**Morgan Stanley Financial Services Conference 2014**

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**Ross McEwan, Chief Executive Officer**

Chris thanks very much, thanks very much for setting my targets, that's fantastic. And I also note my friend Mark Wilson has taken up about three and a half minutes of my time, so we'll crack on. Thanks very much Morgan Stanley for the opportunity to speak to you today.

As you're aware we announced our strategy to build a truly customer centric bank a few weeks ago and I'd like to update you on our plans and our thinking about it.

This bank has some great market positions that I will take you through and customer relationships But it has now not generated positive organic cash flow for many years and it has not been able to pay an ordinary dividend since 2007. Today I will take you through our strategy that I believe addresses each of these issues in turn.

It starts with being much more effective for customers, winning more of their business. It starts with tackling a crippling cost to income ratio. And it starts with a credible plan for capital strength. That's the kind of bank I'm used to, that's the kind of bank I want RBS to be, a bank that earns the trust of customers, investors and regulators because it performs well for customers every day.

Change will be hard. Can I say again, change will be hard. But we have a leadership team determined to build a bank that generates an attractive return for investors. During our session today I will provide an outline on the updated strategy, touch on how we're building our capital base and how we plan to drive sustainable returns. I will also highlight our plans for growing our franchise, before setting out our proposition for our investors.

When I took over this job on the 1st of October I identified some initial priorities that I was keen to address. Firstly to establish RBS capital resolution; that was a vital part of articulation of our capital plan. We wanted to end any distraction over our capital position. These steps were also a part in resetting our relationship with the government and with our regulators.

While these priorities have been achieved we've also made good progress with the government on resolving the dividend access share and we'll report back on that later.

Finally, we have made some important strategic decisions for the future of the bank which I will walk you through this morning.

Our vision is to create a bank that earns your trust. We are the least trusted bank in the least trusted sector of the UK economy. There is a very simple logic to my vision. We need to be a reliable, consistent and easy to deal with bank that will earn customers' trust and win more of their business, which in turn will lead to greater value for you - our shareholders. Our ambition is to be number one in customer service, number one in trust of our customers and number one in advocacy in each of the businesses we operate in by 2020.

Having just reported an £8.9bn loss it's hard to remember that we've got some of the greatest franchises in UK banking under the RBS banner. Looking at our customer businesses in some detail you can see that in the UK and Europe we have market leading franchises with strong international platforms in the US and in Asia. But we can't afford to be complacent. Customers' expectations are changing, we're too complicated to deal with, our technology is not as stable as it must be, and our reputation is damaged and in places our market share is flat or declining.

The shape of the bank has changed massively in the last five years in terms of downsizing, TPAs are down 54%. Our loan to deposit, short term funding and liquidity measures are all very strong. This is an amazing progress by anyone's measure. But our cost base is just down 18% against TPAs down 54%.

We're still carrying the cost of the bank we were, not the one we'll become. We're still siloed; we duplicate functions across our businesses with no consistency. We've too many technology platforms and systems and our processes are very fragmented. In short we have layers of costs, complexity and bureaucracy that need to come out of RBS.

As we've downsized and we've refocused where we have a competitive advantage, you can see the wide ranges of businesses that we've actually exited out of: World Pay, DLG, Asia, EME and Latin American retail, aviation, the list goes on. So we've been very clear about the businesses that we're out of, but what we have is still some businesses that are not generating the return of capital that we require for this business.

Our strategy was set out last month and our future is in UK Retail, commercial with a markets and international capability that supports these businesses. The UK market is one of the most attractive globally. You can see there at number five globally this is a market you'd want to be in. And in the next five years we'll shift to a steady state with the majority of our business done in the UK. We'll also continue to shift an emphasis away from the wholesale towards our retail and commercial; reducing our risk profile at the same time.

We’ve now begun the process of reorganising our businesses in line with our customers' needs. Moving from seven divisions to three customer businesses, as well as our capital resolution business. This is the shape of our business going forward. We'll also rebalance the proportion of staff who are customer facing; today, only 30% of our staff face-off to customers on a daily basis. That's not in line with the business I want this to be.

Once we're fully established the businesses will look like this as you see on screen. First off, the Personal and Business Banking looking after our retail and smaller business customers; we'll also have closer links with Ulster Bank and the business will account for 35% of the bank's RWAs and with an ROE target of greater than 15%.

Our Commercial and Private Banking business is connecting on our customers segments where we are big. But we may be big but we're actually not the best in the marketplace at doing this business. Here we also want to house our private banking service, better connecting our wealth managers with customers who are the actual wealth creators. We target return on equity of 15 plus percent on 30% of the bank's RWAs.

And finally, the one that everybody asks the questions about - our Corporate and Institutional Banking. We want to change the divisional split we currently have in terms of dealing with the UK and international large corporates and utilise our markets business as a core product set we can offer and connect across these clients. Our longer term target for this business is a return on equity of circa 10%.

There was a necessary complexity to running a bank with a £2.2 trillion balance sheet, but we are no longer that bank. We need a much simpler and smarter operating model that is far more cost effective than the one than I've inherited. Under the old operating model you can see our costs and support functions - and just thinking about that from a finance perspective which is highlighted, are duplicated across numerous areas. We will move to a more efficient model where they work across the bank not just for the business.

Our product proposition is also far too complex. We have 109 credit card offerings, five mortgage platforms, 36 savings products, too often our complexity results in a poor experience for customers and for example it takes 17 days to produce a mortgage offer, totally unacceptable in any market.

This is another area we can simplify and save. A streamlined product set, simpler processes and fewer platforms. It will make us a lot easier to deal with, helping our people in the frontline to do more business with customers.

So next our capital plan. I'm very clear that our capital strength must be beyond question. We cannot tolerate any distractions on the capital front. To that end the plan we have set out in October last year outlined a number of key actions to give the bank the solid capital foundation. We started the year with fully loaded core tier one capital of 8.6%. Our target is a ratio of 12% or above by the year 2016. The key drivers of that capital plan are the sale of Citizens, which could yield 250 plus basis points of core tier one ratio, a rundown of RCR, and retained earnings in the medium term.

On timing we plan the first tranche of the Citizens IPO in Q4'14 and we aim to be out completely by the end of 2016. We also expect to have sold a majority stake in Williams and Glyn by that timeframe as well - end of 2016.

RCR has made a strong start and we are continuing to de-risk and lower RWAs. Our restructuring and de-risking of the Group over the last five years has improved our capital position. In the last 12 months we've built underlying fully loaded core tier one by 1.8 percentage points, wholly achieved by Markets and Non-Core de-risking.

Moving on now to how we drive attractive and sustainable returns for our shareholders. The bank has been on a five year path of moving from being a global financial service group to becoming a UK focused retail and commercial bank with international capabilities. At a peak we had £1.6 trillion of funded assets and £30bn of revenues. Today funded assets are down to £740bn and revenues were £19bn last year.

The rationalisation process is nearing a successful conclusion, having moved over £800bn of assets. We have around £140bn left to go. Our end state following disposals and right sizing of our Corporate and Institutional business will be a balance sheet of £600bn, a solid base from which we can target good growth again.

After the turnaround story of the last few years our focus has moved from repairing the balance sheet to driving attractive and sustainable returns. At the end of last year our underlying ROTE was 2.5%; our medium term target is 9% to 11%. There are some key steps that will get us to this point. The first is running down of RCR assets and getting rid of the losses that this creates. The second is around a £2bn medium term cost reduction programme. And thirdly, a further decline in impairments, especially in Ulster and in UK Corporate.

Let's have a look at each of these in a little bit more detail. On RCR we've made a good start with the RCR with the run off £6bn ahead of where we thought we would be last summer. We have firmed up our guidance and now expect to have assets of £23bn at the end of this year and then down to £6bn by 2016. We remain confident that the RCR run off will strengthen our capital position, delivering the target of £2bn of Basel III capital back to the bank over this period of time. In 2013 RCR's predecessor, the old Non-Core division produced a £2bn loss. Clearly eliminating this drag will bring significant benefits for the bank's overall performance.

I mentioned earlier that the bank has shrunk dramatically and we now need to deliver cost base - a cost base that fits our new simpler and more focused operating model. That means over the next four years we intend to reduce the current cost base by £5bn, down to £8bn. £3.1bn of that reduction will come from business disposals, part of our scale back. In the go forward bank we're targeting £2bn of cost savings, £1bn of savings in 2014 and the remaining £1bn by the end of 2016. In the longer term our target cost to income ratio is 50%.

Our cost reduction programme will be done intelligently, allowing us to combine lower cost with much better support for our frontline staff. Our view is we can do these two things at the same time.

In IT and operations we will simplify the numerous systems and platforms we operate cutting out layers of complexity that have built up over years and years of adding businesses. And this resilience and stability will be our number one priority.

Our control and support functions will also work across the bank, ending the duplication of processes we have repeated in different silos across this business. These measures will mean our property requirements will also simplify and reduce. At present something like 70% of our people work in back office or functional roles; so we will also rebalance that with a much bigger proportion of our people in customer facing roles going forward.

While this cost programme is running we will continue to invest in our frontline, allowing our people to deliver better service to our customers.

The bank's impairment charge is beginning to normalise. In 2013 the charge as a proportion of loans and advances fell to 1%, down by a quarter on 2012. We're heading in the right direction. The decline is driven by improvements, both in Ulster Bank and in

Non-Core. Ulster mortgages saw impairments down over £400m or 35% year on year. And in UK Corporate the wholesale watch list for loans under special monitoring has declined by 40% over the year. So looking forward we expect the bank's overall impairment charge to fall to range of 40 to 60 basis points of loans and advances in 2014.

Now the final part of the return equation and that is capital. We will operate with a base of £300bn of Basel III risk weighted assets. We will allocate capital with a broadly even distribution across three businesses. We have set a total return target of 12 plus percent, driven by 15% returns from both our Personal and Business Banking and our Commercial and Private Banking operations, and circa 10% in our Corporate and Institutional Banking operations.

Next let's have a look at how we position our franchises to actually achieve those results. A challenge we face today is revenue growth. While we've been able to drive an increase in our overall net interest margin, our net interest income has declined by over £1bn in three years as the 16% decline in average interest earning assets has outweighed the margin improvement. We need to start growing the book again.

Looking forward, we need to drive balance sheet growth. And the good news is that the outlook is brighter and we are now more optimistic on growth within the UK retail market and we are increasingly confident that the green shoots we are seeing in UK corporate can deliver balance sheet growth.

Breaking down the income opportunities into the three businesses, I see significant opportunities to win more business from our existing customers by offering them a much better service proposition. In Personal and Business Banking that opportunity is based on us providing simpler and more cost effective products and from leveraging our distribution network. We are already seeing early signs of momentum starting to build.

In Commercial and Private Banking the opportunities will come from building deeper relationships with our internationally active customers, proactively letting our customers know we are ready to do more business and from being better connected - our wealth managers with those entrepreneurs who are actually creating wealth. Again, these are encouraging signs from our loan pipeline in each of these businesses.

And finally in the Corporate and Institutional bank there is scope to do more business with our international client base. We have some exceptionally strong platforms and products across our Corporate and Markets business, which we can bring together and offer to our large corporate clients in a much more joined up way than we are today.

The heads of those new businesses will further develop these initiatives and build them out, but in the meantime I would like to walk you through some of the opportunities I believe that we have in our market leading franchises.

Let's start with Wealth. It's a good example of a business that we can improve. As you can see Coutts has excellent credentials, but revenues have been flat over the last 12 months and returns have declined. So as well as deepening the relationships with existing customers we want to do more to connect our wealth managers with the wealth creators who own and run businesses as well as connecting them to our retail banking office.

Growth in our corporate franchise will be an important driver for this bank. The good news is there are early signs of green shoots in this market. Gross new lending has been improving strongly in the fourth quarter. We can also see early signs that net lending is improving also.

We manage our corporate loan book in two parts: a growable book which is the dark blue lines and the non-growable book which is the light blue lines. The non-growable book contains assets such as commercial real estate and shipping where we have been historically overweight and wanted to reduce our exposure. We are now approaching appropriate levels of these kinds of exposures in the book. In the growable book we have seen two quarters of growth, albeit small, the pipeline looks more promising. For example we outperformed the market for start-ups in the second half of last year, increasing our market share.

We are the largest UK SME bank, serving over a million customers every day. And I think it is worth reminding ourselves of the opportunity that exists in this segment. Small and medium sized businesses represent nearly 50% of the UK's private sector turnover and 60% of the private sector employment. So SMEs are critical for the economy and you can understand why the government talks about this relentlessly and quite rightly so.

This market also offers great growth opportunities for us as the market leader. In 2012 and 2013 there was a 5% increase in new business start-ups, we saw a 21% growth in RBS start-ups in the fourth quarter versus a year ago. We are well placed to grow and do more business with these customers as their own businesses grow and flourish.

As I say, we have the UK's leading SME franchise and we need to invest and will invest to stay there. We are best placed to support businesses through all different phases of their growth from smaller business who want to deal with us in a branch, to larger corporates who need dedicated relationship management and more sophisticated product sets. Many of these mid-market companies operate internationally, or expect to expand that way and we can support their international aspirations.

I should say that I recognise we need to do more to support SMEs and are implementing the recommendations from the Large Report - I'm sure a report that many of you will have read. At the same time I am encouraged by the rising loan approvals and the gross lending figures we are now starting to see come through.

Ulster Bank. We all know that Ulster Bank has been problematic for RBS. In fact, we have injected over £15bn of capital to stabilise the business over the last four to five years. But Ulster Bank is being transformed. Transferring assets to RCR has scaled down the business and we're evaluating how we address uneconomic products such as the tracker mortgages.

Going forward we will drive efficiencies by connecting Ulster Bank in Northern Ireland with our Personal and Business Banking operation in the UK. It seems senseless to have the same operations running for the same type of business. In the Republic we will reconfigure to become the challenger bank in the market, but we will not be deserting the customers in Ireland. We except Ulster Bank to move into profit during 2014.

We perceive the environment for our Markets business to continue to change rapidly, from capital intensity, to super equivalence rules and regulation reducing the ability of UK Markets businesses to compete. Our strategic response is to shape a smaller business that offers a more focused product set to our corporate clients. But within that we will maintain excellent capabilities in fixed income, FX, DCM to meet the key requirements. In order to achieve this model and to produce a return in line to the cost of capital - we will reduce Markets RWAs to below £50bn.

And finally a look at our Citizens business. The franchise offers us a very strong base from which to improve returns. As you can see Citizens is very well established, is based in attractive regions of the US and has good market positions across its footprint. The main task ahead of the new management is to turn this potential into constant and sustainable returns.

The new management team under Bruce Van Saun has made a good start on improving the returns of the business with intelligent revenue and cost programmes. However, there is more work to be done. Citizens NIM gap to its peers is also mirrored in the return gap. This gap reflects not only risk appetite, but loan pricing and hedging strategies, as well as asset mix. Regulatory changes, low rates and a subdued economy have also impacted revenues. There is work to be done on cost too. The business has a cost to income ratio of 69%, it's too high. We target low 60s in the medium term and less than 60 in the longer term for this business. With our full range of costs and revenue initiatives that we have in place to fix these issues we target a medium return on equity of 10% and longer term of 12 plus percent.

And finally the investment case - how will we define success? First off let's start where it all should start which is with the customer. We want to be number one in net promoter score in all segments of our business. We also want to be the number one trusted bank for customers who operate with our business.

Our success will also rely on our people. We have great people and we want to have a great place for them to work, so we will measure that on an engagement index. And then finally the financial impacts of this business. We want a return on tangible equity of 12 plus percent, I want a cost to income ratio in the low 50s and we want a core tier one capital ratio of 12 plus percent.

Let me pull together the key points from today's presentation and our investment proposition. We have market leading businesses in deep and attractive markets. We will deliver attractive returns to our shareholders. We will target sustainable and less volatile earnings. We will maintain a robust capital position and a model that is capable of paying attractive dividends. And finally we will continue to provide you with the transparency you have come to expect from RBS and we will track and regularly report back to you on our progress. Thank you very much.

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