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THE ROYAL BANK OF SCOTLAND

Memorandum of Understanding with the RBS Group Pension Fund Trustees
Conference Call
Moderator: Ewen Stevenson
17 April 2018, 3:30 p.m. GMT

OPERATOR: This is Conference # 4789928.

Operator: Good afternoon, ladies and gentlemen. Today's conference call will be hosted by Ewen Stevenson, Chief Financial Officer of RBS. Please go ahead, Ewen.

Ewen Stevenson: Thanks (Luba). Depending on where you're dialing in from, good afternoon or morning all. Given the announcement that we just made a couple of hours ago on the MOU we've just reached with the main scheme pension fund. We thought it would be helpful to have a quick call with you to allow for any immediate questions you've got on this.

We're not going to take any questions on our Q1 results. As you know, we plan to announce these on Friday week, the 27th of April. In the room with me here in London I have Katie Murray, Deputy CFO who has led the team working on this MOU with the trustee and Matt Waymark who many of you all know from our I.R. team.

The MOU with the trustee deals with two issues. Firstly, it aligns the employing entity structure with U.K. ring-fencing legislation, with

NatWest Bank within the ring-fence becoming the main sponsor for the main scheme. Secondly, it sets out the additional funding contributions we've agreed to make into the main scheme. As part of this, we've brought forward by a year the tri-annual valuation to end Q4 of last year.

There's two main parts to these additional funding contributions. Firstly, a pretax payment of £2 billion that will be made in the second half of this year. As at the end of Q4 2017 this would have had a pro forma impact of 80 basis points on core tier one ratio and a pro forma 12p reduction in our TNAV per share. These will be recognized in our Q2 results.

And from the 1st of January 2020 we've agreed to make pre-tax payments of up to £1.5 billion. These are linked to the making of future distributions to RBS shareholders including ordinary and special dividends and any future share buybacks. These additional contributions are capped in any one financial year at £500 million pre-tax and will only impact our core tier one in the year that they're recognized.

There will also be a modest one-off impact on our Q2 tax charge. We expect this to be in the order of £20 million and importantly, under normal market conditions, we've agreed with the trustee that this should represent the final set of deficit contributions into the main scheme.

Overall, we think this is a good outcome both for us and the trustee. For the trustee, since 2016 we've materially addressed the historical funding deficit. This will allow the trustee to run much lower investment risk from here. That in turn benefits the bank via lower stress capital buffers. For us, we get clarity on future contribution into the main scheme. That's very important for us as we work towards returning to capital distributions.

We've also been able to structure a material amount of these contributions in the form of distribution linked payments and thereby avoid up-front recognition into our core tier one of these future payments.

In summary, another important day for us and our recovery. While we recognize it's a large set of contributions we've agreed to, we think we've accelerated the removal of a large potential overhang to our equity story. And in so doing, we've got even greater clarity now in our roll forward core tier one position.

With that, (Luba), if we could please open up for – the lines for questions.

Operator: Thank you, Ewen. Ladies and gentlemen, we will now begin the question and answer session. As a reminder, if you wish to ask a question, please press "*" and "1" on your telephone and wait for your name to be announced.

Your first question's coming from the line of (Claire Kane). Please go ahead.

Ewen Stevenson: Hi, (Claire).

(Claire Kane): Hi. Hello. I only have one question and it's really just around your confidence in that this is the final set of contributions. I wondered if you could perhaps share some of the assumptions underlying the recent valuation, in particular around the discount rates which you suggested could change by 100 basis points. Thank you.

Ewen Stevenson: Yes, so I guess part of the overall package was agreeing that the Q4 2017 deficit was at swaps plus 80. But I'd reiterate what I said earlier, subject to normal market conditions, we and the trustee do now think that we're now done on future deficit contributions.

And the second thing – well, a couple of other things, too. Because of the way the distribution linked payments are structured, it's been done in a way that avoids IFRIC 14 so we don't need to recognize those up-front into our capital, only the £2 billion.

And secondly, in return for that reduction in investment risk it locks in some quite material investment gains that we've achieved over the last couple of years as a result of the previous set of contributions. And secondly, it's going to allow us, the bank, to run much lowest stress buffers given the lower investment risk the pension plan's running.

(Claire Kane): Great. Thank you.

Operator: Thank you. Your next question's coming from (Jonathan Pierce, Exane). Please go ahead.

Ewen Stevenson: Hi, (Jonathan).

(Jonathan Pierce): Afternoon. Thanks for having this call. Can I ask a couple of questions? The first is coming back to, I guess where the £3.5 billion is going? Thanks for the detail on the – on the discount rates. It looks like you're – if I've interpreted what you're saying correctly, you're moving the liabilities into NatWest Bank maybe seven years earlier than you would have had to have done.

Is that a reasonable part of the £3.5 billion as well? The covenant viewed as being a lot weaker as a result of that and maybe as part of that you can tell us what the RWAs are in NatWest Bank PLC thinking into next year. And that's the first question.

The second question is a broader question on, you just alluded to it, what this means for the capital stack and buffers and so on and so forth because presumably the £2 billion top-up will take your IAS 19 surplus towards – I don't know, £9 billion, £10 billion, not recognizing the balance sheet.

But that is going to be significant in excess, one would guess, of any PRA stress as a part of Pillar 2A. I don't know what they do as part of Pillar 2B, but can you talk a little bit about the impacts this will have on Pillar 2A and Pillar 2B post the injection? Thanks.

Ewen Stevenson: OK. There were a lot of questions in there. So part of this overall package is in recognition of the fact that NatWest Bank alone has as a modestly weaker covenant than RBS plc.

That was certainly part of the discussion we were having. NatWast Bank, Katie, have we disclosed RWAs? I'm not sure we have at this point, but...

Katie Murray: They'll be in the – they will be in the Pillar 3 report somewhere. I'll come back and confirm what they are.

Ewen Stevenson: OK. We'll get I.R. to come back out and confirm to you all what the RWAs are sitting in NatWest Bank.

Look, on Pillar 2A and Pillar 2B, I'm going to go back to the philosophical approach we have to capital which is, we want to be at or above 9% under extreme stress.

We think over the medium term that a 400 basis point buffer on top of that provides that stress buffer that we need. Within that thinking was a view that over time we would materially de-risk the pension plan which is consistent with today's announcement.

But one of the reasons I said is part of full year results that we expect to run our capital ratios above 13 for the time being was partly driven by pensions, partly driven by Basel consideration/ Basel III reform, partly driven by mortgage pending - mortgage floors, partly driven by needing to understand better the impact of IAS 9 stress volatility.

So I don't think you should see today as changing medium term plans to be at or above a 13% core tier one ratio.

(Jonathan Pierce): But it is correct, presumably, that that top-up to the IAS 19 surplus can only help Pillar 2A in due course in the same way we say a couple of years ago?

Ewen Stevenson: Absolutely.

Matt Waymark: But don't forget that the other schemes beyond the main scheme will also still attract some Pillar 2A.

(Jonathan Pierce): OK. Thanks very much.

Operator: Thank you. Your next question's coming from (Chris Cant) from Autonomous. Please go ahead.

Ewen Stevenson: Hi, (Chris).

(Chris Cant): Hi. Thanks for the call. I just wanted to follow up, I think, the deficit discount rates that you've already given. You talked about normal market conditions.

What circumstances would we need to see for you to have to go back to the table and discuss further contributions with the trustee that exceptional equity market volatility, what would you be looking for? Because as you say, you're de-risking it substantially.

So would we be talking about a…

Ewen Stevenson: Well, yes. So neither we nor the trustee expect there to be further deficit contributions into the plan. It would have to be something pretty extreme, I think, from here to see that happening.

(Chris Cant): But if your – if your – if the scheme's de-risking and it's moving heavily, presumably, towards risk free bonds – I mean, are you talking about a (differential) in the guilt market there? What – how extreme is non-normal, I suppose?

Ewen Stevenson: Extreme.

(Chris Cant): Extreme. OK. Thanks.

Operator: Thank you. Your next question's coming from Jennifer Cook from Mediobanca. Please go ahead.

Ewen Stevenson: Hi, Jennifer.

Jennifer Cook: Afternoon. With the pension fully funded and you're also reducing your equity exposure, I was just wondering, are you thinking about future buy-ins or buy-outs of that pension scheme at all?

Ewen Stevenson: No. I mean, it's a large scheme so I don't think anyone in the market today would have the capacity to buy it out. But no, it hasn't been part of any other thinking.

Jennifer Cook: OK.

Operator: Thank you. Your next question's coming from (David Lilienfeld) of (Three Bridges). Please go ahead.

Ewen Stevenson: Hi.

(David Lilienfeld): Hi. How are you? Quick question regarding any discussion with the U.K. Government as a condition before they sell down their stake with this or is it just part of the larger plan and progress they want to see? Thank you.

Ewen Stevenson: Look, this was very much driven by us, rather than the U.K. Government. We have very limited dialogue with them in relation to their intentions or otherwise to sell down their stake.

The – I mean, we see our job as continuing to de-risk and improve the equity story of the bank and as we do that, that improves their capacity to privatize. But any decisions are very much up to them and this was not driven by anything from the Government. It was very much driven by us.

(David Lilienfeld): Great. Thank you.

Operator: Thank you. Your next question's coming from (Edward Firth), KBW. Please go ahead.

Ewen Stevenson: Hi, (Ed).

(Edward Firth): Hi. No, it's OK. You've answered my question. Thanks.

Ewen Stevenson: OK.

Operator: Thank you. Ladies and gentlemen, as a reminder it's "*" and "1" if you wish to ask a question. We have another question from (Chris Cant) from Autonomous. Please go ahead.

Ewen Stevenson: Hi, (Chris). Chris?

(Chris Cant): Hello?

Ewen Stevenson: Yes, hi.

(Chris Cant): Sorry, I don't know what's going on with my line. In terms of thinking about this year's stress test, how will what you've announced today be factored in given that it's happened after the end of March? Should we be thinking about a £2 billion impact on your headline, (see if you want to) draw down this year or is this not going to be captured into the stress test? Thank you.

Ewen Stevenson: So it will be captured, but we don't think that it will have any – it will not have any significant impact on this year's stress test and it will be positive for future stress tests.

(Chris Cant): So the £2 billion will be captured, but it's not going to impact your draw down?

Matt Waymark: No, it will be captured and it will impact the draw down. But obviously you've got to think that in prior stress tests there's already been a draw down. There's an element of the ACS that is pension stress. So this is – copy and paste and do it slightly different stress test, but this will hit year one. It will be part of that, but we don't think the overall impact on the stress test will be material.

(Chris Cant): Because you're – because you're already in an accounting surplus so your previous year's stresses to the earlier discussion around 2A under the ACS, you would have had to choose three…

Ewen Stevenson: Yes, and this will increase the accounting surplus and then the stress happens on top of that. So…

(Chris Cant): (So implicitly) your pension stress you think in previous years was about £2 billion?

Matt Waymark: Didn't say that. I just said that there – overall that shouldn't be a huge difference.

Ewen Stevenson: Yes, so the response to the question was there going to be a material impact on this year's stress test. The answer is no, we think.

(Chris Cant): OK.

Operator: Thank you. Your next question's coming from David Lock, Deutsche Bank. Please go ahead.

Ewen Stevenson: Hi, David.

David Lock: Hi, Ewen. I know it's a bit academic, but it's just a question about the contributions. So if there's a contribution – I'm sorry, do you make a dividend payment before the 1st of January 2020 that is, say, £1.5 billion, does that effectively mean that the future distributions are already guaranteed?

Or is it only after – is only for dividends after the 1st of January 2020 that are eligible and matched by the firm? So I guess does it roll up into 2020 or is it only from the 1st of January 2020 where the dividends are matched? Thank you.

Katie Murray: It would only – it would only be from the 1st of January 2020 that the dividends would be matched and then they're capped within any single year.

David Lock: OK. Thank you.

Operator: Thank you. There are no further questions at this time. Ewen, please continue.

Ewen Stevenson: OK. Look, thanks all for joining the call today. I appreciate there was a relatively limited amount we could say above and beyond what was in the press release. We do think this is a positive event for our equity story.

The – we look forward, Ross and I, to catching up with you Friday week to talk about our Q1 results. So thanks for joining the call at short notice.

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

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