Q1 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 Annual Results announcement published on 29 April 2016.

RBS

Ross McEwan, Chief Executive

Ewen Stevenson, Chief Finance Officer

Introduction

Good morning, ladies and gentlemen, today's conference call will be hosted by Ross McEwan, CEO of RBS. Please go ahead, Ross.

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Ross McEwan, Chief Executive

Thanks Will, and good morning, everyone. Thanks for joining Ewen and I for our first quarter results. It's only been a couple of months since we last spoke. So, I'll keep it brief and give you time to ask as many questions as you like.

We recorded an operating profit for the quarter £421 million; and a bottom line loss of £968 million. This largely reflects the one-off payment of £1.2 billion for the government to retire the dividend access share.

A repayment of the debt is another key milestone for us as we clear the path to ultimately return excess capital. I've said many times before, this is another year of heavy lifting. And there will continue to be a lot of noise in our results.

But underneath that noise you will see we're on track and delivering on plan. Today's results show our core business generating a return on equity of 10.9 percent and an operating profit of around one billion [pounds] in Q1 showing the strength and resilience of the bank we are fast becoming.

This bank has great brands and great market positions. And piece by piece, we are building a solidly performing profitable bank doing great things for customers and returning value to shareholders.

We set some clear goals for 2016, to build capital, reduce costs, improve service, and grow our core business in an effort to become the number one bank for customers. And I think we've made really good progress on each.

We said we'd maintain a strong capital position. And at 14.6 percent Common Equity Tier 1, we remain strong in relation to our peers and above our 13 percent target. We said we'd take further costs out this year as we become a simpler, lower cost U.K. focused bank.

In Q1, we completed the sale of our international private bank and successfully exited our business in Russia. Now, nearly 90 percent of our income comes from the U.K. and the Republic of Ireland.

We've taken over two billion [pounds] out of the cost base in two years, and have committed to take a further 800 million this year. We also continued to accelerate our exit of expensive properties.

And, we've announced that we'll be leaving 135 Bishopsgate here in London, which is one of our main London offices by the end of this year.

We've said we would focus on our customers. By improving service, we do more business with our customers which in turn, will drive sustainable growth and higher returns. Our NatWest and personal Net Promoter Score is the highest that it has ever been.

And we've seen improvements across most [all?] of our franchises. We're building positive momentum with our new reward account with over half a million customers now paying three pounds for their current account.

The industry is reshaping quickly through the explosion of online and mobile. And there's been a 43 percent drop in branch counter transactions since 2010, while digital transactions have increased by 400 percent. We are well positioned to benefit with one of the leading banking apps in the marketplace.

NatWest customers are now able to apply for loans and credit cards via their phone. And the number of online mortgage renewals has more than doubled since last year.

We said we would do more business in the markets we like, and at a competitive price. And that is what we're doing. Our loan book, and our personal, and commercial business has grown by 15 percent on an annualized basis.

We've continued to take market share in the mortgage market. And we're punching well above our weight with an 11.4 percent share of new business as the investment we made on increasing advisors and improving our relationship with intermediaries is paying off.

And we are the biggest supporter of British businesses. In Q1, our lending to the smallest businesses.- these are the businesses with less than the two million pound turnover - grew by 15 percent on an annualized basis. When they grow, we grow. And that's while you see a big push from us from the enterprise agenda with more hubs and support for businesses than any other bank.

Our commercial net lending performance outperformed the market. This is now the fifth consecutive quarter of net lending growth in the commercial business.

And it looks like demand is holding up well. Yesterday, we announced – well, sorry – we updated you on our mandatory disposal of Williams & Glyn. As I have cautioned before, this is a very complex process that involves standing up a full service retail and commercial bank that works seamlessly for around two million customers on day one.

The closer we get to delivering this, the more clarity we have on the risks. And we now see a significant risk that the separation and divestment will not be achieved by the end of 2017. That said, we remain committed to our state aid obligations and our exploring alternative means to achieve this.

In summary, we are a much stronger, a much simpler and much fairer bank for our customers. And we're delivering solidly on everything within our gift. As you know, there are a range of things we need to get past that are not directly in our control.

The biggest of these is our legacy RMBS settlement with the DOJ in the U.S. We have no material update to give today over and above what I said at our year-end. So, one quarter in, capital remains strong. Costs continue to fall.

Our customers' scores are improving. And we're seeing growth in the business in the markets that we like. I'll now hand it over to Ewen for more details on the numbers.

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Ewen Stevenson, Chief Finance Officer

Thanks Ross. From our perspective, an encouraging quarter. We're delivering on what we had said we would do this year. Our retail and commercial banking franchises are doing well. And that's despite the competitive operating environment.

Our operating profit in Q1 was 421 million pounds. We made an attributable loss of 968 million pounds. But this included the 1.2 billion pound final DAS dividend to HM Treasury.

The return on equity across our six core franchises was 10.9 percent. After many years of declining income, we're beginning to address this. While income was 13 percent lower than Q1 2015, income across the PBB and CPB franchises was broadly flat.

A very good volume growth is offsetting a combination of margin pressure, asset mix changes towards secured lending, and an ongoing decline in certain non-interest income streams. Stable income across the combined PBB and CPB franchises remains our target for the year.

CIB, had a tough start to the year. Adjusted income was down 37 percent on Q1 2015. But most of this impact was seen in the first six weeks of the quarter. And for the remainder of the quarter, CIB's income has been in line with expectations.

Adjusted operating costs were down seven percent on Q1 2015. We're managing the volume growth across PBB and CPB while remaining disciplined on operating costs. And we're now seeing meaningful cost reductions in both CIB; costs down 16 percent Q1 on Q1.

And capital resolution where costs were down 43 percent on Q1 2015. And we're on track to deliver our cost target of 800 million pounds this year. Restructuring costs were 238 million pounds in the quarter. This includes 158 million pounds for the ongoing separation of Williams & Glyn.

Together with the ongoing complexity of Williams & Glyn separation, the tougher Bank of England stress test criteria for the year and our ongoing U.S. RMBS position, I would continue to caution on the timing for a return to capital distributions.

We'll get there as quickly as we can address the issues that we need to address. And we remain committed to returning Core Tier 1 above our 13 percent target in due course.

Turning to our balance sheet, you're now seeing the benefit of the continuing shift in our asset and liability mix towards PBB and CPB. In PBB and CPB, our low loan to deposit ratio provides us with the funding to grow market share.

We grew the combined loan book at 15 percent annualized in Q1. Mortgage activity continues to strengthen. Applications were up 61 percent from Q1 2015, to 10.3 billion pounds.

This provides us with a strong platform going into the second quarter. Grossnew lending almost doubled to seven billion pounds. Flow market share and mortgages was 11.4 percent. And that compares to a stock share of 8.3 percent.

In commercial, lending was up 4.3 percent year-on-year primarily due to growth in the large corporate segment. And on the liability side, we've been actively managing our wholesale debt.

Over the last six months, we've reduced legacy term funding by 11.7 billion pounds through a combination of both maturing debt and repurchases. And we've also issued 2.2 billion pounds of new MREL compliance senior debt.

As a result of this shift in our asset liability mix, our net interest margin is up five basis points this quarter. And our loan to deposit ratio was up to 90 percent.

Our Core Tier 1 ratio fell by 90 basis points during Q2 – Q1 to 14.6 percent. Around 50 basis points of this fall was due to the final DAS dividends. And a further 30 basis points was a result of the previously announced contribution into our main pension scheme that we made in March.

Our Core Tier 1 ratio was also impacted by our growth in RWAs. They increased by 6.9 billion this quarter; 3.3 billion of this was due to sterling weakness.

And despite only a modest decline in capital resolution RWAs in Q1, we remain committed to delivering our 2016 target of a 19 billion pound reduction by this year end. In terms of outlook for the remainder of the year, we remain committed to delivering the guidance we gave two months ago.

And we're comfortable with the operating trends we seen in our core businesses. But as always, we do caution on lumpy quarter-on-quarter one-offs from expected further conduct, restructuring and disposal losses. And conduct costs in particular are subject to a broad range of possible outcomes.

So, overall a good quarter for PBB and CPB. CIB has recovered from a very weak start to the year. And we're committed to meeting all of our 2016 financial targets. With that, I'll turn it back over to Ross to host some Q&A.

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Ross McEwan, Chief Executive
Thanks Ewen. Will let's 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 star key followed by the digit one on your telephone keypad.

We will pause for just a moment to give everyone an opportunity to signal for questions. And we will take our first question 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, both. The first one, if I may. I wanted to know if there's any more colour on what exactly the hold up is with Williams & Glyn?

And I don't know if you saw a management note – I'm sorry – a note yesterday. It said that it called into management execution on restructuring. I wondered if you wanted to respond to that? And then, you know, anything on the dividend outlook as a result of this?

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Ross McEwan, Chief Executive

Yes, as I've said,and I've said it on every call, this is probably the most incredibly complex project that I've seen in banking anywhere in the world. Where you're taking a complete range of systems out of a bank; and then moving your customer base onto that.

And on the day that it starts, you have to have two million customers absolutely served. The further we get into this – and we are making actually [good] progress on the transfer – the more things you do find.

Because I don't think anyone has actually done this before. Whilst, we're I think very good at taking businesses out; we've gone Direct Line Group. We've done WorldPay.

I don't think there's any bank that's really had to take a group of customer’s right out and put them onto a new system. So, look as we go on, we find more and more things, which does push – it has pushed back the time frames that we're working to.

We're still working very strongly on getting this out. But we had to signal to the market that it was likely to be later than 2017. We've had some good successes though in doing this, with progress in the last quarter.

An example of that would be how we now have all of the staff of Williams & Glyn on their own payroll and on their own HR systems all independent of the bank.

So, there's some of those things that are already happening. And that's just one of the 700 things we have to get done.

Ewen Stevenson, Chief Finance Officer

Yes, and in terms of the impact on the rest of the bank, as I've just said before. I think we remain committed to the restructuring that we set out earlier this year, the 800 million cost take out.

We've reduced costs this quarter seven percent year-on-year. So, there's really no impact in terms of our ongoing ability to commit to continue to deliver against the commitments that we've set out to the market.

Ross McEwan, Chief Executive
And I did make some announcements just on the structuring of our executive team so that we do give every chance of the major success for Williams & Glyn over the next 18 months. Because it is having obviously to consume a lot of Simon McNamara's time.

Because it's – a big part of this is the technology piece. The stand up of the business itself, i.e., a lot of the functions associated with this is anywhere between 50 and 80 percent complete.

And the entire running of the bank from a day to day basis is being run by Jim Brown. So, that's already up. So, I think significant progress is being made.
But we are signaling the technology pieces. That is the biggest piece that we still have to complete. And then the question on the dividend. There were –four things that I think we've been focused on.

One of which we had delivered, which is the final DAS payment. The three remaining are to pass the Bank of England stress tests; and secondly, to settle the majority of our U.S. RMBS exposure. Nothing further really to report there today. And the third is in relation to an assured exit from Williams & Glyn. So, you know, those three things in total remain ahead of us.

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Operator
And your next question comes from Max Colchester of Wall Street Journal. Please go ahead.

Max Colchester, Wall Street Journal
Hello both. Just again on Williams & Glyn. You said you were exploring alternative means to achieve this. What does that actually mean?

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Ross McEwan, Chief Executive

Now, look we do have an obligation to have the business sold and out by the end of '17. So given the fact that we are signaling that we may not meet their time frame, we do have to look at what other options.

I'm not going to go into those today because I think once we have investigated those; and if there is an alternative that's better than the current one, we'll let the market know. But at this stage, we are having to investigate other alternatives.

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Max Colchester, Wall Street Journal

But what are on the other alternatives? I mean, you have to – either you IPO it, or you sell it, right?

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Ross McEwan, Chief Executive

Right, as I said I wasn't going to go into that today.

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Max Colchester, Wall Street Journal

OK. And, just an update on your views on the U.K. housing market. Lloyds yesterday said they were sort of ratcheting back their lending to buy to let. Do you feel the same way about that market?

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Ross McEwan, Chief Executive

No, look first off – we are a smaller player in the buy to let market. We have on our book only about 14 percent in buy to let. We have very stringent requirements. We only re-entered the market about six to 12 months ago.

We entered, re-entered, with some very stringent requirements, all set inside the recent recommendations from the lead regulator.

So, we're comfortable with that. I think there is a strong basis for buy to let in the marketplace. Because there are, you know, many areas that people can't afford to be in. But, you know, where people do need to live in. So, you're going to see a strong demand, I think going forward for buy to let. But you do have to be very careful about, your loans to value ratio.

You also need to make sure that, you have a very good income stream coming out of them. That also shows the core strength of our business here. That, you know, we do have the liquidity to lend. But you do have to be careful about how you do that. And we're holding onto to all of our credit criteria in this market.

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Ewen Stevenson, Chief Finance Officer
Yes, Max, I think it's sort of important when you think about us to also remember the shape of our balance sheet, which is different to some peers.

Because of the rundown and the corporate and institutional bank, we're a very liquid bank here domestically in the U.K. The loan to deposit ratio has increased from 89 to 90. I previously talked about the fact that we would be comfortable in a post TLAC [?] world of having that out towards 105 to 110 percent.

So, we've got plenty of room to grow. And year-on-year, the retail business overall, I think has delivered ten percent growth which is consistent with that.

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Ross McEwan, Chief Executive
And the growth that we're after here is, you know, through growth in our distribution as opposed to pulling down our credit criteria; or playing the big pricing lever. So, we have been building distribution over the last three years; and doing I think are doing a pretty good job at it.

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Operator
And your next question comes from Lawrence White of Reuters. Please go ahead.

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Ross McEwan, Chief Executive
Hi Lawrence.

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Lawrence White, Reuters
Hi, good morning, just returning to Williams & Glyn. Can you clarify what the consequences are, if you do fail to dispose of it by the 2017 deadline?

And then secondly, the 158 million pounds of the restructuring charge, you said was from Williams & Glyn. Can we take that as the sort of quarterly run rate? Or, is that number likely to be quite volatile?

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Ross McEwan, Chief Executive
Well, maybe I'll move to take the firstquestion last . And I think I'll give that one to Ewen just on the 158.

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Ewen Stevenson, Chief Finance Officer
Yes, so we spent 630 million poubds for the full year last year; and 158 million pounds for this quarter. Or, I think it is a good indication of quarterly run rate. I also think it's important as you think about that number, though.

Every quarter, we retain the business, we also continue to consolidate the earnings that we get from Williams & Glyn. Williams & Glyn actually from an operating performance is doing very well at the moment.

It's made about 18 million of operating profits in the Q1. So, the net impact of the quarterly run rate is a lot lower than the headline restructuring costs.

Ross McEwan, Chief Executive
And on the first part, look, Lawrence our job is to get thing out from inside the bank. And that's where we're putting the efforts.

If we don't get there, we'll obviously have to have the conversation with HMT, who have arrangement through the European Commission. But at this stage, we haven't entered any conversations about what happens if we don't. Our job is just to get it out and do it properly.

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Operator
And your next question comes from the line of comes from Nick Goodway from Evening Standard. Please go ahead.

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Ross McEwan, Chief Executive
Hi Nick.

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Nick Goodway, Evening Standard
Good morning, Ross, and hi. Could you tell us a little bit more about Brexit both for what you're seeing your customers doing and what you're doing as a bank in terms of preparing for liquidity shock?

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Ross McEwan, Chief Executive
Yes, look we're not seeing a lot of behavioural change in the marketplace at this point and time. Certainly in the retail SME market, it's business as usual.

And you've seen through our results, we're a reflection of what's happening in that marketplace. We are keeping an eye on liquidity, and those sorts of issues, and seeing, and making sure that they're aren't [any]. We're not seeing any changes.
And we're not really at this stage.

I do think that there are a number of larger corporates who are just holding back on the investment decision for the next, you know, six to eight weeks. And we've heard a wee bit of that, which was no different than what happened in the actual Scottish referendum where some Scottish firms just held back until they saw the answer.

So, at this stage, you've seen our quarterly results. They've been very strong across all lending areas in particular. And we're not at this point seeing any movement.

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Ewen Stevenson, Chief Finance Officer

In the corporate and institutional bank, really there's nothing that looks unusual in terms of trading activity. It's always possible as we approach the 23rd of June that we'll see some slowdown there.

And then, from a bank's perspective, you know, our liquidity position is very strong. Our liquidity coverage ratio was over 120 percent. So, I think we're very well prepared for whatever may or may not happen.

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Operator

And your next question comes from Jill Treanor from The Guardian. Please go ahead.

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Jill Treanor, The Guardian

Hi, good morning.

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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 you quickly. You've got some fresh disclosures in your litigation paragraphs where you were talking about your enforcement proceedings by Finma against Coutts. And I wondered if you could talk a bit about what that means?

And secondly, I wanted to ask you whether or not you're running the bank on the basis, it will actually make a profit in 2016 for the full year? Or, whether or not this quarterly losses is what we're going to see for the rest of the year?

And thirdly, I just wanted to be clear. How many properties you've actually got on Bishopsgate still once you've pulled out of 135?

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Ross McEwan, Chief Executive

Thanks Jill. The first one on the Finma, that relates to the business that we have sold, which was the international part of Coutts. And as we've had the conversation before, I've always thought that thesort of the risks of those sort of international operations were greater than what we've been here [?].

So, we're pleased that the sale went through and went through well. It actually transacted just at the beginning of April. So, it does relate to the international private bank that we no longer own.

Look, the profit will be dictated by more of how much restructuring we do on the business; but also, the conduct and litigation issues that come through this year. So, I won't give you any predictions on that.

But the underlying business here as you've seen is making about a billion pounds a quarter. It is very strong with, you know, just under 11 percent return on equity.

So, you know, the core bank is doing well. I said in '15 and '16, we would have a lot of conduct and litigation issues. And the restructuring that we would want to get most of it done in these two years, if possible. Some of that is outside my gift.

And the final question, it was just on properties. We still have our Bishopsgate 250 and 280, which will be our major offices here. And we still have another three premises within the vicinity.

Yes, the bank was, in the shape, as you know, that was for global expansion. We're bringing it back to a bank that is a U.K. and Republic of Ireland focused bank. And then we don't – no longer need all of those premises.

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Operator

And our final question comes from the line of Emma Dunkley from Financial Times. Please go ahead.

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Emma Dunkley, Financial Times

Hi. I was wondering if you're going to change or would consider changing your capital distribution strategy so that it's not dependent on offloading Williams & Glyn now because of the delays? And if you're not considering changing, then why is this? Is it regulatory requirements?

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Ross McEwan, Chief Executive

Well, first off, tthere are four things that we set out that we had to achieve to – before we believe we would be in a good position to return on capital. One, it was the DAS, which was paid off in the first quarter.

The second one was Williams & Glyn. Because it is a state aid requirement. And you know, we need to fulfill that before we are in that position.

The third one that Ewen articulated to you was around passing the stress test. And the fourth one was RMBS, which is unfortunately not in our gift time wise.

So those are the four. And nothing has changed on those. We have to, you know, fulfill all four of those in our minds before we are in a position.

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Ewen Stevenson, Chief Finance Officer

Yes, I know and I said earlier, Emma. We're not changing our approach to capital distributions as and when we are able to make them. So, you know, we've continued to say that we will return capital above the 13 percent Core Tier 1 ratio.

As you saw today, we're comfortably above that, 160 basis points ahead of that. So, that continues to be our commitment to the market.

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Ross McEwan, Chief Executive

Yes. OK, maybe if I just finish off with a few comments. Thank you, Ewen. You know, you've seen from our results, we are achieving good growth in our core businesses and certainly in the markets that we like.

We're doing very well. The core business does generate close on, or if not over a billion pounds a quarter. And it is, you know, producing a result of close to 11 percent return on equity.

We're a much stronger bank with a common equity Tier 1 position of 14.6 percent net after paying out the debt and topping out the pension fund. We're a much simpler and better bank for customers.

Our metrics on Net Promoter Scores are showing a very good lift in pretty much all areas. And some of the highest scores we've ever seen particularly in NatWest.

And we are being a better bank for customers with, you know, seeing growth in the core markets; and having launched the reward account, which is going very well. But, you know, we do signal there are still challenges ahead for this bank.

But one quarter in , our capital remains strong. And costs are continuing to fall . And our customer scores are improving. So, thank you very much for joining us on the call today.

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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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