

**RBS**  
**Moderator: Sir Fred Goodwin**  
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Sir Fred Goodwin: Thanks JP and morning everyone. It scarcely seems like a year since this conference when I last appeared before you, and I was struck this morning with a great sense of déjà vu, as I came into the building and into the room, everything seemed uncannily familiar. Something though which has changed a little bit is the conference theme. As someone who has fairly religiously tried to stick to the conference theme each year and found it progressively harder and harder work as it became sort of more and more doom-laden as we seem to go through the early part of the millennium, it's pleasing to note at last that we've moved onto a topic which seems slightly more open and less prescriptive. At least that's how it seemed when the invitation landed on my desk, I duly accepted and put it on the to-do list for a bit nearer the time. It was only really as I came round to start putting some thoughts together on strategy 2010 that I saw one or two of the more obvious challenges which it presents.

Firstly and foremost, five years feels kind of too far ahead to look, because strategy isn't something, at least from our point of view strategy isn't something that we send people called strategists in to a darkened room in an exotic location to spend a week or however long it takes locked in to come up with. Strategy is a living part of what we do in the business, and it becomes, in its purest it becomes quite operational and quite focused and quite detailed, so

trying to think out as to what 2010 might be seemed quite a tall order for us. It is too far ahead to be thinking about budget, it's too far ahead to be thinking about physically what the market might be doing. It's too far ahead to be thinking about what economic growth might be doing in any of the individual economies in which we're represented. Clearly too far ahead to be producing anything approximating to a detailed business plan. And so really the only thing that struck me we could talk about sensibly in relation to 2010 would be strategic direction. And that, you'll not be surprised to learn is the thrust this morning.

In thinking about strategic direction, it's helpful just to start off with one or two obvious remarks. It is clearly much less precise than strategy. It is directional, it's not so prescriptive from our point of view as to what will happen in 2010 verses 2009 verses 2011 verses 2008. It is directional and less precise. It clearly is conditioned by data; how our business is performing, what's happening in the world, and of course by experience as to what works, what doesn't work, what is working, what won't work. Conditioned by the operating environment, it's all very well us having a strategy but clearly there are other people out there who have strategies and what we do will be influenced and affected by those. And it's clearly more than anything else conditioned by the position and capability of the organisation, or perhaps more precisely, where we start from. We all begin the strategic journey from a place, and so in considering our strategic direction for the Royal Bank of Scotland Group, where we are today is an important ingredient and contributor to that strategic direction.

I put it to you that where we are today is not somewhere we've arrived at by accident, it is in fact somewhere we've arrived at by virtue of having had a strategic direction, certainly over the last five years and indeed before that, but just to give a sense of why we've come to be where we are today, I want to go back briefly to the last five years and just give a sense of some of the things we've been trying to do because they do very much condition what we are planning to do in the strategic direction through to 2010 and indeed beyond.

In the year 2000, everything seemed so simple then, we had just taken over NatWest, we were up to our neck, indeed, some thought well over our head in 'opportunities' and 'challenges'. The priorities were simple, it required no thought whatsoever to identify that we had to go and deliver the transaction benefits which we'd promised to everyone, we had to keep the show on the road at the same time and deliver underlying income growth, and improving efficiency wouldn't be a bad idea either. Ancient history so I'm not going to dwell on this but yes we did deliver the NatWest benefits, yes we did deliver underlying income growth during the period, 60% of our income growth was organic, just under £7 billion, so the second of the objectives was met, and of course not unconnected with the two things as well, the cost income ratio improved pretty dramatically. But even back in 2000 we had identified some other issues with the group. Integrating NatWest successfully was clearly mission critical but it wasn't enough. Had we done that, and only done that we'd have ended up with a group which had somewhere in the order of 85% of its income coming from the United Kingdom. That felt like too much dependency on a single economy. Our income mix was 50/50 roughly net interest income and non-interest income, that felt like making margins a bigger issue than would have been ideal going forward. As we looked into individual businesses or individual areas of weakness in our platform, yes we had lots of strengths but there were some quite clearly identifiable issues and weaknesses. We were much stronger in corporate banking than we were in financial markets. We were much stronger in CBFM UK than we were outside. Direct Line, strong in motor but weak in home, Ulster Bank very strong in the north of Ireland, not so strong in the south. Wealth, strong in the UK not so strong outside, that's the theme again, Retail Direct, strong in the UK but not strong outside. Citizens, very strong in New England, but we're reaching a place, we thought, one with diminishing returns in New England, need to expand outside it.

In the ensuing period we regaled you from year to year with the famous ticks and crosses chart, so we tried to turn those gaps as we saw them into strategic priorities and give you a sense of what we were going to do and why we're going to do it and how we're going to do it and we've had much fun over the years with all of the ticks, when did something move from being one tick to

two ticks, when did it move to being a cross and so forth, and I think we've mapped out a journey for you over the period as to how we got from 2000 through to 2005, and how we addressed all of those issues. In Corporate Banking and Financial Markets, many of you would have seen the presentation we made yesterday, a particular focus in Corporate Banking and Financial Markets, we engaged in a sequential, if you like, organic development product by product to build out the platform. We did it by making significant investments in our business but at the same time maintaining a stable cost income ratio. We delivered stable income progression, stable contribution progressions while making those investments in our business. We've maintained a very conservative risk appetite in that business. And we've now got ourselves, we've truly I think transformed our financial markets business and have got ourselves to a place where we are top ten in all of the activities that we take part in around the world.

For example in currencies, those of you who weren't at the presentation yesterday we'd commend the website to you where there is considerably more detail and financial information around the progress of Corporate Banking and Financial Markets so I'll just take out one or two of the highlights here. Currency, as you can see, a transformation in our market ranking over that period. Interest rate products similarly, transformation of our position and market share, debt capital markets, it's not quite so easy to get positioning information but again you can see from our market shares the strong progression across the principal currencies. Higher level altogether, looking at the growth of CBFM, outside of the United Kingdom, 28% per annum growth in the United States, 41% per annum growth in Europe, 33% per annum growth in Asia Pacific. Quite a step forward for that business and delivery against some of the gaps we saw in our strategy.

In insurance we acquired Churchill. This makes us number one in both insurance by a bigger margin but clearly the position in home insurance has been transformed to address that specific gap that we identified. Ulster bank, the acquisition of First Active has moved us ahead in key mortgage markets, particularly mortgage markets in the Republic of Ireland which is still

particularly strong, particularly buoyant. Wealth Management, the Bank Von Ernst acquisition again moves us forward in terms of what we have outside the United Kingdom, Retail Direct, I don't propose to go through all of these in great detail other than just to highlight that again we've built out our platform in Europe, and crucially down at the bottom, we now have card issuing capability in the United States, and merchant acquiring capability in the United States, both of which were key missing product capabilities back in 2000. Citizens, you'll be very familiar with what we've been up to in Citizens, but in short the build out, we're were feeling constrained in New England, we don't feel constrained in the footprint we now occupy. Coloured charts like this can be deceptive, many of these states are full of grass and trees and little else in the middle but to bring some conditioning around the scale of the opportunity, simplistically speaking, if you add up the number of households in new England, we've doubled the household representation by acquiring Mellon in the mid-Atlantic figure, and then we doubled the total by the Charter One figure, so we have now carved out for ourselves a much bigger arena in the United States within which to operate.

At the same time, in terms of standing amongst US banks and our ability to do what we do at scale, we have transformed the rankings of Citizens, and also importantly Citizens acting together with Corporate Banking and Financial Markets, which is a theme I will return to in coming years, as we look to build our corporate banking businesses, and our mid-corporate banking business in the United States. As you can see there's no comparison between Citizens' position in 2000, and its position in 2005.

Going back to those high level objectives we identified in 2000, too much of our income was coming from the United Kingdom, well we have moved again forward, I don't view this as yet as the finished article, it would be nice to think of the overseas component growing more strongly than the UK part, in fact, the slide has gone backwards as a result of the first half results, the UK continued to grow so strongly, that the US wasn't growing fast enough to maintain its share. That

feels like quite a nice problem to have, although I'm sure as we go forward the overseas component will grow more quickly than the UK's.

The net interest income proportion has reduced quite markedly from 48% to 38% of our total. And so against that 2000 – 2005 list of strategic objectives, I think we're happy that we clearly delivered the NatWest benefits, we kept the show on the road, we kept the organic growth moving forward strongly, we managed to improve our efficiency, and we did it all whilst maintaining stable credit quality throughout the organisation, and we have addressed the other strategic priorities. Some more successfully than others, some more comprehensibly than others, but I think they have all been addressed; the gaps have all been filled. Not at any cost, we've been able to achieve all of the above while increasing our earnings per share, and whilst increasing the return on equity, our return on equity has increased by about a third during this period, so it was not a case of pursuing the strategy at all cost, regardless of its impact on our shareholders. The returns with earnings per share and return on equity have both moved positively during the same period.

So now to summarise, the simplest summary I can come up with for what we were up to during 2000 – 2005, is really contained in the last line on this slide. We have created a platform for future growth. We weren't filling in these strategic gaps just out of some sense of neatness or to make the slides tidy. We were filling in these gaps because we felt that they were important to our ability to continue to generate growth going forward, and that's the theme I'd now like to move on to: the strategic direction 2005-2010.

May I just remind ourselves then of where we are today. We're not planning to change the strategic direction we've been following. The results of the group have been strong, they continue to be strong, we don't feel there's any need to alter the general strategic direction. That said, as a result of the progress we've already made, there is evolution of some of the strategic priorities and I'll come on to what those are in a moment. The platform has been built, and our

main priority now is to leverage that platform. We have a strong position in the United Kingdom, we now have an established platform in the United States, and it's not established just in the sense that all the bits are there, we have relative scale now in all of the things that we do in the United States. Similarly in Europe, we have established a platform and we have relative scale in all of the things that we do. We have generated some opportunities for ourselves in Asia Pacific, and crucially there is no strategic need for acquisition.

Looking at the platform snapshot of our corporate banking platform around the world, the key at the bottom is important, the ticks are where we would suggest and claim to have a platform, and a platform at scale on an effective platform. The crosses are not the to-do list, the crosses are the areas where we do not perceive building out a platform, we have no plans to build under the corporate platform in Europe or in Asia Pacific. We don't see ourselves going into SME banking in Europe or Asia Pacific. So, the finished article. On the retail front, crosses in slightly different places but again, the crosses are not the to-do list, the crosses are indicative of the fact that we have no plans in those areas.

A strong position in the United Kingdom, still a strength rather than a weakness, we still have very small market shares in a number of key product areas, there still feels like plenty to shoot for in the UK. In the United States, first half results, yes, there's still plenty to shoot for there, there's a huge opportunity for growth now in both the Citizens franchise and the Charter One franchise, we have very small market shares in most of the areas in which we are represented in Citizens. Corporate Banking and Financial Markets, big opportunity for growth as well, coming through in the numbers already.

Europe, very strong there, some of them admittedly from small figures, but others, now even a 40% move forward in Corporate Banking and Financial Markets from a non-trivial start point, real traction being obtained now in Europe from the platform which we have built. Asia, small numbers but again, high percentage uplift.

This probably is the first opportunity I've had to speak to investors face-to-face regarding the Chinese transaction which we announced back in August. I think the reasons for the transaction were fairly well detailed by me in the months leading up to it, and certainly we started talking about it as early as the interim results in '04. The relative scale of China I think is well known to all of you and I don't need to dwell on that here. The transaction that we're still actually in the process of completing, we haven't received all of the necessary approvals as yet, it's a syndicate which is acquiring 10% of the ordinary shares of the Bank of China. Now that will be 10% pre-IPO so the deals which have been announced subsequent to ours have not diluted out interest in Bank of China. For our own part we will take just over 5% of the stake. We've received the appropriate warranties and protections, it will give rise to a small increase in our tier one ratio as a result of the fact that we sold our Santander stake to fund the transaction, and you will note that at the time of the transaction I highlighted that our tier one after the deal by the end of this year will exceed 7% on an IFRS basis. The rationale, because I think the background to the Bank of China I think is fairly well understood but it's a long established bank in China, it is the bank which has focused most on trade-related activities, and is the most external facing of the Chinese banks, the most internationalised bank, and that's played no small part in us identifying them as our preferred partner. Significant branch representation in China, significant market shares in some important deposit areas, and product areas in deposits and loans, and of course the brand itself appeals particularly to affluent customers and large corporates, two segments which we feel we've got a lot to add to.

Cooperation possibilities, and I say possibilities because this is about a partnership and it's about cooperation, so it remains to be seen whether we're able to come to a basis for any or all of these particular areas, but they do seem from our earlier discussions with our colleagues in the Bank of China as high priorities for them and high priorities for us, and you'll see without me running through every single item on the list very obvious synergies with areas of expertise within RBS. Similarly, and I guess this will perhaps represent more areas where Bank of China would see us

providing input in a non-directive business related sense, corporate governance, risk management, financial management, IT and so on, all the areas where they're keen to leverage some of the expertise which we have. So it's a transaction which we think opens up a lot of opportunities for us, it doesn't open up a huge amount of risks. I don't think it's going to be driving huge contributions towards our numbers in the early years but I think it opens up significant optionality for us in an important growing market.

So to conclude, as we look through at how things have changed since the period 2000-2005, how things are likely to be different going forward into the next five year period, some things are the same and some things have changed. Growing income is the top priority, it is the fuel and lifeblood of the organisation. We need to grow our income. I'm comfortable and confident in our ability to do that but it's nevertheless remains our top strategic priority.

During those first five years post the acquisition of NatWest, I think it's fair to say we had to transform our efficiency and I think we've done that. I think we're now into a phase of improving our efficiency rather than transforming it, I don't see that we have an ability at 40% cost-income ratio to transform it, but there's certainly scope to continue to work towards further improvement.

I highlighted that during that period of transformation we increase a return on equity by about a third, and clearly going forward it's another key metric for us. It's easy to achieve growth if you're able to let return on equity slide – that is not part of the recipe or part of the cocktail that we have in mind. Perhaps getting into sort of vaguer language, if the first five years of the decade were about diversification, and I think quite dramatic diversification in many respects of what we do, the next five years feels more about enhancement of the platform that we've built, it feels not so much about whole new steps as about filling in smaller gaps and developing the platforms that we've already built. Indeed it brings me to my final point that I think the simplest way to describe the last five years has been about creating a platform for growth, and the best way to describe

how we see the next five years is about leveraging the platform we've already built, rich in opportunity, rich in optionality and rich in potential for the next five years.

So that I think is the best I can do in providing an insight of what our strategy will be in 2010, I'm happy now to answer any questions that anyone has.

JP: Maybe I can kick off with the first question. I often get asked questions on Royal Bank about the capital ratios, you seem much happier to run with a tighter balance sheet than your peers, but also if you're adopting much less of an acquisition strategy, then clearly the group becomes a lot more cash authoritative. I wonder if you could give a few comments about (a) your current capital position and how you see it moving forward?

Sir Fred Goodwin: The capital position is I think pretty much as you describe it JP. The fact of the matter is that we do generate a lot of capital, there have been calls on that capital both through AVS and through acquisitions. I think as we move into the phase of leveraging the platform, the capital generation remains the same, it's the calls in the capital which become fewer and so it seems to be inescapable and obviously in the comment that our Tier 1 will exceed 7% at the end of this year from 6.6% at the half year. It gives you some sense of the capital generating capabilities of the business, so we would see capital ratios moving forward, how Basel II impacts us at the moment, that would be a reduction. So there's a number of moving parts in working capital, but all of them I feel pretty positive about at this point.

Questioner: Does your reluctance to buy back shares change at all as your stock gets cheaper.

Sir Fred Goodwin: I don't think there's any real evidence of our reluctance to buy back shares. I think we've always been quite explicit about our thinking around buying back shares. One of the precursors for buying back shares is sufficient capital to do it, and it's at the moment 6.6 Tier 1 – that would not fall within the sort of range that we think is appropriate if we consider buying back

shares. Once you get into a zone with your capital where you're buying back shares with an option, we'd be happy to compare it. I don't think it's always as simplistic an equation as is sometimes suggested that based on today's share price you could commit to buying back shares or it's not a good transaction one day because of the share price or it's a weak transaction another day because of the share price, I think the dynamics are slightly more complicated than that. But I would be disappointed if you've ever heard anything from me that has suggested any conceptual difficulty in buying back shares. It's an arithmetic and judgemental matter, not a matter of quality. We'd be happy to buy back shares when the opportunity presents itself, but there are some elements of that opportunity which have not yet presented themselves.

Questioner: Do you believe that the Anglo-Saxon world holds a similar business and economic cycle, especially in the US and the UK. Clearly you're very exposed to that part of the world and to that extent also very exposed to a very overstretched household sector and consumer sector of the business, and also to a flattening if not inverting yield curve. How would diversify working that or whether you see that as an opportunity?

Sir Fred Goodwin: There are a few elements in that. Firstly I don't think all Anglo-Saxon economies perform in the same way. I think we see some evidence of divergence around that and I'm relaxed in that sense. As to diversity, consumers in total only account for about 10% of our total income, so we are already considerably diversified away from exposure to consumer lending, and in saying that I don't personally see that consumer lending is in a dire place that we're trying to run away from it. I think along with other activities that have a place in our business, we're now entering into a phase where I think I would agree with you that we have reached a point where the levels of growth that we see in consumer finance are slowing down. We can debate whether it's overdue or not overdue, but I think it's certainly now timely. That would be less of a drag on our business than it would be I think on a great many other statements, and it has been good business while it has lasted. When you look at the overall economics of it, I think we're still the

better for having done that business. We recognise it may not be as buoyant at times for consumer finance for the coming few years.

The shape of the yield curve in the United States does present some challenges to banks in general and we would not be immune from that, but it's part and parcel, these are sorts of things are part and parcel of being in business. There will be from time to time phenomena out of the control of individuals in the market and it's why not having all of our business in the United States feels like a better place to be in than if we'd had all of our business there in facing that yield curve. I don't think anyone feels that the yield curve is going to be like this forever. It's not particularly helpful, we share that in common with all of our colleagues who are in banking in the United States.

Questioner: At a time of very weak margins in banking and the collapse in corporate spreads, do you think this is not a time for perhaps not putting a lot of leverage on your balance sheet and moving more to protect margins in the hope of spreads rising at some stage in the future?

Sir Fred Goodwin: I think there's one or two misconceptions about what's happening to margins. In the Group margin, it's principally attributable to mix. So it's a particular business area, we talked about consumer financing and I think the growth in consumer finance is beginning to slow down. We were stepping up our activity in mortgaging. The return on capital for mortgages is very attractive but it doesn't come through in the margin line in the same way, and I think too much of the debate has become simply about margins. The economics of the business that we're in revolve around a mix if you like of margin, other income and bad debt costs, so to form conclusions whether our income is declining or not or our returns on capital are declining, we need to look more widely than margins. If you look at our returns on capital, I think you'll see a rather different picture emerging and one which would suggest that the business is directly involved in, there's one which is friendly and beneficial to shareholders, but margins are just far too narrow I think to look at. 62% of our income is not margined income.

I'll give you one example of what's happening at the moment, I guess it's kind of topical given some of the headlines today about increasing interest rates on credit cards, is that you can still get a credit card at 0% interest. We still offer our credit card at 0% interest for the introductory period, so you might think "well, that's no change in margin from last year", indeed, there has been no change in margin from last year. But now there's a 2% transfer fee which dramatically alters the economics of that product, so it comes through not in margins but in other income.

So I think if people want to look at profitability of banks, I think you need to look at return on capital or return on risk adjusted measures to get the proper balance and sense of whether what we're doing is profitable or not. So even though our margin declined in the first half, some of it was due to the yield curve effect in the United States we spoke about. More than half of it was due to a change in mix, but none of the things in there were we unhappy about in terms of the individual product margins.

Questioner: Now you're concerned with the acquisition of the stake in Bank of China, the scale of the global ambition of Royal Bank of Scotland, could you just tell us whether you think you've got management depth and management talent in the organisation to be able to cope with the sort of global scale you're now talking about with Royal Bank of Scotland?

Sir Fred Goodwin: Yes, I do. We wouldn't have done it otherwise and we wouldn't be delivering the sort of numbers we're delivering had we not had that management capability. For any successful business, what I'd say to you is we're always on the lookout for more management talent, not so much a recruiting advert perhaps, but any successful and growing business is always on the lookout for more talent – why would you not be? But if you look at the management teams we've got running these businesses, they're both talented and stable and deep. The business we've got in the United States, we've got a very significant management team there, many of you will have met Larry and you will know a number of his colleagues there. We've got good strength in

depth in the United States both in Citizens and some of the CBFM people, and across the rest of our businesses we've got good management strength, yes. I don't see China being an enormous drain on management time, we're not planning to send an army of occupation out to China. I think much of the relationship will be down to providing strategic input and guidance, people perhaps from Bank of China are coming to work here, and some of our people are going to work with our colleagues in China. We employ 142,000 so it doesn't represent a huge drain on overall resources, but we'd like to have more managers there, absolutely. I'd be very surprised if there's anyone standing up on the platform today who wouldn't answer yes to that question.

Questioner: Just a follow-up on the Bank of China investment, can you give us some information on the length of the due diligence process and your findings, particularly with regard to risk provision levels, risk management processes and so forth?

Sir Fred Goodwin: I think to give you the complete answer, the due diligence processes were run in balance with the protections and warranties process. A similar transaction, if you can't get beyond a certain point in due diligence then you will look for protections to cover you in that situation and I'm very comfortable that the protection we have covers us in the event of anything materially adverse arising. I think you'll have seen some comments yesterday in the newspaper from one of the Bank of China non-executives how we have a protection that covers us if any adverse information comes to light ahead of an IPO. That gives you a sense, whether we need to discuss in detail what all of the protections and warranties are, but that was one that the Bank of China as well have put into the public domain.

Questioner: On Bank of China again, is there a limitation on the number of strategic investors that they can bring in such as yourself, and is there an obligation by the bank to use your services or merely an opportunity for you to sell them?

Sir Fred Goodwin: We have exclusivity across all of the products and services that we offer. In the event that we choose not to go forward with something then it would seem churlish to swap backwards and forwards with someone else, but we have this facility across other areas in which we operate.

Questioner: You've described how diversified the bank has become, when I look at your board and when you look at the board of directors, do you feel that the diversity of the group is reflected in the building up or do you feel that should be changing at some point in time?

Sir Fred Goodwin: I think the composition of any board is always changing. Diversity wouldn't be a full objective in selecting...selecting directors for the board is not my charge, it's clearly down to the chairman and the nominations committee. From where I sit it strikes me that more than anything else you need directors who are capable of directing the business, so they would not I think as a first step try and set out our board which completely in terms of diversity represents every single country that we operate in proportion to ethnic or other mixes within those countries. We need to recruit directors who are capable and competent, and I believe we have directors who are capable and competent. As with any board there will be changes going forward, we've seen some changes this year as some directors have stepped down and some new directors – I'm sure that will continue as we go forward and I'm sure that the chairman and the nominations committee will continue to place great importance on selecting the right directors in relation to their skills and capabilities rather than diversity. That said, it would be hard to imagine that diversity wouldn't feature across the people you see on the board, and I think they are a pretty diverse group of people across the board at the moment, in terms of experience and capability they're very diverse.

Questioner: Can you just say something about leveraging the Charter One platform over the next five years?

Sir Fred Goodwin: Charter One, in the narrowest sense of the platform we've now integrated it, so it's under Citizens IT platform, it's under Citizens management platform which is one of the big things on the "to do" list, and we're very glad to have that behind us. If you look at the market shares, take Chicago for instance you'll see that we in common with pretty much everyone else have got pretty small market shares, so it strikes us that there is a great opportunity to build out that franchise organically. You've heard me say before there are 3,000 banks in the area which we operate in, and you'll know instantly that that means that most of them are microscopic. To be honest, we're at a stage where I'm less sure that we actually have to go and buy...we could go and buy some just to be invisible on the radar screen, so actually the ability to develop the business organically is one which is looking quite attractive at the moment as well.

For instance, you'll have seen I think at the interim results they highlighted the number of new branches we'd opened in the last year, so that's another area of expanding the footprint beyond simply acquiring other banks. As we've got scale on the IT platform, it becomes no longer a strategic matter to buy other banks, it would purely be a financial matter if we felt the returns were attractive, and right now we're not looking to do anything like that.

Presenter: We'll draw things to a close, thanks for your time. There will be a break-out session if people want to continue the discussion further. Thank you.