



NatWest
Group

NatWest Group plc
Barclays Global Financial Services Conference
12th September 2023

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Aman Rakkar: Thank you, everyone. Welcome to the European track of the Barclays Global Financial Services Conference here in New York. I'm in Aman Rakkar. I lead coverage of the U.K. banks research team at Barclays. Delighted to be joined here this morning by Katie Murray, NatWest Group CFO. Katie, thank you very much for your time.

Katie Murray: Lovely to be here. Good morning, everybody.

Aman Rakkar: So, to kick in – to get into things, many U.S. and international investors with us today will be worrying about an uncertain macro backdrop in the U.K. and the implications for its banks. Given your unique vantage point, I'd be interested in your assessment of the operating environment. How would you characterize the outlook for your business?

Katie Murray: I think it's important to, first of all, just confirm the business is performing well in this environment. We've restructured it so that it can perform well in both sort of higher- and lower-rate kinds of environments. We still have maintained our guidance of this 14% to 16% RoTE in terms of what we believe we can deliver.

But certainly, there is a lot going on in the Marco. We can see that inflation has remained a bit higher and a bit longer than people expected it to. I think what's really important against that, as well, is that wage inflation is slightly above that. Now, that's causing different challenges from a cost of living and an impairment perspective. Actually, our balance sheet is relatively secure. Because although people are seeing increases in rates, they're also being paid for by their wage inflation. So, there is the inflation angle.

Interest rates, you all watch it closely. They've gone up significantly and very quickly. In our own models, we had them going up to 5.5%. At the last rate hike, they actually went up to 5.25%. The next meeting of the MPC is on the 21st. We'll see what we do there.

And I think, certainly, the narrative is and the market expectations is maybe the rate rises aren't over, but we're getting to the end of those rate rises. So, whether there's another 25 or 50 basis points come through over a couple of hikes.

But I think for us, as I look at the macro, we feel comfortable that we're able to deal with it. We've had very good performance in the first half of the year. We continue to perform well. Very comfortable about the maintenance of that 14% to 16% RoTE number.

Aman Rakkar: I guess, recent developments on the senior management front at the firm. The CEO departure. The recent appointment of – recently announced impending appointment of a new chairman. Interested in any reflections around the impact on the management team, the business. Is there a chance of a shift in any strategic direction?

Katie Murray:

I mean, I think what's really important to say is that the transfer over to Paul Thwaite was incredibly well managed. It was known that he would be the succession candidate if there was any need for a short-term succession to come in. And that was something he was aware of, the board members were all aware of. So, that, I think was really helpful and important.

And I think from a strategic perspective he's been intimately involved in the development of the strategies that we announced. He is a fully fledged CEO. If he needs to make any strategic changes, he must look at them and propose them, and the board ultimately confirms and sets the strategy.

I'm not concerned about a change in direction. If anything happened, it would be some tweaks around the edges. So, very much part of getting to where we are today and then very much part of the delivery of that.

And what's been really interesting is for the business, because Paul is very well known. He's been with the business for 20 years. He's worked here in the States. He led the C&I business with Robert Begbie. Very well known in the organization. It's been pretty seamless in terms of actually the transfer from one to the other, mainly because he has been such a big part of things.

The search for the new chairman was already announced. That was all very much underway. So, it's progressing as planned.

And then, when Rick, who I met a couple of weeks ago, is in place, he'll then take a view as to what to do around the CEO in the longer term. But for the moment, Paul is very much behind the desk and driving the business forward, as you'd expect him to.

Aman Rakkar:

I guess, a related follow-up question is a key question that we get from investors that we speak to, is the extent of government involvement in the running of the business or that relationship, noting the U.K. government still owns a significant chunk of the share base. I mean, is there anything you can shed the light on there in terms of that relationship?

Katie Murray:

I mean, I think this is the fifth time we've done this conference together, Aman, in terms of that piece. And what I can absolutely say is, hand on heart, is throughout that entire time, you know I meet the UKGI on a monthly basis, is they haven't been involved in the day-to-day running of the business. They'll have some views on REM [Remuneration], but you'd expect any major shareholder to have some views on REM. And so, that's very typical.

And it's always been very comfortable to be able to make that statement. Nothing's changed since the moments of sort of late July. I think, though, what investors need to see is the comfort that that really is the case. But certainly, from what we're experiencing on the ground, I think the particular set of circumstances which we can all recognize, they have always wanted to make sure that they were independent and very much are separated entity.

On my agenda is just to give you point of details. The very first bit on every agenda says, "Please do not pass over any insider information," in terms of that piece. So, I think it's really, they do want to be at arm's length.

I think the job that Paul and I have is to make sure that we're building a business that's delivering to our 14% to 16% returns. We're managing it at 13% to 14%, to enable them to do their continued sell-down, which they've been very public about doing, and we're very keen that they continue to return us into private ownership.

Aman Rakkar: Thanks very much for that. I guess, turning the focus to revenues, NIM - a key driver in the investment case of domestic UK banks. I guess, pressure in recent quarters has seen the lowering of market expectations for net interest income, and that's primarily driven by rising deposit costs. Can you talk about the major drivers of revenues from here? And in particular, we might expect some stability in net interest margin in the coming periods.

Katie Murray: So, if I take you to kind of what we talked about when we met at the end of July, we've got the target of around £14.8 billion for the year in terms of income. NIM is certainly one of the main KPIs. I would say, though, for us, it's an output rather than the original driver. I'm very comfortable to take actions which are income-accretive and RoTE-accretive, but could be NIM-damaging in terms of that piece. Because I feel actually in the round that that's very important.

And I think, actually, deposits are a really good example of that. As we've seen monies transfer from instant access and current accounts into term, obviously, we've tried to make sure that it goes to our term accounts rather than others. So, while that has an immediate impact on the NIM, it's more valuable for us to keep them on balance sheet than it is to not offer that product and have them go elsewhere.

So, I do think it's important when we look at NIM is to understand that it is a very important KPI. But for us, it's a bit of an output of the actions that we take, rather than the kind of sole driver.

So, then when I look at what's kind of driving NIM. So, obviously, what's happening on deposits. We were stable at the end of Q2. And what we said was kind of stable from there onwards. I think what's really interesting is the shape of those deposits. We've seen that they're now 11% fixed, versus I think we were at 4% or 6% when we started. So, that piece obviously has an impact on it.

So, the timing of rate rises, I mentioned earlier already that we thought it would be 50 basis points in August. It turned out to be 25. That has a little bit of a – I mean, that's a short-term impact on NIM, but the timing of when they happen, what passthrough decisions that we make as that comes through.

And then, also, what's happening in the mortgage market. You know that we're in this period of transition where we had written mortgages at very high rates in kind of 2020 and '21, and they're all in the final stages of rolling off. We can see that working its way largely through the book by the end of this year. There will be a little bit into early next year. So, that sort of balances down.

So, what we had sort of said was that we'd take it to around 3.15%. That does mean that in Q3 and Q4, you'd expect the NIM to be lower in the second half than the first half, to average down to 3.15%. So, I think it's important not to be surprised when that comes out to be the case.

But I do think what's really important is the management of income and the management of the RoTE, in that you're managing the whole balance sheet and all of the activity that we do, not just the net interest line.

Aman Rakkar: I mean, deposits, a key source of market focus at the moment. Key sensitivity for earnings. We're seeing deposit costs rise amid a backdrop of rising competition, political pressure, evolving customer behavior. In particular, mix shift, the transition from non-interest-bearing current account to things like term deposit. History suggests we potentially have some way to go on that transition if we look at pre-financial crisis, for example. Where do you think mix can settle from here?

Katie Murray: For me, it's one of the most interesting questions. And I think, particularly in the States, you've also had the different behaviors because of kind of the prevalence of money market funds.

But as I look at it, if we think of our non-interest-bearing, NIBBs, and our interest-bearing, with the IBBs, we were at 40/60 for many quarters. And it seemed it was really stubborn. They weren't moving. And so, that, it doesn't feel quite logical. And last quarter, we went to kind of 37/63 in terms of NIBBs and IBBs balance, and that was the beginning of that transition.

I would expect that transition to continue. And if I look at the assumptions we made for the end of this year and as we look forward to our 2025 guidance, we are expecting that to continue to move. I think what's really hard is, where does it land? And I'm not convinced that history is the best dictator of where it would land. It's what we look at all the time to try to kind of get there. But I've been surprised at how slowly they had moved to date, getting up to 11%.

And then, what I'm really interested in is if we have only one or two base rate rises to go, does that mean it starts to stabilize as well? And customer behavior kind of stables out? Then, you balance it with all customer behavior lags. So, there's still more to come.

I do think what's going to be very interesting – and we'll see, I think, some atypical behavior – where in the past we've seen passthroughs much more linked to the base rate rise, what we do know is that ourselves and many of the peer group have got significant TFSME, which was some funding that was given during COVID into banks to repay, and that repayment starts in 2024 and goes on, I think, out to 2028.

And I think as people are trying to secure some of those balances, you'll start to see some changes, I think, in terms of how they do some of the passthrough. And some of them, I think, will be quite short term. They'll be looking to raise particular amounts for a certain periods, and then it will move itself out. So, I would expect it to be a movable road from the backside as we move forward from here, and I think customer behavior will be very intriguing.

One of the debates that we have – and I know you have it as well a lot is if you haven't moved now and there's already 5.5% available, what percentage are you waiting for to move your excess funds? And I think it's interesting.

And then, to think of you get the best returns if you're willing to tie your money up for a year, people – and we particularly see this in the SME market – they really value liquidity. And actually, the tying up of funds for a longer period of time is something that they value far less.

So, that gives us lots of twists and turns. We have made, we think, pretty prudent assumptions in terms of where we think it will go. We're not at the point of where it got to in history yet, but we continue to watch, and we'll update those assumptions as we move forward. But I do think it's one of the things that it's the hardest to know at the moment in terms of that piece.

And clearly, the financials of a current account or even the instant access account versus a term account are quite different. So, to make sure you kind of have that balance. So, we were very pleased to see kind of stability in volume. And obviously, term accounts are very valuable to us from a liquidity perspective. So, although there might be a smaller margin on them, they are very valuable assets for us and the liabilities we're actually holding on our balance sheets.

Aman Rakkar: So, I guess just to round out the discussion in deposits, the FCA's implementation of Consumer Duty at the end of July. Most notably, a 14-point action plan on cash savings. Interested in your thoughts on the extent to which Consumer Duty may affect your business; the industry, more broadly. Is this the kind of thing that could see passthroughs rise? Fees cut?

Katie Murray: Well, I think what's important to say, obviously, as a large kind of High Street bank, it's something that the outcome for our customers is something that's been key to us all along. So, we probably expect to see lesser impacts on our institution. It's been a big program for us, as we've kind of gone through to make sure that we've got the right things in place. What we don't have is a history of back-group versus front-group pricing. I think that there's some very small pieces in some kind of remote parts of the bank that we need to deal with, but they're utterly immaterial. In terms of that piece of that, I think it's very helpful as we move forward from here.

I think while it's gone in place, the board itself has to attest that it's all up and working only a year from now. So, it's still got a huge focus in terms of actually are we in the right place. I think the FCA is also working at what it means to them. We have seen other players in the market make some significant changes to their fees. I mean, across different aspects, not just in banking. So, that obviously shows it's a piece of legislation and guidance that's needed to make sure that you kind of get to the right place.

But at the moment, we're obviously taking it very seriously – we have a significant project led by one of our senior executives on the ground on doing that –but we don't see it having a particular impact on us on a day-to-day basis.

Aman Rakkar: Great. We might shift to the ARS questions. We have the remote handsets on your desks. We've got six of these questions.

Katie Murray: Perfect.

Aman Rakkar: I'll do a couple now, and then we'll do some later.

Katie Murray: Super.

Aman Rakkar: Question One. Please do participate if you're in the room. "What would cause you to become more positive on NatWest shares: (1) better NII; (2) better fee income; (3) better cost savings; (4) better asset quality; (5) distributions; (6) reduction in the U.K. government stake; (7) clarity on U.K. macro?"

Top response: "Clarity on U.K. macro."

Katie Murray: A pretty emphatic point, isn't it, in terms of their responses. Look, I think any business in any country, stability and clarity on politics and macro is clearly – it's very impactful. And I need to make sure that I do the best I can on numbers (1) to (5), because those are things that are far more in my control.

Aman Rakkar: Question Two. "What are you most concerned about at NatWest: (1) weaker earnings; (2) weaker capital; (3) lower distributions; (4) reg risk; (5) political risk?" I guess that's in the context of the subdued share price for most UK banks.

Top Responses: Again, "political risk," followed by "weaker earnings."

Question Three. "How are you thinking about NII into '24: (1) growing, driven by loan growth; (2) growing, driven by hedge; (3) NII flat; (4) NII falling, given deposit headwinds; (5) NII falling, given other headwinds?;

Top response: Structure hedge.

Aman Rakkar: That kind of neatly brings me on to this topic, I guess.

Katie Murray: Perfect segue.

Aman Rakkar: Perfect segue. I guess, NIM is going through a period of adjustment right now. You've got to catch up in deposit costs. I guess you've alluded to the fact that mortgage margins are a source of margin compression at the moment. Structural hedge is a significant tailwind. Balances are shrinking, I guess, in part because things like current accounts are shifting. But this does look like a pretty substantial multiyear tailwind. So, how are you thinking about the hedge? And does it give you confidence around revenues?

Katie Murray: I mean, certainly, we've talked very openly about the strength of the hedge and the strength of that tailwind that it gives to you. So, I mean, at the moment, the hedge is £202 billion. It fell £3 billion in the quarter. What we've guided to is that by the end of the year it will go £190 billion.

Now, for us, we do it very mechanically. We look at the last 12 months of deposits, and then kind of back-calculate what the size of the hedge would be. So, you can see what we need in terms of that piece as we go forward. We had one quarter of stability and three quarters that are falling. So, the fall in the hedge is very – it's very predictable.

I think what's really important, though, to remember is that £40 billion matures every single year. At the moment, we're putting it on at around 4.4%. Earlier in the year I was talking about 3.3% and 3.6%, and now it's at 4.4%.

Interestingly, what rolls off in '24 is 80 basis points and what rolls off in '25 is at 50 basis points. So, there's a huge natural kind of benefit to that. So, even though I have a falling volume, if we see that deposit stability – and the stability needs to be both in volume and shape – if they were all to move – but it would not obviously all move – into term, then that would have an impact as well in terms of what you were hedging.

That certainly gives us confidence as we move forward from here. And just the mechanics of it, given the lower rate and the significantly – sorry, given the significantly improved rates with a lower volume, it's still is this nice strong tailwind and a very important part of the shape of our income as you move forward over the next couple of years.

Aman Rakkar: I guess the size of the hedge has increased quite significantly since 2019, kind of in line with deposit growth on the balance sheet. I guess now we're entering into a period of monetary tightening, deposit outflows, and mix shift. So, should we expect the hedge to go back to a kind of pre-COVID size in terms of notional?

Katie Murray: I'd probably liken my answer to that a little bit in terms of do you go back to the same level of term deposits. What I think it's important to do is to remember in terms of the hedge what we actually do with it. So, we are predominantly hedging current accounts and, to a much lesser extent, instant access in terms of that piece.

So, what we can see is that as people continue to keep good funds in their current accounts, you can see that kind of slowly decrease in the hedge. So, what we really need to look at with that question is actually the monetary tightening. We can see impacts of the commercial bank much more. And actually, which of our customers are being impacted by that, not necessarily immediately, but over time as well, and how that kind of flows through.

So, I think we haven't made any kind of public statement as to where we think the hedge might land over the next couple of years. I think the deposits and the shape of those deposits. I did say earlier that we've been relatively conservative around the move into term. So, I'd still expect it to shrink a little bit, but we're comfortable with the benefit that we have in that '24 and '25 rate increase, but really the shape will be very interesting for us.

Aman Rakkar: Yes. And mortgages, it feels like a difficult backdrop for mortgages in the UK. Demand is subdued. Volumes are relatively weak at system level. And spreads are low. Competition remains intense in that space, as ever. You actually seem

to have done a pretty good job of navigating that the last couple of quarters. But interested in what your take is and the outlook for the mortgage market here.

Katie Murray:

I mean, look, it has – if we think on mortgages, it came off such highs in sort of '20 and '21. And I think that '22 actually surprised everyone a little bit to the upside in terms of the strength of the continuing mortgage book. So, it's definitely much lower in this year.

We have been pleased – and as you see from the recent market data – that we've gone to 12.6% stock share. So, that's up from when we spoke before. So, we have - we view mortgages really importantly, as a really important growth area for us. We do know that they are – in the U.K., we have kind of a two- to five-year kind of model. There is something – the two and the five years is very much the initial relationship. We have sort of 77%, I think, our retention is at the moment. So, therefore, three-quarters of them you keep on for many, many years in terms of many renewal periods. So, they're very valuable both in that first moment, but also as they renew as we go forward.

But it is challenging. There's lots of competition. People ask me a lot, does the market behave in a very rational way? I think it does over a year, but you can see movements in one week or this week as we all kind of try to manage our flow, manage our balance sheet, make sure we're using the hedges we've got in place in the right kind of way.

We've always talked about that we like to write the book over time at a kind of 80 basis point piece. When swaps move up very quickly, you can see that control. And then we kind of work to how we kind of get back to that kind of around that 80 level.

So, definitely under pressure at different points in this year. But I think, again, it's one of those things that we look at a lot as very much it's income and it's RoTE impact. And very comfortable with it and what we're writing is at the right level in terms of the RoTE. So, again, a really important product for us.

It is challenging. We've invested hugely. We invest in our relationship with the brokers to make sure that it works well. And at the moment, we're kind of comfortable with the performance we've seen. And that, we see as a major continuing growth area. I think when I was here a number of years ago, I was talking about 9.7% or 9.8%. That's a huge move in terms of the size of that market over the last five years. So, we've seen significant continued growth in the book, and we would expect that to continue, going forward.

Aman Rakkar:

So, I think you alluded to it in Q2, this idea that the negative mortgage margin churn or the headwind from mortgage margin pressure is something you'd expect to kind of be a feature for the coming quarters, but thereafter, maybe we're past this headwind.

Katie Murray:

As I kind of look at it, definitely sort of Q3, Q4, it's in the future. But Q1, it kind of starts to diminish, I think. And you can see that. At the moment, the book, if I look at our published numbers, for Q2, the book was earning kind of 101. It has fallen 15 to 18 basis points each quarter for the last number of quarters as

we've seen that kind of churn. When you get to the kind of 101, then you think, well, could you talk about over time trying to write to 80 basis points. Ultimately, those things would marry. It's a bit simplistic because there's SVR, and buy-to-let and lots of other things going in there. But we're definitely reaching the end of the level of pressure that we've seen in the past, which is good to see.

Aman Rakkar: Asset quality. Clearly, many of your customers are facing a pretty significant step-up in borrowing costs, most notably your mortgage customers. And with rates set to be higher for longer, the kind of asset quality outlook is uncertain. It's a key feature of the conversations that we have with investors. It's a remarkable observation so far how benign things have been. I mean, how sustainable is this level of credit performance? And are there any particular areas of stress that you're observing in your portfolio?

Katie Murray: First of all, I would say, no, there aren't any particular areas of stress. We have obviously spent – we spend an inordinate amount of time looking at this. And if I think of it in two different buckets, if I look at the retail side, our mortgage book is now [67%] five-year. And I look at wage growth. And it's not just wage growth in 2023. It's wage growth since five years ago when you took that mortgage out. And five years ago, you'd say, well, that wasn't very much. But actually, 1%, 2% for three years, and then now 3%, and now kind of 6.5%, actually, you've had pretty significant wage growth in those five years. When I tested your mortgage at the time that you took it out, I tested you at rates that were higher than the rate that you're paying today.

And so, therefore, what we can see – and we've done a huge amount of work with this with the economics team – that, actually, the wage rises people have seen – and it's true for two-year and five-year – are bigger than the rate rises that they're seeing in their mortgage. And I think it's important to remember that they are multiyear. So, therefore, you've got multi-years of wage increases. So, therefore, that gives me some comfort.

I think the most important thing for mortgage is actually, are you employed? If you are employed, you will have had the benefit of wage rises. Now, people have taken different paths over those five years. Some people's wages will have gone down for different kinds of personal reasons. But we know – and this is where history is a really good example – we know that people will move hell and high water to pay their mortgage. So, while they might be suffering challenges as well in cost of living in their fruit basket and things like that, we know that as we look at it, actually, they're more comfortable.

So, that is why I think we're not seeing a particular issue on the retail side.

If you look to the commercial side, the economics aren't quite as neat. There's lots of different things going on within there. What we have done, as you know, over many years with our commercial group is to try to make sure that we've moved out of some of the more risky aspects of the balance sheet. We try to make sure that we trade debts that are in trouble before they get into trouble, to kind of protect us from any of those kind of impairments.

We spend – I mean, I get a weekly report from the credit team and the credit officer. We kind of talk about the funnel. What I would say, we're seeing as many things going into the funnel as we saw in 2019 – that's unchanged – but what we're actually seeing is them recovering back out of the funnel as well. And I think that COVID, in many ways, was a fantastic learning experience, particularly for the small and medium-sized businesses as to how they could manage those things, the kind of pressures, well.

I think in the U.K. press, they love to talk ourselves down. And then kind of some of the more recent reports, actually the economy is doing a bit better than we kind of realized. And we can see that when I go to visit customers. And I talk to them, and they say, "We're doing okay, but we're a bit worried about the other guys."

And so, they're doing okay. We're watching it very closely. We've got a lot of work that we do. We try to preempt people before they come into problem. And at the moment, we are rate for the – it's 12 basis points [in H1'23]. So, I mean, really very low. And we'd have to see rates move significantly or situations change quite a lot to get into that 20 to 30 guidance as we move to the second half of the year.

So, at the moment we're comfortable. We did add a bit more on to our PMA, the kind of post management adjustment that we make. About £0.5 billion of that is kind of protection against things going. So, the balance sheet is good. It's performing well. We spend a lot of time making sure we've got a strong balance sheet in that space. We are worried that things will get harder. So, that's why we put the PMAs in place. And we'll just continue to look at them as we move forward.

But at the moment, I'm not seeing any particular signs of stress in any particular areas.

Aman Rakkar: Commercial real estate has historically been a big part of your balance sheet, much less so now. But it is a market focus. People do worry about commercial real estate.

Katie Murray: I think we've changed our commercial real estate book so dramatically. It's less than 4% of the book; it used to be 20%. It used to be loan to value in excess of 100%; I think it was 120% at its worst; it's now about 47%.

What we've also done is changed a lot of where it's invested in terms of that. So, we've got more in kind of the manufacturing kind of level. If you're trying to buy a warehouse in the U.K., it's almost impossible sort of thing. And that's kind of where we're investing so as to make sure that you're looking at the right kind of pieces.

It is an area that we spend a lot of time on, and we will continue to do so. But it's not one that would have given us the worries it would have done in the past, mainly because we have shrunk it so significantly. Looking very much working with kind of prime developers, investors in the areas that we feel are the right areas as we move forward in there. That's not to say that there isn't anything in the book that we wouldn't rather not have, but in the round, we're

very comfortable with what we've got, and the size of it relative to the total is something that we are comfortable with.

Aman Rakkar: Okay. Great. Maybe we'll shift back to the ARS questions. "How do you think NatWest will perform versus market expectations for capital and dividends: (1) beat expectations, given better earnings; (2) beat expectations, given lower capital requirements; (3) miss expectations, given weaker earnings; (4) miss expectations, given higher reg requirements?"

Top response: Half the room thinks you'll "beat expectations, given better earnings."

I might actually ask a question then on the outlook for M&A across your business. So, I don't want to be too leading in the way that I ask the question.

Katie Murray: Don't worry. It's a question I'm well used to. You can ask it any way you like.

Aman Rakkar: I guess, around your fee income ambitions at the group level, I guess the net interest income tailwind has been so strong that the balance of revenues has shifted towards the interest income. I think you've been pretty clear for a while now that growing fee income is a strategic priority for the group. And hopefully, that's driven by growing fee income rather than losing net interest income. But the kind of growth rates that you'd need to deliver in order to rebalance fee income suggests that it might have to come from outside. Do you share that view? I mean, can you deliver on fee income in-house? Or do you need to go...?

Katie Murray: So, I think when you look at our fee income over a multiyear basis, you'll see that we've got a very nice CAGR that's coming through. The challenge is – and I do think it's one of the things, and Alison and I have always been very public, and Ross before her – it is misshapen. We are too dependent on net interest income. It's an absolute reality. When I look at it, it's about 20% of our income is non-interest income. It moves sometimes to 30%, depending what's happening on the top line.

So, even though we've seen nice consistent growth there, if I look at where our investment is – and a huge amount of our management effort is around how do you grow that line, how do we make sure the product that we have in there is better utilized across all of our different customers and things like that – you're going to just get that kind of 2% to 3% to 4% CAGR, which is fine. But the problem is you're not going to change it from kind of being 20%, 25% of the balance.

So, we've always been very public that when we look at acquisitions, that it is something. We're more interested in things that can move that non-interest line. I do think, though, as we look at it, it's very important for our investors. We're an entity delivering 14% to 16% earnings. It's where our price to book is now, it's relatively hard to make the case for some of the very big kind of wealth acquisitions. So, we do look at things. We're quite interested in buying kind of books of business. You've seen the acquisitions we've done to date have been very much around kind of capability.

So, we do have an active team. I spend a lot of time with them. We do look at it. If the right opportunity came up, we would certainly seek to add it. And that is the thing, I think, that would pivot that number.

But in the meantime, it's very important that a significant share of our investment portfolio goes into continuing to develop that kind of growth within that non-interest income line. But I would agree that to change it significantly, it's M&A. But I'm also very clear on the commitments and the conversations we have with our investors around returning capital and the hurdles that we would be making as part of any of those acquisitions.

Aman Rakkar: Yes. Maybe we'll shift through the last couple of ARS questions. "What do you see as the biggest risk to NatWest earnings: (1) rate cuts; (2) competition; (3) cost inflation; (4) loan losses; (5) government or regulatory intervention?"

Top responses: "Competition," followed by "government or regulatory intervention." I guess it has been a concern for European bank investors. You've seen speculation around bank taxes in places like Italy and Spain. I seem to get regular incoming from various people telling me that a bank tax could be coming in the U.K.

Katie Murray: I think it's really important to remember that the U.K. already has two bank taxes. So, it's not an area that hasn't already been accessed. So, we have the bank levy, which we pay in Q4, which costs us around £100 million. It's very much dependent on deposit levels, but think of it around sometimes a little bit higher, rarely lower, in terms of that piece. And then, we also have a 3% surcharge on our corporation tax in terms of that piece.

So, I personally don't feel that – we already are in that position. It's not something that we expect we would see more of. I said it earlier, my job is to make sure that we deliver the right investment case, but I think it would be – the government also recognizes a duty to have a very working banking system as well. So, I think we've already been taken for that.

I mean, I think competition for deposits, I think that's real. I mean, just I do think we'll see some atypical behavior. And all of these things are things I spend a lot of my time on. That one is probably the one that can have more impact than others, because of the TFSME and things like that.

So, let's see how that kind of flows through. I can see the benefits coming through certainly on the medium term on our income of the hedge and how it's going to deliver and also in our kind of continuing growth that we see in the AIEA's (Average Interest Earning Assets). But the competition and deposit piece is probably one we spend a lot of time modeling as to what it might do. But it's comfortable, obviously, on our 14% to 16% return.

Aman Rakkar: Question Six, final one. Just returning to the theme of acquisitions. "How would you view significant acquisitions at the group level: (1) very positive, given potentially higher return on investment; (2) marginally positive; (3) marginally negative; (4) very negative; (5) prefer the capital back to shareholders?"

Top responses: There's quite a balanced set of responses there. The main answer, the main response there is "prefer the capital returned to shareholders."

Katie Murray: And what's interesting is, if I take the "very positive" and "marginally positive," it kind of outstrips that. So, for me, what that tells me is, if you do something, make sure you do it wisely and that we've got the right return so that we continue to – while you could see a short pause in the capital return, it's something that comes back on place. So, actually, if you take (1) and (2) together, that's interesting to see. And we continue to look, accepting we know what our commitments and our expectations on us are.

Aman Rakkar: I mean, I guess while we're on the topic then around distributions, you're a very capital-generative bank now. I guess it's moved away from a return of surplus to driven by the underlying profit of the business, which I guess is a good transition. How do you think about the priorities for capital returns, things like buybacks? You've done specials historically.

Katie Murray: I mean, you're absolutely right. Over the last couple of quarters, we've generated kind of 50 basis points of capital a quarter. There are movements that will come through as Basel 3.1 kind of drips in. Procyclicality, we're always worried about. If I go back to my comments earlier, when we were in impairments, it's sometimes hard to kind of guess where that number is. So, the kind of RWA movement will have some impact on that.

We've always been very, very clear. A 40% dividend return. And then the excess over that, our first priority is the directed buyback. The next priority would be an in-market buyback. You'll recall I think it was summer last year that we did a very large special, because we didn't want to toggle the government back over 50% ownership. They're at 38.7% today. So, that's not something that we're so worried about. So, you could think, well, that would become less likely. But I think kind of the dividend and the directed buyback are things that are our real priorities. And then, obviously, we also use a lot of our excess capital to invest into the business, and it's very important that we continue to do that as we move forward.

I think we've talked about M&A, but we've been very clear that the capital we generate, our preference is to return it to our shareholders and to use it to continue to bring down the ownership structure of the bank. And from conversation with shareholders, that's very strong feedback that we get as well.

Aman Rakkar: We've probably got just enough time. If anyone had a question on the floor, please do put your hand up. Happy to kind of field it for Katie.

On the final question then, just on the cost base. I mean, inflation has been running high, higher than expected. I can't imagine it's easy to control the cost base in this environment. I mean, how are you doing it?

Katie Murray: You're right in your imagination. So, £7.6 billion is what we said we'll do for this year. We'll be there or thereabouts. I'm probably chasing a £10 or a £20 around the building at the moment to kind of make sure we hit the numbers. So, £7.6 billion, and that's an important number for us.

It is helped by what's been going on Ulster. There's a little bit of benefit in that piece.

But look, it has just been really important that as you manage the impact of kind of the wage inflation, that you also manage the size of your workforce in terms of that piece and how you kind of marry both those things together. So, we've made investments where we really need to, in the right kind of specialist kind of areas, whether that's in data and tech, and kind of managed elsewhere. But it's really – it's something that we've done cost takeout in NatWest for the last 15, 20 years, very kind of significantly over the last decade. It's something that is part of the DNA. It's an annual kind of cycle. We're in the conversations as we are for next year.

What we did indicate this year is that because of inflation, we would be going up rather than down. And I think as we get into 2024 and then into 2025, we've obviously got a commitment there around a 50% cost-to-income level. So, it's still huge focus.

There's only three ways you take out costs. It's people, processes, and kind of technology. And we try to work on all of those levers. What's been really pleasing for me is the amount of the activity we do now that is just digital, straight-through processing. And that's been really fundamental to make sure that our sales are done that way, credit cards are opened that way, our mortgages are managed that way. And I think just continue to take that through every single process. We have both external customers, but also internally, and I think we've still got more we can do in that space.

Aman Rakkar: Okay. Great. With that, we'll bring this session to end. Thank you very much, Katie.

Katie Murray: Lovely. Thanks a lot. And thanks for your time this morning. Take care.