Annual Results 2015

WIRES Conference Call
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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 26 February 2016.

RBS

Ross McEwan, Chief Executive

Howard Davies, Chairman

Ewen Stevenson, Chief Finance Officer

Introduction

Howard Davies, Chairman

This is Howard Davies, the chairman of RBS. My crucial role is to speak for long enough to you to ensure that you've got your volume control set to the right point.

And we have here Ross McEwan, Chief Executive and Ewen Stevenson our CFO. And this is obviously a tight timetable. So, I'm going to hand it straight over to Ross.

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Ross McEwan, Chief Executive

Thanks very much, Howard. And good morning everybody. And thanks for joining us on the call for the full year results.

Let me just take a few minutes to give you a quick update before we go to Ewen. He'll walk you through the numbers in more detail.

This time last year I said we were entering phase two of our plan where we would go further and faster, selling or running down assets that didn't support the strategy and working through the remaining conduct and litigation issues that we faced. And that is exactly what we have done.

This pace of progress has resulted in a set of a financials that are noisier than any of us would have liked. But it has resulted in a much stronger and simpler bank with a much clearer investment case.

We are delivering on our eighth consecutive quarter of capital ratio growth. When I took over as CEO, our capital ratio was 8.6 percent. Today it sits at 15.5.

We are becoming a much simpler bank. And we've taken £983 million of cost out of the business this year; and over two billion over the last two years.

We've continued to lead the sector on fairness in support of customers. We've put an end to zero balance credit cards and teaser rates. We've scrapped incentives for front line staff. And we are making it much easier for corporates to do business with us.

I don't see any other bank challenging the industry on customer service in this way and we're not going to sit still.

And we're going to continue this pace. Through our great customer brands, NatWest, and England, and Wales, and the World Bank of Scotland, Ulster Bank, and Coutts, we are becoming the bank we said we wanted to be, firmly anchored here in our home markets of the U.K. and in Ireland. We now earn nearly 90 percent of our income here.

We are the biggest supporter of business in Britain, with lending and commercial banking up £1.4 billion from last year. This year, you'll see us ramp up our support for enterprise because by backing Britain's business to grow, then we grow as well.

In our mortgage business, lending increased ten percent from last year. It was 9.3 billion of net mortgage lending during the year; our strongest growth in mortgages since 2009.

Doing the right thing and focusing on customer needs is leading to improvements in our Net Promoter Scores, NatWest Personal and Business Banking scores are the highest they have ever been. And business banking scores are in general up across all brands. But I've got to tell you, there is still a lot more work to be done.

And finally, the engagement scores of our people are up considerably since last year. And I firmly believe that having employees who are engaged and committed to delivering on the strategy will lead to improved customer service and loyalty; which in turn, will lead to sustainable returns for shareholders.

By the end of this year, we will have moved into phase three of our plan with strong market positions, a real focus on building our customer facing brands to drive improved operating performance across our franchises.

And with most of the heavy restructuring behind us clearing a path to future capital distributions. And today, we are announcing our plans to pay the final dividend on the DAS in H1.

On a final word of caution before I hand over to Ewen, there are clearly big conduct challenges we still face not least in relation to the U.S. mortgage backed securities and the FCA investigation of the GRG.

I look forward to the day when we can put these issues behind us. So, in summary in each of our strategies, we are delivering in each of the areas.

Capital is up, cost is down. We are backing more businesses than any other bank in Britain and challenging industry practices that are not in our customers' interests.

This is exactly what RBS should be doing. There is more work to be done. But it should not dampen determination there is within this bank to earn back customers' trust and to repay our shareholders for their support, and to play our part in supporting this country's economy.

And with that, I'll hand it over to Ewen for more details on the numbers and to outline our goals for 2016. And then, we'll be happy to take questions. Ewen.

Ewen Stevenson, Chief Finance Officer

Thanks Ross. As many of you anticipated following our announcement last month, for full year 2015, we're reporting an attributable loss of two billion pounds. This does reflect a large number of legacy issues that continue to impact our profitability, including significant and ongoing conduct and restructuring costs.

If you remove the one-offs, we made an adjusted operating profit of £4.4 billion pounds. As Ross just discussed, and despite the attributable loss, we're satisfied with the further progress we made last year.

I can see we're on plan to being the bank we want to be. A bank serving it's customers well, a bank producing attractive bottom line profits and returns, and a bank making capital distributions.

But last year in three, 2016, we were focused on doing just two things well; continuing our progress towards creating a sustainably good customer bank; and continuing to address our residual hurdles to be able to return to capital distributions.

In 2015, we progressed on both fronts, our core business here in the U.K., a return to growth with good volume growth in both mortgages and commercial banking. And we continue to address our problems from the past.

Last year, we shrunk our legacy portfolio materially while continuing to make our balance sheet more resilient, turning to some of the key numbers for 2015, and starting with the income statement. Our income was £12.9 billion pounds, 15 percent down on 2014.

This was largely driven by the ongoing rundown in capital resolution and the planned reduction of our CIB business. Our target this year is to stabilize revenues across PBB and CPB franchises while seeing only modest further income loss in CIB.

On costs, we exceeded our cost reduction targets for the year. Excluding restructuring and conduct costs, our operating expenses were down ten percent to £9.4 billion pounds. We've now reduced our annual operating costs by more than two billion pounds in the past two years.

And today, we're committing to a further reduction in 2016 of 800 million pounds as we continue to make progress towards our 50 percent cost income target.

Restructuring costs were £2.9 million last year. And that leads just over two billion pounds to be expensed as part of our five year restructuring program out to 2019.

Our conduct costs were £3.6 billion pounds. And this includes further provisions for FX, U.S. RMBS, and PPI. And as we continue to caution, we do expect further substantial conduct costs to come.

Turning to our balance sheet, our balance sheet is both shrinking and de-risking as we exit portfolios that do not fit with our strategy. We reduced RWAs by £113 billion last year down almost a third. This was largely driven by three things.

Firstly, our full exit out of Citizens. Secondly, the completion of the rundown of RCR a year ahead of schedule. And thirdly, very good progress in winding CIB's legacy portfolios and Capital Resolution.

We also significantly de-risked some of our high risk loan portfolios last year. For example, oil and gas exposure was down by 65 percent in 2015; emerging market exposure by 61 percent. And as our balance sheet shrinks, we're creating a far more resilient bank.

Over the past two years, our core Tier 1 capital is up 690 basis points to 15.5 percent. Our leverage ratio was up 220 basis points to 5.6 percent. And our nonperforming loans are down by almost 70 percent.

For 2016, we want to continue with our cleanup, and with this, continue to address the remaining issues that need to be dealt with to return to capital distributions. We've still got a lot to do on this front. But we're determined to make further substantial progress this year.

This means, we want to resolve our legacy conduct issues particularly around our various U.S. RMBS related exposures. We've got to complete the bulk of our restructuring and wind down of legacy assets.

We want to continue to work toward the clear solution to exit Williams & Glyn consistent with our commitment to separation and completion by the end of 2017. And we want to pass this year's Bank of England stress test.

So, for 2016, if we can progress against these issues while continuing to drive better performance out of our core business, we'll get back to being that bank for serving its customers well; producing attractive bottom line profits, and returns, and making capital distributions.

On that note, our intention is to now seek PRA approval to make the final 1.18 billion pounds of DAS payment. And in doing so, extinguish the DAS.

So in summary, despite the attributable loss last year, that's always difficult for us as a management team to have to announce. We're satisfied with the progress made, almost five percent loan volume growth in the U.K.

Costs down ten percent. We achieved an 11 percent adjusted return on equity across our core businesses. Core capital is up now 250 basis points above our 13 percent target.

Risk is down. Our balance sheet is more resilient. Our legacy issues are getting progressively worked through with our legacy RWAs down 110 billion pounds last year.

But Ross and I recognize we've got a lot more to do this year. Undoubtedly, with some messy results in the quarter ahead – quarters ahead given the legacy issues that we know will impact profitability. But we will remain very determined and focused our plan towards being a sustainably good customer bank.

With that, I'll hand it back to Ross to host some Q&A.

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Ross McEwan, Chief Executive
Thanks Ewen. Joe, let's open up the lines for questions from the media, please.

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Operator
Thank you Ross. Ladies and gentlemen, if you would like to ask a question, please press star key followed by the digit one on your telephone keypad. We'll pause for a moment to give everyone an opportunity to signal for questions.

Your first question comes from Richard Partington from Bloomberg. Please go ahead.

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Richard Partington, Bloomberg
Good morning, two if I may? The first one is do you have any color on the timing or size of the U.S. mortgage backed securities? They are clearly one of the biggest outstanding items that you need to address before capital return.

And then, secondly, you've revised your target for the return on capital to later than the first quarter of 2017. I'm just wondering why you had previously said the first quarter? And what has changed now to mean that it will be probably later than that?

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Ross McEwan, Chief Executive
Yes, thanks Richard. First off, no update on timing, or of the sizes of the RMBS. You'll see we've taken some provisions. But they don't relate to the DOJ, or the Department of Justice, or any of the State Attorneys.

Because you just do not know the size of those fines. And what they're likely to be. And also the timing, I mean, we were hoping that they would come late '15 or early '16. But the timing is not in our gift.

And one of the reasons just on the capital return, we do need to make sure that things like RMBS are sorted out. And we do need to make sure that Williams & Glyn is – has a sale process that people are comfortable with.

We've still got to get through another stress testing. So, there are a number of things that we have to get through. And we've just been cautionary again about the timing.

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Richard Partington, Bloomberg
OK, thank you.

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Operator
Our next question comes from Max Colchester from the Wall Street Journal. Please go ahead.

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Max Colchester, Wall Street Journal
Hi guys. Can you talk us through a bit of the problems that you're facing with Williams & Glyn? And splitting that out. And how that's kind of playing into this decision to potentially delay any dividend payments?

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Ross McEwan, Chief Executive
Yes, well first off, Williams & Glyn is always – I've always said that it was probably the most complex thing going on in banking anywhere in the world, taking a bank outside of a bank. The complexity of this is like, you know, 700 systems.

It's about 50 to 60,000 project pieces all hanging together at the same time. And as we go through each part of it, we do find time delays. Or, we find things are working well.

So, we've just said that we won't be completing in Q1. But we still are determined to get the full sales process out by the end of 2017.

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Max Colchester, Wall Street Journal
And is a sales process to a third party still on the table?

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Ross McEwan, Chief Executive
Yes, it is. We're doing a dual track trade sale IPO. It may be somewhat delayed by this. But we still think we can hit that timetable.

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Max Colchester, Wall Street Journal
Thanks.

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Operator
Our next question comes from Lawrence White from Thomson Reuters. Please go ahead.

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Lawrence White, Reuters
Hi and good morning. I'll ask the obvious one. Just interested on Brexit, have you begun any contingency planning into what it might mean for the bank?

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Ross McEwan, Chief Executive

Howard, I might give that one to you.

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Howard Davies, Chairman

Thanks. Yes, we have looked harder to what Brexit would mean for the bank. RBS is of course, predominately a U.K. focused bank these days. But we do have important businesses in the Eurozone notably in Ireland.

We've looked at the economic forecasts. And I think it's fair to say that almost all of them expect that there would be some downward impact on growth, certainly in the short to medium term. So, that's unwelcome to us.

But we believe that we're well placed to manage through that given the capital strength that we have. There are some particular issues related, of course, to Ulster Bank.

And we're working through those. But we believe we're well placed and managed through this period, albeit, the economic impact would be unwelcomed to the bank.

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Lawrence White, Reuters

Thanks.

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Operator

Your next question comes from Nick Goodway from the Evening Standard. Please go ahead.

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Nick Goodway, Evening Standard

Good morning, good morning Ross. The delay to the dividend, is that going to make it considerably difficult, more difficult for the Treasury or the Chancellor to carry on selling it at the - in the coming year?

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Ewen Stevenson, Chief Finance Officer
Yes, I don't think so. It's Ewen here.

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Nick Goodway, Evening Standard
Hi.

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Ewen Stevenson, Chief Finance Officer
Nothing has fundamentally changed with the long-term equity story in the bank. We're – and still believe we're on a path to produce 12 plus percent returns on tangible equity. We're on a path to produce cost income ratio below 50 percent.

If you look at the adjusted operating profit of those six businesses they made operating profit – operating profits over four billion pounds last year.

The delay in the dividend, I don't think impacts that long-term equity story, which is really what fundamentally underpinning Treasury's ability to privatize the stock.

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Nick Goodway, Evening Standard
OK, thanks.

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Operator
Our next question comes from Jill Treanor from The Guardian. Please go ahead.

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Jill Treanor, The Guardian
Hello and good morning. I just wondered, and can you explain the significance of extinguishing the DAS? I think it was Ewen who described it that way.

And the other question I wanted to ask you that – you know, this bank is now reporting its eighth consecutive loss. Yet here again, we see more than 100 people are getting paid more than a million euros. Do you want to justify why it is people need to be paid such sums when the bank is making losses?

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Ross McEwan, Chief Executive
Jill, maybe I'll start with the latter one. I don't think it's a case of justifying it. We've discussed this before. I have to be pragmatic in making sure that we're paying well enough in the market to hold onto good people that are turning this bank around.

The number is down on last year. You know, you've seen that. Our bonus pool is down on last year. Our bonus pool is a fraction of what it used to be at the height of this.

We are cognizant of the fact that RBS is still making losses. But the underlying performance of this bank is, you know, 4.4 billion of profit with a lot of noise around the side from restructuring, and conduct, and litigation.

Nothing – no, and most of those issues are nothing to do with the people that we're paying bonuses to. So, I think – you know, we do have to be pragmatic on that.
And Ewen, I'll hand it over to you on the – just on the DAS issue.

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Ewen Stevenson, Chief Finance Officer
Yes, on the Dividend Access Share, Jill, as you know this was put in place at the time of the Treasury capital injections some years ago.

We agreed in early last year to a 1.5 billion pound payment with Treasury to extinguish the DAS. We paid 320 million pounds of that in Q2 last year. And this is the final payment. We need to do this in order to pay dividends in the future.

And also, the instrument from the first of January this year started accruing a five percent coupon. So, we are paying over a million pounds a week on coupon payments that, given the strength of our capital position now at 15.5 percent, this is about 50 basis points of core Tier 1. We felt now was the right time given we've rebuilt our capital strength and could avoid those coupon payments.

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Operator
Our next question comes from Tim Wallace from The Telegraph. Please go ahead.

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Tim Wallace, Daily Telegraph

Good morning, and can you tell us a bit more about the 800 million cost cuts planned for this year? And what it means for staff and what it means for branches?

And also, can you give us a bit more on the RMBS estimates? Whether you've been over to the States to speak to the authorities there; and to what stage the negotiations are at the moment? Thanks.

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Ross McEwan, Chief Executive

OK. Look, we set out a program two years ago that we wanted to get this bank down to a sub 50 percent cost to income ratio. And as I said at that time, we were focusing very strongly on a U.K., Republic of Ireland business that had quite a different shape to it, and therefore, cost structure to it. To what was the largest bank in the world.

And we've set out a program to take the cost out and bring it down to that 50 percent. We've done two billion over the last two years. And we've just said in the next year, we'll take in another 800.

A lot of this has to do with much better productivity in the bank; but also reshaping our international portfolio, which is made up of the number of countries that we're extracting ourselves out of. Most of the savings this year will come out of the shrinking of that corporate and institutional bank, and particularly the areas that we're coming out of.

There will need to be some reductions in the overall go forward bank cost structure because they're still trading at higher cost to income ratios than would need to be.

And it was – it does have an impact on staff. I've never given a number because we just work with our own people on each of those.

On the second one on RMBS, look the timing of that, it's still unknown. Of course, you know, our teams have conversations that we're not in any negotiation status whatsoever that we can report on. Thanks Joe.

Operator
Our next question comes from Mark Kleinman from Sky News. Please go ahead.

Mark Kleinman, Sky News
Good morning, this is a question for the chairman, actually. The executive committee – the executive committee no longer is eligible for annual bonuses, which makes RBS even more of an outlier in relation to compensation. Are you worried about your ability to incentivize Ross and his senior team given that they are being paid so much less than their peers elsewhere?

Howard Davies, Chairman
They are paid, we believe appropriately in relation to their peers elsewhere. It is true that at the top level, we are not paying as much as the other major banks.

But I think that everybody inside RBS does understand our particular position. And they understand perfectly well that we cannot be a market leader in pay. But they are strongly motivated by a task that I think they collectively believe is extremely worthwhile from a national point of view.

So, whilst we do lose people to the market, I can't say that at the moment we are losing more people than is normal in market situations. And we believe that we are able to staff the upper reaches of the bank with people who can do the job we have in mind.

And, of course, that is a somewhat simpler bank than before. You know, we are not seeking to recruit M&A rainmakers in the city. We don't do that kind of business anymore.

So, I think you should look at our pay structure and our comparatives against that background of the kind of bank that we are trying to be. But it is a fair question because we – it's something that we keep an eye on very carefully.

Because we don't want, as Ross said in answer to the bonus question – to be in a position where we take a hair shirt approach and can't staff the bank with good people to deal with the job. At the moment, we believe we're setting that balance appropriately.

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Ross McEwan, Chief Executive
(To), that Mark, we've been able to pick up two very top executives to run Ulster Bank in the Republic of Ireland; and also to run Coutts. Both you know, well-credentialed senior executives who are joining us.

And I think for the point that Howard said. You know, they want to see the turnaround of this bank and be part of that and I think we are trying to turn the bank into a place that's a good place to work. But only one of the features is around money. The rest around, you know, wanting to take on the challenge. But also, you know, determination to change this bank.

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Mark Kleinman, Sky News
Great, thanks.

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Operator
Your next question comes from Emma Dunkley from the Financial Times. Please go ahead.

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Emma Dunkley, Financial Times
Hi, good morning. I was wondering when you're expecting the FCA to put out its report on GRG?

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Ewen Stevenson, Chief Finance Officer
Emma, the last we heard was the FCA saying that it would be out in the latter part of the first quarter. So, that's what we've sort of been anticipating.

We would expect it to be sort of in the later part of March. Howard, I don't think you've heard anything different to that, have you, per chance?

Howard Davies, Chairman
No, the last time I spoke to them, that was their expectation.

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Ewen Stevenson, Chief Finance Officer
Yes, so we do expect that late March. There, it comes out in a final report from them that we respond to. So, there may be some delay from there – it's in their gift, the timing of that one.

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Operator
Our next question comes from the line of James Salmon from the Daily Mail. Please go ahead.

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James Salmon, Daily Mail
Good morning, I mean, you talked about the unwelcome impact of Brexit. Can you just confirm, and does this mean that RBS as a company, we would prefer it if the U.K. remained in the EU?

And also, could you spell out a bit more about the political uncertainties in Scotland? Does this mean you're potentially dusting off your old contingency plans ahead of the – ahead of the Scotland vote?

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Howard Davies, Chairman
Well, the Scottish question, we regard as one that may arise rather further down the line than at the moment. So, that's not on our current planning agenda. It involves as you know, a particular outcome in the current referendum. And then a decision to have another referendum, which is by no means clear. So, at the moment that one is I think parked.

On the first one, we take the view that we should spell out to people what the impact on us would be or could be. And that's what we've done. But of course we recognize that there are many other considerations that will weigh on people's minds other than the impact on the economy or the impact on RBS.
So, we are focusing on the economic implications and the implications for the bank. And as I said, I think the appropriate word for that is unwelcome.

Because it does look as if there could be an impact in markets and an impact on growth. That's quoting from what all other economists are saying. We have one or two particular issues. Because we have a sizable bank in Ireland. And as you will know, the Irish themselves have expressed quite a lot of nervousness about the impact of this period of uncertainty on them.

So, we have to look at that. And of course, we have to plan for circumstances; if we were outside of the EU, how would that work with our owning a sizable bank within the EU?

These are things we have to plan for. So, that's really our focus rather than interfering in a broader political debate.

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Operator
Our final question comes from Gareth Mackie from The Scotsman. Please go ahead.

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Gareth Mackie, The Scotsman
Hi and morning. I think you said, Ross, you're looking forward to the day when, you know, you can put all of the conduct and related issues behind the bank.

I mean, if you could have a crystal ball; I mean, what and how long are we talking? You know a couple of years, five years further down the line on that? And just as an aside to that, do you believe that the culture within the bank has fundamentally changed, you know from the past days?

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Ross McEwan, Chief Executive
Yes, thanks Gareth. First off, on time frames, we set in our strategy 2015, and 2016, to substantially tidy up all of the big conduct and litigation issues, and the restructuring of this bank to focus back on the U.K. and the Republic.

And I still think that is a good realistic time frame. We made very, very good progress on that agenda for 2015. And we're well into 2016. A lot of the conduct issues, a number of them are not in our time frame gift unfortunately.

You know, particularly in the U.S. with RMBS, that does revolve around the time frames from the Department of Justice and other State Attorneys. We, so we can't – we don't have a great influence over there.

We need to respond to their time frames and when our case comes up. But I think we are making very good progress. I've been pleased with what we did last year on restructuring of the bank and getting the costs out, and getting ourselves focused back onto the customer; which comes to your second point.

My desire is to have a culture of this organization looking after customers as the primary aim. And if we do a very good job with that, the returns will come to our shareholders. And, you're starting to see that as we do a better job on areas like mortgage providing.

You know, 200,000 mortgages given out last year through, you know, great service delivery from our people, well up on the year prior. The same in our commercial business focused again back onto the customers and their needs.

And we're seeing good growth. So, it's starting to work very strongly. I mean, this is a bank that has a great determination to do the right thing. It's part of our value set. And those values are permeating very strongly throughout the organization.

I would say there's still a lot of work to do. And as I've said to many before, when you run a village of 94,000 people, it's – you know, the job is to get them all focusing on the same things and the right things for customers.

And then, you find every so often one or two lets you down. But, you know, that I think the culture has changed quite dramatically. And we've seen a number of reports that actually show that we're saying is to be true.

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Operator
Thank you Ross. And I'll now hand the call back to you for closing comments.

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Ross McEwan, Chief Executive
Yes, thanks very much, Joe. Look, I – one of the things I think you've seen, we should see out of 2015, was our delivery against our strategy.

We want to be a much stronger bank. Our capital is up. We've taken close to a billion of cost out of the business. We're seeing growth in our core businesses where we said we wanted to see growth.

You know, we saw 1.4 billion of net lending supporting U.K. businesses.

We are really good in this area and doing a much better job in the business banking side of it. And strong growth as we've talked in mortgages up ten percent, which is our best gross since 2009.

We're a much simpler bank for customers and no longer fixated on our global strategy. We're here in the U.K. and in the Republic of Ireland. And almost 90 percent of our income is now coming out of the U.K.

And the final piece is just being much better for our customers. And we've abolished a lot of things that we just thought were not good practice as it didn't really fit long-term for customers or this bank. And I think we've taken the lead on many of these.

So, a tough job for the team. I think the team did a very good job in 2015. And we're facing into '16 trying to finish phase two, which is to create a really good bank here in the U.K. and with all of the heavy lifting behind us by the end of this year.

I can't say we'll get them all out. But our determination is to do as many – as much as we can so that it is a simpler, stronger, and fairer bank as we get into 2017.

Thank you very much for your time this morning. And I look forward to catching up with you. Thanks Joe.

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Operator
Ladies and gentlemen, that will conclude today's call. Thank you for participation. You may now disconnect.

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