Annual Results 2016

WIRES Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
on Friday 24 February 2017

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 Friday 24 February 2017.

RBS

Howard Davies, Chairman

Ross McEwan, Chief Executive

Ewen Stevenson, Chief Finance Officer

Introduction

Good morning ladies and gentlemen. Today's conference will be hosted by Ross McEwan RBS Chief Executive. Please go ahead Ross.

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Ross McEwan, Chief Executive

Thanks very much Gary and good morning everyone. I'm joined this morning by our Chairman, Howard Davies and also Ewen Stevenson, our CFO. Ewen will take you through the details of our results statements shortly and then we'll open up for some questions.

When we spoke last, I said that it would be a tough year as we concluded as many of our legacy conduct and litigation issues as possible.

These costs are a stark reminders of what happens to a bank when things gone wrong and you lose focus on the customers, as this bank did before the financial crisis. The £7 billion loss is of course disappointing, but it reflects £10.3 billion of one-off costs as we put the past behind us. And given the RMBS provision we announced last month, the DAS payment of £1.2 billion in the Q1 and our restructuring costs incurred over the last, or the first three quarters, this shouldn't have come as a surprise to any of you.

We have made good progress against our strategy to build a simpler, safer, more customer-focused bank. In 2016, we met all our financial targets for the third year running, growing both income and lending. Our core business generated £4.2 billion in adjusted pre-tax operating profit for the year, and that's an average of over £1 billion for the quarter for the last eight quarters.

Our six core businesses generated a return on equity of 11% and we grew income by 4% in the core bank for the first time since the start of our plan. We were the fastest-growing bank in the UK last year with £24 billion of new lending into the economy supporting over a million businesses and homeowners. Our customers continue to tell us we are serving them better.

Our net promote our scores for commercial and personal customers with the highest they've ever been this year. And we ended 2016 with over 1.1 million reward account holders. That's up from 202,000 a year ago, an excellent example of when you get a product and service right, the customers want to bank with us.

I joined RBS because I could see that underneath all the troubles that we faced, there was a strong bank with great brands and great colleagues doing outstanding things for customers every day. And that underlying strength is still evident to me today. And the good news is that we have worked through the majority of our legacy issues that have masked us.

In 2014 I set out a plan to make this a simpler, safer and customer-focused bank. I knew it'd be tough, but even in the face of more challenging economic conditions this plan is working. Our common equity T1 ratio has now materially improved from 8.6 % in 2013 to 13.4% today. We have thoroughly reshaped our investment banking franchise and we rebranded it recently to NatWest Markets. We've sold citizens in the US completing the largest bank IPO in US history in the process and also sold our international private banking business.

We've ceased active operations in 26 countries. We've decommissioned 30% of our IT systems and applications and we've closed almost half of our legal entities. We've also completed the run-down or sale of more than 75% of our legacy and non-core assets.

We're not completely done with the past. With two major issues still to address, our RMBS and our EC state aid obligations. Once these are resolved, we can break free from the major legacy issues that have plagued this bank. Despite an eventful 2016 with both the Brexit vote and tougher economic conditions, the fundamentals of our strategy remain unchanged.

We firmly believe that targeting retail and commercial banking in the UK and in Ireland and relentlessly focusing on customer service will deliver the best value for our shareholders.

But with a lower interest rate environment and the changing way our customers are banking with us, it is necessary to go further on costs and faster on digital, as we deliver a simpler, safer, customer-focused bank. I'm announcing today we will take out £750 million in operating costs in 2017, by removing the remaining complexity in this bank and simplifying process for both our staff and our customers.

We interact with our customers over twenty times more through digital channels than physical ones. And our personal bank 35% of all product sales are made digitally and that number is rising. We now have 4.2 million personal mobile users and that's up over 2 million since the start of our plan. We recently won the best mobile app that the British Bank Awards. More digital innovation gives customers more control over how they bank with us.

And just in the last few months we've launched pioneering new products such as ESME, NatWest Invest, NiFT and we're enhancing the functionality of our award-winning banking app. We also have FX Micropay and Agile Markets platform. We have said today that we're targeting profitability in 2018 which will be a big milestone for the bank. And we're also setting clear targets of an unadjusted 12% return on equity, and 50% cost to income ratio for 2020.

We believe that by going faster on digital transformation and further on cost reduction, we will deliver a simpler, safer and even more customer-focused bank with a compelling shareholder investment case. I'll now hand over to Ewen who will provide the detail around the financial performance of the bank and also the financial building blocks for our 2020 targets.

Ewen Stevenson, Chief Financial Officer

Thanks, Ross and to echo what Ross said, it's always a difficult day announcing an attributable loss of this magnitude. But underlying, these poor headline results is a lot of progress last year, both in the core bank and with our legacy issues. We targeting 2017 to be our final year of substantive clean-up and subject to this being achieved; we're seeking a return to bottom line profits in 2018.

For our three core businesses, 2016 was a year of positive progress, adjusted income growth of 4% on the back of strong lending growth in both UK Personal and Commercial Banking, and higher customer flows for NatWest Markets. Combined adjusted operating profits of £4.2 billion, we're up 4% on 2015, and that's despite a tougher interest rate environment.

With an adjusted return on equity of 11.1%. We had our third year of over delivery on costs, a further £985 million taken out last year. That's a combined £3.1 billion of cost take out over the last three years.

And our core tier one ratio of 13.4% continues to be above our 13% target. Turning to Q4 2016 in more detail, our core operating performance was much stronger than Q4 2015. With adjusted operating profits for our three core businesses up 61% to £848 million.

The substantial loss we recorded in the quarter, primarily reflected the combined impact of £4.1 billion of additional come back costs, including the £3.1 billion of additional RMBS provisions we announced last month, and the recent £750 million Williams & Glyn provision.

To give you a few details on our three largest franchises, on UK Personal and Business Banking, we view 2016 as its best operating performance since the crisis.
The franchise had achieved 10% growth in net lending relative to Q4 2015 and had adjusted operating profits in Q4 of £546 million. That's 35% higher than Q4 2015.

With Commercial Banking, we've now decisively re-energised the business from a stagnant franchise position just three years ago. Net customer loans and advances at end Q4 were 10% higher than a year ago. And its adjusted operating profits in Q4 of £228 million were 23% higher than Q4 2015.

For NatWest Markets its Q4 adjusted income was £314 million, 25% higher than Q4 2015 and for the full year 2016, like for like, adjusted income for NatWest Markets was up 16% and it's also a much stronger start this year than last.

As you can read in outlook statement in more detail, we've provided guidance on a few areas. For lending growth in 2017, we planned to grow our combined loan book across Personal Business Banking and Commercial and Private Banking by a net 3%. On operating costs, we're committed to reduce these by a further £750 million in 2017 and by £2 billion in total over the next four years.

On gross RWA's and the core bank, we've identified a series of actions to reduce these by at least £20 billion by the end of 2018, which will underpin both improved returns in the core bank and provide additional capital resilience.

One Capital Resolution, we're continuing to run its legacy portfolios and holdings down. We achieved a 30% reduction in 2016 and we're planning to wind-up

Capital Resolution at the end of this year. On one-off costs, we're planning on the basis of this year seeing further sizeable conduct and restructuring costs, together with additional disposal losses from Capital Resolution.

But we do now expect these to materially fall away from 2018 onwards. Now we've also confirmed today, we're sticking to our medium term targets – a 12+% return on equity and a sub-50% cost to income ratio. We're targeting achieving these in the 2020 financial year. A year later than previously signalled.

So, before I hand back to Ross to host some Q&A, just a few take away messages from me. Underlying our substantial 2016 headline loss was a year of material progress first. Will the financial cost of fixing our past remains high, our legacy issues are now rapidly shrinking. In context just two years ago, around half of our capital was tied up in legacy assets pools. At the end of 2016, that was down to just 20%.

More importantly our core bank is doing very well. Across all three businesses there was strong progress in 2016. We're growing well in the lending and deposit volumes, capturing market shares in those customer and product segments we're targeting. Our core income is growing again, up 4% in 2016; we made £4.2 billion of adjusted operating profits, again up 4%. And with our core bank producing adjusted returns on equity of 11.1%, that's the second year running we've been producing attractive returns. With that I'll hand back over to Ross.

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Ross McEwan, Chief Executive

Thanks very much Ewen. Gary / operator, can we open the line up for questions please?

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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 "one" on your telephone key pad. We will pause for a moment to give everyone an opportunity to signal for questions.

Your first question comes from the line of Richard Partington from Bloomberg. Please ask your question.

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Ross McEwan, Chief Executive

Hi Richard.

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Richard Partington, Bloomberg

Good morning both. Thanks so much for your time. A couple if I may, the first one on the 2 billion of cost take out by 2020 I think it is, is that going to include job cuts? Are you giving any sort of illustration of where that might come from? And then secondly, profit by 2018, does that mean that we might see dividends coinciding with that year, or would it be after that point?

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Ross McEwan, Chief Executive

I'll take the first question Richard. First off, I haven't and will continue not to give job numbers out. My view is that I talk to our staff before we talk to anybody about individual jobs that are going. There's very clear with £2 billion through – over the next four years coming out of this business to get our back end into a competitive shape. There will be job losses that we have to go through and they will be across the business, as we do get this business back into shape. As I said we are transforming this business using technology in line with where customer's preferences are as well.

So over four years, it will be £2 billion that need to come out. We've said 750 million this year and it will be broad ranging where those costs come out. People, property, lower technology costs in some areas; it will be across the board.

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Ewen Stevenson, Chief Financial Officer

Yes, on your second question Richard, on dividends. We've always been upfront; I think that we've got four things to solve before we get there. US RMBS, Williams & Glyn and we need to pass the stress test and we need to be making profits. So, I think you can see out of today's announcement, we're making progress across all of those areas and it's something that we're working earnestly towards.

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Ross McEwan, Chief Executive
Thanks Richard.

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Operator
Your next question comes from Lawrence White from Thompson Reuters. Please ask your question.

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Lawrence White, Thompson Reuters
Good morning Ross, Ewen and Howard. The on the January call on the RMBS provision, you told us that you were not yet in active negotiations. Can you just update us on whether the negotiations have started? And then secondly, on the Williams & Glyn disposal, I guess from a shareholder's point of view the question is just why didn't we come up with this plan to retain the business and propose this alternative fund earlier and save on the £1.8 billion in costs of the attempted restructuring and disposal?

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Ross McEwan, Chief Executive
Thanks Lawrence. First off, no change to our – what we see it in January, with no steps forward from with the DoJ or any other areas around the RMBS. So, nothing to update on there. On the Williams & Glyn, I'd just take you back 7 years ago when the state aid was put into the bank, £45 billion.

There were five things that we had to achieve, of which we've achieved for – the fifth one was create more competition, in the SME market. At that time an agreement was reached that it would be a certain pool of assets that we described as Williams & Glyn, thirty odd branches, with all of the retail and commercial customers. And that was a legal agreement that was put in place when I took over the job 3.5 years ago. The second attempt of that has been sign up and that was to do an IPO.

And we set about diligently to do that, as the legal requirement was and it wasn't until interest rates dropped, to such a level that that bank would not have been viable that we called a halt to it and advised Treasury who then obviously advised the European Commission, that this just was not going to work. And at that stage we looked at alternatives which were the sale of the assets to a number of parties who were interested and then also to look at other alternatives, which is what has come out of the conversations.

So look, we take on-board the issue of why we didn't call it out earlier. But I think the reality of this is, when you have the legal obligation to deliver something, it's not until you've had a really good attempt at doing so that you can call time on it. And that's what the situation was.

So it wasn't – I think it was more months than years that we actually got this wrong given the circumstances we found ourselves in.

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Lawrence White, Thompson Reuters
Just to follow up, apologies if you've already said. Can you give us some colour on the timeline on how long you've got to wait until you know whether you've got approval for the newly proposed plan?

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Ross McEwan, Chief Executive
Ewen, do you want to pick up on that?

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Ewen Stevenson, Chief Financial Officer
Look, in terms of the timeline we think it will take, no earlier than Q4 of this year before we would get to a point of getting support from the European Commission and then a fairly lengthy re-negotiation of the state aid agreement that would follow that.

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Ross McEwan, Chief Executive
There is a process, Lawrence that has to go through here. A consultation process, a research process and then into the 27 commissioners for approval. So there is a laid out process but it will take some time.

Lawrence White, Thompson Reuters

Thank you.

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Operator

Your next question comes from Jill Treanor from "The Guardian", please ask your question.

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Ross McEwan, Chief Executive

Hi Jill.

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Jill Treanor, The Guardian

Hi, good morning, just a few things. I know you don't want to say how many jobs will go this time, but could you tell you what has happened to the number of people employed at the bank since the time of the bail-out?

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Ross McEwan, Chief Executive

Well, Jill, back in the – I think back 2007, 2008, my understanding the bank had about 170,000 employees. As we finish the end of this year we finished with just under 80,000.

But, in amongst there were a number of divestments as well, remembering Citizens came out of there, we sold the Asian business some time ago. But, as we've come out of 26 countries, closed our global transaction services, RMBS in the US, there have been significant changes to this business.

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Jill Treanor, The Guardian

Can I just ask, one of the things about Williams & Glyn – I think there'd been some idea that this would change the RBS disappearing from the high street in England and Wales. Do you know how you're going to brand those branches now under this new arrangement?

Ross McEwan, Chief Executive

No. At this stage they'll stay under the current branding. We'll wait and see what happens with the European Commission, before we make any announcements to any changes because it's not certain that we'll be able yet to get that agreement up.

So I think they stay very much as Royal Bank of Scotland as they sit today and we'll make a – we'll do some planning over the next three to six months. As Ewen said, that's how long it'll probably take.

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Jill Treanor, The Guardian

Thank you

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Operator

Your next question comes from Emma Dunkley from The Financial Times, please ask your question.

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Ross McEwan, Chief Executive

Hi Emma.

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Emma Dunkley, Financial Times

Hi. So on the alternative Williams & Glyn plan, it sounds like you expect to miss the end of 2017 deadline. So I just wanted to check the consequences of this will be. And then, with regards to the plan, I realise its early stages but do you expect to have move a certain number of SME customers and will there be a sort of dividend blocker attached to this?

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Ross McEwan, Chief Executive

Well, first off, on the deadline it's – we said six months ago that we would miss the deadline anyway. And this created the need to have the conversation with the Treasury and the European Commission.

So the fact that we missed the deadline on this one, we would of missed the deadline on the original obligation, Emma. As far as consequences are convergence, we're working with the Treasury and European Commission on this new plan. And we see this is the plan that actually gets us over the line of meeting the obligation so should be all encompassing in this new arrangement.

On the number SMEs, yes they will be, as part of this new proposal, there are a series of obligations put into that and part of that will be the number of SME customers that need to move across, and that'll be part of the consultation process that will happen over the next three to six months.

OK. Next question.

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Operator
Thank you. Your next question comes from Ben Martin from The Telegraph, please ask your question.

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Ross McEwan, Chief Executive
Hi Ben.

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Ben Martin, The Telegraph
Morning. Could you give us a range for the – any range for losses, attributable loses, in 2017? And any range or guidance for the net profit you hope to make in 2018?

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Ross McEwan, Chief Executive
Well, obviously on those Ben we can't give guidance on those. We've given pretty clear guidance in our statements today about what we see in the future. But beyond there I won't go as to what it is.

I mean a lot of this will revolve around what is the final bill for our settlement of the RMBS cases in the US. And also, as we've been discussing what Williams & Glyn looks like.

Ewen Stevenson, Chief Financial Officer

And just to go back on the numbers of the call. The core business today is making over £4 billion of pre-tax operating profits. We still think we've got much further to go with our core bank and improving its operating performance, so as we progressively work through over the few years and the one-off costs run-off you'll see that earnings power come through the bank.

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Ross McEwan, Chief Executive

And – what we've been talking today about is – this will be a bank that has a return on equity of over 12% and a cost to income ratio of some 50% by the time we get into 2020.

So, I think this is a very strong core bank that is getting masked by all of the sins of the past that we're having to clean-up for. But we're signalling today that we do see a profit in 2018, the year 2018, as long as we can resolve, through RMBS and Williams & Glyn satisfactorily this year.

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Ben Martin, The Telegraph

Well I know you haven't been able to give a figure for job cuts but the £2 billion figure by 2020 in cost savings, roughly how many branches do you think that might mean closing?

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Ross McEwan, Chief Executive

To be honest, I do not know the number of branches we'll have but the number will be smaller than it is today because customers are not using them like they used to. You've seen our stats on usage of mobile; it is growing very, very quickly.

So customers aren't going into a branch to move money they're actually using automated ways of doing that themselves. The issue of cheques is declining very rapidly so the – having to go into the branch for a cheque is declining. So the use of a branch is coming around for servicing and it's coming around more of advisory network as opposed to a transaction point. So I don't have a number for branches but it'll be smaller than what it is today given customer usage.

Ben Martin, The Telegraph
What is it today, sorry?

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Ross McEwan, Chief Executive
It's about a 1,050 branches – no actually 1,250 branches today.

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Ben Martin, The Telegraph
Thank you.

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Operator
Your next question comes from James Burton from The Daily Mail, please ask your question.

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Ross McEwan, Chief Executive
Hey James.

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James Burton, The Daily Mail
Good morning all. I just had a couple. On Williams & Glyn, you said that the reason that you weren't able to spin it off was the was the low interest rate environment and the sort of difficulties of getting a banking licence.

I mean that's the same thing you've said before. Can we say then that it's got nothing at all to do with sort of difficulties you had at your end in terms of spinning it off and the kind of IT problems – it's all – it's all to do with the economic environment is it?

And, on a similar theme, you talked, Ross, about how tough economic conditions affected your results this time round. Most of your competitors don't seem to have been saying the same thing, in fact they've been saying the economy's continued much as sort of as it did before the Brexit vote so I'm just wondering what you've seen that was different to them. Thank you.

Ross McEwan, Chief Executive

Well, I'll pick up on the first one. First off, it was lower interest rates that put the conclusions to our Williams & Glyn IPO. We had 90% of the systems and applications out, we had an entire executive team, we had the back office set-up, we had payroll moved across. We just – you know, we had 90% of the arrangements for setting up a bank done.

It was very difficult. I mean, we had difficulties with the technology in the first two years but we were overcoming that. It was costing a lot of money but the real issue was that low interest rates meant that there would not have been a viable business. So, you know, and it was with real disappointment from our technology team that we had to pull it down given the work that had gone into it.

Remembering why we had to do this, it was around the SME outcome and the – I think the new proposal here is good for SMEs because you'll see more competition in that marketplace and it'll be through the use of technology, it'll also give new players into this marketplace, the current banks who want to get into this marketplace, a real opportunity to get into it.

So it's good for customers, I think it's also good for our staff to get some certainty, and it's much quicker solution to get this resolved rather than letting it drag on for what would have been through into 2020. So I think all around it's a much, much better deal. We signalled today, just on your second question on tougher economic conditions, it is for banks in the sense that interest rates have dropped – they certainly dropped last year.

Mid-way through last year was probably the lowest interest rates we've seen in 300 years. They had impacts on banks' earnings power and we certainly saw that. I'm surprised other – you haven't picked that up at other banks results. From our perspective, our strategy is working and it is very clear that our focus back into the UK and the Republic of Ireland has meant that our work going on in this market has been very strong.

£24 billion of net lending into the marketplace last year, we were the biggest lenders of the UK real economy. 320,000 mortgages that we put into the marketplace, £9 billion of lending into the business sector. I mean, those are amazing stats for a bank that has still got the issues we have.

James Burton, The Daily Mail

Thank you.

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Operator

Your next question comes from Max Colchester from The Wall Street Journal. Please go ahead.

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Ross McEwan, Chief Executive

Hi, Max.

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Max Colchester, The Wall Street Journal

Hi, both. Just two questions. Firstly, on Williams & Glyn, I know you've taken the provision and everyone's put out statements, but I mean, to what extent are you confident that this deal will be accepted by the EU and will go through as you've announced? And the second question I had is just on this profitability in 2018. Are you going to make an attributable profit full year 2018, not an adjusted pre-tax profit?

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Ross McEwan, Chief Executive

I'll start with the last one first. From 2018, we will not do adjusted accounts so we'll only do adjusted accounts in 2017 because we've got lots, still some one-off things to come through. 2018 we will not be doing adjusted accounts so it will be an unadjusted bottom line profit as long as we get the resolution to Williams & Glyn and RMBS in 2017.

So that's what we've put out there. On the other, just on Williams & Glyn, the deal is – needs to be agreed by the European Commission, not by ourselves so they've got some work to do in consulting so it's really in their hands. We're comfortable with the deal that's gone through; we do believe that it will be good for SME competition in this marketplace.

And if you look through the package of areas that it's looking at, I think it really does start supporting growth and competition in the market. And as I said, I think it's good for customers, both the Williams & Glyn customers and very good for our staff and a much better and quicker solution. And that's the issue that we've had, getting a bank out from within a bank is very difficult, takes time, and a fully fledged bank with retail and commercial capabilities on its own systems is difficult so – to make profitable.

So I think this is a really good solution but it's not within our – we're not the ones making the decision.

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Max Colchester, The Wall Street Journal
Have the EU given you any comfort or the Treasury comfort that this is a deal that's acceptable to them?

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Ross McEwan, Chief Executive
No, but what they have done is they've said that they will consult on it and they will look to take it to the commissioners.

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Max Colchester, The Wall Street Journal
OK, thanks.

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Operator
Thank you. Your final question comes from Simon English from The Evening Standard. Please ask your question.

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Ross McEwan, Chief Executive
Hi, Simon.

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Simon English, The Evening Standard
Morning, gents. A short one was there's been a lot of speculation about you and how long you intend to be at the bank. I just wonder if you could address that for us. Are you still going to be there in 2018 when the bank's announcing a profit?

Ross McEwan, Chief Executive

I certainly hope so. We've done all the hard work in the last 3 ½ years. I can certainly sense that this bank is on the turn, you've seen our results from last year. The slight but terrible loss that we've had to make, I'd like to be here when this bank fulfils its – what it can in being a great bank for the UK. It is my strategy, I'd like to see it concluded.

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Simon English, The Evening Standard

OK, thank you.

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Operator

There are no further questions at this time. I will now hand it back to Ross for any closing comments.

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Ross McEwan, Chief Executive

Well, thanks very much for joining us this morning on this call. It is very clear it's been a tough year and the loss is disappointing but our strategy is working. And as I said, the loss reflects £10 billion of one-offs and putting the past behind us. You'll see if you get through the results, is this core bank is very strong and getting stronger.

Adjusted operating profit was £4.2 billion, that's up 4% on last year and it generated 11% adjusted return on equity. As I've said, we've provided £24 billion in net lending into this economy and that exceeded our target and I think it made us the largest lender into the UK last year. We have announced further cost reductions and we've said we'll go faster on our digital transformation.

We took out nearly a billion of cost this year, that's the third year we've exceeded our target.

There will be more digital innovation coming through which gives our customers much more control on how they bank with us and I think that's important.

We anticipate a bottom-line profit and as we've said, an unadjusted profit in 2018 as long as we resolve the Williams & Glyn and RMBS issues this year.

That in itself will be a major milestone for this bank as we just make it simpler and safer and even more customer-focused. We've got a press conference at midday today so I hope to see you all there but thanks for joining us this morning. Cheers.

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Operator

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

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