Q3 Results 2016

MEDIA 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 Q3 Results announcement published on Friday 28 October 2016.

RBS

Ross McEwan, Chief Executive

Ewen Stevenson, Chief Finance Officer

Introduction

Good morning ladies and gentlemen. Today's conference call is to be hosted by Ross McEwan, CEO of RBS. Please go ahead Ross?

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Ross McEwan, Chief Executive

Thanks very much Jenny. Good morning everybody. Thanks for joining our Third Quarter Results Call.

We are just over halfway through our five-year strategic plan and as we've said previously that 2015 and 2016 would be a noisy part of our plan, as we deal with the many conduct and litigation issues as possible and also restructure the business to align with the future shape of the Bank.

This is hitting our financial performance and combined with the tougher operating outlook, will inevitably change our future outlook on returns.

These results reflect that this is the most challenging part of our plan as we work through many of our legacy issues, in the coming months and quarters.

Despite this tougher outlook our ambition remains the same and that's to become a sector-leading, lower-cost, low-risk, customer-centric UK and Irish bank that delivers solid returns for our shareholders.

As you will have seen our core business results were good with a £1.3 billion adjusted operating profit and a 14 percent return on adjusted equity. This is our best quarter for the core bank since 2014.

The core business has now delivered on average over £1 billion in adjusted operating profit for the last seven quarters. This is the business we need to protect and continue to invest in.

Overall we made a bottom-line loss for the quarter, mainly driven by restructuring costs, conduct charges and the deferred tax asset write-off. The bottom line loss reflects continued progress in restructuring the business and addressing some of their legacy issues that we will continue to talk to you about.

With income under pressure, we had to continue to improve efficiency and reduce costs. We still have considerable work to do but we have made progress; we've saved a further £695 million so far this year and we're on track to meet our cost target for the third consecutive year.

At the same time as taking out costs, we're making further changes to the core bank. Last month we refocused our main customer facing brands, some of you may have seen our new adverts on TV and social media and we'll continue to invest in those to win more customers and business.

We also provided clarity on our proposed plans for the structure of the bank under ring-fencing legislation and regulation.

Customers continue to change the way they bank with us. More customers than ever are using our digital channels with a 26 percent year-on-year increase in the use of our mobile app.

We've more than doubled the number of loan, overdraft, and mortgage applications on mobile since the start of the year. It is fair to say that we have gone beyond the tipping point in the way customers are now doing their banking. With already over 20 times more digital interactions with customers than face-to-face ones and over a third of our sales done through our digital channels.

We've also introduced technology that allows new business customers to receive their bank account number and sort codes in under an hour, this used to take eight days and we could still do better, but these innovations show that we are responding to the way customers want to bank with us.

Our engagement with customers is flowing through to the financials. In the UK PBB mortgages, net lending is up £3.6 billion in Q3. We are consistently growing market share, with a 12 percent of new business compared to our stock share of 8.7.

Across our franchises, the strong lending performance in the first half of the year has stood us in good stead. We're still comfortable on track to surpass our lending target for the year in Personal Business Banking and Commercial with lending of 9 percent, that's above our 4 percent target.

We saw sustained, high-customer activity in CIB, as we benefited from the post-Brexit volatility, delivering a very good income performance in Q3.

Costs are still too high but they continue to come down steadily in this business as we had planned.

However, there are challenges ahead for our core business and for the industry. The impact on income of lower-for-longer interest rates, ring-fencing, proposed future Basel regulations, and the uncertainty that Brexit brings are all well trailed and for RBS these issues are compounded by the Williams & Glyn disposal and other conduct and litigation issues.

Despite this tougher operating environment, we have delivered a solid performance from our core customer-facing businesses.

We said previously that this is a noisy part of our strategic plan and it continues to be so.

On RMBS, we are pleased to announce a settlement of the NCUA earlier this month, settling for $1.1 billion. This is the smallest of our three large RMBS cases. It is good to have it settled and behind us.

On the other two material cases, FHFA and the Department of Justice we have nothing to update you on at this time, but we'll let you know as soon as any progress is made. These issues continue to hang over the bank and of course will have a negative impact on our capital levels when they do land.

On GRG, the FCA have now received the Section 166 Special Person Report into our treatment of distressed business customers and we await them publishing their findings.

Let me be clear, the bank did not always meet the standards it set itself in dealing with customers who are having difficulty with their loans.

We see nothing however to support the allegations that we artificially distressed SME customers for our own gain and I am keen to work through this matter and get it behind us and our SME customers who were in GRG. The sooner we can do this the better.

And on Williams & Glyn, we continue to pursue discussions with interested parties and we intend to provide a further update in due course. However, we cannot under any options see full divestment by the end of 2017.

We are in discussion with HMT and expect further engagement with the European Commission to agree a solution with regards to our State Aid obligations.

To sum up, this is a pleasing set of core business results, but there is still a lot to do, for us to become a simpler, smaller, customer-focused bank. We look forward to giving you a much fuller account of the next phase of our plan when we present our full-year results in February.

I'll now hand over to Ewen who will give you the update on the financials.

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Ewen Stevenson, Chief Finance Officer

Thanks, Ross.

Consistent with the trends we've been seeing in recent quarters, the core business continues to do well. The run-off of our legacy portfolios and de-risking of legacy non-performing loans continues and we are making steady progress against our conduct issues.

Overall we made an attributable loss for the quarter of £469 million and an adjusted operating profit of £1.3 billion.

The attributable loss included £1.2 billion of one-offs on three items: namely restructuring costs of £469 million; litigation and conduct costs of £425 million; and a write-off of deferred tax assets of £300 million.

Underneath this, the core six franchises are performing well, our best quarter since 2014 and that's despite a tougher market outlook since early summer.

Costs continue to come down over the last 11 quarters, we've reduced costs by some £2.8 billion and we are on track to deliver our £800 million target for the year.

Ross and I clearly recognize these costs remain too high, so we're very focused on achieving material further cost reductions from here.

The rundown of capital resolution continues a further 9 percent reduction in RWAs in Q3 and despite adverse currency movements we remain on track to be below £35 billion of RWAs in Capital Resolution by year-end.

On Williams & Glyn, we took restructuring costs of £301 million in Q3, this includes £127 million in relation to the standing down of developing the cloned IT system.

As you can see from today's results, Williams & Glyn's core operating business continues to do well with an adjusted operating profit of £96 million.

On core capital, largely driven by a 10 billion-pound reduction in RWAs, our core Tier 1 ratio increased by a further 50 basis points in Q3 to 15.0 percent but we continue to recognize the potential impact on our core capital from large one-off costs and charges.

So, overall a good quarter for the core business, the best since 2014. £1.3 billion of adjusted operating profit of 14 percent adjusted return on equity. We continue to do de-risk our past by running down and exiting legacy asset pools and legacy conduct issues are getting progressively addressed.

But all of this is given with a note of caution; the operating outlook has got tougher in recent months and the potential for further substantial one-off costs to clean-up our past remains.

As a result of this changed outlook and despite just posting a good quarter in the core bank, as previously indicated we no longer expect to meet our long-term targets by 2019, a 12-plus percent return and equity and a sub-50 percent cost income ratio, but we remain committed to achieving these targets and we'll be back to you as part of full-year 2016 results, with more details on how we plan to deliver these.

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

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Ross McEwan, Chief Executive
Thanks, Ewen.

Operator, happy to take any questions?

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Operator

Thank you, Ross. Ladies and gentlemen if you would like to ask a question please press the "star" key followed by the digit "1" on your telephone keypad. We'll pause for a moment to give everyone an opportunity to signal for question.

Our first question today comes from the line of Richard Partington from Bloomberg. Please go ahead?

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Ross McEwan, Chief Executive
Hi Richard.

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Richard Partington, Bloomberg
Good morning. Morning both. A quick couple of questions.

The first one on Williams & Glyn, what are the consequences of missing that deadline? Do you have an EU appointed disposal agent, is there any sort of monetary fine attached to that?

And then – and then secondly, can you just give some colour as to how the rates business performed so well in this quarter?

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Ross McEwan, Chief Executive
Well I'll take the first one. Look we don't know what the consequences are, we are not in conversation with the EC about that. At this point in time we are working with the parties to see if we can actually devolve the business and that's what we are focusing on at the moment.

It is between HMT and the European Commission, the agreement we've got a back-to-back with HMT, so our objective right now is to meet our commitments. We just said we want meet the timing of that and we are looking at alternatives if that's not to be met. But we are making progress on it and that's what we're concentrating on.

There is a monitoring trustee that has been involved for the last six or seven years since the commitments were made that are aware of the situation. They come along to the steering committees of Williams & Glyn divestment, so it's not as though the European Commission doesn't know what's going on, they are very well-informed.

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Ewen Stevenson, Chief Finance Officer
Yes, on the rates question Richard, I don't think there was anything unusual, you saw I think across the street everyone's rate franchises do very well in Q3.

I think we did pick up a bit of share in that but you're right overall, rates had about a hundred-million-pound increase in income in Q3 versus Q2 and was running at almost double the rates income in Q3 of last year, so we're very pleased with how the business did, both in absolute and relative terms.

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Ross McEwan, Chief Executive
I think the other thing with the business Ewen is that, you know, it went through a lot of change in 2014 and 2015, so it's a reasonably stable business now and

very focused around the customer groups it serves, I think that's also helped it in this marketplace.

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Operator
Thank you very much.

Our next question comes from the line of Lawrence White from Thomson Reuters. Please go ahead?

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Ross McEwan, Chief Executive
Hi Lawrence?

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Lawrence White, Thomson Reuters
Good Morning, hi. Two quick ones for me.

On the 2008 rights issue case, can you just give us an update whether you are in remediation talks with investors over that issue or whether you plan to resume such talks? We had some press coverage that you had met with the investors over that issue but it came to nothing.

And then secondly, just some more colour on the Williams & Glyn missing the deadline? You've spoken the past about the complexity of the divestiture, but could you give us some more details on what exactly is causing that delay and what the prognosis is for eventually divesting?

Thanks.

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Ross McEwan, Chief Executive
Well at this stage, I'll start with the latter one first.

We'd say – we did say at the last meeting that we were stopping the IPO and we'd stop the work on the IPO because we had parties interested in purchasing the assets that we…there's nothing changed on that.

And as I said on the last call – to the last caller, we – you know, we are working through that.

We are working also with…, if we don't, you know, at this stage we've got nothing more to add to that.

On the 2008 rights issue, the reality here is that we did enter a mediation with the claimants back in July but we didn't get a settlement.

We did take a provision in this half based on the outcome of that discussion. We're not sort of giving any further details on any additional provisions so – or any conversations we're having to date.

Clearly we are exploring settlement options because that's what you do as a prudent management team, but if that fails we'll be in court in March 2017.

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Operator
Thank you. Your next question comes some the line of Emma Dunkley from the Financial Times.

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Ross McEwan, Chief Executive
Hi Emma

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Emma Dunkley, Financial Times
Hi, hi, good morning. I just wanted to check what the lowest price tag is that you're willing to accept for selling Williams & Glyn?

And then also get a bit more detail on what the alternatives are if you don't strike a sale agreement?

I think you mentioned in the text about being in positive discussions and the parties buying substantially all of Williams & Glyn, so does this mean you could sell off parts of it?

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Ross McEwan, Chief Executive

Well I'll go to the first one, that's a pretty quick answer. I'm not going to say what the last price would be Emma. When you're in discussion with people you're obviously not going to let them know what the price is. That's a competitive advantage in the – in the market at the moment.

And of course, as I have said, we you know, what is the option at the end of the day we are working with Treasury on what the options are to fulfil our commitments.

Remembering we fulfilled four of the five commitments to date. This is the last one which is around creating more competition in the SME market and that's what I'm pretty sure the government and the European Commission are interested in.

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Ewen Stevenson, Chief Finance Officer

And Emma, I mean as you saw today we do think it's a good business, it may just under another £100 million pre-tax operating profits, Jim Brown and his management team continue to do good job running that business, so we do expect to get an attractive price for it.

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Emma Dunkley, Financial Times

Great. Thanks.

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Operator

Thank you very much. Your next question comes some the line of Max Colchester from the Wall Street Journal.

Max Colchester, Wall Street Journal

Hi, good morning both. This is about your financial targets, your long-term financial targets. You've obviously – you're obviously revising them, is there a chance that this five-year turnaround plan turns into a six- or seven-year turnaround plan?

And my other question was, just on the sort of how the UK economy is holding out post-Brexit, could you just give us your take on that?

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Ross McEwan, Chief Executive

Well we have signalled that it will take us a bit longer to get the targets we set, mainly because the interest rate environment for banks does hurt income and that's certainly the case going through the banking industry at the moment.

It does really hurt when half your balance sheet struggles to work but we are committed to the targets, it just may take us a bit longer and we're doing some work at the moment on what that plan looks like for the third stage of our strategic timeframe.

We've got a very, very strong core business; you've seen that in the results from this quarter. You know this quarter 14 percent return and equity, it just shows how strong this bank is and it's a matter of us getting the conduct and litigation and restructuring behind us as quickly as we possibly can manage to show that through.

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Max Colchester, Wall Street Journal

And on the outlook for the post-Brexit economy?

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Ross McEwan, Chief Executive

Although we said that we thought that the economy would be slower in the short- to medium-term, I think you've seen it starting to come through. The last quarter results were pretty good at 0.5 but people had you know, originally been thinking that would be 0.7, so I think the economy is holding up.

But there is – there is uncertainty out there and that's what we've called. We did see some fall-off in mortgage applications, for example, on the first two months of this last quarter, but in the third month it's was back to normal, so time will tell.

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Ewen Stevenson, Chief Finance Officer

And you can see in the numbers today Max, that we are still seeing very good growth in our mortgage franchise, as Ross says it's picked up nicely in September and continuing to see good growth in the mid-market of the corporate sector as well.

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Operator

Thank you very much. Your next question comes some the line of Jill Treanor from The Guardian.

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Ross McEwan, Chief Executive

Hi Jill

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Jill Treanor, The Guardian

Hi, good morning. I wanted to ask three things really quickly if I may?

When do you think, this Bank will ever report a headline profit for the full-year?

Secondly, you talk about how Williams & Glyn is actually making a profit, I wondered how that actually tallied with this idea that it can't survive as a standalone bank, and without getting into the detail, I just wanted to know how much redeeming this exchangeable bond had cost you?

And the third thing I wanted to ask is, have you made any provisions for the GRG?

Thank you.

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Ross McEwan, Chief Executive
I'll try and rattle through those.

No provisions for GRG in this quarter Jill.

The issue around Williams & Glyn, we stopped the IPO because the IPO would have full functioning systems, applications, staff, operations, everything going with it on the books that we're talking about here that would not have made the profits that would have got it the Banking license.

As it sits inside RBS, you're seen it reporting the results of a hundred million a quarter, now that's because it actually shares the resources with this – with a much bigger and broader bank.

The other thing on the – on the profits, when we stop seeing conduct litigation in the tunes that we've been seeing, this Bank will make a profit. You see the underlying performance of this bank is very strong, it makes a billion a quarter, pre-tax and then unfortunately it gets knocked around because of the conduct litigation and restructuring.

The heavy restructuring, we wanted to do in '15 and '16 and the big conduct issues are still outstanding on RMBS, both the Department of Justice and with the FHFA; those are the two that make the biggest difference.

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Ewen Stevenson, Chief Finance Officer
Yes, and on the exchangeable bond Jill, there was a very modest premium to redeem the bond, and overall it will be P&L beneficial to us.

They've been very, very good partners I must say but – so a very small premium to take out the bond but overall P&L positive for us.

Operator

Thank you. Our next question comes some the line of Ben Martin from The Telegraph.

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Ross McEwan, Chief Executive

Hi Ben.

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Ben Martin, The Telegraph

Morning. Just two questions. Just on the appointment of a trustee, there's some sort of confusion as to when that might happen, just to confirm, will Brussels be only allowed to put in a trustee after December 31st, 2017?

And second question, just going back on another question, when you say you look at yourselves essentially or all of the business, so does it mean then that Clydesdale is only in talks to buy some of the branches, could you just give us a bit more clarification on that?

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Ross McEwan, Chief Executive

Well on the first point, our understanding is that the trustee only gets appointed if we don't fulfil by December '17.

But we are – you know, we will be in conversations with HMT and the European Commission. You know, they're very familiar with the – what we're doing here and they've been involved and as I said, with the monitoring trustee on a monthly basis, so there's no surprises here.

And the last piece was around?

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Ewen Stevenson, Chief Finance Officer

The shape.

Ben Martin, The Telegraph

Yes, the shape, the actual shape of the Williams & Glyn that you're going to look to sell?

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Ross McEwan, Chief Executive

Yes, look, there are parts of this that are more difficult in a transition across to another purchaser and there are parts of it that a purchaser may not want as part of the deal, so that's what we're looking at and that's what we signalled.

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Ben Martin, The Telegraph

So, if you don't sell all of it, are you going to ask the European Commission, whether selling the bulk of it would still meet its – its condition then? Is there – is there a chance you might retain all or some of it?

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Ross McEwan, Chief Executive

… we'll cross that bridge. We have clear obligations to create more competition in the marketplace, you know, and I think if we don't sell it all they're only going to be small parts of it that maybe the systems or applications actually can't look after, it's not part of their business model.

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Operator

Thank you. Your next question comes some the line of James Burton from The Daily Mail.

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James Burton, The Daily Mail

Good morning. Good morning both.

I just wanted to ask on the GRG, you obviously sort of seem to, now, recognize that some mistakes were made, so does that mean that you accept that some compensation is likely needed to be paid to businesses that were affected?

And secondly, on Williams & Glyn, does Brexit change the picture at all now, so that do you think it might mean that your obligations have changed?

Thank you.

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Ross McEwan, Chief Executive
Probably, on the latter one first, no.

I think the rules are the rules and that's what we're working towards and that's you know, clearly the position from HMT as well is that you know, we're still part of the European Community and the rules are the rules.

On GRG James, I just want to make it quite clear, when we did our first review of this business nearly three years ago, we said we didn't get it all right and there were some things here that we didn't manage well on behalf of our customers, so I don't think there's any new revelation here.

I'd draw you back to the Clifford Chance report that I think it is still sitting on our website, where we actually said that there were sort of three things that we didn't think we had right and we didn't live to the standards that we should've been – that we'd set for ourselves.

On the issue of any compensation, we'll work with that with the FCA and see where that comes out to, but you know, as I said, we have said for the last three years, there are some things here that if you know, it all happened again, we wouldn't be the same way the bank would operate.

That we also understand that at that time, there were thousands and thousands of cases coming into our restructuring operation and the volume, you know, certainly overwhelmed the resources that we had in this bank but still no excuse for that.

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Ben Martin, The Telegraph
Thank you.

Operator

Thank you. Our final question comes some the line of Adam Clark from Alliance News.

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Ross McEwan, Chief Executive

Hi Adam

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Adam Clark, Alliance News

Good morning. Thank you very much.

I just wanted to ask quickly about the decrease in distributable reserves and the plan for a capital reorganization in 2017, just wondered if you could give a little bit more detail about that and if there is a target to try and be able to pay dividends again at the end of 2017?

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Ewen Stevenson, Chief Finance Officer

Yes, so look, I mean, on the second part of the question, we've obviously been very clear on the pre-conditions we need to meet in order to pay dividends.

We need to pass the stress test; we need to settle conduct, particularly US RMBS; we need an assured exit from Williams & Glyn; and we need to be profitable, and we said we're continuing to work through all of those without giving guidance on when we might meet them.

On the distributable reserves, it's a – it's a quarterly accounting test that we need to do. It doesn't have any impact on capital, on our capital ratios; distributable reserves are obviously required in order to pay AT1 Coupons and I think we're just doing, proposing the normal capital reorganization in relation to the distributable reserves.

But as I say no impact on our capital ratios.

Ross McEwan, Chief Executive

We are on the overarching P&L of the business.

Jenny, thank you very much for hosting the call.

And all I'd say is that, 2015 and '16, I've always said will be noisy years for us as we work through the many legacy issues and as we sit to transform this bank for our customers, these results do reflect that noise.

We are making very good progress on the core bank with the £1.3 billion underlying profit and a return and equity of 14 percent. That is the best quarter performance since 2014, which shows the real strength of this business.

Our strategy remains the same, it has become a simpler, smaller, customer-obsessed bank here in our key markets of the UK and of the Republic of Ireland, so I hope you all have a good day.

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Operator

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

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