The Royal Bank of Scotland Group

Q1 2012 Results

MEDIA CONFERENCE

Held at the offices of the Company

280 Bishopsgate London EC2

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FORWARD-LOOKING STATEMENTS

This transcript includes certain statements regarding our assumptions, projections, expectations, intentions or beliefs about future events. These statements constitute "forward-looking statements" for purposes of the Private Securities Litigation Reform Act of 1995. We caution that these statements may and often do vary materially from actual results. Accordingly, we cannot assure you that actual results will not differ materially from those expressed or implied by the forward-looking statements. You should read the section entitled "Forward-Looking Statements" in our Annual Results announcement published on 23rd February 2012.

Presenters

- **Stephen Hester (Group Chief Executive)**
- **Bruce Van Saun (Group Finance Director)**

Presentation

Operator

Good morning, ladies and gentlemen, today's conference call will be hosted by Stephen Hester, Group Chief Executive of RBS.

Stephen Hester – *Group Chief Executive, RBS*

Hi, good morning everyone. Thank you very much for joining us. Bruce Van Saun is with me as usual and obviously our purpose today is to try to answer any questions that you might have on the first quarter results that we announced this morning. What I'll do is just spend a couple of minutes introducing them, as it were, but then dive straight into your questions. So I think, standing back, we are happy with the progress that we've reported today in our first quarter, although cognisant of the tough economic and regulatory background and I think the best way for me to go through it with you is in the context of the two different jobs that we are trying to do at RBS. So, as you know, one of our jobs is to, what I've previously described as, diffuse the risk time bomb, correct the mistakes of the past – whatever way you want to look at it. I think terrific progress continues in this whole area. Any metric you look at: reducing our non-core assets, increasing the liquidity strength of the bank, increasing the capital ratios of the bank – all of these have again in the first quarter gone in the direction of safety and soundness – greater safety and soundness. We're pleased with that. I think in particular there are a couple of, I guess, important symbolic milestones that we've been able to announce with these results.

The first of those is that within the next week we'll have completed the process of paying back all of the Central Bank support from whatever source that we received liquidity support in the crisis – that's a number well in excess of £100 billion – and, in particular, the last piece that we're finishing paying off next week, which is the UK treasury credit guarantee scheme. I'm pleased to report that the government will have made a profit of £1.5 billion, never having been called upon that guarantee, so that's obviously the way we'd like it to be and I'm sure the way they're happy with it to be. Secondly, we're also able to announce another step in what I'll call the normalisation of RBS today, which is beginning to service, once again, our preference shares in Hybrid Capital and paying dividends on those obviously. We're all looking forward to the day when we're paying dividends on ordinary shares as well, but this is a further step forwards and a milestone for us and, as you all know, more in the symbolic category than anything else, the share consolidation we've got coming before the AGM this month as part of all of these milestones in, if you like, looking forward rather than looking backwards. So I think the recovery path, the safety and soundness of RBS, you know, some really good things to talk about in this quarter. That said, we need that to happen. You know, we're correcting things that were wrong from the past and we're very conscious that the outside world remains a tough and unforgiving place. We're conscious that, you know, the probability is things go wrong more than right at the moment for the economy as a whole and for markets and so, you know, it's important that we get over these past weaknesses and that we are strong and resilient and able to absorb whatever bumps in the road are thrown our way in the coming period.

Turning to our second vital job, and that's running this big, complex bank as well as we can, doing a good job for our customers, improving that and laying the foundations for the long term recovery of the bank which ultimately, of course, will express itself in a high share price and the government selling its shares. Here progress is also significant, but probably less visible for the following sense that one of the important lessons, I think, out of financial crisis – you know, I've spoken about it on many occasions – is that we all had to learn, perhaps painfully, that banks are as healthy as their customers and, of course, our future is entwined with the health of our customers and so, if the outside world is leaving our customers feeling a little flat, feeling like their businesses are not increasing, they're not feeling expansionist, then they're not doing more in their businesses, they're not doing more with us and so it's hard for us to grow our revenue. Nevertheless, despite those headwinds that all banks are facing, we are going about our business of strengthening the bank, making improvements in areas where we needed to. The US has improved again this quarter in its underlying return on equity and making sure that we provide lending support to those who need it and you'll see again in our results today, you know, that we're again punching well above our natural weight in terms of lending support, albeit in a market where mostly people don't want to borrow more and are still reducing their debts.

So followed profits for the ongoing bank: £1.7 billion of profits for the ongoing bank. £1.2 billion of profits for the whole bank before the accounting charge for fair value of own debt which, you know, is largely accounting noise, but nevertheless bringing us into loss with irony that that simply reflects – investors thinking that we're stronger and safer again and how it arises. Plenty still to do and, although within the guts of the business we've noted improvements, the investment bank is another area where we've been restructuring and where a 21% return on equity in the first quarter was pleasing, although not one, I think, we can extract later on. All of that work will continue and we will try at a report in a quarter's time, you know, progress in both our two jobs once again. So I think that's what I'd say by way of an opener and now I'm very happy to dive into any questions you have.

Questions and Answers

Operator

Thank you, Stephen. Ladies and gentlemen, if you would like to ask a question, please press the star key followed by the digit one on your telephone keypad. We will pause for a moment to give everyone an opportunity to signal for questions. Your first question comes from the line of Patrick Jenkins from the Financial Times. Please go ahead.

Patrick Jenkins – *Financial Times*

Morning, Stephen, a couple of things. Firstly, I just wondered if you could talk a little bit about the underlying performance of the bank as you say that's what, you know, the core business going forward is going to become the bank going forward and there it seems that your profitability trend is going the, kind of, wrong way at a time when rivals are maybe at a pretty decent quarter. I wondered if you could go through to what extent the investment bank wind-down is responsible for that. And then the second question is on your AGM and I was just wondering to what extent you expect that to be a difficult affair other banks and companies generally seem to be having trouble with their shareholders? You're obviously in a different position slightly with the 82% holding in the government, but I would love to hear your views on that.

Stephen Hester – *Group Chief Executive, RBS*

Well, on the second one first, sadly for me I don't think there's going to be any controversy over my bonus levels, so controversy is to be had, but I guess that's not going to be one of them. Your question on the underlying business is an important question. Actually, of course, our underlying trends are sharply up on the last quarter – some of them are up and some of them are down on the quarter a year ago – but let me try and give you my take on it. The investment bank, I think, has a lot of quarterly volatility in it and when I cut through that basically I think the investment bank is doing fine within the context of its industry – badly when others do badly, well when others do well. We've obviously (sound slip) the investment bank. So it's down 20% in the last year alone, which no other investment bank is. However our profitability levels are 21% return on equity, I think, is right at the top end of the industry, albeit on smaller resources.

I think it is better for shareholders that we have a business balance that favours the more stable and retail and commercial businesses, but on the other hand the investment bank is crucial to our customers, provided we get it the right size. And so I'm comfortable with that and I think our performance stacks up well against others, as I say, adjusted for the resource reduction that we've made. In terms of the 80% of the bank which is retail and commercial, our return on equity, excluding the Ulster losses, which I think is probably a fair underlying one, is 14%, I'm told. I thought it was 13%, but anyway it's higher than our cost of capital and so, again, I think that that, as a profitability measure, compares well with anyone you might want to compare us against and

I would say the retail and commercial bank is basically treading water in terms of growth – so reasonable profitability, but treading water in terms of growth for the reasons that I talked about before. I think that we actually, ironically, have a better position than a number of our competitors, which is to say that we have done so much work so successfully on the way the bank is financed that in our core business we now have more deposits than loans – a 93% loan to deposit ration – and so, while others are still having to shrink their core business in order to come into line on loan to deposit ratio, our problem is the other one – we'd like to find some more people to lend to in our core business and we've got the money to do it. Obviously that will require the economy to feel more expansionist, but at least I feel that we're poised with the financial resources to support growth once our customers want to take advantage of it.

Patrick Jenkins – *Financial Times*

Okay, thanks very much.

Operator

Thank you. Your next question comes from the line of Miles Costello from The Times. Please go ahead.

Miles Costello – *The Times*

Morning, Stephen, Bruce – three quick questions. Firstly, have you decided yet how you're going to fund the renewed dividend payments on the Hybrid Capital? Secondly, there's been some talk of you might issue fresh shares, I suppose, is in my mind... secondly, can you remind us of what the, sort of, outlook and the timeframe is for the beginning payments of dividends to the ordinary shareholders? And, third, just a quick one on direct line – I think you've, sort of, indicated all along that you will be prepared to consider an approach from a buyer of direct line at the same time as preparing it to float, but what's your appetite for the, kind of, sort of, cash and shares proposal that's being floated by the likes of Tungsten?

Stephen Hester – *Group Chief Executive, RBS*

Well, let me ask Bruce to talk about your dividend point and then I'll pick up on the... sorry, how we're funding it... and I'll pick up on the ordinary dividends and direct line.

Bruce Van Saun – Group Finance Director, RBS

Okay, sure. We did indicate today in the release that the cost of the dividends this year will be about £350 million and we will make that neutral to our core tier one ratio through adjusting our, kind of, term... Two things... The first is we're going to adjust the equity funding of our incentive awards and that will about £250 million. We're selling shares that we have in an employee benefit trust and that's largely already complete and then that leaves about £100 million which we will have new issuance of shares that will dribble out over the rest of the year. So the net of that, our core tier one ration, is protected and we get to turn those coupons back on.

Miles Costello – *The Times*

Does that feel like it's going to be an annual issuance of shares based on an annual commitment to dividends?

Bruce Van Saun – Group Finance Director, RBS

I guess, at this point, given that the FBC is being cautious and wants banks to manage their capital levels very carefully and we're still frankly transitioning from recovery into a bank that's making profit. Hopefully this is still the transitional phase and when we get to next year we'll have more robust profit and we wouldn't have to go to the market and issue an offsetting amount in shares to the coupons.

Miles Costello – *The Times*

All right, thank you.

Stephen Hester – *Group Chief Executive, RBS*

Just on your other two, on the outlook for ordinary dividends, I mean, the first thing is, you know, I think we're crystal clear the RBS that we're trying to design for the future will be one that pays attractive, good and regular dividends and so that's the path that we're wanting to be on. I think that the different issues on that path, first of all, while we're making good profits in our core business, at the moment we're still spending them on the cleanup from the past. We obviously have to get through that and I've said before I think that, you know, there's another 18 months or so of what I call heavy lifting on that. Secondly, the FSA have got to allow us to pay ordinary dividends. Regulators around the world, for example, the United States, are being cautious in allowing banks to resume dividends. My guess is the FSA will be cautious so we have to, I suspect, get through Basel III before they relax on that and, thirdly, the government has to remove the dividend access share that it holds in order for ordinary dividends to be a sensible thing to do and, you know, clearly that will be on their agenda, I'm sure, nearer the time. So those are the differences which mean, I'm afraid, it's not imminent but, you know, we are absolutely in no doubt that RBS of the future will be an attractive dividend-paying stock.

Miles Costello – *The Times*

Okay and thirdly?

Stephen Hester – *Group Chief Executive, RBS*

And your third thing on direct line, our belief is that this will be an IPO. We have a duty to shareholders that, if someone put us, you know, a proposal that was superior to that, we should consider it. At the moment we are not in any talks with anyone on alternative proposals.

Miles Costello – *The Times*

But my thinking was rather than... I mean, not expecting you to comment directly on Tungsten who are saying that they haven't made any, kind of, approach because they can't, because they've not listed yet, but it was the complexity of an offer. You know, how important is it that you have a clean sale of direct line if you receive an attractive approach? I mean, are you prepared to explore the, sort of, complexity of, you know, being offered shares as well?

Stephen Hester – *Group Chief Executive, RBS*

We're rational people. I think, like any rational people, that our first choice is to do simple and valuable things, but if complicated things are more valuable we'll always look at them in any aspect of our business. But, as I say, my view is direct line will be a terrific public company. I think that's likely to be the best route and that's the route we're pursuing but, you know, we will be shareholder friendly in everything we do.

Miles Costello – *The Times*

Thank you very much.

Operator

Thank you. Your next question comes from the line of Sara Munoz from The Wall Street Journal. Please go ahead.

Sara Munoz – *The Wall Street Journal*

Hi, good morning, Stephen and Bruce. First question, I noticed that you said that the impairment charges were falling. I wonder is that the result of an improvement in the UK economy or is that due to more aggressive recovery efforts? And I'm also wondering if you can give me any kind of an update on the horizon at this point for selling some of the government [estate] back into the private sector?

Stephen Hester – *Group Chief Executive, RBS*

On impairments I would say, you know, there are nuances. Economies are flat, but the US is a bit better than flat and so underlying impairments are probably really falling there. For the rest of the world, you know, corporations and individuals are, sort of, healing themselves and so there's some gradual positive trends and also we're finishing provisioning of things from the past, but I don't think... there's not, sort of, big moves in the rest of the world. The US is the only where you can say, you know, this is really looking better; the rest is all ticking better and Ireland isn't obviously yet ticking better, but we hope it will.

Sara Munoz – *The Wall Street Journal*

Okay, so it's really just being pulled along by the US more than any...?

Stephen Hester – *Group Chief Executive, RBS*

Well, no. The US is where the most clear growth is happening of the mature economies, but the UK, you know, the UK is flat – the economy – and along with that, you know, because it's flat, businesses are not in bad shape; they're simply not expanding and people in general... you know, the unemployment rate has been relatively stable and so, you know, credit has been okay in the UK to slightly positive, but so, in a sense, that's where we are. But I don't think there's sharp trends to the positive going on in the UK. There are sharper trends in the US reflecting the resumption of growth.

Sara Munoz – *The Wall Street Journal*

Okay.

Stephen Hester – *Group Chief Executive, RBS*

On your second point on government share sales, I mean, look, I suppose the point I'm always going to make is this is entirely up to the government. They choose when to sell, how to sell, you know, and so on and so forth and, as far as I'm aware, they haven't communicated to me or anyone else, you know, what their definitive plan is on that but, you know, I'm unaware of, you know, anything imminent. On the other hand my state of belief is that they consider it desirable that the £45 billion they invested in RBS can be used for other things in the UK economy and we consider that desirable so, you know, I think we're all anxious for the process to start.

Sara Munoz – *The Wall Street Journal*

Okay, thank you.

Operator

Thank you. Your next question comes from the line of Steve Hawkes from The Sun. Please go ahead.

Steve Hawkes – *The Sun*

Hi, Stephen, just picking up on that point, when you talk about you're all anxious for it to start. Would you be quite disappointed if that process hasn't started in the next 12 months?

Stephen Hester – *Group Chief Executive, RBS*

I have learnt to my pain that sometimes ones hopes and fears don't come out the way one wants. You know, there's lots of uncontrollables for us, so I think the best thing is that I need to focus with my colleagues on, you know, having RBS in increasingly good shape. We obvious don't control what the outside world is, we don't control the stock market and we don't control the government so, you know, if it's a short haul, that's terrific, if it's a longer haul, we'll deal with it.

Steve Hawkes – *The Sun*

Can I just ask what you think of Mervyn King and his record?

Stephen Hester – *Group Chief Executive, RBS*

Well, I think that that subject has been extremely well-rehearsed in the press in the last couple of days. I'm not sure I have any opinion that isn't covered in some way or another in the coverage.

Steve Hawkes – *The Sun*

But do you share his view that there are signs of recovery? I mean, your customer deposits didn't seem to grow that much given that everyone supposed to be saving. I just wondered what you felt about the sense of a recovery because, I mean, you are probably quite a big barometer of that.

Stephen Hester – *Group Chief Executive, RBS*

Well, as I say, as it relates to the UK economy, our current sense is the economy is a little bit to the positive side of flat. So I know the most recent GDP numbers were a little bit to the negative side of flat. I think our view is it's a little bit better than those GDP number show, but it's still close to flat and, you know, while some businesses are doing well, others are doing less well and so the overall picture is one where people are a bit short on confidence and their order books are not especially growing nor are they going down. So that's roughly what we see. You know, I'm hopeful that the recovery in the US, if it has legs and if it continues – and those are ifs – will, as it so often does, you know, help pull the UK and Europe behind it and that we may see a better second half. So, you know, I would be hopeful of that but, you know, I think one would be wrong to ascribe high levels of confidence to these things given all the other stuff out there in the world that there is to worry about.

Steve Hawkes – *The Sun*

Last one, but I take it you're not suggesting... I take it you would quite like RBS to move their bonuses into June next year, wouldn't you?

Stephen Hester – *Group Chief Executive, RBS*

Why June next year?

Steve Hawkes – *The Sun*

Everyone else would have gone before you then.

Stephen Hester – *Group Chief Executive, RBS*

What I really want is for us to create value by, first of all, reducing risk for the UK economy and all of the [alliance] and, secondly, having a better business and, you know, I hope people will have the grace to appreciate it when we do that and as we do it.

Steve Hawkes – *The Sun*

Do you think the pay row has gone too far, Stephen?

Stephen Hester – *Group Chief Executive, RBS*

You know, I think I've had enough controversy on that subject. I'm not going to invite more.

Steve Hawkes – *The Sun*

Okay, thanks.

Operator

Thank you. Your next question comes from the line of Jill Treanor from The Guardian. Please go ahead.

Jill Treanor – *The Guardian*

Hi there, I just wondered do you have any updates on when you might exit the asset protection scheme.

Stephen Hester – *Group Chief Executive, RBS*

No, nothing new. I mean, our view is we'll never call on it. The government will make a very healthy profit out of it and we'd like to cancel it. We need to get to the end of the minimum period and we need the FSA to agree with us and that's where we are.

Jill Treanor – *The Guardian*

I noticed you say in the statement that you have repaid the minimum fee of £2.5 billion, so does that mean you're at a point now where you can start talking about it?

Bruce Van Saun – Group Finance Director, RBS

Well, it's actually, Jill, just to be clear; we expensed the £2.5 billion. We haven't paid the cash over yet, so the accounting words, it's a derivative and so, since we don't think we're going to claim on it, it has no value, so we have to expense it and we have the obligation to pay the full £2.5 billion. The actual cash flow of paying that, we're paying quarterly this year and we would fulfil the £2.5 billion on a cash basis roughly by the end of September, early October and so that would be the period that we could leave. Again we're in discussions with the FSA over the stress test. As we speak they're doing a stress test on all UK banks through the second quarter. I think when we get to that point and add more visibility into performance into the second half of the year and into next year, that would be the opportune time to bring those discussions to a head.

Jill Treanor – *The Guardian*

Okay and are these routine stress tests or are they emergency ones that have been caused by the Eurozone crisis?

Bruce Van Saun – Group Finance Director, RBS

Yes, they're just an annual stress test they apply to all UK banks in addition to the ones we do for the EBA and for the rest of Europe.

Jill Treanor – *The Guardian*

Okay and so, assuming that you get through that stress test, you might then be able to talk about leaving the APS. Is leaving the APS part of those discussions then with the FSA?

Bruce Van Saun – Group Finance Director, RBS

Well, I think there's a forward view on capital that we have as a discussion. I mean, how strong is our capital, what stressors do we see coming down the pipe? It's a broader discussion than the APS would fit inside that context.

Jill Treanor – *The Guardian*

Okay, thanks.

Operator

Thank you. Your next question comes from the line of Sharlene Gough from The Financial Times. Please go ahead.

Sharlene Gough – *The Financial Times*

Hi, I just wanted to pick up on what you were saying earlier about your capacities for lending this year and a bit more detail about where we might see that coming through. We've seen a couple of the other banks say that they're going to deliberately contract their mortgage books this year. So I guess you're not in the same position as that, but is it mortgages or is it other areas? Thanks.

Stephen Hester – *Group Chief Executive, RBS*

Our desire is to deliberately expand our lending. Whether our customers have the same desire will remain to be seen. So, you know, we've been expanding in mortgages all the way through the crisis. It's been easier to do that because other people have been having to shrink and so there's been market share to pick up. On the corporate side it's been harder to pick up market share. In part, we're being forced to sell some market shares centred there but, you know, other people have not been departing the market as much. So there, you know, we've, kind of, been running, hard to stand still but, you know, if there's loaning to do, we're there to do it.

Sharlene Gough – *The Financial Times*

And on mortgages, have you been tightening up your risk appetite like some of the other banks as well or do you not feel the need to do that?

Stephen Hester – *Group Chief Executive, RBS*

Well, I mean, we're continually looking at it. I would say, as you know, the FSA has been very, very active in applying pressures to banks to cut back on high loan to value and to examine interest-only and affordability criteria and so all banks, you know, under pain of regulatory wrapper are having to look at those things even if they weren't doing it anyway. But, you know, I think... I can't remember the stats, but something like a quarter of all our new loaning is to first time buyers so, you know, within the context of what I hope our... you know, our prudent criteria... you know, we're trying to do our bit.

Sharlene Gough – *The Financial Times*

Okay and then just on confidence among SMEs, it seems in the statement that you'd seen a few positive signs in the early months with a bit more overdraft uses etc. I just wondered whether that continued through April or whether the talk of falling back into recession had maybe knocked that on the head a bit.

Stephen Hester – *Group Chief Executive, RBS*

As I say, I think we're slightly to the positive side of neutral, but I wouldn't put it stronger than that at the moment.

Sharlene Gough – *The Financial Times*

Fine, okay, thanks.

Operator

Thank you. Your next question comes from the line of Gavin Finch from Bloomberg News. Please go ahead.

Gavin Finch – *Bloomberg News*

Hi. Can you tell us, do you think loan losses have peaked in Ireland now?

Stephen Hester – *Group Chief Executive, RBS*

I hope so but, you know, that will be very economy and then house price dependent. So, you know, we're, kind of, along with you, watching how the economy pans out.

Gavin Finch – *Bloomberg News*

Have you injected more money into Ulster Bank since in the first quarter?

Stephen Hester – *Group Chief Executive, RBS*

I don't know the answer to that.

Bruce Van Saun – Group Finance Director, RBS

Yes, we have. Obviously to cover the loss we infused capital pretty much on a quarterly basis.

Gavin Finch – *Bloomberg News*

Can you say how much that was? So it was £10 billion, I think you said, in February...?

Bruce Van Saun – Group Finance Director, RBS

Yes, I think it's probably been year-to-date close to... It's a high triple-digit number, so it's under a bill, but it's significant.

Gavin Finch – *Bloomberg News*

No answer. £900 million?

Bruce Van Saun – Group Finance Director, RBS

I don't know exactly off the top of my head. It's probably between £500 million and £800 million, I would guess.

Gavin Finch – *Bloomberg News*

Okay, thanks, and last question, do you plan to package and sell off tranches of Irish non-core real estate loans?

Stephen Hester – *Group Chief Executive, RBS*

Well, I guess, in the end we would like not to have those loans and so we will, in principle, explore every possible means to get to that position. I am doubtful whether there will be meaningful inroads in the near term because there isn't a meaningful market in the near term but, you know, we want to be looking at every angle as and when opportunities that are sensible present themselves.

Gavin Finch – *Bloomberg News*

Okay, thanks very much.

Operator

Thank you. There are no further questions at this time. I would now like to hand the call back to Stephen for any closing comments. Thank you.

Stephen Hester – *Group Chief Executive, RBS*

Terrific. Well, again, thank you for spending the time with us. As I said, you know, I think reasonable progress this quarter in our job of safety and soundness, removing mistakes of the past, and in our job of supporting customers and trying to build a better RBS. We're conscious it's a tough old world out there, so there will be bumps in the road, but I think RBS has, you know, absorbed those bumps even if we don't like them and hopefully the world will recover and that will help us all. Thank you again, see you in a quarter. Take care.