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# Chief Executive's review

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**Ross McEwan**  
Chief Executive

In 2016 RBS made an attributable loss of £7.0 billion, mostly reflecting charges for outstanding litigation and conduct, and costs associated with restructuring of the bank. The financial impact of these issues is a difficult but necessary step in working through the bank's legacy issues. These costs are a stark reminder of what happens to a bank when things go wrong and you lose focus on the customer, as this bank did before the financial crisis. The more progress we have made on clearing these past issues, enables us to sharpen our focus on the core bank.

Our service level and product improvements are already delivering benefits for both customers and the core bank. In 2017 our focus will turn to going even further on reducing costs and faster on digital transformation in order to deliver a more simple, safe and customer-focused bank.

#### **The bank we were**

I joined RBS because I could see that underneath all the troubles it faced, there was a strong bank, with excellent brands and great colleagues, doing outstanding things for customers each day. This underlying strength is still evident today.

In 2014 I announced a three phase strategy. We are moving to the final phase of this, after delivering much during the first two phases, which were about building a platform of strength

and stripping away unnecessary complexity. Our CET1 ratio has now materially improved to 13.4% from 8.6% at the start of 2014. We have thoroughly reshaped our investment banking business, now rebranded NatWest Markets. We have sold Citizens in the US, completing the largest bank IPO in US history in the process, and also sold our international private banking business. We have ended active operations in 26 countries, decommissioned 30% of our IT systems and applications, and almost halved the number of legal entities. We have also completed the run-down or sale of over three quarters of Capital Resolution legacy and non-core assets. We have reduced our cost base by over £3 billion, exceeding our target for the third consecutive year, with an operating cost reduction of £985 million.

## In 2016, we improved on our position in a number of rankings, including achieving our highest ever score in the Dow Jones Sustainability Index.

The past is not completely behind us, with our dealings on Residential Mortgage Backed Securities (RMBS) and Williams & Glyn, our residual European Commission State Aid obligations, two significant issues that we still need to resolve. The recent proposal by HM Treasury on an alternative way to increase competition to allow us to meet our State Aid commitments would deliver an outcome more quickly, and with more certainty than undertaking a complex sale. We have been able to provide for both of these in our accounts, though there may still be substantial additional provisions on RMBS.

### **The bank we are today**

We are now in a much better position to focus on our long term aspiration – to transform the bank into the number one for customer service, trust, and advocacy. While the signs of this transformation have at times been masked by our wider organisational changes, the core bank has already evolved materially since 2014. Our decision to refocus on the UK has seen our balance sheet shrink by £229 billion since the start of our plan. This is net of the continued growth in our Personal and Business Banking and Commercial and Private Banking franchises. We are seeing the benefits of our service-led strategy in the financial performance of the core bank, generating £4.2 billion in adjusted pre-tax operating profit for the year, an average of £1 billion per quarter for the last eight quarters and 4% up on 2015.

While Q4 was down from the levels seen earlier this year, our Net Promoter Scores for Commercial and NatWest Personal in 2016 were the highest they have ever been.

With £30 billion of gross new mortgage lending in UK PBB, we helped 320,000 customers with their mortgage in 2016, growing our market share for the fourth consecutive year without leading on price or risk.

We are the largest commercial bank in the UK, and are ranked joint number one by Net Promoter Score. Our ability

to generate value here is shown by the scale of support we have provided to the economy in the past year, with almost £9 billion of new net commercial lending.

### **The bank we are becoming**

We still have more work to do. In part, that means finishing the restructuring of RBS, resolving the remaining legacy issues, and preparing the bank for ring-fencing. In the main, however, it is about adapting to the changing nature of the UK and Irish banking sectors, and investing to meet our customers' evolving needs.

Digital innovation means customers are doing more of their transactions online. We interact with our customers over 20 times more through digital channels than physical ones. 35% of all new products were taken out digitally in UK PBB, and this is rising steadily. A fifth of our customers now solely use mobile and digital to interact with us. As customers change the way they bank with us, we must change the way we serve them. This means continuing to simplify for our customers, and accelerating our deployment of digital and mobile capabilities. The role of the branch is fast moving to an advice and service centre, away from transactions. While the branch will still be a core part of our offering to customers, inevitably some branches will have to close.

We're working to blur the line between traditional and digital banking channels. We are investing in a video sales and service proposition that will connect customers, no matter where they are, to the right specialist.

This shift isn't only in personal banking. We are aiming to service 95% of our commercial customers' needs through mobile and online by 2020, up from nearly 80% today, by introducing a new digital banking service that will greatly improve experience. We're also responding to customer preferences for more innovative lending platforms and products.

We are investing heavily in technology in our NatWest Markets business.

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Hundreds of separate product databases will be replaced with a single, scalable platform, which will help reduce costs significantly and dramatically increase the speed at which we can deploy new capabilities for our customers. We are also introducing a single dealer platform, an electronic front door, through which we can provide FX and Rates solutions to our clients. These are the kind of changes that will lower costs while protecting revenue and delivering even better customer service at the same time.

We are committed to running the bank as a more sustainable and responsible business, serving today's customers in a way that also helps future generations, generating long term value for all of our stakeholders and society. In 2016, we improved on our position in a number of rankings, including achieving our highest ever score in the Dow Jones Sustainability Index. We continued with our commitment to manage our impacts on climate change and support our customers to move towards the transition to a low-carbon economy. We continue to support financial education and our goal is to help a further one million more young people understand all about money by the end of 2018.

Our commitment to sustainability is also evident in our annual results, where we have replaced our annual Sustainability Report with a more integrated approach. You will see a number of new elements in the Strategic Report that explain the key influences on our operating environment, and some of the impact we have had over the past year. This is an important step towards fully integrated reporting over the coming years.

### **Delivering our strategy**

The decision last summer by UK voters to leave the EU will have wide-reaching consequences. In light of this, we reviewed our plan to ensure that it remained valid in a changed macro and political environment. Following that review, I want to re-iterate our

commitment to the strategy we have been pursuing since I became CEO – we firmly believe that our aspiration to reach No.1 for customer service, trust and advocacy will maximise value for our shareholders.

This year we have met all our operating financial targets, though the results of some of our customer NPS and employee engagement surveys show we still have work to do. After the EU referendum result, we promised an update on our targets. We are targeting an unadjusted 12% or greater return on tangible equity, and a below 50% cost to income ratio by 2020, one year later than envisaged when we first set out our plan in 2014.

Our service levels are improving and we believe we can meet our 2020 aspirational customer and colleague targets. Our focus on capital strength remains a cornerstone of our plan. In 2017, we will continue to reduce legacy RWAs, and we will target a CET1 ratio of at least 13%.

This has also been another tough year for our colleagues. I am grateful for their determination in serving our millions of customers every day, despite many negative headlines. Our colleagues are the face of the bank for our customers, and their engagement is critical to our success. One of our five key targets in 2017 is to improve employee engagement.

We no longer have global aspirations and we need to go further still on our operating costs. We expect to take out an additional £750 million of operating costs in 2017 through our focus on simplification and digital transformation. A simpler bank is a more profitable bank and a bank that delivers a better customer experience. Where we can make it easy for our customers, the more business they will do with us and the more sustainable our earnings will become.

### **Looking ahead**

The progress of the last three years positions us well to achieve our vision for the future. We have the right strategy, and it is starting to deliver

results. Now, we need to go further on cost reduction and faster on digital transformation.

We aren't alone in searching for efficiency gains and investing in digital capability, but the unique strength of this bank lies in the fact that we have a diverse business profile, with scale in all of our chosen markets. Investment in our market leading brands and better customer service will deliver steadier, higher quality earnings. Our focus on service rather than price has also shown that we can continue to grow in areas of strategic opportunity, such as mortgages, without compromising on risk. All of this will deliver a sustainable competitive advantage and a compelling investment case in the longer term.

This is a bank that has been on a remarkable journey. We still have further to go. But the next three years will not be the same as the past three. Legacy issues will take up a decreasing amount of our time and focus. Our customers, our cost base and the measures we plan to implement to return the bank to sustainable headline profits will be where we focus our efforts. Assuming we can conclude our issues on RMBS this year and resolve our residual State id obligations, we aim to have RBS back into profit in 2018 representing a significant step towards being able to start repaying UK taxpayers for their support.