Annual Results 2018

MEDIA Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
on Friday 15 February 2019

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 15 February 2019.

RBS

Sir Howard Davies, Chairman

Ross McEwan, Chief Executive

Katie Murray, Interim Chief Finance Officer

Introduction

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

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Howard Davies, Chairman

Good morning, Howard Davies here. Thanks to everybody for joining. I'm just going to give a brief introduction the results before handing over to Ross and, indeed, Katie Murray who's also here to talk about our performance in a bit more detail.

In 2018, the bank delivered a good financial performance despite an uncertain economic outlook and a highly competitive environment, especially in the mortgage market. Paying a dividend for the first time in a decade showed the progress we've made in building a stronger, safer bank.

On capital distributions, we're giving more detail today on the proposed dividend payout for 2018 and it was good to receive approval from our shareholders last week to participate in share buybacks should the Treasury deem that appropriate.

We're grateful for the support we've received from all our shareholders in our recent years and are pleased that we're now in a position to reward them tangibly for their support.

We continue to make progress against a very uncertain backdrop. The Brexit process continues and we have planned for a range of scenarios associated with exiting the EU.

We now have a subsidiary in Amsterdam that will be in operation at the beginning of April and have applied for licenses to operate in Frankfurt, which we expect to be functional at the same time.

That will allow us to continue to serve our large corporate and financial customers in Western Europe and continue to clear Euro payments. Practical preparations rather than nerve is what we need now.

Overall, the board was pleased with the bank's performance in 2018 during a period of significant uncertainty.

We still have more work to do to reach our 2020 ambitions, but we continue to make good progress on improving returns for shareholders and delivering better service for customers.

And I'll now hand over to Ross who'll give you some more detail on the results.

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Ross McEwan, Chief Executive
Thanks very much, Howard. Look, today we are pleased to announced pre-tax operating profit of £3.4 billion. That's up 50 percent on the full-year 2017, and attributable full-year profit of £1.6 billion, more than double what was achieved in 2017.

A pre-tax operating profit of £572 million for Q4 2018 and our first fourth quarter bottom line profit in eight years of £286 million.

We have a proposal here to pay a final dividend of 3.5p following the 2p interim dividend and a special dividend of 7.5p. Taking our total dividend payments to shareholders in 2018 to £1.6 billion, of which around £1 billion will be paid to the UK taxpayer.

We've left the year with a very strong capital position with a 16.2 percent common equity tier one post-dividend payments.

In 2018, we delivered £30.4 billion in gross new UK mortgage lending in UK PBB. We also supported UK businesses with over £100 billion of lending through our commercial and business banking franchises. And given the Brexit uncertainty, we also made £3 billion of funding available through our Growth Fund to help businesses ready their supply chains for the UK's departure from the EU.

I don't think I'm alone in saying that political uncertainty around Brexit has gone on far too long. Our corporate clients are pausing before making financial decisions, and this, of course, is damaging the UK economy and will affect our income performance.

With our financial performances more assured, we are aware that there is a significant gap to achieve our ambition to be the best bank for UK customers. Today, CMA scores provide further evidence of that.

We must do better and we will do better.

We have to get our core service right first time, every time consistently, and we're investing £1 billion in 2019 to upgrade legacy infrastructure and deliver better products and services for our customers.

We have taken a dual approach to our innovation strategy. Firstly, we're looking at our customer journeys in the core bank and seeing how we can automate, simplify, and digitise these to improve for customers.

Paperless mortgages is one example. This is a market leading initiative. Cora, our artificial intelligent chatbot which we launched in partnership with IBM Watson now handles over 83,000 queries a week.

Secondly, we are piloting a number of innovations outside the core business to meet more customers' needs. Bó is our digital, personal bank targeted at helping people to manage their money better and Mettle is our digital bank for business customers.

We are taking the learnings and apply them into our core bank. Not everything we pilot will be a complete success, and as long as we learn as we go, we are comfortable with our approach.

We are building a leading UK retail and commercial bank, with strong non-ring-fenced banks in NatWest Markets and RBS International. Strong brands supporting growth in key markets, a lower-cost, customer-led, digital enabled model.

And finally just to reiterate, we are pleased to have been able to return £1.6 billion in dividend payments to our shareholders, of which around £1 billion will be paid to the UK taxpayer.

With that, I'll hand over to Katie Murray for a detailed run through of the financials.

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Katie Murray, Chief Finance Officer
Thanks, Ross. Good morning, all.

In summary, a good set the full-year results in a highly competitive market and against the backdrop of continued economic uncertainty. Our key legacy issues are behind us and we passed the BoE stress test, allowing us to pay our first interim dividend in 10 years.

Today we're clarifying our medium term CET1 ratio guidance to circa 14 percent and we aim to reach this in 2021. We expect to get there through capital distributions over the coming years, and we'll be doing this using the most appropriate methods as the Board sees fit at that time.

Our 2020 targets are a below 50 percent cost income ratio and a return on tangible equity of more than 12 percent, as we progress towards a circa 14 percent CET1 level in 2021.

There are growing risks to income as Brexit, global trade issues, and economic uncertainties continue, and we're also now required to carry additional costs to deal with the ongoing operational costs of Brexit and ring-fencing. And of course, we need to continue to invest and innovate within our business to meet our customer needs.

We are, however, comfortable on our 12 percent return on total equity target, but in the round it's fair to say that these are challenging targets to achieve, but we continue to drive the organisation towards them.

During the year, we executed well against our four key priorities – resilient income, continuing cost reduction, actively managing capital and delivering capital return.

Income was broadly stable despite the challenging markets and we are growing in areas that we like.

Cost reductions continue. We've taken out another £278 million in 2018. That brings our cost reduction total to £4.2 billion in the last five years, a significant change to our cost space by any standard. We plan to reduce our other operating expenses by a further £300 million in 2019.

On RWAs, theses are down £12 billion from last year at £189 billion ahead of our guidance. We have come to the end of this phase of very active management of the portfolio, and we are comfortable that we have exited the areas we wanted to.

On capital, we have ended the year with a CET1 ratio of 16.2 percent, as a result of our strong capital build both from profits and the management of our capital. We are in a good place to return to generate and distribute substantial returns.

We have achieved a 40 percent ordinary payout ratio for 2018, but that won't be enough to distribute the capital back down to the level we think is appropriate for this bank.

Therefore, as we have done this year end, we will look at other ways of giving capital back. We would also want to help the government reduce this stake should the opportunity present itself to do so.

So to summarise, we're pleased with our full-year results.

A doubling of bottom line profits in the year, continuing cost reduction, very strong capital generation, and the substantial clean-up of our balance sheet being complete, we have started the process of significant capital return to our loyal shareholder base.

And with that, I will hand back to Howard to host the Q&A.

Howard Davies, Chairman
Thanks so much, Katie and Ross. I will go straight into Q&A which I think Charlotte's managing.

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

We will now take our first question, comes from Stefania Spezzati from Bloomberg News. Your line is open. Please go ahead.

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Stefania Spezzati, Bloomberg News
Hi, good morning. I was wondering if you could please give some more colour on what is in economy and if there is any deterioration in the current condition because of Brexit and what's you're latest assessment on this? And also if maybe if you can give us some comment on how the first quarter started that would be great? Thank you.

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Ross McEwan, Chief Executive
Well, maybe if I…

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Howard Davies, Chairman
Yes, Ross…

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Ross McEwan, Chief Executive
…on the economy. Look, the area that we have seen a slowing down is in the large corporates. They are pausing investment and waiting to see what the

outcome from Brexit is, this has been the case for the last three or four quarters.

Overall from a mortgage perspective still remains a very competitive marketplace out there. Of course, London has slowed down, but other parts of the UK have remained reasonably robust and the same is happening in the small business market.

It's clear that the economy is cooling off. The Bank of England has called a GDP growth down from 1.7 percent to 1.2 percent, which will start to be felt and we are starting to feel it. And that's why we're calling it out that there may be some impact on our income over 2019 and 2020 because of this.

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Howard Davies, Chairman
Thank you.

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Stefania Spezzati, Bloomberg News
Thanks.

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Operator
Thank you. Our next question comes from the line of Iain Withers from Reuters. Your line is open. Please go ahead.

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Katie Murray, Chief Finance Officer
Morning, Iain.

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Ross McEwan, Chief Executive
Hi Iain.

Howard Davies, Chairman
Can anybody hearing him?

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Ross McEwan, Chief Executive
We're not hearing you.

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Iain Withers, Reuters
… pay out. How will Brexit impact that going forward? And just another one on Brexit, how concerned are you about a no-deal Brexit and what practical steps are you taking to prepare your customers? Thanks.

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Howard Davies, Chairman
We missed – there was a cut-off. We missed the first part of your question. Could you please try again?

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Iain Withers, Reuters
Sorry about that. It's on the outlook for capital pay-outs. I'm wondering what that's looking like particularly with Brexit. Thanks.

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Howard Davies, Chairman
Yes, we'll go to Katie on that and then I'll pick up a bit on the preparations for Brexit.

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Katie Murray, Chief Finance Officer
Yes, I know. Sure. Thanks very much, Howard.

I mean, obviously today we've made significant capital pay-outs. It gets to a pay-out ratio of 97 percent of our profits for the year, so that is as much of a reflection of the very strong capital position that we are in.

We've also guided you towards a capital level of 14 percent, by circa 14 percent by the time we get to 2021. So sitting at 16 percent today after the CET1 ratio and working our way down from that, I think we can – obviously there's still ongoing capital to that we expect to pay-out.

What I would say I wouldn't take into linear fashion. It will, by its nature, be lumpy depending on the actions that we use and we'll do the right thing that the Board feels at the time, but certainly we would expect to continue to distribute significant capital.

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Howard Davies, Chairman

On the Brexit preparations, first it's fair to say that we are not the worst affected bank here because our Western European business is not enormous, but we do wish to maintain service to our Western European corporate and financial clients both in the investment bank and straight forward lending in our corporate bank.

In order to do that, we have set up a subsidiary in Amsterdam. That has now been fully approved by the Dutch Central Bank and can be operational on the first of April, if that is necessary.

And secondly, we've applied for branches in Frankfurt in order to manage Euro payments, and we have every expectation that they will be completely approved and ready for operation on the first of April.

We're now getting to the point where we have to put those things into operation anyway because now it is far too late to sit there and make just contingency plans. You actually have to get people in place. So those things will happen, whatever outcome because the process has now gone on too long for us to sit and wait.

Iain Withers, Reuters
Cool, thanks.

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Operator
Thank you. If you wish to ask a question, please press the star key followed by the digit one on your telephone keypad. Our next question comes from the line of Nicholas Megaw from the Financial Times. Please go ahead.

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Ross McEwan, Chief Executive
Hi Nicholas.

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Katie Murray, Chief Finance Officer
Morning, Nicholas.

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Nicholas Megaw, Financial Times
Hey guys. Two questions – one, can you just give a little bit more detail on the higher costs you saw coming through 2020. Like what – I mean, what among – you've mentioned ring-fencing and Brexit. What's there that wasn't known about or predicted three months ago?

And the second point, I know you obviously don't control when the government chooses to sell-down more shares, but it does have to – and they don't expect to make a profit, but they do kind of have to justify that it's value for money. Do you think your share's a good value for money at the moment?

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Ross McEwan, Chief Executive
Well maybe if I pick up on the first one to start, but then, Katie, you come in behind as I leave pieces behind.

Just on the higher cost structure, remember when we set these targets back in 2014 for 2020, the things that have changed dramatically since then are Brexit and around ring-fencing.

We've spent a considerable amount of money on both of these, and the ongoing costs of running an operation in Amsterdam, and the branch structure that Howard talked about in the likes of Frankfurt and a branch structure across Europe, are additional cost to what we thought we would be baring before Brexit.

So, those are additional costs. And the additional costs of ring-fencing, where we are running two treasury systems because we're running two different banks now. There's also additional cost that were not planned, probably in the region of about £100 million.

We're still targeting very strongly at 50 percent cost to income ratio. And we're pretty confident about our 12 percent return on tangible as we go – as we are in 2020. So, all we're doing is saying that there are additional costs coming through.

You've seen inflation, increase on wages, so these are sort of things that we are absorbing. But we're confident about the shape of this business, and what it will perform on behalf of our shareholders.

On the government, I don't think we can say anymore. It's really their call on when they sell, that's not in our hands. What my job and the Board's job is to create a really good bank, so they get the best value for what they want.

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Howard Davies, Chairman
I think that's right.

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Katie Murray, Chief Finance Officer
Yes.

Ross McEwan, Chief Executive

It's their decisions whether they keep the money in a bank or whether they put it in to other things like schools and hospitals and things.

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Howard Davies, Chairman

Next question.

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Operator

Thank you. The next question comes from the line of James Burton from the Daily Mail. Please go ahead.

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James Burton, Daily Mail

Good morning, all. Thanks for the question. I just had a few quick ones. First of all, I think there's a line in your accounts about an anti-money laundering investigation, launched by the FCA at the end of last year. I was just wondering if you could give me clarity around what that is. Is it because they've noticed something? Is it just a routine sort of thing that they do for all banks from time to time?

Secondly, I wanted to ask about reports of the delay to this system by which banks will have to check the name of the payee as well as their sort code and account numbers to try and prevent fraud. I think it's been reported that can be delayed by 18 months. I mean, do you think that's letting customers down and do you think that banks should perhaps compensate in terms of fraud, to lose money, because this isn't in place over those 18 months. It is delayed by that long.

And lastly, I believe you got a moratorium on branch closures now. I think you said about 400 last year. I mean, is it finally coming to an end? I guess, I was just wondering if you sort of acknowledge that the closures of those branches and the cash points as well across the country has harmed the communities where they disappeared.

Thanks very much.

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Ross McEwan, Chief Executive

Thanks, James. I'll pick up on those. We're not going to give any details on the anti-money laundering piece. It's an investigation that's going on, and we want to see what comes out of that. So, obviously the regulator does want to come in to see what's been going on, and not just us but all banks. So, no more detail on that.

On the delays, look, this is a major industry issue. There are many things hitting the industry at the moment around opening up payment structures. You've got open banking, you've got all sorts of European regulations coming through. We're still trying to finish off the likes of cheque clearing.

And now we're trying to actually open up and give more detail on these things. These are massive changes for the industry and it's an industry that has to actually coordinate right across the board in to payment structures.

And I think that's what we need to be very careful of when we keep opening up payment structures and making changes to them. They're not easy. And every time they work – they have to work when they are open.

So, I'm not at all surprised there's a bit of delay. But the industry is productively working on this and wants the solution on behalf of the industry and on behalf of customers.

On the issue of compensation, look, we'll believe that there's work been going on, on that. I think we just need to make sure that there's a balance here that it doesn't all fall on the banking structure, because that gets passed through to other customers.

And I'm not in every home and not able to listen to every phone call that a customer makes and what details they give away.

On the branches, we have said that there are no more branch closures in 2019. We finished the last ones that we declared last year in January of 2019. It will be done more in 2019. We have no plans in 2020.

Branch closures is all about who's using them, so like any resource, any business, let alone a bank. If people don't use that resource, we have to change the way we operate. But can I be clear, we still have one of the largest branch networks.

We have 700 sites that our mobile vans get to. We've got 60 community bankers and 11,000 post offices and we've got well over 3,000 ATMs. That's a pretty massive network on behalf of the customer. And our job now is to get out, start focusing on going forward and talking to customers and giving certainty for our customers as well.

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James Burton, Daily Mail
Thank you.

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Operator
Thank you. Our next question comes from the line of Simon English from the Evening Standard. Please go ahead.

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Simon English, Evening Standard
Morning, all. Hi, Ross, I was just wondering if you could just elaborate a bit on the dividend payment. It looks to me like – I mean you weren't under pressure to pay out as much as you have.

And given that you are saying other big companies aren't spending any money and the economy will probably slow this year, perhaps more than the Bank of England thinks. So, actually is there a possibility that in six months time you might be thinking actually, I wish we still had that money. But you are today saying you were going to pay out. I just wondered if you could just elaborate on your thinking on that issue for us please.

Ross McEwan, Chief Executive

So, if I start and then Katie can pick up. But look, the Board did spend quite a bit of time on our dividend strategy. We recall we said last year we'd pay out an ordinary dividend to the 40 percent pay out ratio, that's what we've concluded.

The bank was in a very strong position from a capital perspective. We have over the last five years been rebuilding our capital stack. Remember back in 2013, we had a eight point – I think it was a 6 percent common equity tier one, today after making this payments of 16.2.

I think we are a very strong bank which is what we set out to do. And we are very cognisant of the effect of uncertainty in the marketplace and we believe we've got very strong liquidity and capital that will see the bank through any shocks that may well come.

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Howard Davies, Chairman

I'd just comment briefly from the perspective of the Board. As we have said, medium term targets of capital is about 14 percent core tier one, there's reasons that Katie could go into. And that means that even after these payments, we have very significant head room above that medium term target, which in itself is pretty prudent.

I think the context is important to remember. But until this year, we had some very significant uncertainties abut the scale of payouts that we might have to make particularly in the US on subprime mortgage selling. Eventually, we did settle that for an eye watering sum of almost $5 billion.

But it could have been worse and so we're now in a position where we can look more sensibly at our capital position in a normal way, rather than have to keep a large sum back in case of a huge fine, which we now have dealt with.

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Katie Murray, Chief Finance Officer

And I think Howard, the only add-on to that is to remember that this business generates capital very comfortably. Our franchises are very strong.

We generated 240bps this year, 130 of that was from profit alone and the balance from capital management activities.

So we know our capital will move up from 16 percent on its journey to moving down to 14 percent, so we're very comfortable on that basis.

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Simon English, Evening Standard
All right, thank you.

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Operator
Thank you. The next question comes from the line of Kalyeena Makortoff from the Guardian. Please go ahead.

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Katie Murray, Chief Finance Officer
Morning, Kalyeena.

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Kalyeena Makortoff, The Guardian
Hi, good morning. So obviously earlier this month, you received shareholder approval to buy a stake in the Treasury. I'm just wondering whether you can detail on whether those discussions have begun?

Secondly, on the Amsterdam and Frankfurt operations, can you give us some details on how many staff you're moving from the UK? I understand that it's not going to be many, but if you can just give some numbers, that would be useful and in that case, have they all been notified? Thank you.

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Ross McEwan, Chief Executive
I'll start with Amsterdam and then Katie or Howard can talk about the directed payback.

First off, the Amsterdam operation, in Amsterdam will be about 150 staff. We have a number of staff at the moment who are being seconded and will go over there full time if the operation is required. And so it's about 150, which is the number that we said about probably a year ago, would be the number and not much has changed to that.

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Katie Murray, Chief Finance Officer
And then if we look at the directed buyback, in terms of discussions with the Treasury, those are discussions we don't have, it's very much something that they will take the view and they will notify us at the same time that they notify the rest of the market if they have any intentions of executing on it.

The important thing that we had to do was to make sure that our plumbing, so to speak, was in place so that if the opportunity arose, that we could augment any sale they were doing by directed buyback. We were ready to do that, and we're now in that place, which is very comforting.

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Kayleena Makortoff, The Guardian
But have they contacted you in that case then? Have those discussions started?

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Katie Murray, Chief Finance Officer
Absolutely not.

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Howard Davies, Chairman
We don't have those discussions. I mean, we are very scrupulous and they are very scrupulous about the relationships we have.

The relationship we have with the Treasury, is like that we would have with another large shareholder, they come and quiz us about our business from time to time, but the shareholding and the selling of shares is something for them and as Katie said, we get to know about it when other people do.

Katie Murray, Chief Finance Officer
It would be utterly inappropriate to have those conversations.

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Kayleena Makortoff, The Guardian
OK, thanks.

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Operator
Thank you. If you wish to ask a question, please press the star key followed by the digit one on your telephone keypad. And our next question comes from the line of Katherine Griffiths from the Times. Please go ahead.

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Katie Murray, Chief Finance Officer
Good morning, Katherine.

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Katherine Griffiths, The Times
Good morning. I had three questions, if that's OK. One is, could you give us some more detail about Bó and Mettle? Could you tell us how much does that cost, or I don't think those costs are in the one billion you identified as being some innovations infrastructure. So could you kind of give something around cost? And also how many customers you actually expect to move over to those two?

Also, I just wondered, can you kind of talk a little bit about this asset protection agency situation? I wonder if you could kind of give a sense of whether you expect that more kind of litigation involved in that or even if there's current further litigation going through the courts. And indeed why perhaps you can't kind of illuminate further, are there historical agreements there… (inaudible).

And then finally, Ross, I think you kind of sort of signalled you might stay until 2020. Can you give us a sense if this the penultimate time we'll be hearing from you, or in Annual Results or not? Thanks.

Ross McEwan, Chief Executive
Maybe we'll start with the last one, it comes up each time. Thank you very much for your concern for me. I'm still here. What we'll do is we'll put out an RNS when I'm ready to go. I think that would probably be the most appropriate thing to do. But still we've got targets to do and things to get on with, so as long as there's a challenge, I've still got life in me.

On Bó and Mettle, we have a number of innovation programmes going on in the business and we signalled to the market last was about £150 million in 2018 we'd spend and a similar number we'll spend in 2019 on these operations.

Bó in the personal space and Mettle in business space, but we also have a number of other initiatives like Esme and quite a few others that are coming to – will come to market over 2019.

One of the really important things here is that we are looking at things that will be attractive to customers, but also, the learnings from these are very, very important for our core bank because the core bank is not standing still either.

We have initiatives that are working through the core bank to make it easier for customers and to be more informative to customers, and we've put some of those out there today.

Mimo is for our core retail customers, where over the next 12 months, we'll get much more information and advice on how to actually save money and make money for themselves and also things like helping them out with utilities and things that are actually quite pertinent to personal customers and very similar.

Mettle is a digital bank that actually connects into a whole raft of APIs including FreeAgent, which is the accounting package we bought, payment structures, lending platforms that I think will be very good for business customers.

So, about £150 million in 2018 and a similar number in 2019. And just be aware, we know that all of these things will not be successful, but the success comes out of learning and putting these into our core bank. The core bank is not standing still either.

On the AP scheme look, there's no secret about this, this was very clearly in the market probably nine years ago.

The government put £45 billion into save Royal Bank of Scotland at the time and there were requirements around that to get it and mainly large corporate assets off the books. Do I see this forming into any further litigation? No I don't. There's no secret about what it was there for. But the decisions around customers staying on or off the books was a decision for the bank, but we had obligations and we've looked for those obligations, as you would if you would £45 billion into an organisation, on behalf of the taxpayer. So I don't expect any litigation. There may be some who try, but I doubt it being successful.

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Katherine Griffiths, The Times
Thanks.

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Operator
Thank you. Howard, I will hand the call back to you for closing comments.

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Howard Davies, Chairman
OK, thank you very much for everybody who came on the call.

We do think we're making progress, good results, nice payment back to the government and on we go. Thank you.

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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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