Goldman Sachs

Twenty-Second Annual European Financials Conference

Thursday, 7 June 2018

THE ROYAL BANK OF SCOTLAND

Moderator: Ross McEwan, CEO

Martin Leitgeb (Goldman Sachs): Ladies and gentlemen, it is a pleasure for us here at Goldman Sachs to introduce the next speaker. We are delighted to have Mr Ross McEwan here, Chief Executive of Royal Bank of Scotland.

I am sure no particular introduction is needed. Mr McEwan became Chief Executive back in October 2013. Prior to this he was Chief Executive for UK Retail, having joined from Commonwealth Bank of Australia where he was Group Executive for Retail Banking for five years.

Again, it is a great pleasure having you here today in Frankfurt. Let's start straightaway with the progress RBS has made during your tenure and obviously, it is not only progress in working through a number of legacy issues, but also improving profitability of the core business franchises, retail, commercial in the UK.

Now that RBS has reached an agreement on both the pension top up earlier in the year and most recently on the resolution of US RMBS with the DoJ, what do you consider to be the main milestones left in terms of the restructuring of the group before RBS reaches the kind of steady state going forward?

Ross McEwan, Chief Executive Officer:

Yes, thanks, Martin. Nice to be here. When I look back on the strategy we set out for the business, which was back in the beginning of 2014 we said we wanted to create a predominantly UK Republic of Ireland business with offshoots that just served our customers, mainly our corporate customers and we wanted – we were very clear at the time that we wanted to have a business that had a sub-50% cost-to-income ratio, +12% return on equity on a really good capital base, and we had the debates at the time what that capital base should be, and we put a 12-plus in, back in 2014, which shook the market at the time, because I think everyone was trading at around 9.5% - 10.5%.

Since then we moved it to 13 and I haven't moved off the fact that I think we need 13% common equity tier 1. We will trade at a greater deal more than that for a period of time.

However, what is left between us and – we have done a huge amount of clean up of this business. We have moved the capital position dramatically. We have put the resource into our strategic assets, being our retail business and our commercial business and we are in the final 18 to 24 months of restructuring the markets' business, which was a very, very large capital intensive business and it is now a much more focused business that only does three things.

The have focused the private bank around Coutts. We have the international business, which is the Jersey/Guernsey business, which is a highly profitable business and the one I am sure we will talk today is Ireland – not without its difficulties.

The portfolio is either investing and we are growing, or a couple of them need some investment to actually get into a return on equity shape that I am comfortable with, but we have progressed incredibly well.

The last three months I think has been the biggest indication of how much this business has moved, because in those three months; first profit in ten years for the full year, our quarterly profit that was three times the size it was for the first quarter of last year. The Department of Justice pension fund agreement with our trustees on how much we are putting in to make sure it is fully looked after. Williams & Glyn independent party put in place. Highest Our View scores for our colleagues inside the business in ten-plus years and of course there is ring fencing. The first phase of ring fencing that went across one weekend without a glitch. If you look at even the three months, that is just life at RBS. It has been that for the last five years.

Martin Leitgeb: If we go a bit deeper into your 12% return on equity target, as you say, initially no one believed in it. I think more and more consensus has moved towards that number over time.

What are the main moving parts here for RBS to achieve? Is it revenue growth, mortgage growth, costs?

Ross McEwan: First off, where does the primary part of this come from? It comes out of our retail business and our commercial franchise. We do have the largest business and commercial franchise in the UK. Despite what we have been doing and despite business pieces that we have been selling off it is still the largest franchise.

That business has been focusing on the utilisation of its capital, because my firm belief in corporate business is that you can throw a lot of capital at them and get very little return, because a corporate always use your balance sheet and try and get it for free, and you have to make sure you are getting something back out of this through the services and the products you are putting in there.

I think that is probably what Alison Rose, who runs that business, has been very focused on. How do you get a return out of this business, particularly at the large end?

At the very small end we have moved that business from a 6% to a return on equity. This is the SME part, and now the late teens, early 20s return on equity.

So, we have focused on each segment and said, "how do we get a return and do good things with our customers?" Most of it has been us taking cost out of an old structure and I am sure we will chat about how do you go from being bricks and mortar to a digital operation, but that's a big theme for us.

If you look at the retail business, we've growth the mortgage book. It is becoming much more difficult to grow it highly profitably at the moment, and I am sure other speakers have talked to you about that, but the retail business is a very profitable business for us, and it is a +20% return on equity business.

Can it stay at that level? Yes, I think it can, but you have to change the shape of it.

Private bank was doing 4, is now doing 12. RBSI last quarter did 23. Assume it is going to do somewhere around 18. It was an aberration last quarter.

Ireland needs to perform, and NatWest Markets 8 to 10 by the time we get to 2020.

You pool all of those businesses together and those are not for you just to throw into your spreadsheet. I am just giving you the indication of what those businesses should do. You have a +12% return on equity business all day and every day, but it is being masked with all the noise that has run through our organisation, with all the one-off conduct litigation and the heavy restructuring this business has been brought to, because it was a global business. At one stage it had a balance sheet of £2.4 trillion. It was the biggest thing in the world when we did the ABN Amro. It was a mess and now it is back to the franchises that have strategic advantage and we will get the returns out of them. So it has been a pretty interesting journey, but 12% return on equity is a non-negotiable for our team.

Martin: Perfect. Let's move to the prospects for capital returns. Some time ago you set out the major hurdles in terms of what needs to happen before you can recommence, and as far as we, and probably the market reads, you have met all of those hurdles in practice with the settlement of RMBS very recently.

You have also highlighted the importance for you on recommencing dividend payments as soon as practical.

Ross McEwan: Yes.

Martin: Is there any update you can give us on the discussions you had with your regulator and what role the coming Bank of England stress test later in the year has with regards to those recommencements?

Ross McEwan: We did have a reasonably long list of things that we had to achieve that our regulator was quite clear about – it will be four years ago now, and they did include a whole raft of things like the sale of Citizens, the passing a stress test. They were making sure that we had a profitable underlying business. There was a raft of them. Paying out the dividend access share, which we paid out in 2016.

Therefore, each year we have just focused very strongly on what are the things we need to achieve to get this business back in shape and to tick off all these items off the list. The last one being DoJ was the last big one for us.

The piece that I think the PRA will be looking at is around the stress test, and we are going through that stress test at the moment. It is pretty much the same stress test as last year, and last year we just missed on getting over the hurdle. I thought it was 70 basis points, but Alexander tells me it was 30 or 40 basis points we missed by.

We didn't have to take any additional capital actions because we had them in train.

If you take that as the starting point, we are 250 basis points better on the start than we were when we went through last year's stress test, so if you missed by 40, 250, we are 210 in front of where we started. We have taken assets off the books in that period of time.

We have settled DoJ at the $4.9 billion, which is a huge amount of money, but I don't know, because we never got disclosed what the regulator had in their plan for the Department of Justice. Was it $4.9? I suspect it is well in advance of $4.9. They also would have had some capital layering in there for us with our pension fund, which we have also negotiated with the trustees.

So I think as I look at it and from a very simplistic perspective, I think we will pass this year's stress test. I am very confident in the shape of our business and what we have done. I hope I don't regret those words, but I am very confident that we will, because the starting point is so dramatically different to what it was the year before.

We are putting the inputs into that at the moment. They will go to the regulator by the end of June. We've had a conversation with the regulator and it is up to them to allow us to pay a dividend. I make no bones about that. It is not in my gift, it is theirs. I hope that they see themselves through that we have done everything that we said we would do.

That is the sort of business we have been building with our people is one that when you say you are going to do it you get on and do it and when they look back they will see we have done everything that was asked of us, but it is in their hands.

I don't think they, nor we, will want any embarrassment factor about starting a dividend only then to fail a stress test. I wouldn't want my regulator in that position, and I wouldn't want the bank.

We are in that process. If we've got news we will put it out at our half-year results, which will be 3rd of August. I hope we do have news, but, again, it is not my gift to do so. I think we have passed everything we needed to do.

On the dividend itself, we have to remember that this bank hasn't made profits until last year for ten years. We haven't paid a dividend for ten years. So our ask will be, I think, modest, and I think it should be modest because we want to build into paying a dividend and we want to make sure that when we start paying a dividend we don't pull it down again.

Now I know the investment community says a small dividend, and then specials, and then when you don't deliver up a special everybody says, "but hold on, what about our special?" as though it was a given. I get that. So it is the levels of disappointment we don't want. We don't want to put a dividend in place and then have to walk away from it is the way we think about it.

So start low. Build to a percentage. Stay with that pay specials, and if we can participate with the Government on the sell down be part of that as well. But everyone says, "you can just participate." Well, you need to understand, we get very short notice about when the Government is going to do a sell down. I happened to be with an investor the other day when the Government started its sell down at 4.40pm. They put the order in while they were sitting in front of us. We did a very good job, Alexander and I, of selling to them why they should, but that is the timeframe, so you need to have all of the approvals in place well and truly before you go anywhere near a sell down. You have to get, I think, the PRA's approval, on-going approval, and you also need to get your board's approval to move very quickly on the day of a sell down.

So we have a lot of machinery to put in place, but our view is a basic dividend, let's get in place to pay specials where we can, and also to participate is what we are looking for.

Martin Leitgeb: Touching on the capital bond you made, so 260 basis points progress pro forma for settlement pension. You still have probably the best-quoted tier 1 ratio amongst some of your UK peers. What do you think about the scope for and the importance of potential share buyback? Is that something that is further out once the dividend gets in place, a more secondary priority?

Ross McEwan: Yes, it is fascinating. It is a piece of history. When I look back on this. When we started we were, other than the Co-Op Bank, we were the worst capitalised bank in the UK at the end of 2013. Now I said to the regulator with a tongue in cheek the other day, "how does it feel to have the highest capitalised bank being RBS?" to which she laughed at me!

It just shows how far we have moved this bank, because we knew that the Government would never put another pound into this thing, so we had to do it ourselves from a sell down of assets.

But, we do want to participate and the reason we want to participate is our shareholders and investors have told us they would like us to participate in the buyback when the Government or UKGI sells. They have told us they would like us there as long as it is a reasonable pricing, but to be there, to actually help the Government get out as quickly as they can.

I say this not just because I am sitting on the stage and somebody might write this, but I think the Government has been an incredibly good shareholder. For what we have to do to RBS and take it from global to being a local bank, and all of the change we have gone through, we needed a solid shareholder that understood the strategy and was with us the whole time, and they have been.

But, they have their determination they want to get out. Philip Hammond, the Chancellor has said they want to get out in the next five years, 60-70% of it out. £3 billion a year for five years. My view is can we be helpful in getting them out to that tune or even more without damaging our shareholders as well? I think the best way to do that is for us to participate.

But, there is a restriction on how much we can participate on the listing rules. That you can only do 5% of your market capital, the capitalisation of the bank. So there are some restrictions that we have, but even that at today, let's say that's £1.6 to £1.8 billion – it is very helpful if you can do part or all of that in a year to help a Government get out and that is what we want to do. However, there is some machinery that we have to put around that. We have to get approvals.

My first priority is to get the dividend flowing. My second priority would be on the buyback piece. I wouldn't sacrifice dividend for getting approval on a buyback, for example.

It is second nature for me, but, yes, we do want to participate.

I think we have plenty of capital. I still believe that the bank should run at a 13% common equity tier 1. The reason I think we will run at a higher level than that for a period of time is there are quite a few changes coming through on the capital stack between now and 2021/2022 with Basel III-plus, with mortgage floors. I think we will want to get through those before we say, "let's get ourselves down to 13%." We will have had a lot more of running the bank, but our capital build for this business is very strong. Once we start making money and don't restructure anymore as we get into 2020, and we don't have big conduct litigation this bank makes very, very good money.

Martin Leitgeb: That leads us nicely into the next question, so a very strong capital decision to start with. Equally, if I look at your liquidity position, particularly in the ring fence going forward, probably around £30 billion excess deposits, and on top of that probably a large part of the £20 billion or £19 billion left around on the TFS sitting within that, that is an extremely comfortable position to look at – growth and the opportunity for growth within your respective markets.

How does that influence your thinking about growth in the UK, and what segments could you imagine RBS to grow over the coming years?

Ross McEwan: We set out with a very clear goal, because I am a firm believer of just going to the liquidity and capital piece, and then we will come to where I think the growth is.

We set out with two things in mind, because I am a firm believer that a financial service organisation, it doesn't matter whether you are a bank, or an insurance company, or an asset manager, it really doesn't matter. There are only two things that you actually have. One of them is your capital strength, and the other one is your reputation, and we blew both of those away.

The first one, which is how do you rebuild capital strength and feed into that liquidity, because that was as big a problem for RBS as it was capital, and our view was, particularly while we were going through issues like the Department of Justice, build up liquidity and build up capital because we don't know how big these are going to be.

So, we have left ourselves now in a very strong capital position, having paid those pro forma first quarter 15.1% capital. Liquidity very high because we wanted a position that if we got into any difficulty and the rumours in the market hit and said that we were going to be paying £20 billion and the markets froze on us, we wanted no issues for us on our funding.

So, we have built liquidity. We took the TFS, we took about £19 billion of TFS. We were growing the mortgage book quickly, and we thought it is money you can give back if you need to as well quite quickly.

We are sitting there in a very strong position. Where is the growth? How do we use it? Other than giving it back to shareholders, which we would like to do, in the retail side of the business, mortgages, we like mortgages. I like secured assets. It is not that I don't like unsecured, but I do like secured assets. When things are getting very competitive, and the UK market is very competitive in mortgages, I don't actually care what anybody else tells you, it is very competitive, don't drop down the credit line. Don't go down and try and get higher prices because you have dropped and got worse credits, and that is something we have right through this business. Don't you do it. The second piece is don't lock in terrible pricing.

That is what those two things this business did, and if you look at Ireland, we have a massive tracker book that is stuck on 57 basis points forever. You have locked in forever 57 basis points when the rest of the market is running well over 200 to 300. So, don't lock in. When you do it, if you have to come down the pricing piece, don't lock it in, and don't get caught with bad credits. You will regret that for five to ten years.

We like mortgages. It is not that I am against unsecured. We are doing very well in the personal unsecured, and we are doing very well in the SME unsecured because they pay you back, as in you have them on monthly paybacks, every month the cash flows back, and they are in the habits of actually giving you the money back.

I have been very vocal on zero balance credit card, and we don't participate there, because they don't. They don't have to pay you back, and I think customers should be in the habit of paying banks back. That is a good habit to get into, and I don't like seeing customers building debt after debt, and it sits there at zero until it doesn't sit there at zero.

So, we haven't participated there. We have, I think, a fantastic product I could put into that market that encourages the pay down, we just think the market is a wee bit toppy at the moment, but we will at some stage come in when we think it is less toppy.

On the commercial side we are the biggest player there. We still see some really good opportunities in sectors, and we do do big sector analysis in the market place.

We are a little bit risk off in some, and we are risk on in other sectors, and we do that from a macro economic perspective, and then we get into individual company levels.

So, whilst you may be risk off in a sector you may still be very supportive of a group of customers that you think will do well in that sector. But, we have been backing manufacturers in the UK. When the pound came off we did think that that was actually a pretty good market to be in, and it has proved to be fine.

There is very little impairment going through the commercial market at the moment, which seems a little bit strange with the uncertainty going on. So again, we are a little bit cautious but the impairment in that market has been something like around 10-11%, which is not normal, and considering we are 25% of the business market, we will get caught with things, and that is why we have always said it is about a 30-40% impairment level.

But, there are parts of the commercial we like. We have plenty of growth we can do in retail and mortgages. In unsecured we only have 4 or 5% credit card market. We have some sectors that we are quietly looking at from a market's perspective within the FX rates and debt capital markets. Those are the three areas we are in.

We have a private bank that can grow, but, again, we are not constraining it, but we are saying to them, "if you grow, do it with customers, but also don't bring on people that will destroy the culture in that organisation."

We have a business in Jersey/Guernsey that is probably a little bit restricted in its growth because it is a big player in that market, but it is highly profitable.

Ireland I think we can grow in, but we want to stabilise that business first before we grow it and we will only grow in sectors that we know aren't going to get hit with massive ups and massive downs every ten years, as Ireland has a habit of doing to itself.

Plenty of growth in the UK and the Republic of Ireland from my perspective; we haven't outgrown ourselves.

Martin Leitgeb: On competition, looking at ring fencing I think most UK banks have by now completed, or pretty much completed ring fencing, and this expectation that it leads to additional liquidity, which previously was used elsewhere within group to be redeployed within the UK retail banking space. What is the outlook, do you think, on both the asset side and the liability side potentially, because one would imagine increased liquidity should supress to the asset pricing? On the other hand, you could see some of the benefits coming through on the deposit pricing side.

Ross McEwan: We have seen the advantages on the deposit side over the last year or so. One interest rate movement helped us lead into this year. We haven't anticipated many interest rate rises. We actually have only two in our plans through to 2021, the end of 2021.

Again, we only run on the economic consensus for all of our own budgeting. If it said there were three we would put in three. If it said there was one we would put in one. The economic consensus says two - that is all we have in our planning.

The reason for that is when I took over the business, everybody had this huge hockey stick of when income would fly through the roof and we would be saved and nobody ever wanted to go after cost because it is a bit more difficult. If you take out all of that hockey stick and just put what economic consensus is it completely dampens down all that income that people dream about getting but never do.

So, we have had that discipline running through the business and it has worked for us, but the ring fencing has, particularly, for a couple of banks said, "this is the money that's of a liquidity that's available in this marketplace", and you can't use it outside of the ring fence, so it is in there, and it has created, particularly in the mortgage market and parts of our commercial market some reasonably aggressive pricing.

Is that abnormal? Given that they have the liquidity and they want to put it into the marketplace, I think it is a normal behaviour at the moment until it is occupied and it is working for them. So, you are getting pressure on the assets.

We have less pressure on the deposits pricing. When you start to see what's happened to some of the smaller banks, though, you are seeing their deposit pricing coming up because they don't have the attraction of a large bank that has a big deposit pool. Therefore, I think they are getting a wee bit more squeezed than us, and with TFS coming off the lending scheme, I think as another 12 months rolls through, I think they are going to have to push the pricing up even more to get the liquidity to put back into the market on assets.

We are in, I think, a really good position. Probably second to only one other bank that's got a lot of liquidity trapped in the ring fence.

But, it is creating pressures in the marketplace and we accept that, which means it puts a lot of pressure on your cost base. You have to keep taking the costs out and then when you get into costs you are looking at wage growth of about 2.5%. As soon as you put wage growth at 2.5% it is 60% of your cost to your bank. You have to take out at least 2.5% to stand still, and we have some pretty aggressive targets to take money out over the next two-and-a-half years.

Martin Leitgeb: Turning to costs and looking at RBS, RBS has been taking out costs probably for the ten years at least and at least for the period you have been there, but, equally, RBS, at least from what we, from an external perspective can perceive has also been one of the more aggressive ones in taking out costs, so you have probably closed more branches than any other bank in the UK over the last couple of years.

How much more room is there to address costs and to improve costs? What role does digitalisation, automation of processes and so forth play for RBS?

Ross McEwan: We have been very aggressive on the cost base of the business because we had to, because as you come out of a global structure you lose revenue very, very quickly. You lose the revenue in the year, but your costs tend to hang around for three or four – it takes you that long to get them out.

So, we have been very aggressive, particularly as we reshape the business of taking that cost out and now we are getting into the core costs of the business. We have taken £4 billion out in four years. I am not too sure if there is any bank in the world that has done that, and what I find with banks is they say, "I am going to take a billion out, but I am going to invest x back in, and I've got inflation", and by the time you have actually worked it out they have taken out about nothing.

I don't think you can do that when your income is under pressure, as it is in banking in the UK. You have to take real costs out of the business greater than the increase and the inflation on the costs that are going in. That's the facts of what we have been doing with our business.

This year I have allowed the business a little bit more leeway, particularly around innovative activity and there is about £150 to £160 million I have let the businesses have, and we will do exactly the same for next year because there are some areas I do want them investigating and it is a bit more than having a play with, but I want them thinking about where could we find growth for the future of this bank?

We had to come out of a lot of businesses. As part of the European Commission edict of putting £45 billion in we had to come out of a lot businesses, and my view is you wouldn't go back into those businesses the way they are, but there are some things we should be doing for our customer base.

So, we are looking at a number of areas there. Some of them hit the market already, some of them haven't. For example, we have a little innovative SME lending tool called ESME, so Electronic SME. It sits on an Israeli platform. It has our credit engines. It has all the connection into the company's office to get all the data and know your customer and the first few lines we put through that they were done electronically 15 minutes and funded. When you consider that the market at that time was taking about four weeks it was a fairly big step forward.

Why did we do it? One, we are actually quite interested. There are parts of the peer-to-peer market we quite like, so we will go after them there. Bits of it – some of it we don't like and don't want and we actually refer customers to them because we don't have the credit at the time, but it also said to our business, if others can do it in 15 minutes why can't we? Therefore, we have put the challenge into the business, in our SME business of, so why are you taking two weeks? Now, if you are a customer of ours you can go online and it is constantly being updated where you can do your own application and use a vehicle you want to use for lending and it takes four minutes, and we fund it overnight because we run a batch process.

Therefore, we have taken the learnings from doing something quite innovative and spun it back into the business. Alison and the team will take it from SME up into the mid-business market and make it really easy for customers to do business, and what's happened in our SME, as I said earlier, SME unsecured, it is growing very nicely because it is that simple.

All that credit, all within our policies, and we are doing the same when it comes to use of mobile for our personal bank, and these are things that we have tried outside of the business and then brought it in. There has been talk about the things we are doing. We won't come to market with them until we are ready with them. Will a number of them completely fail? Yes. Will a number of the failures actually teach us a huge amount and from an investor perspective, is it worth spending £150 million a year for two years, to have a go? Absolutely, and that is what we are doing, but there are also some major platforms in the bank that we are changing from a technology perspective. So, this business moves a lot faster, and some of that is quite innovative.

We have people globally who are just seeking out new activity and new innovation and we have a couple of them over in the States. We have a team that go in and out of Israel. We have them in and out of businesses in the UK. We have scouting teams that bring back things that can help our overall business, and we have about

30-plus sandpits running in the organisation where our teams are having a play with how can we make this bank a better bank?

So, I am pretty encouraged by it. I only need one or two of those to fire up to make some reasonably good income out of them.

Martin Leitgeb: Good. Maybe the final question from my side before opening to the floor for Q&A. Brexit – there is another ten months to go, obviously, to the March deadline. What kind of impact are you seeing on the business from the Referendum? Is it more on the growth side? Is it maybe a more muted growth outlook? Whether that is some of the unsecured recently, or on the commercial side, businesses holding up investments, or do we see some pockets of risk where at least their performances have deteriorated recently?

Ross McEwan: The thing with Brexit, I have been pleasantly surprised that the market hasn't really slowed down to beyond the extent that it has. Put aside the first quarter in the UK and we've seen what happened in the first quarter really in the second quarter because it was 0.1% growth, or 10 basis points. Really, was that weather, or was that something else? Let's see what the second quarter looks like before we call it.

However, it has been, I think, okay. At 1.5-2% growth, it is down from 2-2.5%, so it is not as good as it was, but it is nowhere near what I and others thought would happen.

But, you are starting to see some commercial, larger commercial businesses asking the question about how do you serve me in a Brexit environment? We have had to set up an operation in Amsterdam for our markets business and our Western European commercial business, which has about 250 large corporates, and we also need to have our UK customers, who are operating and selling into Europe serviced as well. So, we have had to move forward as though there is a pretty tough Brexit because I can't sit back and wait on behalf of customers and then try and find a solution for them in the first quarter of next year.

We all live in hope that between Europe and the UK a sensible solution will be found for all, because I don't think anybody wants to do self-harm to either Europe or the UK, and we do need to find some solutions, but some of those solutions, I think, won't really be negotiated for another three-odd months, because everybody is playing a tough game, but I think we need to think about customers in all of this, and that is my only interest is how do we serve customers? Therefore, we have had to put in place some entities and they will be served with people and systems and processes that will work for our customers to trade and bank across the jurisdictions.

It has been hard to know what's really going on. I think everybody is holding their cards pretty close to their chests. There are some big issues to be nailed around the border in Ireland. There are some big issues about how the banking sector will operate.

When we step back and think about how we want our customers to operate and how do we make it easy for them, I think we just need to take cold towels over the head and find nice solutions, to be quite honest, rather than absolute political solutions. I am an optimist that it will be okay, but we are having to plan as though it is going to be a bit more difficult.

Martin Leitgeb: Perfect. On this note, let's open up for questions from the audience. I think we have two microphones at the back. Just waiting for a hand.

Ross McEwan: Very quiet group.

Martin: Otherwise, I will continue with the next question. Obviously, following Williams & Glyn, and the resolution of the European Commission mandated state aid proceedings, and M&A, or at least acquisition ban fall away, and I think since you have booked a business, Free Agent.

Ross McEwan: Yes.

Martin Leitgeb: Could you just shed a bit of light on how you think about acquisitions, whether it is a smaller mortgage book? Then, maybe more specifically on that Free Agent one. I think it is quite an interesting story, the risk to the business, how that fits into RBS?

Ross McEwan: We have not been able to look at acquisitions. Some time ago we looked at a mortgage portfolio and walked away. What was quite interesting about just looking again, the organisation had this massive acquisition fever about itself up until ten years ago when we completely fell over. I can't remember – it was something like 94 acquisitions in a very short period of time, and what we found when we looked at this one that we had lost a little bit of the muscle and we also found within the organisation an absolute fear of doing an acquisition, which was, in itself, a cultural problem for us that we had become so risk averse that people were saying, "why are we even looking?"

I don't think there are many things that I am that interested in from an acquisition perspective, because I get asked by investors, "what are you going to do with this capital?" What I would like to do is give it back to you. I would like to keep enough to grow the business, but at the moment we don't have anything that rears up and says, "that's fantastic".

Why did we buy Free Agent? When you look at digital capability and what are the services that we could or should provide to the SME, mid-market, there are a number of things that a small, medium-sized business has to do, but they really don't want to do.

For example, if you own a dry cleaning shop your business is dry cleaning clothes. It is not running payrolls, it is not doing accounts, it is not doing all the invoicing at night, and on a Sunday afternoon the last thing you want to be doing is spending three hours working your way through all of this.

If you take that mindset and think about a customer, what are the things that we can do to help them? Free Agent fitted into that. It is a really smart accounting software piece that has the ability, it is quite intuitive. It is API-based. It will work very well with some of the other innovative things that we are doing from an invoice perspective, that then flow through the accounting process and into bank accounts.

It is some of the work we are thinking about around how does a merchant payment structure work today as compared to how it used to work – all those sorts of things, and we are building a large picture that has many, many pieces to it that we are going to cobble together nicely for our customers and Free Agent was just part of that.

It wasn't until Monday I think I was allowed even to talk about Free Agent because even though it was quite small there are some very strict rules about what you can and can't say.

But, it also for us, and it probably gives you an indication of where we are looking as opposed to big things. What are the technical expertise and pieces that we need for this organisation that will push us forward on behalf of customers? As opposed to, do I need to go and buy businesses?

There are some portfolios that we are weaker in that we would look, but then again, maybe I just put some capital to grow as opposed to go and buy, because right now we have some pretty good technology. We can go out and make propositions to customers. We have 16 million customers in the UK. I have 1.3 million of them just in Scotland alone. Why don't we do better things with customers with some of the options we have today?

But technology will be a massive driver. We have put a very, very small amount of money into a quantum computing operation. We have looked at a whole raft of other things that we just think we need to understand.

We have also been very good on partnering, and we have built some very good partnerships, so there are many things we will just partner with organisations to put into that pictures for customers as well, and I think in today's world you have to be a good partner. You can't do it all yourself.

But, there is nothing that stands out for me that I should be putting a lot of capital in to acquire.

Martin Leitgeb: I think we have time for one question. I will just pause for a moment if there is anyone from the audience.

Otherwise, maybe my final question. Just looking at risk costs across the UK banking space, they remain at or very close to historic trough levels. What do you think the path of those risk costs is going forward? With write backs maybe fading over time, should we expect a normalisation, or do we really need rates to go up for them to pick up? What is the kind of full cycle number you are looking for RBS here?

Ross McEwan: I will talk about two parts of the risk costs, because one of them is just the impairment and we have had lots of write backs, particularly out of Ireland. It has slowed down now.

I think we see for the size of our business about a 30-40 basis point charge per annum is about the right impairment level we should have in our business. At the moment we are running at about 10-11 basis points, so we are well below. Even in the last quarter we just had next to nothing coming through our commercial book.

Whilst I would love that to continue, it is just totally unrealistic to think that that will continue.

30-40 basis points is what we built into our budgeting process. Even though we are getting 11 we will have in our plan 30-40, and each sector will be slightly different.

The other cost to risk is the very high cost of running your business and thinking about risk and the risk operations that you run. It is not just the people, but the capital you have to hold aside for operational risks, and the like. It is much, much higher than it used to be in our business, and it will be in every other bank. I think those will have to get to a more normalised level.

Therefore, there are two parts to it: the cost of doing risks – anti-money laundering, the risks around know your customer, CDD, customer due diligence and major issues and major expenses that you just need to get better at.

30-40 basis points on the pure impairment risk is probably where we see it.

Martin Leitgeb: Perfect. I think this is a nice conclusion of the presentation today. Thank you very much for joining us today.

Ross McEwan: All the best, thanks, Martin. Thank you very much.

[*Applause*]

[*Ends*]