



H1 Results 2016 Fixed Income Call
Moderator: Ewen Stevenson
5th August 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 H1 Results announcement published on 5th August 2016.

Operator: This is conference # 46974381.

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

Ewen Stevenson: Thanks, (Jenny), and thanks all for joining the call today. It's Ewen here. With me today are John Cummins, our Treasurer, Robert Begbie, our Deputy Treasurer, and Richard O'Connor, our Head of Investor Relations.

In terms of format for this call, we plan to speak for about 15 minutes, leaving plenty of time for your questions at the end. You'll find on our investor relations Web site, we've provided a set of fixed income slides that we'll refer to. I'll cover off our Q2 2016 results, together with a quick update on our strategy. And then, John will give you an update from a Treasury perspective. So if I could now refer you to the slides.

On slide 3, the fundamentals of our plan remain the same, to deliver a safe and sustainable UK Bank with solid returns from six customer franchises. We're currently halfway through our five year plan. So far, we've substantially strengthened our balance sheet, we've materially taken out risk, we've lowered cost, and we're now consistently generating strong returns in our core bank, and we've returned to good growth.

In the wake of the EU referendum, our re-built financial strength across funding, capital and liquidity equips us to better manage a more challenging outlook, while still being there to support our customers. We are continuing to deal with outstanding legacy conduct and litigation issues, but we're making steady progress in addressing these, including the conduct items that we've taken provisions for today.

Turning to our Q2 results in more detail on slide 4. I think these were a good set of core results for us, showed progress against all of our financial targets. Central to our strategy and credit story is a strong and growing core bank. Across the six franchises on a combined basis, GBP3 billion of income, and

for the second quarter in a row, an adjusted operating profit of just over GBP1 billion. That represents a return on equity of 11 percent.

Growth in the UK was again well above market, and this volume growth has helped shift it, helping shift our balance sheet towards high-yielding personal bank and commercial banking customer loans. Underlying like-for-like income across PBB and CPB was broadly stable on H1. The corporate and institutional bank had a much better quarter, income up 46 percent on Q1 and up 18 percent on Q2 of last year, and we had positive JAWS across the three divisions.

We've taken out a further GBP400 million of cost in the first half, and we remain on track to deliver GBP800 million cost target this year, and that's despite adverse FX movements in recent weeks.

Turning to look at our progress and restructuring on slide 5. We know that we need to be relentless on costs, and we think we're building a very credible track record on delivery.

Over the last 2.5 years, we've taken our run rate costs down by some GBP2.5 billion sterling. That's 21 percent of our cost base, or a compound annualized reduction of 9 percent in annualized -- in nominal terms. But we recognize we need to continue to target this sort of reduction for several more years, until we get our overall cost structure back to acceptable and competitive levels.

We've been told that we've done the easy cost cutting, that it will get harder from here. Personally, I don't agree with that view. I still think we've got a lot of latent cost opportunity across the bank. We've got firm plans to take it out, in addition to the longer term opportunity to re-engineer the cost base via technology.

On slide 6, another area that I think we've done a very credible job on, is reducing our legacy exposures. These continue to get cleaned up and reduced. We've exited over GBP120 billion of legacy RWAs in the last six quarters, with the residual portfolio now down to GBP55 billion. That's less than a

quarter of our total RWAs, which is down from around half at the end of 2014.

In Q2, we completed the sale of Private Banking International, the residual operational risk RWAs of Citizens are now off our books, and capital resolution reduced RWAs by a further GBP5 billion. And in achieving this accelerated run-off, we've also significantly de-risked the Bank.

But given this new environment and the impact of unfavorable FX, we now expect the rate of run-off of capital resolutions RWAs to be more moderated this year. So we've adjusted our year-end target to GBP30 billion to GBP35 billion from the previous guidance of GBP30 billion. But on disposal of losses, there's no change to our previous guidance.

Turning to slide 7. We believe that we're going into a tougher environment, relatively comfortable with our exposures and our core credit books. We've got a well-diversified portfolio, given our strength in both personal and commercial banking.

In recent years in personal banking, we've strongly prioritized secured lending over unsecured. And in commercial banking, we've had a conservative risk appetite limit, so we've not allowed ourselves to become overly exposed to any single sector.

As part of our results today, we've provided much more detailed disclosure on our commercial real estate and UK mortgage exposures in the interim management statement. And there's also some detail in the appendix to the slide pack.

On slide 8, in respect of our legacy exposures, at the end of 2013, our risk elements and lending were some 96 percent of the Bank's tangible equity. At Q2 this year, this was down to 29 percent.

This is a result of a very deliberate and sustained commitment to de-risk legacy credit exposures, together with a progressive improvement in our core

books. We've still got a few pockets of high risk elements in lending, such as in Ireland and capital resolution, but overall, we're in solid shape to deal with the downturn in the credit cycle.

On slide 9, given the recent shift in the market outlook, I did want to give you some thoughts on the new environment. On our medium-term targets, a 12 percent-plus return on equity and sub 50 percent cost income ratio, I think it's too early to give you a revised guidance. But we recognize that reaching these targets by 2019 is now uncertain, and is likely to be more challenging.

On volume growth, we think our growth will now moderate across PBB and CPB, from the very strong growth we've seen in recent quarters, but we still expect to grow ahead of market while remaining within our risk appetite limits.

On NIM, the net interest margin, we've put into the back of the slide pack, a breakdown of our non-interest bearing demand deposits, some GBP85 billion at the end of the second quarter, which together with our equity means we have around GBP125 billion of zero interest rate funding for the Bank. So in the longer term, as our structural hedges progressively roll off, a 100 basis point negative shift in rates without any management actions to protect asset-side margins would reduce income by over GBP1.2 billion.

On non-interest income, we remain more positive. The final impact of the change and interchange fees will flow through this year, and we remain positive on the outlook for trading income in the corporate and institutional bank.

Our weaker net interest income outlook reinforces the need to be relentless on cost reduction. We think we've got the discipline and drive to continue to deliver this. The impairment cycle is likely to weaken. But as I've said, we've materially de-risked over recent years, and we do now also expect a modestly higher day one impact from IFRS 9, given the likely changed credit outlook at end 2017, relative to our previous more benign modeling assumptions.

On capital resolution, much of the remaining wind-down is relatively insensitive to the changed environment. So over the medium-term, while we're signaling caution around year-end 2016 RWA targets, we don't believe at this stage, we need to change either our target to wind-up capital resolution at the end of 2017, or the GBP1.5 billion of total disposal losses to achieve this.

On pensions, while our current defined benefit pension liabilities are substantially hedged for interest rate risk, the very low interest rate environment means changes in discount rate assumptions could lead to a higher actuarial deficit at the time of the next triennial valuation. But post the accelerated contribution we made into the plan in Q1, no further additional top-up contributions are required until Q1 2020.

So to summarize on slide 10, before handing it over to John, we've got a strong and growing core Bank that delivered again in Q2, over a GBP1 billion of operating profit, and 11 percent return on equity. PBB and CPB are capturing share, much better customer servicing with a better product offering, and resultingly, income has had stabilized across these two divisions. CIB recovered strongly from a weak Q1, and overall costs continue to come down.

Legacy exposures continue to get cleaned up and reduced. Capital resolutions RWAs are down by a further GBP5 billion this quarter, and legacy RWAs are less than a quarter of our total RWAs now. And on conduct issues, these are getting progressively settled or provided for.

The EU referendum does create new uncertainty for us, but we feel robustly positioned for this, both defensively and offensively.

Defensively, we've materially de-risked going into the cycle. Our legacy credit portfolio has a much reduced and more seasoned, and our legacy rundown is well progressed.

Offensively, we've got six strong customer franchise positions, each well-positioned to capture market share, and collectively producing attractive returns.

With that, I'll hand you over to John to give you an update from a Treasury perspective.

John Cummins: Thank you, Ewen, and welcome to all. A few simple messages to leave with you today. We maintained our strong funding and liquidity metrics, and reported a 14.5 percent Core Equity Tier 1 ratio. We've also made strides towards our 2016 MREL issuance target, and we continue to target issuing AT1 this year subject to market conditions.

So let's start off on an update on our funding and liquidity position on slide 13. It's a consistent message here, I'm pleased to say. We continue to operate comfortably within our funding and liquidity targets. This balance sheet strength means we do not have an issuance need from a funding perspective. So our issuance plans remain focused on solving to the future capital requirements.

If we turn to slide 14 and our capital position. Again a consistent message here, with ratios maintained above our 13 percent target. I would note this has been in the context of a distribution of GBP5 billion in recent quarters, both through a GBP4.2 billion contribution to the pension fund, and a GBP1.2 billion dividend to retire HMT's dividend access share.

If we stay with capital on slide 15. It's also a consistent message on MDA. Our 2019 head room remains over 2 percent, based on the regulatory requirements as we know them today. I appreciate there's been a lot of moving parts on MDA within Europe, however, I am pleased to note the UK regime has been comparatively stable.

Notable change since we spoke, the full year results have been supported with the PRA. We're drawing the current plans to phase in a counter-cyclical buffer, and the UK guidance on systemic risk buffer being set at the ring-

fenced bank level. This considered, we continue to believe 13 percent is the appropriate CET1 level, as we continue our restructuring.

And all things being equal, we continue to anticipate a reduction in RBS's future Pillar 2A requirements, reflecting over time our progress in restructuring and the pension scheme contribution. Needless to say, this will all remain subject to regulatory discretion.

Turning to servicing AT1 coupons, a subject everyone is interested in distributable reserves for the holding company were GBP14.6 billion at H1 2016. The primary driver of the reduction at the half was the final DAS dividend. Although going forward the level of distributable reserves will continue to be sensitive to amongst other things: capital actions, profits remitted from our banks, and the value of investments in subsidiaries.

Moving on to slide 16, we continue to reduce our overall wholesale funding, with balances down over GBP28 billion during the last 1.5 year, and we continue to expect redemptions to be greater than issuance going forward. For example, our target of GBP3 billion to GBP5 billion of senior issuance this year, compares to over GBP9 billion in maturities.

Reductions have been seen in the capital space. For example, our non-CRR compliant Tier 1 stack has been reduced by about a third in the last 18 months. And I'm pleased to say, this includes calling the three remaining NV trust preferred securities. And I do appreciate there still remains questions on our core policy, and we have tried to set our approach in this slide. We manage the stack for value, and we balanced the following factors including: the current and future regulatory value, the relative funding costs, and rating agency considerations as well.

Slide 17 provides a reminder of what we are working towards in the UK, a single point of issuance for purposes of resolution. It's a simple structure. And as I alluded to before, our market activity has reported our progression towards this, with recent LME activity reducing the non-compliant funding

costs, while senior issuance continues to build up outstanding MREL. On the subject of MREL, let's turn to the loss absorbing stack on slide 18.

Here we're already above our TLAC requirement for 2019. From this starting point, where we came to believe meeting our future TLAC and MREL requirements should be manageable. So what does this mean for issuance going forward?

So let's turn to slide 19. We're monitoring the MREL developments, however, our base plan hasn't changed. We continue to target GBP3 billion to GBP5 billion senior HoldCo issuance this year, of which we completed GBP2.2 billion so far. There is no immediate need for further Tier 2. And finally on AT1, we continue to target issuing up to GBP2 billion this year. Markets, they have not been conducive, but if the demand is there, we continue to target getting this done.

So on slide 20. So in summary again, we have maintained our strong funding and liquidity metrics on our CET1 ratio above targets, MREL and AT1 continue to be the driver of issuance in 2016, however, we think the requirements for RBS are manageable.

And with that, I'll now hand it back over to the operator or to open it up for any questions.

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

We'll take our first question from Greg Case from Morgan Stanley.

Ewen Stevenson: Hi, Greg.

Greg Case: Hi guys. Just a quick couple for me. I know you spoke about the investments in subsidiaries point around available distributable items. I wonder if you could give us an idea of how you think about that.

I guess it's currently on balance sheet around GBP50 billion in terms of your overall subsidiaries it seems, I guess in the context of market cap and current earnings generation with that business a little bit high, I was wondering how you think about future impairments on that asset.

Ewen Stevenson: Good question, Greg. We obviously look closely at the carrying value of our assets as subject on a regular basis to review both by us and our auditors, I think we're comfortable having just been through that process, with the carrying values of the business, but we do regularly review it.

At the moment, I think that we are quite comfortable with where things are having just produced our results today.

Greg Case: And when is the review process, is that part of sign off for the full year results?

Ewen Stevenson: Well, it was part of the sign off for Q2. We've just done it recently.

Greg Case: OK, great and then just another one from me. Just on the AT1 target for the GBP2 billion to get done this year, I was wondering if there's any consequences of not achieving that in terms of the regulator, and how focused you are in getting that done?

Ewen Stevenson: Look, we're obviously very conscious of the commitments we've made to the PRA, to seek to raise GBP2 billion of AT1 this year. We would like to do it if we could do it. I think the PRA understands that the AT1 markets haven't been particularly conducive so far this year, but if we could raise that we would certainly like to try and do it.

Robert Begbie: I think, it's not like we've made that commitment and we don't have an ongoing dialogue with the PRA. We sit down with them every month to go through the capital plan and they are aware of where the markets have been and the fact that we have ongoing monitoring of it and we're ready to go when

the markets are good and clearly there's been a positive trend to the market since the referendum and long way it continue.

Greg Case: OK, thanks guys.

Operator: Thank you very much. Our next question comes from the line of Lee Street from Citigroup.

Lee Street: Hello, afternoon all and thank you for taking my questions. A few for me. So firstly, a bit hypothetical but if you were to take a significant loss that would push your CET1 ratio down below your target of 13 percent, what management actions do you think you could take, if any, in the relatively short time frame to potentially boost your CET1 back above that 13 percent level?

Secondly, on loan loss provisions, also you've now had two quarters in a row where these have come back up, after having a few quarters of write backs. And now I know there is a one off in there, and you signaled the potential for more one offs to come, but are you able to give us any context as you look ahead, whether you think broadly you might return to write backs or provisions be lower than Q2 -- higher than Q2 or a lot higher than Q2, any context there would be really helpful.

And just finally something that John referenced in regards to the call policy and rating agency considerations. Are you able to give context, are you particularly close to any thresholds either to the upside or downside of any of the agencies that are particularly with regards to causing your outstanding securities?

Those would be my questions. Thank you.

Ewen Stevenson: Thank you. Well, maybe I'll take the first two and then Robert or John can take the last one. So we obviously have a broad array of management actions we can take of our Core Tier 1 ratio was to fall below 13 percent. It's not something that we currently anticipate, but at a very basic level we could go out and raise equity, we could sell businesses, we could slowdown growth, we

could sell portfolios of assets. So I think we've got a full array of recovery actions that would be available to any bank that's sitting comfortably above its Core Tier 1 targets today.

On loan loss provisions, I think if you look in Q2 what you saw actually is many of it was actually the portfolios that were already under stress ahead of the referendum. They drove most of the impairment losses, mainly Shipping Oil & Gas, and metals and mining.

It's still really too early to really say that there's been any significant deterioration in any of the other core credit portfolios. You can obviously see the Bank of England stress test results last year. When you look at those results what you see is the credit metrics of our bank are broadly in line, I think, with credit metrics the other large UK banks. The big stress for us is really around conduct which again you saw in the recent EBA stress test.

Do we think we're on a trend? I mean if you look over the last few quarters what you seen is in the core books, risk elements and lending start to stabilize now, they are no longer going down.

When we look out do we think we're going to see meaningful write backs from here? Going back in the past obviously, RCR was a big source of those write backs and we think that trend is now passed. In Ulster Bank, maybe modest write backs, but nothing significant. So I think you should anticipate we're now back into a more sort of regular cycle of impairments.

The question we ask ourselves constantly is, if you're on a cycle back to normalization, what is 'normal'? Because you can't, I would add, really look back in history, given the sort of exceptionally low interest rate environment that we're in, which makes previous analysis of 'normal' difficult to draw references from, but definitely I think you should expect those to see ongoing impairment charges now coming through the P&L rather than write backs.

John Cummins: So going to the agencies, we're very conscious of rating agency value on these factors but also, just need to say that in terms of the overall rating agencies

and where we sit with the different agencies, it is far more important to deliver on our strategy and that will help our eventual upgrades, which we'd like to see.

I think that's kind of the best way to describe it in terms of it's not particularly one model or one agency that we are trying to manage to, but if we get the strategy right then you've already seen the commentary post Brexit on the bank in terms of they do see very good progress we're making, we just need to keep delivering on the strategy and that will eventually come through in the ratings.

Lee Street: OK, thank you very much for your comments.

John Cummins: Anymore questions?

Operator: I believe we have some questions from the Web, sir.

Ewen Stevenson: So one of the questions is: given your current Core Tier 1 ratio is significantly higher than your guidance level of 13 percent, how can we think about when the Core Tier 1 ratio will move closer to the target range?

Look, we've always been, Ross and I have been fairly open that we intend to manage the banks capital base to a 13 percent Core Tier 1 ratio. As and when we're able to return to a cycle of capital distributions? Just as a reminder, we said there's really three things that we need to really do to satisfy ourselves and the PRA.

The first is to pass the Bank of England's stress test. The second is to substantially settle our US RMBS exposure. Look, just quickly on that, really nothing new to add. You'll see one small settlement we made and announced today in relation to Connecticut that was settled within our provision.

And the third thing is to have an assured exit out of Williams & Glyn. On the latter I think the decisions that we took yesterday at the Board to stand down the separation of Williams & Glyn as a standalone bank and probably

accelerates our ability to get to a solution because we believe that we should be able to sign a trade sale on an accelerated basis relative to a standalone separation.

So there's really no change out of what we've announced today that changes our guidance and when we expect to return to capital distributions. I think realistically, at the earliest that would be First Quarter 2018 and we will seek to normalize back to our 13 percent core Tier 1 after that.

John Cummins: OK. Can we go back to the lines please? I see more questions.

Operator: Thank you. So your next question comes from the line of Neel Shah from Credit Agricole.

Ewen Stevenson: Hi Neel.

Neel Shah: Hi there. Just a quick question regarding management decision in terms of issuing AT1 1 bonds. You were very formal in terms of wanting to issue GBP2 billion this year, but I don't understand the rationale from an economics perspective, where if you assume it's a high single digit cost, you're paying close to 200 million a year on coupon payment when your statutory losses for the first half was 2 billion.

So it's very expensive funding and given your Core Tier 1 is very robust and your leverage ratio is fine as well, are you just paying for buffer in the Bank of England stress test effectively?

Ewen Stevenson: Look, your right, it's expensive funding and we don't need it as funding, we don't view it as funding. We view it as part of building up our capital structure. I do think as you know, we've been pretty clear about the fact that we want to have two plus percent in the capital structure in the form of AT1.

I think it is -- we are a bank that is in recovery and have been in recovery for several years, so I think it is an important signal to the PRA that we continue to strengthen various layer of our capital stack, including AT1.

Robert Begbie: I think it comes back to that ongoing dialogue with the PRA about managing that stack and clearly it was part of the plan, it was part of the plan we agreed with the PRA. And it's part of the ongoing dialogue as to how we optimize our capital stack over time.

Neel Shah: Great, thank you.

Operator: Thank you. As a reminder, if you would like to ask a question, please press star key followed by the digit one on your telephone keypad.

Your next question comes from the line of James Hyde from PGIM.

James Hyde: Hi, thank you for doing this. I've got a few questions.

First of all, to wander into the territory of equity analysts a bit, and NIM and all those boring areas, I was wondering about this GBP1.2 billion impact of the interest rate stress that you're talking about. It seems a bit higher than what we've had communicated by peers in the weeks running up to the base rate cut.

I just wonder is there something specific about RBS's positioning that makes for a harder hit?

Ewen Stevenson: On that I think what you're probably hearing from the other banks is their one year impact and not the lifetime impact. So, yes, that GBP1.2 billion assumes that all of the structural hedges that we've got have rolled off and that we've had a 100 basis point negative shift in interest rates...

(Multiple Speakers)

Robert Begbie: ...it's all based on that lower interest rate.

Ewen Stevenson: I think if you look in the back of our disclosures you'll see our equivalent one year impacts which are materially different and lower because you've only got a partial roll off the hedges and I think that it's probably we aren't comparing apples with apples in the comparison with the other banks.

Robert Begbie: I think if you look at the comparison to the other banks in terms of the size of the hedging portfolios which is not materially different to ours and the average duration then it's just not a lot to choose between the main peers.

Richard O'Connor: And we assume no benefit, when you would assume some modest benefit at today's rates. And obviously, the product hedge rolls off over five years, the equity hedge rolls off over ten years so it's not going to come from straightaway but something we need to manage over the next five plus years.

James Hyde: Right, yes OK, that's why you saw kind of the match it with a longer term cost take out target....

(Multiple Speakers)

Richard O'Connor:...yes.

James Hyde: Secondly, on the EBA stress test, so backing out it's very difficult to get the numbers that, I know you aren't allowed to disclose them, but it does look like they have stung you with a double digit billion in Euros operational conduct risk charge. So that's at least as far I can work out -- and do we just view this as the fact that the UK in general just didn't engage and did this as a box ticking exercise because the real stress test that counts is at the end of this year?

It just seems really bizarre that the bank that's most affected in Continental Europe has something that I work at in very lower single digit billions in Euros and for you is clearly a massive multiple of that. So just want to understand where we are on this.

Richard O'Connor: James, we obviously can't comment on other people's results, you'd have to ask them about that. In sterling it's around GBP10 billion you saw the difference between that in 16 with no assumption of that in the base case...

James Hyde: That's how I worked it out. Sorry.

Richard O'Connor: ...it's not just conduct and litigation and also under the EBA framework you had to make some assumptions for counterparty credit losses and that's part of that number. It's fair to say the majority relates to conduct and if you look at analyst ranges for future conduct and litigation costs they tend to range between GBP5 and GBP9 billion, so it's obviously a big number and it's obviously a stress number as well. And it assumes that in all areas you have a bad outcome whereas obviously, a lot of our cases are not correlated like that. So all those factors are at play.

Also, just remind you the Bank of England stress test last year had an aggregate stress conduct and litigation number for the whole system of GBP40 billion pounds. They didn't disclose individual banks, but obviously, we're let's say 23-25 percent of the UK banking system.

So it's not a dissimilar methodology to the Bank of England stress test, but it is obviously a stressed case.

Ewen Stevenson: Just the other comment about EBA versus B of E, we treat all of our regulatory stress tests worth equivalent levels of seriousness. The results of the EBA stress test, we are quite pleased actually with the progress we've made in terms of an 8.1 percent end point, under stress, improved on the year before and relative to peers actually, we thought performed quite well.

But, yes the fact that we have a very high sensitivity to conduct stress is not something we've hidden away from and I think you'll see, you've seen that play out equally in recent years in the Bank of England stress test results as well.

James Hyde: OK just one quick other one, for John probably. It was very helpful slide showing the whole MREL / TLAC debt stack, on the LAC capital. One of your UK peers basically indicated this week that they are only counting HoldCo sub debt and not legacy Tier 1 OpCo, legacy Tier 1 OpCo at all, and legacy tier 2 of the OpCo. I mean I just wonder is there any clarity on this or does every bank just have to make their own assumptions?

John Cummins: Well, I don't want to comment on other banks because that's not a good place for me to start, but OpCo qualifies in transition, this is a transitional view and kind of the view we have. And obviously we are still waiting for the MREL details from the Bank of England and when we do that we'll give people greater clarity in terms of issuance in aggregate, and in terms of what we have to do, in terms of meeting, I said we met TLAC, but MREL guidance what we're looking for the banks so these qualify in transition -- and we're in transition at the moment.

James Hyde: Thank you, John. Very, very finally...

(Multiple Speakers)

...sorry.

John Cummins: You're getting your moneys worth out of there..

James Hyde: I am John. You know me -- I do. W&G sale, I mean, it's difficult to understand how this next bit's happened. Is it do we just, I know it's not a big number in terms of RWA reduction but is it more likely scenario then that these RWAs just go off your balance sheet? Or is it just going to be an op risk hand over because of the systems issues that will be quite substantial, should whatever you're hoping gets done?

Ewen Stevenson: Yes -- look, I don't think it will be op risk for the systems issue. Actually work on the systems is actually going quite well. We stood up by the 90 percent of the systems we needed to stand up and we were about to go into a very elongated period of testing, but I think what we've progressively seen over the

last sort of, well year-to-date really, since January is a progressive ratcheting down of interest rate expectations, which accelerated after the EU referendum went down further again yesterday.

And all of that took what we thought at the end of last year was a business plan that looked viable to us to a business plan that now looks like we were on a path to create a non-viable standalone bank.

So I think we took the right business decision which is Williams & Glyn needs to be part of a larger institution to create the right economies of scale and be effective as a challenger bank. It's nothing to do with the IT system but it's a good question on op risk.

And my assumption is, there will be not dissimilar to the disposal of Citizens and it may be some residual very modest op risk relating to existing op risk that will roll off over a three year period.

James Hyde: Great. Thank you very much.

John Cummins: Thank you.

Operator: Thank you. Our next question is from the line of Robert Smalley from UBS.

Robert Smalley: Hi. Thanks for taking my question and also thanks for doing this call and overlapping time with the US, greatly appreciated. Really one or 1.5 questions.

Going back to Slide 4, we have about 2/3 of the way down RWAs and then a couple of lines down below that, adjusted ROEs. Can see that from commercial banking the ROEs about 6.6 percent, and CIB is 3.5. First off can you tell me two or three years from now how you'll see the ROA percentage moving around and will we see 40 percent of it in commercial banking and almost that much in the Investment Bank, what's that going to look like in a couple of years? And how does that marry up with the adjusted ROE now in calculations and in the future?

Ewen Stevenson: OK, I'll try to answer that. I do tend to think more in RWAs and ROEs than ROAs, but longer term I said we want 80 percent of our RWAs sitting in the ring fence bank, retail, commercial banking, across UK and Ireland. The predominance of that will be in commercial banking, given the higher RWA density.

And we've said that we want the corporate and institutional bank to be 15 percent of RWAs around GBP30 billion and that our Channel Island business, the other non-ring fence bank, to be about 5 percent of RWAs.

In terms of the returns, we've been very public about our return expectations of the Corporate and Institutional Bank that made an adjusted ROE in the quarter of 3.5 percent. We want that to get to 8-10 percent over next couple of years. It actually doesn't need a lot of revenue growth from here. What it needs is a significantly lower cost structure.

We started out with a business that had a front to back ratio of about 1-4.5. We've got a plan to deliver a cost structure which is 1-2, front office to back office. That should see the cost structure come down to a range of, call it around GBP750 million.

On the commercial bank, I would just note in Q2, there was a very large single non-impairment charge which impacted returns. It's the biggest commercial and corporate bank in the UK. I would think under a normalized environment it should be able to earn comfortably above the cost of capital, as the biggest market share player that has about a 25 percent market share.

So I think you'll see returns improve from here up into the low teens, I would hope. That's very much dependent on where we are in the interest rate environment and return environment for the sector, I think at the time.

Robert Smalley: And the cost of capital for the commercial bank is...

Ewen Stevenson: Yes, well it's a very good question about what cost of capital are under this interest rate environment.

Robert Smalley: Yes.

Ewen Stevenson: We've got a long rate of less than one percent, equity implied discount rates in the order of 10-11 today which feels exceptionally high, medium term.

I would think over time as we continue to de-risk, to continue with the current plan of getting less and less volatile earnings, that our equity story would migrate to a cost of capital under this interest rate environment below 10.

So and, yes, you call it nine to ten being applied against the commercial bank, so it should comfortably be able to hurdle on that basis over the medium term.

Robert Smalley: That's very helpful, thanks very much and again thanks for doing the call.

Operator: Thank you very much. Your final question today comes back from the line of Greg Case from Morgan Stanley.

Ewen Stevenson: Hi Greg.

Greg Case: Just one follow-up for me just on NV and I guess one of the large assets that's now in there, Saudi Hollandi, I was wondering if you could give us an update on where we are on that and where we might be thinking that could come off the balance sheet, please.

Ewen Stevenson: Yes, look, it's been on our balance sheet for a long time as you know, we are continuing to work towards being in a position to be able to sell the stake as the fourth CFO who have been sitting on that holding, I'm reluctant to committed to a timetable, but it is becoming an increasing number in the context of both Capital Resolution and the NV.

We are very focused on finding an exit out of it, but yes, my assumption is that it will not be months. But I would hope some time over the next year or so, we will find a solution to get out of the holding.

Greg Case: And then does that -- is that one of the last pieces in the jigsaw puzzle for NV, or are there still some other tail assets that could be around for a while in there?

Ewen Stevenson: Yes, there's bits and pieces, but increasingly it's becoming the major holding within the NV.

Greg Case: OK, thank you.

Ewen Stevenson: OK. Well, just to finish up, thank you all for joining the call today. As I hope you've heard, we continue to think we've got progressively improving credit story. We've already got a very strong core bank which had another good quarter, good volume growth now coming through, income and Non-Core bank is stabilizing second quarter in a row of achieving adjusted operating profits of over a billion pounds and returns of 11 percent. So that's becoming increasingly a very consistent profit generating bank that we're aiming towards.

The rest of our balance sheet we are tidying up, our legacy assets are being managed down in the last six quarters we've reduced them by almost 70 percent. They have gone from half our capital to less than a quarter. And you've seen today a number of litigation and conduct issues, the major items in there, have well flagged, today's provisions for PPI and the 2008 shareholder are two issues we've regularly identified. So I do view taking those provisions as a further step in cleaning up our past.

So thank you for taking the time to join the call today. I look forward to talking in due course in another quarter. And Richard O'Connor and Matt Richardson and our IR team will be more than happy to follow-up on any questions you've got after this call.

Operator: Thank you very much, sir. Ladies and Gentlemen that will conclude this afternoon's call. Thank you for your participation. You may now disconnect.

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