



Goldman Sachs European Financial Services Conference 2010

RBS CONFERENCE PRESENTATION

at 3:25pm on Thursday 10th June 2010

Presenter

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

Speaker Key

AI	Aaron Ibbotson
BS	Bruce Van Saun

AI Apologies for the short coffee break, but I hope you had a chance to maybe have a quick cup and stretch your legs. So we will now embark on our UK afternoon, with the three largest UK banks all presenting here. And I guess until very recently being a UK bank was generally perceived as being something quite negative, and more recently it's been a more mixed picture, and I've even heard some UK banks making the noise that it's been a positive thing being in the UK, so at least that's a breath of fresh air.

We will start off with Bruce Van Saun, who is Group Finance Director of Royal Bank of Scotland. He joined RBS last year and was appointed to the board in October. He has over 25 years' experience working within the financial services industry and that includes ten years with the Bank of New York, later New York Mellon, most recently as Vice-Chairman and CFO. And I think it's probably fair to say that of all the challenging positions you can hold within the financial services industry today, being group finance director of RBS as they continue on one of their biggest restructuring efforts ever taking place, is probably one of the most challenging jobs. RBS has been at the centre of attention I guess over the last three years, and I'm sure that you're all looking forward very much to hearing what Bruce has to say about moving RBS into the next phase. So please, Bruce, go ahead.

BS Thanks very much. And I was looking for a challenge and I have one, but I do think we're making progress. I'm going to start off here, please look at the cautionary language at your convenience, and let me move right in to an update and summarize some of the key messages about the progress we're making in rebuilding and recovering RBS. We've re-affirmed our 2013 strategic plan targets. I think we've made good progress in 2009 against those targets and so far year to date; we believe that we're positioned for a solid recovery in the medium term. We have some very robust customer franchises and we continue to service our customers very well. The retail and commercial franchises are in the early stages of a cyclical recovery, and these businesses are the ones we expect to power our way towards achieving the overall financial targets for the group. Our GBM business, the investment bank, had a fantastic year in 2009. We've also had a very strong start to 2010 in the first quarter. We're encouraged with the success that we've achieved with the re-focussed business model.

Our Non-Core run-off is continuing to meet our targets; it's important, both in terms of risk reduction, and also in lessening our dependence on wholesale funding. Our balance sheet is also getting stronger. Our capital base is solid; we continue to make progress in improving our liquidity and our funding position. We were pleased to see that S&P recently recognized this progress in upgrading our stand alone credit rating. Of course there are still many economic and regulatory threats to contend with at present, and I'll delve into those in more detail in a little bit. But at this point our leadership team is highly focussed in execution in 2010.

We've been very clear and transparent about our plan to recover and rebuild the RBS franchise. This involves a re-shaped, well defined set of businesses, and tight parameters on how they're operated. It also involves new management disciplines such as better risk management processes, focussing on return on capital, and paying for long-term

performance. As you can see on this timeline, we're focussed on many change management projects in 2010 to strengthen each of our business franchises. We expect these investments to pay off within our 2013 planning horizon. We currently expect to be profitable for the full year in 2011, and to build towards a 15% ROE in 2013. Our ambition is to re-make RBS into a world class financial institution and we've set 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 the plan. We hope to achieve a stand alone AA credit rating by 2013. We've made good progress in 2009, and so far in 2010, against these targets, but clearly there's much more to do. Let me move on to focus on the inherent strengths of our franchise, and the various businesses that we have.

The first slide here: Who are We? As a group, we have two major businesses in our core activities, namely the investment bank, or GBM, and our retail and commercial bank. We do retail and commercial banking in three markets: in the UK, in the US, and in Ireland. We also run an insurance business, which has to be disposed of by 2013. We currently have 160,000 employees; 60% of those are based in the UK. We generated £32 billion in revenues in 2009, and we have good diversification across a number of activities and a number of markets. The Group is very highly connected, as evidenced by this slide. We estimate that of those 32 billion of revenues in 2009, over 10% is linked across selling. The advantages of the Group go beyond cross-selling though; additional synergies exist around shared services like technology, and also a more robust capital and funding profile. Taken as a whole, we have a significant customer base that continues to grow in spite of some of the challenges that have faced 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. In fact, our customer satisfaction rankings in the UK, which already top our peer group, are continuing to rise. That said; we recognize that more can, and will, be done.

Now taking a look at the retail and commercial performance, these businesses today generate around 50% of our core revenues, and we've shown a pretty steady pre-provision profit level. We expect performance here to improve over time which will be on the back of a global economic recovery, as well as returns that will attain from some of the investment that we're making to strengthen these business franchises.

We've seen good growth in the UK in balance sheet measures, in mortgage loans, in our retail deposits, and in corporate deposits. We've seen very favourable asset pricing trends, in particular UK mortgages and in UK corporate, and those have more than offset the pressure that we have on deposit margins from the low-rate environment. In the US both NIM and impairments have started to trend favourably, and Citizens posted a profit in the first quarter compared to a loss in the fourth quarter of 09.

On the UK credit front, we're showing stability across our portfolios. One area where we're seeing definite positive trend of late has been in the UK: personal unsecured credit is definitely on the mend; it's showing a positive improvement. Low interest rates have

been very helpful to borrowers, but I'd say with the economic recovery still fragile, the credit improvement trends overall are likely to be gradual.

Flipping over to our GBM franchise, I'd say, to put it in current terms, our GBM has undergone a real makeover. So we've narrowed and sharpened the business focus; we've emphasized a much greater churn in the balance sheet: all of our risk capital and funding disciplines are much tighter than they have been in the past, and results so far have been really outstanding. We had a 30% ROE in 2009 in the business, and we had a 28% ROE in the first quarter; granted the first quarter is typically seasonally strong. So while these results partially reflect a favourable market backdrop, we're confident that we have here a very defensible, sustainable franchise in GBM. It's worth noting that the balance sheet used by GBM has more than halved; in particular, loans have dropped by about 50%. So while impairments in this business tend to be lumpy; our more granular, better-risk disciplines, along with the economic recovery of course, should result in lower credit costs over the planning horizon. There's a lot... This is a hard slide to read, but the gist of it is that the GBM balance sheet is also highly liquid. We've made excellent progress in orienting the business model around flow trading, so we're not carrying positions for the sake of proprietary trading and holding the inventories: we're basically moving the balance sheet, having a lot of through-put on the balance sheet.

Next would be our Non-Core business, so a critical aspect of the plan is to successfully wind down the Non-Core division. We were quite successful with that in 2009: we exceeded our TPA target by about 15 billion, as customers de-levered and they paid off loans more quickly than expected. Most of the wind-down occurs through run-off and asset sales and we feel pretty good about these projections, but of course they're subject to market conditions. Note on the right side of the page, we have made provision for rollovers of existing credits where customers are unlikely to have borrowing alternatives. The 20 to 30 billion estimate is roughly equal to that residual balance that we see in Non-Core in 2013. So far in 2010, we're tracking well towards our targets: the objective is to reduce Non-Core assets about 40 billion per year for the next four years. In the first quarter we hit about 13 billion, if you adjust for FX, and we remain very confident of our outlook for the full year 2010.

So what exactly is in the Non-Core portfolio? This slide breaks it down into major asset classes, and you see the corporate exposures are 42%; commercial real estates 28%; and the market trading assets 13%. Those are the biggest areas. And when you think about how this runs off, the tougher elements of the run-off, clearly the CRE book, given its bespoke nature, there's lack of alternative financing and current weakened collateral values. The project and asset finance asset class I'd say also has a bespoke nature and there's a relatively long duration to those assets for those who are a little harder to move, and warehouse loans given lack of securitization take out currently. Note that we have highly professional managers engaged on each of these asset classes within our Non-Core division. The Non-Core impairments dropped for the third straight quarter in Q1. We avoided any meaningful single-name hits, which is always a risk in Non-Core, given there are some significant single-name concentrations. Where we've seen improvement in the credit picture, I'd say corporate credit, clearly leveraged loans another area, and

then retail loans. Where we've lagged a bit is commercial real estate, in particular our exposures in Ireland.

So let's move on to the balance sheet which is top of mind lately, given some of the geopolitical events of the past several weeks. So while there's been significant anxiety in the market around funding and liquidity profiles of the UK banks, we believe we've made good progress already and we have a tailwind from running down the Non-Core bank. As we run down our Non-Core assets, we facilitate our ability to achieve better loan to deposit measures, which will continue over the planning horizon. So the bottom line here is we simply won't need as much wholesale funding as these Non-Core assets run off.

While you can see much progress in strengthening our funding and liquidity position over the past few quarters, we still have work to do to enhance the quality of our liquidity portfolio and to continue to lengthen the maturities of our wholesale funds. This will continue on a steady and gradual basis over the planning horizon, and the cost of that is baked in to our NIM guidance that we've given to you. We also have to factor in where the ultimate Basle and FSA Study framework land, and that will have to be factored in to these plans, but I think we're roughly in line with... certainly where the Basle proposals lie. So while the direction of travel overall is clear on liquidity and funding, and we've made good progress, the job clearly hasn't been made any easier in the past few weeks. Three-month Libor rates have risen over May into June, in particular in US dollars. In addition, tenors have tended to shorten. But I'd say on a positive note, however, the impact of this is not expected to have a significant impact on our NIM. We continue to have good access to the market, certainly on the short end of the market.

A related topic these days tends to be exposures to some of the southern European countries, in particular Greece. We've indicated the extent of our Greek exposure in our first quarter IMS, which we consider to be manageable in terms of scope, but more broadly I would say the new management team has been working hard to decrease some of the geographic industry in single-name concentrations that we inherited, and we've made some progress there. You can see that on this slide, some of the progress, but again, clearly there's more to do here over time, and we can't turn a dime on these things and so we're working through that.

Our core Tier 1 ratio remains strong. We continue to rank near the top of our peer group, and I'd say we have a nice buffer relative to our long-term target of 8% plus, which helps us absorb both our Non-Core losses, and also the pending regulatory change. One thing I'd point out is, embedded in these numbers, our APS insurance coverage provides a 1.4% core Tier 1 benefit in Q1, and that will shrink over time as the portfolio that's insured runs down. And as you know, there are many proposals under consideration for strengthening capital, liquidity and funding. We believe overall the thrust is sensible, but the devil's clearly in the details and the timing for implementation is one of the most critical details and with the banks in the mode of rebuilding capital and facing uncertain economic conditions, the pace needs to be measured to avoid serious economic consequences. And I would add that I think that there's been a very good, healthy

dialogue taking place between the industry and the regulators and I think policy-makers are certainly sensitive to these arguments.

So let me offer a few brief remarks on the outlook for several key income statement categories. A big driver of the improving performance at RBS over the second half of last year and into Q1, has been rebounding NIM. During Q2 of 09, NIM reached a low point of 1.7%, but then it's increased steadily to 1.92% in the first quarter of 2010. This increase has been powered by improvement in asset margins in our retail and commercial business. We've been able to book new loans at higher margins in each of our retail and commercial businesses, which has offset continue pressure on deposit margins, given the low rate environment. Of course one other drag in NIM has been our liquidity and funding initiatives, which will continue over the planning horizon. That said we should be able to continue to absorb those initiatives, and post stable to improving NIM in 2010. So notwithstanding some of the current issues in the marketplace, I think we're still feeling good about the NIM outlook for the balance of the year. As we look beyond that and we look into 2011 and beyond, again we expect rates to rise, the forward curve would say that rates eventually rise and that should boost them further because that alleviates some of the compression that we have on deposits today.

Another area that we're focussed is improving our cost base. We have a 2.5 billion cost reduction programme that we have made good traction on: we have over 75% of the benefit that is in the run-rate today, and we're looking for ways to expand that. I think there's more that we can do as we continue to dig into how we're operating the business, and there are opportunities to be more lean. Disposals and Non-Core sales; they also create shrinkage of the cost base that overall is a tailwind in these efforts. Offsetting these factors to some degree, the little arrows on the right, obviously we expect revenue growth, so there'll be some variable costs that go with that, and then we are making investments in the core businesses that will hopefully pay back within the planning horizon.

The next area to comment on would be our impairments outlook, and again on this slide you can see impairments in 08 and 09 were significantly elevated relative to historical levels. That said, we continue to believe we saw the peak in impairments in the second quarter of last year, and the path back to historical levels will be dependent on the path of the economic recovery, so we've seen three straight quarters of reducing impairments. My one caveat around that is, given some of the single-name concentrations we have in the Non-Core book, there could be some lumpiness quarter-to-quarter, but I think the net trend is favourable and will track back towards those historical levels.

So let me close by saying that we feel we're making very good progress on the journey to recover and rebuild RBS. There are many, many challenges, but we've remained committed, and we remain confident, and we remain up for it. So with that I'm happy to... I think we've got five or six minutes for some questions.

AI So we open for Q&A. I think I will actually kick off with one question myself, if that is okay.

BS Sure.

AI I'm not sure if you're going to appreciate the question, though. But there has no doubt been a lot of noise coming out of the... our new government in the UK, that they would like to see a separation between investment banking and traditional banking; they use various ways of expressing this view. But it would be interesting to hear your thoughts: firstly on if you think this is a real intention or more of a talk around an issue; and also if there's any way in which that could actually be executed in a way that you wouldn't have to necessarily break up the group, but maybe separate it into independent entities. I know it's a difficult question, but it would be great to hear your thoughts, particularly in light of the government also being your majority shareholder. Thank you.

BS Yes. Well, that's obviously a politically sensitive question, so I would say they'll take their time to study this. But let me just lay some facts as to how I think it needs to be analyzed. And basically if you look around historical examples of where has an investment banking been cleaved off of a universal, bank there really are none. If you look at the top 15 investment banks, the only one that's really not affiliated with a bank is Goldman Sachs. And if you look at in the rest of the world is anybody jumping on this bandwagon, I think in the US where they had Glass-Steagall on people have bandied that about, they've settled on something which is the combination of the Volcker Rules and potentially de-risking the investment banking activities to keep the broader universal bank strong by either higher capital charges on certain activities, or giving the Regulator an ability to cease certain activities or limit certain activities. So my... given that backdrop, and I won't say it's my personal view, but one might surmise that the UK will study this and see that that's probably not realistic to form that separation, but to attack it through some of the similar ways as make it... reduce the leverage in the investment bank, reduce some of the risky activities in the investment bank, maybe create some firewalls to make sure the retail side of the house is protected. And I think that's more the way the world is going. And the UK has the opportunities to see how things develop, because they've given themselves a year to put out that report.

AI Any other questions from the audience? I'm going to fire off at least one more question, Bruce, if that's okay with you.

BS Yes, fine. Go for it.

AI I just would be intrigued to have your view of basically the progress I guess and the difficulties or potential challenges in reducing your Non-Core assets. I realize that there are some that you will be able to sell as separate groups, but when you look at the last bit of the reduction, it feels to me that at the same time as funding markets becomes challenging, that will also be exactly the time when it's difficult to fund any buyer of your assets. And when the funding markets are good, you can also fund them. So to reduce your assets to free up funding might be challenging. I was just wondering to see who you see as the natural buyers of them.

BS Yes. Well, I think it's important to point out that if you look at, say, that 40 billion a year target, around 60% of that run-down comes from what we call natural run-off, and so a facility expires and it's not renewed or if we're in a syndicate and we're one of four banks and another bank steps in and takes our place, that's been happening pretty well according to the plan. In fact, we're running ahead as companies have de-levered or bigger companies have accessed the bond market. So there are also securities in there where there's payment against cash flows, so there's natural amortization of balances. So I think we will be de-levering and we will achieve that. The next issue is on the sales, probably another 30% of the total, let's call it 15-ish billion per annum, comes from asset sales where we have a pipeline of things that we're working on. We have discrete businesses in there, so we have things like the old legacy ABN AMRO, retail and commercial franchise in Asia and Latin America, which has strategic value to different buyers, and so we're making progress in getting those things done. And there's a whole business aspect of some of the aircraft leasing and different things like that that will sell, because there'll be a strategic value. And then there are other, I'd say, asset classes which again there are real money players who have less than one-to-one loan to deposit ratios and are choking on the low yields on securities and are looking to put money to work, and so we've had a good level of interest in the assets that we do have. I'd say so when we look into 2010, there were enough things in our pipeline, enough things far enough through the pipeline that I feel reasonably confident we'll still hit our 15, even though we probably were working on more than 15, and there are some things that have been parked until those potential buyers see which way the wind is going to blow here, and the rest of the year. But we always expected that, given the nature and extent of the imbalances in the global economy, that things would recover over a long period of time – maybe five years – and that you'd see a saw tooth pattern of recovery where you went through periods where things were running a little ahead of where they really were, and then other periods where they felt worse than they really were, which we're certainly in one of those periods now, but I wouldn't change my view that we'll accomplish what we're setting out to accomplish there. It might feel a little harder right now, but we got a good jump on it early in the year and so I think we have things pretty far through the pipeline at this point.

AI Very good. Any questions from the audience? If not, RBS and Bruce will host a breakout session just right now after this, on the first floor in Villahermosa and we will now have Barclays speaking in the main room just in a couple of minutes. So thank you very much and sit back, because the next presentation is coming directly.