accretive but also value enhancing because you will be buying them back off unsuspecting Shareholders who don't realise their true worth? (Laughter)

SIR FRED GOODWIN: I know there are lots of Shareholders out there who don't appreciate their true worth! (Laughter)

MR. JOHN-PAUL CRUTCHLEY (Merrill Lynch): I want to take advantage of Larry being around to ask a question. It is actually less about Charter One but more about the legacy Citizens business where clearly there has been very strong volume growth lagging net interest income growth, and you do flag the margin issue there. I am just wondering, is that a balance sheet positioning issue, is that a competitive issue or is it transitory? I wonder if you could just give us a bit of a flavour about what is happening in the historic Citizens business?

MR. FISH: The historic Citizens business grew loans 18 per cent and deposits grew 13 per cent. Interest rates have been very low, so there is some margin compression. I think long term the United States, and I am thinking now of a number of years, long term the United States has had better margins than other parts of the world. There probably is going to be some competitive pressure on margins when you think long term, but at the moment it just has to do with the fact that interest rates are lower.

Our business is growing nicely in New England, better than nicely in the Mid Atlantic where we have become now the second largest bank in Philadelphia, the fourth biggest city in the United States. We have passed PNC; we are second only to Wachovia. We are the second largest in Boston which is the hub and the capital, and many of you have visited us there, of New England. We have a 42½ per cent market share in Rhode Island. The business in New England is fine and it is better than fine in Mid Atlantic.

Our hope is, our expectation is, that we can take some of these models that Fred talked about and move them into these markets in the Midwest. Chicago is bigger than Philadelphia and

Boston combined; it is the fourth largest deposit market in America. A 1 per cent share point in Chicago is $3 billion of deposits. We have zero share of commercial banking in Chicago. We have just started to do small business banking in Chicago.

Detroit again is a market roughly the size of Boston, Cleveland is just a little bit smaller than Detroit, so there is a lot of work to be done but it is a big opportunity. Being long-winded, New England is doing fine; Mid Atlantic is growing even stronger than New England.

MR. MICHAEL LEVER (CSFB): Really a couple of questions just on the Insurance business, if I may. Firstly the amount of insurance you are planning to cede as a percentage of earned premiums in 2005 will be of interest? I do notice that you are ceding less and less in terms of reinsurance of premium and that has clearly benefited the earned premium numbers for 2004 versus 2003.

The second is a more general question on the state of the General insurance market. Clearly the organic growth of the Royal Bank Insurance business is significantly faster at the moment than the organic growth of the General insurance market we can expect for 2005. I wonder if you could give us some flavour on how you see market developments in terms of premiums, pricing, claims, and so forth? Thank you.

SIR FRED GOODWIN: I will get Annette to do that, Michael!

MS. ANNETTE COURT: In terms of our reinsurance position, as you say, we have ceded less in 2004 than we did in 2003 and that is really in relation to our size and our market position and so on. Obviously we need to make sure we are making the best use of our size in order to look at the market and also take note of reinsurance rates which obviously have been increasing as a result of various world events and so on. We look at the balance of our book and take the best position in the market place, so expect to see a slightly lower position again in 2005 than in 2004.

With regard to the market place as a whole, talking at market rates which I think is what you are getting at really, during 2004 we saw premium rates in the Motor market place pretty much flat or in some cases declining against a market position where insurance claims have been going up at the rate of about 6 per cent per annum, mostly fuelled by increased personal injury claims.

Against 2005, again we are seeing insurance claims going up at the rate of about 6 per cent per annum and some quite competitive market conditions with regard to Motor insurance rates where again we are seeing quite low increases. Now obviously we don't believe that position is sustainable going forward - it just doesn't make sense with regard to the relationship between premiums and claims. Our view, the position we are taking, is to put our premiums up by a small percentage.

MR. LEVER: Thank you very much.

MR. JAMES HAMILTON (West LB): A couple of questions please. The first is on the strategy with Charter One which you say is revolutionary. Presumably you are not the only bank to have spotted that there are going to be 6 or 7 winners out there, if you like, and I was wondering what the implications are - given the state of the market, given that we are near the end game - for pricing and, if you are not going to overpay, how much do you think is left for you in terms of acquisitive growth in the US?

My second question is sort of macro! Recently Alan Greenspan has obviously highlighted that he is surprised by the shape of the yield curve. What do you think the implication for your business is if he is less surprised in 12 months' time?

SIR FRED GOODWIN: Okay, if I deal with the first point and then I think Larry will be far better placed than me to deal with the second.

I don't know that we did actually say this was going to be revolutionary. But anyway! I think Larry did describe the end game scenario very well. I think one of the features of Charter One is that we have 'bought our ticket to the game'. We have got ourselves into that pool. We have an organic way ahead to stay as part of that group, if needs be, so actually the kind of priority or a need to go out and do an acquisition for that strategic purpose is for all practical purposes gone. I remember you describing it at the time, Larry!

For some of the reasons you are describing, James, we were quite glad to have our - what was it? - 'pony in the barn', as you put it. If we wanted to buy a bigger property in the US now, it is not there to be done, so I think someone now wanting to go in and embark on a strategy as ours would find it certainly extremely expensive and in reality probably too difficult to do. I don't think there is any priority for us any more to make acquisitions in the US to address the strategic opportunity or to derive growth, because you saw the market shares and deposits and so on in the big cities we are in with Charter One - there is a huge organic opportunity there!

That said, there are 3,000 or so banks in the vicinity, not all of them are going to survive going forward, but the reality is they are not all going to get bought either. So I think you will see sensible pricing around small banks, conditioned as much as anything else by the fact that none of the big players have to buy them - the big players are all kind of getting themselves into the franchise footprint that they want. With Charter One 'in the barn', as it were, I think we are in a much better place than we would have been. (A pause)

George makes the point that Charter One makes us number 8, makes Citizens eighth largest bank in the US, and if you combine Charter One with Greenwich and Johnny's business over there we are the sixth largest bank in America with our American operations. We are 'at the races' in America now without the need to make any further large acquisition. I think, as it happens, there will be small acquisitions along the way just because there are so many banks, but they are not on the 'must do' category. I think that is one of the really important aspects of Charter One.

You also asked, James, a second bit about Alan Greenspan!

MR. FISH: We position the bank in the best possible way we can, immune to what happens to yield curve or interest rates. I have got enough to worry about every day: I have got credit quality, operational integrity, compliance, the morale of the company; all of those things need to be worked on every day. Our position has always been - to the maximum extent we possibly can we - that we position the balance sheet to be immune to rising interest rates or lowering interest rates and have over the years been quite successful at doing that.

I think what Alan Greenspan was saying is that he is expecting the long end of the curve to go up, he has been surprised that it hasn't, and in the last two weeks we have seen some movement in that regard.

THE CHAIRMAN: Okay. Just behind!

MR. ED FIRTH (SG Securities): Could I just ask you to update us on your outlook or your strategy, if you like, in Asia and I guess particularly China? I picked up on that there was a story a couple of weeks ago about you had been short-listed as an accepted partner; I think it was with Bank of China. It would just be interesting to get a feel as to what you see as the opportunity for somebody like you - which I guess is coming in a bit cold into that region - and whether it will be a corporate or a retail-type presence and what the outlook would be?

SIR FRED GOODWIN: We have got a corporate presence. We have had a corporate presence in China for the last 10 years or so and we, in fact, uptiered that earlier in 2004 into a full branch in Shanghai. During the course of last year we have uptiered the licence we hold to allow us to trade derivatives, and so on, which puts us into a small handful of foreign banks in China who have both a branch and that type of licence.

The business there has been growing strongly organically but it is from a very low base - it doesn't raise a flicker on the overall radar screen! - but I suspect for that reason and for the time-honoured reason that our name gets associated with everything and anything it could explain why we are featuring in rumour. If we are thinking of the same rumour, I think the Bank of China were quick to deny it. We feature in rumours!

What we are doing is looking in China, and Asia more generally. There is a lot happening out there just now. That said, you don't have to spend too much time looking to kind of appreciate that the acquisition route is an unlikely one to pursue and that you are looking more at joint venture type activity in particular product areas, and that we look at. (A pause)

THE CHAIRMAN: Are there no more questions? (A pause) Okay. Thank you very much everyone.

(The proceedings then terminated).