



The Royal Bank of Scotland Group

Merrill Lynch Banking & Insurance CEO

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“Competing in the ‘new normal’”

PRESENTATION and Q&A SESSION

STEPHEN HESTER, Group Chief Executive of

The Royal Bank of Scotland Group,

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Stephen Hester - CEO - Royal Bank of Scotland Group

Good morning, everyone.

I am attempting this morning to change the focus a little bit of what we're talking about on the subject of RBS. Of course, much of the last year has been dominated by the radical restructuring that we have had to undertake and that we are in the process of undertaking to rid RBS of all the risk and other issues that nearly brought the Company down in the winter of last year. And as you know, that involves a really massive restructuring effort, totally changing the bank, not just in cultural terms, but something over a 40% gross reduction in balance sheet in cost and constant currency terms and a whole range of other things that we are reducing or getting out of.

However, all of that restructuring is going to be useless what we are left with, the core RBS, is in fact an attractive, strong competitor and able to drive shareholder value. It is our belief that it will be and it is very much that forward-looking RBS, the onward core, on which I want to talk today, [acquist] to the focus of today's conference being future looking competing in the new normal.

So a couple of words first of all on the environment looking out the next handful of year. A hazardous thing to do at any moment and particularly so as we pull out of recession in the world economy, but still with a relatively wide range of outcomes possible. Nevertheless, I think we would regard in economic terms the almost [MOST] likely part of the new normal, not forever of course, but for the next handful of years, as being a world which does return to growth but where that growth is impacted and constrained by the unwind of past successes, which were the root cause of what happened to us over the last year and which are not yet unwound.

And that can obviously feed through into both economics and banking markets in a number of different ways, low interest rates for a while, limited growth, demand for credit restrained as people repair balance sheets, probably the same in terms of house price growth and so on. So an environment where, if you like, growth both for economies and therefore, for bank income lines is tough to come by and wherein payments also stay high for a while, although growth, we believe it will be.

Now thinking of the banking industry and what the new normal for the banking industry is, I think that there are some important points that arise both out of the crisis and that arise out of the economic environment we'll all be facing. One of the most important points is the banking industry has continued to consolidate and that process was, if anything, accelerated by the pressures of the last year and I think is still continuing in a number of places around the world as weaker players in effect go to the wall or are absorbed by stronger players. And so the structure of the banking industry becomes more dominated in almost every market out there by the top players.

And similarly, the if you like, the day of the banks being able to see themselves as massive growth vehicles indulging in major investment in terms of conquering new territories, moving into new activities, I think will be behind us for a while as people stick to their knitting, focus on their core businesses and the strength of those core businesses and how they have adapted to the future.

We all know that part of the reaction to the crisis, both driven by markets and by governments and regulators, will be sharply higher cost of doing business for banks, whether that be measured in terms of availability and cost of wholesale funding, whether that's measured in terms of capital requirements and all the things that wander around the subject of capital like liquidity and so on.

So therefore, in terms of applying that, if you like, new normal banking environment to the way the banks will behave, I think we see, if you like, the benefits in some cases and also the implications of that being that the competitive environment is rational. The industry structure allows a rational competitive environment that if you are already top tier in markets that are consolidating, there is in fact attractive business to be done and if anything, to be gained. Of course, deposits are seen as ever more high quality funding relative to wholesale and it is therefore likely that the deposit margins don't go back to where they once were, even when interest rates normalize, as competition remains fierce.

Our balance sheet growth muted in line with the economic outlook and therefore, an overwhelming focus for banks on disciplined margin rebuild and cost management. And then of course, because of the impact of the extra capital, even with margin rebound, it is our overall observation, it is likely that ROEs stay below prior peaks, but nevertheless, can be rebuilt to cover the cost of capital and of course, there is a degree of obscurity still about buying, by how much they will cover and indeed exceed the cost of capital and so there is an illustrative chart that you can see. Hopefully, you have got the slide packet. If not, they are available outside afterwards, given that's a little hard to read from where many of you are. But see the sort of influences that we see on the ROE in both directions.

So taking both that economic backdrop and the banking industry backdrop, let's just take a quick look at RBS. And the vision that we have laid out or the direction that we have laid out for RBS, or more particularly, for the core RBS, is set out in this slide here. This is a simple repeat of the one that we published with our half year results and our strategic discussion in August, so I won't spend a whole lot of time dwelling with it. But it is clear that this vision in fact is attuned with our view of the new normal, with its focus on sustainable ROEs covering the cost of capital, with its focus on a risk profile that is if you like, in tune with the new normal and the regulatory requirements and a business mix emphasizing profitability but also stability in the different mix of businesses that we have.

So what I thought that I would do is spend a few slides talking about how the core businesses of RBS are today positioned to compete in the new normal. But then as importantly, to take you through the efforts that we are expending to retool every one of our core businesses to make sure that they can compete even better than they are already able to do. And we start, I think with the benefit in core. I think -- again, throughout this presentation, I am ignoring the things that we are winding down or stopping doing.

We start, I think, with some very important benefits in the businesses we have selected as core to go forward. All of them are in fact, if you like, naturally profitable in terms of their positioning, have a history of strong profitability and strong ROEs. They all enjoy and they are all positioned in large customer driven markets with a strong customer base, which we can demonstrate already we have the potential to grow further.

We have very naturally strong deposit franchises, which although we are not immune from competition, I think will demonstrate that it is -- will be easier for us than for some others to develop a balanced funding model. The brands and the customer loyalty that lies beneath our customer base stood up phenomenally well, which I think is a fantastic sign for the future -- stood up over the last year, and I think you will all see that the portfolio is pretty balanced, operating at scale. That said, every one of the businesses has been hit by recession. Every one of the businesses needs to retool, in any event, in part to fix weaknesses of the past and in part, to retool for, if you like, the new normal environment.

Taking each of those in turn, again, I won't try and go through most of these charts in any detail, but this takes our ongoing core businesses on the left and shows, if you like, backward looking, which have historically met our ROE targets, which have had net interest margins which although squeezed now, suggest that we can get back to a place that is healthy in our margin rebuild, which have achieved our cost income ratio targets in the past and which we have achieved the loans are positive, as you can see.

The most work that we have to do, other than, if you like, returning to the past, is on costs and on the funding structure. And again, lots and lots of words on this page, so it's really more for you to take away afterwards. But the basic point is, every single one of our core businesses, whether retail or wholesale, whether in the UK or outside the UK, has -- none of them have lost customers over the last year and virtually every one has actually gained customers over the last year. And if that could happen to our core businesses with the level of disruption and if you like, reputational noise that has surrounded RBS, I think that should give everyone enormous comfort about the ability of these franchises to generate real shareholder value in more normal times and after we have worked on them.

I mentioned deposit franchises and again, what we do on this slide is to go through each of our major deposit franchises to demonstrate the quantum of deposits that we currently get from them. As I say, they are large, we are naturally advantaged in having these. However, not a single one of them has historically been run other than purely for profit. We are now going to run them for both profit and funding ability.

While that will have a negative margin impact, not currently in the sense that rising interest rates will improve margins, but we think deposit margins won't go back to their peak prior levels, but nonetheless, we feel confident that we can get extra growth out of these natural franchises where we have less concentrated on volume than we will do in the future and you can see that we believe in every single one of these, that we have growth in the coming years that we can accomplish, which is important for our balanced funding model, about which we will talk later.

The charts here take just four of our businesses, our businesses in UK retail, commercial and in the US at Citizens, where if you like, there are easy consumer and brand loyalty and satisfaction data and they demonstrate that again, notwithstanding the pressures of the last year, not only have we not lost customers, but we haven't lost or we haven't lost much customer affection relative to the people against whom we compete. And of course, this is an important qualitative measure of, if you like, franchise damage in the position from which we have to recover and I think our conclusion is that actually, we have been very fortunate and indeed, our people have been hard at work during difficult times for them in ensuring that our customers get served.

I mentioned a balanced portfolio, again, on the thesis that in the new normal, top tier positions are more important than ever. Our core businesses have been selective among other things, because they contain the top tier positions that we have as a group and we put out a number of them. I won't go over them. It also gives a balance and a complementarity to the group, roughly one-third of the group over time, we expect to come from the wholesale and investment bank, two-thirds from retail, commercial and insurance and again, the retail and commercial reasonably well balanced. I could present similar balance geographically, although of course the UK would be the largest area.

Now we start with therefore very strong core businesses, strong market shares, not too damaged by the last year and indeed, in many cases, already showing some signs of underlying fall of momentum and each with a history that suggests it is doable to get to our targets, about which more later on.

However, I mentioned that every single one of our businesses can be improved and we mean to do it and we mean to do it aggressively. And we set out here seven areas, if you like, of improvements that are themes that cut across each of our business areas and let me go through each of them.

Cost income ratios, in a world where we all need more capital, the cost income ratio has to improve, which of course means work both on the cost line and on the revenue line. And we have set out for every single one of our businesses, not only where they currently are or where they were last year on cost income, but where within the next five years, we believe we can get them and what we call, in the middle column, a competitive benchmark, which is, if you like, just taking the better end of the people against whom we compete in each of those submarkets, noting where they are.

In some instances, we think we can beat them. In other ones, within this timeframe, we think we can't for specific reasons to do with our own positioning and so on, although obviously ultimately in every instance, we want to get to the best out there in the market. And on the cost side, we have a GBP2.5 billion cost reduction program, which is well underway, ahead of plan. I believe there is scope to improve upon that, certainly in the outer years and that is going to be a key device to enable, if you like, revenue gains to be taken straight to the bottom line as both we gain revenue through coming out of recession and through our business actions, about which more later.

However, in addition to saving money, there is another different type of fundamental remake that RBS requires. RBS was built as an acquisition machine and as a consequence, some of the quality, which drives businesses and enables businesses to grow organically, was neglected through a series of distracting business integrations. And although -- again, apologies if some of that slide is hard to read, you can see that in certain key areas, which in my judgment, drive organic growth, having been under spent and neglected at RBS.

One example is technology spend. Both absolute in ratio terms relative to our competitors, we have under spent on technology and we have also spent more of it of running the bank, i.e. dealing with lots of different systems inherited from past acquisitions, than changing the bank. And similarly, another signal of a franchise that has not been oriented to organic growth as much as it should be is not being spent where, in some of our key markets, we are systematically under spent on, if you like, the front line brands.

And so therefore, part of the plan in the next five years is all in the financial targets that we have laid out. Part of it is to undertake some very important retooling investment in each of our business areas. We have set out on the right, if you like, the five basic categories under which this comes.

The investment program will total over GBP6 billion, although that is expensed over a longer period as it is mostly CapEx that then is amortized and as I say, is fully taken care of in our financial projections, although what is in effect does is ease up the cost savings and leaves the cost line broadly flat. But the business much fitter, not just able to bring revenues straight to the bottom line, but able to generate revenues better without having to write checks by businesses all the time.

In addition to that, very important plan for every one of our businesses to refocus their service proposition, to make sure that we both acknowledge weaknesses in the past and acknowledge changes in our markets and move the way that we serve customers, whether that be geographically or across product lines or across mediums, to best in class levels and we put out -- again, I won't go through each of the words, we put out a number of examples across different businesses, some of which are channel migration.

We are behind in the UK, for example, in online service to our customers, particularly on the retail side. We are middle of the pack. So for me, whenever it is middle of the pack, it is behind. Our ambition is to be better than middle of the pack.

Similarly, when we go across the Atlantic into the United States, we got too distracted by trying to move out of our footprint. We are moving very strongly back into our 12 State footprint and integrating our consumer finance and branch networks to -- with massive opportunities to improve cross-sell and deepen relationships in our core markets, which will be much more profitable than spreading ourselves very thinly across the United States, which was our prior strategy. And in each of our other businesses, there are examples of, if you like, our reorienting the customers we serve, how we serve them and through which channels.

Now the purpose of course, of these, if we are keeping our costs comparatively flat, but improving the organization's ability to compete, is that we need to increase income. Some element of that happens naturally as the recession unwinds, as interest rates go back up, as economic activity resumes and some of the slowdown in income lines unwinds as well. Some of it is obviously gains that we need to get on top of that.

Because of our view, if you like, of the new normal being an environment of relatively restrained growth, we do not have greatly ambitious double digit income growth rates in mind. We have single digit income growth rates in mind and margin is very, very important to us, as you would imagine, in that context.

And again, in a little bit of detail across this slide, we have illustrated for each of our businesses both some of the things that we think will impact margins in the next few years, and some of our initiatives to drive non-interest income, which also obviously drops to the cost income margin line. And I think the positive thing that I want to say to you about this slide is when we concentrate on margins, that the margin story is really in two pieces. Asset margins in our industry need to go up a lot to pay for more capital.

The good news is that they already have, as it relates to the front book. So every one of our businesses is more or less where it needs to be already in its new business level on asset margins, albeit it will take some time, a different amount of time with each of our businesses for that to work through the entire book. And of course in some areas, there may be actually a little bit of competition back down again at the margin in some of these areas.

But most of the heavy lifting is done on the asset margin side. That needs to work through the book and we need to make sure, which I believe the competitive structure of the industry will do, that those margins can be broadly sustained. I think as we all see the regulatory changes coming through in hard numbers, the industry will indeed be able to sustain those higher asset margins.

On the liability side, it is a slightly different picture. There are a number of different things going on, higher liquidity requirements will be a continued drag on liabilities. Obviously wholesale funding, competition for deposits. On the other hand, there has been a huge liability margin squeeze coming from low interest rates and that will go in the opposite direction.

In our plans, we are thinking that interest rates will start going up again in 2011 and not be, if you like, normal until 2012. Hence most of our liability margins return not to where it was, but to healthier levels, occurs in the out years of the plan. Of course, there is upside if interest rates were to go up earlier than that. So again, these are, if you like, broadly our thoughts on the different issues that will drive revenue, what we have to do to drive revenue in our franchise to make good on the ability to improve profitability in a modest and a constrained growth world.

The icing on the cake for each of our businesses, so far I talked about them, in the sense, almost as independent businesses, but I have also talked about the way they complement each other, both in terms of the balance of the group geographically by product, but also essential that they complement each other in funding profile with major deposit providers that we've talked about before, and deposit users as part of the group mix. However, we also believe that each of our businesses already extract synergies one to another as being part of the group, but we can do a lot better.

Again, a busy slide which I won't go over, but inherent in the detail of the five-year plan that we've set out is for every single one of our businesses to have signed up to measurable targets across a range of if you like exploitation of joint activity, cross-selling clients, product development and so on and we'll be getting on with that.

And this slide here, as of, if you like, showed the starting point in terms of the principal types of synergies that exist across our businesses. In some cases they are business flows, which we give you a revenue number for. In some cases, they are sharing cost bases, which we just simply shade for you. And in some cases, there are obviously expertise synergies which are harder to value, but nonetheless, very, very important.

Cultural change is a form of retooling. We intend to manage the core business better and differently than before and although this in itself is almost an essay and a very detailed discussion, I think at one level, it can be quite simplified and that is to say in common sadly with many banks, the key drivers of recent years were top line growth, profit growth without too much attention to the input to that growth.

And we put on the left hand side a slide actually used at this conference two or three years ago focusing, if you like, on the earnings per share growth part, but also showed beneath it, which was a slide that was not showed at this conference, that was largely being accomplished by leveraging up the balance sheet and not being accomplished by improved margins and wiser use of inputs.

And so on the right hand side of this slide, we now show the measures that we have put out; the ways that we are measuring our business very clearly, looking at inputs as well as outputs, looking at organic growth as our key driver, looking at returns on the things we use, whether that be balance sheet, whether that be capital, whether that be the cost income ratios and trying to make sure that the business model that we build is indeed a lasting and higher quality one, which does indeed produce growth, does produce good profitability, but through a sustainable use of resource.

I have mentioned balanced funding. I think that this is an absolute prerequisite. It would be very easy for us to believe that there are no lessons to be learned in funding models. I think the regulators will ensure and the rating agencies will ensure that we don't get away with that, even if we are tempted to. And we have clearly set our stall out saying that one of the many ratios that will be important is how we fund our balance sheet and making that as stable as we can, with a group target of 100% loan to deposit ratio, and you'll see here on this chart the individual business targets which will add up to that.

That is enabled really by, you have to believe two things to believe we can get there. You have to believe that we can run down our non-core division, which is the main source of reducing our loans. And you have to believe that we can get 4% to 5% per annum growth in deposit over the next four or five years, a touch ahead of expected nominal GDP growth over that period, therefore requiring in my judgment a bit of market share gain.

But I think with the natural franchise we have, that is, if you like, a responsible expectation and target put out, not necessarily a no-brainer, but one that we feel is legitimate as a target. And I think again, a sign of the underlying health of our franchise as well as the way we are targeting our business that we can in fact aim and aim legitimately for that kind of a target, which I regard as a global gold standard for banks. And if you look at the other banks and in whose company we would keep at that one to one ratio, you will understand why we think that's a good place to be.

So trying to bring all of that together, this is a repetition of our August targets we've put out. I hope to repeat them many, many times, because if I do, we will simply be steering RBS along a consistent route, which I think is an important thing for us to do. But it is very clear that not only do we have words around what we are trying to do in our core businesses, but we have put -- set our stall out for you in terms of our expectations as to what that can add up to.

Could we do better? Yes. But we could also do worse and of course, every quarter, we'll be reporting back, although as I have said many times, it is unlikely to be next year that we see much forward progress in these targets. It is likely to be the outer years, once our restructuring has been largely completed and the momentum regained in our business.

However, when we try and put all of this together now, of course, this is a presumptuous slide, because you are the ones who will decide whether or not our efforts create an attractive investment tool. But we humbly submit that they should and we have gone through, if you like, six categories here on this slide of what we believe makes an attractive core holding in our sector. And we believe that RBS will tick every one of these six boxes as once we have completed the restructuring and attained the goals that we've set out and of course, the better momentum we show along that path, the more credit we will be given earlier for doing it.

So in conclusion, we do see the new normal for at least the next handful of years as having challenges, as having headwinds and rebalancing still needed in the world economy. We think that that will create modest growth opportunities, where the accent will be on margin rebuild and using resources more wisely for banks.

We think the bank environment will be enormously aided in that process through a rational competitive structure in all of our major markets and it is our belief and our plan that within that, RBS can indeed present an attractive turnaround story, driven by strong business fundamentals, driven by a credible and fundamental restructuring plan, driven by retooling of the core businesses to make them still better and then by transparently and I hope, in an investor-friendly way, reporting to you.

So those were my remarks. You will find in the appendices to our slides a whole series of, if you like, more details, charts on each of the core businesses and their starting position and a couple of other things. With that, I would be very happy to take questions.

QUESTION AND ANSWER

Unidentified Speaker

Perhaps I could just ask the first question while we wait for the microphones to come out. GBM clearly remains a big swing factor going forward and I think at the half year, you were vocal saying perhaps how unsustainable the first half profits were. I don't know whether we could tempt you into giving us some broad indications to how GBM has done in the third quarter, or if not, perhaps just give us an update in which lines that business, you think they stand a chance going forward?

Stephen Hester - CEO - Royal Bank of Scotland Group

I would say that every comment we made in the outlook section of the half year results in August, I would make again today. And so we are not trying to change guideline, either positively or negatively, from how we saw the world with possibly one exception, which is not on GBM. We might do a bit better in the second half than we'd thought on net interest margin, as things look at the moment.

With respect to GBM, we have significantly slowed the pace of revenues from the first half. We expected to do that. I think people didn't necessarily believe me when I said I expected it to do that, but that indeed has happened, not in a worrying way, but in a significant way. I think that we put out a chart with the August half year results that said the core GBM -- remember, we have taken 45% of the capital out of GBM. So GBM, if you like, going forward, as we reported as core, is a very different beast than before.

That core GBM, we think has a normalized run rate of revenues today of around 2 billion a quarter. We expect over the course of our five-year plan to be able to build at that normalized run rate and if you like, probably to be able to build it back to the sort of revenue levels that we will accomplish this year, courtesy of our unusual first half. But that will require patient build and retooling of the sort that we've laid out.

Unidentified Speaker

Let's upon it up to the audience.

Unidentified Audience Member

You alluded to consolidation within the sector. Could you comment on that specifically within the UK and the US? And then within the US, if Citizens were part of that consolidation, what sort of multiple of book do you think it would fetch?

Stephen Hester - CEO - Royal Bank of Scotland Group

Well I think that, clearly I can comment on it historically in the sense that in the UK, obviously we have seen a number of players disappear, in particular among the building societies, the Northern Rocks, Bradford and Bingleys, the Alliance Leicesters and so on. It is probably quite hard for the UK market to consolidate further from where it is now. And, in fact, if the EU have their way, there will be a bit of opposite movement.

In the United States, the same has happened. Obviously, the disappearance of the Wachovias and Washington Mutuals and so on of this world, but is continuing, not a week passes without some of the smaller banks disappearing. And since the Big Four in the US are pretty much up against their deposit caps, if you like, the positioning of the super regionals, which is what Citizens is, I think is actually an advantaged positioning since the opportunities for market share gain, I think will lie more there than at the top of the pile.

And since the United States remains such a large country that regional banking is both possible and very sustainable. So we are very comfortable with Citizens' positioning as a super regional, as top tier in its 12 states and in fact, better than top tier in Massachusetts, for example, which as you know, is a very large and affluent state. We actually have the number two ranking in the market behind Bank of America.

I think this -- if you just simply look at the number of banks left in the United States, there are many decades of more consolidation possible for the United States, even if the top guys have reached their deposit caps and so I am sure that that, driven by in-market synergies, will continue. Of course, at the moment, it is continuing in a forced way through bank failures.

In more normal times, it occurs in a positive way through exploitation of synergies, which allow people to pay more than something might be worth, if you like, for the seller and for the synergies to be shared. So our ownership of Citizens in this context does give us strategic options in both directions, because Citizens will enjoy synergies with other banks in the United States, which could either allow us to make acquisitions on an advantaged basis or to be acquired.

However, at the moment, it is our intention to stick to organic development of Citizens until we have got that business to where we believe it can be, namely one of the best regional banks in terms of actual operating matrices. Its cost income ratios, its quality management, all the things that were neglected in its previous roll up strategy. Over the course of the plan, Citizens is a core business. We think we can make it a terrific business and that will then open up future optionality, although we have no plans to sell Citizens, but equally, there are no businesses in the Group that we would be irrational about in the light of shareholder opportunity.

Unidentified Audience Member

A follow-up vis-à-vis a comment on NIM for the second half. I think you indicated 2010 would be flat. Can you say whether you have revised that relative to your slight tweak-up in terms of your own identifications?

And I guess secondly on the non-core side, we have seen securitized credit prices rally in some cases, quite substantially. Can you give some kind of indication of the scope for mark-up on the non-core?

Stephen Hester - CEO - Royal Bank of Scotland Group

On the NIM side, I mean, although the world looks a whole lot more predictable today than it looked six months ago, I think it is important to understand that it is still not pinpoint predictable, even if it ever will be. And so, I don't think we should get caught too closely in outward predictions on something like NIM for next year.

However at the moment, I would say it still feels that the balance of interplay of the things that we put on that slide would leave NIM next year at comparable levels, broadly comparable levels, to that that we exit this year, although hopefully we are going to exit this year a bit higher than we might have thought a couple months ago.

With respect to your question on non-core, the run down schedule and assumptions that we have published on our non-core business always assumed economic recovery, always assumed price recovery and it is exactly for that reason that we wanted to do it in a measured way and courtesy of APS, assuming that that's in place, which I do, we will be able to do it in a measured way that is friendly for shareholders.

And so I think at the moment, all I would say about the improvement in pricing is that it is going in the direction that we had expected. We don't want to be trigger happy. We want to capture best value and so I wouldn't change our forecast. But it is positive that it is going in the direction we expected, probably a bit faster.

Unidentified Audience Member

Good morning. If I looked at the capital requirement of the business is doubled, business wants to move to a more balanced funding platform, there is going to be a focus on organic growth and spend on building up the organic capabilities of the business. What type of back book asset margin repricing is implicit then between 2013 in getting to a 15% or greater ROE business? The mathematics seem challenging to me.

Stephen Hester - CEO - Royal Bank of Scotland Group

Well, I think the -- I mean, you could choose to disbelieve us of course, and I guess time will tell whether you are right to do or not. I think we have made the mathematics really very easy for you by setting out cost income ratios, by setting out balance sheet targets and by telling you that the costs will be roughly flat. So it is pretty easy to reengineer what we think and we have also said that if you look at our current front book margins, we think that they by and large in most businesses, will be enough to see us through as they unwind through.

So within, I think the bounds of propriety, we've tried to give you as much help as we can, understanding that these are no more than our own version of crystal ball gazing and of course, we know the world won't work out like that, we just don't know in what direction and by how much we will be wrong. As I say, we are fundamentally encouraged in the beliefs that we've set forward by the fact that we actually are already getting the asset margins that we need, not in every single business, but in the vast majority of our businesses, on new business.

What we need to do is run that through the book and sustain it. And then we need to make some assumptions about what happens to liability margins once interest rates rise again and to what extent you get back to some of what we had before, but not all. So again, I feel that the evidence is there to make this a reasonable stab at the future, but that you are of course completely entitled to take a more pessimistic view, as in fact some people also take a more optimistic view of the ROE that we can accomplish.

Unidentified Audience Member

Question, in your discussions with the regulators on coupon deferrals and the ability to call your hybrid securities, do you have a seat at the table? And then what is your best guess for actions RBS will have to take to receive EU approval on the APS?

Stephen Hester - CEO - Royal Bank of Scotland Group

I suppose we have what we have -- I am not sure whether I would call it a seat at the table or observer status. We are certainly able to put in our views -- our views are sometimes listened to and sometimes ignored. That is par for the course. We have been told we can't call pending EU approval of state aid. And remember, state aid is primarily the money we received this time last year.

It is also APS, but even if APS didn't exist, the exact same process with the EU would be outstanding. We are expecting them to stop us paying coupons as well on the old stuff as part of an overall settlement, but they haven't actually done that yet, so they might not. But we are expecting that they will.

The other pieces of the EU pie are that they need to get comfortable with our restructuring plan is in fact, aggressive enough and does have a good likelihood of giving us viable and safe capital ratios at the end of it. I believe that we will persuade them that that is the case, because I believe that that is the case, but they do need to rule of that and could mandate greater balance sheet reduction if they were uncomfortable than the 40%-odd that we've already provided for.

And then finally, as everyone knows, the EU wants to take a pound of flesh or a kilo of flesh probably out of the competitive position of banks in receipt of state aid as if you like, compensation for the artificial boost that we have received by state aid and in our case, that will involve a divestiture of part of our small business market share, the exact dimensions of which are still under active discussion.

But while I expect that to be a destructive thing for the customers involved and a disruptive thing for our internal processes, I think it is unlikely to be -- if I could say it, it is unlikely to be a major shareholder event in terms of either accretion or dilution of value.

Unidentified Audience Member

Sorry, this might be an ignorant question, but your presentation seems to focus entirely on the P&L and it actually includes the words insufficient attention to balance sheet, where an investor, and I am a global investor in [inaudible] and financials, it seems that an investment in your company is entirely about the balance sheet to me, given that is trading according to Bloomberg at 0.35 of book.

Perhaps you could explain what I have missed and is it -- it is elements that are not within your control or perhaps that it is legacy issues that you are not responsible for? But that seems to be missing from the presentation, to my mind.

Stephen Hester - CEO - Royal Bank of Scotland Group

Okay, well, I am sorry. Perhaps some of the writing on the slides is a little too small and perhaps I didn't read it carefully enough. But if I could just quickly bring your attention to a number of things. The slide of targets that you can see that I have just gone back to on this slide, actually the five most prominent targets on the top left coming first are in fact all to do with capital structure and stability.

A number of the slides prior to that, such as this one, are to do with the runoff of our risky assets and its pace and the funding structure in terms of loan to deposit ratio of the remaining bank. And at the opening, in my very first slide, I said very specifically I was going to spend less time on this presentation on, if you like, the misery, the restructuring, the things we have to get out of, because I think that we have spent enormous time over the last year describing to people what we are doing there and there are many, many presentations available on our website in relation to it.

But all of that will be for naught if what we have left is not strong, valuable and competes successfully and that is why I deliberately, if you like, changed the focus of this presentation. But please rest assured that absolutely at the core and fundamental to everything we are doing is a successful restructuring and a strong, AA category financial institution that can compete in a sustainable way, creating shareholder value off a safe base.

Unidentified Speaker

Stephen, thank you very much indeed. Stephen and Richard will be doing a breakout session in the drawing room. Again, in the meantime, perhaps we could share our appreciation.