



**NatWest Group plc**

**Q3 2022 Results – Management Presentation**

**28<sup>th</sup> October 2022**

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## **Management Script**

### **Alison Rose:**

Good morning and thank you for joining us today. I'm here with Katie Murray, our CFO. I'll start with a business update before Katie takes you through our financial performance. We'll then open it up for questions. So let's start with the headlines on slide 3.

Against a volatile and challenging economic backdrop, we continue to demonstrate the strength and resilience of our business, delivering a strong financial performance whilst supporting our customers. Operating profit for the first nine months of the year was 4.1 billion, up 15% on the same period last year, and attributable profit was 2.1 billion. Our return on tangible equity was 10%.

We are reporting positive jaws of 21% as a result of strong year on year income growth of 23%, generated across our core customer franchises, along with cost growth of 1.8%. We maintain our cost reduction target of around 3% for the full year and are on track to deliver that.

Our cost income ratio for the 9 months was 54%. We continue to lend responsibly and support our customers with strong net lending growth of 5.4% since the year end to £372bn. Our strong capital generation gives us confidence in our ability to continue delivering for all our stakeholders in challenging times.

Our Common Equity Tier One ratio of 14.3% is approaching our 2022 target of around 14% and we continue to return excess capital to shareholders. We have now paid or accrued 750 million towards our committed dividend distribution of at least a billion pounds in 2022. Together with the special dividend of 1.75 billion announced at the half year and the directed buyback of 1.2 billion in March, this brings total distributions accrued or paid in the nine months to 3.7 billion.

Clearly the macroeconomic environment has become more uncertain since we spoke with you in July - inflation, interest rates and energy costs have increased further amidst heightened market volatility whilst supply chain disruption continues. The outlook is now more challenging for our customers with a drop in business and consumer confidence together with lower economic growth.

In light of this, we have revised the combined weighting to our downside scenarios to 55% compared to 34% at the half year. As a result, we have taken an impairment charge of 242 million in the third quarter compared to a release of 39 million in the second. However, we are not revising our full year impairment guidance.

While we believe our economic scenarios are conservative, it is important to note that we have yet to see any material signs of stress from customers.

We continue to grow our lending responsibly with disciplined risk management. We have remained open for business deploying capital in the mortgage market whilst pricing appropriately. We have a well-diversified, high quality loan book with limited exposure to areas such as unsecured personal lending, mortgages with a high Loan to Value and Commercial Real Estate.

We are on track to deliver our 2022 targets on cost and capital and have increased our income guidance for this year to around 12.8 billion based on the current Bank of England interest rate of 2.25%.

In this uncertain economic environment, our purpose led strategy puts us in a position of strength. Our four strategic priorities remain as relevant as ever and we continue to deliver against them to create and protect long term value for all our stakeholders. Let me talk more about how we are supporting our customers on slide 6.

Though we are yet to see signs of customer stress in our credit metrics, we know that many people, families and businesses are worried about the pressures they face. We are doing what we can to stand alongside them as they navigate through this economic uncertainty.

Our strong balance sheet and capital generation enable us to lend a helping hand to those most in need – so we have created a 4 million hardship fund to support individuals and businesses through charities such as Citizens Advice and Money Advice Trust. This includes 2 million to fund a dedicated team at the debt charity Step Change, helping small businesses that are struggling to manage their finances.

We are supporting mortgage customers who face higher financing costs by extending the refinancing window from 4 to 6 months. Some eligible customers who took advantage of this early window during the quarter saved around 2% on their next mortgage rate.

We have also carried out around 600,000 free financial health checks in the first nine months this year via our app whilst also helping people to understand and improve their credit rating. This month we launched a benefits calculator which enables customers to check their eligibility for state benefits and access income they may not have realised they were entitled to. And year to date we have made over 8m approaches to personal customers with information to help them manage the increased cost of living.

For commercial customers, we are tailoring support to sectors that are most likely to be impacted. For example, we are helping 40,000 customers in Agriculture, which has been hit by rising prices, especially in fertilisers. This includes making available a £1.25 billion lending package for UK farmers with capital repayment holidays where appropriate.

We have a well-established ecosystem for SMEs providing them with sector specialists as well as business hubs around the UK. In July we froze SME current account fees for 12 months and we continue to monitor our customers carefully to identify those that are having difficulties early on. We have also reduced Tyl transaction fees for micro-businesses to help them weather the increased cost of living.

We are supporting our colleagues by making targeted pay rises for the lowest paid across the Group as well as investing in learning and development programmes and parental leave.

So we are working with our customers, colleagues and communities to alleviate the worries of those who are most vulnerable.

Let me turn now to how we are delivering our strategic priorities on slide 7

Notwithstanding the near-term challenges, we continue to invest for the long term and grow across our core franchises by acquiring new customers and broadening our product offering to meet more of their needs. In doing so, we are diversifying our income by customer, by product and by generating more fees and commissions. We are also actively supporting our customers in their transition to a net zero economy.

A good example of how we are investing for the future is the strategic partnership we recently announced with Vodeno which aims to create a leading UK Banking-as-a-Service business. This will enable other businesses to embed digital banking services such as payments, deposits, point of sale credit and merchant cash advances directly into their own propositions and customer journeys.

Our new strategic partnership combines Vodeno's technological capabilities and cloud platform with banking technology developed in Mettle, our digital bank for small businesses. This allows us to leverage our position as a leading supporter of UK businesses in order to meet the evolving needs of our corporate customers and expand our client base in a rapidly growing market. It also enables us to grow our fee income and diversify our revenue streams.

As importantly, we will continue to lend responsibly and support our customers, and in turn the wider UK economy.

We are also delivering a wider range of our products and services more effectively across our franchises. For example, by extending our asset management expertise to customers in retail as well as private banking, we have increased our affluent investment customer base and attracted net new inflows, which amount to 1.7 billion for the first nine months of 2022, of which 17% was via digital channels.

Finally on slide 7, as the UK's leading underwriter of Green Social and Sustainability Bonds, we are well placed to help our customers transition to a net zero economy. Last year we set a target of delivering £100 billion of climate and sustainable funding and financing by 2025. We have contributed 26 billion towards that target to date.

Slide 8 shows how our investment in digital transformation is continuing to improve the customer experience as well as increase our own productivity. 90% of retail customers and 84% of commercial customers now interact with us digitally and we are making this easier and simpler as we continue investing to improve customer journeys. 72% of retail bank accounts and 96% of credit card applications are now opened with straight through processing and we're seeing this feed through into continued improvement in customer satisfaction.

For example, our Retail NPS is now 20 compared to just 4 in 2019, our affluent score has increased to 29 from minus 2, and we have one of the leading scores in Commercial Banking at 22.

In the current environment a strong balance sheet, disciplined risk management and effective capital allocation are important differentiators. Our loan book is well balanced between personal and wholesale lending and well diversified by sector. And the level of defaults across the Group remains low.

Our personal lending book is largely secured and 93% of our mortgage book is fixed. We have limited mortgages with a high loan-to-value - those above 80% represent less than 3% of our book. Commercial real estate represents around 5% of our total loan book and the average loan to value is 48%.

Looking at liabilities, deposits remain elevated in both Personal and Commercial Banking, supporting our strong liquidity position. We continue to actively manage our liabilities, offering strong propositions for youth and digital savers and fixed term accounts for business customers.

We are managing our capital allocation to maintain a strong balance sheet and our phased withdrawal from Ulster Bank Republic of Ireland, which we expect to be capital accretive, is on track. We have binding agreements in place for 90% of the loan book and deposits have reduced 42% since the year end as customers move to other providers.

Our strong capital generation gives us the ability to support our customers in difficult times as well as invest for growth, consider other strategic options that create value and return capital to shareholders. As I outlined earlier, capital distributions accrued for or paid in the nine months amount to 3.7 billion.

With that I'll hand over to Katie to take you through our Q3 results.

**Katie Murray:**

Thank you Alison - I'll start with the performance of the Go-forward group in the third quarter using the second quarter as a comparator.

We reported total income of £3.3bn for the quarter, up 2.1% from the second. Excluding all notable items, income was 3.4 billion, up 10.7%. Within this, Net interest income was up 14.3% at £2.6 billion and Non-interest income was broadly stable at £800 million.

Operating expenses rose 5.3% to £1.8bn and we made a net impairment charge of £242 million compared to a release of 39 million in the second quarter. This reflects an increased weighting to our downside economic scenarios rather than any underlying deterioration in the book, which remains robust.

Taking all of this together, we reported operating profit before tax of £1.2 billion for the quarter. Attributable profit to ordinary shareholders was £187 million, after the impact of losses in Ulster Bank associated with our withdrawal from the Republic of Ireland and return on tangible equity for the go-forward group was 12.1%. I'll move on now to net interest income on slide 12.

We saw continued strong momentum in Net interest income, which increased 14.3% to 2.6 billion as a result of strong lending and higher margin. Net Interest Margin

increased by 27 basis points to 299 basis points driven by wider deposit margins which added 47 basis points.

This reflects the benefit of higher UK base rates, which increased by a further 100 basis points in the quarter, and higher swap rates on our structural hedge, net of pass-through to customers.

These increases were partly offset by lower mortgage margins on the front book which reduced net interest margin by 7 basis points, and by the mix effects in Commercial & Institutional, which decreased NIM by a further 8 basis points. Net interest margin of 273 basis points for the first nine months was supported by the faster than expected pace of interest rate rises, and at current interest rates we now expect NIM to be above 280 basis points for the full year, with strong momentum into 2023. I'll move on now to look at volumes on slide 13.

We are pleased to have delivered another quarter of balanced growth across the Group. Gross loans to customers across our three franchises increased by £9.2 billion or 2.7% to £347 billion.

Taking Retail Banking together with Private Banking, mortgage balances grew by £4.2 billion or 2.2%, with flow share of 13% and good retention; unsecured balances increased by a further 200 million, across credit cards and personal loans.

In Commercial & Institutional, gross customer loans increased by £4.8 billion. Lending to large corporate and institutional customers was up £5.6 billion, driven by growth in working capital and supply chain finance, as well as funds lending. This was partly offset by continued repayments on government lending schemes of £600 million. I'd like to turn now to deposits on slide 14.

Our robust deposit profile, with a loan to deposit ratio of 76%, has allowed us to support our customers throughout this period of market volatility, maintain our mortgage offering and provide lending across the economy.

Customer deposits across our three franchises decreased by £7 billion or 1.5% in the quarter to £448 billion. This was driven by outflows of £8 billion across Commercial & Institutional, reflecting the withdrawal of short-term institutional inflows made in the second quarter, coupled with some seasonality.

Across Retail Banking and Private Banking, deposits increased by £1 billion, a slower rate of growth than in prior quarters. We are not seeing any significant change in customer behaviour in terms of switching balances between non-interest bearing current accounts and savings.

In Retail we saw some seasonal reductions in savings balances over the summer holidays, offset by higher current account balances. We have provided new disclosure on the split of deposits for Commercial & Institutional by customer segment to match our loan disclosure.

You will also see on the slide the cumulative pass-through on our interest bearing deposits by franchise, including customer rate changes effective on October 18th. This equates to an average pass-through of 25-30% across interest-bearing

deposits, which account for around 60% of total go-forward group customer deposits.

Our deposit pass-through decisions consider current and expected behaviour across all our customer accounts.

We continue to expect pass-through rates to increase with higher levels of interest rates, and our interest rate sensitivity disclosure provided at the half year, which incorporates a 50% pass-through, remains relevant.

Turning now to our hedge, where we have an ongoing income tailwind into 2023 as maturing swaps are being reinvested at higher yields. As you know, we hedge the majority of our current accounts and a small portion of savings, so £205 billion of balances are included in the structural hedge. The notional increased by £1 billion during the quarter, reflecting growth in balances over the last year, and if deposits were to remain broadly flat from here we would expect the hedge to increase by a further £5 billion over the next 3 to 6 months. I'd like to turn now to non-interest income on slide 15.

Non-interest income, excluding notable items, was £800 million, stable on the second quarter. Within this, income from trading and other activities increased a further £28 million to 250 million, driven by higher foreign currency cash management in Treasury.

Fees and commissions decreased by £25 million to £550 million, due to seasonal lower financing fees and our no fee Foreign Exchange offer for our Retail customers through the summer. Turning now to Costs on slide 16.

We have delivered strong operational leverage or positive jaws of 21% over the first 9 months. Other operating expenses for the go-forward group were £4.9 billion for the first nine months. That's up £87 million or 1.8% on the same period last year reflecting higher strategic spend in areas such as Financial Crime and Data. Along with strong income growth this has contributed to a 10 percentage point improvement in the cost income ratio to 54%

We continue to expect to reduce costs by around 3% for the full year. As we told you at the half year, we expect inflationary impacts on our cost base to be more significant next year. But inflation is now forecast to be higher than projections at the half year so we no longer expect costs to be broadly stable year on year in 2023.

As you would expect, given our strong track record, we remain committed to maintaining cost discipline and improving operating leverage. Turning now to credit risk on slide 17.

We have a well-diversified prime loan book. Over 50% of our Go-forward group lending consists of mortgages, where the average Loan to Value is 53%. 64% of balances are on 5 year fixed rates, 27% at 2 year and just 9% are on variable rates, including SVR.

Our personal unsecured credit exposure is less than 4% of group lending and is performing in line with expectations. On the wholesale side, we have de-risked over

the past decade to bring down concentration and single name exposures. You can see this from the reduction in our RWA intensity, which is down 15 percentage points since the end of 2019. For example, our Commercial Real Estate exposure represents less than 5% of group loans, with an average LTV of 48%.

Our corporate book is well diversified, and we have shown here selected exposures that we expect to be more vulnerable to cost of living pressures. So our strategy has delivered a well-diversified, high quality loan book which is not showing any significant signs of stress.

However, we recognise the economic outlook has deteriorated, so let me tell you how we have addressed this on slide 18.

We will update our economic forecast at the year-end but you can see at the top of the slide that we have increased our weighting to the downside and extreme downside scenarios from 34% to 55%. This has driven a deterioration in our weighted-average expectations for GDP growth and unemployment, the key drivers of expected loss sensitivity. You can find details in the appendix and IMS.

The net effect of these changes is a £127 million increase in the good book Expected Credit Loss provision which was more than offset by the reclassification of Ulster mortgages to fair value.

The Post Model Adjustment for economic uncertainty reduced slightly in the quarter to £545 million, due to further release of COVID related adjustments. We continue to be cautious on the release of these provisions as we have yet to see the full impact of the economic challenges play out

We reported a net impairment charge for the Group of £247 million in the third quarter, equivalent to an annualised 26 basis points of loans. While the economic outlook remains uncertain we continue to expect the full year loan impairment charge to be under 10 basis points, given the current performance of the book.

As you know, our through-the-cycle impairment guidance is 20-30 basis points, and as I sit here today I see this as an appropriate level to think about for 2023. Turning now to look at Capital and Risk Weighted Assets on slide 19.

We ended the third quarter with a Common Equity Tier 1 ratio of 14.3%, in line with the second quarter, as Go-forward group earnings were offset by Ulster exit costs as well as dividend and linked pension contributions. This includes IFRS 9 transitional relief of 19 basis points, up from 16 basis points at Q2. We generated 46 basis points of capital from go-forward group earnings, net of changes to IFRS 9 transitional relief. This was partly offset by higher RWAs which increased by £1.5 billion, due to growth in lending balances and market volatility.

Progress on our phased withdrawal from the Republic of Ireland consumed 9 basis points of capital in the quarter as we incurred €514 million of the €900 million expected exit costs. This is net of a £2.8 billion reduction in RWAs due to the ongoing transfer of the corporate loan book to AIB. Turning now to our balance sheet strength on slide 20.



Our CET1 ratio of 14.3% is moving towards our target range of 13-14% as planned. Our UK leverage ratio of 5.2% is in line with Q2 and 195 basis points above the Bank of England minimum requirement. We have maintained strong liquidity levels, with a high-quality liquid asset pool and a stable diverse funding base.

Our liquidity coverage ratio of 156% is down from Q2 due to growth in customer lending and dividend payments of £2.1 billion. Headroom above our minimum is £68 billion.

We are pleased that Moody's has recognised our strong balance sheet by upgrading both Natwest Group plc and Natwest Markets by 1 notch. Turning to guidance on my final slide.

As you heard from Alison we have strengthened our income guidance for 2022. We now expect to deliver income, excluding notable items, of around £12.8 billion with Net Interest Margin of more than 280 basis points for the year.

This assumes UK base rates remain at the current level of 2.25%, though we clearly expect UK base rates to increase further before the end of the year. Rather than predicting that increase I suggest you look at our interest rate sensitivity disclosures to help understand the benefit this may bring in the final two months of the year.

On costs – we expect to deliver a reduction of around 3% this year; and on loan impairments - we still expect to remain below 10 basis points for the full year given the current performance of our book and we reaffirm our guidance on capital.

As we look ahead to 2023, we are confident in our plan to deliver a Return on Tangible Equity of 14-16%. However we expect the make of those returns to change given the evolving macro-economic outlook. Inflation is pushing up interest rates and in turn we expect both income and costs to be higher next year, together driving an improved cost income ratio. Based on the current performance of the loan book, we expect impairments to be within our 20-30 basis points through the cycle average.

With that I'll hand back to Alison.

**Alison Rose:**

Thank you Katie. So to conclude, against an uncertain economic backdrop, we are pleased to report another strong performance as we continue to focus on supporting our customers, communities and colleagues and delivering our strategic priorities.

You have heard today how we are helping those most in need as well as investing to create sustainable growth for the long term; continuing our digital transformation to deliver product innovation, an improved customer experience and higher productivity and deploying our capital carefully.

With a strong balance sheet, well diversified loan book and robust risk management we continue to drive operating leverage in the business whilst managing the macro-

economic challenges and we remain confident in our ability to deliver returns in the range of 14-16% next year.

Katie and I will talk more about our outlook for 2023 and beyond at our results in February. Thank you very much – we are happy to take your questions now.

## **Q&A**

### **Operator:**

Ladies and gentleman, if you would like to ask a question today, you may do so by using the raise hand function on the zoom app. If you are dialling in by phone you can press \*9 to raise your hand and \*6 to unmute once prompted. We do ask that you limit yourself to 2 questions each, to allow more of you a chance to ask a question. We'll pause for a moment, to give everyone the opportunity to signal for questions. Now our first question comes from Aman Rakkar of Barclays, would you please unmute and go ahead?

### **Aman Rakkar (Barclays):**

Good morning, can you hear me ok?

### **Alison Rose:**

Yes, we can hear you, good morning.

### **Katie Murray:**

Hi Aman.

### **Aman Rakkar:**

Good morning, Alison, good morning Katie. Two questions if I may?

First of all, on costs in 2023, I note the stepping back from flat cost guide in 2023. Can you help us understand exactly what's changed versus a couple of months ago when you issued the guidance? My take is that the inflation backdrop probably hasn't shifted too much versus what I think the market, and where the conversation was back then, so it would be really helpful to understand in your mind, exactly what's changed and can you help us think about - if you're not going to point us to a number in 2023 - the moving parts about where costs potentially could land, a range or anything to tighten that up? I think it's actually quite an important thing based on the market reaction and conversations we're having so far.

The second question was around revenues, so I'm just noting the £12.8bn revenue guide for this year - I think it implies Q4 revenues are around £3.5bn that annualises at £14bn - I know you might not want to give us exact numbers for next year but, directionally, do you see scope for that annualised revenue run rate to grow from here? That's probably mainly about the interest income, do you think the Q4 annualised net interest run rate can grow in 2023? Thank you very much.

**Alison Rose:**

Thank you - let me take the revenue one; the short answer to your question is yes, but a slightly more detailed look - for the remainder of 2022 and into 2023 we will see the full year benefits from the previous rate rises flowing both through the hedge and the managed margins, so that is going to give us a significant tailwind into next year. If you can see from our rates sensitivity disclosure - we're also going to benefit from any further rate rises and that will also drive improvements in them so I think a very positive and significant tailwind into next year on revenues. So hopefully that gives you comfort on that. Katie, do you want to pick up the cost question?

**Katie Murray:**

Yes - specifically on costs, we know that costs have been lumpy over the course of the year, as it was last year. I think Aman, I probably differ from you, I see since H1 2022 that there has been increase in the macro-economic uncertainty and this has driven greater inflationary pressures. That is certainly what we are experiencing on the ground, so, while we expect future increases in interest rates, against this, we can no longer expect costs to be broadly flat, given those increased inflationary pressures.

To be very clear, cost management remains a significant priority for myself and Alison and our Executive. We will continue to manage tightly on costs, as we have done over the past number of years, and I think we have a very strong track record. We expect positive jaws in 2023 and an improving cost income ratio in 2023 as well.

We will talk more about our expectations for the 2023 outlook for the business when we meet again in February.

**Aman Rakkar:**

Thank you very much. Can I just ask one small follow-up - what inflation assumption are you making now around 2023?

**Katie Murray:**

So, if you look to the inflation assumptions that we've used in terms of IFRS9 - that's probably your best guide. If I look at the CPI in 2023, it's 6.2%, 9% for this year and 6.2% on a weighted average basis. We will do a bit of an update of that when we do the year end piece - look at what we've done on our IFRS9 - and we work very hard to make sure that the economics align across the whole income statement and balance sheet, so that's probably a good guide for the moment.

**Aman Rakkar:**

Thank you so much.

**Operator:**

Thank you, our next question comes from Jonathan Pearce of Numis, Jonathan please go ahead.

**Jonathan Pearce (Numis):**

Hello both. Sorry, I've got to push you on this cost point again if that's okay. Prior to today, we've had 2 revisions to cost guidance this year and it's understandable - inflation is obviously much higher than one would have thought, certainly in the early part of this year. But we're flying very blind now into 2023 with no guidance at all and I really would encourage you to help us as much as you can on this. If you're not going to be any more precise on full year 2023 versus 2022 guidance, is it sensible for us - as you've just alluded to - to look at the CPI on your weighted economic scenarios which is now 6.2%. That was 3.9% at the interim, so if we call the delta 2.5% and add a little bit on, is that the way we should be thinking about this? If you were guiding to flat before, we should now maybe be thinking about up 3%, maybe up 4%? We just need any sense of scale, because if it is up 3%, or up 4%, your shares probably wouldn't have been down 9% this morning! So, a bit of help with that would be useful.

The second question on deposits - you've encouraged us to look at the Go-forward deposit number excl. central items where the repos are, which makes sense, and then most of the rest of the drop is in corporate and institutional at £5.5bn in the quarter. Is that very low margin stuff? So the stuff that's really generating the deposit revenue in the retail bank, the SME, commercial, midmarket deposits, is that the way to read the deposit numbers? Thanks.

**Alison Rose:**

Thanks Jonathan, on the deposits, that's the way I would read them. In terms of our commercial bank, the deposits that have fallen have really been a combination of timing of year end, timing of the quarter end and some payroll. We're still seeing a lot of excess liquidity sitting in our SME and our commercial book, which are the valuable deposits, and deposits remain at high level, so, I think that's exactly how you should read the deposits. Katie, do you want to take the costs?

**Katie Murray:**

Yes absolutely. Jonathan, I'm probably going to disappoint you a bit on costs at the moment - I'm not going to give you any more refined guidance. We've got a very strong track record on cost management. We are seeking to continue to improve the operating leverage of the business over the plan through continuing to reinvest opportunities that we have in terms of the savings that we make. We do expect as we go into next year that we'll see positive jaws and throughout 2023, and we'll see the cost/income ratio improving.

**Operator:**

Thank you, our next question comes from Benjamin Toms of RBC, Benjamin, please do go ahead.

**Benjamin Toms (RBC):**

Thank you for taking my questions. Firstly, thank you for the disclosure on the cumulative deposit betas, I think your weighted average cumulative deposit beta is

about 27%, do you have a feeling of how long it will take this number to converge to 50%?

The FCA came out this quarter and said that they expect banks to clearly explain to them how they've decided on the pace at which they pass on base rate increases to savers. Does this nudge change the trajectory of deposit beta progression from here, do you think?

Secondly, you're not going to be pushed any further on costs, but maybe you can give us a direction of the magnitude of any headcount reductions or direction of headcount reductions for next year? Lloyds told us this week that they're hiring about 1,000 people to help manage the cost-of-living crisis, are Natwest Group doing something similar? Thank you.

**Alison Rose:**

Okay, well let me address a couple of those and Katie will pick up the rest. On FTE reductions, we would always speak to our staff first about any changes but we are not hiring extra staff for cost of living, we have sufficient capacity. We have invested a lot in our digital transformation and our financial health and support team who look after issues around defaults and distress. Just to remind everyone, we're not seeing defaults and distress on our book. We've had significant investment in those, and journeys are much more digitised, which means we're able to help customers self-serve and we have sufficient capacity to be able to deal with any challenges. A good demonstration of that would be, for example, around our operational capacity during the volatility in the mortgage market, when we stayed in the mortgage market, we saw 5 times the normal volume, which operationally we were able to manage very well with our team. So I think we're not expecting an increase in FTE as others have indicated.

On deposits and your FCA question, as we've said, we will manage our deposits and passthrough in a very sensible and competitive way and thinking about how we help people. If you look at where we have put support in place and put deposit rates in place, our digital regular saver paying at 5%, our youth accounts paying at 1%, and on our business side we have some of the best fixed term deposit rates for our business customers. On the whole they're largely preferring to stay liquid and keep cash in transactional accounts, so we will continue to manage that on an active and competitive basis in the right way. Katie, anything you want to add?

**Katie Murray:**

The only thing I would add is the sensitivity that we give you in terms of, is it a 50% rate, we think that's quite appropriate. At the most recent rate rise, we passed through about 40%, so you're absolutely right in terms of your numbers Benjamin, it's moving upwards from where it started, which is perfectly natural given the low rate that we started at. We have said consistently as the rates go higher, you would expect to see a little bit more pass through coming through and that's what we're seeing on the ground and I hope that you found some of the analysis around how much of it is interest bearing and non-interest bearing, helpful within there, and I think we spend a lot of time looking at what do we think customer behaviour is? How do we think that they're reacting to rate rises? Alison's already talked about

the rates that are on offer, and what we're not seeing at the moment, is people moving in that area, we obviously spend a huge amount of time looking at that for any indicators of movement. Thanks Benjamin.

**Operator:**

Thank you - our next question comes from Fahed Kunwar of Redburn, please do unmute and go ahead.

**Fahed Kunwar (Redburn):**

Hi both, thanks for taking the questions. I've got a couple of questions. The first one is on assumptions. From what we can see, the CPI hasn't changed that much in the cost guidance but it's clearly led to an increase or a change in your cost guidance.

On your loan loss guidance for 20-30bps next year, how are you confident on that number. No one else has given proper 2023 guidance. It's quite low, given the small change in inflation leading to a cost change. Why are you confident enough to give that 20-30 basis point guidance on loan losses given the uncertain environment we're in?

The second question was following up Aman's question earlier. If I look at your exit NIM, you're looking at 315-325bps before Q4 - is that right? And secondly does the NIM grow from that level? Is it flat? Does it go down from that level? If you could provide colour on how it progresses through 2023 that would be incredibly helpful, thank you.

**Alison Rose:**

Thank you. I'll get Katie to take you through the detail, but in terms of our impairments and the outlook, what I would remind you is of the shape of our book - we have good risk discipline - the book is well diversified, it is largely a secured book, less than 4% of our group loans are unsecured lending, we're largely a fixed mortgage book. Commercial Real Estate is less than 5% of our book at 48% loan to value, our mortgage book is largely fixed at 53% loan to value and you've seen the active capital management that we've done on our books. So it's well diversified, we're proactively helping our customers, we're not seeing any significant signs of stress. So I'd just point you - as a starting point - to the shape of our book. Katie, do you want to add a bit of colour to that and take the next question?

**Katie Murray:**

Absolutely - so in terms of the assumptions, we moved from slightly below 20 to 20-30 basis points. We've updated our economics in terms of changing the weightings that we're applying to them and then we've spent a lot of time looking at the book and what we're seeing within there. What I would say and point you to is, that we still hold significant PMAs, £545m, there was a small release, that gives us some protection as we move into next year. But when we look at what we've seen in terms of how these books are performing, we look at what we think the economics could do, and how they could actually manifest themselves in terms of stage 3 and also look at the sensitivities that we had at the half year. That is what got us

comfortable in terms of that 20-30 basis points. Looking at the book, looking at what we know today, we felt that was a good place to land.

If I look at the NIM, 299bps for the quarter, we're guiding you to over 280 for the year. So there's clearly a further increase in NIM as we go into next year, and go into the last quarter. You need to take your own view of what the MPC might do next week, but looking at the market, we think we could all be comfortable there'll be more rising rates, that's obviously going to be positive for NIM as we go through. The other thing to remember as part of the NIM is the importance of the structural hedge within there; at the moment when I look at the structural hedge, it's been rolling off at 78 basis points, and we're reinvesting that at 305 basis points, so that's obviously a strong benefit. And you know from our sensitivity that in Year 1 the benefit is lower and it grows as you get the full annualised impact on that, so we're pretty comfortable on NIM and we're comfortable that income trajectory as we go into 2023 will be strong.

**Fahed Kunwar:**

Thank you. So we should grow from the exit NIM in 2023 rather than growing in Q4?

**Katie Murray:**

So when you look at the trajectory for income into next year, one would expect that to dribble into the NIM definitely.

**Fahed:**

Thanks a lot.

**Operator:**

Thank you, our next question comes from Guy Stebbings of BNP Paribas Exane, Guy, please do go ahead.

**Guy Stebbings (BNP Paribas Exane):**

Hi, good morning everyone, thanks for taking the questions. If I could firstly come back to costs one more time, I think it seems entirely reasonable you wouldn't want to hold yourself to a flat cost space next year given the inflationary backdrop and available rate tailwinds. But I would imagine that most people, and certainly consensus, assume very significant positive operating jaws next year, not far off 10%. Can I just check we're not talking about low single digit positive operating jaws and something more significant? Otherwise given anticipated revenue, if we're talking about north of 5% cost growth when only 6 months ago the guidance was 3% take out, and that level of revision looks large even set against the inflationary backdrop - maybe we can just clarify around jaws that we're not talking low single digit? That might be helpful for the market today.

And then the second question was on capital - I appreciate there's no change to headline targets, but given the more uncertain backdrop, would it be fair to think you might want to target more towards the upper end of the range to give yourself a bit more of a cushion into an uncertain environment? Thank you.

**Alison Rose:**

Thanks Guy, yes, I think you can expect to see very good positive cost jaws next year. We are continuing to focus on driving operational leverage out of the business, you can see for example the continuing improvement in things like our adoption of digital, our straight through processing and the benefit of our investment in digital and technology. So yes, you can expect to see very positive cost jaws going into next year; we definitely see the higher rate environment as a positive for us. The tail winds are greater than the head winds so we're feeling increasingly confident in our 14-16% ROTE guidance. But yes, positive cost jaws.

On capital, there's no change to our guidance. We're very clear on the 13-14%, we focused on our strategy on a well-diversified, well risk managed business. You can look at the shape of our book, we've made sure that it is in a good and secure place. We're lending responsibly into the economy, the benefits of our investment program are delivering real benefits and we're seeing continuing customer acquisition and continuing growth in our customer scores. So, I'm very confident on that, I'm not changing my guidance. Risk diversification is good, the book is performing well and we're being very proactive in how we manage it and will continue to do so going forward.

**Guy Stebbings:**

Okay, thank you.

**Operator:**

Thanks, and our next question comes from Martin Leitgeb of Goldman Sachs, please do unmute and go ahead.

**Martin Leitgeb (Goldman Sachs):**

Good morning, thank you for taking my questions. Could I just ask about revenue outlook a little more? I'm just trying to understand if the market implied policy rate outlook is correct and we're heading into a c.4% rate environment, and I'm conscious about your conservative guidance on the back of the 225 current base rate environment.

I was just wondering, with your disclosed sensitivity in terms of interest rates - £275m year one benefit from 25 bps increase - could you just help me understand how to think about the potential 2023 NII as we progress? Looking at least at consensus at this stage - it seems like a lot of the step up from 2022 to 2023 is driven by the hedge rollover which I think is around £100m a year for 25bps. I was just wondering how conservative consensus is? Secondly, with regards to deposits - and thank you very much for the new disclosure on slide 14 in terms of the split of your deposit base into interest bearing and non-interest bearing - I'm just trying to see if I understand correctly that the passthroughs you show are interest bearing only. So on a blended basis, the passthroughs so far are below 20%, and your assumption here going forward in terms of the sensitivity is around 50% pass through on the entirety of the deposit base, which implies 100% pass through on the interest bearing part? Thank you.



**Alison Rose:**

Thanks Martin, I'll let Katie dive into the detail. But we continue to take a conservative view on the path; the MPC is next week, you can see our assumptions are on the 225 - I would point you to the fact that we think the tailwinds for us going into next year are greater and there's a good benefit from that, but, there's a lot of fiscal policy being announced over the coming months and we continue to take a conservative path in our assumptions. Katie, do you want to try and answer Martin's detailed questions?

**Katie Murray:**

So, Martin, I won't comment too specifically on some of the detail of your maths but let me help you see how I think about it. When we spoke at H1, we said that the hedge was giving us, in comparison in 2021, for the full year, £600m of benefit. That's now £700m of benefit, as we've seen the improvements that have come through in the second half. What we know from the sensitivity is that that the first year, in terms of those rate benefits from the hedge movement, are lower and it grows from there, so if you look at year 2 and year 3 of your sensitivity, the managed margin stays relatively static but the hedge continues to grow. It looks like almost 100 for each of the different years and if you take that on your number of rate rises we've had that's something for you to think about.

I think we've also got a volume benefit in that the hedge has grown and also the margin benefits. Both of us give us a positive flow into income as we move into next year. As I said earlier, it's rolling off about 78bps during Q3, we put it on at an average of 305 basis points - obviously in Q4 in the early October, we'd have put it on at slightly higher than that.

So, I think that's one way to think about it, that more than offsets any pressure that we're getting in terms of the mortgage margin. So, as you can see there's a strong tailwind into the income for 2023.

When I look at the deposits - and we've given that extra disclosure, and when you get a chance Martin, you'll see in the financial supplement that we've given you the shape of the commercial book over the last number of quarters as well, so you can see how that's moved. But yes, you're absolutely right, that passthrough is on the interest bearing balances. 40% of our balances are non-interest bearing, so when we talk about the passthrough, it is looking at those that we're paying passthrough too, not those that we are not paying passthrough too.

Our sensitivity is done on the basis of 50% of any rate rise being passed through. We've always said that as rates go up a little bit, you'll see that passthrough move, the exact timing of the move will depend on what's happening in terms of market activity as well. I hope that helps you a little bit.

**Martin Leitgeb:**

Thank you, can I just follow up on the deposit comments you made earlier, that you haven't seen any meaningful migration from current account into savings account, either on the personal or corporate side at this stage?

**Alison Rose:**

No Martin we haven't and behaviourally what we've seen on our consumer deposits is a £0.4bn reduction in savings accounts, as people use their savings in the summer for example to pay for their holidays – but there's a £0.8bn increase in cash sitting in their transaction accounts. On the commercial side, as I said, we've got some very compelling fixed deposit accounts through businesses - but largely on the whole, they're wanting to stay liquid and a lot of the deposits are sitting in transaction accounts, so we're not seeing any meaningful movement. Deposits remain at elevated levels and we're not seeing those deteriorate or being spent, and a preference for liquidity, and just to give you another example - on our bounce back loans, around 24% of those are still sitting in cash in people's transaction accounts rather than paying down the loans, so there's no meaningful change.

**Martin Leitgeb:**

Thank you very much.

**Katie Murray:**

Thanks Martin.

**Operator:**

Thank you, our next question comes from Raul Sinha, JP Morgan. Raul do please go ahead.

**Raul Sinha (JP Morgan):**

Good morning, thanks very much for taking my questions. The first one to follow up, Alison, on what you were saying just now. The other banks are suggesting that the deposit passthrough on commercial and institutional deposits is going to be much higher than retail, and I think one or two competitors suggested that we should be ready for deposit betas of greater than 100% as rates go beyond 3%. So I wanted to follow up in terms of your assumptions - and I suspect you probably will update your interest rate sensitivity at Q4 for the higher rate environment - but in terms of your assumptions, is that consistent? Do you think that commercial deposit betas will be above 100% or do you think that your deposit base is perhaps slightly different?

**Alison Rose:**

I'm not going to comment on other people's assumptions but that's certainly not ours. Katie's given you the view on our assumptions and we are, as I said, watching very closely what's happening behaviourally. We've got some really compelling notice accounts for our business customers and there is a preference to stay liquid, and cash is staying in transaction accounts, so that certainly wouldn't be our assumption. We will continue to review and manage competitively on what's right for our customers. The other thing is to consider the structure and composition of deposit books - our commercial deposits sit within the ring fenced bank, where there are high levels of liquidity, so that might be a distinction between other banks that you're looking at and their comments.

**Raul Sinha:**

That's really helpful, thank you. The second question I had was on costs, I'm just looking at the implied Q4 cost number; given that your costs are up 1.8% year to date, and your guidance is cost reduction, that does imply double digit cost reduction in Q4 unless I'm getting my maths wrong? Is that fair, and can I just try and understand what might be driving that? Is there a significant item that we should be aware of in Q4?

**Alison Rose:**

So, on costs, for this year, we've reiterated our guidance very clearly, that we'll have around 3% cost reduction. I have consistently said throughout the year that it will be non-linear. The benefit of our cost reduction is coming through on the back of the investments that we make - the operational leverage we're driving through, it will be lumpy, Katie and I have both said it will be lumpy, we remain confident in the around 3% guidance for this year.

**Raul Sinha:**

Thank you very much for that. What I'm trying to understand is, is there some externality that you might be waiting to get clarity on perhaps? Perhaps the rate of inflation - where it settles - before you can give us more detailed thoughts? Because 3 months ago, you were giving us guidance on 2023, so I'm just struggling to understand why we don't have an updated guidance for 2023 now?

**Alison Rose:**

I think we've answered the question on cost going into next year. We're very confident with our guidance on costs this year, as we go into next year, we're very comfortable with positive jaws. If you look at the tailwinds going into next year, they're very strong and we are increasingly confident in our 14-16% RoTE guidance for 2023. As Katie said, the mix of that may change, but I would point to the fact we have a very strong track record and continue to have the discipline to manage our costs. On operational leverage, it's clearly a higher inflationary environment, we'll be considerate of that, but our RoTE guidance remains very strong, our tailwinds into next year remain very strong. You should be confident of positive jaws and us continuing to drive operating leverage out of the business as a result of our investment, and you can see the momentum that we're continuing to deliver.

**Raul Sinha:**

Okay, thanks very much.

**Operator:**

Thank you, our next question comes from Andrew Coombs of Citi, Andrew please unmute and go ahead.

**Andrew Coombs (Citi):**

Morning, I'll give you a break from costs. Let me ask one question on the mortgage roll and one on impairments, more broadly, and ECLs. Thank you for the additional disclosure on the mortgage book, the split between 5YR/2YR and variable is very helpful, can you just give us some thoughts - what we don't have is the time series of that, so how much of the book do you expect to roll in Q4 and then going into next year as well, that would be helpful?

And then the second question, if I look at slide 34 and 35, where you provide the stage 1, stage 2 and stage 3 coverage. The stage 3 coverage I think has dropped from 40% to 31.5% over the course of the year, I think that's probably largely to do with the move in the Ulster Bank assets but perhaps you could just clarify the driver of that, thank you.

**Alison Rose:**

Thanks Andrew, so look on the mortgage book, let me try and give you a bit more colour, so as you know our book is largely fixed, we've given you the 5 year/2 year, as we look towards the end of the year, the 70,000 customers who will roll off their fixed mortgage at the end of this year, 80% of them have already rolled into a new deal, and just to be clear 90% are on capital repayment, so it's a good quality mixed book.

There's around £51bn of fixed rates expiring by the end of 2023 and that's broadly half and half between a 2 year and a 5 year. So, that's the shape of the book.

Obviously, with our reach out program, the extension of the window, we're helping more people sort out their mortgages as they move forward, but hopefully that gives you a little bit more colour of the shape and the movements and the dynamics of the book.

**Katie Murray:**

I'll take the Ulster question. Andrew you're absolutely right, it is the movement of Ulster. If you go to page 18-20 of the IMS you can see it broken out by segment and by staging. What we did see in terms of the QoQ is that in June, £350m of stage 3 within Ulster, that's 68. And remember we talked about the mortgage book at Q2, because we'd done the transaction it would move to fair value, so it's moved out of here and is part of the fair value accounting rather than the amortised cost. So that's what's driving it, and then you can see that within the stage 3 for the main group, it's up slightly but there's not anything of any particular significance in that.

**Andrew Coombs:**

Thank you very much on the mortgage one. On the ECLs - even if I look at the disclosure in the report on page 18 and 19, looking at the numbers excluding Ulster Bank, your stage 3 coverage still looks like it dropped quite meaningfully, from 39% to around about 31%. So there seems to be something more in it than just the Ulster Bank transfer, so I don't know if it's just a function of mix or anything else you can comment on?

**Katie Murray:**

So if I look at the coverage piece there, 31%, it really will be mix, we'll have had a smaller amount of write offs in the period as we do than normal clean up. There's nothing else within there. The other thing of course to remember is, that the BBLs come through there and they mess up your numbers a little bit, just because of the way that they're dealt with. So then the question I always ask - because the BBLs are all on guarantee, they flow through but they can make a little bit of noise - what about the associated lending on the BBLs? That's in the report as well, and you can see that, that's performing very well.

**Andrew Coombs:**

Great, thank you.

**Operator:**

Our next question comes from Ed Firth, KBW, Ed please do go ahead.

**Ed Firth (KBW):**

Yeah, thanks very much. Morning everybody, I just have two questions. The first one was on cost but not about next year's target. I was thinking more conceptually about the variability you have in your cost space. The context of that is, you're clearly hugely benefiting from higher rates, but one has to imagine that at some point, the central banks will finally crack inflation and we'll start to see rates coming down then, and then a lot of NII will start working into reverse. So if, as we go through next year, we start to see rates coming down, is there quite a lot of flexibility in that cost base? Is there a chunk of investment spend that you could say - well look, we can delay that - or is the cost drag about wages and salaries which will then be baked in, ad infinitum? That's the first question.

The second question - I'm still struggling a bit with savings rates and what you pay on savers etc. If I look today, your instant access saving, you're paying 50 bps on your main account and based on your comments you're assuming that goes to, if we have a 2% rise, about 1.5%. But if I look back into 2005/6 when rates were last at the same level, you were paying 3%, so double effectively on savings. I get the answer that your customers might be financially unsophisticated and a lot of them are elderly etc. So they don't all move onto the rate so you can pay less and still fund the business, that's fine. But in terms of your conversations with regulators and politicians about withholding taxes etc. I'm still struggling honestly about why you think that is a fair rate for an oligopolistic supplier. Thanks.

**Alison Rose:**

Okay, let me try and answer that. So a couple of things just on deposits; the liquidity and funding position is fundamentally different to previous cycles. At the moment, if you look at Bank of England data, looking at deposits, there are £300bn more deposits sitting in household accounts and £25bn less debt, so deposits are inflated. I wouldn't describe my customers as elderly, vulnerable or unsophisticated at all. What you've seen with where we're directing deposits, is we're directing them in a way to help people save, youth, digital regular saver - we have a strategy of

encouraging more and more people to save and to build up resilience and we're offering competitive rates. So I think firstly, it's very different to previous cycles, secondly, I would say, we're making sure that we're passing on fairly. Thirdly, there are excess liquidity hangovers as a result of COVID, and fourthly behaviourally customers are wanting to stay in liquid positions.

I gave the example of our business accounts - at the moment we're offering some of the best fixed deposit rates in the market in terms of them wanting to fix their deposits and on the whole, businesses are wanting to stay liquid because it's largely transactional balances that they're keeping in place.

We will continue to manage our liability strategy in a way that is very competitive and also very targeted and also making sure we're passing on in a balanced and fair way to our customers. So hopefully I've answered a few of your questions. I disagree with some of your assumptions and our customers are actually very sophisticated. One of the reasons we've undertaken 600,000 financial health checks with our customers; 9 times out of 10 when we do those, we save our customers money, because we help them reorganise their budget and their balance sheet in a way that's really helpful for them. I was looking at one earlier this week where a customer was paying £2,700 a month on various credit cards and they're now paying £400 because of the actions we've taken, so we look at it across the whole budget.

On your cost questions on variability of costs. A lot of our costs are on staff, making sure that we're looking after our colleagues; we put through this year the highest pay rises that we've done in 5 years and we put an exceptional pay rise in at the half year as a permanent pay rise to help people. Obviously with our investment we are increasing automation in our business, our straight through processing that gives us a degree of flexibility in our cost space and we have significant investment as well that we can be flexible and agile with. There are fixed costs in our business clearly, but we actively manage our cost space.

**Ed Firth:**

Thanks so much.

**Katie Murray:**

Thanks Ed.

**Operator:**

Our next question comes from Jason Napier of UBS, Jason, please do go ahead.

**Jason Napier (UBS):**

Good morning, 2 quick ones please. The first is, can you just be explicit in the Bank of England rate that's assumed in the 14-16% ROTE target for next year? Secondly, thank you for slides 12 and 14, the breakdowns of the NIM walk and the deposit betas on the interest-bearing base. There's more uncertainty in some investor's minds around the durability of the tailwinds from the commercial book in particular. I wonder, is there a difference in the benefits of the hedge as pertains to that block

in particular? It certainly feels to us like the retail one's tailwinds are in train given the size of the hedge and the rates that you're putting on there. But I just wonder whether the same could be said for the tailwinds of the commercial piece, which in the last couple of quarters has been just as big for the firm the retail side. Thanks.

**Katie Murray:**

So if you look at the 14-16%; when we set that target, we had set it with a 2% and flat. We're not upgrading the target today, but what we have said is that we're increasingly confident in our 14-16% and that's really because of the strong tailwinds that we'll get and that significant movement that we'd expect to see in terms of the cost impairment guidance and the positive jaws that we're expecting to see coming through.

When I look at the hedge, the way I think about it is that there is £11bn a quarter, so about £40bn a year that rolls off on that, and we're continuing to reinvest that piece. I would say that the tailwind, it's across both retail and commercial in terms of that piece and given where the rates are and given the low level of what's rolling off and what we're putting on. Then there's this caterpillar effect that we've talked about in the past, that obviously gives us a strong tailwind as we go through, which helps support our increasing confidence on the RoTE.

**Jason Napier:**

Can I come back to the ROTE question please. The market this morning says the Bank of England is going to 4.9%. Can you hit the bottom end of your range at the 2% rate number that you had used, or can you say that you are, or aren't using 3 or 4% as your new terminal rate?

**Katie Murray:**

You've got to remember that when inflations rising that's what's pushing interest rates up, so those two things are not happening in absence of each other. So what we've seen happen since the half year is inflation expectations go up, you can see that in our economics. We always work a little bit lower than market implied, because market implied often has a frothiness that doesn't come through. So clearly as we work through that, when we came out in the half year with the 14-16% we were comfortable. Since then, the rate guidance has improved, that's naturally had an impact on the inflation aspect of things. But we're increasingly comfortable about that 14-16%, accepting we already were at June and since then the rate side has obviously been more positive.

**Jason Napier:**

Thank you.

**Operator:**

Thank you, our next question comes from Alvaro Serrano, Morgan Stanley. Please do go ahead.

**Alvaro Serrano (Morgan Stanley):**

Good morning, hopefully you can hear me okay. Two questions, one on the structural hedge and another on provisions.

On the structural hedge I've got a follow-up; my recollection was that you and other banks in early 2021 were doing shorter durations because back then we were flirting with negative rates. The question really is, if we're doing shorter duration - I think it was 2 years - is there now an outsized rollover of the structural hedge next year that we should take into account which could increase/step up the contribution to structural hedge a bit faster than the caterpillar affect that you often refer to?

The second is more conceptual on provisions and the sequencing of provisions. You obviously reiterated your guidance of less than 10bps this year which suggests provisions will be down in Q4. Is this about you intending to use the PMAs up in Q4, because obviously if you're guiding to between 20 and 30bps next year, it sounds counterintuitive. I would have thought the IFRS9 world you would be front loading, and it seems like any macro updates that you might do in Q4, you wouldn't expect to lead to any top ups? So just a bit of colour on the provisions side, what to expect? Thank you.

**Katie Murray:**

So if I take your hedge question first, we've gotten very consistent on the duration of the hedge, slightly shorter than 3 years, that hasn't particularly changed. You will recall in the first half of this year that we did do a review of the behavioural life piece, but that's going to come out in the same time length. I do recall the shorter durations but it's not something that would have any particular impact from the 2021.

So, if we look at provisions, we've done a fairly significant move on our weightings in this quarter that's caused us to recognise some additional provisions there. I think Alison and I have both talked a lot this morning about how we're just not really seeing anything in the book. So IFRS9 does talk about front loading, but it does have to have the evidence of deterioration in terms of that front loading.

I've talked about the PMAs, they're there because we do believe that things will continue to decrease. We've done a lot of work to support them in terms of looking at different cohorts of customers, whether it be retail and who's going to be more impacted etc. We're not expecting to release them significantly in the next quarter, I've always said that the release of them will be gradual as we see it coming through. So I think let's wait and see how we run our models through, but we're comfortable with the guidance we've given you to you based on what we're seeing on the book today and the update on the economics that we've shared with you this morning as well.

**Operator:**

Thank you, our last question comes from Omar Keenan of Credit Suisse, would you please go ahead Omar.



**Omar Keenan (Credit Suisse):**

Thank you, good morning both. Hope you're both doing well?

I just had 3 questions if I may. So firstly, I just wanted to ask about deposits, I appreciate your comments on deposit migration being limited. I was hoping perhaps you could give us some idea of how deposits are changing in October? Are balances growing again after the seasonality point that you made on the 3rd quarter and are you seeing any changes right now in terms of terms and mix? And if not, do you have an idea as to what level of interest rates might start to induce changing behaviours? That was my first question.

My second question was just on the structural hedge, could you elaborate on what buffers you have on modelled deposits? Lastly, on RWA rating migration, I was wondering if you could perhaps give us a sensitivity on the RWAs if house prices were to fall by 10% and also give us some help with how to think about rating migration in the corporate book? Thank you.

**Alison Rose:**

Great, thank you. On deposits, we're seeing no real change, we've seen a little bit of reversal of commercial outflows in Q3, but nothing else of note. Deposits remain pretty stable. Obviously, there are inflated deposits, I talked about the £300bn broadly across the economy - we're not yet seeing the cash burn or the rundown of deposits or particular switching of deposits out of interest, and non-interest into interest bearing. So at the moment there is a preference for people to stay transactional and liquid. I don't think it's as simple as saying there is an interest rate level that would induce change of behaviour. The dynamic we saw was interesting around retail deposits where people use their savings accounts for potentially paying for holidays, and yet transactional balances have gone up, so I think there are a couple of behavioural dynamics.

As we've been going through financial health checks with our customers, what we have seen is people using their balances to pay down credit card borrowing. We have a very small unsecured book, but as we look across broader balance sheets, people are paying down their credit card debt, building up buffers of savings, so I think as the cost of living squeeze continues to bite with higher costs and inflation you might see people use their transactional accounts to manage that expenditure. But we're not seeing significant increases in debit or credit card spending, so I don't think it's as simple as an interest rate, so we'll keep a close eye on all those elements of behaviour.

Katie, do you want to pick up the others?

**Katie Murray:**

I'll take the structural hedge and the RWA one, Omar I didn't quite catch your structural hedge question so if I answer the wrong question jump back in and correct me.

We don't share the buffer with you in terms of exactly how much we hold back, but we do take a conservative view on the eligible balances that we do hedge. We hedge

the proportion of a 12-month rolling average to make sure that we don't have any exposure to short-term variability of balances. So if things started to move, I'm very comfortable that wouldn't cause us a problem. The other thing to remember is the product hedge churns approximately £35–40bn per annum so if we did need to readjust because of customer behaviour, we would be able to do that very easily. So, I'm not concerned on that side.

Thinking about RWAs, the house price moves are important obviously and our book is 54% loan to value, so we can sustain a 10% movement in terms of the security on that book. Even the new business has got an average of 69% loan to value, so we'd be comfortable in that range we were to see that. We start to see procyclicality in RWAs when we start to see actual defaults. So one of the things on house prices, although it might move, it doesn't necessarily move in terms of defaulting on that piece because actually your mortgage is an agreed 2 or 5 year rate and so therefore the house price move might cause some anxiousness around the dinner table but it doesn't actually make any real difference on your cash flow. So we need to start to see that cyclicity.

What we've actually seen over the last number of quarters is positive procyclicality, we saw that again this quarter of 0.1 from retail and 0.6 in terms of C&I. The thing I think about is, if you remember on RWAs we do expect a further reduction this year for UBIDAC. I'd hope to see about £4bn of RWAs coming off in the quarter and then obviously what happens on lending and market volatility could move that in the other direction as well.

**Omar Keenan:**

Okay thank you. So if I've understood things correctly, in October, corporate deposits had been stable and actually some of the outflows have actually reversed and come back in. Then just on the RWA migration point, house prices, if they were to fall 10%, would not affect LGDs in the NatWest model?

**Katie Murray:**

It wouldn't have a particularly significant effect; it will clearly move it around a little bit but it's not something that we're overly concerned about.

**Omar Keenan:**

Great, thank you.

**Katie Murray:**

Thank you very much.

**Operator:**

Thank you, I'd now like to hand back to Alison for any closing comments.

**Alison Rose:**

Thank you. Thank you very much everyone for joining the call and for your questions. Katie and I are very pleased with the results that we've announced today for the quarter, it's another consistent delivery, we've seen income growth, good

performance for operating profit, we continue to grow our loan book with responsible lending, a 5.4% increase in loan growth. Our CET1 at 14.3% is moving towards our year end targets and our book is well diversified and strongly secured. We're not seeing any signs of default in our book and we're being very proactive with our customer base to support them.

We continue to meet our cost reduction target for next year and remain very confident about our 14-16% ROTE guidance for next year with very strong tailwinds going into next year as well. So, good, strong, continuing performance, deliver of strategy as you would expect, we're mindful of the environment both in terms of our customers and various fiscal events that are coming up and we'll look forward to updating you on our guidance when we talk to you in February, but hopefully you can see strong continuing performance and resilience in our business. Thank you very much.