Royal Bank of Scotland Group Plc
H1 2018 Results – Management Presentation

Howard Davies – Chairman
Ross McEwan – Chief Executive Officer
Ewen Stevenson – Chief Financial Officer

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Operator: This is Conference # 1363718.

Howard John Davies: Great. Thank you. Well, good morning, ladies and gentlemen. Thank you very much for coming along. The board is very pleased with the progress the bank has made in the first half of the year in both resolving legacy issues and also delivering a consistent operating performance.

As you heard, we're announcing an intention to pay a 2p interim dividend, subject to final settlement of the RMBS investigation by the DOJ. We announced a fine of $4.9 billion in May. We need now to finalize the nonfinancial details of the settlement.

Looking further forward, we aim to reach a dividend payment of around 40 percent over time. I would like to thank all shareholders for their patience and support over the last decade while dividend payments have been suspended as the bank has been rebuilt and reshaped.

Now Ross and Ewen will take you through the details of the results in a few moments, so I'll just briefly provide a little bit of a context in which they're set. We think they're good, given the low interest rate environment and the competitive pressures all banks are facing.

Despite the uncertainty around Brexit, the U.K. economy continues to grow, but it is growing at a fairly subdued rate. Inflation, of course, is a little above target. Yesterday's rate rises in an attempt to bring it closer and gives the Bank of England some headroom if we enter into a downturn into the future.

We have, in our business, seen some corporate customers delaying investment decisions as they await further clarity on Brexit. As for our own Brexit plans, we've explained we plan to use our existing license in the Netherlands, and we are well advanced in discussions with the Dutch Central Bank.

In the first half of this year, we announced an agreement with the trustees to improve the funding position of our main pension scheme. We've agreed to make a GBP 2 billion payment before the end of 2019 and GBP 1.5 billion of further payments linked to future capital distributions. And this agreement substantially addresses the fund's historical funding weakness. So it's also a major step forward.

We were also pleased that the FCA announced this week that it's closing its investigation into GRG with no enforcement action to be taken against the bank or its senior management.

So with our major legacy issues largely behind us, the management team are now focused on accelerating our transition to digital banking. We're making good progress, but we have more to do. We've also largely completed the organizational changes needed to meet the ring-fencing requirements. That change program has proceeded smoothly. And finally, we welcomed the government restarting the share sell process a couple of months ago as another important milestone in the bank's recovery.

Before I hand over to Ross, I would like, on behalf of the board, to thank Ewen for his contribution over the last 4 years. The bank had made very significant progress in his time here. Its balance sheet has been radically transformed. It leaves us with an extremely strong capital base, as you will see, it's over 16 percent core Tier 1. The search for his successor is progressing well, and we'll update the market in due course.

You all have seen that we recently announced the recruitment of new Chief Risk Officers for the group for NatWest Markets and the ring-fenced bank, the latter, an internal promotion, so the senior team is changing a

little here, but Ross and I will be with you for a while yet, strongly focused on our 2020 targets.

So I'll now hand it over to Ross and then Ewen for more detail before I host Q&A. Ross?

Ross Maxwell McEwan: Thank you, Howard, and good morning, everyone. Thanks for joining us today. We are pleased with the progress we've made in the first half of 2018 and see these as a good set of results in a more uncertain and a highly competitive environment.

We built on our good start to the year and delivered a further quarter of profitability in Q2 2018 with a profit before tax of GBP 613 million and a bottom line profit of GBP 96 million. This is despite continued margin pressure.

For the first half, the bank delivered a profit before tax of GBP 1.8 billion and a bottom line profit of GBP 888 million. These figures include a GBP 1 billion charge related to the settlement in principle for the U.S. Department of Justice, which we announced in May.

We remain committed to our 2020 financial targets at a sub-50 percent cost-to-income ratio and a 12 percent or greater return on tangible equity.

Our sector is undergoing significant change. We are positioning ourselves well to compete. We're continuing to rebalance our investment from physical assets into our digital infrastructure. We still have a lot more to do to achieve our ambition of being the best bank for customers in the U.K. and the Republic of Ireland. However, with our major legacy issues largely behind us, we are able to fully focus on closing this gap.

In terms of the results for the – at a group level, excluding NatWest Markets, central items and one-offs, income is stable compared to the first half of last year. This is not unexpected given the low interest rate environment and a more uncertain macro economy at the competitive

pressures that we are facing. The NatWest Markets income was down GBP 175 million against the first half of 2017.

This reflected the turbulence in the European bond markets in the second quarter and is compared to a very strong first half of last year. Costs are down for the group by GBP 133 million or 3.6 percent compared to the first 6 months of 2017. This excludes a VAT release in 2017.

Our capital position is very strong, including the impact of intended dividend, the negative impact of pension contribution, that settlement in principle of the DOJ, we have a common equity Tier 1 capital ratio of 16.1 percent. Excluding these items, our CET1 ratio increased 110 basis points in the quarter.

This slide provides just a few examples of how we are supporting customers in the U.K. and the Republic of Ireland. We have delivered gross new mortgage lending of GBP 13.6 billion in the U.K. PBB since December 17 despite the competitive environment. We've increased total customer deposits in U.K. PBB by GBP 7.5 billion or 4.3 percent since first half of last year, and this compares to a market growth of 2.5 percent.

Growth – we've grown our lending in the SMEs in the U.K. PBB business banking ahead of the market, up 1.5 percent on the same period last year. We've continued to support Commercial Banking customers with over GBP 90 billion of loans and advances. And NatWest Markets has helped customers, both here and internationally, raise GBP 130 billion in debt capital markets in the first half of this year.

Overall, we are growing in the markets that we like and within our risk appetite. But we still have more work to do. And to get what was going to be the Williams & Glyn branch network into shape and further downsizing the Royal Bank of Scotland network in England and Wales will take place by end of this year.

The Royal Bank network in England and Wales aside, we are now in a position with the size and shape of the branch network will be stable until

at least 2020. And at the same time, as we're shaping our branch network, we continue to invest in our other channels.

The price of change and how our customers interact with us is stark. In the last 12 months, check usage is down 16 percent. Customers are also telling us they don't even use their cheque books. In fact, only 3 percent of those that we sent out were being used.

So for obvious reasons, we stopped automatically sending out checkbooks for new accounts. Branch counter transactions are down 7 percent, and volumes of calls into our contact centers have reduced by 11 percent. This allows us to reduce our fixed cost base and simplify the business further. In the last year, we've seen – we've exited 35 nonbranch properties, and we've retired a further 545 systems and applications.

But at the same time, the shift to digital channels continues at pace. We had 1 billion logins to the mobile app in the first half of 2018. That's up 20 percent on the same period last year. And over 80 percent of our commercial customers now regularly interact with us through a digital channel.

This investment in digital functionality is helping us lower costs, improve our controls, protect and grow income streams and most importantly, deliver a better customer experience. Delighting our customers is central to everything we aim to do, and we are committed to build on the solid progress that we have made.

As the shift to digital channels continues, we're improving our core business and moving into new growth areas. Our mobile app capability improved in the first 6 months of 2018, and we now have 6 million regular mobile app users. That's up 20 percent on last year. And the Net Promoter Score of the NatWest app is plus 41 percent. We now have 8.4 million digital customers in the personal bank. Bank line is a key payment channel for our commercial customers.

And in the first half of this year, the average monthly payment total sent by bank line and direct channels was close to GBP 234 billion, again, up 7 percent on the same period last year. We also continue to roll out our new bank line functionality for commercial customers with over 40 percent of customers now migrated.

The part of the bank line mobile continues to be successful. Early indications are positive. With a Net Promoter Score of plus 62 percent from our commercial customers is proving incredibly popular. The volume of conversations with our artificial intelligence chat box, Cora, continues to grow across the bank. From 360,000 interactions in the first quarter, we have doubled the number of conversations to 650,000 interactions, taking us to over 1 million conversations so far this year.

We're also working on a number of new innovations and leaning – and learning a lot as we go along with these as well. Earlier this year, we acquired FreeAgent. This provides cost-effective cloud-based accounting software to our business customers.

In 2017, we launched Esme for small business customers. This is a new platform that can provide funds to small business in minutes. More importantly, we're taking the learnings from these projects and applying them to our core lending proposition.

NatWest Markets are currently piloting a new FX product with Business Banking customers, bringing them real-time rates through a simple-to-use app called CurrencyPay.

Digital innovation and automation are driving improvements to our core business. And our new innovation projects are providing us with helpful lessons as we go along. This is setting up a great future for this bank.

Last year, we transferred a number of assets between business segments as part for the preparation for ring fencing. We anticipate that as a consequence, this can make prior year comparisons more difficult at the business segment level, and therefore, we're providing you with more

details in the following slides. I'll take you through the financials on a like-for-like basis, giving you a clear look at the performance of the businesses.

Our U.K. PBB and Ulster Bank Republic of Ireland business segments were not materially impacted by these business transfers. The U.K. PBB mortgage flow share was 11.5 percent in Q2 '18, supporting our stock share of 10 percent. The future pipeline was also strong with approvable share of around 14 percent. That's up from around 12 percent in the first quarter of this year. And personal advances were up 8.8 percent on the same period last year as digital sales volumes to our existing customers increased 38 percent on first half last year.

U.K. PBB operating profits are up GBP 101 million to GBP 1.4 billion. It's based up on the first half of last year or 7.6 percent. Costs are down GBP 162 million due in part to a 10.6 percent headcount reduction. That shows how our investment in digital and automation is delivering further cost reductions. Impairments remain low at GBP 147 million. That's up GBP 50 million on the first half, largely – mainly explained by lower releases from previous years.

Ulster Bank Republic of Ireland operating profit were GBP 100 million – euro – sorry, EUR 100 million. This was supported by an income growth of 4.1 percent or EUR 14 million due in part to a number of one-off benefits.

On costs, the business decreased operating expenses by EUR 57 million or 16.7 percent due to lower strategic costs, litigation and conduct charges and lower staff costs, which benefit from recent restructuring initiatives and lower pension costs. The business continues to support customer shift to digital channels with mobile users increasing by almost 10 percent in the first half to close to 200,000.

Looking at our Commercial & Private Banking franchise. On total income, the Commercial Bank benefited from asset disposals and fair value gains of GBP 192 million, helping grow income by GBP 172 million or 10.7 percent.

On costs, our combination of lower strategic, staff and conduct costs helped the business reduce costs by GBP 143 million or 14.4 percent. The result was that the Commercial Bank grew operating profits by GBP 352 million on the first half of last year to GBP 912 million.

In Private Banking, net lending increased by GBP 1.3 billion, and assets under management were up GBP 1.8 billion. This combination helped increase income by GBP 43 million or 12.7 percent. Operating costs were down GBP 12 million on the first half of last year or 5.6 percent. Taken together, Private Banking delivered operating profits of GBP 156 million. That's up GBP 62 million or 66 percent on the first half of last year.

The reshaping of this business is really paying off. In comparison to 2013, income is lower due to the sale of Coutts International. But despite this, the Private Bank is delivering much higher returns than it did 4 years ago. We've achieved this through being focused on capital efficiency and cost reduction. Private Banking delivered a 58.9 percent cost-to-income ratio and return on equity of 15.8 percent in the first half this year, its best performance in many years.

Turning to the business segments outside the ring fence. RBS International's performance is impacted by the transfer of funds and trustee deposit business from Commercial Banking as well as transfers from Private Banking. The franchises benefited from deposit margin improvements in the first half of this year, lifting total income by GBP 7 million or 2.4 percent to GBP 294 million.

This improvement was, however, offset by higher operating costs in the business of GBP 13 million, most of these due to ring-fencing costs. Overall RBSI delivered operating profit of GBP 173 million in the first 6 months and a return on equity of 25.7 percent.

Looking at NatWest Markets. The franchise is making good progress and has been assigned an investment-grade rating with positive outlook by all 3 rating agencies.

On the financials, compared to Q2 '17, total income decreased by GBP 182 million largely due to turbulence in European bond markets. Despite this, the Markets business maintained good customer flows. In addition, the second quarter of 2017 was particularly strong quarter for the Markets business.

So for the first half of 2018, total income decreased GBP 175 million or 19.5 percent. Q2 operating costs were down GBP 189 million, reflecting the legacy cost wind-down and lower strategic and litigation costs. Compared with the first half of '17, the Markets business delivered a GBP 420 million cost reduction. This resulted in operating loss in the Q2 of GBP 51 million for NatWest Markets and a GBP 46 million operating profit for the first half.

These results demonstrate the investment case for this bank: a pretax profit of GBP 1.8 million – GBP 1.8 billion; a bottom line profit of GBP 888 million; and excluding the impact of RMBS, a return on equity of 10 percent. We see this as a good performance given the uncertain operating environment and a highly competitive marketplace.

Add to this, we've announced today our intention to declare a dividend of 2p, subject to reaching a final settlement with the DOJ. And our ambition is to reach a payout ratio of around 40 percent over time.

We know that customer efficacy is not where it should consistently be in this business. With our major legacy issues largely behind us, our team are fully focused on delivering innovative solutions, which will improve our performance and delight customers alike.

I'd like to reiterate Howard's thanks for the support of all our shareholders during what has been a very long decade. But the turnaround of this bank is almost complete. We are now focused on the future.

And with that, I'll hand over to Ewen. But before doing so, I would also like to give my thanks to Ewen for his support over the past 4 years. He's played a key role in this turnaround. Thank you very much.

Ewen James Stevenson: Thanks, Ross. And Howard, Ross, thanks a lot for the kind words. It's been a real privilege and honor to work with you here for the last few years. And morning, all. Three topics I wanted to cover: firstly, first half results; secondly, 2020 financial targets; and lastly, capital and capital distributions.

On our first half results, I think we are happy with the continuing progress we're making, while acknowledging we are operating in more difficult operating conditions. On income, excluding one-offs in NatWest Markets, we think we did a decent job to keep income flat H1-on-H1, and that's despite significant ongoing margin pressure in some areas.

This reflects the continued good volume growth in some segments. We had a better Q2 in relation to mortgage originations. Flow share was 11.5 percent versus our stock share of 10 percent. We also saw very good growth in U.K. Personal & Business banking and private deposit gathering with H1-on-H1 growth of around 4 percent and 5 percent, respectively.

Net interest margin in Q2 was down 3 basis points on Q1. Relative to our expectations going into the year, front book spreads, I think, in several segments, are weaker than planned, particularly in mortgages and parts of commercial book. Our NIM is also getting impacted by our liquidity coverage ratio.

As you all have seen, our liquidity coverage ratio of 167 percent at the end of H1, we are holding significant liquidity buffers. Partly, this is to fund pending one-offs. We've got a $4.9 billion civil settlement with the DOJ to pay. We've got a GBP 2 billion additional contribution to put into the main fund pension plan. But there's also a degree of caution on our side given the heightened uncertainty with the Brexit deadline approaching.

NatWest Markets had one of its weaker income quarters relative to recent quarters. If you back out legacy runoff and then credit adjustments, underlying core income for the quarter was around GBP 300 million and around GBP 700 million in first half. This did reflect more difficult trading

conditions that we saw in Q2. But if you looked at underlying customer activity in the quarter, it was broadly in line with expectations.

On costs, other operating costs continue to come down, stripping out GBP 51 million VAT recovery. Other operating costs were down 3.6 percent on first half of last year. That includes a 5,000 reduction in FTEs, and that's despite a materially higher investment and innovation spend so far this year.

On impairments, they continue to positively surprise, 8 or 9 basis points in H1. Also to note, we did benefit from a number of positive one-offs in the quarter – in the half, including fair value and disposal gains in commercial, some GBP 192 million, and then RMBS indemnity recovery of GBP 241 million. This did help underpin TNAV per share in the quarter with a fully diluted TNAV per share at the end of the quarter of 286p.

You also may have seen in today's results in Note 14, a commentary on a pretax GBP 272 million insurance recoverable that will book into our Q3 results. That will obviously provide some further support both to earnings and TNAV next quarter.

As a reminder, on our 2020 targets, a 12-plus percent return on tangible equity and a sub-50 percent cost-to-income ratio, 2 things to talk about on this, income and costs. On income, to achieve our 2020 targets, income forecasts are a mix of improvement in the rate environment and relatively modest underlying income growth.

With – while the rate environment did deteriorate in Q2, it remained better than we've built into our forecast at the end of last year, and we certainly welcome yesterday's base rate rise.

On underlying income growth and despite continued margin pressure, we continue to believe that our business model can offset this with volume growth ahead of market growth in the segments where we have risk appetite to grow. But with the Brexit deadline approaching, there remains

a lot of uncertainty out there. We think the balance of risks is skewed to the downside on income at the moment.

On costs, we're broadly comfortable with consensus all-in cost forecast for full year 2020. As you can see from those forecasts, that requires further substantial reduction by the operating costs and one-off conduct and strategic costs.

For operating costs, we've previously said that we expect the 2018 cost reduction to be lower than trend, and we expect cost reduction to be materially higher both in 2019 and 2020.

For strategic costs, we've previously said that we expect strategic cost to be GBP 2.5 billion over this year and next. Nothing really to update you on here. We had GBP 350 million in H1, and we do expect this to be higher in the second half.

And on conduct costs, H1 results were clearly heavily impacted by the GBP 1 billion additional provision we took for the DOJ settlement. That was partly offset by the GBP 241 million recovery we had on 1 RMBS indemnity this quarter. But away from this, we can clearly see that legacy conduct costs are now trending lower.

Finally, on capital, our core Tier 1 ratio is 16.2 percent pre the interim dividend and 16.1 percent post the dividend. On a pro forma basis, our core Tier 1 ratio improved by 110 basis points in Q2. That's after stripping out the impact of the DOJ settlement and the pension top-up. Pre any additional distributions, we do expect this ratio to continue to accrete in the second half with RWAs continuing to reduce within first half levels.

On capital distribution, as you all have seen today's announcement, we've declared an intention to pay an interim dividend of 2p per share. That's around 12 basis points of core Tier 1, with the intention to pay this dividend post the signing of the DOJ agreement.

We've also announced today an intention to build towards a 40 percent payout ratio – regular payout ratio over time. As we thought about the ratio of what would be an appropriate ratio, we considered a range of factors, including an appropriate buffer for IFRS 9 volatility.

Given a slightly lower core Tier 1 relative to tangible equity, a 12-plus percent return on tangible equity target translates to approximately a 13-plus percent return on core Tier 1. With normalized RWA growth likely to be materially below that, this would imply a through-the-cycle payout capacity in excess of 40 percent.

As such, we do expect, with our existing capital buffers, the need to normalize core Tier 1 through additional distributions. We don't expect to begin these to 2019. We will need full consultation and approval from the PRA in due course, and I think it's very dependent on a clean bill of health from this year's stress test.

So to summarize, we're pleased with the results in the first half set against the backdrop of less supportive operating conditions and attributable profit for the first half, including remaining profitable in Q2 despite significant legacy conduct provisions. With a further RWA reduction in Q2, a very healthy core Tier 1 ratio, 16.1 percent, including the dividend, we remain confident on our 2020 financial targets.

However, as I said earlier, I would note, with the Brexit deadline approaching, uncertainty is increasing, risks are skewed to the downside. Subject to signing with the DOJ, we are delighted to be finally announcing an intention to pay a dividend.

It's been a long journey back for us. Ross and I, in addition to thanking shareholders, also, I wanted to say many thanks to all of our employees who worked really hard over the last few years to help deliver this. It is a modest 2p per share with our existing capital buffers. And the fact that those capital buffers could be expected to grow from here, we do expect distributions to materially grow over the coming years.

So thanks. And with that, we'll open up for Q&A.

Howard John Davies: So thank you, Ewen. So let's go straight to Q&A. We may have some coming across the (ether), but I'll do people in the hall first. If you can give your name, institution, whether you're a buy, sell or a hold target price, et cetera.

Ross Maxwell McEwan: (Inaudible).

Howard John Davies: Yes.

Alvaro Serrano Saenz de Tejada: Alvaro Serrano from Morgan Stanley. Two questions, both around capital. You mentioned that you're done going through the major litigation items. But if I look at your capital, 16.1 percent now, it looks like you should be – accelerate in the capital build and, or in my numbers at least, you can easily get to 17 percent by the end of the year.

Is there any – I don't know if you can comment around PPI or any sensitivity around PPI or any other item that we might not have in mind around litigation that would prevent you from reaching sort of 17 percent by the end of the year or disrupt the capital build addition in the first half?

And the second, also relates to kind of your dividend and shareholder distribution for next year. You mentioned that you intend to do something on top of the 40 percent. Again, considering if that 17 percent is right or the capital build is as strong as it looks, can you maybe talk us through how it could look like, the capital distribution, next year?

You've obviously had a conversation with the PRA around the interim. Stress tests don't seem an issue given they've allowed you to pay the 2p. How quickly can we expect – is 100 percent payout a limit? Or how quickly can we expect you to normalize that capital ratio?

Ross Maxwell McEwan: If we start just on the first one around what are the other pieces coming through, we did a review on PPI and chose not to take a – didn't believe we needed to take further provisions on PPI in this quarter. This is one of those things if we can't pay, you have to go back and review is your

provision strong enough for the stress test. We're doing another one in Q3.

As we go through the report, there's obviously a number of items still to be resolved. But from that perspective, from what we see, the big ones are now accounted for. On the dividend, it is quite clear that we have built very, very strong capital in this business, and so 16.1 percent, after we've taken account of pensions, dividend and DOJ, leaves us in a good position and building.

We still haven't accounted for Alawwal, which comes in the accounts we suspect first quarter of next year, just depending upon when that's finished. So we're in great position. We've clearly said we'll build to a 40 percent, but there won't be enough to distribute to a level that we think is comfortable for this bank. So we've got a lot of work to do with the regulator on how do we get that capital back to shareholders.

As Ewen said, we will look at – we got a better work to do around how do you do a proper buyback and what would we do on specials. But as I said, 40 percent isn't going to be enough to get the levels down. So I'll probably not going to make any more comments on that. At this stage, we do want to get through the stress test. We do want to see what Brexit brings, but this bank is very, very well capitalized.

Any other?

Ewen James Stevenson: No. I mean, look, the – we're not going to obviously comment on new profit forecast for the end of the year, whatever. But the – on Alawwal, yes, it feels like that. It hasn't announced yet. Yes, we do expect it to announce, but obviously, we think it's about 6 months from announcement to completion.

So RWAs are likely to, therefore, come out first half of next year, I think at this point, but it will happen. And we've obviously got the continued rundown of other cap res assets, which – so RWA should continue to trend down from here, I think, which will provide further capital support.

I mean, I would just sort of caution everyone. We've obviously gone from a base of not paying a dividend for 10 years. And then for you to say how quickly we can get back to 100 percent payout ratio, you obviously don't know the regulators as well as we do.

But I mean, we're certainly – we certainly take comfort from the fact that in a sort of U.K. context, it will always just paid out more than 100 percent in a given year recently. And we will – we obviously recognize the fact that we are sitting on large surpluses, and we need to figure out how to get some of that back.

Howard John Davies: Thanks. Next, yes, and here. Where the microphone's gone?

Andrew Philip Coombs: It's Andrew Coombs from Citi. I will just follow up quickly on the capital distribution. As you say, post Alawwal, post the insurance contribution coming through that you flag and get a pro forma 16.5 percent core Tier 1.

However, on Slide 20, you've also flagged all the potential regulatory RWA inflation coming through, and that doesn't come through until 2020 to 2022. But when you are thinking about capital return, are you front-loading that in your calculations? Are you saving that in your calculations? How do you think about that when you're thinking about your 13 percent-plus capital requirement? So that will be the first question.

Second question is just on some of the metrics that you've outlined both on Slide 7 in terms of digital adoption, lower branch usage. But also on Slide 32, I think you said mortgages switching down to digital channel, 30 percent, 40 percent, 50 percent in a single year, and it's an enormous move.

With that in mind, why are you talking about stable branch network through to 2020? Is there no room for more cost save potential on that front?

Ross Maxwell McEwan: I'll take that one up. Ewen, do you want to go on the capital…

Ewen James Stevenson: Yes. On the – as what we said at full year, we do think for the time being, we are going to target a core Tier 1 above our long-term target of 13 percent. there's a bunch of things going on behind that, I think. We're still working through IFRS 9 volatility and want to understand it better. This will be the first year of stress testing where you'll see the impact of IFRS 9 volatility in the results.

Yes, we do think that we've got a business mix that's less IFRS 9 cyclical relative to some peers. We've got IFRS 16 next year, which should be relatively modest, GBP 2 billion to GBP 3 billion, I think, we've previously indicated. Second half of '20, the GBP 12 billion-or-so uplift from mortgage flows that hasn't really changed in terms of our planning. And the only thing, I think, that has changed, it feels like the Basel timetable is pushing out where previously, we would have thought the end of '21. But now it feels like that could be end of '22, end of '23.

So on question on phasing, I mean, it's obviously something we take into account and around, and I think part of it will come back to wherever we are when we start making additional capital distributions. There will be some glide path down from there over time.

I do think 100 percent of earnings, when you start going through that, it is something that everyone is going to think about, even though there is precedent here in the U.K. and actually, now in the U.S. as well for people doing that.

Andrew Philip Coombs: I think it's (worth it) another way. When you do commit to excess capital, you buy back some specials. Is that something that you would like to maintain or potentially grow going forward? Or would you happy to do 1 large amount and perhaps lower amount of (VGA) if you get RWA inflation coming through?

Ewen James Stevenson: Well, as I said – as I went through the math before, if you think about the 12-plus percent return on equity or 13-plus percent return on core Tier 1, if nominal RWA growth in the U.K. is, say, 4 percent or

something, that would imply the business model should be when we're at, at sort of return and able to generate a sort of 70 percent payout ratio.

We're committing to a 40 percent payout ratio, so should mean through the cycle, there's surplus capital. But obviously, IFRS 9 – one of the reasons for setting the payout ratio of 40 percent is because IFRS 9 is going to introduce a degree of earnings and capital volatility to every bank.

And we wanted – as we thought about it, we wanted to set a payout ratio that we could be confident of paying through most parts of the cycle. At the business model, if we're achieving those returns, we should be achieving a natural surplus every year above that.

Ross Maxwell McEwan: Just on the second question, I mean, there is a very fast move towards digital and away from the traditional branch network, but our branch network remains a very important part of our distribution going forward. So as the growth in the digital channel is happening fast, quicker than probably we have already anticipated, we still do a lot of business through our branch network, and we will maintain a very large branch network.

The reason for giving the commitment through to 2020 is we think there's more value and stability for our people and for our customers. There's a lot of people who need to manage the changes that have been going through, well, they're doing that. They're actually not managing our people to talk to customers, and we're not getting out with customers doing business.

So there's a real value in stability. And we believe at around 820 branches, that's the size of the network that we see for the short to medium term. And there are some areas that we want to save some money on that network to make it much more profitable and much more productive and better for customers. So there's value on stability, I suspect, in that area now.

Ewen James Stevenson: I mean, the other thing with our branch network increasingly, a significant part of what the branches are doing is also helping customers migrate to digital because we've got a lot of customers who are just somewhere between unfamiliar and uncomfortable with using digital channels and walking into a branch and having a branch assist them through that process is a sort of key part of what the branches are doing as well.

Howard John Davies: Next, second row, second in.

James Frederick Alexander Invine: James Invine here, Soc Gen. I've got 2, please. The first is on your liquidity book. I mean, I think we have this discussion every quarter, but it really is getting very, very large, particularly when you've only got GBP 13 billion of short-term wholesale funding.

But assuming that you pay the items that are coming out in the second half of this year, assuming that Brexit is kind of OK, can you give us some sense of where you think your liquidity ratios may land in a more normalized environment?

And then the second question is just on mortgages. When you're looking to grow, I mean, how – do you target the gross or the net? And what I'm getting at is the fact that if your mix has really shifted a lot towards the 5-year side, then in kind of 2 years' time, you're going to have much lower redemptions where people aren't redeeming because they're on 5 years. So you're going to see a big pickup in the mortgage book 2 years from now.

Ross Maxwell McEwan: We'll give the mortgage one to Leslie, as like I, loves mortgages, and it's his first part of the business. So on the liquidity, we'll let you know what a normalized environment is, and we'll let you know where the normalized liquidity position is.

Start with that one, but maybe, Ewen, you can talk about the ratio, where we are and...

Ewen James Stevenson: Yes, so the ratio at end of Q2 was 167 percent. It was 151 percent at the end of Q1, so it's dropped a lot. Various things are going on to drive it up. Firstly, just a timing issue of when we put money to the DOJ and pension plan.

The – we've taken a quarter's view on the second half of this year in terms of availability of funding and the wholesale funding markets, and we've done about 80 percent of our wholesale funding in the first 6 months or so. And because the U.K. economy is growing slower than we expected, we've actually seen loan growth weaker than expected and deposit growth surprisingly better than we expected. So we've had a bit of a delta there.

We do think you'll see that begin to come down in the second half. I think until we get a sort of firmer view on direction of travel of Brexit, we'll probably be a bit cautious through '18. I think, broadly, we're targeting a sort of longer-term liquidity coverage ratio of about 135 percent. Probably about 10 percent of that is due to technical reasons, so it's really the difference between about 20 percentage points of LCR.

Remember that we've got GBP 19 billion of Team Funding Scheme, which is entirely in our domain as to if we choose to repay that early. So we feel we've got plenty of flexibility to adjust our liquidity ratios as and when we feel comfortable to do so. But it is representing a drag on NIM and part of the reason NIM would stand 3 basis points in the quarter.

Howard John Davies: Les, do you want to talk a little bit about (inaudible) regarding mortgages?

Leslie D. Matheson: Yes. Look, I mean as far as mortgages are concerned, we are targeting a flow – a share of flow of about 12 percent. We were a little below that in the first quarter. We're been a bit above that in the second quarter. Our stock share is 10per cent. So our absolute volume is obviously trying to continue to grow. You're right.

When you look at 5-year, you've obviously seen big shift in that, particularly over the last 6 to 9 months. That is a market phenomenon.

It's not just – it's not unique to us, and it really reflects, I guess, a growing view from customers over the last 6 months that interest rates might start to go up.

I guess yesterday, they were shown to be right. But I do think it's a market phenomenon rather than one that's peculiar to us. So I don't expect that that's going to give us a significant competitive advantage, but although were targeting a share of 12per cent of stock, we're certainly comfortable at looking at – moving that up over the medium term and starting to think about 15per cent. But for the moment, we'll stick with 12per cent.

Howard John Davies: Next? Yes, third row. Yes, thanks. In the middle.

Martin Leitgeb: Martin Leitgeb from Goldman Sachs. Three questions, please. And the first one...

Ross Maxwell McEwan: Got 2 to 3. Got 1 to 2 to 3 now.

Martin Leitgeb: The first one briefly, just going back to your strong capital and funding position. Has anything changed with regards to your grow ambitions in the U.K? Obviously, you highlight mortgages, which are very capital-light. Are there any other pockets of growth in the U.K. you are particularly excited about at the current time?

The second question is just a more general question on – in terms of deposit pricing, deposit betas going forward forward. Obviously, with ringfencing being in place now, in practice. And excess liquidity trap in these (ringfences), do you expect the deposit betas in the current time will be somewhat lower than they used to be in the historical context? And the third question is just a very short number questions.

Ross Maxwell McEwan: Short number?

Martin Leitgeb: I think previously, you gave up the differential between front book and existing book mortgage spreads and I think the last number, there was around 70, 80 basis points. So was just wondering if you could comment if that has stayed stable or changed?

Ross Maxwell McEwan: Could be the last one first. It's about 80 basis points, difference between front and back. It's moved a couple basis points up and down, and even in the last quarter, but it's probably back to what, about 80 basis points – 70, 80 basis points. So still a big spread between front and back book.

After the first question, Ewen, you can maybe pick up the second. And again, either Chris, Les or Alison, sort of uncover the points that you think we should. Happy to do so. We think there are really some good pockets of growth in this marketplace. This was a great market to be in. There are a number of segments that Alison's got in the commercial space that we like. There's some that we are, I think a bit more cautious about.

As you'd expect in this sort of environment, but there are some areas around the sort of a manufacturing, tech-type areas that we like. SME lending, we have been growing greater than market. We have a strength in that area, and one of the things we have developed using innovation is to actually – the speed with which we can actually get the right decision to people. And you've seen on the screen we're looking at a little service proposition called ESME.

These are quite interesting spaces that – I mean. we're getting better and better as a bank internee as well to SME. And secured our own customers – their own customers has been growing very nicely. And these are our customers, so we know their behavior. That's showing us some really good growth in unsecured personal.

And again, we think safely – let me be quite clear, safely. We think there's some space in there. And even within the mortgage operation, there are some areas that we are way underweight in areas that we could be – again, well within risk appetite that we think we could deal with. So just from the commercial personal side, we're not untapped – tapped out on any way on any of the markets that we're in. I mean, we have a smaller retail business than many others have.

You've seen us now coming to #4 position on mortgages. When we started, we were probably at about 8. Lots of growth. And I'm thinking Chris' business is the – we get real stability in our markets business. You'll see growth in that as well.

So we're not untapped in the U.K. and the Republic of Ireland, lots of work to be done there. But as long as, again, let me use the word safe for Ireland, we don't do what we did last time. I think we can see some pockets of growth there as well that we're happy with.

Male: Yes, third row. Just on the second...

Male: Sorry. On this...

Ewen James Stevenson: So on the deposit pricing question. I don't think – we don't think we're ringfencing. I mean where we see ringfencing more impacting us is on the asset side because our balance sheet looks like some other balance sheets around us. And therefore, I think you can attribute a lot of the behavior of everything that we're doing or other banks are doing to the structure of their – to the structure of their ringfenced banks.

So yes, we're short assets on personal banking. For us, we're long liquidity, short assets, it makes sense for us to go into mortgages. HSBC's balance sheet looks the same. Equally, if you're Lloyds or Barclays, I think for them to go into more into unsecured consumer makes sense for them. So I think all the behaviors are natural. We don't think it makes a significant difference to the deposit market.

Howard John Davies: I'm going to take one from outside the room. Edward Firth from KBW. Two questions. One, can I ask you to help us a little more with how the GBP 2.5 billion strategic cost will play out? If well below the run rate, you'll be – still be looking at a 50-50 '18/'19 split?

And the second is, can you give us a good analysis on NPS scores? In the appendix, the picture is not very encouraging, which I guess must be a concern in the current environment. There's something else which I can't

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see, but I think it's an NPS question. Ewen, do you want to deal with the first?

Ewen James Stevenson: Yes, on the – as we previously announced we expect strategic costs to be GBP 2.5 billion over 2018, '19. Obviously, we booked GBP 350 million into H1. Yes, I think given that, it's possible that more of that GBP 2.5 billion will be in '19 rather than '18, but I wouldn't over think it too much in terms of your modeling.

So there's some big, lumpy items in there, like this building, and when we choose to exit this building. So our timing on those may just flick from one quarter to another. But I was set with the GBP 2.5 billion.

Howard John Davies: OK. On the NPS, the end of the question was, "When can we expect this NPS to turn. Do you have any specifics in the pipeline?" Les?

Leslie D. Matheson: So I'd say is – on NPS, we've probably seen more of an impact than we might have expected from the branch closures, and that's probably true in Personal as well as Business Banking. But what we are doing is we're really focused on those customer segments where we're trying to grow and try and make sure that we have a really good NPS there. So if you look at our NPS on mortgages, for example in the last quarter, we really started to make a difference.

As of a couple of weeks ago, we are now second in the market of the big banks on mortgages, and partly that's due to the improvement we've made in processes, which are simpler and faster. We've got a large proportion now of our book actually using paperless mortgages, which is making the process really simple and easy for customers, which they appreciate.

The other area where we are still strong is on mobile. We've won a number of awards there. Our NPS is in the 40s. It's one of the strongest areas and it's the area where people are moving toward. That isn't to say there are other areas where we're not as strong as we'd like, and we're

working on those, particularly in the branches and on current accounts, for example.

Ross Maxwell McEwan: If I can comment there, too. Look, change is really difficult, and it doesn't matter whether that's – the change we're making have an impact into customers or the change we're making impacting to our colleagues.

Change is really, really difficult, and we, as a bank, have made some pretty big causes, and some big changes as we're going from really physical distribution to digital to stay up with where customers are going. And that – those moves, be they around how we operate in the SME marketplace, we were over serving that, the customers get used to it.

So when you take it away and try and balance that, getting a return out of it from what service you give, you do expect quite a big drop off and how they feel about it, and the same has happened with customers around the branch network. But one of the things I would say, that the executive team now are getting 99.9 percent of their time on the go-forward business.

A prime example is just recently, Les and I have been talking about even parts of the branch network and what are we doing. And last night, he got an e-mail from another part of the network. So – But cause – we've got more time to spend on these things. So he's got to enjoy it well and truly, as will other executives.

Howard John Davies: Thanks, Ross. Next? Yes, the second row – third row the end. Thanks.

Joseph Dickerson: It's Joe Dickerson from Jefferies. A couple of questions. I guess, on the NatWest Markets numbers, the rates and FX, revenue line. How transitory was the weakness we saw in the second quarter? And then secondly, if I look at the business unit level quarter-on-quarter, in terms of the net interest margin performance, every segment ex NatWest was either flat or up quarter-on-quarter.

Can we build from here, given the tailwind of liability, margins? Appreciate that there's competition. Then lastly, I guess, I'm a little bit surprised on some of the comments you've made so strongly about Brexit. Others haven't.

Is there something particular you're seeing already in terms of behavior? Or is it more of a health and safety warning? Because I suppose last time, when the currency depreciated, there was a pickup in export finance, which I think broadly helped the commercial business. So I was just wondering, particularly as you link that risk, if you will, to income.

Ross Maxwell McEwan: Just on the last point, if I can perhaps deal with that. I mean, the – I think it is still extremely difficult to determine how Brexit will go, frankly, and I've been a little bit surprised by the sort of certainty that some other commentators have had.

What we can see is some slowdown in investment decisions in large corporates, particularly. And a sense that people have been continuing investments to take out costs, et cetera. That's been an observable factor in the last couple of years. But when it comes to expanding capacity, putting sizable amounts of money around for a factory extension or whatever, that we are seeing some hesitation and some pause.

And overall, what we see is an economy growing at a relatively sluggish rate. Nothing in our figures would invalidate the assumption generally in the market that we're growing at 1 percent to 1.5 percent. That's what we see. Chris, on the first point on NatWest Markets? Chris Marks?

Chris Marks: There's not a massive amount more to say than has already been said. The second quarter was impacted by pretty turbulent European conditions, as you all appreciate. That where we're a big (Break) market maker. So we're in the flows. Customer activity throughout the whole period was consistent low, actually consistent with Q1 and slightly up on Q1, which is good. So whilst it's difficult to monetize a bit of a spread in those conditions.

Actually, we deepen customer relationships and continue to make progress. I think you asked about FX as well. FX, after the flow FX products have been very consistent. There's been reduced FX volatility in the markets that we are in, and for our options businesses, so that has resulted in a sort of slowdown for a little while.

And it's also quite a competitive market. But nothing indicates that this is anything other than, sort of geopolitical, macroeconomic drivers that are impacting our business. And that would certainly show with how that business is performing since the next quarter.

Howard John Davies: Thanks, Chris. Ewen, do you want to deal with the second question?

Ewen James Stevenson: Yes. Look, on net interest margin, I guess there's a range of things still going on. So we're still got, as we talked about earlier, an 18 basis point differential between back book and front book pricing on mortgages. That's actually improved back to 80 points.

It was quite tough in April and May and got a bit better in June. The – we do expect liquidity ratios to come down. We obviously had base rate rise yesterday, which again will be beneficial, if you roll that forward. We've put disclosure into the document.

But if you just look at that, that should provide about GBP 300 million of additional net interest support by the time you get out to 200 – 2020. But I would think NIM, for the second half – I mean – though I don't like forecasting NIM versus just some other members of the team that are here. The – I mean, I would think it should be flat to slightly up in the second half. And...

Howard John Davies: OK. And I got one again from outside. (Russell) (inaudible) from Redburn. This has got Les Matheson written all over it. In light of the recent paper on the FCA, how worried would you be about the introduction of a basic savings rate in the U.K. and what confidence would you have to be able to offset that on the asset side?

Leslie D. Matheson: Look, I think there's still got – quite a way to run. It's an initial thought piece around how things might work. I think what – if you actually go through the details of the paper, what becomes clear is actually, what the FCA is talking about is a base savings rate for each organization.

So it isn't a base rate across the whole industry. It's that each company or organization should have a base savings rate that they communicate to their customers. So I think this would – has got a long way to run. I think, as far as we're concerned, we are – we're less concerned about this because we don't actually have a back book on savings. Our savings back book and front book are actually the same thing. So from our perspective, it would have a little or no impact.

Howard John Davies: OK, thank you. Next, Ian. So if you go along the same row. Next to – the second one in. Thanks, and then I'll come back.

Raul Sinha: It's Raul Sinha from JP Morgan here. If I can have 2, please. Just, on the first one. I just wanted to get your thoughts around why you've gone with an open-ended core Tier 1 ratio target now that you've settled with DOJ?

If you look at the other 2 big domestic U.K. banks, they put – stuck their necks out and actually given us a capital ratio target. That allows the market to have some sense of pricing of how much excess capital they may or may not have.

And so, I was wondering if you might be able to tell us whether this 13 percent-plus target is only around till the stress test, when you actually find out your new PRA buffer and that the full year result, we should probably expect a little bit more certainty on how much capital you intend to run the business with. That's the first one.

Ewen James Stevenson: Yes. Look, so I don't want to comment on how other people set their payout ratios and core Tier 1 targets. I mean for us, we've always had a fundamentalist approach of saying, "Where did we want to be under extreme stress?" Which we think is 9 percent, and then we build up from that.

We've always said we think that's about a 400 basis point buffer, which gets us to the 13 percent. I think 2 new dynamics at the moment are you've got a lot of RWA inflation pending through particularly mortgage floors and Basel III reforms. The Basel III reform component of that I think is particularly uncertain until there's more clarity. And then offsetting that, you've got the additional capital volatility introduced by IFRS 9.

Again, which I think we're in the beginning to understand. So we think 400 basis points past all of that impact is the right approach, but there's still quite a lot of assumptions in that modeling to get there. If you look at the RWA inflation, including the impact of mortgage floors and Basel III reforms, it's not an insignificant number.

So going back to this is, you'll always want to sort of progressively build into that. So yes, part of the caution on giving you a firm guidance on where we're aiming for on capital is, until you can tell me what the impact of these Basel III reforms, which no one can today.

It's very hard to say, understanding that's where your RWA goes and therefore, what the impact is under stress buffer. You need to have, as a result of that, including understanding IFRS 9. I would be surprised if any of our peers could try do that with clarity and a direct flow-through into their stress testing buffers. I think we'll provide you, frankly, more clarity than anyone else on that.

Secondly then in terms of payout ratio. Again, IFRS 9 is going to introduce a degree of additional earnings volatility into everyone's earnings. People may have been less transparent with you on that point, but it will introduce a degree of pro cyclicality.

We do think that setting a conservative payout ratio for now, until we understand that pro cyclicality better, is the right thing to do. But what we are committing to do is to pay out any surplus on top of that to get you back to long-term capital planning assumptions.

Raul Sinha: I guess, the market wants an idea of what hurdle rate that you should look at when it's priced. How much surplus, you can return obviously. That's the direction which we're coming from. We get – you also said that you are less cyclically geared to IFRS 9 than your peers and your management buffer, actually 1.9 percent, is bigger than the other 2 peers.

So that would indicate to me that you've got a lot more conservatism baked into your capital plan, and that's why I was wondering, if it's just the PRA buffer reset that you're waiting for and (inaudible).

Ewen James Stevenson: No, no. As I said, it's got nothing to do with the PRA buffer. And actually, banks shouldn't manage themselves to PRA buffers. They should manage themselves to what they think the appropriate stress buffer is that they need in their business model. Which always, I would have thought, would be higher than whatever the PRA buffer is.

So we think that answer for us is a 400 basis point buffer on top of the 9 percent extreme stress capital target. That gets us back to 13 percent. I think we've been clear on that, always introducing as a degree of caution, and we're not quite sure until we understand some of the other components how quickly we can reconfirm the 400 basis points is the right buffer in the context of Basel III reforms and IFRS 9.

So I think for the time being, we'll be slightly ahead of that. But I think we've been clear on it.

Raul Sinha: Maybe just a second one on the payout ratio. I know you've made it clear that when we think about the return on Basel III capital, 13 percent, you should theoretically see that in the long term. If you hit your 12 percent ROE target in 2020, you should be able to do a 70 percent payout ratio.

But again, you're choosing to commit to only a 40 percent payout ratio here. And I wonder if you are saving – putting capital aside for a potential investment plan in the future beyond the 2020 timeline, because, clearly there are the investment needs, particularly on technology.

Ewen James Stevenson: No. Well, maybe I'm not explaining myself. But – or you're overthinking it. But the 40 percent payout ratio is based on a through-the-cycle view of – if you go through a cycle view on sort of – assuming there's a mild stress event in that cycle. But we have confidence that we'll be able to commit to continue to meet that 40 percent payout ratio.

So it just means – But you're never going – you're only going to hit that point – that weak points in the cycle. Most points in the cycle, you'll going to be able to pay out comfortably more than the 40 percent.

Howard John Davies: Fourth row back. Yes, thank you.

David John Lock: David Lock from Deutsche. One on mortgage retention, please. I think Lloyds has given information that more than 80 percent of their customers will retain their mortgages. I just wondered if you can give any comments on whether thats changed for RBS in Q1 or Q2?

And then second question is on Ireland. I think looking at the release today, your risk-weight intensity there is 92 percent, and we're seeing a number of other players in Ireland that are looking to perhaps sell more portfolios to reduce their risk-weighted assets.

And it seems from press reports, the regulators are very keen for that to happen as well. I just wondered if there was any potential for you to perhaps accelerate the ability to get capital out of your Irish division, given that you got about EUR 2 billion though, at least in capital at the moment.

Howard John Davies: Thank you. Les can get the first one, perhaps. Or…

Ross Maxwell McEwan: I'll have the second here.

Howard John Davies: Ross on the second here.

Leslie D. Matheson: Yes. Look, I mean it's a quick answer on the first front. So we have not really seen much change in terms of our retention rates. Our retention rates are a bit lower than Lloyds. They are more like 65 percent to 70 percent, but there hasn't really been much change over the half. Ross?

Ross Maxwell McEwan: Just on the Irish business, we have got a portfolio in the market at the moment. And over the next couple of weeks, we expect to get final bids on that, and there's been some strong interest on that, so that's good.

The question for us is there's another portfolio or perhaps a portfolio we should be selling. The answer there, I suspect, is yes. Let's get the first tranche done and the team work on the next. And as you know, we've got a very, very experienced team that work on these and get them structured up well enough to get it in the marketplace.

The risk-weighting intensity in that business is very high. We have got a lot of work to get the regulators stable – comfortable with that business, so that's in a great, stable shape. And most of that is in our hands, and part of that is around portfolios sales getting the nonperforming loans down. But without a CEO over there at the moment and a number of roles, so we have a bit of work to do to make it.

Ewen James Stevenson: Yes. I mean, they are linked, David. (Inaudible) always problems involved is the fact we think the cost of capital is lower than the cost of capital of hedge funds and private equity you were calling from us. But – yes, so for something like the tracker and mortgage portfolio, which is a big part of what Ireland is for us, it's performing, it's a decent portfolio, it doesn't end any return. If you'd like to buy it from us at par, we'd be happy to sell it to you.

Ross Maxwell McEwan: But there is a drag on that business because of that portfolio, such that we are building the plan to actually get that in much better shape. And there's been some really good work, as you've seen in the accounts in the first half of this year.

Costs are coming down but there's quite bit of remediation still going on in that business and not in the shape that we wish it to be in yet. But the team are working hard on it, and I think in another 2 years, you'll see a different business.

David John Lock: I guess, just to come at it from another angle, you got GBP 5 billion to GBP 10 billion is your target on RWA reduction this year. Could we actually see that being higher or extending into next year, if you're doing more portfolio sale?

Ross Maxwell McEwan: No. I think – Well, the big swing factor whether it's GBP 5 billion or GBP 10 billion will be Alawwal. If Alawwal falls into next year, it's going to be at the low end of the scale. This year, it would be the GBP 5 billion. If Alawwal falls into this year, it's going to be a GBP 10 billion.

We have got some portfolio ourselves connected into our plan for this year, and it's in the market, and we think it will sell. And then we will – as I said, we'll look at the next one. And what else can we sell? It's probably better in somebody else's hands.

Howard John Davies: Next? We're going to go over here, second.

Jennifer Cook: Jenny Cook from Mediobanca. I just had one very quick one, which is more of a quick clarification. I appreciate you don't want to get any more specific at the moment over timeline to reach about 40 percent payout ratio. But I just want to check, is that the payout ratio you see as part of your PRA annual stress test this year?

And does that include the glide path up to that 40 percent, if I guess, you kind of covered the 5-year time horizon, you can imagine you've already all reached that over the course of that stress test period? And would there be any buybacks in that as well?

Ewen James Stevenson: Certainly, the payout ratio was part of this year's stress test submission. But payouts on top of that wouldn't have been, because they're nonregular payouts. And when do we expect to get there? Look, I'm going to – we said a lot of conversation around payouts.

But certainly, if you think about the excess count – we should be able to build to that payout ratio quite quickly over the next couple of years. But I think the fundamental issue is even if you're paying out 40 percent from

now, we're still sitting on a lot of excess capital, and the excess capital will continue to build. So we do need to find other mechanisms to return it.

Ross Maxwell McEwan: Yes. I think that's a very good point. The 40 percent payout ratio, we're still building capital, and we've still got too much. But – So that's why next year we have to work through the other ways of getting it back to shareholders.

Howard John Davies: Thank you. Fourth row, just on…

John Cronin: It's John Cronin from Goodbody. Firstly, just coming back to your point on mortgages, and I think mentioned, you've identified other segments of the market that you're going to expand into in the U.K. context. I know you referenced to aspirations around professional buy-to-let lending back in Q3. Is that something that we can expect to see you develop into in the near or medium term?

And then the second question is on Ireland. It struck me that you struck a slightly more upbeat tone this time around compared to last quarter, with respect to new business. And given the recent significant rate – downward rate move and the – what does that mean in terms of your share ambitions, I guess?

And another question, in Irish context, is the RWA intensity point, coming back to David's question. So outside the portfolio of sales, are you doing anything with the regulators over and above the work you had been doing in recent years to achieve risk-weighted asset reduction intensity?

And as long as I refer to Bank of Ireland's test presentation, where they called out, and quite loudly, about the RWA intensity pertaining to Irish mortgage book. It's a complete outlier in the European context. So anything you can say about that or anything that can happen on look back periods would be helpful.

Ross Maxwell McEwan: But just first, on the mortgages. (Alawwal) is an area that we are looking at. There are pockets of the Alawwal that we think can

participate more insightfully or keep coming back to that word safely. We are not rushing into markets that – just to put more assets on the book. So yes, we are looking at the Alawwal market as an opportunity in parts of that of that Alawwal market.

On Ireland, my more upbeat – was probably just a bit more upbeat today announcing a 2p intention to pay a dividend, and the profit in the second quarter that we didn't – many didn't anticipate us pay. So this probably be the outlying of upbeat and it flows through into Ireland. We are building a team in Ireland that we believe will do a very, very good job for us over a longer period of time.

I will reiterate what I said at the first quarter results. This is taking us longer than I ever anticipated. It is #2 on our to-get-done list or things-that-worry me list. And we are putting the resources accordingly. And getting – see, I went there with a really strong team, which was what we're building at the moment. I am very – I'm pleased about.

We are starting to see things like, we'll get the nonperforming loan book reduced. We are stuck with a tracker book. We just need to accept that and go forward, but we need that quietly to grow that business. The Irish economy, as we all know, goes up and then that Irish economy comes down, and it goes back up and down again, and the loser on all of these is always the banks.

So let's not be a loser in this cycle round. Let's be all – be sensible is what I'm saying. But...

Ewen James Stevenson: And for the point on RWA intensity and modeling, but to be fair to the regulator, Ireland had one of the highest peak-to-trough falls in terms of its residential housing market, which flows through the models. So the people should expect RWA intensity in Ireland to be significantly higher than other markets, because that's just what the models produce.

Ireland has been more cyclical, as Ross just says, and that produces higher RWA density through the model. The Irish banks may not like it, but that's the reality of the market where we do business in.

Howard John Davies: Just to be clear, in case anyone's wondering, he said Ulster is his #2 on his worry list. Someone's bound to ask # 1. That's me, actually. Yes, I got – some woman there, and I'm going to get back to you. Thanks. We're running a little bit short on time now.

Claire Kane: Just 2 quick questions. Maybe to – Sorry. It's Claire Kane from Credit Suisse. Just on the capital question, one last way to look at it. 2020...

Ross Maxwell McEwan: You sure that's not (inaudible).

Claire Kane: How comfortable would you be to say that you didn't deliver on 12 percent ROTE because you have to retain too much capital? Could we say that actually, your distribution, that you will be balancing an item to get you there, if earnings weren't available?

Howard John Davies: You can answer that one, Ewen. (Inaudible).

Ewen James Stevenson: I think the more binding constraint on target is sub-50 percent cost/income ratio. So actually, retaining capital doesn't help – retaining capital helps, that actually. But actually, the more binding – so yes, so when you solve for the 2 of them, you can play around with your capital ratios. But I don't think we're going to play around with capital in order to try and solve 2020 financial targets.

I mean, as we've kind of committing to, yes, with any degree of caution as we've gone from a place where we haven't paid out any capital in 10 years. And you're all sitting there trying to get us – to encourage us to pay out more than 100 percent of our capital in any given year.

We are sitting here naturally, skeptical about the pace at which we'll be able to get there, but we're certainly not trying to pretend that we understand that we're sitting on a lot of excess capital. And we're going to try and figure out how to get it back to the market as quickly as we can.

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Claire Kane: So my second question then was on costs. Which you – you've done so nicely. So the GBP 1.8 billion we have for this quarter, you mentioned previously that cost saves are slow this year. Is this the run rate you'd like our sense to move to for this year? And any comments on the (inaudible).

Ewen James Stevenson: Yes – no, no. So I tried a full year to encourage people to moderate the cost reduction targets. I obviously failed. So...

Howard John Davies: It's not entirely you, Ewen. It was another guy.

Ewen James Stevenson: Slicing the first half by 2 might be a better estimate of what we currently think that where consensus currently sits.

Ross Maxwell McEwan: Ewen did try a full year to actually moderate the cost reductions. He failed badly. This year, we said we do want to spend some money on this business.

There are some things that we are doing that we think will be beneficial longer term, but we are committed to the 2020 targets of the 50 percent or less cost-to-income ratio. And there's further cost and income that makes that ratio. And a 12-plus percent return on equity, so that's what we're willing to do. But this year, will be a slower rundown of the cost as we do see things that will help us in '19 and '20 and beyond that as well.

Howard John Davies: Thanks. Can you move it just along to your right?

Christopher Robert Manners: It's Chris Manners from Barclays. Just 3 really quick ones. The first one was, yes, in the appendix, slide 33, talking about the pass through, the rate hike and that will help your NII. Just in that managed margin assumption, can you let us know what sort of deposit beta you're assuming?

The second question was on the 40 percent payout ratio. Is that 40 percent payout of staff profit or was that out of adjusted profit? And so if we do get one-offs in a given year, would that actually necessarily just

bring down your dividend? Are you going to leaver yourself vulnerable to that?

And the third question, maybe this is for Howard and for Ross. Yes, I think we'd all agree, Ewen has done a great job as CFO, and you're obviously looking for candidates. What qualities are you looking for in the replacement?

Ewen James Stevenson: I've got the answer to that.

Ross Maxwell McEwan: So yes. Ewen can add after you start. Maybe if I can start on the final one. We are looking for a new CFO. I am losing a CRO, who is an Australian, and I'm losing a CFO for Kiwi (inaudible) in Australasia, just to balance the thing up for the rest of the U.K. population that I work with. No, we are in the market looking, both internally and externally, and that search will, I think, last for a number of months.

Ewen James Stevenson: Yes, so I don't think we're going to share what our pass-through rate is on deposits. I mean it's obviously a competitive thing. But I mean – yes, that's based on the modeling that we see.

As I said earlier, we think yesterday's base rate rise should add about GBP 300 million of income to 2020 income projections, which is sort of triangulating the GBP 275 million in year 2 and GBP 350 million-odd in year 3.

The 40 percent payout ratio, we don't do adjusted numbers anymore, Chris. So it is on bottom line statutory profit. But as I said, that you should lead that as a regular payout ratio and we'll optimize on top of that as we need to optimize.

Christopher Robert Manners: So you would be happy not to have a progressive dividend to meet the payout ratio policy just cause it seems other banks (inaudible).

Ewen James Stevenson: Yes, I mean it's very clear regulator progressive dividend payout ratios because they think it unnecessarily ties banks into being forced to make dividend payments in years that they can't afford to do so. So we think we're very well-aligned with the PRA's views on these payout ratios is a good place to go.

Howard John Davies: And going to take one more, I'm afraid. Right at the back. Anyone? Because we are running on quite a tight timetable. Anyone who is, sorry, they didn't get in can blame Goldman for taking 3 long questions. So – and then Ross – one more question, and then Ross will wind up then.

Fahed Irshad Kunwar: Fahed Kunwar from Redburn. Just one question on margins. If on the deposits side you're front book and back book is now in line, and you got an 80 basis point spread, which I'm seeing is all on the asset side, why – and obviously your taking flow, you're taking market share in mortgages and you see the environments still very competitive.

Why should we not think that margins are just – in kind of steady decline? I understand you had a bit of a bump from the rate hike in H2. What am I missing in my understanding of why your NII might grow because volumes are good but why should I not think margins are steadily declining from here?

Ewen James Stevenson: Yes. So I mean, the balance between liability spreads and asset spreads may move around. So – we think even where we're writing mortgages today, we're still earning 50 percent on capital, well above the cost of capital.

But so – we do think there could be some rebalancing over time as we get back to more normalized rate environment with mortgage spreads continuing to come down, but capturing more on the (deposit) side. I don't know if there will be anything unusual on that, but it's obviously the net spreads between those 2 that is important as well.

Howard John Davies: OK. Ross, do you want to wind up?

Ross Maxwell McEwan: Yes. Thanks for that. Thanks, Howard. I'll just finish by giving my summation of where we think we're at. I think these are good set of results in a pretty tough environment. Profit before tax GBP 1.8 billion, after tax and other items, GBP 888 billion. It includes the DOJ, the intention to pay a dividend announced today, and still we have a 16.1 percent CET ratio and a return on tangible equity of 10 percent if you strip out the DOJ.

So this is a great bank and worth investing in. We have strongly supporting the economy we operate in. If you look at the numbers here, we are a big part of this economy, and we plan to remain that way. We have seen growth in the segments that we do like, and will continue pushing to those markets as long as it's done safely.

The big issue for us, the legacy issues, the big ones are behind us, and now we can concentrate on this business and get all of our people focusing on looking after our customers. And I think that's a big part of the story today as well with the big items behind us, we've got more time. We've got a quick executive team doing a great job and that team can be unleashed on the marketplace much more than we've been able to in the past.

A big thanks to Ewen, but also a big thanks to my team. It's been a big 5 years for this organization. And I think this thing – this business has turned the corner for the positive. Thank you very much for your support.

Howard John Davies: Great. Thank you for coming. Bye.

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