

## **RBS Markets Round Table**

**Monday 24 September 2012**

### **John Hourican, CEO, Markets & International Banking**

First of all thank you all for coming and thanks to those of you who are on the web for joining in. We are going to talk about the Markets business today. And I'll start by introducing myself and my colleagues. I'm John Hourican; I'm the Chief Executive of the Markets & International Banking businesses of RBS. We've got Peter Nielsen he's Chief Executive of the Markets business. David Coleman, Chief Risk Officer of the Markets and International Banking business; and Chris Kyle, the Finance Director of the International Banking and Markets business.

The format of today will be about 45 minutes of, we'll present to you and run through a presentation, which we'll run fairly quickly through because you'll have it at your disposal afterwards you don't have to take notes and we won't take them back. I will do a very short introduction, will hand over to Peter who'll talk about the Markets business. And then we'll reinforce some of the issues through Chris and David doing a bit of presentation on it as well. And then we'll open it up to questions with anything you want to talk about.

So, I'll start on page five of the presentation, which is I'd like to start where we will finish, which is really the key messages that I think I'd like you to walk away with. And the first one is: since the cardiac arrest moment of October 2008 this management team has broadly delivered on everything we've set out to do. So, we have a track record of doing what we said we would do, and coping with the issues that arise exogenously, either through regulation or through the economic circumstances we find ourselves in.

The second thing I wanted to leave you a message with is that the Markets business is fundamentally a part of the universal banking group that is RBS. It houses the product engines that are relevant to and central to the customer proposition across RBS Group. The customer segments are housed in various divisions across the Group – the Financial Institutions one is housed in the Markets business, the International Corporate space is housed in the International Banking business, and of course the Retail and Commercial businesses are housed in other parts of the Group. We will demonstrate to you that the product strengths of that business are real and have been sustained over a long period of time. And the other thing I would say is that we are making progress in a, not just in a tactical way, but in a clearly strategic way on making sure that the strategy is one that can create a sustainable advantage for the bank.

So, they are the messages that we want to leave with you. And I will try to underpin with some actual evidence, which I think you'll probably find useful.

Page six sets out just a little bit of proof of the track record. In the announcement of our results this year we unveiled the promises that we made to our board three years ago; so in January 2009 we set some challenges and strategy around our business, and reinforced it at our Strategy Day in June 2009. Page six sets out what were those promises to our board against the delivery. So, we said we would make £9 billion of operating profit in the GBM business as was; we delivered 10.7. We said we needed a balance sheet of 500 billion, that's in the middle box; we actually used by the end of that period a balance sheet sum of £150 billion lower at 362 billion – and of course that is against a backdrop of a business that was running significant leverage on the equity in it at 874 billion at its height. We also did

that within the context of change in the way we manage risk; and David and Peter will talk about that particularly. And you can see the volatility of revenues evidenced in the third box has come down dramatically.

Page seven then just refers to the fact that in January this year we altered our strategy. And I would like to just put that in context. In January 2009 we made a decision to continue with providing equity and M&A advice for our customers, that this was a product offering we had in place with reasonable technology, and we thought we might be able to make that a relevant and profitable component of the business for our Group. 1,000 days in we reassessed that, not just because of economic headwinds, just because of the progress our franchise was making, and we decided that our withdrawing capacity from that market was a sensible thing to do. And we did it clinically; albeit we did it with an eye to making sure the human consequences for our people were dealt with by selling parts of those businesses rather than just shutting the whole business.

Again, we put the business through the tests of our five tests, which are about having enduring strong customer franchises, making sure the cost of equity in the medium term can be repeatedly delivered or above it; that we're using a sensible risk envelope; that the business is, in normal markets, capable of growing with an economy; and that is actually a part of the Group that is ultimately relevant to the RBS proposition to shareholders. So, we did all these, and in doing that we redefined how we present the business to you. We combined our international cash and trade business with our international banking business to create International Banking, so that you can see a fully funded customer relevant division front to back, and all the risk metrics and vertical stuff you would expect to find around it – that is now disclosed. That is not the subject of today's presentation the subject of today is an unveiled Markets business which houses the Financial Institutions Group and the product engines that serve the rest of the Group, including the Financial Institutions Group.

Page eight sets out, to give you context again, the 2007 shape of the Group in terms of revenue delivered and the use of capital, and compares that to the facts of 2011. And you will see that the Markets component of the business now is 20% of the revenues of the Group, using 23% of the capital of the Group. And we believe that to be a sustainable proportionate level of capital deployment and return.

Page nine sets out for you how we present our business. And Peter will talk a bit more about how the Markets business works with the rest of the Group. But you can see we think about it in a relatively clinical way: who are our customers; how do we serve them; are we connected. And again Peter will come back to that during the course of the presentation.

And on page 10 I wouldn't want to gloss over what we promised in January 12<sup>th</sup> of this year. We said that we were going to exit cash equities and the M&A businesses and that we would reduce headcount by some 3,500 – we are on target to deliver or over-deliver against all of those promises.

So, with that I'm going to hand over to Peter.

## **Peter Nielsen, Chief Executive Officer, Markets**

John, thank you. Good afternoon ladies and gentleman – I'll assume we have some ladies on the webcast. Good afternoon gentlemen. We'll spend a few minutes on the next ten or 15 slides, beginning on slide 12. Again, I don't presume to read them to you or the audience. It's important to say and to reiterate, as John has already said, that the Markets business doesn't function on its own; it's not something that is severable or clip-offable; it gathers its unity and its importance from being a part of the Group. And indeed the Group behaves similarly. How does it do this? By being best in class across all three pillars of the Markets and International Banking proposition: number one, Risk Management; number two, Debt Financing; and a strong capability in the Transaction Management business. We don't presume that this will be an easy strategy to deploy; everybody around this table and indeed on the webcast understands the headwinds that the industry is currently facing. We have a very clear five-part strategy to deal with those headwinds and the structural impediments that we find in the middle of the road, and we're well advanced on those strategies.

There's a different depiction of how we think about the business and the Markets proposition on page 13, but again highlighting, as it's preeminent and at the forefront of both my mind and my management team's mind, the importance and primacy of Risk Management, Debt Financing and Transaction Services. Since I met this group previously a couple of changes. On the left-hand side of the slide you see in front of you you'll see, as John has already outlined, that we now incorporate the Financial Institutions Group, our FIG group, into the Markets business proper. And in addition to that we have welcomed all of our DCM colleagues. And one of the things that we'll get into some of the changes that we made in addition to removing ourselves from the cash equities and M&A business is we are now operating that business, our credit sales and trading business, in conjunction with our DCM capabilities. And we find that that gives quite a bit more structure, quite a bit firmer exoskeleton around that business. We're pleased with the progress that we've made there.

There's another way of looking at the intermediation equation that Markets products find themselves in terms of the franchise, both across Corporate Banking and Retail and Wealth. That's depicted for you on the left-hand side of the screen. And then not to ignore the almost £2 billion of revenue that accrues to the rest of the business through the sale of Markets products in other divisions. And those are material accretive amounts of RoE that derive from that. It's not a one-trick pony, it's not just a UK franchise, as you can see on slide 15. This is well diversified across the range of both the bank's Corporate as well as Financial Institution clients, we're well diversified across the range of geographies that we operate in and also across the range of products that we behave in.

A couple of minutes on the numbers, beginning on slide 16. On the left-hand side you see the kind of ineluctable math of the revenue and cost equation, and in addition to that the headcount progress that John has already alluded to across M&IB, but you'll see across Markets the progress we've been able to make since the end of 2010 through halfway through 2012, and indeed the front office component of that. This is ex, so this is net of what has materialised because of the equity move so this is a like-for-like business Dec 10 against June 2012, with a reduction of 16%. It isn't just heads, they are a critical resource; but they are not the only critical resource. And we measure our productivity, as we'll see in subsequent slides, against both our balance sheet as well as our risk weighted assets or our capital leaving the mathematical results of our RoE on the right-hand side of slide 16.

17 and 18 give you a little bit of insight of the lens we look across our businesses. And again the data and comparisons on 17 and 18 are not our own data they're performed for us by the industry by Coalition Partners. You can see they're across all products offered by all investment banks, that we're sitting right at number ten, nine, ten, 11 which is kind of where

we've been for the last year, 18 months. However, very importantly across the products that we are in, and that makes sense for us, that are important to us, and most importantly are important to our clients, which is ex-cash equities the commodities business and exotic credit businesses that we have removed ourselves from, you can see that last calendar year, the full year 2011, we ended up at number five. That's across all of the debt rates credit and currency businesses. The southwest quadrant of that slide depicts the same result; you just have a little bit more breakdown in terms of the actual products represented. And the important thing here isn't five versus four, or five versus six or seven, but if you leave aside the other globes top three in those particular products – and I think we all know who those are – we find ourselves very firmly in that next rung of competitors. And we're finding it easy to be very relevant to our client base from our vantage point. And it isn't just that revenue vantage point that obviously is important the profitability and bottom line is kind of the key metric of who's getting across the finish line in the best shape early. And we look at our business across both profitability, across how well we're doing and how efficiently we're doing in generating those returns across an individual unit of balance sheet. And again, the bottom right-hand corner of slide 18, our IFTA results over our trading assets.

The headcount reduction – again this is Coalition data this is not our data – shows us in pole position at kind of a 29%, 30% reduction in headcount. That's probably flattering. There are some things that they do in terms of the denominator, including non front line sales and trading individuals – the numbers that I showed you earlier a few slides ago I think had a 16% reduction, but whether it's 16 or 30 we find ourselves on the proper side of that particular depiction of all of our competitors.

We'll spend a few seconds on awards. We don't run the business for awards, awards are nice to pick up. They're industry and client justification or identification of what they think we're good at. We're pleased with our position in the rates businesses, our position in the main portion, the major currencies, the euros, sterling and dollars, both on a primary dealer basis as well as our investment grade business we're pleased with. Our Global Securitisation House of the Year award last year was particularly pleasing, our first Global IFR cap. It is interesting, as somebody has pointed out to me, that after managing the same management team over four years, since we had our cardiac event that John referred to in autumn of 2008, we actually picked up more awards last year from IFR in the DCM businesses than we ever did during the bull market years. So, that was particularly pleasing to see.

Do we think that it's all smooth sailing ahead? No, we absolutely don't, the array of challenges that the industry face and then we face are truly seismic, the movement of plates, the geographic plates underneath the industry are not stable as you gentlemen around the table understand. And indeed, we continue with some idiosyncratic risks, both on the client franchise and people challenges that we're also focused on. We think we understand them, we have those risks well enunciated, they're well understood by myself and the management team, and we have strategies in place that are summarised on the right hand side of slide 20, and the subsequent few slides that we'll spend a few minutes on.

First, and most important, slide 21, our product strengths, these are our core products, we're proud of them, we're not ignoring them, and all of them are undergoing either to a greater or a lesser extent, a fair bit of change. I won't read the slide to you, but I'll highlight again the progress that I think we've made on the credit market side, taking our credit trading sales and the sales and trading and structuring and research business, and appending it to the banks, the DCM franchise, and running that as a credit vertical has paid dividends for us this year. So no longer spraying liquidity around and up to six and a half thousand credit curves, not that we were doing so, but you can dilute an awful lot of effort in both the European as well as the US credit businesses; and we're substantially more focused on the bank's

particular client franchise and offering support on the origination, sales, trading, structuring and research side to those particular counterparts.

And just a word or two if I might on our asset backed products, we're justifiably proud, we think of our mortgage business or our ABP business, it's not just a US business, there's obviously a substantial number of cylinders that operate on the US side of the Atlantic, but it is well and truly and global business. The clients of that particular business, the seekers of assets that we target, are increasingly interested in those assets coming out of Europe; they're either setting up funds here or they have a substantial amount of funds to deploy to purchase assets that have as their origin this part of the world, and we find that our sales trading structuring and research capability in ABP is increasingly relevant as we look at what Europe is doing to put back together the kind of one and a half to two trillion dollars worth of disaster that they've got in mortgage product that line and litter the balance sheets of many of the banks across the continent. We're finding that that's a quite fertile ground to till.

The products don't make any sense without a few words on our client base, our FI client franchise and our corporate franchise are arrayed for you on slide 22. Again, just to pick out a couple of highlights, you can see we have quite a large percentage of our FI franchise that is focused on banks, you'd expect that from our position and where we are in covered bonds and UK building society as well as the European franchise, and we're happy with that. We find ourselves a little bit overweight, and less well represented across insurance and the leverage community and on unleveraged asset managers so we're attempting to migrate and make sure that the relative importance of those last three categories of FI client continue to get the focus that we know that will allow us to remain successful.

Our corporate franchise, the origins of RBS and NatWest are on the corporate side as you gentlemen know, and we're pleased with where we are going into the second half of a very busy 2012, being number one, two or three in the UK since we took over, and number one in the continent, the EMEA investment grade, and that is excluding the high yield market. And so we talked about products, we talked about clients, and those are obviously very important but we can't forget what I referred to as the three Cs, so increasingly myself as well as the senior management team, are focused on control, on cost and on capital, with an emphasis on control. This is the new central furrow of our business and you can't expect the mistakes that we've seen from some of our other competitors, whether it be UBS or JP in the news that has caused us to want to back up and look again harder at all aspects of our business. And both myself and David will have more to say on that particular item.

You can see that we continued to spend above historic levels as we continue to reengineer the business on the tidal wave of regulatory change that on its way requires that we continue to do so. You can see the risk and control agenda on the right hand side of the slide in front of you, there's a little thumbnail there, a little vignette that David will have more to say about, but it gives you a little bit of a taste of what we've been able to do in the business in removing and reducing the historic stress.

I know there'll be some questions at the end on capital, and what is the business doing about optimising its use of capital, especially with all the headwinds that face us, and if you look at the numbers that were displayed earlier or indeed here, June 11 to June 12, 107 to 108, it looks like nothing's going on, but nothing could be further from the truth. That looks like a calm and static number, but the paddling that's going on underneath the water in order to keep those numbers there, it almost defies belief. We have scores and scores and scores in fact across the business, literally hundreds of people that are focused on model remediation, actual hedging that can take advantage of the new models. You can see that we've been able to through a variety of efforts and are happy to take questions on it or delve into the specifics, but we've been able to ameliorate virtually all of the Basel two and a half

CRD III as well as the increases that have attended the new corporate models over the period of the last 15 or 16 months. And we hope to continue on that path.

How are you going to continue to keep that revenue going? We're continuing to manage the balance sheet. We're pleased with the progress that we've made so far, so we continue to sweat the balance sheet, we continue to sweat the assets that we have, and indeed as John has highlighted in my initial slides, we have been able to do so with actually a smaller balance sheet going into the end of the first half of the 303 number for all our markets and this is just constant and continuous hard work. This is reallocation of resources that we're not being paid for in terms of repo lines to clients that are not paying their fair share in terms of numbers of transactions and being more rigorous and more clinical about that. And continued reallocation, both within client segment as well as geography as we become more and more scientific about where those valuable resources can best be deployed.

We look at the business both on a filled up bathtub basis as well as the hot and cold and warm water coming into the bathtub, so that's our back book, we literally have scores of people working on and, indeed the entire sales force continue to focus on how do I make that back book, how do I make that existing bathtub of transactions behave better, both going through the Basel two and a half and looking at the Basel three numbers. And there are lots of different metrics, there isn't a day that goes by that we don't have a restructuring of an existing transaction that comes across my desk. Some of them are big, some of them are relatively minor, but they do all add up. And one of the points here, the third point in the top section, refers to the tri-party risk triangulations, we've been very, very active in this in the first half of this year, the number of transactions that we've run through TriOptima is in excess of 55,000 and we anticipate that there won't be any cessation of that particular deal flow.

We're seeing a number of products change the way that they behave. Our inflation business is no longer pricing, the industry doesn't price 30 and 40 and 50 year transactions without break clauses, all of the later data transactions that come from the demand of the LDI or the pension funds have three and five year break clauses and we're seeing a number of the sovereigns, or near sovereigns, that used to be completely uncollateralised and used to take offence and affront if we suggested that we wanted a two-way CSA and we're seeing that change as well. In fact our own Bank of England has recently made some massive strides in that regard.

Not just focused on RWAs but overall size of the balance sheet, the right hand side of 24, gentlemen, it tells you what we've been able to do on the revenue side across 2010, '11 and '12, versus where we're taking the balance sheet. We are capable of generating the returns on fewer assets.

Are we positioned for market structure changes? I think we could spend the rest of the afternoon on what's happening in the market and what the likely impact is and I don't think anybody knows yet, so it's like sitting down and having a conversation on ICB, the timetables are fluid, the actual makeup of what elements are going to happen when continue to be fluid, what happens on either side of the Atlantic also continues to be under avid discussion as all of you sitting around the table know. But certain trends, certain directions of travel, migration away from over the counter derivatives into cash securities and futures is well underway, we're already seeing that as one of the ramifications of the direction of travel, and we feel that we're well placed to be able to capitalise on many of these initiatives.

And finally, we aren't able to do any of that, and we're pleased with what we've been able to accomplish over the last four years, but we wouldn't be able to do any of it without people, and we feel that we were early on, that we had to be, we came out of the emergency room

after our cardiac event, and we were early with the debate on people, the people agenda, at maintaining the engagement of our staff, and maintaining that dialogue. We went into 2008, when John and Stephen offered me the position, and my nine direct reports from the autumn of 2008 eight are still with us.

So I feel very fortunate that the team that we went into this with are still there four years on, and we wouldn't have been able to do that without that. We're spending a great deal of time focused on the level of management underneath them at the moment as my direct report are very involved in the regulatory change, the industrial change and the change in the microstructure as well as the macrostructure of the markets, we are asking more of the leaders underneath those individuals and I'm pleased to say that they are responding.

And then finally, we are, and we feel that we've been leaders in, emboldening and paying attention to that bottom layer of the pyramid as the industry recalibrates and retools the type of individual that it attracts and is going to attract to maintain the health of the industry in upcoming years and in fact decades, that introductory layer, that analyst layer and graduate layer has received a great deal of attention up and down my management team and indeed from John himself. And we're pleased with the other progress that we've made there.

I think I'll ask Chris to say a few words on the numbers and then David and then we can turn it over to questions.

### **Chris Kyle, CFO, Markets & International Banking**

Thanks Peter. Page 28, one of the reasons that we've shown the numbers in the way we have here, is to unveil part of the story that Peter talked about earlier, which is there is a significant element in the markets income which is paid away before it's actually reported in the statutory numbers, so you see here that in terms of 2011 there was 767 million of revenue paid out of the division to other parts of the Group. So actually the underlying business is substantially bigger than our reported numbers because of that estimate. You also see, though, that in terms of those revenues H1 to H1, that there has been some economic stiffness in terms of those revenues in relation to levels of the client activity.

If we talk to the contribution number, you can see that in terms of operating profit, there has been headwinds of around about £350 million; those are broadly broken into various pieces. In terms of revenues, the revenues are down £400 million H over H, that's broadly in our ABB, Asset Backed Business, about £200 million, and in our investor product area about £200 million. All other products roughly similar in size and magnitude. We believe the overall results are pretty much in line with our peers. What is quite different is that we have been putting a very strong focus on our cost base. You can see that in terms of the H-on-H movement, we have taken over £200 million in costs; that does help the contribution reasonably significantly, that downward trajectory is on-going, there is a lag in terms of headcount leaving and costs following that. So, you can see that in terms of the staff cost, that is down about 15%, and I'll go into more detail later on. And in terms of Other, there is two headwinds going on in that number, which is effectively increasing the investment cost, but a hard focus on discretionary spend. And the more sticky part of our indirect expenses is clearly the property technology and group functions.

You can see that in terms of overall impairments, there is some small numbers backwards and forwards. We had in H1 (2011) some reasonable small recoveries, and in H1 this year, some small pay-aways, but a reasonably clear number that in terms of ebbs and flows, small numbers in both directions. So that gives you an overall movement in terms of profitability of about 300 down.

The other thing I will point out to you is you can see what Peter talked about in terms of RWAs: it isn't a straight line; there are aspects where mitigation follows changes in regulatory rules. You will see that in H1 2011, we had RWA impact of 107, which rose to 120 by the end of the year, and that we have taken a series of mitigating actions to bring that back down to that 108 number that Peter talked about.

If I turn over to page 29, I think the other side of the story is the work that we've been doing in terms of the quality and absolute size of our balance sheet, and also the efficiency in which we're trying to squeeze how that balance sheet is funded. So in absolute terms, if you look at the balance sheet, it has fallen from 338 to 302, round about 10%. If you take out deals pending settlement, which can be a reasonably jumpy number, reasonably volatile number, that's around about 15%, like-for-like reduction in TPAs over that period. If you look at the quality, as depicted in the pie charts, you can see a large part of the biggest parts of our balance sheet is highly liquid and also of a high grade. So in terms of reverse repos, you can see that 76% of that is in the rate space, the rate space being dominated by effectively the top five governments that we trade around the world.

In terms of debt securities, you can see again the rates business makes up about 50% of that number. Money markets is effectively pledgeable assets held within the money markets business, so around about 11%, those pledgeable assets have to be, by nature, liquid and high grade. And then in terms of the 28% in the asset back business, again a mixture of that is in high grade asset backed securities and mortgage backed securities, and David will talk a bit more about that in his presentation.

The other thing I'll point you out to is the third party liabilities. You can see how we have been trying to improve the funding of our third party liabilities if you look at two items, which are effectively debt securities in issue, and deposits uncollateralised. That effectively is a proxy to the amount of money that we have to take in from the market place to fund this business, and you can see that that number has been falling steadily since 2010, the £87 and £49 billion coming to £136 billion, falling to a rough £93 billion overall. The following page will show how that's being deployed within the business. Equally, this is part of a group, so there are money market operations that affect the rest of the Group.

So turning over to page 30, it gives you some sense of how we're trying to squeeze the efficiency of our funding. You can see that in terms of the two charts here, the first one shows the absolute, the unsecured funding requirement, and this is what we believe is the refunding requirement, as opposed to the funding absolute, which I showed you in the previous page, has fallen from £83 billion to around £70 billion in the first six months of this year. What drives that £70 billion? You can see that in, effectively, the pie chart beneath, a number of things require funding: payments collateral, going back to what we talked about, this is the money that we put into payment systems around the world to facilitate this activity. There is lending within the business, which is effectively the FIG business within the markets activity. Derivatives collateral, which is effectively the haircut on derivatives in one direction. So those are the things that we know we have to fund, if it's not being funded from other sources, and then we have been driving down the inefficiency in terms of securities not repo'd, equity securities not borrowed or lent, and then there are other things like local liquidity buffers and central holdings of cash for reserves. So that shows you the efficiency that we've been trying to squeeze out of our funding balance sheet.

If we talk about capital, I think you saw in page 23 the story of how regulatory change can happen, and then what we do to mitigate that impact. We believe that we have a similar story for CRD4, Basel 3; we believe the net impact of those regulatory changes will be around about £35 billion on this business. We believe that over time we will be able to further mitigate that increase by around about that number. We've given you the big headings here,

portfolio restructuring, effectively the novation and redeployment of various assets, various exposures, in a way that makes us much more efficient under Basel 3. There is various detailed mitigation work that we are doing, and as Peter talked about, we have an army of people looking at our overall deployment of capital, on a line-by-line basis, seeing if we can improve the efficiency, be that from netting, be that from a credit quality, be that from just improving the overall way that we manage this business, and then we have some various other mitigating aspects where we believe we can drive the efficiency of our capital down in the medium term to, again, around about 110. So it looks like a very similar story to CRD III, but actually it's more of the same, it is a similar story, but the timing of that is unclear. We are working on the basis of what we're hearing in the market place of an implementation of early H2 2013.

In terms of the cost story on page 32, I think this gives you a little bit more detail as to what makes up the cost base. You can see that the front office cost pre the run-off businesses, so the run-off businesses are shown separately here, but on the like-for-like businesses that are maintained, we have squeezed front office costs by 15%, H over H. We have done a similar type of percentage in our back office costs supporting those businesses. The run-off businesses, which effectively you saw the income being extinguished in H1 of this year, you can see that those costs are being run down aggressively from £132 million to £60 million in H1 of '12. You can see that we have a slight headwind in terms of investments spend, where the depreciation and written-off costs in relation to that investment portfolio is a slight positive, from £143 to £149 billion, and then you see a bit of stickiness in our group costs, which are broadly unchanged, half over half, those representing property, IT infrastructure, like data centres and the hard wiring, plus group functions. And I think I'm going to hand back to David Coleman now.

### **David Coleman, CRO, Markets & International Banking**

Thanks, Chris. Good afternoon. I'd like to start by moving on to page 34 and just briefly touching on the control agenda. As you might imagine, after the events of 2008 we conducted a rigorous, and continue to conduct, rigorous reviews of our control environment, and have enhanced, substantially, and continue to enhance, our framework. This includes what we expect of our staff, and for those defined here in the first line of defence, we're in a substantial stage of defining for these people what their roles and responsibilities are, what they will be held accountable for. This runs from the job description, their goals and objectives, all the way through to having the control agenda at the heart of their appraisal and their incentives. And this is supported by the second line of defence, conducting challenge sessions and testing of the day-to-day activities. In the realm, what we're looking for is a proactive risk management framework, and the way in which it's conducted by staff is proactive and of helping us to avoid the major pitfalls that the industry and the company face from time to time, and we're going to illustrate where we think we've been successful.

Let's move on to page 35 and look at some of the components of those changes to our framework. Let's start with risk appetite. We've established a risk appetite for the business, from the top of the house, that affects our strategy, for the Group and for the business, right the way down, cascaded into, even down to the asset classes that we manage day-to-day. We use stress testing extensively to analyse the outcomes of the portfolio that we have, and to measure them against parameters such as earnings volatility and capital constraints. In particular, one of the key components of changing the nature of this business has been implementing dynamic limits, which move automatically, depending on sales turnover, market liquidity and credit spreads, and in this way we've managed to change the nature of the business so it becomes more dynamically responsive to change in market volatility and changes in liquidity.

As you might expect, and as Peter mentioned earlier, when we see events in the market, such as UBS and JP Morgan, it's incumbent upon us to make sure that those things couldn't happen here, and where we find that there are things that we haven't thought of, or need enhancing, that we take steps to address them. In addition to all of this, we're facing, as an organisation and as an industry, a generational change in regulation, which we've been seeking to influence, engage in, estimate its impact on us, as you've seen in some of the earlier parts of the presentation, and then prepare ourselves for that implementation. As a result of all of these things, we believe that we have created an environment where the management and the people that work for us are proactively engaged in managing our business, and particularly you can see that in the way in which we've de-risked the business over the last couple of years in the face of emerging events. I think we were successful in being ahead of both the Eurozone situation and last year's more illiquid and more volatile markets.

Let's take a look at some of the metrics on the next couple of pages to bear that out. So, on page 36, the aged inventory at the top left-hand side, we can see how the dynamic limits in the face of those changing environment have helped to force the management of this business. And in the bottom left-hand side, we can see that of the total inventory that we hold in the trading business, 95% of it is investment grade. Moving up to the right-hand side at the top, VaR is the orange line and is the traditional measure by which you are able to see the banks publish their exposure to market risk. As a single measure it has limitations, and for us the historic stress measures are more valuable, and in this respect, the blue line, we've taken approximately 50% out of our risk exposures over the last 12 months. And if we turn to the bottom right-hand side, that all plays its way out in terms of the reduced volatility in our earnings.

If we flip over the page to 37, and we look at the widened sense of risk management in this business including all of the counterparty risk and other exposures, the geographic distribution, in the top left-hand side, reflects our footprint, it mirrors a dominant part with a reasonable distribution elsewhere in the world. And also on the right-hand side at the top, the sector distribution dominated by financial institutions, but with a spread of other sectors for our corporate clients. Asset quality we've covered in part and is similarly reflected here with 84% investment grade included in that counterparty exposure. And on the right-hand side, to demonstrate the comments that I made earlier with regard to how we manage the peripheral Eurozone issues, we can see in our Sovereign exposures the dynamics of that business. In the early part of this period we took action with regard to Greece and so on, and in the latter period, when we become uncomfortable with the volatility in Italy, we've reduced that as well, and more recently, we've allowed the business to grow back into some of those liquid sectors, as you can see at the end here. But in all and all, a well-managed business around this particular event.

If we turn to the final slide in the risk section on 38 what we see here is that component part that's not the trading inventory but the counterparty exposure, and a slide that's probably similar to many of those that our peers produce, illustrating the benefits that we get from netting, collateral and then the base £28 billion as at June of our mark to market breakdown that's unsecured and how that's split out between investment grade and non-investment grade, and the trend with which we've been taking in terms of managing this. We have a counterparty exposure management team who is proactive in looking at ways of improving our documentation, our collateral, our pricing and most importantly looking for opportunities to reduce the amount of transactions through tools like TriOptima and other industry standard methods. The net result in the final piece of the presentation in the bottom right-hand side is that our counterparty exposure has a falling trend line as a result of that action, despite the fact that the mark to market components are very volatile, and with that I'll hand back to Peter.

## **Peter Nielsen**

I'm happy to turn it open questions here. In sum it's a business we're proud of, it's a strong business, it's important to the Group and the Group's important to us. We think we've accomplished what we set out to do. There's more to do, we think we know what that is and we're making progress. John I don't know if you had any...

## **John Hourican**

No I think we'll open it to questions and hopefully cover any further items you might have.

## **Questions and Answer sessions**

### **Question 1**

#### **Tom Rayner - Exane BNP Paribas**

Just on slide 16, looking at your medium term targets, return on equity and size of balance sheet and capital. I'm just trying to get a sense for how much flexibility you think you'll have if the revenue environment doesn't get any better or maybe gets worse, I mean would you seek to deliver those returns by more aggressive cost management or possibly by shrinking the balance sheet more than indicated in these targets? I'm trying to get an idea of the mix of which you could actually end up with your target level of return?

#### **Answer: Peter Nielsen**

Well I'll have a crack at that and I imagine Chris will as well. I think all of those variables are in play or might be in play. I think the third quarter that we're seeing a little bit more optimistic outlook than certainly I was looking for. The origination markets are kind of open and open wide and the behaviour of clients who have been geared towards taking advantage when the window's open has meant that that's a busier August than I've seen in a number of years. So there's a little bit of a ray of sunshine on the client behaviour side I think, and I'm not suggesting that we're back to '09 and '10 levels of client activity but it's better than we had thought we might see. Those are medium term targets on TPAs. Chris has identified some of the difficulty in triangulating where we might be on the RWAs and when, and that remains a non-trivial quadratic equation. But I think the message to take away is the team has, it isn't a static plan we put in place at the end of '08 or '09, we have adjusted that plan during the first three years, we adjusted it in a pretty discontinuous way at the end of last year. We're ahead of those targets. I think we're, if not in front of, at the vanguard of the institutions who are dealing with the excess capacity that remains in the industry and I think we have a management team that's well equipped to be able to take additional steps if we think that those are necessary.

#### **Further question**

Is there any issue of minimum efficient scale in some of the old businesses because I guess there comes a point where costs just can't be cut any more so the option becomes to shut the business down rather than keep...I mean how do the...in your core big businesses...

#### **Answer: Peter Nielsen**

It's a good question and if you go back to some of the original slides that we pay attention to, not just revenues but results and efficiency of that next...the fixed income and DCM

businesses have a little bit bifurcated into the top three and this next four, five, six in many respects. And as long as in most of the respective markets and products that we remain in that second category there really isn't anything that we feel that we're prevented from being able to offer to our client base. Now were that drift down in our chosen clients to outside those groups undoubtedly there's a question of scale with one or another of those products or one or another of those geographies, but we don't appear to be there. And indeed the work that we've done I think the decisions that the management team has taken on making clear decisions on M&A and equities is that we realise you can't just run through the business and take 3% off, 5% off, you need to be very, very clear about what you're doing in which geographies and so in that respect I think we've been quite discreet.

**Answer: John Hourican**

And as we've analysed the business for those strategic choices, not just recently but at the beginning, we size the use of resources to make ourselves relevant to a market as well and the market is the customers. So we do, as a matter of natural strategy, look at the size of our business, the size of the technology you're deploying, the requirements for volume for information, all of those things are natural components of making good businesses. So I think back to your point we're focused on making a return, a repeatable return. You'll notice we've taken the costs down quite hard, we continue to watch the costs. The business will remain existentially challenged in my mind and Peter's mind and the management team's mind until it demonstrates it can, through many different optics, deliver the returns through that constrained optimisation lens that we are putting it through religiously. So it's another way of belt and bracing what Peter has said, we are looking at the components of return on equity in the context of a resource deployment, recognising its scarcity. That's the way to think about the business and that means you make choices about business you're in rather than the strategic tourism of some of the predecessor organisations.

**Answer: Chris Kyle**

One of the reasons that we put slide 28 in in the way that we did was because I think one of the things that our competitors do is show their revenues gross whereas we show our revenues net. So one of the things that we tried to give you there was that sort of sense that there's £360m of revenue that we take out of our reported line and put into other divisions, we think other peers actually leave that within their IBs and so that gives us a bigger sense of scale. I think in terms of the cost that cost trajectory is a very firm downward cost trajectory in terms of the 1.7 number that we've got here.

## **Question 2**

**Manus Costello - Autonomous**

Thanks for the extra data you've given us here in the appendices. I'm just looking at slide 44 on your Asset Backed products. I'm interested in the non-agency US business which is a larger chunk of your Asset Backed business and it looks like it's about sort of 13, 14% of overall markets' revenues, I wonder if you could explain what the headwinds are in that business going forwards because it looks like you've got it shrinking and give us an indication of why RBS markets in US non-agency still has that as a core product?

**Answer: Peter Nielsen**

Well it continues to be a core produce and even as recently as the last month in an environment where we're lower for longer it appears to be the message coming from the globe central banks that the non-agency space and some of the more, the trickier bits of the

agency space appears to be where there's still five, six, seven and 8% yields available. So it does so. So this continues to be, and it's an important capability that we have. We're very fortunate our sales and trading and structuring and the risk management team, all of them I think are amongst the globe's best. If you go back, and many several of you have done this work around the table, if you go back and benchmark our returns in this product area I think we do end up in the globe's top handful.

Now that doesn't mean that we're not always analysing that business with an eye towards where is that going to be in the future, and we feel that the gains that have accrued to that particular slice of the business has been a good run. It's been a good two and a half years and we're not anticipating that that necessarily will continue. And if you look at what we're doing on the balance sheet side in our holdings within non-agencies you can see that they have come down and we're planning for them to continue to come down. If you look, in fact, on what we've done on the US agency side and also we can't forget the ongoing different capital treatment which will hit part of that US non-agency business as we come into a different capital regime. So we are planning for that but we're attempting to quite deftly manage the timing of that. The people who plan for that too early would have missed in the last 12 or 14 months, which we haven't. So we're pleased about that.

**Answer: John Hourican**

Do you want to talk about its contiguous nature to rates in the US and to the European business?

**Peter Nielsen**

Well that's exactly right, John. So I think the question was specifically around non-agencies but the mortgage business in general and the relevance that we have to our clients who come to us for just non-treasury it does something outside the treasury call, obviously we're an important treasury call for dealers in the States and other clients in the States, but our relevance in US agencies which are on an option adjusted basis are quite close to some of the other treasury markets, as well as non-agency businesses and it broadens and in fact leavens out the other client offering. And then you add to that, if you exempt the US high yield market and deals underneath £250m, I think that we're right behind the top three in terms of US DCM, at number four or number five. So it does if you take the US treasury business and you take our mortgage business in all facets, the agency business as well as the non-agency business, our DCM and credit business, those portions of the US credit business that we think we can be very relevant in, that all of a sudden is something that has the requisite economy of scale to be significant and relevant to our clients. And we think that that's...it's not just US so again, as I tried to allude to earlier, the clients that come to us that started two and three years ago to come to us for those offerings now all of those clients are coming to us, it's kind of first or second call, what have you got in Europe? So our avenue into that client base, into that pool of assets is exceedingly important as we try and restructure and place the European equivalent of those assets. The people who have tried to do it in Europe without the US anchor find it very difficult.

### **Question 3**

**Jason Napier - Deutsche**

Three questions on slide 32 please. The first is the headcount split I'm just trying to understand what investment means, it's a fifth of the headcount base and I just wonder whether that's something that shrinks as you go from spending £700m per year annualised, does it naturally fall off or...

**Answer: John Hourican**

It's mostly change professionals and IT and process re-engineering.

**Jason Napier**

So over time you'd expect that number to fall?

**John Hourican**

Yeah that number would round up after we took on the task of restructuring the Group in 2008 and has remained high and it goes back to Chris' slide which shows the level of investment in the business over the years. I think in a world where the level of change is at its max across every financial institution this will remain high but it isn't correlated with P&L today, it's correlated to the P&L as the depreciation of that investment cost comes through.

**Answer: Chris Kyle**

If you look at a combination of page 32 and page 23 you get a sense of how the two interplay. The exception is in '10 and '11 there was quite a significant investment in what I would call hardware investments of data centres, cables, resilience and various things like that; so that had a high cash cost but a low headcount number. So actually the headcount this investment number is playing to is around about a £350m type number. A lot of that now is being redeployed more towards the regulatory and compliance issue and making sure that we're in a good place for that over the next two years, but after that you'd expect that number to come down, but all be more redeployed towards the business or be more balanced. So that number should come down but not necessarily in the short term given the amount of regulatory pressure that we have.

**Further question**

Okay and then following on from that, if you look at the evolution of headcount between front and back office, the ratio is flat at 2.1 to 1, back to front. I just wondered whether the sort of investment in, as you say, hardware, data centres and so on should be reflected somehow in a mix change in the business, whether there is a more efficient RBS somewhere out there in that respect?

**Answer: John Hourican**

You're right, and that's exactly the paradigm that management are chasing. I think if you were in ceteris paribas in 2008 to today you would have achieved some of that, but the sheer changes in regulation legislation, prospect of... organisation of the industry has eaten up much of the efficiency that might naturally sit today in the P&L, and we will go chase it again, but it is a constant journey.

**Answer: Chris Kyle**

But again if you look at in quantum in terms of cost broadly falling in line that the headcount can be... although the headcount is a good proxy to cost it's not necessarily a perfect one because we have done a lot of work in terms of reducing the cost of FTE by offshoring and outsourcing and various things of that nature. So you are seeing that trajectory. There is a lag, I mean clearly as Peter shrinks the capacity in the business you'd expect the back office

to follow shape, but it's not always one for one in the same time zone, so there may be a bit of impetus in that space as well.

### **Further question**

That was actually the third question, and we don't have all of the numbers in the time series here, but it doesn't look like front office per capita costs have changed a great deal, sort of half one twelve and half one eleven and I just wondered, one of your peers in Europe has suggested there's quite a lot of work to be done on per capita pay. Is that something you would agree with or...?

### **Answer: Chris Kyle**

Difficult just to do the maths for the accounting numbers because of the way that the accounting kicks in, because there is a fair element of deferral and of course we preceded quite a lot of our competitors in terms of implementation of deferral so we're not necessarily in the same step. But industry-wide...

### **John Hourican**

I think we would agree, but we have been on that journey actually proper... if you look at the proper cash compensation costs of employees in general and then split it you will see that that trend is absolutely in place already. What you're not necessarily seeing is it comes through in the accounting. So if you continue to shrink you will not see that shrinkage cost come through until you've gone through a period of deferral, and in fact one of the cleverest – I'm sure you've already done it – questions you'll ask is to break it down between what's being accrued and created and what's coming through from prior years, which has got literally nothing to do with this year's revenues.

### **Further question**

But isn't that the sort of outline for costs for next year is sort of more of the same there's no huge moving parts in the strategy that should reflect in a markedly different cost number for 2013?

### **John Hourican**

Should we continue to tighten our cost base?

### **Answer: Chris Kyle**

You should expect to see that trend continue in the next year.

### **Question 4**

### **Andrew Coombs – Citi**

Just a couple of questions on slide six on the five principles that you have applied tests. The first question is how granular, to what extent is that applied so over how many product lines would that be applied, or is it a case of you would lump product lines together to come up with the five major product lines?

**Answer: John Hourican**

We tend to look at it around our customer offering first, and then we tend to look at it every way. So we're looking at it in terms of major product groups or... it's a filter through which we put all management decision making. Of course it's not the only filter, but it is.... these are the tests that this business that Peter and I run, the guys run, must achieve for our group shareholders repeatedly over time. And inside that business there will be businesses meeting, exceeding and not meeting those tests in various bundles, which will get more management attention depending on what stage they're at. So it isn't quite as simple as saying if you meet it you're gone, or if you meet it you're in, if you don't meet it you're out. It has to have absolute customer relevance over time, and it has to meet our view of a changing world. But these are fundamentally the simplified sort of management maxims that cause us to make decision making over time around our businesses, and in particular around our customer segments, so we must look at the customer first and then say what is it that we engage with our customers on, and do we have relevance for that customer, both sides of the equation.

One of the things that I think is very important is our customers are both sides of the market in this particular part of the bank, as opposed to just serving a one-way customer market. But these tests are very straightforward, do we have competitive positioning is the first one, and it's how you interpret it. Are we capable of giving back to the shareholder the return of the capital deployed through a lens? Are we satisfied that the risk community are comfortable with the level of risk we're running in various dimensions, and it won't just be in pure capital and P&L, it'll be in leverage and volatility and event and historic stress and various other ways of looking at it. I don't mind the business not growing if the economy around it is not growing and if market shares are static or there's changes, but it needs to be capable of advantaging ourselves in a growth market, were that market to grow, and then of course it must have a reason. I mean we could have a business all the way over to the side serving a customer group that doesn't connect in any way, shape or form to the Group, and that business absolutely is a business that you would sacrifice over any other decision around a customer.

**Further question**

What do you classify as a top tier competitive position, and the reason I ask is if I look at your credit position in the back of the appendix you talk about a number ten position there, and if I look at your FX and rates business it's very much geared towards G10 rather than emerging markets, for example. So I'm just trying to work out how you think about it on a sub level?

**Answer: John Hourican**

Well again it's the technology that people, the capital, the customers, in a clearly defined market. So G10's quite a good one to think about it, and Peter can talk about this. But a credit one we would look at is we reorganised the business so that the primary activity was doing debt capital market activity for our customers, and making sure we were advantaging our market making side of the business with those customers. Then creating the secondary market in stuff that we do for our customers was the key point, they're not just making a market in an asset class per se. So depending on how you measure it we're number one in investment grade corporates in Europe today because we are capable of making markets in there as we are a go-to house for DCM. It would be different depending on the customer segment you're looking at. Do you want to...?

**Answer: Peter Nielsen**

No, that's exactly right. So number ten, so eight or nine or ten, you want to be relevant on the secondary side. But many people look at market making on that credit side very similar to being in the cash equity business; you do it in order to be able to facilitate the primary side. If people can carve out a business that hedges one or two on the origination side like some of my competitors have in the equity space, if you can do that and sit underneath the radar at kind of number eight or number nine on the secondary side, many professionals would say that's your sweet spot. So actually where we are in credit isn't a million miles away on the primary secondary side from where we want to be.

### **John Hourican**

Yes, so that's a very important point; the secondary market is there to serve the customer needs on both sides of the equation, which determines your outright market positioning, but actually our primary market positioning is very, very strong supported by a deliberately weaker secondary market making position.

### **Further question**

And then just thinking about the second point, just a last question. Is it possible to get a ballpark breakdown of the 143 billion pro-forma risk quoted assets between the five key product lines?

### **Answer: John Hourican**

No, we don't disclose that do we? Never disclose that. And actually a lot of the capital is calculated across counterparts, not by product. So while we proxy it for management decision making the nature of these tests force you to look at it in a number of different optics around the Rubik's Cube of how you run your business. And I think that... you know, so we think of it in product in terms of customer and geography, all of those metrics all the time, but to make a decision based on one only actually usually means you haven't thought about it properly. So, no, you're not getting it! What you'd end up actually is a very small part of the capital base broken into the products and the rest being the operational risk charges and various things and not...

### **Question 5**

### **Frederik Thomsen - Goldman Sachs**

Could I ask you a question on slide 18, which in the bottom right hand corner it looks like you have amongst I guess the highest margin and trading assets of any of your global peers. But I guess if I flick to slide 29 it looks like you have a pretty plain vanilla book of assets and inventory. So I was just wondering if you could throw some light on how you think about that, what's the driver behind that high margin?

### **Answer: Peter Nielsen**

Chris can actually talk about the actual construction of that balance sheet ex derivatives and differences between... I think this is normalised for differences across US and...

### **Chris Kyle**

Yes. So normalised against US...

## **Peter Nielsen**

Many of the other risk disciplines that David talked about and that we've inculcated since the first part of 2009 is... and believe me the guys scream about them often, but we turn this stuff over and I have my much-vaunted ABP guys that are telling me in their dialogue with their counterparts and their competitors on age policy and that the regulators will say you're best in class and then my counterparts will say, wow, we're glad we don't have to live with that kind of regime, it does. So I do think that if I listen to the guys and the anecdote and talking to my colleagues I do think we turn the stuff over more frequently than other people. And again, Chris is right in terms of the high quality nature of the business, but all of that is not going to be US Treasury, so for primary dealer in 22 different markets and a large portion of that is going to be dollars, sterling, euros, and Japan, but it's been a good first half, or first eight months as well, in terms of opportunities in Spain and Italy, at three to seven, back to three, back to seven, or seven and a half, and back down, so there have been some opportunities as well.

## **Answer: Chris Kyle**

But I also think, Peter, I mean I think your business has made a virtue out of a necessity. I mean you've been squeezed really hard on the balance sheet, and when I talked about on page 29 how we've driven another 15% out of the ex DPS number that 15% on TPAs, if that was still there you'd go from number three to number eight and you'd be asking why are we inefficient on margin. So...

## **John Hourican**

Also if you look at that we're actually in company of four there, after the last two so it only takes a tiny movement to stick you at the other end for the question to be inverted, about how inefficient we are.

## **Chris Kyle**

Correct.

## **Peter Nielsen**

And both comments are exactly right. And if you look at what's happened at competitor balance sheets over the last little bit you'll see them going in the opposite direction to us.

## **Question 6**

### **JP Crutchley - UBS**

Two questions if I can. First, as you look round the globe at the business model, clearly you've had historic relative very strong businesses. Where are the areas currently that you feel, I guess, most threatened or weak or strategically disadvantaged in terms of where you need to actually put more capacity and build up the business, or why you're happy with the franchise as it sits at the moment.

And secondly looking forward in terms of delivery, what are the biggest threats to you in terms of delivering on a model strategically? Is it being a UK bank with additional regulation or other issues that you would worry about?

**John Hourican**

Do you want to take that first, Peter?

**Answer: Peter Nielsen**

Sure. I think in terms of where do we think there's opportunity, as I mentioned I think there's real opportunity in being able to take the asset backed skill set and apply it in Europe. And we're spending a great deal of time and management effort to make sure that we're capable of doing that. But that's a non trivial exercise, there are a lot of very ambitious counterparts in this part of the world and there's a big pie to deal with in terms of distressed ABS assets and willing purchasers. But that'll be a non trivial exercise. I think the other – and we didn't talk about it but in the beginning on my product slide I mention it – I think the other opportunity that's been afforded us in how John and the management team have redefined our business M&IB combining our business, the product strength and the product engines in terms of emerging markets, emerging market currencies and the currency business, and being able to try and capture, or recapture, some of the flow that comes from the transaction services business. There are only four banks in the world who are at top five in both the currency business as well as the transaction services business and it's a lucrative vein, and I think there's a... I think we would all say that we're not doing as well as we might in terms of capturing all of that globally. We're active in 30+ countries around the world and many of our clients come to us to facilitate activities in China and other parts of Asia, I don't think, in terms of opportunity, we've yet gone over a kind of 60% or 70% mark of being able to capitalise on that.

**John Hourican**

I would agree with that. A lot of the opportunity exists in doing what we do better and making sure the money and the gaps, which I'm sure all of our competitors talk about, just getting that sort of transaction services, FX business is a perfect example where I think we can do much more. We are not deploying any more capital, so really actually it's not about chasing down opportunities, it's about locking down the franchise we've already got and making sure it works well. And the stress that are around it are fundamentally exogenous stress; I mean we've got market structure, regulation, legislation, the emergence of nationalism through regulation and whether we have a level playing field or playing field that undulates. And I think they're the things we are keeping a very close eye on because they're the things that can cause us to get tripped in moments of time.

But these are interesting times we're reinventing the business, low cost and efficient cost advantages are important in this part of the cycle. And as Peter says we're focused on very clear singular advantages or competitive points but there's very little new in what we're doing.

### **Question 7**

**Unidentified analyst**

Can I just ask you a question on the mitigation because there's a couple of slides sort of suggesting that the impact on revenue will be fairly minimal. I can see where it's a purely regulatory driven increase in RWA as you can probably find ways to offset that without

obviously doing too much damage to revenue. When your nominal balance sheet is forecast to come down not quite 20% but certainly between 15% and 20% it seems a little bit more of an ask to actually do that without seeing any similar drop in your revenue. Could you explain a little bit about sort of how that would work? I mean the nominal balance sheet coming down and the revenue not.

**Answer: Peter Nielsen**

It is going to be hard work, and it has been hard work up until this point, and it will continue to be hard work. If I look back when we started this exercise when many of the new regulations were announced I wouldn't have said that we, in fact, were ahead of our internal forecasts of where we'd be at the end of the first half, and the progress that we think we had most of the bad news in for the balance of the year, and we need to discuss where about Basel 3 is going to land and when. So I wouldn't have said that we would have been as well situated as we sit here now. And every time we uncover a stone on this, whether it be a transaction or a method of doing business, and we need to be careful about this, I'm not sitting here being a blind optimist, because as my bosses know I tend to be a glass half empty guy on this, but we've been encouraged by the opportunity because it isn't just us that are facing these exercises. So if you look at everything that is going on on the pension side, on the insurance side we have entire industry groups that are grappling with how are the new regulations both with Basel 3 in terms of what's going on with their banking counterparties, but obviously also importantly Solvency II what's going to happen if insurance industries demand for rougher swaps and swap counterparties etc.

So as far as we can see, that RWA, that net 35 number which is a net number of additional capital plus benefits from model equivalent. Plus, importantly, and this is the most difficult thing for us to be able to forecast, how much more efficient is our hedging going to be post the migration of certain products from standardised into advanced treatment which open up a whole new range of hedging opportunities.

So if I'm sitting here telling you that we have complete foresight of it and that the way ahead is not cloudy that's not the impression I'm trying to give, it's foggy, but it's mapping forward the progress that we've had over the last 18 months and examining this, and we've got guys in Brussels every other week and everybody's following what's going on with the corporate exemption and dates and times and whether or not that's going to be limited to OECD counterparts or not. And we're looking at the jurisdiction of our counterparts that may or may not be able to take advantage of that. That's our best guess.

**Further question**

It's interesting a couple of examples I think you gave there of where demand for certain products like hedging might be going up. With the interest rate environment that we're in and if it continues for many years is there a danger that a lot of corporates will may decide they no longer need to hedge various risks whether it's currency or weight and that's an offset. I just wonder how much of a risk that might pose?

**Answer: Peter Neilsen**

Absolutely, and that I think we touched on that earlier when you look at what kind of gains is the industry eking out of the DCM bone, all of the corporate issuance that has run through the window here, it differs to what the street is having to share those spoils amongst more and more book runners. So it's not unusual to see seven handle book deals which of course is not what my syndicate managers want to see. But in addition to that, you have dialogue with corporate treasurers or CFOs about the hedging and that tends to be a short

conversation these days, it's, "I'll call you next year". It's also the hedging activity that traditionally appends that flow has certainly not been for the last year, and for the foreseeable future we're not anywhere near as large a piece of business as the industry has become used to.

**Answer: John Hourican**

And you can see it on page 23 even half on half comparisons in the what we call inter-divisional revenue share you'll see it's fallen 2 down to 360. That number is so the impact there is a lower revenue share.

**Chris Kyle**

Page 28.

**John Hourican**

Page 28? 28. So that in itself demonstrates to you that some of the economics of what you describe are already coming through that because of the economy. But our job then is to go and try and find another way of fixing that so the transactional FX push is an important part of that the capture of the bid offer in emerging market currencies is a proper part of that. So this is just... We're in a business that lives day on day these are the things you've got to do. You've got to make sure we understand what our customers are doing and then you'll extract in that capacity whatever margin is there.

**Question 8**

**Andrew Coombs - Citi**

Just a question on competition but also particularly the Moody's downgrade. You shifted from P2 to P1 and long term at A3 where a lot of competitors stayed at A2 so just an idea of how that's impacted on the business if you have seen any impact? And how you've met that impact on competitive edge going forward as well?

**Answer: John Hourican**

We certainly have seen an impact but I don't think we'll talk to it.

**Answer: Peter Nielsen**

We have seen in impact and we've been expecting the impact so we're very well resourced to deal with the impact and all of the collateral and termination events and all the rest of the other risk management that comes along with that particular exercise, we've been advanced on... And there are certain clients, I spoke to one of them in the US last week, who are prohibited from undertaking transactions with you. And in terms of the number of clients a number of them are significant, I'm not going to sit here and tell you that they're all in far corners of Wichita, Kansas or something like that. But we have been pleasantly surprised I would say with the willingness that our clients have displayed to understand that the entire ratings universe appears to be changing, and the willingness that those clients have displayed in giving us and giving the industry a chance to actually redeploy themselves and their strengths into a different way that many of these counterparties are looking at ratings. I don't want to sit here and say that the rating agencies have been marginalised but in many cases the internal credit analysis with some of these counterparts that has actually

happened. I would have said apropos this that our credit intermediation, our prime brokerage business, our swaps clearing business would have seen more stress or fewer deals than we have. We've signed up 28 or 29 new counterparts in the first half of this year many of them post the Moody's downgrade, both for FX as well as derivative clearing. And I would have, six months before that when we were planning for this I would have said that number wouldn't even have been half of that.

So you're right and there has been an effect by the same token I've been pleasantly surprised... Another example, just a little anecdote, the LDI business, big business for us with our inflation franchise and our presence with the utility business, they were one of the top two or three participants in a number of those contracts dreamed up by some smart actuary five or six years ago, have termination events at certain downgrade triggers. I've been very impressed that most of the buy-side as well as their clients have expressed willingness to re-evaluate those ATEs and how they judge the other credit worthiness of counterparts. So they know that the other business in the industry is changing.

### **Further question**

Is is a case you think most of your customers are already reacted so there's probably not a great incremental amount more or do you think there's still some way to go?

**Answer: Peter Neilsen**

I would say that's fair.

### **Question 9**

#### **Ian Gordon - Investec**

Just on the restructuring spend you've guided us in terms of what's still to come in 2012 looking to 2013 is there much material to come over and above those associated with the headcount?

**Answer: Chris Kyle**

No. I think in terms of the guidance that Bruce has given we will almost certainly hit this year's number and I think next year's number is reasonably small and in the overall Group context.

### **Concluding comments: John Hourican**

Thank you for coming. The message I would leave with you is if there are any other questions direct them through to Richard. But fundamentally we're, while not trying to appear boring, we're trying to just demonstrate to you that we set a plan and go do it. The resources used in this business are dramatically down on where they were, some of that is our decision as a management team, some of it is us anticipating the changes in the world we live in. And we talked earlier about the scale of businesses and we have sized this business to what we thought was a smaller scale it would be needed to be at in terms of market making capacity as we went into a plan in 2009. We were able to run this business £150 billion tighter than that and we are continuing in our suggestions to you to run it tighter as the market changes shape and those around us give us the opportunity to be able to do that but yet maintain our market position.

We are chasing return in the context of a well controlled, well organised customer centric business. And I think ultimately that's what we're trying to demonstrate as part of the Group that this business mix is valuable. It is the case of this business has a third of its revenues which are fundamentally and directly linked to the customer franchises of the Group outside of its own purview. And then the rest relate to market making activity up to the financial institutions community which is also a customer segment of the Group. So I think it is quite important that we talk about the markets business we talk about it as the product engines that service the customers of the Group. And that's the way we think about it, that's the way we run it, that's the way we manage it, and that's the way you'll see us talk about it.

The regulatory and legislative changes that are occurring around us do give us reason to have uncertainty in the level of capital usage and the level of business but that is for us to manage and we have a lot of plans around making sure we react to those in a way that advantages this business over any other business.

But that's all we have to say for today. I hope that was useful. I'm delighted to take any questions you've got offline or through Richard. Thank you. And thank you to those who watched patiently on the web.