H1 Results 2015

WIRES Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
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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 H1 Results announcement published on 30 July 2015.

RBS

Ross McEwan, Chief Executive

Ewen Stevenson, Chief Finance Officer

Introduction

Ross McEwan, Chief Executive

Good morning to you all. Thanks for joining the – both Ewen and I for our first half results call.

You'll see from our results this is the bank moving forward on its plan, it's a plan to build a stronger, simpler and (purer) bank for customers and for our shareholders. The bank no longer chasing global market share, but instead focusing squarely on our core strengths in the UK and the Republic of Ireland and bank determined to innovate the trusts of their customers and to be the best bank in this country.

As I've outlined before, there are three phases to our plan. Phase one was 2014. We got the capital up, the cost down, and simplified the structure of the bank. This gave us the financial strength to go further and faster with our strategy. We are now very clearly in phase two and there are three clear jobs to be done here: run down the exit bank, get through as much of the restructuring and conduct charges as (time scales) and court dates allow, and most importantly transform the performance in our core businesses.

We want to move as quickly as possible to our third phase. A solidly performing bank with improving customer service scores, high returns and the majority of exceptional items that (overshare) all the (shared) at a profitability of our cool business behind us.

Today's results show the growing strength of our underlying customer businesses with operating profit excluding restructuring and conduct charges of GBP1.81 billion, up for the quarter, up 11 percent on Q1. And there is an attributable profit of GBP293 million on the quarter but that moves to a GBP153 million loss for the half year. This clearly reflects the GBP1.5 billion of restructuring and GBP1.3 billion of conduct costs we are actively working through the business.

I just want to be clear on this, I don't like seeing losses in value and Ewen nor I will rest until these charges and costs are behind us and we can start delivering sustainable profits to the bottom line. Our UK personal and commercial businesses which are the real engine room of this bank are great franchises with leading market positions and they are making strong returns above the cost of equity.

We have more customers choosing to buy their home with us with a 43 percent lift in our gross mortgage lending in the quarter. Our net lending year-on-year in the commercial bank is positive despite continued rundown and our nonstrategic book. So again this is a really pleasing sign.

In each area of our strategy we are on track to deliver. Firstly we are a much stronger bank, our common equity tier 1 ratio is up 80 basis points from Q1 to 12.3 percent. We are becoming a much simpler bank (seated) in the UK. We've sold over two thirds of our North American loan portfolio as well as the majority of our Australian and Hong Kong businesses. This year we've also sold to third of the tranches of citizens as well as our international private banking business.

RCR is scheduled to run down a year ahead of schedule and we're on track to take 800 million pounds of costs out of the business by the end of this year. Yes, restructuring plus conduct and litigation costs hit the headline numbers, but the quickly -- quicker that we work through these the faster we can return value to shareholders and we can invest in being a much (fairer) bank with exceptional service for our customers.

Again good progress had been made. We've just recently launched Reward, a new and very simple current account proposition which will allow customers to receive 3 percent cash back on their household utility bills. We came –- we became one of the first banks to launch Apple Pay and our customers can now log into mobile banking using their fingerprint. We've refurbished over 100 branches so far this year, halved the time it takes to open a personal current to 30 minutes, and we've removed 127 products (to sub) and delivered a 75 percent reduction in commercial customer paperwork.

We are making fee free overdrafts more accessible with 600,000 customers now newly eligible for a fee free GBP100 overdraft, helping those customers who might otherwise approach payday leaders for short-term borrowing where interest rates are higher and could lead them into just more debt.

There are some very encouraging signs in our net promoter scores. In four of the seven businesses we have improved and for (NatWest) mobile banking our net promoter score has improved to number one in the market. More work needs to be done to regain the trust of our customers and we want to be upfront on our progress so that you can hold us accountable.

One final word of warning, this will continue to be a noisy year as we go further and faster on restructuring and deal with the conduct issues from the past. We've made no secret there are some tough issues coming down the track, not least our mortgage-backed securities in the U.S. Putting these issues behind us is a vital part of our plan.

I do welcome the government's intention to start selling down our stake but we're at an important moment for this bank. For our part, we will continue to push ahead with our strategy as we seek to deliver a bank the country can again be really proud of.

Thanks and now I'll hand over to Ewen for more detail on the numbers and then will be happy to take your questions. Over to you, Ewen.

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Ewen Stevenson, Chief Finance Officer

Thanks, Ross. And good morning, all. As Ross said, three things we're focused on currently in phase two that would earn value in the go forward bank through improved customer service, enhancing growth and raising returns, accelerating the rundown on the exit bank while protecting value, and progressively working through our list of other issues. And against each of these we've made steady progress during the quarter.

Total income was up a modest 1 percent on the first quarter, underpinned by better growth in our mortgage franchise. Across the UK personal and business banking and commercial banking we saw annualized line growth of 2 percent in the first half. On costs we think we're building a good and disciplined track record. As we've committed to do we're on track to deliver another GBP800 million of cost savings this year.

Our second quarter costs this year were 12 percent lower than Q2 2014 and 22 percent lower than Q2 2013. As we continue to move further and faster with our restructuring, we do expect our structure and costs will remain at elevated levels through the remainder of this year and into next. Overall, our go forward bank had a normalized return on equity in the second quarter of 14 percent.

Stepping through the main reported segments in our go forward bank for UK personal and business banking we had another good quarter and better than the first quarter. Operating profits with GBP667 million, up 92 percent on Q1. Growth was much stronger with mortgage origination volume stepping up materially and our Q2 share of applications was even higher, setting us up well for the third quarter.

For commercial banking we had operating profits of GBP400 million in Q2. You should note that as we start repositioning for ring fencing we transferred around GBP2.1 million and loans from corporate and institutional banking into commercial banking during the quarter and this will be followed later this year with the transfer all of our Western European large corporate lending relationships into commercial banking.

With corporate and institutional banking we've had a heavy focus since our February announcement on stabilizing the go forward business. In this context we're satisfied with the revenue performance and progress for the business overall. The go forward corporate and institutional bank was broadly breakeven for the quarter. And as we highlighted in February we expect that the turnaround back to cost of capital returns for this business will be in the order of 3 to 4 years.

Turning to our exit bank we continue to make excellent progress in reducing the size and scope of this. On citizens you'll no doubt have seen that we just completed a further significant sell down. And pro forma for the exercise of the over allotment option and the pending directed buyback we will hold 20.9 percent.

On RCR we continue to run off the asset pool at pace. Based on current self processes we would expect to comfortably meet our accelerated target of exiting RCR at the end of this year. On Williams and Glyn, we're working hard towards a plant separation in just over a years time and then an IPO by the end of 2016. You'll have seen that we've also strengthened the management team in recent months of Williams and Glyn with a new CEO and a new CFO.

On CIB capital resolution from starting RWAs are GBP64 billion at the start of this year. We've already reduced these by some GBP19 billion or 29 percent. So overall with the exit bank we're very happy with the progress we're making and we're comfortably ahead of our plans at this point.
We're also making progress addressing a number of other issues. We're diligently working through a number of legacy conduct and litigation issues. These include U.S. RMBS litigation and regulatory investigations amongst others. We're not currently in settlement discussions for our various U.S. RMBS exposures but we have given you expanded disclosure this quarter with a good summary of these exposures.

We're also continuing to restore our capital resilience. You'll have seen today that we announced our intention to launch our first additional tier 1 deal in the next few days. This is another important milestone for the bank and part of our intention to raise at least GBP2 billion of 81 this year. Our core tier 1 ratio has improved by a further 80 basis points to 12.3 percent and that's up 370 basis points from 8.6 percent at the end of 2013.

And if we were to pro forma for the full exit out of our citizens stake at the end of Q2 we'd have had a core tier 1 ratio of 15.3 percent at that point. As Ross and I have said before, we intend to return excess core capital back to shareholders above our 13 percent core tier 1 target in the form of either dividends or buybacks and once we have PRA approval to do so.

Realistically, though, we need to achieve the milestones we set out last quarter. These include sustained profitability, improved stress test results, and resolving our major conduct and litigation issues. And as a result we do not expect in our central planning scenario to be in a position to return to capital distributions until the first quarter of 2017 at the earliest.

So, to conclude, we're pleased across the three fronts we've been targeting this quarter. Our go forward bank is growing, it's producing healthy returns, and it's making increasing progress against our customer goals. We're accelerating out of our exit bank well ahead of plan and we're working diligent -- diligently through our legacy conduct and litigation issues while continuing to rebuild our capital resilience.

So with that, I'll hand back over to the operator so Ross and I can take your questions.

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Ross McEwan, Chief Executive
Thank you. And over to you, Kelly.

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Operator
Thank you, Ross and Ewen. 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.

We will take our first question from Matt Scuffham of Reuters. Please go ahead.

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Matt Scuffham, Reuters
Good morning. Can I just start by clarifying something that Ewen said in his introduction? Did you say that you are not currently in settlement discussions with U.S. authorities?

And also, there's a question on return of capital. You're saying today that you don't expect to return capital until first quarter 2017 at the earliest. I think some analysts were optimistic about a dividend next year. Can you just talk through the reasoning for holding off until 2017?

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Ewen Stevenson, Chief Finance Officer
Sure, Matt. Look, on the first – first question on U.S. RMBS you heard me correctly. We're not – we're not currently in any discussions -- settlement

discussions with U.S. authorities. I think as we've signalled before we would hope and expect that we would enter into discussions over the next 6 to 12 months but we're not currently in any discussions.

On the return of capital, you're right. There were some analysts out there with expectations of capital distributions in 2016. That's why I think we felt it was important to be transparent with people and to ground people in what we think is a realistic expectation. In terms of what I talked about, sustained profitability, improved stress test results and resolving major conduct and litigation issues, I think it's important as you think about the annual stress testing cycle, it's effectively a look – another 11 month look back so this year's stress test results will come out in November with a look back to last year's closing balance sheet.

So realistically we think we have to go through this year's stress test round then another stress test round which -- which factors into first quarter 2017.

Matt Scuffham, Reuters
All right, that's realistic.

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Ross McEwan, Chief Executive
Thanks, Matt.

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Operator
We will take our next question from Richard Partington from Bloomberg. Please go ahead.

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Richard Partington, Bloomberg
Morning, both. Similar sort of question. The capital return Q1 2017 at the earliest the citizens disposal will unlock around 3 percent of capital, so you'll be well above your 13 percent. Again, there's no chance of an earlier distribution? What do you do with all of that excess capital? Is it just something you have to hold during that period?

And then secondly the mortgage-backed securities fine, when do we expect to see charges for that in the – the accounts?

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Ewen Stevenson, Chief Finance Officer

Yes, so look, on the 13 percent of a – to go back to what I just said, we don't expect to make capital distributions before Q1 2017. We may well pay the DAS ahead of that so that is one use of capital, but I'd also say that Ross and I have been pretty clear. We are going to pay it back at some point so people should view it effectively is a timing difference. When we get -- when we -- we are committed to managing our core tier 1 ratio to 13 percent once we have PRA approval to return capital.

On -- you know, we're not -- because we're not currently in settlement discussions we're not currently able to reliably estimate what final settlement costs will be for U.S. RMBS so we're not able to take additional versions at this point. You know, we continue to monitor that quarter-on-quarter. If we do enter into more substantial discussions then we'll revisit it at that point.

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Ross McEwan, Chief Executive

And I think the other thing, (Richard), even these accounts we've given even more detail around RMBS because there's a lot – I think a lot of confusion about what is actually meant in some of the -- the headline numbers so we've put those in our disclosures this time around just to give more clarity.

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Richard Partington, Bloomberg

OK, thank you.

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Operator

We will take our next question from Max Colchester from Wall Street Journal. Please go ahead.

Max Colchester, Wall Street Journal

Hi. Given delay over the negotiation of the settlements, RMBs and the fact that obviously you'll be facing a stress test later this year, do you in that anyway hampers the government's plans to quickly start a sell down process in RBS?

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Ross McEwan, Chief Executive

No, I don't think it does at all. I think what you're seeing is the governments desire to actually start the sell down which is probably positive from our perspective that they think the -- the bank is in much better shape. As you've seen, out capital position has built very, very strongly with the actions we've taken.

We have got the cost down. We've reshaped the business so I think it's in much better shape than it was even 12 months ago. It's giving the government the confidence to say, you know, this is a bank that we can start selling off. It will take some time but timing itself is really up to the government. Our job is just to get bank in good shape.

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Max Colchester, Wall Street Journal

And just on the settlement discussions on RMBS. Can you just tell us why it's taking so long to kind of get these under way? Is it just because of courts over there are moving slowly or is there some other dispute?

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Ross McEwan, Chief Executive

No, its all around the timing of the court cases. We're – I think we're number 17 of 17. 16 was Nomura, they're still going through the courts, and we just happen to be at the back end of the queue for no other reason than that's where we are.

So until those discussions start, we're not able to be any more specific. Anyways we've given you some pretty good disclosure which there is some read across on some parts but absolutely none on others.

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Max Colchester, Wall Street Journal
OK, thanks.

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Operator
We will take our next question from Nick Goodway from Evening Standard. Please go ahead.

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Nick Goodway, Evening Standard
Good morning, Ross. I know these aren't your words, but chairman talks about conduct and litigation costs great exceeded expectations at banks for their investors. What's (Philip) getting at there?

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Ross McEwan, Chief Executive
I think what (Philip) was saying there is that either time if you look back, what you start to think is the likely cost of (all this), you know, heading (got a lot higher). So I think that (Philip) was making an observation having been chairman for six and a half years of the organisation and probably one of the chairmen of the bank that's been around the longest.

It's what's been happening in banking was his commentary.

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Nick Goodway, Evening Standard
OK, thanks.

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Operator
We will take our next question from Martin Arnold from Financial Times. Please go ahead.

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Martin Arnold, Financial Times

Hi, Ross. How much of your capital is currently tied up in the exit bank as you call it? And how long do you think it will take before you can completely exit all of the exit bank so to speak? I mean, I know citizens is a big part of that but it's GBP148 billion of risk weighted assets assets, so it's a big chunk of your balance sheet, isn't it?

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Ross McEwan, Chief Executive

Yes, it is. We've got a chart and our results we'll be putting out today. I think it's on page –

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Ewen Stevenson, Chief Finance Officer

Slide 11.

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Ross McEwan, Chief Executive

Slide 11 that gives you a pretty clear rundown of where out risk weighted assets are. We certainly do get a drop off when citizens is deconsolidated.

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Ewen Stevenson, Chief Finance Officer

I mean, Martin, I think you should assume, I mean, citizens, as you say, is a big part of it. Look, our expectation is by the time we get to the end of next year you guide three of the big pieces (off at) citizens will have been exited. Williams and Glyn we expect are of IPO, the International Private Bank we'll have sold. RCR will have accelerated out to the stop by this year and we think that a lot of the heavy lifting on CIB capital resolution will have been done over the next 18 months.

So I think at that point, though, there are some longtail assets in both RCR and capital resolution which will represent a sticky stop but effectively most of our capital by the end of next year we expect to be dedicated to the go forward bank.

Martin Arnold, Financial Times
OK, thanks.

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Ewen Stevenson, Chief Finance Officer
Talk about going further and faster, you know, our transition away from those parts of the businesses faster than many people have, I think, thought possible.

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Operator
We will take our next question from Jill Treanor from The Guardian. Please go ahead.

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Jill Treanor, The Guardian
Hi, good morning. A year ago you were reporting that you'd make your highest off profits since the bailout. Now we're going to be reporting that you've made a loss again. When is this volatility in the bank's earnings going to end?

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Ross McEwan, Chief Executive
Well, Jill in July operating profit has been very strong. As you've seen it's up a 11 percent on the last quarter. So, the underlying core strength of this bank are still there.

The two things that -- that the we've warned about because we're removing faster and restructuring this bank, are restructuring charges and also the conduct and litigation. Just -- I think it reflects where we are with our strategy of turning this back into a very strong UK and Republic of Ireland-based bank. And, you know, it's costing us money to get there but I think it's worth those we through get to the end.

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Ewen Stevenson, Chief Finance Officer

In terms of trying to help people understand the direction of travel deal we do as you know now breakout what we call the go forward bank profile and when -- when you look at that bank it is earning mid-teens returns. And as I said in answer to the previous question, we do think by the time we get to the end of next year the predominance of our capital -- great predominance of our capital will be dedicated towards that part of the bank.

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Jill Treanor, The Guardian

Can I ask another quick question?

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Ross McEwan, Chief Executive

Go for it.

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Jill Treanor, The Guardian

Can you just explain to me what new provisions you've taken this half?

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Ross McEwan, Chief Executive

Half or the quarter, Jill?

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Jill Treanor, The Guardian

Well, I guess I want both numbers, really. I've got this table on page 78, but I'm having trouble making sense of it. Is that the right table to be looking at?

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Ewen Stevenson, Chief Finance Officer

Yes, so, look at this quarter there were some with some additional provisions, about GBP69 million for interest rate hedging product. I think the bulk of --

there were two parts of U.S. RMBS which is the bulk of the additional provisions this quarter. And about half of the overall number we would expect to get back. It's a court case that we're involved in with Nomura in the U.S.

We are indemnified, but until we have certainty of returns it's about $350 million claim that's part of that additional provision number. And then in the first quarter there was some PPI, there was some FX. I think that's the bulk of it.

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Jill Treanor, The Guardian
Is the actual figure 785 then for this quarter, or?

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Ewen Stevenson, Chief Finance Officer
No, the actual conduct cost for this half is GBP459 million, for this quarter it's 459 million.

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Ross McEwan, Chief Executive
Q2.

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Ewen Stevenson, Chief Finance Officer
Q2 of which I said just under half of that is a provision for a settlement that we expect to be reimbursed on the coming years.

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Ross McEwan, Chief Executive
But we have to take the charge now.

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Operator
We will take our next question from Holly Williams from the Press Association. Please go ahead.

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Holly Williams, Press Association
Good morning. Just wondered if there's any – if you've got any idea of the cost of the IT troubles you had recently?

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Ewen Stevenson, Chief Finance Officer
First off Holly, – any incident which leaves customers without the service or without payments is unacceptable. The – it was one major file that didn't get transferred through over a couple of days. The overall charge of that was quite limited but we did make redress to all customers that were impacted by that, but it was – it was a very small number. I haven't got the number here but it was very small.

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Holly Williams, Press Association
OK, and can I just check as well, obviously your restructuring is going on ahead and you're saying it's further and faster. I'm just wondering in terms of jobs, is there any new impact on jobs in the group?

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Ewen Stevenson, Chief Finance Officer
No we haven't put out a job number. As I've said many times that if we're going to be changing the job – jobs for our people will be letting our people know first but it does impact our levels of headcount over the next few years, particularly in our corporate and institutional bank which is becoming a much smaller part of our business. But we haven't got any job headcount numbers that we're putting out.

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Operator

We will take our next question from Howard Mustoe from the BBC. Please go ahead.

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Howard Mustoe, BBC

Good morning, everyone. I just wanted to as a bit more about where the reduction in cost came from in this quarter compared to the last quarter. And also a bit more detail about where the new mortgage business is being written and where the jump came from. And to find out a bit more about how you'll be balancing the mortgage business against loans to businesses SME lending going forward, whether there's going to be a rebalancing there? Thanks.

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Ross McEwan, Chief Executive

OK, maybe if I pick up on the last one. There isn't any rebalancing. We've got plenty of capital and we've got pretty of liquidity so we've got – we're in a very good position to lean into the economy. We are just seeing a lot more in the mortgage side coming through because built at capacity but also our process service level's up in that area and a lot more customers are doing business with us. You've seen their applications up 40 odd percent quarter-over quarter.

But we're also still leaning very strongly into the business bank in both small and medium-size. Ewen, do you want to just cover off on the cost piece or where the major parts of the cost have come in as of there?

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Ewen Stevenson, Chief Finance Officer

Yes, look, when you look on I think page 20 of our interim results, you'll – and you look at the cost structure. I mean, over half of our cost structure, you know, operating costs are people related, staff, expenses. We had an 8 percent reduction in staff expenses first half on first half. And then associated with that, we're getting out of a lot of expensive real estate as we continue to reduce the size of the bank.

So it's mainly staff, and staff, staff related to that. In addition there's quite a lot of work going on in the bank in terms of automation and processing efficiency which is driving a lot of efficiency gains out of some of – some quite historically cumbersome processes we've been running in the back.

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Operator
We will take our final question from James Salmon from The Daily Mail. Please go ahead.

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James Salmon, The Daily Mail
Could you just give us an update on how many customers you've compensated for packaged accounts and how much compensation you've paid out and what you're kind of doing on this issue? Are you actively contacting customers or are you just receiving complaints from customers and also from claims management firms?

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Ross McEwan, Chief Executive
Well, first off, James, if I could just give you a little bit of background on this. About three years ago it was quite clear that some customers probably hadn't had the communication they needed in some areas around packaged accounts and what benefits they were getting. And we spent quite a bit of time actually going back to a number of customers and saying, look, this is the product and the range that -- the benefits that you get from that.

We did see last year spike in the number of complaints we were getting from the product and we made a provision that started this year for recompensing where we thought that was necessary to put them right. Those claims have actually come down over the last quarter, so there was a spike in the -- the number of enquires in claims we had customers but it actually backed off quite significantly in the last quarter and we haven't taken any and don't see a need to take any further provision at this point in time.

It's a very worthwhile product, just make sure that customers know what they've got and make sure that they're using the product as well as the keys to it.

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Operator

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

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Ross McEwan, Chief Executive

Thanks very much. Look, I just think closing comments are make – we're making good progress on the plan to build a stronger, simpler, and (fairer) bank and it is totally focused on customers and centered around the UK and the Republic of Ireland.

In each area of our strategy we are delivering. You'll see from the results that capital is up, costs are down, and there's a growing strength in our going forward business, and more customers are choosing to buy their homes with us than ever before. This will continue to be a noisy year as we go further and faster on the restructuring and deal with the conduct and litigation issues that we've been quite clear about. And these are tough issues, you know, coming down the track, not the least is the mortgage backed security issue in the U.S. that we've just been talking about, but we need to get through these.

Putting these issues behind us is a vital part of our plan and we are determined as a bank to earn back the trust of our customers and to create the best bank here in the UK and in the Republic. Thanks for joining us this morning and we'll talk to you later.

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