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RY.TO - Royal Bank of Canada at National Bank Financial Canadian
Financial Services Conference

EVENT DATE/TIME: MARCH 28, 2018 / 2:55PM GMT



CORPORATE PARTICIPANTS

Doug McGregor *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

PRESENTATION

Unidentified Participant

All right, I would like to welcome our final guest before the lunch break to the stage, Doug McGregor, head of RBC's Capital Markets business and the Investor & Treasury Services business, the custody business that flies under the radar a little bit compared to Capital Markets, but nonetheless a very important one for Royal.

We might as well just jump into it. And I'd like to lead off with the FIC business. It has been a -- and not just for Royal, but banks globally have been challenged with FIC. The performance hasn't been great over the past year plus. What do you think needs to change in that business to make it better I guess?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

Let's see, let's break the FIC business down. So there's rates, there's credit, high-yield. So, on the rate side, the last good rates market we had was just after Trump got elected and there seemed to be a more clear direction there. And so, there were some pretty good numbers that the Americans put up in rates.

For us, rates is not nearly the size of business that the global flow monsters we call them have. So like JP and Citi, BofA to a lesser extent maybe, Deutsche, these are very large rates players. We are the largest rates player in Canada, that is government bonds and rates derivatives in terms of swaps. But outside of Canada our rates business is about the same size as our credit business.

So our numbers in our FIC business have actually held up much better than the Americans because we have a smaller rates business and, perhaps proportionate to our size, a bigger credit business, which is where we're more focused, both in investment grade outside of Canada and in Europe or outside of Canada, US and Europe. And high-yield is just where we think we can make a bigger impact; we like the margins better.

So the rates business, very thin margins and a lot more of it being executed electronically. So, we just said a while ago this is not where we want to be focused. And frankly, the spend on things like MiFID in rates, which people don't talk about much in Europe, is pretty big in terms of trade reporting. So yes, I'm not terribly concerned with the performance of our fixed income business though; it's continued to improve year-over-year for the last several years.

Unidentified Participant

What about the -- I was going to ask about the muni business because it comes up on calls every now and then. And maybe not just single that one out, but how is it being affected by US tax reform, like there's some expectation that the muni business won't be as strong? Are there any other parts of your business that are benefiting or not from the tax changes?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

Well, the tax change in the US is quite important to the investment bank at RBC. More than half of our earnings now are in the US. And we said on the call last quarter that our earnings were impacted -- the investment bank's earnings were impacted by \$40 million positively by the tax change. And I think it's actually a little bit more than that, but I think it's at least \$40 million a quarter or \$160 million a year of more net income on a business that made \$2.5 billion last year.

So that is fairly significant and it has a number of benefits. I mean it's just obviously the earnings benefit is important. The return on equity benefit is important as well. So, yes, the tax change in terms of our bottom line is very helpful. In terms of the muni business, it's not -- we are a 6th or 7th in the league tables in the US. It's a reasonably good-sized business for us. There's a couple parts of the business.

The US banks, a lot of them hold very big portfolios in munis because they are tax efficient, they get a decent return on them, good capital treatment. We have a muni portfolio; it would not be near the size of the Wells and JPs of this world. But that portfolio, the return is a little bit less than it would've been because you take into consideration the tax savings.

There was a real rush to the market in the munis new issue business before the year-end because people thought that there was going to be significant changes in what would qualify for muni funding. That didn't happen. And so it was kind of business as usual.

Unidentified Participant

Well, I'm thinking about behavior, market behavior and stuff like that. I think the LIBOR issue is one where people are trying to figure it out. But part of it is repatriation of funds back to the US. Is there anything else like that?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

I just think, look, I think the tax change in the US; the implications are it's just a much more attractive environment. So whether it be an American company or companies like ours when they're deciding where to put capital to work, if you look at the US and say the two weaknesses to the strategy of making big investments in the US were taxes, 36% or 37% versus 26% or 27%. So that is -- when that's hitting your bottom line it wasn't a big negative for the US.

The second is regulation, just the tone of it; the potential problems evade the cost of complying. It would be the potential problems if you don't comply, not intentionally, but even if you are trying and you don't get it right, like it was quite unnerving there for a couple years. I think that side of the equation is also getting better, the tone from regulators and some of the changes that they are proposing and going through. So I would just say right now that is a pretty attractive place to do business.

Unidentified Participant

On the LIBOR issue, getting a lot of press these days, you could benefit on the asset side with your LIBOR base borrower is paying for. And then on the funding side might hit. Is that -- what is the net view on this issue?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

We float. You measure your exposure to fixed rate assets, it is called PVO1. And so, we manage that very carefully as I think all banks have to. And so, our assets float; the return on our loans float. And if we have fixed rate paper on our balance sheet then we will swap it to floating. And so, our asset returns will move at LIBOR just as our funding costs will move, at least the unsecured funding costs. Deposits, we have a little more control over, so -- yeah.

Unidentified Participant

Not too fast?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

No, no. I mean higher interest rates -- you read a lot about them benefiting banks. I mean to the extent they have massive clauses, they cannot raise what they paid on deposits at the same rate that they are earning on loans. That's -- spreads are enhanced.

Unidentified Participant

On the corporate lending side, that was a big ramp up story about the loan book. Largely US driven and it has kind of been flat. And I know you have talked about this on the calls and de-banking customers where the capital allocation didn't necessarily make sense. And are you expecting it to start growing again and what have you learned in this process?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Yeah. A couple things. First of all, that loan book, we disclosed in the sup that that loan book is in the low \$80 billion's. And about half that loan book is in the US. And that book, we grew it from say 2010 to 2015 double-digits every year.

What was going on was we were adding bankers, senior bankers in the US who needed loan capital for their customers. Like if you hire another energy banker, he'll come with 10 or 15 customers. He will need \$1.5 billion of committed lending over the course of two or three years as he reconnects that lending relationship with his customer. So as you are adding bankers your loan book is growing. It is growing in other places too like leveraged lending with LBOs, with sponsors and so on.

We hit 2015, the bank bought City National. We looked at the CET1 ratio and said: we are not going to be able to grow this loan book at least over the next 12 to 18 months at the same rate. Let's take a harder look at recycling some of the capital from customers that aren't paying as we expected they would and recycling into customers who pay well.

And so, we did. We had, and have, in the US about 800 lending relationships and we would have identified a number of those where we would visit them and talk to them and say, look, this isn't working out the way we anticipated. Is there any hope in the future that we're going to get back on side in terms of other revenue and other business? And if we concluded it wasn't going to work then we would take the opportunity, when it became available, to move that capital somewhere else.

That's an important process because lending is not a high return business given the kind of capital you have to commit to a loan book. And the margins that are available, even though the US -- margins in the US are pretty good. In any event, we are in a position now where the bank's earnings are -- have been quite significant. We have a lot of capital; we have been buying back stock.

But clearly the bank is telling us, look, we have -- the capital is available to the extent that you want to put it to work. So I think given the size of our book, which is not small, we are not going to grow it at 10% a year going forward, but 3% to 4% or 4% to 5% depending on the year, that is what we see in our plans.

Unidentified Participant

Is there a -- I recall kind of a target ratio of ancillary revenue to the spread income that you targeted for that type of business?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Yes, we like to think --.

Unidentified Participant

It's hard to track.

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Yes, the multiplier, so can you get \$2 of other revenue against \$1 of loan book revenue? Yes, I don't think we are far off. We're just getting better and better connected with the customers, better product groups, better brand frankly in the US. So we continue -- our investment banking fees continue to grow nicely there.

Unidentified Participant

You mentioned City National and I'm just curious from a collaboration standpoint. Is there a story there from a -- their customers that you can help out or any other way that you can work with City National?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Yes, yes, but it's not -- it doesn't impact our bottom line. I think the places where we collaborate the most; they are famous for being the bank to the stars I guess. They do have a good communication, media, entertainment business. They have good business banking in the restaurant industry.

There has been some referrals that we've done business with, but then they do participate in some loans that we originate. So we collaborate, but in terms of the capital markets business, it's not a big part of the business.

Unidentified Participant

Into I guess the numbers a bit. The capital markets business had good growth in 2017. The lion's share of that growth was related to lower loan losses. You came off of 2016 whether it was a pickup in oil and gas loan losses and then 2017 was the recovery period and just lower losses. What's the -- that tailwind has faded, so how do you kind of replicate that growth going ahead?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Well, first quarter, we made \$750 million, which would have been 10% more than any other quarter. So we are off to a decent start in terms of growing the numbers this year. I would say where is the growth going to come from? Probably outside of Canada. I think Canada is just -- it's okay but it's not great in terms of --.

When you have the mining business and the energy business struggling, I think the pure investment banking of the business, notwithstanding the fact that some of the smaller dealers are making money on pot, we are not. But in our core businesses it's been a little slow. And the US continues to be pretty robust.

Leveraged lending is a good business for us as high-yield buyout funding and just normal course M&A. And so, I would say the growth will come from all those businesses, putting on some balance sheet, as we talked about, both in our repo business, which is fairly big, and our lending business in the US and we're doing much better in Europe.

I mean, five or six years ago we were barely profitable and quite inconsistent in Europe. And we had a record first quarter and clearly in our trading businesses and our investment banking business in Europe is off to a really good start. So we will keep doing what we're doing.

Unidentified Participant

You brought up the pot, I can't let that one go. But one of the other banks is taking -- they have taken a position there. They've participated in that segment. What has your approach been or what is your decision?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

You know what, we have figured it out, but we haven't acted on it. I think under certain circumstances where we don't think we are at risk for our US franchise I think you will see some activity to support customers in narrow parts of that industry. So I don't think you are going to see -- you will not see RY in the near-term being robustly active in supporting startups in that business.

Unidentified Participant

MiFID II, we had touched on that when we were talking about FIC earlier. It would be a good question for your wealth business. Capital markets, is it hurting at all?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

It is expensive. In terms of MiFID, the two things you have to do really or the two big spends are: one, figuring out who's paying you on an equities desk and how are they paying for research, who are you sending research to and keeping track of those activities. But the other that people talk about less is just trade reporting and fixed income.

And so, there is a technology spend that isn't cheap that we are finished with thankfully. And now we're just really trying to see the impact on the business. On the equities business, it hasn't been frankly all that noticeable. And we're just waiting to see in the fixed income business whether it affects margins -- the trade reporting, whether it affects margins.

Unidentified Participant

I wanted to ask you about the efficiency ratio in the business. It's at about 56%, one of the higher ones in the group. And kind of tie that into the geographic composition of your business. And was that a structural reason why that number doesn't have much downside to it or improvement to it I guess? Or as Europe matures you get a boost?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

I think if you are comparing us to the other Canadians, so our investment banking revenues or earnings would be twice or more -- most if all the other Canadians, except for B&S, which would be 1.5 times their business. We'd be at least twice the size.

It's really the fact that if you are breaking into the US, or if you are trying to improve your business in Europe, which we have, it's not going to be as productive. And the efficiency ratio is not going to be as good as Canada where your brand is as good as ours has been and where you can keep your costs down and your market share up.

So yes, we have been investing. But frankly I think the business -- given the tax changes in the US, the business will produce a 14-plus return on equity in a decent PCL environment, which is like globally top 10, and produces 30% to the after-tax bottom line from revenue.

So, I think if Canada improves it will improve as your brand improves and as you get more productive per head of banker and trader.

Unidentified Participant

Is the -- 14% ROE, years ago it was 18%. Capital rules changed and that has had an effect. Do you think -- maybe not 18% is achievable again but getting it higher, what would be the biggest contributor to that?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Well first of all, the bank is doing 17%, or 18%. I would say when you look at the Canadian investment banks, the way they attribute capital or hold to the center of the house, the way they attribute funding costs, like it's obviously different for each bank. Like we pay full wholesale funding costs in our investment bank. We get 9.5% RWA capital attribution. I know some of the other investment banks, it is obviously less than that. So, they are hard to compare.

In terms of how do you get an investment bank to make 18%, the answer is you don't anymore. And all you have to do is look at the biggest ones in the world, whether it is Morgan Stanley or Goldman, is pure investment banks. Or JP, these firms are all now just getting through 10%. So there's a lot of delevering that has gone on in investment banking and a lot more capital per \$1 of RWAs on the balance sheet. So yes, it's -- 14% would be near industry-leading for global investment banks.

Unidentified Participant

Before I ask anymore, any questions from the audience? Nope, okay. Something that's not directly in your business, but the mortgage market and Canada is important to everyone. And I'm just wondering if -- a couple things. One, the B20, B20, is that an impact on your mortgage desk and -- your mortgage trading desk, lower amounts of mortgage (multiple speakers)?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

Yes, we will see. I think it is a little too early to tell, although I guess early returns would be that you are seeing less product. There has been a slowdown there.

Unidentified Participant

Now what about, and this one might be the bigger opportunity, the nonbank lenders having greater challenges accessing funding? Would we potentially or could we potentially see a private MBS market in Canada develop as a result?

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

I think the challenge around that really is that the spreads, if you are going to do a mortgage-backed security I don't know -- there would have to be pretty good spread in the senior or in the mortgage itself to actually tranche it and get it done. That has historically been a challenge. I think when you saw a huge market in the US you have more spread to work with, so I don't know.

Unidentified Participant

Okay. Commercial real estate in Canada, I forget which quarter it was, a couple quarters ago you gave me a good answer on a call, very detailed and what's in that book? I think it is around 28 billion or so in Canada specifically.

Doug McGregor - Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services

No, not mine.

Unidentified Participant

Oh, no, no, no, but that includes (multiple speakers).

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

Oh, the rest of the bank, yes, yes.

Unidentified Participant

Yeah, that includes the rest of the bank. How does the slower housing market affect the outlook for your real estate book and the corporate book?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

My corporate book, I'm going to give you the numbers exactly because we don't split them out. But it would be -- in Canada I can say that I am more than \$5 billion. I am a real estate banker by background. I've been doing it for a long time and that book is really against large commercial office buildings and shopping centers for customers, private equity, KingSett would be a big customer. We lend against [Sacasa's] assets, we lend against OMER's assets, a lot of institutional names and institutional quality assets.

We take very little development risk, we don't take spec development risk. And our loss experience in that book over the last five years has been zero. So it's good, we have a similar book in the US and we have a similar book in Europe frankly. We lend to Brookfield and Blackstone globally. They would be our two biggest borrowing customers.

And the nice thing about the real estate loans is that the returns are good, they're draw on loans, good revenue, and good ancillary business. It was in the paper today we are acting for Brookfield to fund -- in the bank group to fund their GGP bid. And we are quite active with them globally.

Unidentified Participant

We actually have about a minute left. It says 6 but we add 5 for some reason. Wouldn't mind ending up on the Canadian landscape? You sound more bullish about growth in your business outside of Canada. And partially that's a reflection of a maybe weaker investment climate in the resource sector. If you had a wish list of policy change I guess, what would it look like?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

I was in Calgary a couple weeks ago and I met with the CEOs and CFOs of 10 large energy companies over three days. And I would say I think every single one of them expressed disappointment and concern over the lack of federal and provincial government attention to some of the problems they are having getting infrastructure built.

And there's been massive job loss and that is an important business for Canada. So I would say one is to get some pipelines built and support that industry -- regardless. So the policy change there was we have to make some progress there.

In terms of other policy, I'd like to get a trade agreement that we can all live with and kind of stabilize that situation. I think that would be important.

In terms of other policies, we seem to have a governor of the Bank of Canada that has a weak dollar policy. I've got to say, given the size of our US business, that that's not so bad for us at the moment. But I think longer-term the inflationary and other impacts might not be so great. So we'll see where that goes.

But I would say fix the problems in Alberta, get a trade agreement done and continue to -- or continue -- or try to make some headway in terms of making sure we don't go the wrong way on taxes because I'm fearful of us doing that as well.

Unidentified Participant

Well, on that note -- we do have a question from the audience.

QUESTIONS AND ANSWERS

Unidentified Audience Member

(Inaudible). What's your outlook for credit (inaudible)? I know last year was a strong year for DCM (inaudible). So is that your goal (inaudible) this year?

Unidentified Participant

I have to repeat the question in the mic for the record. What is your outlook for credit high-yield and DCM?

Doug McGregor - *Royal Bank of Canada - Group Head, Capital Markets and Investor & Treasury Services*

Yes, so we will see how credit hangs in over the next little while. Credit has been so strong for so long that the syndication market for leverage loans has been -- like hardly anything has been hung in the US for over a year. So, would I like that to continue? That would be great.

If you continue to see equity markets churn around and you continue to have kind of disruptive discussions around trade and so on, then it's possible you could get a backup in credit.

Yeah, the demand for loans though, as of Monday morning when I had my group meeting, we went through our portfolio, is still quite good. High-yield, the challenge there is credit has been strong but people are expecting rates to backup and that is fixed income product. So -- or fixed-rate product.

And so, I would be a little more concerned about high-yield than I would about loans. And origination debt capital markets, it's on track for last year's numbers which were really quite strong. So, corporations are still leveraging up, maybe fearful of higher rates, they are going at it pretty strong right now.

Unidentified Participant

All right, that about wraps it up. Doug, appreciate the time.

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