H114 Interim Results

FIXED INCOME INVESTOR / ANALYST PRESENTATION

Held at the offices of the Company

280 Bishopsgate London EC2M 4RB

on Friday 1st August 2014

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 2014 Interim Results Announcement published on 1st August 2014.

Presenters

Ewen Stevenson

Royal Bank of Scotland – Chief Financial Officer

John Cummins

Royal Bank of Scotland –Treasurer

Operator: Good afternoon, ladies and gentlemen. Today's conference will be hosted by Ewen Stevenson, Chief Financial Officer, and John Cummins, Treasurer.

Please go ahead, Ewen.

Ewen Stevenson: Thank you, and many thanks for joining this call to discuss our second quarter results that we published earlier today.

As you know, this follows on from our summarised preliminary results that we published last Friday, and I have John Cummins here, our Treasurer. We will quickly run through the highlights of the second quarter, and then leave plenty of time at the end to follow up on any of your questions.

In terms of the results today, we posted another solid set of results. We reported an attributable profit of GBP230 million, which includes an accrual of GBP320 million for the initial repayment of the dividend access share. A milestone for us, this is our second consecutive quarter of reported profits this year.

While we are clearly pleased with this quarter's results, we recognize that revenues have been flattered by some one-offs and impairments have been exceptionally low. As a result, we remain cautious about a direct read-across of these trends into the second half, and also anticipate higher conduct and litigation expenses in the coming quarters.

This attributable profit combined with good progress in reducing RWAs in both RCR and CIB, allowed our Core Tier 1 ratio to strengthen a further 70 basis points in the quarter to 10.1%. Our Core Tier 1 ratio is now up 150 basis points year-to-date. Year-on-year revenues were down 10%, reflecting the on-going reduction of the bank's balance sheet. Over the same period, in comparison, funded assets declined 13% and RWAs by 17%.

We continue to make good progress on lowering our operating costs and reiterate our target to reduce 2014 costs by GBP1 billion. The reported second quarter cost income ratio was down 1 percentage point year-on-year to 75%.

Our restructuring spend increased by over GBP250 million in the quarter to GBP385 million, as we start to step up the pace of our restructuring efforts.

Looking forward, we expect restructuring costs to be in the order of GBP1.5 billion this year, versus our previous guidance of GBP2 billion. We still anticipate an overall restructuring spend of around GBP5 billion across 2014 to 2017.

On conduct charges, we took an additional PPI provision of GBP150 million in the quarter, as well as a further GBP100 million provision for interest rate hedging products.

Impairments were exceptionally low in the second quarter, with a net provision release of nearly GBP100 million.

The strong quarter-on-quarter improvement of nearly GBP0.5 billion reflects a very supportive credit environment driving both provision releases and lower new default cases across all our businesses. This positive macro environment that we now see in the UK and Ireland means that we now expect lower impairments in the order of GBP1 billion for the full year.

Risk elements in lending have fallen 110 basis points in the first half to 8.3% from 9.4% at the end of 2013. This has been driven primarily by disposals in RCR and an improvement in credit metrics across the core book.

With that, I'll now hand over to John to talk through the balance sheet and capital.

John Cummins: Thanks, Ewen.

We reaffirm our targets of our fully-loaded Basel III core Tier 1 ratio of 11% by the end of 2015, and at least 12% by the end of 2016.

Under U.K. transitional Basel III rules, improvement of in our Core Tier 1 ratio helped improve our total capital ratio to 15.6%. Increasing our total capital ratio from 15.6% to our target of above 17% will primarily be driven by the build-up of Core Tier 1 ratio to 12% with some optimization of supporting the debt stack as we go down the road.

Our liquidity position remains strong with the LCR standing at 104%, and the liquidity buffer is up slightly on the quarter, primarily relative to further deleveraging in the RCR and CIB. Our short-term wholesale funding remains modest at GBP34 billion versus our liquid asset buffer of GBP138 billion, and we continue to have opportunities to reduce the buffer whilst remaining prudent.

In the half year, we've issued GBP1.4 billion of public benchmark senior debt from the holding company and GBP2.2 billion of subordinated debt. We have achieved our stated targets and are comfortable with both the levels of liquidity and amount of subordinated debt issued for 2014. As such, we expect little to no further issuance for the remainder of the year.

On Additional Tier 1, we continue to monitor market conditions but we do not expect issuance in 2014.

With that I'll hand it back to Ewen.

Ewen Stevenson: Thanks, John.

To summarize, another good quarter for us in terms of profitability, capital build and risk reduction but we do remain cautious on the outlook, given potential headwinds, such as further anticipated conduct and litigation costs in the coming quarters.

With that, I'd like to open up for your questions.

Operator: Thank you, Ewen, 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 will pause for a moment to give everyone an opportunity to signal for question.

First question comes from the line of Corinne Cunningham from Autonomous. Please go ahead.

Corinne Cunningham: Hello, John. A quick one please. You just mentioned some optimisation of the capital stack. What sort of things have you got in mind there?

John Cummins: I think what we have in mind there is managing our amortization profiles and looking to make sure the capital stack stays in compliance with the new and changing regulatory environment we have. It's very much about making sure, as things amortize over the period, we continue to have issuance levels which are appropriate for our profile. We do expect next year to issue a couple billion of AT1, and we expect a modest amount of senior debt in the holding company as well.

Corinne Cunningham: And with that AT1 would you do that as a clean issue or would you contemplate doing an exchange, a la Barclays recently?

John Cummins: I can't comment on what other banks have done. I wouldn't want like give guidance whether we do an LME or not. I mean we did have to take a lot of things into account when we look at the timing of particular issues. So I'm afraid I can't give any more guidance than that.

Corinne Cunningham: Thank you very much.

Operator: Thank you. The next question comes from the line of David Polson with AXA Investment. Please go ahead.

David Polson: Hi. Pardon me if I missed this subject in your comments, where are you on considering Citizens to divest, or an IPO, or otherwise?

Ewen Stevenson: Hi, it's Ewen here. David, we're in a close period with the SEC so there's not a lot I can say beyond what we've currently said in market disclosure around our IPO plans, other than to say that we're on track with those plans.

David Polson: When did you feel like you started this process really trying to bring it to market? What would be like a fair period in order to get it off the ground?

Ewen Stevenson: We filed the S-1 in May. But as I say, there's not a lot I can say. I consider to mention May, the other end point I can give you is that we have a European Commission requirement to have fully exited Citizens by the end of 2016.

David Polson: OK. What's the range of capital help that you might see from, if it happened today or soon, what's your estimate of what capital buffer that would provide?

Ewen Stevenson: Look, I think we previously said 200 to 300 basis points of guidance. The 200 basis points is more guidance on today's RWAs. The 300 basis points is more guidance on where the RWAs end up to because we're also running down RCR in some other portfolios, so a meaningful increment in terms of our capital structure.

David Polson: Thank you very much.

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

Your next question comes from the line of Robert Smalley from UBS. Please go ahead.

Robert Smalley: Hi. A couple of questions, one, operationally, you in the deck talked about SME growth. Could you talk a little bit about where that was? Was that just really green shoots, sporadic, or is that something that's more of a trend?

I know that's an area that you have been positioning yourself to take advantage of, and one where you feel that you can essentially outgrow the growth in the economy, given your franchise. Are you starting to see that now?

Ewen Stevenson: Yes, Robert, in terms of where we're seeing the growth, a couple of things. Firstly, in terms of our CPB business, where we're seeing, we've got a mix of things going on. There are some portfolios that we're running off, for example, commercial real estate. We continue to run that business down.

What you actually see in the combined figures is negative overall growth in the loan portfolio but underneath that as you point out, there is growth in the book that we want to grow.

We're seeing pretty broad-brush growth I would say. Would I describe it as green shoots? I don't know, but there's certainly emerging demand.

Would we like it to be stronger? Yes. Do we think that it still feels like the economy is generally deleveraging? Yes.

Robert Smalley: And in terms of going back to a couple of questions before, you had mentioned on the Tier 2s, I think it was, managing the amortization profiles. I'm taking that to mean that you're looking at potentially doing something with those Tier 2 securities that are less than 5 years, and therefore amortizing, or potentially those that may be going through the 10-year amortization period in Tier 1s into Tier 2s.

Could you give us a little bit more detail on what you meant by that? Where's the real sweet spot for you in terms of getting capital treatment versus maturity there?

John Cummins: OK, I would say that the main focus we will continue to have is to manage our regulatory capital process, so that we have a consistent capital stack. And that in terms of sweet spot, it is very much driven by what market opportunities present themselves at the time. You have asked me to give you exact clarities as to what we're going to do in terms of step-ups or compliance step-ups.

We've got very clear delineation that we have to take the decisions on calling any securities on an economic basis across the board in terms of all the different factors we look at. It's hard for me to give you specific guidance on any one issue.

We are definitely clear we want a 5 percent capital stack and that will be made up of Tier 1 and Tier 2. As we have maturities coming through, I think, not for regulatory requirements but we'll also look at. It's along with other factors that will impact the security which may be useful for other funding requirements other than just regulatory capital.

Robert Smalley: OK. That's helpful.

Last one, one of your competitors talked about what their Pillar 2 requirements were. We see the nice growth in capital here, potential talk about AT1. Is that something you're going to disclose, and when?

John Cummins: OK. This remains a private number between us and the regulator. Obviously, it appears that I have disclosed which are required to do so as part of AT1 issuance. We will look at this as when we consider similar issuances, so it is a matter we will address as part of our issuance process.

Robert Smalley: That's great. That makes sense. Thanks very much.

Operator: Thank you. Once again to ask a question, lease press the star key followed by the digit one on your telephone keypad.

There are no further questions at this time. I would now like to turn the call back Ewen for any closing comments.

Ewen Stevenson: Thank you all for joining the call. I appreciate it is a Friday afternoon for some of you, and a nice summer's day in London.

But like I said we are pleased with this quarter. It is not often we can say that, and it's the second quarter in a row that we've been pleased. We do think we are making very good progress.

We're particularly pleased with the build-up of our capital ratios of 150 basis points, since the end of last year, which is really sort of fundamentally I think shifted us into a much stronger capital position than we'd anticipated at this point.

Thank you all for joining our call, and if you do have any follow-up questions, please go through the normal Investor Relations channels.

John Cummins: Thank you much for your time. Have a good weekend.

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

END