Morgan Stanley European Financials Conference

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FORWARD-LOOKING STATEMENTS

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Presentation

Ross McEwan, Chief Executive Officer
Thanks very much Fiona. And no real surprise on the conduct and litigation issues, but I can tell you that all five of those aspects that were up there are very important to us.

Good morning, it's a pleasure to be back, where on earth did the last 12 months go? It's good to be back here also just to discuss the progress that we're making on transforming RBS into a UK and Ireland focused retail and commercial bank, with an international capability.

Let me start by making it clear that nothing has changed in our equity story. This is the blueprint that we're working towards, you would have seen it last year, and followers of RBS will be familiar with the triangle and it demonstrates the continuity in our plan. Our ambition, our purpose, our values, or brands, our priorities and our long term targets are unmoved.

All we've done this year is just set out the goals that we've set ourselves for 2016 that will take us another step closer to meeting those long term targets.

This year we aim to; firstly maintain a common equity Tier 1 ratio of 13%. Secondly, to narrow the gap on all of our core brands to get to that number one net promoter score position. Thirdly, to take out another £800m of core costs out the business. Fourthly do a net growth of loans in our PBB and our Commercial and Private Bank parts of the business. And finally, with our employees we want to raise engagement to within two points of the Global Financial Services norm. In fact this is the only long term goal target that we've actually moved to the upper quartile.

We are clearly in Phase 2 of our strategy plan, Phase 1, I'll remind you, came in 2014 and it was about rebuilding financial strength, which we're now, I think, in good shape on. And in 2015 we moved clearly into Phase 2, Phase 2 was 2015 and 2016 and this year is the second year of that phase, where we're aiming to complete the bulk of our very heavy restructuring work on the business.

We've been very clear that the timing of many of the conduct and litigation issues is not in our gift, but we are working to resolve these issues wherever and whenever we can on terms that are acceptable to us.

We recently said that due to the incredibly complex nature of separating a bank from within a bank, the separation of Williams and Glyn will run beyond Q1 next year; nevertheless we do remain committed to full divestment by the end of 2017.

Overall by the end of this year we should be carrying a more normal set of demands on the business and certainly on the balance sheet. So 2016 primes us to move into Phase 3 of our plan with a much stronger, a much simpler, and a business with very, very good market positions, with improved operating performance and the heaving restructuring behind us.

And as we get through Phase 2 and subject to regulatory approval, it is at that stage that we can start getting to the capital distributions, and I'll say a little bit more on that shortly.

Over the next few minutes there are four areas I want to take you through. Firstly ever since I became CEO of RBS I've been clear that the long term success of this bank will come through doing a much better job with our customers, so I'll start by setting out the progress we're seeing on that front.

This slide supports the logic of our strategy to focus our business here in our home market - the fact that as especially now the UK is still a very attractive market for banks. Financial services remains a cornerstone of our economy, delivering a £39bn trade surplus in 2014, well ahead of any other sectors, and it's attracted some £100bn of foreign investment since 2007. And we sit right at the heart of the sector, if you take payments, we are the leading provider in the UK and in this market we're now seeing electronic payments outweighing cash and the huge growth of mobile. In fact across the spectrum we have what I think is the best franchise mix of any UK bank and our long term plan will make the most of that.

I mentioned the enviable quality of franchises that we possess, and we're getting behind our great brands, NatWest, Royal Bank of Scotland, Ulster Bank, and Coutts, by making targeted investments aimed at winning more business from our customers. These brands have been undersold since the crisis and we're now resetting each one to deliver better more targeted customer engagement. And I certainly know from experience that good customer service and increased advocacy is delivered through engaged employees. Actions like our Banking Skills programme and the wider ranging leadership training are helping to improve this engagement across the organisation.

And I'm also happy to see evidence of the service time improvements for both Business and our Commercial customers, but I've got to say there is a lot more to be done.

Our highest profile product launch in the last year was the NatWest reward current account and, in my view, the best in the marketplace because of its simplicity, where customers get 3% back on their household bills. It's a high quality current account and that is central to our plans to build deeper customer engagement. And as you know one of the things that marks us out as a bank is our fairness agenda, and we've continued to push on this area by ending teaser rates on home insurance in 2015.

Our mobile banking app is market leading, it's good for engagement, but it's also an efficient sales channel for us as well. And that's why we've improved the NatWest app to offer loans and savings and products at the touch of a button. We're also the first to introduce tough ID with over 1.5 million logons to date.

All of these points I've mentioned are examples of the many investments that we are making to become number one for customer service, trust and advocacy. And by winning the loyalty and advocacy of our customer in serving him efficiently we can build more sustainable, higher quality returns for our shareholders.

I've described the transformation we've been undertaking, from global bank to an organisation focused on Retail and Commercial here in the UK and Ireland. And you can see the evidence of that shift in this growth, as in the last two year the proportion of income derived from the UK has increased from 63%, to 88%, just shy of our 90% target. And risk weighted asset distribution is also shifting towards our Retail and our

Commercial business and now at 81% and we have a target of 85% for this. An attractive market where we're deploying a growing proportion of our resources, I think that signals a good opportunity over the next few years.

We're also managing to attract good quality deposit flow and currently have over £120bn of free funds to support client activity, which I think bodes well for the medium to long term. We've seen good growth on this front in both Personal and Business Banking and Commercial and Private Banking over the last two years. And you won't be surprised to hear from me that the low interest rate environment remains a challenge for all banks in the short to medium term, but our gearing means that we are well placed to take advantage when they do begin to rise again.

And as I say, as we refocus on our home market we are very well placed to support growing activities with our customers. Our funding profile is in excellent shape and we're well placed to lend, supported by a strong liquidity position. Our front book margins remain attractive as we target a loan to deposit ratio of 105 to 110%.

Lending growth is already coming through well in our UK and Personal and Business Bank and our Commercial franchises. In UK PBB mortgage lending balances are up and we are winning market share. We've also supported just over one fifth of all start-ups during 2015 in our SME market, it's a vitally important area to get in early to generate new business from customers for the long term. And in this spirit we now have ten entrepreneurial hubs across the UK, helping entrepreneurs and small businesses access free space, mentoring and financial supports, with a further three hubs due to be opened over the next 12 months.

We are the biggest supporter of business in Britain and it's pleasing to see good growth in our support for larger businesses as well, with lending balances in our Commercial banking up £1.4bn year on year. I think that’s the first time we've seen growth in five years. And our larger Business customers will increasingly feel the benefit of our scale and capability as we hardwire our revised corporate institutional bank business to our Commercial banking customers, giving them a better quality service, this approach is already starting to pay off.

Just let me give you a little bit more detail on our mortgage growth, because I know a number of you say when you're growing that fast you must be sacrificing price, or you must be sacrificing credit quality. Well our view is we've done neither. We have worked very hard to improve our distribution and our service capabilities and we've built the capability and capacity in our business and this has been rewarded. As you can see on the graph our two year fixed rate mortgage, which is where we sell most of our business, has remained above the weighted average market price. The number of mortgage advisors we have us up 21% and we're now agreeing a mortgage every minute. Service times are improving, speed to offer has gone down from 20 days to 16 and our retention rates are best in class, with around half our customers now renewing online in less than ten minutes. This is a business we do like.

Benefits of our Retail and Commercial focus are also clear when you look at the borrowing trends for UK corporates. Here we've seen firms increasing their buying for the second year running and we expect in 2016 will see solid growth in UK Commercial lending, with lending to property companies expected to grow for the first time since 2008.

So you can see our core businesses operate in what are healthy markets and we have the funding to take advantage of that, and in order to maximise that advantage we're also improving our service offer.

Here you can see the evidence of our service; we are one of the few banks committed to sharing our progress on net promoter scores on a quarterly basis. And as I said when we started showing these results in 2014 we'll keep reporting them whether they go up or whether they go down. It's very pleasing to see the NatWest Personal and Business Banking net promoter scores are the highest they have been since 2010 and Business Banking scores in general are up across all brands. This demonstrates good progress, but it's clearly not good enough across all areas of our business. And we can and we will do a lot better.

I'm a firm believer that once your customer service improves and your new products bed in we'll be reporting greater success on our net promoter scores across the board.

Since we set out our plan two years ago we've been very consistent in saying that our model and our future success is based on turning RBS into the best bank for customers. I think what's also been consistent over that time, is our record on delivery, which enabled us to go further and faster in 2015.

Here you can see our scorecard with the goals we set ourselves last year. Our strength in sustainability improved further with the rundown of RCR to substantially complete, and Citizens sold, both of these one year ahead of schedule. We met the targets that we set for net promoter score on six out of the nine categories and I've said that's not good enough for this organisation.

On simplifying the bank we started the year with an £800m cost reduction target, then we raised it to £900m in Q3 and in the end we took out £983m out of the business. This takes the total over two years to over £2bn, and we'll continue to relentlessly focus on costs through the next few years.

Note this cost takeout figure doesn't rely on divestment impacts or inflation and is separate to the investment we're putting into the business. This is a solid £2bn that has been taken out of the core operating parts of our business going forward.

We targeted lending growth in UK Personal business and in our Commercial at or above nominal UK GDP and we beat that with a 4.8% lift, core franchises are growing again.

And lastly but just as importantly on employee engagement we saw a big uplift this year and closed the gap substantially on the global financial service norm. I was actually delighted with this result given what's going on inside the organisation.

A key aspect to our transformation is the rundown of parts of the business that don't fit our strategy any further. We have a very successful track record on this and that continued through 2015. I mentioned we got Citizens away and here you can see we also halved the risk weighted assets within our capital resolution division, with the expectation that will get down further to around £30bn by the end of 2016, and work is being done on the solution for the remainder.

We're committed to completing the divestment of Williams & Glyn by the end of next year which will release another £10bn. And overall we saw a 63% reduction in our legacy portfolio in 2015 and we can be very satisfied that we started this process back when we did and have been able to take advantage of actually some pretty good market conditions in doing so.

Our balance sheet is now more resilient. As our balance sheet shrinks that improvement is material. And on this we think we've delivered impressive absolute and relative progress over the last two years. Our common equity tier one ratio was up 690 basis points to 15.5%, an 80% increase.

On AT1 we raised £2bn last August, and if market conditions allow we plan to raise another £2bn during the current year. Our leverage ratio is up 220 basis points to 5.6%, a 65% increase. And our risk elements in lending are down by £27bn to £12.2bn, and as a percentage of gross loans, risk elements in lending are now down to 3.9% compared to 9.4% at the end of 2013.

We also took advantage of more benign market conditions to significantly de-risk higher risk exposures last year. For example we reduced our oil and gas exposures by 63% during 2015, we reduced our emerging market exposure by 61% over the same period, our shipping portfolio is also reducing and we do remain very focused on the risks posed here as well as considering the best options for further reductions. And given market conditions we remain vigilant with all of these higher risk portfolios.

We are becoming a much simpler bank and as well as safer we've made this business a lot more efficient. The rapid expansion of RBS pre-crisis created a hugely complex organisation but over the last two years we've begun to drastically simplify this bank. We're making good progress in managing down our property portfolio, particularly in London, going from 11 properties down to eight. We had become a highly complex structure, and that has successfully been cut back as well with one third fewer registered companies that just two years ago. We've also been rationalising our product set and have made substantial reduction to the number of systems that we actually operate.

And across all of these areas we will grow still a lot further. The aim is to get the London properties down to five, less than half the original number, and the number of systems to around 150 which is less than a quarter of where it was.

The simplification process has supported a substantial reduction in our operating costs and with the revenue outlook we foresee the only near term lever we have to drive jaws is to reduce operating costs in the business. We think we're building a decent track record on costs and as I said we've lowered operating cost by more than £2bn over the last two years.

And as we committed to last month, we're planning to reduce operating costs by a further £800m in 2016. This would reduce our cost structure down to £8.6bn this year, 9% lower than 2015. And with our already announced plans beyond 2016 to further reduce costs in capital resolution and corporate institutional bank, we continue to make firm progress towards a 50% cost to income ratio which is the long term target.

And as you will know and we put it up on the screen, like all other banks we do have a number of litigation and conduct issues we still have to deal with. And I've said before we will do whatever we can reasonably to get resolution to these matters that we believe warrant resolution.

The biggest is of course US RMBS and we recognise that providing certainty around this is critical to our equity story. In Q4 we took an additional £1.5bn of litigation provisions, bringing our total US RMBS litigation provisions as at the end of 2015 to £3.8bn. To date we have no provisions for potential resolution of investigations by the US Department of Justice and various US State Attorney Offices, and we continue to repeat that additional settlement costs in relation to our overall US RMBS exposures, on top of our new higher existing provisions, could be substantial. And you can see from the slide that the number of other conduct and litigation issues remain live and our comments on these.

I mentioned at the start that there were just two parts to Phase 2 of this plan. One is getting through as much of our restructuring and conduct and litigation as we can, and the other is driving value and performance out of our core franchises. We said last year that we have three categories of businesses. The first one is to invest to grow, the second one is repositioned for returns and the third and the last is to close or dispose. And as you've seen the last category I think we've made very good progress and from here on in we're going to be talking about the first and second categories on this list. UK Personal and Business Banking is targeting market share growth and mortgages. We have a good mortgage proposition to offer customers and as mentioned increasing our support here will help customer engagement and give us a platform to be main bank provider for most of these great, valuable customers.

In Commercial Banking we will continue to move capital towards businesses that deliver higher quality returns and cement our position as the biggest supporter of UK businesses. A new addition to this invest to grow group is RBS International, our Jersey based banking business which we have broken out and will be reporting separately from here on in. This business has a new CEO and a new strategy to grow and improve for customers, and with the advent of ICB this business will exist outside the ring-fence.

The second group makes up our reposition for returns businesses. This is where we have strong brands and we can win in these markets, but we do need to take actions on poor performing businesses. Ulster Bank Republic of Ireland is a good business that carries the legacy of poor capital allocation and too high costs. Gerry Mallon will be joining us later this year from Danske Bank as the new CEO with a mandate to tackle its issues and restore the brand.

Private Banking is another business we like. We've employed Peter Flavel from JP Morgan as CEO, he's come on board this month. And I'm confident that over the next two to three years this will be a much better focused business and its return on equity will improve.

It is great to have senior hires with great track records actually joining us at this time.

And lastly CIB, Corporate Institutional Bank, it is undergoing a multiyear large scale transformation and will require some patience as we get it to a position where we can expect to see sustainable returns. I've said to you before and I will say it again, we always knew that in this market income comes off a lot quicker than costs do and you can see that in our numbers. However it does have a clear path to offer wholesale services we excel at providing and to do it efficiently, and I'm glad we started the process when we did.

Just on the outlook. So looking at this year we expect to stabilise income in PBB and CPB as we target 4% growth in customer loans. We're also looking at modest income erosion in CIB. On costs we've targeted another £800m reduction and we're looking for positive jaws across core franchises, and on a combined basis anticipate cost reduction exceeding income erosion. We've established a good track record on costs and plan to maintain it as we reach for our long term goal of cost to income ratio below 50%.

So let me turn to some conclusions. Starting with capital distribution. Both my CFO Ewen Stevenson and I, we've made it clear that we have no intention of holding onto surplus capital in this business. As we see it there are five milestones to pass before we can make distributions. Firstly normalisation of our capital structure, and to achieve this a final DAS payment is almost certainly going to be paid in Q1 of this year. On Williams & Glyn it is a complex project but our commitment to divest by the end of next year is unmoved. We need to get past the peak of conduct and litigation issues including US RMBS and we need to be showing the ability to deliver a sustainable profit. And we need to also to make sure that we get a pass in this year's Bank of England stress test.

In summary our underlying franchises are strong. We have the market leading positions in very attractive banking markets, particularly here in UK and the Republic. We have over 18 million customers in the UK and the Republic, and our strategy is to do more business with them at a lower cost. Our plan remains the same and the end destination is very clear. We are committed to delivering a UK currency bank that has a 12% plus return on equity served from a cost to income ratio below 50%. We have no intention of sitting on excess capital and as soon as the time is right we will distribute as quickly as we can in agreement with our regulators.

The value in the business and the forward value of the franchise positions isn't captured in our price because of two remaining hurdles. Firstly Williams & Glyn, it's something as I said we're committed to delivering. RMBS remains on the horizon and we will deal with that as it matures, ideally sooner rather than later. However as I've said the timing is not in my hands.

But our track record on executing stands for itself. On average we have taken our assets equivalent in size to two Northern Rocks every year for seven straight years. We've restructured our investment bank ahead of our peers, we've built capital faster and we're growing in the markets that we actually like. Thank you very much.

Applause

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