

In 2006, the Group once again demonstrated its inherent strength and breadth, achieving impressive growth and capital generation enabling us to increase the dividend by 25% and raise our payout ratio to 45%.

At last year's AGM, Sir George Mathewson stood down as Chairman and the Board appointed me as his successor. George's 18 years at the helm of RBS, as Group Chief Executive and latterly Chairman, marked an extraordinary period of growth and success. I thank him for the fine legacy he provided and for all the help he gave me in ensuring a smooth and easy transition.

Over the last year I have travelled widely across the Group, meeting many employees, customers and shareholders in Europe, the US and across the Asia Pacific region. I have been deeply impressed with the RBS people I have met and have found our businesses to be in good health, continuing to grow strongly and making significant impact in their respective markets.

Financial performance and use of capital

In 2006 the Group operating profit increased by 14% to £9,414 million (2005 – £8,251 million). Total income grew by 10% to £28,002 million (2005 – £25,569 million), while operating expenses grew by just 8% to £12,252 million (2005 – £11,298 million).

Impressive profit growth in 2006 coupled with increased distribution, which helped minimise the capital required to support origination, enabled us to be strongly capital generative. As a consequence, the Board is recommending raising the total dividend by 25%, which raises the payout ratio to 45%. In addition, we completed the repurchase of £1 billion of shares announced last year. Our adjusted return on equity increased to 19.0% from 18.2% in 2005, and our total shareholder return in 2006 was 18%, in line with the average over the last decade.

Bonus share issue

The company's shares traded at an average price of £18.09 over the course of 2006 and have moved higher since. This is significantly above the average share price of companies trading on the London Stock Exchange and we believe that many shareholders prefer to deal

in shares with a lower price per share, more in line with the average. We therefore propose to adjust the price per share by a bonus issue of two new ordinary shares of 25p for each ordinary share held.

Staff profit sharing

This is the ninth successive year we have announced a profit share of 10% of salary for all eligible employees, in addition to performance bonuses. On behalf of the Board, I would like to express my warm thanks to our people for all they have done to deliver our success.

Board of directors

I would also like to thank my Board colleagues for their commitment and support during 2006.

The economy and environment

In general, we have enjoyed benign economic conditions which have proved favourable to our businesses, though there have been and will continue to be challenges.

The Group is well positioned for growth in all its geographies and invested £2.8 billion in infrastructure in 2006 to support our growth ambitions.

In the UK there has been much debate about the retail banking model. Studies have shown that the UK has one of the most efficient and competitive banking services in the world, offering excellent value to customers overall. With the largest branch network and the highest customer satisfaction scores amongst our peers we are confident that we will be able to respond effectively to any changes which may occur in the marketplace.

The environment has appropriately become the focus of much attention. I am pleased to say that with our adoption of the revised Equator Principles and our approach to sustainability in all we do, RBS has established a fine reputation as a responsibly managed company.

I have been proud to serve as your Chairman in 2006 and look forward to the continuing progress of The Royal Bank of Scotland Group.

Sir Tom McKillop
Chairman

