



Barclays Global Financial Services Conference  
Fireside Chat with Ewen Stevenson  
11<sup>th</sup> September 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 24<sup>th</sup> February 2017.

Rohith Chandra-Rajan: Good morning. Thank you very much for joining us today. Very pleased to welcome Ewen Stevenson, Chief Financial Officer of Royal Bank of Scotland. Thanks for joining us again, Ewen. In terms of the format for this session, we have got a few questions to run through with you and after which there will be a few audience response questions to gauge your views on some of the topics affecting RBS. And then with time at the end, we'll have some Q&A.

So Ewen, maybe if I could start with just sort of the 2020 targets, where a number of other banks have sort of stepped back from their 2020 targets. RBS, I guess, has been quite forthright in its belief that it can achieve more than 12% ROC by 2020. There's clearly some good progress being made in terms of restructuring, closing Capital Resolution, etc, but there's also a lot of uncertainty in terms of the UK economic outlook and perhaps also regulation. So why is it that RBS feels particularly confident that they can meet its 2020 targets?

Ewen Stevenson: Yes, I mean, I guess if you go back and say why did we put those targets out a few years ago, we're obviously extremely conscious of the fact that we're not like normal banks. We're in the middle of a complex multi-year restructuring. And we felt it was important at the time to give investors clarity on where we were driving the institution to. So I haven't put those targets out. They proved actually very effective internally as well in terms of driving the bank to the set of outcomes that we think we need to achieve. If we didn't believe that they were achievable, we would have backed off of them.



And as I have said a number of times to people, therefore, they're goals rather than targets. So we think we can exceed them. Obviously, depending on what's happening both macro economically and with the interest rate environment, the degree of flex in those numbers varies quarter on quarter. But as we sit today, I think, we remain confident in getting to those numbers. As I look at those targets, core Tier 1 ratio, 13%. we're already sort of hovering around 15%. That's up 50%. Cost to income ratio, I don't view this particularly ambitious. Again, good banks in the world today are operating in the low 40s.

One of our UK peers is already in the mid-40s. So it's aspirational from where we started from, but it's not particularly aspirational as a target. I think we do have more confidence in the market and income growth, but that's a natural difference. I think, that we'll see play out in the coming quarters, and the GBP 6.4 billion all-in cost base, again, the way we think about that is a stepping stone to a much lower cost base over time. I do think the impact of technology is going to have a revolutionary impact on the banking sector. But much of what we do, I think, is going to enable us to take that cost base down significantly further beyond 2020.

**Rohith Chandra-Rajan:** If I could just follow up on that there, I mean, the GBP 6.4 billion that you just mentioned is still more than 15% below where the 2017 guidance is. I guess NatWest Markets is one of the key areas for cost takeout. But if you could, I guess, talk about the key steps to get to that GBP 6.4 billion, as you say, it's a milestone, but what are the plans for the next 3 years?

**Ewen Stevenson:** Yes. So if we deliver to GBP 750 million of cost takeout that we said we're going to do this year, we'd already taken out around GBP 500 million by the middle of the year. So we're pretty confident that we'll get to the GBP 750 million. That will take our cost structure down at that point to around GBP 7.6 billion. It's not like-for-like with the GBP 6.4 billion. The GBP 6.4 billion includes restructuring and conduct costs in 2020. So we think we need to take the GBP 7.6 billion down to about GBP 6.1 billion to achieve that GBP 6.4 billion target. That would imply that another GBP 1.5 billion of cost takeout from here. It does get progressively harder.

We've largely got what I call the easy cost cutting out of running down businesses, running down our bad bank, etc. About GBP 500 million of that will come out of the investment bank. We're pretty confident in the delivery of that. There'll be significant cost takeout on the reintegration of Williams & Glyn. The other big piece of work that we're in the process of, in the middle of



it at the moment is we're really going through the retail and commercial bank and all of our core processes. I'm just saying how can we digitalize in order to make those processes. I think when you do that, if we project forward a few years, my assumption is, yes, most of our processes are going to have to be instantaneous paperless and people-less.

And then once you design that process, you then need to go back and strip out the bad book and the legacy technology costs. So overall, it's actually more ambitious than the 15%, because we're sort of targeting to get to about 6.1%. But we're pretty confident, as we sit today, given our track record, by the end of this year, we'll have taken out GBP 4 billion of cost in the last 4 years, which is, I think, demonstrably further than most of our peers across Europe, leaving us with about GBP 1.5 billion to take out in the next 3. So if you think about it in those terms, we are not particularly daunted by taking out a further GBP 1.5 billion of cost.

Rohith Chandra-Rajan: Thank you, I guess, one of the topics you touched on there was digital. How would you describe RBS's digital strategy? I guess, particularly in relation to fintech, how do you feel about fintechs as a threat or an opportunity to learn and adapt? Or are they likely to kind of start to eat banks lunches sometime soon?

Ewen Stevenson: Yes. I mean, we're definitely trying to shift pace at the moment at RBS. Yes, we've had lots of things to distract us over the last couple of years around a bunch of different legacy issues. Today we're probably in partnership with about 60 technology companies of different shapes and sizes. We track about 1,000 fintech opportunities globally and technology companies. Yes, we are out doing stuff.

For example, we've just set out this year a very small SME bank, called Esme. It cost us a few million pounds to develop in one of our labs. What Esme was set up to do was to compete with peer-to-peer lenders, who were taking share from us. With Esme, it's an SME bank, you can get GBP 150,000 of credit in 10 minutes and the money can be in your bank in an hour. So we've just launched that product, about 80% of the customers are new to bank and we're about to launch and start to scale out that business now.

Earlier this year, we teamed up with IBM Watson and are ready to take company. We introduced WebChat into the bank about 3 years ago. We're now getting IBM Watson to doing WebChat for us in Scotland. We're the first bank to do this. We've taken our very best telephone sales people, our very best WebChat people and they are training with IBM Watson at the moment.



It's now up to, what I describe, about second quartile. It's answering about 60% of the questions. There are only 5 or 6 people behind it. By the end of this year, we'll have that scaled across all of our WebChat channels. It will be answering about 1 million customer questions a month.

And if you think about that, every single customer conversation is recorded over time. It will know you intimately because it will remember every conversation it has had with you. So it's great for the customer experience. It's fantastic for the control environment, because it's all recorded. It's also super for costs, because we can strip out large numbers of WebChatters and telephone salespeople over time. So I'd say we're doing a lot. And we're trying to do a lot on the call. We're trying to do some stuff off to the side as well. But we are trying to take a number of bets at the moment, given the uncertainty the way technology has hit.

Rohith Chandra-Rajan: If I could come back maybe shorter term to the revenue environment in the UK, I guess, one of the particular positives from performance over the last year or 2 has been the growth of the mortgage book. I guess, what we saw at Q2 was that starting to come at some costs now to the net interest margin. So it'd be really interesting to you talk about how you think about that volume margin dynamic, and then to zoom out may be to a broader view of the UK retail and commercial banking landscape?

Ewen Stevenson: Yes. I mean, look we spend a lot of time debating that internally. Just in terms of metrics, we have about 9% share of the mortgage market in the UK and we have been consistently growing our mortgage share at about 12% to 14%. When Williams & Glyn has agreed with the European commission, we'll add about 1% of both stock and flow market share as part of that recombination of Williams & Glyn. About 70% of the distribution in the UK is through brokers. And about 90% of the distribution through those brokers is through 10 brokers. So if you do an excellent job at servicing 10 brokers, you can take a disproportionate amount of share in the UK mortgage market, which we think that we've demonstrated a track record of doing.

We actually took that same track record and handed over 3 brokers to Williams & Glyn. And as proof-of-concept, they too have now built a very good market share with those 3 brokers. We obviously look through that brokering channel constantly at the trade-off between margin and return. Mortgages for the time being, even if you assume significantly higher risk rates in the future, are still achieving well above cost of capital returns. So while that dynamic continues, I think, we will continue to ripe healthy mortgage volumes. If we have got to a point of thinking that we were achieving below cost of capital



returns, we would obviously stop writing mortgage business at that point in the same volumes we've been doing.

Rohith Chandra-Rajan: And then more broadly on just the UK banking landscape for Retail and commercial?

Ewen Stevenson: Yes. I mean, our commercial customers for some time have been slowing down. I guess, post-Brexit, we were amused at consumer behavior. It didn't feel right. And we're not big in unsecured credit, but some of the trends there looked unnatural in terms of the growth rates we were seeing. I think consumer behavior is beginning to normalize now in the UK. Our corporate clients have, for some time, been cautious on investment, which again makes sense given the uncertainty around Brexit outcomes. I think it's also important to recognize that some parts of the economy there are doing great.

If you are an exporter into Europe and you're not importing inflation, you've just had a significant devaluation. So export volumes are great. If you're in domestic tourism, you're doing great. So the Brexit impact on the UK economy at the moment is quite varied. But mortgage volumes for some time have only been growing at sort of 2%. So that to us feels like the UK is deleveraging in mortgages and SMEs are not growing significantly. The only part of the UK lending market that has seen disproportionate growth; there has been some elements of consumer lending and consumer debt.

Rohith Chandra-Rajan: I guess, I mean, that's clearly an area of regulatory focus in terms of consumer credit. Would you see it from FPC later this month? Are you expecting any sort of intervention from the regulator?

Ewen Stevenson: Not sure. I mean, as I think, I never even know. We took quite a strong stance a few years ago against a product that existed in the UK called zero-balance transfers for credit cards. We thought it was a bad customer product. Because when we surveyed our customers, over half of them didn't know the interest rate that they were going to be switched into at the end of zero balance period. Since we took that stance, credit card market share has shrunk dramatically. But equally, that zero balance period now has extended out to something like 43 months in the UK. We still think it's a bad product. We think at some point that exposes, if it's a bad customer product, it carries undue conduct risk, we thought. So that to us would be an obvious product to see some intervention on.

Rohith Chandra-Rajan: Perhaps something like relating to income multiple caps on the flows that we got in mortgages?



Ewen Stevenson: Yes. I mean, it's clear from sort of various messages out of the PRA, they're concerned about consumer lending behavior at the moment.

Rohith Chandra-Rajan: I guess, more broadly on credit quality. So UK credit quality has held up, I think, much better so far than most people had anticipated. From what we're hearing, I think, from RBS, but more generally across UK banks is at least near term, things ought to be holding out well. They aren't really at the moment any early indicators of deterioration? I guess when we look across the different loan books, what will you be looking for to sort of identifying the potential areas of weakness?

Ewen Stevenson: Yes, we will spend a lot of time looking for canaries and every crisis has different scenarios. So at the moment, impairment levels continue to be exceptionally benign. We've been seeing about 10 or so basis points of loan losses through our core loan books. We've told the market that we expect over time to be managing towards 30 to 40 basis points through the cycle. So inevitably, we expect deterioration at some point. But as every quarter goes by, we're really not seeing that deterioration come through yet. So we regularly track all kinds of metrics. We are the biggest Commercial Bank in the country. So we also have an exceptional amount of data flow to track both consumer behavior and corporate behavior. But as I say, we and all the banks, I think, are consistently telegraphing at the moment that we're not seeing significant change in impairment trends.

Rohith Chandra-Rajan: And what would it take from a macro prospective to drive that change. Is it unemployment, property prices, interest rates, overall GDP growth?

Ewen Stevenson: Yes. I mean, if you look at the sort of central GDP forecast for the UK, despite all of the impact of Brexit, because I do think Brexit will be a long slow burn impact on the UK economy. And all of those forecasts have low growth, low rates. They don't have significant recessionary events coming. So if it is a sort of low growth, low rates, and unemployment levels remain in low, I don't think that that's a bad scenario for the banks. Obviously, low interest rates are a problem. You can see that impacting our net interest margin. Structurally, we have a higher percentage of our funding in current account and on demand deposits than the other UK banks. So we are more rate sensitive on the way down, rate sensitive on the way back. So yes, our business brands are seeing some improvement, very modest improvement in rates by the time you get to 2020, but nothing significant.



Rohith Chandra-Rajan: Maybe to move on to nonoperating items, which have been, I guess, a huge driver on RBS for much of the last 8 or 9 years. Full year results, you were hopeful that from 2018 – RBS could move back to profitability in 2018. Clearly, there has been a lot of progress made on things like Williams & Glyn, settling with FHFA etc. This year I guess US RMBS and the DOJ remains the kind of the key issue. So I don't know if there's any update there at all.

Ewen Stevenson: Nothing of note. So our whole approach this year has been stronger. Every other legacy issue resolved. And we're pretty confident that we'll get to the right outcome on Williams & Glyn in the coming weeks. FHFA was an important milestone for us. So it's not really just settlement with the Department of Justice. The lawyers do talk to them. And I guess, we remain confident that we will be able to make progress with them. So look, we fully understand that, that single issue holds back a whole range of things for us. It inhibits the government's ability to privatize. It inhibits our ability to do well on our stress test and therefore, get back to a point of paying dividends.

But I think if you project forward to the point where that has settled, I would argue our stock carries a very, very high discount rate as a result of that single event. If you strip out that single event and say that we sold it, what you see on the line is 85% of our income is Retail and commercial Bank income or very connected income from the investment bank like FX. What we're trying to build is something that has a very, very higher degree of predictability to it. We think that should attract a much lower discount rate. And therefore, when we reverse engineer share price, we assume the market is ascribing a very high cost of capital on resolution of the Department of Justice. So we know that we've got to get solved. We're working hard to get it done and we remain hopeful of making progress.

Rohith Chandra-Rajan: And you just touched actually, I guess, on the dividend. And I guess there were a few milestones to turning dividends back on, many of which have been achieved. I guess, the one that sort of stands out is DOJ and passing the stress test. If the DOJ is not settled and the stress test remains a challenge this year, does that mean that the dividends resumption would be delayed until after the 2018 stress test? Or is there, if you know the stress test impact and you can back that out with the settlement, does that mean that the dividend could be started sooner? And is the dividend dependent on fully settling with the DOJ?

Ewen Stevenson: Yes. I mean, look I think we need to get pretty strong clarity on outcomes on the DOJ, much better clarity than what we've got today. It's a pretty easy calculation at that point for the PRA, should we add it back out the impact of stress assumptions that got on Department of Justice. We actually don't spend



enormous amount of time with them debating dividends. I mean, they always come back, settle RMBS, and then sit down and talk to us. So I would think logically the bid asks for it to sit somewhere between an interim dividend in 2018 versus a final dividend of back full year of 2018 results. And remember, we're not talking about huge amounts of capital to be -- interim dividend is about GBP 240 million of Core Tier 1, which is 12 basis points. So it's not the capital impact that holds back the PRA. But it's not really us being how to give them clarity on outcomes on Department of Justice.

Rohith Chandra-Rajan: Like I said, the dividends have gone from those settling impacts, its evidence of you being perceived as a normal bank again.

Ewen Stevenson: Yes. I mean, if you go the other way around and back to what I was saying earlier, what are we trying to build? We're trying to build a bank that can operate with stress sensitivity of less than 400 basis points. So if you go back to why the 13% core Tier 1 target? It's because under extreme stress, we don't want to fall below 9%. We think when we look at the characteristics of what we're building, we are building a bank that's able to deal with that, including with IFRS 9 overlays. So we know that we're on a path to deliver a very stress resilient, largely Retail and commercial Bank over time. And it's just a question of getting these final one-offs solved, that's creating excessive stress to our stress test results.

Rohith Chandra-Rajan: And then the last question from me would be on regulation, difficult to have the banks discussion without talking about it. You mentioned IFRS 9. You want it to be, I think, probably the only UK bank has -- or 1 of 2 UK banks has come out and given us a sort of definitive number, which was a positive in terms of day 1 impact. I'm just wondering, I guess, in particular how you think about the volatility of IFRS 9 will introduce to the P&L and also to capital and net of capital planning? And if you've got any indication how the regulator thinks about that?

Ewen Stevenson: Well, to be fair to the regulator, we haven't given the regulator data to enable to them to form an opinion yet. So we're all being asked to run IFRS 9 stress test analysis for the moment, which will go in shortly. As you can see from the other banks, we think it is a material price-sensitive piece of information. That's why we wanted to give it to you in our interim results. But you can see with the other banks, the fact that they don't have same degree of comfort, I guess, at this point to disclose it means that it's still somewhat premature to speculate what the impact is on capital and earnings.





I mean, it clearly introduces an additional degree of volatility. It means under a stress test, you're going to get a sharper V. So we're doing a lot of modelling at the moment to make sure that we're comfortable with our 400 basis point assumption under extreme stress, so that still is robust under an IFRS 9 context. I think it means, for dividend policy over time, probably the whole banking sector is going to have to think about lower regular rate, run rate payout ratio because of that volatility and rely on top of that or on special dividends and buybacks.

So again, we are doing a lot of analysis at the moment to understand what I have sort of 1 on 10-year, 1 on 15-year impact would be on our earnings as a result of IFRS 9 volatility. So I think, it's also going to be quite high for the banks with any degree of confidence to give you impairment forecast for next year, given that you're effectively going to have to project forward a year in terms of your assumptions on the macroeconomic outlook. So it's not great from an investment point of view, but we will give you as much disclosure we can as we feel comfortable disclosing it.

Rohith Chandra-Rajan: Next, we move to the audience response questions. There are keypads in front of you. The first one, if we can bring that up on screen, please? So the first question is what would make you more positive on RBS shares. So number one, better macro, number two, positive revenue surprise, thirdly, cost savings, fourth, resumption of dividends, number five, clarity on mitigation and conduct risk, six, reduction in UK government ownership, or number seven, further restructuring progress?

Ewen Stevenson: All of the above.

Rohith Chandra-Rajan: So that's perhaps surprising and probably it's something we've --

Ewen Stevenson: No. I mean, it's not a helpful reminder to us of how we all feel about it. And look, you're broadly in the same place that we are. So particularly when that relates to really just one single issue.

Rohith Chandra-Rajan: So if we move on to question two, which is maybe perhaps something more than -- is maybe perhaps within your control. So how do you feel about the biggest influence on RBS' revenues over the next 12 months? So number one, volumes, secondly, pricing, thirdly, policy rates, number four, fees and commissions, or number five, restructuring benefits? That's actually quite mixed. I mean, even though it didn't help, I think volumes have obviously been a big factor in terms of the mortgage business. But...



Ewen Stevenson: Well, I mean, if you think about our income, net interest income is, obviously, the biggest single driver by some margin, which is obviously a mix of rate and volume. I think we worry more about rates. It's been something that's probably less in our control, because we're trying prices, mid-market. And obviously, as the market fluctuates, and this year, for example, we're seeing greater competition than we might have expected at the start of the year.

Rohith Chandra-Rajan: And if the restructuring benefit do you think has come through in terms of revenues?

Ewen Stevenson: Yes. I mean, there's certainly an influence in our income from restructuring. As you know, we've committed to take out about GBP 20 billion of RWAs out of the core bank. That will have a GBP 250 million, GBP 300 million income hit to us. But we think its very NPV accretive what we're doing. CapRes is almost done now. And obviously, there'll be some impact on Williams & Glyn. But again, on Williams & Glyn, we expect to keep all of the retail earnings out of Williams & Glyn and lose a proportion of the commercial earnings. There are bits and pieces of the restructuring across us, but I'm surprised that's the biggest single item.

Rohith Chandra-Rajan: And if we move on to cost switches the next question. So really how do you feel about RBS' cost-saving assets, so likely to exceed them and reach the bottom line, likely to meet them and reach the bottom line, offset by cost inflation, possible revenue attrition or more what required?

Ewen Stevenson: But I'm glad to say it's not number 4, given the amount of it that we are doing. Look, I mean, clearly, I don't see it being offset by cost inflation. I mean, just look at those numbers that we talked about before taking GBP 7.6 billion of costs this year down to GBP 6.1 billion on a like-for-like basis. You would have to be absolute there-on on inflation to think whether that's going to get offset, and those numbers build an inflationary impact as well. And I don't see -- we are worried sort of longer term about the peak income as I've described it, peak revenue, as a result of technology disruption on some of our revenue streams. But I really don't see that having that degree of impact in the next 3 years. So we got a lot of work to do. But I would naturally probably be somewhere in 1 or 2.



Rohith Chandra-Rajan: Okay. If we can then bring question 4 up, which is around capital dividends. So how do you see RBS positioned on capital and dividend? Number one, upside surprise from regulatory clarity, secondly, upside surprise from earnings and restructuring, third, downside from earnings and restructuring, or four, downside from regulatory requirements? That's quite a positive expectation.

Ewen Stevenson: Yes. I mean, that sort of tends what you mean by regulatory clarity. I think we're all waiting as a sector to see what comes out of Basel at some point. And I think there is still quite a wide range of potential Basel outcomes, some of which would be positive and some would be less positive. But overall, I mean, if you project the journey that we've been on the last few years, our core Tier 1, when I joined in 2014, was about 8.6% at the end of '13. So we're now up to 14.8%. So, I mean, we feel pretty confident about our capital position at this point.

Rohith Chandra-Rajan: I guess, perhaps included in that regulatory pieces is may be the conduct as well may have got grouped into. So clarity there clearly would be helpful. So the last question is really around technology change. So fintech and digital, do you expect that to be positive or negative for RBS. So number one, positive because of revenue potential, number two, positive because of cost savings, thirdly, adding to the cost burden if negative, four, negative because of pricing pressure, or five, negative because new entrants taking business away? So cost savings seems to be a key positive here?

Ewen Stevenson: Yes. I mean, we would probably think one, two, four, and five. The cost of shaping up your mobile channel is pretty cheap or as I said, we set up those new SME bank on the side for a handful of million. So it's not particularly costly to set up new technology. We get and we see a massive opportunity in cost savings. If you think about just digitizing all of your process, we still have about 75,000 employees in the bank. Yes, a digital process should involve no humans. Yes, revenue potential, we are spending a lot of time on that at the moment. I think we can't rely on some of the returns we make out or some of our products being sustainable over the longer term. So we definitely recognize. We're going to have to think about how we can add some new revenue streams. And we're very alive to what we're seeing across the number of new entrants and how they are trying to attack us, a lot of what they're doing we can replicate relatively quickly, but we are able to pay attention to it.



Rohith Chandra-Rajan: Okay. I think we've got time for one question in the room, if there's any question?

Unidentified Speaker: My question relates to how you guys think about your cost of equity, and also how you think about some of the legacy instruments that you guys have outstanding?

Ewen Stevenson: How we think about our cost of equity? Well, as I said earlier, I think it should be much lower than what it is today. And again, if you think about the bank that we're building, it's predominantly a retail and commercial bank with a very high degree of predictability in terms of revenues. Even in the investment bank, a lot of it is attached to the Retail and commercial Bank. So it's only a bit of trading revenue that flips around quarter on quarter. So I think if you mapped quarter on quarter income, what you would see increasing predictability as we continue to drive operating jobs, therefore increasing stability of operating earnings.

When I reverse engineer cost of capital amount today, I come up with a much lower cost of capital. And therefore, I think we're getting a very near-term detriment around the uncertainty, particularly around Department of Justice as it's really the only single major issue that we've got left on the table. So I'm intrigued about how the share price reacts and how the cost of capital reacts, the day that we get that settled. Also generally, the UK banks today to me seem to have a very high cost of equity. And then on the legacy instruments, I think, as we've been doing, we've been very actively managing them for value and we'll continue to do that. But it's a complex trade-off across multiple different considerations. But I think, we have been actively managing those down quite consciously over the last few years.

Rohith Chandra-Rajan: Okay. That's great. Thank you very much, Ewen. That's what all we got.

Ewen Stevenson: Thank you a lot, Rohith. Thank you.