Q3 Results 2018

MEDIA Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
on Friday 26 October 2018

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 26 October 2018.

RBS

Ross McEwan, Chief Executive

Katie Murray, Interim Chief Finance Officer

Introduction
Good morning, ladies and gentlemen. Today's conference call will be hosted by Ross McEwan, RBS Chief Executive.

Please go ahead, Ross.

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Ross McEwan, Chief Executive
Thanks, Joanna. Good morning, everyone.

Today I'll give you an overview of the group's performance in the third quarter and then Katie Murray, who's with me today, our interim CFO, she and I will be very happy to take questions after that.

In the third quarter, we made a pre-tax operating profit of £961 million and a bottom-line attributable profit of £448 million. This is up 14 percent or £56 million on the same quarter in 2017. So far this year, we've generated a pre-tax profit of £2.8 billion and a bottom-line profit of £1.3 billion.

This is a good performance set against a highly competitive market and an uncertain economic outlook.

Our income performance this quarter is impacted by a number of one-off items so I thought I'd just take you through some of the larger ones.

The most significant items are on the positive side our £272 million insurance recovery and £77 million of IFRS volatility gains.

On the negative side, we've taken additional conduct and litigation charges of £389 million, which does include a £200 million PPI top-up. We've taken an additional £100 million charge in relation to more uncertain economic outlook and a further £60 million impairment charge in our Irish business, in relation to ongoing sales from our loan book to further reduce the level of non-performing loans.

Excluding central items, NatWest Markets' income was stable, quarter-on-quarter and year-to-date after accounting for one-offs and transfers. Other expenses decreased by £183 million, year-to-date and £50 million compared to the same quarter in 2017; that's excluding one-off impacts. Our digital strategy is a key driver of this cost reduction; as we digitise customer journeys, we are taking out costs.

Strategic costs were £299 million in the quarter, as we continue to invest in our digital transformation.

Our bottom line profitability, combined with RWA reduction, drove a 60 basis point improvement in our Common Equity Tier 1 capital ratio, taking us up to 16.7 percent, at Q3 2018. We also expect that the final merger agreement over Alawwal Bank is to be completed in H1 2019 and estimate this will create an additional 40 basis points of Common Equity Tier 1 capital next year.

Given this strong position, we are looking to return capital to shareholders and we will update the market at the appropriate time.

We continue to support our customers as we await further clarity on Brexit negotiations. We have committed to an additional £2 billion of funding to our growth fund to support British businesses and this takes the total fund to £3 billion, of which £900 million has already been deployed. The fund is helping businesses invest in manufacturing, technology and in development.

In addition, we have received approval from the Dutch regulator for the repurposing of the existing banking license of NatWest Markets NV, based in Amsterdam. This will ensure we are operationally ready to serve our customers based in the European Economic Area, when the EU leaves, sorry, the UK leaves the EU.

We know that our performance on customer advocacy is not where we would like it to be and our results from the CMA survey, earlier this year and our own NPS tracking showed us that there are signs of encouragement.

Our digital initiatives continue to deliver improved customer experiences with our mobile apps. Paperless mortgage process, new bankline and Esme lending platform, all generating very strong customer advocacy. As these channels are used more widely and we continue to develop them, we expect to see our customer service improve.

So in summary…

- A pre-tax operating profit of £961 million and a bottom-line profit of £448 million for the quarter.
- A good performance in a competitive market and with uncertain economic outlook.
- And for the first nine months, a pre-tax operating profit of £2.8 billion and a bottom-line profit of £1.3 billion.
- Strong capital position with CET1 at 16.7 percent and we are looking to return excess capital.
- We are growing lending in our target markets and we've continued focus on digital transformation, innovation and improving customer service.

And with that, Katie and I are happy to take your questions. Back over to you, operator.

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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 will pause for a moment to give everyone an opportunity to signal for questions.

We will now take our first question from Lawrence White from Thomson Reuters.

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Ross McEwan, Chief Executive
Morning, Lawrence.

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Katie Murray, Interim Chief Finance Officer
Hi, Lawrence.

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Operator
Please go ahead.

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Lawrence White, Thomson Reuters
Morning, Ross. Morning, Katie. Thanks for letting me go first. Just on the fresh £100 million impairment on greater economic uncertainty, can you tell us a little bit about how you arrived to that number? Is it the kind of mid-point between your various Brexit outcome scenarios? And also, what's your current base case? Are you forecasting that we will get some sort of withdrawal agreement or are you increasing the likelihood of a 'no deal' scenario? Thanks.

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Ross McEwan, Chief Executive
Maybe if I just start with a couple of comments on that one, Lawrence, and then hand over to Katie to take you through how we got to the £100 million.

Look, I did participate in a call that many CEOs did with the Prime Minister last week and whilst I'm not going to go into the detail of that. It would be inappropriate. There was, I think, we got a sense that there was a position that was starting to be developed. It was a lot more optimistic than I'd heard in the past.

Our view is that we just have to be prepared, be prepared for our customers no matter what happens here and that's the work that we've been doing and with our Amsterdam branch and how we're structuring up payments and the likes to make sure that we're available no matter what happens. But we did sense, a more optimistic tone last week than we've probably had in the past.

But Katie, maybe if you take Lawrence just through the how do you get to £100 million…with no impairment provision.

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Katie Murray, Interim Chief Finance Officer
Sure. Thanks, Ross. I mean, Lawrence, IFRS 9 is an interesting standard. It's very model driven.

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Lawrence White, Thomson Reuters
Yes.

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Katie Murray, Interim Chief Finance Officer
It looks both backwards and forwards. I mean obviously, as we look backwards, we're looking at a period where we haven't really had a lot of volatility on our impairment charges at all. We are running at 16 bps for the year-to-date, even including the extra £100 million that we've taken.

But what we do see that while consensus economics aren't moving, they're still in the same kind of mid-base / mid-place. What we are seeing is a lot of widening of the assumptions around about there.

You'll have heard us talk at the interims around that we thought there's a bit more threat to the downside and this £100 million is really just us putting in more of those, so we're slightly more a threat to the downside scenarios and some probabilities around where that might be.

I think, given where we are in terms of the negotiations, I think we can agree that there's actually greater uncertainty as we move forward and the £100 million really reflects our view on that. And then we'll see how it kind of unwinds through, over the coming months as things firm up and develop. But it's certainly what I would say, as you look at the book, 16 bps year-to-is an incredibly low number.

It's important to remember that while the £100 million itself feels like a large number, it's actually against a very, very low level environment and I think that we're really benefiting from a lot of the cleaning up that we've done of our book over the last number of years and I think that's why we're relatively comfortable about it.

Lawrence White, Thomson Reuters
Great. Thanks.

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Ross McEwan, Chief Executive
Thanks, Lawrence.

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Operator
Thank you. We will now take our next question from Stefania Spezzati from Bloomberg News. Please go ahead.

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Ross McEwan, Chief Executive
Hi, Stefania.

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Stefania Spezzati, Bloomberg News
Hi. Good morning. I was wondering if you could please elaborate a bit more regarding the access of capital and the distribution that you are planning for and if you can give us more details, maybe, on the timing, if there's something that you're going to look for next year, and if there is a preference for a special dividend for buybacks. Thank you.

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Ross McEwan, Chief Finance Officer
Yes. Maybe if I pick up first and then, Katie, you can come from there. Look, we currently do have a very, very strong capital position at 16.7 percent. As I've said, it's up 60 basis points since the last quarter. Long-term, we target 13 percent. We've said the interim needs to be 14 percent, just over 14 percent.

And you and I would agree we have a lot of excess capital, we do want to get back to our shareholders. This will not all be done at once and we're currently working through those options. We've declared the interim dividend, which we've paid, and we'll certainly be going back to the regulators around our full-year dividend.

We are assessing the different options from directed buybacks to specials, but, look, we haven't got anything more to say on this time and remembering, too, we do want to get through a stress test that's at the beginning of December. You won't be hearing anything from us until we've got through that as well.

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Katie Murray, Interim Chief Finance Officer
And the only thing I would really add to that, Ross, is it's important that we note our capital level of the 16.7 percent. What you will see if you get into the real detail behind that number is that we've taken a 0.1 hit on that, so as we start to recognise our full-year dividend. What we're required to do under the regulations is as we take profits, is to set a portion of that back for dividends.

Now, that's a thing that every normal, everyday company does and for us, I guess, it's the first time that we've done it on a quarter. So, it's just great to see the return back to normality. It also gives you comfort that clearly, the full-year dividend is on its way.

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Ross McEwan, Chief Executive
And part of the other point on that, on the directed buyback, there's quite a mechanism...

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Katie Murray, Interim Chief Finance Officer
Absolutely. Yes, yes.

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Ross McEwan, Chief Executive
...that has to put in place as well, Katie, which is around having an EGM, unless we take it to an AGM, but have to have an EGM and there are some restrictions about how much you can do on a directed buyback, which is 5 percent of your total capital, share capital, in any 12 months. So, there's quite a bit of work to be done around getting ourselves prepared for any of those eventualities.

Katie Murray, Interim Chief Finance Officer
And probably the most important thing on the directed buyback, Ross, is it's not entirely in our gift.

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Ross McEwan, Chief Executive
Yes.

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Katie Murray, Interim Chief Finance Officer
Ultimately, it requires the shareholder to make a decision that they that they want to participate.

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Ross McEwan, Chief Executive
Yes. Thanks, Stefania.

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Stefania Spezzati, Bloomberg News
Thank you.

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Operator
Thank you. We will now take our next question from Lucy White from Daily Mail. Please go ahead.

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Ross McEwan, Chief Executive
Hi, Lucy.

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Lucy White, Daily Mail
Hi. Hi, Ross. Hi, Katie.

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Lucy White, Daily Mail
Ross, you've previously said in the past that payment of fraud victims are -- perhaps don't deserve refunds from the bank, such as yourselves. At a time when this doesn't seem to be going away at all, are you any closer to kind of coming to any kind of method of accounting for payment fraud victims? And do you kind of go back on your previous words saying that it's perhaps, often people being careless?

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Ross McEwan, Chief Executive
Now, look, I understand that when you get hit with fraud, it's a traumatic experience for customers who fall victim to a fraud. Not only in terms of the financial impacts, but these sort of emotional impacts that come through from that as well.

And look, we'll also refund money paid out of their account by a fraudster as long as we've, you've kept your security information safe and haven't given it to the fraudsters, because the issue for me is I can't be in every house taking every phone call for customers. There does need to be a two-way obligation on this.

Look, we have dedicated scam teams who try to help customers recover as much money as possible and we're reasonably successful at this and we do this in partnership with other banks. And we also have eight community protection managers who work across the bank to raise awareness of financial harm and scams and I think we're doing a huge amount of that with our programme, around getting a million Friends Against Scams.

So look, lots of work being done here, but I see this as a partnership between customers and the bank itself.

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Lucy White, Daily Mail
Great. Thanks, Ross.

Operator
Thank you. As a reminder, if you would like to ask a question, please press the "star" key followed by the digit "1" on your telephone keypad. Our next question comes from the line of Mark Broad from BBC. Please go ahead.

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Mark Broad, BBC
Morning, both. Hi. I just wanted to see if there's any more detail on that £100 million. Can give me detail on what that's on? Is that sort of concerns about Brexit? Is that worries about sectors like retail? Where does that that number… how did you arrive at that number?

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Ross McEwan, Chief Executive
Well, Katie, I'll put it to you because it really is an accounting treatment from the IFRS9, which is quite a new treatment coming through. Maybe if you just take Mark through that again.

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Katie Murray, Interim Chief Finance Officer
Yes. No. Thanks. Morning, Mark. I mean, when you look at IFRS9 and the standard, what it requires us to do is to look both forwards and back. When we look at back, we obviously look at our loan models and see what kind of experiences we've had and what we know is that, at 16 bps in terms of the year-to-date impact of impairments, we're not seeing anything in the underlying models. And that's 16 bps including this £100 million.

And so then we run a number of, a significant number of forward-looking scenarios. What we can see is while consensus hasn't changed, it has definitely broadened around about the views of the economy going forward and that's really what's giving rise to this £100 million. And as we continue to run our models as we go through and then take it from there and it's something that we felt that was appropriate to recognise.

Mark Broad, BBC
And Ross, just in general, how do you… how do you see things? I mean are you seeing more sign of stress amongst customers or amongst companies at all as we enter this… still in this period of uncertainty?

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Ross McEwan, Chief Executive
Well, what we have seen, as Katie said, 16 basis points. That includes this £100 million provision. You are not seeing the stress coming through into small businesses or into the retail customers' book. What we're really just trying to be there in support of customers. You've seen our strong lending position. We've put together the growth fund. We're having really good conversations, I think, with many, many of our business customers around their needs, particularly around Brexit and their supply chains.

And you have seen, at the very large end of town, just the investment pause and we've called that out for the last two quarters. You are seeing larger companies just pause their investment until they get certainty. But look, it's not showing… nothing showing through in our impairments and we have taken a provision on the £100 million, as well as the Irish book provision for the non-performers book that we'll look to take out over the next six odd months.

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Mark Broad, BBC
Great. Thank you.

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Katie Murray, Interim Chief Finance Officer
Thanks, Mark.

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Operator
Thank you. We will now take our last question from Michael Bow from the Evening Standard. Please go ahead.

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Ross McEwan, Chief Executive
Hi, Michael.

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Katie Murray, Interim Chief Finance Officer
Hi, Michael.

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Michael Bow, Evening Standard
Hi. Morning. Sorry to drill down on this £100 million, but just on terms of… no other bankers I know has done this, so what does this suggest? Does this suggest anything about your particular loan book? That you're more exposed to customers not being able to pay back their money? Just can you give us a bit more of a flavor about why you've taken this charge and others haven't?

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Ross McEwan, Chief Executive
Yes. No, thanks, Michael. Thanks for clarity on that. Look, we've probably got one of the lowest impairment positions in the marketplace at 16 basis points and over the last four to five years, we have gone through and cleaned up our book dramatically. And that's one of the reasons why you're seeing only 16 basis points.

But as Katie said, under IFRS9, you do have to look forward as well as backwards and there is a lot more uncertainty in the marketplace at the moment until we do get agreement and that's what this is reflecting. Nothing more than that. We do have to look forward as well as backwards, but at 16 basis points, you're seeing a very, very clean book at the Royal Bank of Scotland.

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Michael Bow, Evening Standard
But if your peers are not doing it, why are you doing? Is it because… do you have something different than they have? When you say… you have to look backwards, what does that mean?

Ross McEwan, Chief Executive
Well, if you actually look backwards, that we are not taking impairment. I mean have a look at 16 basis points, when we would normally be trading at a 30 to 40 basis points. That's what the guidance was given to market. We probably have some of the lowest impairments in the marketplace and that is because, over the lowest last five years, we have cleaned up our banking books, right across the organisation.

But this is a more look forward position than it is looking back because looking back it would be even lower than 16 basis points if you extract out the £100 million.

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Katie Murray, Interim Chief Finance Officer
No, absolutely. I mean I think I will leave other banks to comment on their own position, but certainly as we look at our book, it's very lean. Our guidance in the cycle is 30 to 40 basis points and we're just not touching that at all at a year-to-date of 16 bps.

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Michael Bow, Evening Standard
And the impairment's related to loans, are they? That's where the impairment comes from?

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Ross McEwan, Chief Executive
Yes.

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Katie Murray, Interim Chief Finance Officer
Yes. It's all to do with lending. IFRS9 is for a lending standard.

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Michael Bow, Evening Standard
Right. OK. Consumer lending, not commercial.

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Ross McEwan, Chief Executive
Well, it's all lending.

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Katie Murray, Interim Chief Finance Officer
It's all lending. It's all lending.

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Ross McEwan, Chief Executive
…it's our total lending, as you're seeing across the book at 16 basis points, is very low and as we've said, we had guided to 30 to 40 basis points and we're sitting at 16 bps so it's a very low position and that includes £100 million of additional provision in there. Along with an additional provision inside our Irish book.

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Katie Murray, Interim Chief Finance Officer
Yes.

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Ross McEwan, Chief Executive
... which is a €60 million position. As you can see, if you extracted both those out, this would be a very, very low impairment position for any bank.

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Michael Bow, Evening Standard
OK. All right. Thank you.

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Ross McEwan, Chief Executive
Thank you.

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

Ross McEwan, Chief Executive
Yes. Thanks, Joanna, and thanks for joining us on the call.

Look, we're pleased with this quarter's performance. It is set against an uncertain economic outlook. We're also aware that there's much more work for us to do and fully focused on improving our customer service and that's what we're now very firmly focused on.

But thanks for joining us and have a great 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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Ross McEwan
Thanks, Joanna.

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