



Q3 Results 2016
Moderator: Ross McEwan
28th October 2016

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 28th October 2016.

Operator: This is conference # 95686059.

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

Ross McEwan: Thanks, (Jenny). With me as well is Ewen Stevenson joining us for the third quarter results announcement.

We're just over halfway through our five-year strategic plan. We've said previously that 2015 and 2016 would be noisy as we deal with as many of the conduct and litigation issues as possible and also restructure the bank to align with the future shape of the bank.

This is the most challenging part of the plan as we work through more of our legacy issues in the coming quarters. We remain focused on building a better bank for customers, on clearing up as many of the past issues that continue to cloud this company. We continue to successfully deal with these items within our control.

We are reducing assets that we no longer want. We've exited 25 countries. We're in the process of finally closing our Global Transaction Service business. And we sold Citizens Financial Group. With this background in mind, it's unsurprising that we continue to be impacted by a large number of one-off items.

Our ambition remains the same though, to become a sector leader in lower-cost, lower-risk, customer-centric U.K. and Irish bank that delivers solid returns for our shareholders.

I'll talk for a few minutes on our progress on this quarter, and then I'm going to pass over to Ewen, who'll walk you through the detail before we take any of the questions.

On our path to profitability, it will not be smooth, but this is the best quarter since 2014 for the core business. As you will have all seen, our core business delivered a good result, with a 14 percent adjusted return on equity and a GBP1.3 billion adjusted operating profit. The core business has now

delivered, on average, over GBP1 billion in adjusted operating profit a quarter since 2014.

Overall, we made a GBP469 million bottom line attributable loss for the quarter, with a GBP1.3 billion core adjusted operating profit offset mainly by GBP0.5 billion in restructuring costs, GBP400 million in conduct charges and GBP300 million in deferred tax asset write-off. This takes us to a point – sorry, a GBP2.5 billion loss for the year so far.

On the core business, the bottom line loss reflects continued progress in restructuring the business and addressing some of our legacy issues, and we will continue to talk to you about these. With income under pressure due to lower interest rates, we have to continue to improve efficiency and reduce costs. We still have considerable work to do, but we are making progress. We've saved GBP695 million so far this year and on track to meeting our cost target of GBP800 million for the third consecutive year. And at the same time as taking out costs, we need to continue to improve the core bank.

Last month, we refocused our main customer-facing brands. Some of you may have seen our new adverts on TV and social media, and we will continue to invest in these to win more business. We also provided clarity on our proposed plans for the structure of the bank under ring-fencing legislation and regulation.

Customers continue to change the way they bank with us. More customers than ever are using our digital channels. The use of our mobile app are up 26 percent year-on-year. New app releases have improved the application process for a number of our products, and we are now delivering more personalized prompts than ever before. This has more than doubled the number of loan, overdraft and mortgage applications on mobile since the start of the year. And as we establish these services, our mobile app increasingly deepens and enriches our interactions with customers.

It's fair to say we have gone beyond the tipping point in the way banking is now being done, with already over 20 times more digital interactions for

customers than face-to-face ones, and over a third of our sales are now done through our digital channels.

We want our colleagues spending as much time as possible speaking to customers about their needs rather than being tied down at low-level administrative tasks, and to help this, we will be piloting a WebChat adviser powered by artificial intelligence to deal with simple customer queries. And next year, we'll start rolling out a new technology tool to allow customers to make their own investment advice decisions. We've also introduced technology that allows new business customers to receive their bank account number and sort code in under an hour. This used to take 8 days. And we still can get better. But these initiatives and innovations show that we're responding to the way customers want to do business with us and bank for the future.

I'll let Ewen give you the detailed divisional financial performance. But this engagement with our customers flows through to the financials. In U.K. PBB, net mortgage lending is up GBP3.6 billion for the quarter, and we're consistently growing market share, with a 12 percent share of new business compared to a stock share of 8.7 percent. By differentiating on service, we're writing this business within risk appetite and at a good price.

Across our franchises, the strong lending performance in the first half of the year has stood us in good stead. We're still comfortably on track to surpass our lending growth target for the year in Personal, Business Banking and Commercial, with lending growth of 9 percent, well above our 4 percent target. We saw sustained high customer activity in CIB as we helped our customers deal with the post-Brexit volatility, resulting in a good income performance in this quarter. This is the best quarterly performance from our CIB franchise since the start of 2014. Costs are still too high, but they continue to come down steadily in this business as we had planned.

However, the impacts on income and a lower-for-longer interest rate environment is a challenge faced by our core business and the industry. At the same time, you're all familiar with ring-fencing, proposed future Basel regulations and the uncertainty of Brexit. For RBS, the impact of these issues

are compounded by the Williams & Glyn disposal and other conduct and litigation issues that we face. The open banking initiatives also bring both opportunities and challenge. And the potential to provide a wide range of feedback services through owning the customer relationship will become increasingly important for banks.

Over the 2.5 years since we launched our plan to turn the bank around, key measures on colleague engagement, leadership, clarity of direction and pride have all improved, signaling the long-term shift we are making on changing our culture. Overall, while recognizing these significant challenges – that there are significant challenges ahead, we've continued to reduce costs, grow lending and deliver a solid performance from the core customer-facing businesses.

I know that you're all interested in our progress in resolving the key issues that face this bank. We're pleased to announce the settlement of NCUA earlier this month, settling for USD 1.1 billion. This is the smallest of our 3 large RMBS cases, but it's good to have it behind us. On the two other material cases, FHFA and DOJ, we have nothing to update you on this time, although we'll let you know as soon as we do. These issues continue to hang over the bank and, of course, will have an impact on our capital when they do finally land.

On GRG, the FCA has now received the Section 166 skilled person report for the review and to our treatment of distressed business customers. And we await them publishing their findings. We've seen nothing to support the allegations that we artificially distressed SME customers for our own gain. I'm keen to work through this matter and to get it behind us and our SME customers who were in GRG. The sooner we can do this, the better.

Turning to our final EC divestment obligation, that's Williams & Glyn. We've wound down our separation operation from a team of 7,000 to a core team of 350, who remain to support any alternative divestment. We've also redeemed the GBP600 million exchangeable bond issued to a consortium of investors in 2013. The bond was issued to support the planned IPO of Williams & Glyn business and would have converted into equity at IPO. Given the decision not

to progress with an IPO, it made sense to redeem this now. We are grateful to Corsair, Centerbridge and the other investors for their support over the last three years. They've actually been very good and constructive partners.

We continue to pursue discussions with interested parties, and we'll date – update more when we can. However, we cannot, under any options, see full divestment by the end of 2017. We are in discussions with HMT and expect further engagement with the EC to agree a solution to regards to our State Aid obligations.

Though the timing of many of these issues are not within our control, we're hopeful of seeing good progress on as many as possible over the coming quarters. As we work our way through these, we remain focused on what we can control, getting the core bank in the best shape possible and delivering even better service to customers.

We need to continue to focus on improving the core business. We know that income will be harder to come in the future, and there are also other headwinds which are faced by all banks. This only reinforces the need to be both unrelentingly focused on costs and strive to be the best bank for customers, so they choose us and not the competition. We are growing in the markets we like, and tens of thousands of our colleagues get out of bed each day to do the right thing for our customers. This is a pleasing set of core business results, but there's clearly still a lot to do for us to become a simpler, smaller and customer-centric bank. We look forward to giving you a fuller account of the next phase of our plan when we present our full year results next February.

With that, I'll hand over to you, Ewen, for more detail on the results themselves.

Ewen Stevenson: Thanks, Ross. Consistent with the trends that we've been seeing in recent quarters, the core business continues to do well, the run-off of our legacy portfolios and derisking of legacy MBL continues, and we're making steady progress against our conduct issues.

Overall, we made an attributable loss for the quarter of GBP469 million and an adjusted operating profit of GBP1.3 billion. The attributable loss included GBP1.2 billion of one-offs relating to three items, namely – restructuring costs of GBP469 million, litigation and conduct costs of GBP425 million, and a writeoff of deferred tax assets of GBP300 million. Underneath this, the six core franchises are performing well, and that's despite a tougher market outlook since the summer. Overall for the six franchises, our best quarter since 2014, adjusted operating profit of GBP1.3 billion, adjusted return on equity of 14 percent and adjusted income was up 2 percent on the first nine months of 2015.

Across PBB and CPB, we are continuing to be able to offset a decline in their NIMs through strong volume growth, 13 percent annualized in the first nine months. The U.K. PBB mortgage franchise continues to do well, 12 percent flow share in Q3, with its stock share now up to 8.7 percent.

However, we do recognize that this interest rate environment is presenting new challenges that we're beginning to address. These include the challenge to returns and pricing models for our liability franchises and certain customer segments where asset returns are weaker. We do expect core NIM to continue to be under pressure.

As a reminder, at end Q3, we had structural hedges in place of some GBP122 billion. These hedges have provided us a net interest income benefit of GBP0.9 billion in the first nine months. And around 72 percent of these hedges are part of a five-year rolling hedging program that will progressively roll off over the coming years.

CIB had a very good quarter, particularly the rates franchise. Total income, excluding own credit adjustments, was up 30 percent on Q2 and over 70 percent on Q3 2015. So on the back of this quarter, we now expect full year 2016 income for CIB to be modestly up on 2015.

Costs continue to come down. We've now reduced costs by some GBP695 million this year against our target of GBP800 million for the full year. And over the last 11 quarters, we've reduced costs by GBP2.8 billion in nominal

terms. At an overall bank level, in Q3, our adjusted cost to income ratio was 58 percent; and across the six franchises, 57 percent. While these continue to improve and absolute costs continue to come down, Ross and I clearly recognize they remain too high, so we're very focused on achieving further material cost reductions from here. As part of this, we'd expect to provide you with another annual cost-reduction target for 2017 as part of our full year 2016 results announcement.

We also expect to incur a charge for the bank levy in Q4. In 2015 this was GBP230 million. And we'd expect it to be modestly below this in 2016. The recent sharp devaluation of sterling will add some headwinds to our cost-reduction program while benefiting those franchises with non-sterling income. Overall, CIB should benefit with a greater percent of its costs than income in sterling; as will also the bank ROI via income translation benefits of the now much stronger euro and a significant part of its indirect costs in sterling.

But the reverse is true for CPB and U.K. PBB given a partially off-shored cost structure for both. Impairments continue to be relatively benign in the core books for the bank overall, GBP144 million for the quarter, but this included GBP190 million of further provisions against our legacy shipping book. While we are more cautious on the outlook for credit, to date it is difficult to point to lead indicators to support that conclusion.

On derisking, ex-Ulster Bank ROI and Capital Resolution, risk elements in lending are now just 1.7 percent of gross loans. The increase in risk elements in lending during the quarter was driven by shipping and Capital Resolution and modeling changes in Ulster Bank ROI that broaden the definition of its risk elements in lending.

On Ulster Bank ROI, we recently announced the sale of a EUR 1.8 billion portfolio. On a pro forma basis, this would have reduced Ulster Bank ROI's risk elements in lending to gross loan ratio by around 6 percentage points.

The rundown of Capital Resolution continues, a further GBP3.7 billion or 9 percent reduction in RWAs in Q3. And despite adverse currency movements, we remained on track to be below GBP35 billion of RWAs by year-end. Ex

the stake in Saudi Hollandi Bank that carried some GBP7.9 billion of RWAs at end Q3, we would expect Capital Resolution's RWAs to have reduced to some GBP15 billion to GBP20 billion by end 2017, and we intend to wind up Capital Resolution at that point. However, the environment to sell and runoff non-core books has deteriorated, and we now expect total disposal costs for Capital Resolution to be in the order of GBP2 billion versus the previous guidance of GBP1.5 billion.

On Williams & Glyn, we took restructuring costs of GBP301 million in Q3, including GBP127 million in relation to the stand-down of developing the cloned IT system. As you can see from today's results, Williams & Glyn's core operating business continues to do well, with an adjusted operating profit of GBP96 million.

As a reminder on pensions, given its topicality for others, we made a top-up contribution of GBP4.2 billion in Q1 and, as part of that, agreed with the trustees that the next triennial valuation would occur end 2018, with any further agreement on additional contributions needing to be agreed by end Q1 2020.

On conduct. This quarter, we took additional conduct provisions of GBP425 million. Note there was no incremental charge within this for PPI this quarter given the top-up we took on PPI in Q2. We did take some additional provisions for the U.S. RMBS. In Q3 we settled our second largest piece of U.S. RMBS litigation NCUA. On our remaining RMBS litigation, over 85 percent of the original principal balances left to resolve relate to our FHFA exposure.

On the U.S. Department of Justice, for RMBS, nothing new to update you on. The DOJ's criminal and civil investigations of RBS are ongoing. We're not in active settlement talks. And to remind you, we have no existing provisions against settlement costs for DOJ.

We have also several other large conduct issues that remain in focus over the coming quarters, including the GRG review by the FCA and the 2008 rights

issue shareholder litigation that comes to court for the first time in March 2017.

On core capital, largely driven by a GBP10 billion reduction in RWAs, our Core Tier 1 ratio increased by a further 50 basis points to 15.0 percent. But we do continue to recognize the potential impact on our core capital from large one-off costs and charges.

On the carrying values of our RBS Group subsidiaries and consistent with the more subdued outlook, we've taken a GBP6 billion write-down today that you'll see noted in our IMS. As you know, this has no impact on our core capital, but does lower our distributable reserves. At end Q3, post this writeoff, these stood at GBP7.2 billion.

And as we've noted in the IMS, we're in an early stage of planning to undertake a capital reorganization in order to create additional distributable reserves and plan to put a proposal to our next AGM.

So overall, a good quarter for the core business, our best since 2014, GBP1.3 billion of adjusted operating profits, a 14 percent adjusted return on equity. We continued to derisk our past. Legacy NPLs are being managed down, legacy asset pools are reducing, and legacy conduct issues are getting progressively addressed.

But all of this is given with a note of caution. The operating outlook has got tougher in recent months, and the potential for further substantial one-off costs to clean up our past remains.

And as a result of this changed outlook and despite just posting a good quarter for the core bank, as previously indicated, we no longer expect to meet our long-term targets by 2019, namely a 12-plus percent return on equity and a sub-50 percent cost to income ratio. But we do remain committed to achieving these targets. We'll be back to you, as part of our full year 2016 results, with more detail on how we plan to deliver these.

And with that, I'll hand back to Ross to host some Q&A.

Ross McEwan: Thanks very much, Ewen. (Jenny), let's open the lines up for questions, please?

Operator: Thank you, Ross. Ladies and gentlemen, if you would like to ask a question, please press the star key followed by the digit one on your telephone keypad. We'll pause for a moment to give everyone an opportunity to signal for questions.

Our first question comes from the line of Raul Sinha from JPMorgan. Please go ahead.

Raul Sinha: Hi. Morning gents. Good performance in the core banks, so maybe if I could start on that and ask you about the NIM going forward. I guess there's a lot of deposit – or there might be some deposit repricing to come. So is there something we should keep in mind in terms of the profile? And how should we expect that very strong performance in the PBB and CPB top line to move over the next quarter or two? That's my first one. And I've got a couple more, if that's OK.

Ewen Stevenson: OK. So look, I mean, in terms of the deposit profile, I think post the 25 basis point cut, we did go out and significantly reprice a lot of the remaining deposit base. So much of our deposit base now is sitting at or below 10 basis points, so there is, I think, some but relative limited ability to reprice further.

As you know, in terms of what's been going on over the last year or so, we've had good underlying growth in average interest-earning assets. They were up about 10 percent Q3-on-Q3. And we've almost halved the non-core piece of our interest-earning assets. So we're now down to under GBP50 billion of non-core assets. And that runoff has been providing a boost to our NIM, because while core NIM has been coming down, the overall bank NIM is increasing. So I think that trade-off will begin to moderate now. I don't think you should expect NIM to continue to accrete from here.

As I said earlier, there's also the impact of the progressive rolling off of the structural hedges, which should provide about an annualized benefit this year of about GBP1.2 billion. So I think you'll see a gradual reduction in NIM over the next few quarters.

In terms of volume growth, mortgages slowed down a bit immediately after the vote; picked up again towards the end of the quarter. I think we continue to be pretty positive about our ability to take share in mortgages.

I think in the commercial side, we've become a bit more cautious on the large corporate sector and – but we're still seeing good growth in mid-corporates. So I think commercial growth overall will probably moderate a bit, as you saw in Q3. And also remember, within commercial, we've also got a pool of what we've previously described as non-variable, that we'll continue in to sort of manage down and manage for value.

So I think overall, I think overall we have signaled that we expect income to be flat across PBB and CPB, we're obviously up 2 percent in the first nine months. I think that represents pretty cautious guidance as we sit today looking into Q4.

Ross McEwan: As then Ewen got on them, it's just the repricing that we have done after the Bank of England change, quite flat really into Q4 but will probably neutralize itself out as we've moved SVR, which we can have a huge amount of lift of and reduced our deposits, so they'll flow through in different ways in the book in the next quarter.

Raul Sinha: OK. If I can just follow up on this write-down of the reserves and the fact that you're now distributable reserves are down to GBP7 billion-ish.

Ewen Stevenson: Yes.

Raul Sinha: Should we be concerned about that, Ewen, given the size of litigation risks you're facing? And I'm just wondering if there might be a scenario where if you did face a big, big penalty, would you have the flexibility of being able to move up your reserves at short notice without approval so as to not kind of put any coupon payments in jeopardy?

Ewen Stevenson: Yes. I mean, firstly, you should have seen that we've made assumptions on conduct and litigation costs in the numbers within the valuation and news of

the subsidiaries already. So you'd have to be talking about numbers that were not part of our modeling assumptions.

We would need to go through a EGM. We would need to go through a core process after that. But we've added into the document of the IMS appendix 1, which you can look at, you can see there that we've got over GBP25 billion in the share premium account and just under GBP5 billion under capital redemption reserves.

So subject to court approval, there's plenty of reserves that can be reallocated into distributable reserves.

Raul Sinha: Sure. OK. I mean, so basically, the GBP7 billion is sort of – one way to look at it is also sort of a worst-case estimate that you don't think will be exceeded in terms of litigation costs?

Ewen Stevenson: Yes, well, well, as I said before, embedded in that is our central planning assumptions on conduct and litigation already.

Raul Sinha: Fantastic thanks. And just the last one from me before I sign off. On Williams & Glyn, I think last quarter, you made a comment that you didn't think it would have a viable business model in this environment given the requirement to grow its loan book substantially to cover its cost of capital. But obviously, you are seeing some pretty strong growth even after the referendum. So I was just wondering if you still think that comment is valid.

Ewen Stevenson: Yes. I mean, I know that, Raul, that comment was based on us separating out Williams & Glyn as a stand-alone business. When we separate it out, it goes from advanced to standardized modeling, which means that we'd have to put in about another GBP500 million of capital into it. Its cost structure, it's about 1/10 of the size of our U.K. business, so it suffers significant cost disadvantages as a stand-alone business. And that's why I think the right thing for the business is to be owned as part of a larger group who can both get to advanced modeling and can take cost synergies out.

Ross McEwan: And also, Raul, one of the advantages also becomes its disadvantage. It is a broadly spread Retail & Commercial bank that needed systems, applications

and operations to support that. And as you see, it makes about GBP100 million a quarter sitting inside RBS because it shares that burden of costs with us, but standing on its own, as Ewen said, becomes very problematic.

Raul Sinha: I was just thinking what it might mean for a challenger bank, that we might be looking to acquire Williams & Glyn given the kind of scenario you're describing. But that's really helpful.

Ross McEwan: Yes. I think inside another bank actually probably has a very attractive – some very attractive features because of you move the assets across, and you don't end up with what we had with an IPO of Williams & Glyn, all of its IT and infrastructure costs on top of it.

Raul Sinha: Sure.

Operator: Thank you very much. Your next question comes from the line of Michael Helsby from Merrill Lynch.

Michael Helsby: Hiya, morning gents. You're going to be disappointed because I'm not going to market your Reward account for you this morning but ...

Ross McEwan: Oh, come on. Come on, do it.

Michael Helsby: Yes – no, no. I've done it too many times. But what I am going to do is ask you about your mortgage business because that's one area where you've been doing extremely well from a market share point of view. And in a way, when you've not been, to your usual slides, competing aggressively on price, so I was actually quite surprised the other day when you cut your prices through the NatWest channel, through the intermediary channel, by quite a lot actually, by up to 75 basis points. So I was wondering if that is a – just a reflection of the market, or is it a fair reflection of you being even more geared into growing your mortgage book or what. Thank you.

Ross McEwan: Yes. Thanks, Michael. Disappointed you're not going to push the Reward account, so I will. (We know it's a great account), everyone should have one at GBP3 a month.

Just on the mortgage business, that was more a reflection of the market. Les and the team had moved their pricing up to test the flexibility in the marketplace, actually, as we led into just prior to the Brexit vote. And it did start knocking around our growth, and therefore, they did move the pricing down again.

But they are, I think, being quite careful on where they price. We do not want to lead the market down. We want to follow it if anything else, move the band. You can – you have to be within to actually get the business.

The other thing that we have been doing and it's showing through quite nicely now, is the growth of our own direct distribution through our own branch networks, through the online and our telephone sales and soon-to-be video sales. That's gone very, very well. So we're getting growth in all fronts at the moment; good profitable business. Actually, just had a review at the board Risk Committee recently; and staying within our risk appetite as well. So we like the business. You do have to be careful with it. You don't want to chase the market too much, but I think it's our distribution and service levels that are showing through.

Michael Helsby: OK, thank you. Very clear. Thanks very much.

Operator: Thank you. Your next question comes from the line of Chira Barua from Bernstein. Please go ahead.

Chirantan Barua: Good morning. Ewen, a quick question for you. You mentioned that PBB and CPB has a non-sterling cost base, which I can understand the middle office, back office probably. If you could just give us kind of what size is that which is kind of a headwind.

And the second question is, again, going back to the mortgage, sorry to say this, but in a flat mortgage market, very strong growth, GBP3 billion plus you're clocking. Can you give us some breakup of where this net – so the net must be GBP3.5 billion, GBP4 billion at least. So where are you getting these mortgages from? What segments – right, what are you taking significant shares of a certain back book? And how long can this go on if you don't have tailwinds in the market?

Ewen Stevenson: Yes. So for the bank overall, about 20 percent of our cost structure is non-sterling. So you can use that maths. But remember, within that, we've got things like Ulster Bank, parts of the Commercial Bank. But obviously, we said that's all going to be in addition to the back office. Ross, do you want to take mortgage?

Ross McEwan: Yes, mortgage. We're picking up quite a bit of the refinances going on in the market, remembering we had very little of our own SVR book left to churn, for anybody to churn. We're down to about 12 percent. But there's still a lot of other players that actually have held up the SVRs on their mortgage, and have been trying to hold onto them. We've been picking up quite a bit of that business, and we still think there is probably still two or three years to go of quite good recycling of – re-financing of business coming through there.

I think that's probably ...

Ewen Stevenson: Yes, the other thing, Chira, remember that – I mean, you've seen in the performance of others this week that there are sort of – I guess, other people have different strategies in the mortgage market at the moment.

Just as a reminder that only 12 percent of our – back of our existing book is in standard variable rate at the moment, so we're not trying to protect back book. So you have got a sort of unusual dynamic in the market at the moment with – so we – it's not – we took 12 percent share in Q3 against the natural market share of current accounts of around 16 percent.

And as a advanced modeler, we're clearly not incented relative to some of the standardized models in terms of higher-risk lending.

Chirantan Barua: Got it. Thank you.

Operator: Thank you. Your next question comes from the line of Andrew Coombs from Citigroup. Please go ahead, Andrew.

Andrew Coombs: Good morning. Two questions from me, please, one on the Markets business and one on risk-weighted assets. On the Markets business, obviously, another

strong result for rates in the quarter. And you referenced the referendum and Central Bank actions once more as being favorable market conditions. Just trying to get a feel for the run rate going forward, whether you do think there is a big atypical component to the Q3 result and what you think is more of a likely underlying run rate there.

And then second question, risk-weighted assets, so just the unwind of the mortgage parameters. Obviously, that's been quite beneficial in terms of the risk-weighted asset lease. Is that just a natural function of a low in time period? Or have you specifically reviewed components of the model? Just trying to get a feel of if there's more to come on that or assuming that's one-off in nature. Thank you.

Ewen Stevenson: Yes. So look, on the – on Q3 for CIB, obviously, as you observed, it was a good quarter, particularly for the rates franchise. I mean, other parts of it, like financing, also had a very, very good quarter as well but a relatively smaller contributor to that increase.

Look, I think going forward, we previously guided to about GBP1.3 billion of income. I think the only new dynamic to keep in mind about 40 percent of the income of CIB is non-sterling-based. So yes, that previous guidance was under previous exchange rates, so today it's probably modestly a bit higher than that going forward. But I would certainly not take Q3 and draw conclusions from that.

I mean – and as you know with your own franchise, Andrew, (FIC) had a very, very good quarter across the Street in Q3.

On the modeling adjustments, and that was really an unwind from Q2. It didn't represent any change in the underlying models. I think the biggest influence, frankly, on RWAs for the mortgage franchise going forward is the likely change in mortgage RWA, risk weights that will come out of the PRA at some point. Yes, our best estimate of that, at the moment, is probably about a GBP12 billion to GBP15 billion increase in RWAs when it's introduced, so call that from 2019 onwards. But the quarter-on-quarter change was really just an unwind of something that occurred in the models in Q2.

Andrew Coombs: Just to be clear, the GBP10 billion to GBP15 billion inflation that you mentioned going through from the PRA, that's as a function of the Basel credit clause? Or this is something separate?

Ewen Stevenson: The mortgage consultation paper that's out.

Andrew Coombs: The mortgage consultation paper. OK, very good.

Ross McEwan: That's also one of the reasons why Ewen and I have been cautious about returns going forward and starting to just re-forecast. Because there are some changes of that nature coming through that you're starting to see in – see the impact on the business, so ...

Ewen Stevenson: I mean, on Basel III.5, 4, if people have a good estimate of what that is, we'd be delighted to know.

Ross McEwan: Yes.

Andrew Coombs: Very good. Thank you.

Operator: Thank you very much. Your next question comes from the line of Martin Leitgeb from Goldman Sachs. Please go ahead.

Martin Leitgeb: Yes. Good morning. I got three questions, please, and two are related to Williams & Glyn. And I was trying to get a sense on how your market share in SME lending has evolved from 2009 onward. And now do you think that it's roughly stable, or did you have a meaningful shrinkage there over the years? Which leads me to the next question. I'm just trying to get a sense to what degree trade sale is the main way forward here, whether there's any potential alternative solutions which could work.

And the background, just looking at some comparable restructurings in Europe and which European Commission mandated, we have seen some of the other banks being mandated to run down assets instead. And just looking at the spirit of the initial State Aid, a requirement that would be somewhat contrarian to it in terms of fostering competition, I was wondering whether a waiver altogether could be also on the table, or up for discussion.

And lastly, to the extent possible that you can comment, I was just wondering whether you have received an initial demand from the DOJ with regards to RMBS or whether that's pending – the criminal leg of the investigation. Thank you.

Ross McEwan: Maybe before I pick those ones up, I'll start with the latter one. We haven't had a demand from the DOJ, so there's nothing more to update on that. I mean, we still obviously have conversations with them and the normal course of them doing their investigation. And they haven't made their mind up whether it's criminal or civil or both or – so we're still having those conversations.

On the next one, just on Williams & Glyn, our market share in the SME mid-market is down, from our calculation, from about the time you were talking about that, Martin, at about 5 percent, over the last seven years. And this is through our sales of assets and the likes. So we're down about 5 percent on our calculation.

And then your third one, just on the – whether a trade sale, I mean, as we clearly said in our Q3 results, that we are talking to interested parties in a trade sale. Let's see where that goes to on the alternatives.

Is there – would they waiver this and say no, I don't think so. I think there was an obligation here that needs to be fulfilled, and that's the spirit with which we are looking at it. But we do need to look with HMT, who have the agreement with the European Commission on what could those alternatives be if we were not able to trade sale this business out. And that's what we are doing at the moment.

But I think in the spirit of the agreement, I don't think there'll be a waiver. I'd be delighted if there was, but I just can't see that. (Being the) case, there has to be some fulfillment of this, and that's what we're working towards.

Martin Leitgeb: Thank you very much.

Operator: Thank you very much. Your next question comes from the line of Chintan Joshi from Mediobanca. Please go ahead.

Chintan Joshi: Hi Good morning. Can I visit the margin versus volume debate here? When I look at consensus, just for the U.K. PBB and CPB lines, and thanks for giving that out in consensus. You've got revenues going down 1 percent from 16 to 18. Now if you look at your average interest earning asset growth in those divisions, it is clearly high single digits at the moment. It might moderate down, even taking into account a structural hedge, that suggests that NIM should be down something like 8 percent from current levels. Are you seeing that kind of NIM pressure coming through if rates don't move further lower? That's the first question. And then I have a couple more.

Ewen Stevenson: Yes, so if you're asking me my views on consensus – so look, I mean, you can do the math in terms of the roll off of the structural hedge, which is obviously benefiting net interest income at the moment. I think as you would expect, we are probably more bullish than the market on our ability to sustain volume growth. So I think that's what you have to reflect on.

Chintan Joshi: But if rates don't go further lower, I mean, where do you see – when do you see NIMs dropping? I won't ask you where, but when do you see it dropping?

Ewen Stevenson: Well, no – I mean, on that structural hedge, it's progressively rolls off – the product hedge rolls off and amortizes over a five-year basis and equity hedge rolls off on a 10-year basis. So you should expect that over the next five years that there's quite a sharp decline, which will be offset by, we think, by volume growth.

Chintan Joshi: And excluding the hedge, are you seeing that NIMs are kind of where they should be going forward?

Ewen Stevenson: Yes, I mean, if you look at the structure of the book, I think most of the sort of big shifts that we've seen in the book over the last few years, so the big shift from unsecured to secured has largely, I think, played out. The big shift within secured from a standard variable rate to fixed rate has largely played out. There is some pressure on the large corporates, but that would probably a benefit to NIM if we reduced our exposure and increased exposure to the mid and smaller end of commercial. So I don't think you'll see sort of core

underlying NIM by the time you strip out the hedge of being under substantial pressure – any substantial pressure from here.

Chintan Joshi: OK, that's good to hear. Can I take up restructuring charges and disposal losses? On restructuring charges, I see a new guidance for 2016. What are the variables for 2017? How should we think about that? You had a cumulative guidance before, which I understand no longer stands. So just wondering how we should think about restructuring charges for the next year or so? And then on disposal losses, I take your higher guidance GBP2 billion, but again thinking kind of longer term, is there anything else we should worry about? What are the main drivers of the delta here?

Ewen Stevenson: Yes, so on restructuring charges, I think we'll be back to you as part of full year 2016 results. I mean, any observation I would make is do think about the fact that we haven't backed off our cost income target.

So as you think about that, I think people previously had worked back from a number in the mid-6s. I don't think anyone is out there forecasting GBP13 billion of income today. So to get to a 50 percent cost-to-income ratio it probably means, we're confident in our ability to be below GBP6.5 million on costs. But the offset for that is potentially some incremental restructuring charges. But we'll give you more detail on that at the full year.

On the GBP2 billion, I mean, we're now down to 35 – GBP38 billion, GBP39 billion of residual RWAs sitting in Capital Resolution. A lot of that amortizes. We scrub the numbers pretty carefully every quarter. So there has been a deterioration in the shipping book. What's embedded in there, there is a view of probably trying to accelerate post the end of 2017, some of the residual GBP15 billion to GBP20 billion of RWAs in terms of the timetable to get out of those.

So I think we're comfortable with it as of having scrubbed it over the last few weeks, this is as good an estimate as we can provide at this point. And then in terms of other disposal losses, you'll have to factor in your own views on Williams & Glyn.

Chintan Joshi: OK, and one final one. We've got an investor seminar in December. I hear a lot of things that you'll declare with your full year results. So just wondering what we expect to hear from the investor seminar?

Ewen Stevenson: I think you expect to hear a bit about Ulster Bank, a bit about private banking and a bit about RBS International.

Ross McEwan: And these are three businesses that I don't think the market cares much about, and they have got new CEOs over the last 12 to 18 months and good core businesses for us.

Chintan Joshi: Thank you.

Operator: Thank you very much. Your next question comes from the line of Tom Jenkins from Jefferies. Please go ahead.

Tom Jenkins: Hello there. Just I'm going to go on a slightly different talk here. I want to talk about RBS NV, if I may. I think back in July, you signed an agreement with Saudi Hollandi to compensate Saudi Hollandi on a sale should it go ahead. I wonder if you could give us some – an update on the progress of that sale, it being the major asset in NV.

And then maybe if that does look like it's imminent or soon, what you guys intend to do with the capital and debt in that structure once it's been concluded? I know in the past you talked about winding down NV and returning the license. So I was just wondering if you could perhaps give us an update on that part of the business?

Ewen Stevenson: Yes, look. So really, you're right in terms of the status of the outstanding dispute that we had with Saudi Hollandi has been resolved. There's really no update on getting out of the Saudi Hollandi stake. I don't think you should assume that, that's going to be in any way imminent.

Tom Jenkins: Right.

Ewen Stevenson: The target has always been, I think, to work towards a license hand back of RBS NV over time. The biggest part of that obviously, as you've observed, is

the Saudi Hollandi stake. So we're sort of continuing to sort of work towards that, and we haven't really given any guidance beyond that at this point.

Tom Jenkins: OK, so in the meantime, we just expect the balance sheet to stay relatively similar with that excess capital there as well.

Ewen Stevenson: Yes, I mean, look, there will be a slow wind down of some of the other portfolios in the residual balance sheet of the NV.

Ross McEwan: Because some of the old international portfolios that sits through the NV as they're wound down and flow back through NV and back to ourselves.

Tom Jenkins: Super. Thanks, gents.

Operator: Thank you very much. Your next question comes from the line of Jonathan Pierce from Exane.

Jonathan Pierce: Hello. Thanks for letting me get a question in. I wanted to come back on this mortgage stuff. I mean, first, just to clarify something, looks like pretty much all but about GBP5.1 billion reduction on RWAs is due to the recalibration. Is that right?

Ewen Stevenson: Most of it, yes.

Ross McEwan: Yes, most of it.

Jonathan Pierce: OK, I mean, that would suggest, just looking at the pillar three document from the interims that the mortgage risk lay in RBS plc and NatWest plc was backed down, it's about 7 percent now.

Ewen Stevenson: Yes, which is where it was ...

(Crosstalk)

Ewen Stevenson: ... as you know, yes.

Jonathan Pierce: So then, it's really to follow up on this point you raised about the PRA consultation paper because if you – did you say GBP12 billion to GBP15 billion or GBP10 billion to GBP15 billion? Just to be more ...

(Crosstalk)

Ewen Stevenson: GBP12 billion to GBP15 billion, it's was the Zealand accent, Jonathan.

Jonathan Pierce: If we take now on the exposure at defaults across RBS and NatWest, that implies about another 10 percent – 10 percentage points on the mortgage risk weight. So are you essentially suggesting that your reading of what's going on is your mortgage risk weights, outside of Ulster Bank, so in RBS and NatWest, could go up to the sort of 17 percent type level? And if that is the correct interpretation, give an idea as to why you think that is and what level of confidence you have in that?

Ewen Stevenson: Well, what level of – so I'd just say it's our best estimate as we currently sit here today. I would shy away from putting a degree of confidence around it.

Jonathan Pierce: OK. But ...

Ewen Stevenson: But your maths are right, Jonathan. So ...

Jonathan Pierce: But your portfolio has relatively low LTVs and PD experience and these sorts of things. I just think people might be a bit surprised to hear that mortgage risk weights according to one of the major players in the U.K. could be going up to that sort of level?

Ewen Stevenson: What 15 percent to 17 percent?

Jonathan Pierce: 17 percent, yes.

Ewen Stevenson: Average risk weights. It doesn't sound excessive.

Ross McEwan: No.

Jonathan Pierce: All right. Well that's helpful. Thanks for that.

Ross McEwan: Still this is a consultative document, so it will be interesting – at this stage having read it, that's what the team thinks it could be – end up being.

Ewen Stevenson: And the other players obviously joining, could get caught anyway if there's output flaws out of the Basel capital into those capital papers.

Jonathan Pierce: Can I press you on something else then? Because you do tend to be very good about talking about some of these issues ahead of others. IFRS 9, are you willing yet to put a number on that?

Ewen Stevenson: No, I mean, I think I had a chat with the IFRS 9 team a few days ago. I think Q2 is when we would expect next year to give you a view on the quantitative impact of IFRS 9. We may talk more qualitatively about it as part of full year results.

Jonathan Pierce: OK. All right, that's helpful. Thanks very much.

Ross McEwan: Thanks, Jonathan. Thanks for getting on but also thanks for talking about core business.

Operator: Thank you very much. Your next question comes from the line of David Lock from Deutsche Bank.

David Lock: Morning. Two questions for me, please. First one is on Williams & Glyn. I know in the past, you have obviously tried to target it at end state with Williams & Glyn where it was completely off your balance sheet, and you don't have any liabilities connected to it. I just wondered, given that the European Commission may now be involved, if it does run beyond the end of 2017, is a potential TSA now on the cards for getting rid of this business that you think you might have to face, a kind of longer-term drag from this business if they require you to get on with the sale of it?

And I have a second one which is on Ireland. Ross, I noticed press commentary a few weeks ago suggesting that after about 12 months' time, you may look at potential acquisitions in Ireland given the cost base in Ireland as it is still very elevated. And I wondered given the position you're facing on litigation and Williams & Glyn, how we might think about the steps in going

towards that, because I'd have thought the European Commission and HMT would be perhaps cautious about you going and acquiring anything if you're still trying to get rid of Williams & Glyn? Thank you very much.

Ross McEwan: Yes, I'll start with the back one and Ewen can pick up the other. You're absolutely right on Ireland. I mean, it was a common decision. Would you look, at given the shape of the business there, would you look at some stages at acquisitions? I see we've got lots to do to clean up this business before I'd a look at that, but at some point time in the future, we would if we were ready. We still got – we can't do major acquisitions, while we've got commitments through our Williams & Glyn because there's a cap on what we can do.

We've said that the Irish business is attractive. We're getting it back into shape. And at some point, it needs to start growing again safely, can I just say again, safely, not like we did last time. But at some point in time if we are really and we've got a cleaned up business flow, I'm open to it, but won't be at the moment.

Ewen Stevenson: Yes, look, on the TSA, I'm just – I mean, it's possible there will be some bits and pieces that would require a TSA in terms of services from us to a potential purchaser for certain products and certain systems, but the general sort of construct that you would imagine around, say, the Lloyds TSA around TSB is not something that would be involved. So if there is, it would be relatively de minimis.

Ross McEwan: And we're used to these TSAs of smaller nature. We still have a couple in place with ex subsidiaries of ours that are now standing on their own. There are some things that we still provide, not much now. And we may end up having to do this for a purchasing party, but I wouldn't like to see it being large TSAs. They are quite burdensome on all parties.

David Lock: I guess, the kind of root of the question is given where we are after, however many years, does a TSA – a larger TSA now look more likely than before because it may have been a stumbling block?

Ross McEwan: No, no. We're both very clear on that. We've examined that. The answer is no. It's actually more complicated than people think.

David Lock: I'll take your word for it. Thank you.

Operator: Thank you very much. Your next question comes from the line of Joseph Dickerson from Jefferies. Please go ahead.

Joseph Dickerson: Hi, good morning, gentlemen. Thank you for taking my call. A few things. How has the recent curve steepening impacted the roll off of your hedges, firstly?

Secondly, Ewen, you mentioned in your comments something around challenges to liability repricing. Could you elaborate on that? Are you referring to systems or just the overall rate environment, where we are and where the liabilities are priced? Some clarification there would be helpful.

And then lastly, you talk about deterioration in the economic outlook, and that's one of the things that led you to take down your Distributable Reserves by 44 percent. What in the economic outlook is deteriorating? I mean, the GDP print in U.K. has been better, unemployment's at a multi-decade low and rates are nearly zero. So I'd like to know what in the economic outlook has deteriorated? Thanks.

Ewen Stevenson: Yes, so on the – sorry, there are three questions. So the challenge to the liability pricing, and it's really a reference to the fact that we have about just under GBP90 billion of either on-demand deposits or current account money. Obviously, in this rate environment, it is challenging with a current account product where we don't pay fees and if all you do every month is put in your monthly paycheck, write down do the same thing, I think most current account franchises in the U.K. are suffering with that pricing model.

So all of that, I think – so all of the banks in the U.K. have the same issue with the historic structure of how they charge for liabilities. That's all that's a reference to.

On the economic outlook, I guess maybe I'm more cautious. But certainly, if you look at pre-Brexit forecast versus today, even with the GDP bounce that

you've just seen, I think most market commentators still have GDP forecasts as being weaker for next year in 2018 than what they were pre-Brexit.

Certainly the interest rate environment is in a very different place to – in outlook to where it falls pre-Brexit, even with the recent bounce. It's had no impact on our hedging strategy. It's a rolling hedge that we progressively take off and put on. So it's not driven by interest rate movements at any particular time. We don't try and pick the market. We don't think we're smarter than the market in trying to understand forward interest rate curves.

Joseph Dickerson: So basically, the recent move and the curves steepening is not going to have an impact in the roll off of the hedges?

Ewen Stevenson: No.

Joseph Dickerson: OK.

Ross McEwan: And the other ones worth chatting about, Joseph too, just RWA inflation, Basel III and unknowns. ICB, the industry still got to go through ICB in the separation of companies and assets and customers. All of those coming in the next couple of years. And certainly, I think it will have an impact on bank's results.

Joseph Dickerson: Yes. No, I don't disagree. It was just more of a reference to the economic outlook. And I completely agree that there are idiosyncrasies to the sector, but it was just more on the economic outlook.

Ross McEwan: Yes, OK.

Operator: Thank you very much. Your next question comes from the line of Chris Cant from Autonomous.

Christopher Cant: Hi. Good morning. I just wanted to follow up on the comments you've given on the outlook for CPB and PBB income overall being broadly stable year on year. Ewen you said that it's up 2 percent for the nine months and I think that guidance is cautious. But even if I assume, by broadly stable you mean up slightly by less than 2 percent, it appears to imply quite a meaningful tick

down into the fourth quarter, and if you were to annualize that 4Q number it would imply quite a meaningful downgrade to consensus revenue expectations. So I just wanted to understand whether that is a reasonable piece of math to do in light of some of your other comments?

On margin, you said – core margin, ex the hedge, will not be under substantial pressure, but does that mean there is some pressure plus pressure from the hedge with softening volume growth given your remarks on stepping back from large corporate? Thank you.

Ewen Stevenson: Yes, so look, I mean I'll just repeat, I think that flat guidance for the year given where we are through Q3, is pretty conservative at this point. I wouldn't over-egg the precise wording to such a minutia of detail. So I think we are, as we sit today, pretty confident meeting that guidance. I think in the personal bank mortgage volume growth certainly through September was very good. So if that continues, I see no issues in U.K. PBB.

I think in commercial, it's very much a strategic choice for us through a combination of which segments of the market we want to play in, and what we want to do with the legacy runoff book that we've got on that within commercial. But overall, going back to the 2 percent guidance – the 2 percent through nine months, do I think we'll be able to achieve flat plus? Yes, for the full year.

Ross McEwan: Just remember, too, fourth quarter, we've got the banking levy, wandering its way through as well, so.

Operator: Thank you very much. Your next question comes from the line of Rohith Chandra-Rajan from Barclays.

Rohith Chandra-Rajan: Morning. Just a couple of quick ones from me, please. The first one actually is just following up on a comment that you just made and which was a follow-up to previous ones. Just on the mortgage growth outlook, and you just commented, Ewen, that September was decent in terms of volumes. Which is slightly, I guess, at odds with the applications data that you showed with the Q2 results. Just wondering what the applications looks like going into Q3? So what sort of pipeline – sorry, going into Q4. So what sort of

pipeline is visible to you for the rest of the year? So you saw good volumes in September, was there also a pickup in applications which gives you confidence on the pipeline? That was the first one.

And the second one was just a clarification. Could you remind us within the GBP5.6 billion litigation and regulatory provision, how much of that relates to U.S. RMBS please?

Ross McEwan: Maybe I'll just make a comment on the pipeline. This is actually quite stronger in the fourth quarter given our September numbers. The volumes have picked up quite considerably since the July, August, and it's across all of our channels as well. So I would still be comfortable to get reasonably good growth in this fourth quarter given what we've seen coming so far. Of the 4.6 RMBS, was it GBP3.9 billion or GBP4 billion?

Ewen Stevenson: I mean we said as part of full year 2015 that we had GBP5.6 billion of RMBS provisions, and then from that, I think you need to back out something for NCUA not before GBP1.1 billion because we've obviously just topped that up, and the GBP120 million settlement that we've had with the state attorney in Connecticut. So that would imply the majority of that litigation provision relates to RMBS still.

Ross McEwan: OK. (Jenny), I think we're timed out now. So just if I make a few comments and close.

We always said that 2015 and '16 would be noisy as we work through these legacy issues and transform the bank for our customers. And I think these results do reflect on that noise. But we've made very good progress with the core bank posting GBP1.3 billion of underlying profit and the 14 percent ROE. That is the base quarterly performance for this bank since 2014, which shows the real strength of the underlying businesses.

Our strategy hasn't changed, we just want to be a simpler, smaller and customer-obsessed bank here in the key markets for the U.K. and Ireland. And I think our strategies are the right one for this bank. And thank you very much for your time and I'm sure you'll be talking to our IR team and Ewen and myself over the next few months. Thanks ...

(Crosstalk)

Ewen Stevenson: Thanks a lot.

Ross McEwan: ... on the line.

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

END