



Morgan Stanley European Financials Conference 2010

RBS CONFERENCE PRESENTATION

at 8am on Wednesday 24th March 2010

Presenter

- **Bruce Van Saun (RBS Group Chief Financial Officer)**

Introduction from Chris Manners (Morgan Stanley):

Good morning everyone.

It's my great pleasure to introduce Bruce Van Saun Chief Financial Officer of the Royal Bank of Scotland. Bruce please.

Bruce Van Saun:

Thank you and good morning.

It is my pleasure to be with you this morning. With me today is Richard O'Connor, our Head of Investor Relations who joins me on the podium.

Be sure to read our cautionary language at your leisure.

Let me start off by summarising some of the key messages from our Annual Results Meeting of last month. We have reaffirmed our 2013 strategic plan targets and we have made good progress in 2009. We believe we are positioned for solid recovery in the medium term. We have robust customer franchises and we continue to service them very well. Our GBM business had a fantastic year in 2009 and we are encouraged with the success we have achieved with a refocused business model.

Our retail and commercial franchises are in the early stages of cyclical recovery. These businesses will power the way to achievement of our financial targets. Our income statement is getting better. NIM is expanding, impairment trends are moderating and expenses remain well controlled inspite of significant investment spending.

Our Balance Sheet is getting stronger, our capital base is solid. We continue to make progress in improving our liquidity and our funding position. We have provided a framework for thinking about how to value the stock focused on delineating core from non core which I think will be increasingly clear over time. Of course there are still many economic and regulatory threats to contend with at present. But at this point our leadership team is highly focused on execution in 2010.

We have been very clear and transparent about our plan to recover and rebuild the RBS franchise. This involves a reshaped well defined set of businesses and tight parameters on how they will be operated. It also involves new management disciplines such as better risk management processes, focusing on return on capital and paying for longer term performance.

Our ambition is to remake RBS into a world class financial institution and we have set a set of financial targets for 2013 that need to be hit to reach that ambition. You can see here that developing a much stronger balance sheet is a critical aspect of our plan. We hope to achieve an AA stand alone credit rating by 2013.

We have made good progress in 2009 but there is clearly more to do. Importantly we have reaffirmed our target for RoE of 15%, inspite of EU disposals and potential for regulatory capital for increases.

So let me move on to talk a little bit about our franchise. As a Group we have two major businesses in our core activities, namely our investment bank or GBM and our retail and commercial bank. We do RNC banking in three markets, the UK, the US and Ireland. We also run an insurance business which must be disposed of by 2013. We currently have 160,000 employees with 60% in the UK. We generated £32 billion in revenue in 2009 with good diversification across a number of activities and markets.

The Group is highly connected as evidenced by this next slide. We estimate that of the £32 billion of revenue in 2009, over 10% was tied to cross selling. The advantages of our Group go beyond cross selling however. Additional synergies exist around shared services like technology. And a more robust capital and funding profile.

We have dominant market shares in the business segments where we compete. Our UK franchise is number one in many market segments. GBM and GTS are top five players in most of their activities and we are top five in most of the areas where we compete in the US.

Taken as a whole, we have a significant customer base that continues to grow in spite of some of the challenges facing RBS over the past two years. Our employees continue to focus on delivering superior service to our customers which is reflected in strong results in customer service. That said, we continue to look for ways to stay focused on our most important customers and to deepen these relationships even further.

We show you several examples here on this slide on how we continue to refocus our service proposition. For example, in UK retail we have been building our online capabilities and in GBM we have developed a platinum, gold, silver, bronze rating schedule to priorities our client coverage.

Let's take a closer look at GBM and the progress we are making in refocusing our efforts. Top left of this page you see the results of a narrower and more focused business plan. Half the capital, two thirds of the people, much better results. The business is now oriented towards flow activities which generates much better turnover and utilisation of the balance sheet. We had an outsized year in rates in Q1 of last year, but we have good balance across the franchise we have built out, as we build out our credit, our DCM and our ECM capabilities.

We are also balanced geographically, with the UK generating 37% of our revenues, the US 33% and the rest of the world 30%. Our retail and commercial franchise today is much more UK centric. 70% UK, 20% US and 10% Ireland and rest of the world. We have got excellent market share in each of the geographies where we compete. Now we saw signs of improvement in our revenues in the second half of '09 led by expanding margins on asset pricing in the UK. We expect that to continue for a while.

But the RBS story is not just centred around cyclical recovery. We are in the midst of a £6 billion investment programme over 5 years that will make each of our franchises stronger. Paybacks include greater efficiency and continuous cost reduction, better customer service and increased cross selling. And a more automated better controlled environment.

Let me move on to touch briefly on our balance sheet plans. While there has been significant anxiety in the market around funding and liquidity profiles of UK banks, we believe we have made good progress already and we have a tail wind from running down the non core bank. As we run down non core assets, we facilitate our ability to achieve better loan to deposit rate measures, which will continue over the planning horizon. This gives us comfort with respect to rollover risk on wholesale funding in light of the winding down of Government support programmes. We simply won't need as much wholesale funding as these non core assets run off. To elaborate, today, we have £187 billion in third party assets in the non core which we expect to run down by about £160 billion by 2013. Our wholesale funding under a year in duration today sits at about £140 billion, roughly the same.

We still have work to do however to enhance the quality of our liquidity portfolio and to continue to lengthen the maturity of our wholesales funds. This will continue on a steady but gradual basis over the planning horizon and the cost is already included in the NIM guidance that we have given you. The new liquidity and funding guidelines by Basle and the FSA will need to be factored into these plans.

On the capital front, we posted in an 11% core tier 1 ratio at the year end. This provides a nice buffer relative to our long term target of 8% plus which will help absorb both non core losses and pending regulatory change.

Now there are clearly many proposals under consideration for strengthening capital, liquidity and funding. We believe that their thrust is sensible, but the devil will be in the details. And timing for implementation is one of the most crucial details. With banks in the middle of rebuilding capital and strengthening the balance sheets, the pace needs to be measured to avoid serious second order consequences.

The proposal that we have the most visibility into, the trading book charges on RWA's might cost us about £60 billion in higher RWA's in 2011. And beyond that I think it is premature to give numbers on the 2012 capital proposals as their shape and their timing are not yet set.

Let's move on to look at how we are reducing risk. A critical aspect to our plan is to successfully wind down the non core division. We were quite successful with that in 2009, exceeding our TPA target by £15 billion as customers delivered and paid off loans more quickly than expected. Most of the wind down occurs through run off and asset sales. We feel pretty good about these projections but of course they are subject to market conditions. Note we have made provision for rollovers of existing credits where customers are unlikely to have borrowing alternatives. This £20-30 billion estimate is roughly equal to the projected TPA balance in 2013.

So what is the non core asset portfolio? The biggest elements are corporate exposures at 42%, commercial real estate at 28% and market trading assets at 13%. The tougher elements of this run off I'd say would be the CRE book given its bespoke nature, lack of alternative financing and current weakened collateral values. Second I would say would be project and asset finance, given also its bespoke nature and the long duration of the assets. Lastly I would point to warehouse loans, given lack of securitisation take out currently. One further point, we have been asked whether the expense base in non core will glide with assets? The answer is yes, although it starts slowly and picks up steam in 2012.

On the loan management and work out efforts, we have taken action on several fronts to improve our risk profile. Our trading and monoline/CDPC exposures are now about a third of '08 levels. We have disposed of many retail and commercial operations around the globe. We have more to do there, but we are making ongoing progress. And we have disposed of several businesses, most recently our asset management business. And will continue to look at alternative for others, such as our aircraft lease business.

There is not much new on the EU mandated disposal front. We are working through sales processes on three of the four businesses and we aim to have signed deals on all three this year. On insurance we envisage a hold strategy for the next couple of years as we take steps to strengthen the business.

We gave some commentary on our near term outlook at the Results Meeting, which I will briefly touch on again. A big driver of the improving performance at RBS over the second half of the year was rebounding net interest margin. During Q2 NIM reached a NTR of 1.7% but then increased in Q3 to 1.75 and in Q4 to 1.83. This increase has been powered by improvement in asset margins in our retail and commercial franchise. We have been able to book new loans at higher margins in each of these businesses which has offset pressure on deposit margins. Of course another drag p the NIM has been our liquidity and funding initiative. We now have £170 billion liquidity portfolio, £20 billion of that is in FSA eligible governments. And the percentage of our wholesale funding greater than a year in maturity now stands at 50%. That said, we should be able to continue to absorb those initiatives and post stable to improving NIM in 2010. And as rates rise in 2011 and beyond that should boost NIM further which when the rates go up, that will alleviate some of our deposit spread compression.

On the impairment front, we have highlighted that REIL's were flat in Q4 relative to Q3 after previously showing significant increases. In addition, the case referrals into our workout group have declined sharply over the past two quarters. We are seeing these favourable trends continue so far in the first Quarter. That said, while the trend is definitely better, we still have a lot of inventory to pass through the pipe.

So let me close by saying, we feel like we are making progress on this journey to recover and rebuilt RBS. There is a big mountain to climb. There undoubtedly will be some bumps in the road, but we feel up and ready for the challenge. So with that, let me open it up for some Q&A.

Question & Answer Session

Question # 1 :

So Bruce if I might be able to ask the first question. You mentioned asset repricing in the UK market as being a source of potential revenue growth. Which areas do you see as being the most lucrative currently? And how long until you think competitors may try and regroup and actually compete those margins away? Thanks.

Answer from Bruce Van Saun:

Sure. I think it is worth looking separately at both retail and then at corporate. On the retail side, what we have seen is you know a big player like ourselves has had roughly 20% deposit share and we have had a relatively low mortgage share of 7%. And the reason was it was pretty unprofitable business for some time to do mortgage business. The securitisation markets had supplied I'd say, mispriced unsustainably cheap wholesale funds to some marauding competitors, say Northern Rock and the Conduits. At this point, with the securitisation market dried up, there has been that wholesale funding has not been there as a weapon for some of these competitors. So we are sitting there with an opportunity to take back market share and to write the business at attractive levels. So currently the personal mortgage market is a good place to be. We have lending commitments around that and given kind of the loan to value ratios that we are underwriting and the pricing, that has been pretty favourable.

Same condition I'd say on the corporate side as well. We have seen customer de-levering. Some of the loans that are being paid off were at points of heightened competition when credit spreads were very tight and as that is paid off we have been able to reprice new facilities and rollover facilities more reflective of where the cost of credit is today.

So both of those phenomena at this point I'd see continuing for a while. Obviously there will be competition that comes in at some point, but I don't see it in the near term.

Question # 2 :

[Not possible to hear question]

Answer from Bruce Van Saun:

Sure, the question for the rest of you was, we have this stoppage of coupons mandated by the EU that is close at hand. So there has been speculation about a liability management initiative and I believe I said at the Annual Results that we would be studying this. It is a carefully calibrated decision, given some of the uncertainties around regulatory proposals and we will be out shortly with the decision and tell you where we are on that. I think I said mid March so I am a little tardy on that. But I think we are pretty well to the point where we have studied it carefully. We have a Board Meeting later today, where we will talk through some of the pros and cons and I would say, very shortly thereafter we will be out with something. So a decision is close.

Closing comments from Chris Manners (Morgan Stanley):

Thanks very much.

We are going to move next door for the break out Q&A.

End