Morgan Stanley European Financials Conference

Tuesday 17th March 2020

Alison Rose, CEO

Magdalena Stoklosa, MS: I'm absolutely delighted to be joined today by Alison Rose, Chief Executive of Royal Bank of Scotland here at Hilton. Alison, tremendous thank you for being here with us today. So let me start. At the full year results, you presented a vision of the future of the bank. Maybe we'll start with an overview of where RBS stands today. And as we look to the future, what should investors look forward to and what are you going to manage differently?

Alison Rose: The plan I laid out was really setting up the bank for the long-term and building a sustainable long-term future and sustainable returns. Really, what we're focused on is making sure that the bank can deal with the rapidly changing disruptive environment and the strategies that myself and my team put together, which really focused on that. How can we build a business that will deal with those disruptive changes, whether those are customer behaviors, the increased use of technology and digital, the aging population, the rise of the rental economy, and those disruptive threats, and now obviously things like COVID-19 as well.

So making sure that we're building a bank for the future, responding to changing needs, as well as basing that on a much lower rate environment and a lower for longer scenario. For me, what we have as a great starting point and great foundations are really strong positions in our retail, commercial, and private bank. Very solid foundation with good market share, good returning assets, a very strong capital base where we have built up capital and good risk management and capability in terms of how we manage our capital going forward.

Importantly, across those very strong foundations, real capacity to grow in market share with our customers as well, and an ability to distribute a good return so that we are delivering long-term sustainable returns. I also announced a purpose driven strategy, which is about making sure we deliver the right environment for our customers, investing in the right way, and continuing to build value over the long-term.

Magdalena Stoklosa, MS: Absolutely and we'll come back to the kind of lower for longer interest rates. Of course, we'll come back to the capital question. But of course, one of the highlights also of the February presentation was the decision to shrink your markets business by half. And of course, when presented with different options, as you looked at the kind of whole of the organization, what do you think is the value creation of that decision?

Alison Rose: NatWest Markets is probably the burning item in my entry as I took over as CEO. And so that really was the most important issue to face into. When I did the strategic view, which I launched as soon as I took over, we looked at all options for that business, as you would expect me to. And the outcome of that was really to refocus that business very significantly and align it much more closely to our core franchises in our retail and commercial book. Those are higher rated, lower volatile businesses, and therefore shrink our capital that is allocated to NatWest Markets.

For me, the outlook of that business, particularly in a more challenging market and lower rate environment was really of the shape and size that we wanted it to be. We've continued to be loss making. So taking it from around 21% of the group RWA, in the end state once we finished restructuring it to around 10%. It will be more closely aligned in serving with the products and services it has, our core customer base.

And of course, what I was mindful of is as we structure that business, we do it in a very measured way. So our plans that we outlined were that it would capital accretive during that period, so that as we restructure, we're managing that rundown and that refocus in a very orderly way.

What you end up with at the end stage is a business, which is very tightly aligned to our core customers, more capital in the higher rated and less volatile earnings, and coming out of the more volatile earnings of the business, with products and services that are aligned to our core customers. So I think the plan that we laid out was giving a sense of where we would go and state 10% of the group RWAs and releasing half the capital that’s allocated to that business.

What I talked about as well when I did my presentation in February was to give a sense of what that business would be through a customer lens, a client segment lens. And that's around an 8% ROTE (ph) is where you should be thinking of the contribution of that business in a lower rate environment with the economic forecast. And that point over the medium term, that feels like a reasonable set of returns for that client base with much lower volatility.

Magdalena Stoklosa, MS: Now, when you announced the restructuring, I think that it was the downsizing of the business that was slightly more than the market expected. And of course, there was a conversation about the downsizing of the business versus also the cost cutting initiatives or cost cutting targets you have also shown. How should we think about your cost management beyond 2020? And taking into account, of course, the strategy for the business as usual. But also at the same time, the rundown of the market.

Alison Rose: So we have built a really strong track record on cost reduction over the period. We've taken $4.5 billion of cost out of the business since 2014, which is about a third of our starting cost base and continued to build good momentum in really executing cost reduction. I can assure you the focus of my management team is that we're very focused on making sure we continue to take costs out of the business to drive the right sort of efficiency and value towards the business, whilst also protecting the control environment to the right type of cost.

What we announced this year was that we would take $250 million of costs out of the business. If you look at our track record over the last years in terms of where we haven't been shutting businesses, sort of the big lump of cost reduction that we've been doing, we've been on average taking around 3% to 4% out of our cost base. That's probably the best way to think about it, that post-restructuring and conduct investigation; it's around 3% to 4% of cost reduction.

So that's what the $250 million represents of our core cost base and that's not a bad way of thinking of the ongoing cost reduction that we will continue to take out of the business. We're in a different phase of cost removal out of the business. Now, it's about reengineering what I call the customer journey. So the end-to-end journeys. And the advantage of those types of cost reductions is they're best of quality cost reductions because they're really about taking long-term sustainable costs out of the business. They improve the customer journey because you can increase productivity and throughput. You increase efficiency. You reduce permanent costs within the business and your control environment improves.

And a good way to kind of bring that to life is if you think about our experience on the paperless mortgage journey. As a result of putting that in, we reduce the number of handoffs. We increase the productivity. We saw the volume increase that we have. Our customer experience improves and our error rate diminishes. So the $250 million will be driven through a lot of those reengineering processes as we continue to drive efficiency through our business model.

Magdalena Stoklosa, MS: Absolutely. So effectively, we're talking very much of a kind of efficiency gains -- annual efficiency gains coming through.

Alison Rose: And I think what you'll see is they add much more to the long-term investment value of the business as you're taking really substantive costs out of the business on an ongoing basis.

Magdalena Stoklosa, MS: Alison, let's talk about kind of the current environment, the current situation. Of course, we're facing quite an unprecedented volatility in the markets but we're also facing the economic disruption, which is very difficult to scale. How do you and your management team deal with this level of uncertainty, particularly from the perspective of operational side? But also what are you seeing from the client's perspective? Your the largest business bank in the U.K. so how do those conversations over the last couple of weeks evolved. Maybe what's happening on the kind of credit commitments side as well. If you could give us a sense what you are actually seeing.

Alison Rose: There are a number of things. Clearly, matters are evolving on a real-time basis. So we're dealing and looking at it both through an operational lens and also our economic scenario planning, as we look at how this unfolds. From an operational perspective, we've actually been running what we call our incident management program since early January. So making sure most importantly that we have underlying resilience and the ability to operate.

So our technology teams have been working on split sites. Our critical functions have been working on split sites for some time. We've tested all our disaster recovery sites so that they are fully operational. And as matters have evolved over time, we're making sure that our critical services can operate very well and the split site means we protect against cross-contamination and infection.

Increasingly, huge numbers of our teams, where they can, are working from home. On Monday last week, we had about 19,000 of our colleagues able to work from home log on and have the technology and capability to do that. We have the functionality to have over 36,000 people work from home and increasingly, we will do that, making sure that our operational services are resilient and doing well, is important. I think we've seen sort of levels along sort of the Black Friday levels of payment flows going through our businesses with no issues whatsoever. So making sure we can operate and our contingency plans are operating very well.

Our branches are operating and serving customers and making sure that we can meet their needs. Like most large organizations, we plan for these scenarios. We have a pandemic scenario, which is one of the things our incident management team are doing, that and our teams are working from home very well. My executive team are already on split sites and we're operating to create developments in technology and our provision of that, means we can manage business as usual, which is really important. So that's the operational resilient side.

From a customer perspective, we clearly need to make sure that we're managing and supporting customers through this process. So that is the near term requirement. I announced some changes last week in terms of putting a \$5 billion liquidity fund out into the market for SMEs to the extent they may need help and support with short-term liquidity crises. And my relationship managers, because we are a relationship managed led model in local regions up and down the country, have been proactively calling customers for a period of time. So I think the numbers are much higher now, but we were making over 5,000 calls to individual customers to reach out and connect with them directly.

So that relationship managed led model is very powerful in connecting obviously our core centers and our support for our customers and consumers, both through branches, a mobile app where we have over 7 million active users on that, is making sure messages are available. So real active support, proactive support for customers. So that's the today that we're dealing with and we're responding to those measures on a daily basis to make sure people know, businesses know, consumers know we can support them and our operational resilience allows us to do that.

From a more longer-term view, I mean this is evolving really rapidly in terms of what will happen. And so making sure that we are running a number of scenarios of what that might mean. I don't think anyone has the full view of that, but clearly, what you can see from our business is that we have incredibly strong capital base, 16.2%, our LCR is at 152%. We have \$200 billion of liquidity on ceiling, we're in a very strong position going into this scenario. We also, as you can see from how we risk manage our business, have continued to actively manage our capital and our risk profile.

So making sure that all of those good risk disciplines remain in place is critical. And then as you also can see is how we perform over the Bank of England stress test, which is the 1 in 100 year scenario, in that we performed very well and didn't need to bail in our AT1 capital. So I think in terms of very actively managing it, focused on financial resilience, strong balance sheets with our capital base, active support of our customers, and obviously, the scenario planning that we will need to do as we navigate through this period.

So myself and my team are very experienced at dealing with these situations and we will continue to monitor it very carefully as we go forward.

Magdalena Stoklosa, MS: How do you think the asset quality side is likely to evolve? And so the market is struggling with two things, of course, the suddenness, the duration, the kind of depths of the actual outbreak and what it means, but also the pro-cyclicality of how we kind of look at provisions at the moment. How do you see it evolving?

Alison Rose: Look, I think it's too early to say because it is going to evolve. I think balancing between short-term liquidity challenges, which businesses are facing, versus medium to longer-term solvency challenges that they may face. Obviously, IFRS-9 is an issue for us and all banks in terms of how we recognize any provisions. But I think it's too early to say how that will evolve.

Certainly, what we're seeing from our customers, and again, making sure we're staying very close to them, is being able to support liquidity challenges that we have, that as we move into more of a closed down period, it is going to be challenging for businesses. The government has put out funds to help support small businesses. So the guarantee scheme that they've announced, I think that will be extremely helpful. I think there's been good cooperation between the Bank of England, the Treasury, and also the banks to make sure that we're providing the right support.

So I think at this point, it's making sure we manage through this period. We obviously look at the cyclicality and the performance of our asset base through the cycle, and we've guided to a 30 to 40 basis point through the cycle over the medium to long-term. And you can see from our performance in the 2019 results, relatively low levels of impairment on a real level. So I think it's just managing through that cyclicality as we go forward.

Magdalena Stoklosa, MS: The Bank of England, of course, also has kind of taken -- has cut the countercyclical buffer as one of the measures to prepare us for the potential disruption. And of course, the bear case scenario. You can argue that they're cutting the countercyclical buffer was to keep the credit flowing into the economy, really real economy kind of part. But of course, you could also argue that in a bear case scenario, it can be used to cover potential losses.

Can you conceive a scenario where you or the industry use it up to cover provision?

Alison Rose: I think the decision by the Bank of England to release the countercyclical buffer is a helpful one. That's what it's there for. And I think in terms of sort of supporting continuous lending into the economy, and particularly to manage any increase in RWAs that comes through, or to absorb any provisioning that comes through, particularly if we're sort of managing through the IFRS-9.

I think it's too early to say and predict what that will be used for. From my perspective, I come back to I'm sitting with a core Tier 1 ratio of 16.2%, my LCR and our liquidity and I think that sort of strong risk management and investment in the capital strength of our bank and our balance sheet, and how we've actively managed the risk in our capital I think gives us comfort to manage through this period. But it's too early to say what the impact of that kind of cyclical buffer really be used for. But I think it was the right thing to do at this point.

Magdalena Stoklosa, MS: Of course. So let's move towards the interest rate, another part of the package of the BOE was the 50 basis points cut. You already in the beginning of the year talked about interest rate cuts, but of course also the lower for longer environment we're likely to be dealing with. How do you see your margin sensitivity now after effectively seeing the cut coming through?

Alison Rose: It's interesting, isn't it? I think I was sort of viewed as being conservative…

Magdalena Stoklosa, MS: Very much at the time.

Alison Rose: In building that economic place. Look, my focus is -- remains on building a long-term investment plan, which will drive sustainable earnings. My view has always been that we will base on economic consensus and the plan that I've built is very much around -- build in a 25 basis point cut within Q2 and then a lower for longer interest rate environment. So my business model and assumptions were really based on building sustainable returns through that environment.

Now, clearly, the 50 basis point cut, adds an extra sort of impact on rates. Broadly, our interest rate sensitivity that we've always talked about is a 25 basis cost around 170 million. So you could double it but then you look at that’s not a bad proxy. But you've got to look at the other end of the curve. But clearly, a lower rate environment does place more pressure on the NIM and we will obviously respond to that and we've taken some action on that.

And of course, we will adapt our business model to make sure we can do that. But I think for me, building a business and a plan that can operate in a much lower interest rate environment was very much my base case that the rate reduction has been higher than my economic scenario obviously.

Magdalena Stoklosa, MS: Brilliant. Before I ask the next question on capital, could I just ask for the iPad that I left on the front desk. I'm really sorry about this but this is where my questions are. Question from the audience? Great. Thank you very much.

Alison Rose: So I think just to continue with that question, clearly, as we have increasing risk to the economic outlook, whether that’s at the lower for longer or the impact of COVID-19, which is too early to say, I think we will continue within our business to look at the levers that we can pull across the foundational business that we've got, and making sure that we are being disciplined and focused on our costs and our capital, and also the segments of the market that will continue to grow.

Actually, the increasing investment we've made in our digital and our technology gives us an agility to respond and make sure that we can continue to serve our customers. I think the fact that I'm able to put 19,000 of my colleagues working from home gives you a sense of the value of the investment that we've been making in our technology over the period. So facing into those sorts of lower for longer scenarios, we will look at the levers we've pulled to adjust on that.

Magdalena Stoklosa, MS: And maybe kind of one of my last questions on capital. Of course, you've mentioned your very strong current liquidity around of more than 16%. Kind of medium term, you talked about 13%, 14% of your target, to go level. Of course, that also incorporated quite a significant amount of base case dividends coming through. Do you think that given what's happening now temporarily, and of course the conversation with BOE from the perspective of not using the countercyclical buffer for any distributions, has your thinking changed in any way from the perspective of how you medium term will, one, see the capital target, but two, the distributions coming with them?

Alison Rose: Look, our medium to long-term guidance was to be around the 13% to 14% Core Tier 1 and that was based off of an evaluation of maintaining that safety and soundness of our balance sheet, as well as being able to distribute our capital in a meaningful way during that period.

My plans and my assumptions haven't changed there. I think that medium to long-term guidance remains appropriate but clearly, starting at a 16.2% capital base in a period of uncertainty, safety and soundness, and the financial stability of the bank as well as giving us ability to continue to support our customers during a very disruptive period, is a position that I'm very comfortable being in. My plan remains over the medium to long-term, that we will continue to distribute capital, but obviously we're not going to compromise the safety and soundness of the bank to do that.

Magdalena Stoklosa, MS: When you think about the regulatory response you have seen, of course we talked about the impact of it. We've seen the 50 basis points. We've seen the countercyclical buffer. How do you assess it for now, from the perspective of how proportional it is, versus what we can potentially see?

Alison Rose: Well, look, I think what's been very positive here is the good collaboration and coordination between the Bank of England, the Treasury, and the banks working together and I think the response has been very rapid in terms of making sure support is in place for businesses. I think that coordination has been very helpful. As I said, I think we're in a very evolving situation. I think the fact that the Treasury announced extension of guaranteed loans for small businesses, that type of support, the countercyclical buffer for the banks, and the different measures that have been put in place. I think they have been proactive and on the front foot. I think that we will continue to watch the situation as it evolves. But I think very positively, good coordination across regulators, and government, and banks, which is important at a time like this.

Magdalena Stoklosa, MS: I remember last year, when we talked about the mix of business. There was a question asked whether you shouldn't have grown more in the consumer business. One year on, and with your own strategy in mind, do you think that that's, again, in a kind of more normalized environment, something that you would consider more, the consumer business, the credit card business?

Alison Rose: Look, I think a key part of our growth plan going forward and the opportunity within the business, and thinking about the customers through their entire life cycle, which I talked about, we absolutely have the capacity to grow within our risk appetite into more value for our consumers. And the increased use of digital products, the areas such as unsecured are areas that really represent potential for us to grow.

You saw in Q4 that we continue to have very strong growth in our mortgage business where we have capacity to grow at very accretive levels, and again at relatively low risk. And the mix, which I'm very pleased about, is as we've grown the different segments of our business, we have done that whilst preserving the credit quality and the credit discipline, and the risk appetite of our balance sheet. So in our commercial and in our consumer and unsecured business, you can see that actually the risk metrics show that actually we're putting on as good a quality business as our old business, so not chasing the wrong type of business.

And in commercial, we've grown in our key segments whilst also reducing our RWA intensity. So there is a real capacity to grow, I think in the consumer business, with our relative market shares, we can really grow in the segments that really matter to our customers. And I think that's a real strength of the business franchise going forward.

Magdalena Stoklosa, MS: Now, we have probably about 13 minutes to go. I've got a couple of questions from the web. The first one is about actually the government guarantees that we've talked about during our conversation. And the question really is can you explain how that work? So will you extend the credit line to the customer and the government guarantees? What's the mechanics?

Alison Rose: So the mechanics are being worked on at the moment. What the government announced is they would likely extend some of their existing schemes that they have. So the enterprise finance guarantee scheme is effectively allowing the banks to lend money, which are then guaranteed by a government scheme. So what they're working on is extending that scheme in order to do that. I think the comment that the chancellor made at the time was that they were looking at that, and they were making that scheme as big as it needed to be, to support small businesses.

So the mechanics are being worked from but I think what they'll do is look to expand existing schemes, which were in place, which is making sure there is a guarantee that sits behind any lending to SMEs that normally wouldn't be able to access lenders.

Magdalena Stoklosa, MS: Okay, and literally just a follow-up on this question. How will those loans, you think, will be treated from an asset quality perspective?

Alison Rose: So I think that is what's being developed at the moment. I would expect over the coming week, we'll get more detail on that scheme, U.K. finance, along with the banks and the treasury are working together to shape that scheme. So more details of that will come out over time.

Magdalena Stoklosa, MS: Perfect. Thank you. And we've got another question about the use of the credit lines because some of the kind of largest ones make the headlines. But the question really is what are you seeing and how much impact could this have on risk weighted asset growth.

Alison Rose: So at the moment, what we're seeing is what you would expect in terms of customer activity is an increased request for drawdowns at the moment. We're not seeing a really significant shift but in terms of key sectors, people drawing down their liquidity, existing lines, and making sure that they have sufficient liquidity to manage that. I think at this stage, it's too early to predict the outcome on RWAs as we go-forward. But one of the advantages that we have had in some ways is when we put out the growth fund last year, which was a fund we put in place for Brexit uncertainty -- Brexit seems to have gone away these days. When we put that fund in place, we really looked at which businesses would really suffer from supply chain disruption. And this is not a bad proxy for some of the customers who are looking at those challenges. And that's where we've been proactively working with customers.

Actually, the amount of drawdown on us has been very low. And as the situation unfolds, and I think it is too early to say, we then need to look at whether we're talking about liquidity gaps or more challenging sort of liquidity requirements with customers. So we're seeing an increase but not a very significant shift at this point.

Magdalena Stoklosa, MS: Okay, perfect. Now, there's one more question about the exposures. Could you sort of give us a sense of the bank's exposures, particularly to energy and hospitality sectors?

Alison Rose: So on -- I think that we have some disclosures in our results in terms of our pillar 3. I think it was Page 87 of our disclosures, which gives all the details there. In terms of the category we're talking about, it's listed as accommodation of food services. We have around 5.1 billion of gross exposures to that sector. In terms of oil and gas, that's obviously a key area of focus as we've been managing that and I talked in our results about our focus on climate and transition. Around 1% of our exposure on our balance sheet is to the oil and gas sector, which is about GBP 4.6 billion. So that is the level of exposure we have to those two sectors. But we have more detail in our Pillar 3 disclosures there.

Magdalena Stoklosa, MS: Page 87, just to remind everyone there. Got a couple of liquidity questions. So do you think liquidity in the market will stop you from reducing deposit remuneration because of weaker smaller banks paying up? Do you think that that's a possibility of how those kind of deposit pricing may evolve?

Alison Rose: That's an interesting question. I think it's too early to say. I think from our perspective, we have strong liquidity. Obviously, as a relationship led bank, we're very focused on that. We have made reductions to our deposit pricing, which was announced to the market. But equally, we've given flexibility to our customers to manage their savings during these periods. So I think it's too early to predict what's going to happen in the broader market. From my perspective, I can manage our banks supporting our customers. We have strong liquidity positions and we're clearly working very closely with our customers.

Magdalena Stoklosa, MS: There's another slightly more industry-based question about the term funding scheme. How do you see that particularly helping medium sized banks from a perspective of keeping the funding costs still relatively low?

Alison Rose: I think the extension of the term funding scheme is a helpful intervention, particularly for the small and medium sized banks. A lot of them are funded by the original term funding scheme, and some of that was due to repay. So I think the extension of that funding scheme is a very helpful intervention, clearly making sure that the system is operating efficiently and in a stable way, which is the most important thing to support customers as we go through that period.

For us, we have around 10 billion lending from the term funding scheme. So we will review but as you can see, our liquidity position is very strong. And I think that intervention was very helpful in terms of just extending a new term funding scheme, which therefore gives flexibility to those banks.

Magdalena Stoklosa, MS: Perfect. I think there's one more detailed question about the potential for the undrawn lines. You of course kind of mentioned is that what you're seeing is very, very little. But when you think about it more top down, do you think that that's the where most of the risk weighted assets kind of inflation is going to come from? Or do you think it's going to be more from this proactive lending on your side, particularly, following the conversations that your relationship managers have? How do you think that kind of growth is likely to pan out, more client driven, you driven, or let's just say some of the drawdowns?

Alison Rose: I think it's too early to say and too early to generalize as well. Clearly, what we need to do is support our customers during this period through the right risk length. So we're obviously making sure we manage that. And as you can imagine, we run a number of economic scenarios, stress test scenarios, and look at how our book will manage. For a lot of customers right now, it is really about managing a short-term liquidity disruption issue, making sure they have the right liquidity to trade and deal with the challenge that are facing them. I think the situation is evolving.

As I look at our medium to long-term forecasts of our RWAs that we laid out to around 200 billion, that built in a level of RWA inflation, as well as our active capital management and we will continue to do that, and obviously apply a sort of very disciplined risk lens as we go through this period.

Magdalena Stoklosa, MS: I think it's a great point to finish on. Thank you, Alison. Thank you very much for being here with us today and thank you everybody for watching.