

## Group Chief Executive's review



For The Royal Bank of Scotland Group, 2007 was defined by another strong operating performance and by the acquisition of ABN AMRO.

The diversity and quality of our business platform enabled us to deliver good financial results, with operating profit for the enlarged RBS Group rising by 9% to £10,282 million. Our earnings momentum remained powerful, notwithstanding the impact of challenging credit market conditions in the second half of the year.

Our results demonstrate the resilience of the Group in the face of testing circumstances. The summer floods came during the wettest May to July in England and Wales since records began in 1766. While RBS Insurance responded magnificently to meet the needs of customers in distress, the impact on profits is evident. The pace of activity in the US slowed as the housing market weakened, leading to challenging conditions for Global Banking & Markets ('GBM') and Citizens. Later in the summer began the dislocation in credit markets, which made the second half a turbulent period for the financial services sector.

Delivering such a robust financial performance in this environment is the consequence of action in two areas: over a number of years we have diversified the Group's income streams and last year also saw us benefit from our focus on credit quality and risk management with our impairments, excluding ABN AMRO, down 1%.

#### **Our customers and businesses**

The Group now serves over 40 million customers in 53 countries worldwide. In each of those markets we will continue our relentless focus on customers' needs.

GBM enjoyed another strong first half performance and took full advantage of the volatility in the second half to deliver excellent performances in interest rate and currency trading. Inevitably, the second half witnessed significantly lower origination volumes in credit markets and write-downs on US mortgage-related exposures. Our UK Corporate Banking business enjoyed another very successful year maintaining its consistent record of high single-figure income growth and further advancing its market share from a position of leadership. By continuing to invest in service quality we have achieved market-leading customer satisfaction scores and customer numbers increased by 4%.

Retail delivered strong growth in savings and investment products while maintaining a cautious approach to unsecured credit. Our success is built on customer satisfaction, and on this metric RBS and NatWest maintained their lead over the other major high street banks. Wealth Management's trajectory remains very strong. We continued to expand Coutts UK's regional franchise and achieved significant growth in Asia-Pacific.

Ulster Bank maintained its strong growth record and we have continued to invest in the good opportunities for future growth presented by the Irish market. Citizens further developed its franchise, increasing its consumer banking customer base by 2% and achieving good results in its growing corporate and commercial banking operations.

In RBS Insurance, we have built on our strong position as the UK's leading personal lines insurer by further sharpening our focus on selective underwriting of the more profitable segments, reducing volumes in others. Of course, results were held back by the floods, but excluding this, operating profit grew strongly.

Manufacturing is central to the way we operate, underpinning our determination to deliver service to our customers while deriving scale benefits achievable from sharing infrastructure, processes and services across our businesses. We held cost growth to just 1%, despite continued investment in technology and property to support increased transaction volumes and the development of our business.

#### **Capital**

The Group's Tier 1 capital ratio at 31 December was 7.3% and our total capital ratio 11.2%, within our target ranges. At the time of the bid for ABN AMRO we indicated our intention to rebuild our capital ratios. We remain committed to this goal, and the improved financial returns now expected on the acquisition will help to accelerate delivery of the Group's capital regeneration commitments.

#### **Positioned for growth**

This decade has seen considerably stronger economic growth in the developing world, especially Asia, than in the West. Trade and capital flows have been the main drivers of rising prosperity. This growth has spurred demand for many commodities, notably energy. Within the dynamic Asian economies, the number of wealthy people is growing and around the world affluence is increasingly common.

In recent years we have created options that will allow the Group to pursue the opportunities for profitable growth stemming from these economic changes. Rapid economic growth raises demand for the routine risk management and payments services in which we have excellent capabilities. Economic development requires infrastructure investment, playing to our strengths in project finance. Growing demand for commodities was among the factors prompting our forthcoming joint venture with Sempra Commodities. We increased the number of private bankers in Coutts Asia to capitalise on the region's growing wealth management market.

We had also positioned the Group for continued growth in mature markets. In UK retail banking we anticipated that households would save more and successfully boosted our sales of savings and investment products. We focused on investing in customer service in UK Corporate Banking and have strengthened our market leading position. In the US our distribution and product capabilities now provide an excellent platform in the corporate and commercial markets.

### **ABN AMRO**

The acquisition of ABN AMRO gives us the ability to accelerate our existing strategies for growth outside the UK, particularly in rapidly expanding markets, while adding complementary capabilities and customer franchises to our portfolio of businesses. The integration has made a strong start, and synergies are now expected to total €2.3 billion, compared with our original estimate of €1.7 billion.

### **Our employees**

The quality and hard work of our employees are the source of the Group's success. Each year we seek their views, benchmark their responses against our peers and then act on what they tell us. While the weakening external environment and the demands of the ABN AMRO transaction made 2007 a challenging year for many employees, a record 90% of our employees participated in Your Feedback 2007. We made progress on all of the 15 measures, exceeding the Global Financial Services Norm on every indicator.

### **Group structure**

RBS's organisational architecture has remained largely unchanged since 2000. It now needs to evolve to recognise the fact that we are present in over 50 countries and to facilitate the integration and operation of the ABN AMRO businesses. This new organisational structure will give us the right

framework for managing the enlarged Group in a way that fully capitalises on the enhanced range of attractive growth opportunities now available to us.

Some of our businesses can best serve customers' needs by organising themselves on a global basis. Others are best managed with a more regional focus. We have therefore established Global Markets which comprises two divisions, Global Banking & Markets ('GBM') and Global Transaction Services ('GTS'). The first corresponds largely to the existing GBM, enhanced by the product capabilities and customer franchises of ABN AMRO. GTS will combine ABN AMRO's world class capability in international payments with our existing corporate transaction banking and merchant acquiring activities. It ranks among the top five payments businesses in the world with operating profit of approximately £1.6 billion in 2007.

The remainder of our banking franchises have more distinctively national or regional characteristics. It makes sense to continue to manage them on this basis. We are now represented in an expanded range of countries, and in order to ensure effective coordination and control we have regrouped our retail and commercial banking activities into four regional divisions: UK Retail and Commercial Banking, US Retail and Commercial Banking, Europe and Middle East Retail and Commercial Banking, Asia Retail and Commercial Banking.

RBS Insurance will retain its existing structure and strategy. We will further extend our manufacturing model across the enlarged Group globally.

### **Outlook**

It is tempting to think of the task before us in 2008 only in terms of the integration of ABN AMRO, and delivery of the substantial cost and revenue synergies. To do so, however, would overlook the real opportunities for the enlarged Group.

Whilst the future seems as difficult as ever to predict, it is clear that we enter 2008 with real momentum behind our organic growth, and with our product range, distribution capabilities and customer franchises materially enhanced. Coupled with our greater presence in the world's largest and fastest growing economies, there is much to be done, but a confidence that it will be, to the benefit of our shareholders, our customers and our employees.

Sir Fred Goodwin  
Group Chief Executive