Q3 Results 2017
Moderator: Ross McEwan
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Operator: This is conference # 59366016

Operator: Good morning, ladies and gentlemen. Today's conference call will be hosted by Ross McEwan, Chief Executive. Please go ahead, Ross.

Ross McEwan: Thanks very much, and good morning, everyone. Thanks for joining Ewen and I on the call this morning.

I'm pleased to say that the third quarter, we've continued to deliver on the four commitments we set out at the start of the year. We've grown income, reduced costs, made better use of our capital and, finally, we've continued to make progress on our legacy conduct issues. These are a good set of results.

Today I'll provide a brief overview of the bank's financial performance and then Ewen and I are happy to take any questions.

We've generated our third consecutive bottom-line profit of GBP 392 million in Q3. This brings our year-to-date bottom-line profit to GBP 1.3 billion, with an adjusted return on equity of 10 percent. Our core bank has continued to grow earnings, with a further GBP 1.4 billion adjusted operating profit in the third quarter. This results in a core adjusted operating profit of GBP 4.1 billion for the first 9 months -- that's up 20 percent on the same period last year. We've now delivered an average of around GBP 1.1 million in core bank adjusted operating profits in the prior eleven quarters.

Adjusted income is GBP 10 billion for the year-to-date -- that's up 11 percent on the same period last year, while the core bank delivered GBP 3.3 billion in income this quarter -- its best performance since Q1 2014.

On cost reduction, we've taken out a further GBP 708 million this year, and remain on track to head out GBP 750 million. It's the fourth consecutive year we will have hit the target we've given you. Our adjusted cost to income ratio is down to 53.9 percent from 65.9 percent on the same period last year. We also remain on track to get below the 50 percent by 2020.

Our actions on capital efficiency are well on track. We're committed to reducing our core RWAs by GBP 20 billion by Q4 2018. Excluding the volume growth, we've achieved GBP 18 billion reduction in the first 9 months of this year.

The wind up of Capital Resolution remains on track for the end of this year, with an GBP 11 billion RWA reduction year-to-date, putting us at the bottom of the GBP 15 billion to GBP 20 billion RWA range we gave you at the start of the year, that's excluding – remember -- Alawwal Bank. With the bottom line profit and continued de-risking of our balance sheet, our common equity Tier 1 ratio remains above our 13 percent target at 15.5 percent. That's a 210 basis point increase since full year 2016. And as we disclosed in our half year results, we expect a further 30 basis point uplift to come on the 1st of January 2018 on the introduction of IFRS 9.

In terms of one-offs this quarter, we had a GBP 168 million gain on the sale on the U.K. PBB and a GBP 52 million gain on the disposal in Commercial Banking.

In addition, our restructuring costs were GBP 244 million, taking us to just over GBP 1 billion for the first 9 months. On conduct and litigation, charges were GBP 125 million for the quarter and GBP 521 million for the year so far, reflecting more progress in cleaning up the past issues.

Now, touching briefly on our legacy issues. You will have seen that we have received formal approval from the European Commission on our alternative remedies package for W&G is good outcome for both the bank and for competition in the U.K. SME market, and I'm pleased to report that as we began the process of integrating Williams & Glyn into the core bank, this is the final quarter in which we will report financials for this franchise separately.

Earlier this week, the FCA published its interim report into the historic treatment of customers within GRG, and we have apologized for the mistakes that were made at that time. We're pleased, however, that the regulator has confirmed that the most serious allegations made against the bank have not been upheld.

And finally, while we again have no further update on the DOJ, we obviously would like to resolve these investigations this financial year so that the most significant legacy issues are put behind us.

Turning now to our core bank performance in more detail.

We remain on track to meet our 3 percent net lending growth target in PBB and CPB, with lending up 3.4 percent on an annualized basis for the first 9 months. We're very focused on ROE and appreciate that this loan growth poses a challenge to our net interest margin. NIM decreased 1 basis point quarter-on-quarter. But when you exclude one-off benefits in the third quarter, NIM reduced by 7 basis points. Despite this, our lending growth has generated returns well above our cost of capital.

We've focused on secured lending. And within that market, we remain within our risk appetite. And despite a very competitive mortgage market and low interest rates, our personal business has continued to grow both market share and total income in the third quarter. Our decision to increase mortgage pricing in Q2 has led to a lower flow share of around 10 percent this quarter. Despite this, our new business approvals in the third quarter were 14 percent, and we therefore expect our flow share to increase in the final quarter of 2017.

The reintegration of Williams & Glyn will also add close to 1 percent to our stock mortgage market share, and we are currently adjusting pricing because of the impacts that we have had on returns.

Our commercial business, it continues to be the largest supporter of U.K. business with a stock of close to GBP 100 billion in loans and advances. Income is up. Costs are down. And franchises delivered an adjusted ROE of 10 percent for the first 9 months.

We've grown lending in mid-corporate and SME, reflecting the sustainable long-term profits we anticipate from the sector.

Natwest Markets continues to support customers in their target markets of rates, currency and financing. Adjusted income was up 14 percent compared to the first 9 months of 2016. And while compared to Q3 2016, total adjusted income this quarter was down 24 percent or GBP 125 million. This is due to the heightened level of customer activity experienced in the third quarter of 2016 following the EU referendum result. By comparison, customer activity in Q3 2017 was at the more normal level.

Turning to what we're seeing in our book given the current economic outlook. To date, we have witnessed no notable deterioration in credit quality, although we have observed a few isolated issues relating to some sectors and customers. As ever, we will watch for signs that things are getting more difficult for our costumers. We've also given you guidance on the predicted impact that the U.K. interest rate rise will have on income in our statement today. For each 25 basis point increase, we estimate an additional GBP 175 million in income. That said, our business model is helped by, but not dependent on business rate increases to deliver good returns. Our core franchises are performing well despite the challenging rate environment.

Digital and mobile technology is revolutionizing businesses, and banking is not immune from this change. A decade ago, our branch network was the main contact point for the majority of our customers. But today, over 5 million customers now use our award-winning mobile app. Every quarter, we expand the functionality of the app. And every quarter, we're seeing increasing customer take-up. Take product sales, for instance, sales this quarter are more than double the volume we experienced in 2016, as customers increasingly turn to mobile in the first instance.

In our mortgage business, we are enhancing the latest in digital technology and innovations, making our customers lives easier. For example, in 2016 I challenged the personal bank to build a paperless mortgage delivery model. With many aspects of our customers lives moving to digital, I could not understand why we still expect that our customers visit the branch to submit hard copies of their documentation, wasting both time and money for them, and of course, the bank. And I'm pleased to report that today, Natwest offers a U.K. banking first paperless mortgage. Customers can now apply for a completely digital mortgage, which uses the latest technology to securely share and verify documents online. With this new proposition, mortgage offers can now be made within 24 hours.

You'll hear more from us in the coming quarters around how we are harnessing digital technology. The opportunity if we get this right is significant. Digital innovation enables us to serve customers more efficiently, be more responsive to their needs, and at the same time, take costs out of the business and build a more solid controlled environment.

So in summary, we have almost finished our large legacy cleanup. Our core bank continues to generate strong profits and is delivering on the 2017 financial targets we set out 9 months ago. And we remain on track to hit our longer-term 2020 targets as well. We are now entering a new phase of transforming the core bank through technology innovation and end-to-end process reengineering. Our future will be high-tech and high touch, which means lower costs, high-quality digital services with human expertise available when required.

And with that, Ewen and I are very happy to take your questions. (Over to you, operator).

Operator: … thank you – thank you, Ross. Ladies and gentlemen, if you would like to ask a question please press the "star" key followed by the digit, "one," on your telephone keypad. We will pause for a moment to give everyone an opportunity to signal for questions.

Your first question comes from the line of Michael Helsby from Bank of America.

Michael Helsby: I've got 3 questions actually. First, on costs. Ross and Ewen, you clearly delivered GBP 708 million of your planned cost save for this year. Even if I allow for the levy, looking at the run rate you've got in Q3, it does look like you should be doing better than the GBP 750 million. Are you being just too cautious there in sticking with your guidance? Or is there something going on in Q4 that we need to reflect in our numbers? Second, on Pillar 2A, Lloyd's got a surprise bump up in its requirements at the other day. I was wondering if you had an update letter? And specifically, I think Lloyd's were alluding to the fact that pensions was something that drove their increase. Clearly, pensions is something that you've consistently actually talked about in terms of where there is some residual risk in your capital base. So I was wondering if you could educate us on what the PRA is looking at when it's set in the Pillar 2A add-on for pension risks, and whether the big driver is the accounting surplus or deficit, or it's more about the actuarial position, the funding position and the market risks within the scheme. And then, finally, a broader question, actually. But I'm just mindful that open banking's around the corner. And if we take a step back from what this means for all – the witty tech guys and the cyber risks, it's all about giving customers more choice and the tools to compare prices a lot more effectively to improve switching, which for the incumbent banks it's quite a challenge, I think, from a business model point of view in the terms of pricing. Because I think it implies that the gap between front book pricing and back book pricing needs to change more rapidly, if you can take part in that revolution. So I was just wondering if that's how you see it. And how do you see open banking change in the business model in the coming years, and particularly around what it means for pricing and competition? So sorry for the wooly last question, but this gets quite interesting I think in the context of RBS.

Ross McEwan: Michael, given that it's taken you so long to ask question, we'll call at the end of the entire conference. Maybe I'll make a couple of comments on the first one around costs and maybe open banking and Ewen I will throw to you on Pillar 2, one of your expertise, Ewen. Just on costs, we have set stay with the GBP 750 million, give or take. We've done very well, but there are costs that flow through in the fourth quarter, if you look through the accounts from prior years, that there's always a quiet a year to take out. And so I would stay around that number. I wouldn't get too excited. We've told you GBP 750 million this year, we'll be there or thereabouts. So I wouldn't get too excited on that one. The cost program changes quite dramatically now over the next 2 to 3 years as well. So whilst we hate to take costs out because of restructuring of the business, coming out of things like global transactions, services, the United States, MBS business, the whole Asian operation, lots of Europe, we had to take the costs out to get to match up to revenue coming off. Now we're into a different costs take, which is around process reengineering and end-to-end processes. So I'd sort of stick with the guidance on that, if you don't mind. And so Ewen on Pillar 2, and then I'll come back with open banking.

Ewen Stevenson: Yes. On Pillar 2A, for us, I think you shouldn't expect any material change in our Pillar 2A requirements. As you pointed out, Michael, we did put GBP 4.2 billion into our pension plan at the start of last year. In return for that, we pushed back the next valuation until the end of 2018, and we need to conclude any negotiations with the pension trustee on additional contributions by Q1 2020. For us, we do have slightly different accounting capital treatment and that as and when we do agree those additional contributions, we will need to reflect them immediately into our capital ways, which is obviously different to the treatment of some others. Because we are running a substantive accounting and the actuarial surpluses based on our current assumptions, which you can find in the 2016 annual report, if you want to play around with the actuarial assumptions in there, but I think your question is probably more directed to Lloyd's than us, Michael, in terms of why their Pillar 2A changes as a result of pensions.

Ross McEwan: Still, open banking; it's a bit of the unknown really as to what customers will do. The research shows that very few customers will actually allow people to scrape their data and move it across. So I think there is -- in this different behaviors showing through of what customers will do based to an age groupings as well. So I think you should see this as a uniform. Everybody's going to want their data scraped and moved across to get a better deal from somewhere else. I think it's going to be a quite cautionary at the start of the day now the huge market I think will be far more active and open, but I think those who probably sit with the money will be a lot more cautionary. And I think I want to know if I do have my data scraped, who is going to pay if things go wrong, and I think that's a big issue that needs to be thought through. So we have been building the model so that we can work with the legislation on being able to have our APIs around our transaction business that can be looked into and also from we can look into others. So that's in place. And we will look at some areas that we think we can be quite proactive for customers as well on how do we show them some advantages of being with us as a bank that we'll reveal next year. So this is both defensive and there is an offensive play in open banking, and we'll be both of those. But I don't think we should expect in the early stages of this little customers are going to open up and say, please take my data. I just don't think it's going to be happening. It's maybe different in insurance, but I think it's to banking, I think people are much more cautious about where their information goes. And particularly, when there's a whole group of people that are currently trying to steal data anyway, I think people are much more attuned and cautious. So I think we've got to be very careful how we deal with customers data. And I think customers will look to see who is going to look after us if things go wrong.

Operator: The next question comes from the line of Joseph Dickerson from Jefferies.

Joseph Dickerson: Can you just on -- a couple of things. Just on the DOJ, could you give us some sense of new discussion? You said you'd like to have it resolved by the end of the financial year. And we're obviously late October, just if there's any -- what conviction -- what your conviction level is around getting this done so that you can be profitable in 2018? And then, secondly, just if I look on Slide 14 of the slide deck, the net promoter scores in business banking continued to deteriorate. Can you discuss why you think that is? And any efforts that you're trying to undertake to that turn around, because I suspect it would help volume growth and return in that business.

Ross McEwan: Maybe you take the first one on DOJ and I'll pick up the net promoter scores in business banking.

Ewen Stevenson: Yes. Look, you're obviously right, as the year progresses, we still got 4 months obviously until our financial year-end, so in terms of reporting, so we continued to be hopeful that we will get things resolved with the DOJ. There are sort of low-level discussions going on, and we remain hopeful. So I'd also distinguish between the accounting, provisioning and settlement depending on where those discussions are over the coming months. There's always a possibility that, that would give us the ability to reconsider the provisions we've got, which are just over $3 billion today.

Ross McEwan: Just from the business banking, I'm quite disappointed in the net promoter scores, but we have done a fundamental rethink of how that business operates. 3 years ago, that business was not giving us a return on capital that we expected from it. It was probably around the 6 percent to 7 percent. We've done made a lot of changes to that business around its pricing, and it helped goes to market. 80-odd-percent of customers now in this very small end of that marketplace go online to actually get a business banking account with us. They don't come through a relationship manager or even a branch. Now they have just to go online to open up an account, so you're seeing some quite big changes. We made some fundamental changes. You may recall in our commercial business, about 3 years ago, dipped the actual net promoter scores quite badly, and now you're seeing them best in market again. We're making some quite big changes in this business around how it operates. And we are confident that we're getting pretty close to the bottom end of this before they start rising again. And we've got quite a few different service propositions coming at the customers, both small and medium as well. So I'm confident that we are on the right track. We have to make the adjustments to it. It wasn't getting a return that we would be comfortable with now, and I think you'll see it changing.

Operator: The next question comes from the line of Andrew Coombs from Citigroup.

Andrew Coombs: If I could ask one on interest rate sensitivity and then one on the commercial losses. On the interest rate sensitivity, you're growing to GBP 175 million in the next 12 months, I mean a 25 bps hike. That's quite a bit high if you have in your annual report, I think with GBP 96 million at end '16. So I just wondering what's changed in your assumptions there. And also, would it be possible to provide the impact in year 2 and 3 as well? And in the second question, commercial losses. The GBP 151 million you draw out, was that spread across the board number of names, or were there a specific name single exposure in that?

Ross McEwan: I'll take the last one, and you get the first. There was one single name in there, Andy. We're obviously not going to disclose who, what that was, but there was maybe not around by a single name.

Ewen Stevenson: Yes. On interest rate sensitivity, I guess if you look at the half year, Andy, it was GBP 209 million, I think, and to GBP 175 million, so it's actually reduced. We haven't provided disclosure on year 2, year 3, but I think you can play through the mesh with what is happening with our structural hedge, and you can factor that in, but we haven't provided the year 2 and the year 3 disclosure [inaudible].

Andrew Coombs: I guess just following on that. With your peers, when they've guided year 2 and 3, a lot of the benefit comes through in year 2 and 3, with yourselves because you have a bigger current account franchise, I would assume that more of the benefit will come through in year 1, albeit there will be some (inaudible) in year 2 and 3, is that fair?

Ewen Stevenson: Yes. Look, I mean, I think we give a pretty detailed disclosure on our structural hedging, and I think you can sort of model that through and assume that builds over time, we sort of aggressively put it on and take it off, so you should be able to model that out.

Operator: The next question comes from the line of Claire Kane from Credit Suisse.

Claire Kane: And so 2 questions, please. Firstly, on the NIM, can you tell us if we should expect any more of an impact from liquidity into Q4 if it's just an averaging effect from Q3? And also, if you could update us on where you see the front-book, back-book mortgage margin differential. And I noticed the U.K. PBB NIM has declined by a lot less this quarter than last quarter. And then, secondly, on mortgages. Just maybe if you could comment on the competitive environments this quarter, if you seeing still a good demand, if you think there's any impact from some of your peers being more active, and if you (inaudible) widespread and rate increases which may help on the margin outlook.

Ross McEwan: Claire, I'll pick up on just on the mortgages piece, then flip to Ewen for the NIM pieces. Look, it is a strong competitive back up place out there. Is it any stronger in Q3 than it was in Q2? I don't think so. I think it has been all year quite a strong marketplace, but I know there would be lots of players saying they're coming into the market. But at this stage, on Q3, on approvals, we were up to 14 percent. But the reason we were down in Q2 is we did try to move the pricing up a bit, and we sort of left on their own and knock about 10 percent, or 10 percent or 11 percent in that in the second quarter, which then flows through into the third quarter, but we've seen very strong flows in Q3, which will flow to Q4. So, comfortable with that mortgage progress. I'd say we are focusing on it. We're being cautious about where we are focusing, but our distribution is very strong.

Ewen Stevenson: Yes. Just also this is obviously the final quarter that we're going to be reporting Williams & Glyn as a separate business, so you should all expect next quarter that we be about a 1 percent of additional stock and flow market share into our mortgage numbers in U.K. PBB. And just flying that through to the NIM question, Claire, that the front book is still pricing today at about 40 basis points lower than the back book. So there hasn't been a dramatic change in the competitive environment. I know some of our peers have been talking about seeking to grow more assertively into mortgages, but we're continuing to see with that sort of 14 percent application share pretty consistent, 13 percent, 14 percent flow that we have seen for a long time. On NIM, overall, I think the liquidity impact that we've highlighted in the slides of about 4 basis points, that was a result of averaging in Q2 to build up those liquidity buffers, and we'll continue to, I think, run high liquidity through to gain to quite a certainty around DOJ. But I don't think that will impact Q4. The 3, 4 -- the 3 -- we previously talked about 3 or 4 basis points a quarter of NIM per share just coming through a combination of what we talked about earlier, the front book, back book phenomena in mortgages, the shift towards mortgages, over other parts of the portfolio and the ongoing roll of a structural hedge. If you combine that with 6 basis points of sort of one-offs, you could expect that NIM will be down 10-odd basis points in Q4.

Operator: Your next question comes from the line of Jonathan Pierce from Exane.

Jonathan Pierce: 3 and hopefully quick ones. The first one - just back on the rate sensitivity. Obviously, there's a parallel shift in your cast. Would I be right in assuming that if you had a 25 basis point increase at the short end, we move into the longer end, most of that GBP 175 million would still come through because of the time it takes to structure hedge to reprice that? That's the first question. The second question - coming back to costs and thinking again about a 2020 cost target. It's obviously where consensus I think it's probably the most variance with your target. It might be helpful if you can just set out again in 2017 that this is a lumpy item that you should drop away over the next 3 years like expense, investment spend, Williams & Glyn overspend, those kind of things? And then the third, just point of clarity, because clearly, the return on tangible equity targets are sense will be based on a 13 percent equity tier 1 ratio. I understand you're probably factoring in some degree of RWA inflation as well, so maybe you could clarify what level of RWA inflation you are assuming for both PRA, mortgage risk rates and anything that might come on Basel IV within those targets?

Ewen Stevenson: Okay. So just, well, perhaps in reverse order, the RWA inflation, just again, to clarify, we said we're going to take GBP 20 billion of core RWAs on a gross basis out of the core bank. We've taken -- by the end of next year, we've taken 10 out so far in the first 9 months of this year, and so we feel sort of comfortably on track to deliver that. At this point, there will obviously be growth through that period. IFRS 16, and real estate coming back on balance sheet will be about a GBP 2 billion to GBP 3 billion impact. We've talked about the PRA mortgage floors, which for us will be about a GBP 12 billion, we think, impact on RWAs now pushed back until the second half of 2020. And on top of that, we've assumed about a 10 percent overall uplift in RWAs as a result of Basel III amendments. How that hits us, I think, depends very much on what come through in terms of the final rules if they get the final rules on credit and operational risks. And therefore, whether they're more binding than our footfalls or the reverse, but I guess the other thing, we've assumed that those will be in our 2020 targets, including the mortgage floors. So it's more likely that, that RWA uplift now looks starting to hit in 2021 than overall in 2020.

Jonathan Pierce: Okay, I'm so sorry to come back. Just to be clear, your return on tangible equity aspiration of an at least 12 percent on a 13 percent equity tier 1 ratio is taken into accounts all of those different banks, including Basel?

Ross McEwan: Yes.

Ewen Stevenson: Then and the other thing I just add on that, obviously, is a return to tangible equity. So if you think about it in core tier 1 terms, it's a slightly higher return in core Tier 1 terms. On 2020 consensus cost targets, you're right. I mean where I wouldn't say it's just costs. We have a stronger view than the market. We obviously believe that we can continue to grow volumes and income faster than, I think, the market will give us credit for. And we think as we continue to sort of demonstrate the fact that we're continuing to grow faster than market in commercial where we want to grow mortgages, that gap should close over time on costs. Today, I think at least a few days ago, consensus all of them we're sitting at GBP 6.8 billion versus a GBP 6.4 billion target. We need to strip out about an additional GBP 1.5 billion of costs post this year in order to get to probably an underlying cost of about GBP 6.1 billion or so. And then we're assuming there will be some regular run rate combination of restructuring and conduct costs on top of that. In order to do that, we previously talked about taking the cost structure, Natwest Markets down from GBP 1.3 billion to about GBP 800 million. And GBP 100 million of that is just remediation costs dropping out over time. About GBP 200 million of that is expense -- currently expensed, investment spend as part of about a GBP 500 million or GBP 600 million multi-year investments spend that won't drop out until mid-2019 that we're effectively redoing all of the systems of markets to allow us to take out about GBP 200 million of back office costs as a result of that. Williams & Glyn, this will be the final quarter of reporting, but you can see the cost structure there, it's very much, I guess, people should think about as a sort of classic in-market synergy case and base your assumptions on that. Yes, unlike normal end markets, synergy cases so, this is a bank that's already on our systems, already has our processes. So -- and we'll update the market, I think probably in Q4 about where we think the restructuring costs will be on that. And then as Ross referred to earlier, yes, for the rest of the bank, I think it's just fundamentally core process reengineering. And I think almost every process that we choose to look at the moment, we see a pretty significant opportunity to take costs out with really some real benefits now coming through with some of the developments in technology. In terms of rate sensitivity, we had a 25 basis point increase in rates if that was to come through over the next week, the -- I think the savings, managed rate is more dependent on the base rate. And obviously, we've got the structural hedge that sort of rolls of over 5 years and 10 years for the equity. But overall, I think in terms of a base rate wise, if it was to come through next week, partly it depends on what the competitive response of others is, some of that would obviously be passed through to customers as well, but I think we'll be in a better place to guide people once we see whether that rate rise comes in and what the competitive response is.

Operator: The next question comes from the line of Rohith Chandra-Rajan from Barclays.

Rohith Chandra-Rajan: Three hopefully quite quick ones. The first, just to clarify, just on the structural hedge, I mean your guidance I think on the kind of the underlying margin progression is not much changed from what you were talking about it in Q2. So I just wanted to check that the kind of the structure and the yields on the structural hedge hadn't really changed materially from what you've disclosed in Q2. So that was one. And just on Natwest Markets, I think in Ross' comments, he meant -- or yes, Ross mentioned earlier that kind of customer activity levels that you saw in the third quarter were what you would consider normal, the same goes for the income, or is there some seasonality there that we should think about? And then finally, just on DOJ, just wondering if whether your interaction with the DOJ has changed over the last few months.

Ewen Stevenson: So for the DOJ, I would say rather to the first few months of the year, there's definitely been increased dialogue with the DOJ. It was obviously, as you'll appreciate, Rohith, with your own parents, there was a flurry sort of activity prior to the last administration leaving, and then it went very quiet for a while, so -- but certainly dialogue has sort of picked up over the last quarter and so. On Natwest Markets, I mean, I think you've seen across everyone reporting in fact that rates FX, customer activity has been lower in Q3. This year, it was obviously very, very high last year on the back of Brexit, whether it represents more normal levels. We previously guided to the fact that we think we're building a business model which should able to sustain itself on income of about GBP 1.5 billion for the full year. We're currently sitting at about GBP 1.4 billion through the first 9 months. So we are happy with the performance of the business so far this year, performing better than we may have expected. But I think looking out to next year, we would certainly expect activity levels to potentially be a bit lower. And on the structural hedging, nothing really new has changed. I guess the one other thing to note will just be we previously talked about the fact that our disclosures cover the main operating entities, but there is additional structural hedging around things like and Royal Bank of Scotland International and Ulster bank which will be in about the order of about GBP 25 billion of additional hedging.

Rohith Chandra-Rajan: And the spread on that is similar to what disclosed on the -- what you disclosed for the main hedge?

Ewen Stevenson: Yes. Although one of them is obviously in euros.

Rohith Chandra-Rajan: Right. And similar duration?

Ewen Stevenson: Yes.

Operator: The next question comes from the line of David Lock from Deutsche Bank.

David Lock: And I've got a couple, please. First one is on the central items. I was just wondering if you could help me, because if I take the GBP 39 million of adjusted income, and then I adjust for the items on page five release relating to central, so I'm getting about GBP 85 million of income in central in this quarter. Just wondered if you could let me know kind of what's within that GBP 85 million. Is any of that sustainable? Or should we assume really that goes away and is a one-off?

And then the second question relates to Ulster Bank. I see you've had had some releases again this quarter. I just wondered if you could remind us what property price assumption you are using in Ireland at the moment? Thank you.

Ewen Stevenson: Yes. So look, we've previously sort of guided the central items being 0 over time, they continue not to be 0, but certainly the rate of volatility around 0 has reduced a lot this year. There are sort of 5 or 6 smaller items in there, and none of them are what I would describe as sustainable. So I think, yes, we're comfortable people modeling 0 for central items.

On Ulster Bank, we model as we do across the bank on consensus. So if there was a consensus view on Irish house price growth, that would be consensus view that we would be using.

David Lock: And just to follow-up on that actually, in the last week, there's been a lot of media and political focus on the tracker mortgage investigation and Ulster Bank is obviously mentioned as part of that. I just wondered if you confirm that you don't really expect any material change to provisions in that business relating to that investigation? Thank you.

Ewen Stevenson: Yes. Just we obviously put a press release out a couple of days ago, but just to give everyone the facts. We've got about 3,500 cases that we're currently doing a full review on. We currently paid out on about 100 of those. We expect to have completed payments on 1,000 by the end of this year and about 2,500 by the end of Q1 and to have completed it by the end of Q2. We've got a current provision of just over EUR200 million that we think covers us for what I've just described. So overall, for the time being, we're comfortable with our provisioning, but -- so nothing really further to add beyond that.

Operator: The next question comes from the line of Edward Firth from KBW.

Edward Firth: Could I just have 2 quick questions. Actually, one was just to clarify. You said you thought that the margin in Q4 will be 10 basis points down. Was that -- so are we talking there for the group margins? So effectively, the 212 becomes 2 02? So I guess that is...

Ewen Stevenson: Yes.

Edward Firth: Okay. And are you assuming we have a rate rise next week in that or not?

Ewen Stevenson: Well, no. so and we're obviously if the rate rise comes through next week, we're almost halfway through the quarter, and so I don't think it would have a material impact on Q4 NIM.

Edward Firth: But it might do I guess into Q1 next year and beyond? So I guess that was just a detail question. I guess the broader question was, if I look at some of bank of England data, it does appear that there is some pricing pressure I guess apparent already in some areas of the customer or personal deposit market or a funding market. And I noticed that you continue to grow your customer deposit quite strongly in contrast, I guess, to some of your peers who seemed to be focusing more on the wholesale side. How do you look at that? And how do you look at that in terms of your margin progression? Whether you're going to be stepping into the personal market of wholesale funding for the business?

Ewen Stevenson: I mean, we have been -- I mean as you've seen this year, we have been trying to diversify some of our funding sources. We did a large covered bond financing early on this year, which is our first for many years. We disclosed around deposit NIM. Then there wasn't anything unusual going on for us. Most of our deposits are priced at or below 10 basis points currently. So obviously, depending on what happens next week, we -- there's likely to be some impact on that, but there's nothing particularly that we're seeing. I think, obviously, the challenge of banks probably already starting to think about what happens when term funding scheme rolls off. And I guess that's beginning to have an impact around how they are thinking about their funding strategies, which may be flowing through to the deposit market. But as you've seen with the growth in our deposits, I think we are able to fund the growth that we're putting on at the moment with deposit growth.

Edward Firth: So some of the pressure you're seeing is not specifically funding-orientated? It's more about continued competitive pressure on the assets side?

Ewen Stevenson: Yes, so I don't think I said that we were feeling pressure on the deposits side.

Ewen Stevenson: I think we are seeing ongoing pressure between front book and bank book pricing and mortgages. But -- and you can see in our commercial book, which is also significant for us, and NIM actually went up in the quarter as we continue to reposition that portfolio away from lower returning to higher returning exposures.

Ross McEwan: The pressure on NIM is really liquidity piece which we've been building up for different reasons. It's been around our shift to secure from unsecured. And this is a competitive marketplace. That's where our pressures come and it hasn’t come from the deposit side. We've been funding quite nicely in the deposit side across that, we haven't seen huge pressures in it.

Operator: The next question comes from the line of Martin Leitgeb from Goldman Sachs.

Martin Leitgeb: Could I have 3, please? The first one is again to go back to mortgage competition and your strategy in domestic mortgages. And what we pick up from some of the industry data is that the swap rates have risen quite sharply in the third quarter, but mortgage pricing has lagged in terms of trying to make up for that higher funding costs. And similarly, there seems to be some pressure, upward pressure on the one-year deposit rate according to the latest Bank of England data, which all suggests that competition finally has probably continued to intensify during the course of the third quarter. Is that something you see? And more broad, how should we now think about RBS's mortgage strategy going forward? Because from the way I think about it, there’s two conflicting strategy for positions here.

On one hand, RBS seems to have a lot of excess liquidity, excess deposits and their liquidity book on top of that. On the other hand, there seems to be a conscious decision to drive up pricing or to focus on pricing and margins and to consciously [inaudible] less business than your liquidity and probably internal marginal pricing decision would allow for. So when you have to balance growth versus margin, how should we think about that going forward? The second question, briefly on stress tests. And if I recall right from last year's stress tests, litigation seems to have been one of the major items driving the large drawdown in terms of stress core tier 1. How should we think about this in this year's stress tests? Because #1, you settled a couple of items in the meantime and then for outstanding items, you have significantly increased provision. Would it be fair to assume that, that drawdown this time around should be significantly less in? And thirdly, just to confirm, the acquisition ban, has that come off now following the Williams & Glyn agreement? Or is that still pending? Or is this something you consider (inaudible) for you?

Ross McEwan: First off, on the acquisition ban, that has been listed other than in the SME marketplace where we restricted that, to something that had SME market share, I think it's a very small number of customers we could take, other than that has been lifted. Secondly, on the stress tests, you're right. With FHFA out-of-the-way, some of that thumb on the scales will have disappeared, but we don't know how the regulator will take the left [inaudible] DOJ if we haven't settled by the time, probably next month. So it will still weigh on us, but to what extent, we've got no idea. On the mortgage front, I think, Matt, what you're missing and I think people have missed in the mortgage area, yes, it's very competitive, but you have to have good distribution, and we've been building distribution for the last 4 years. So it's around -- there's much around distribution. We'll be there on pricing. That's what we've already said. We're not going to leave the pricing up or down. We tried that, it didn't work. So really, and we've said we moved to the pricing because of the swap rate changes, so we'll see what happens over the next few months. But Q3 for us, 14 percent of the applications coming on aftermarket want be strong provision.

Ewen Stevenson: But we talked in Q2 about [inaudible] basis points differential between front book and back book. We're talking at the end of Q3 about [inaudible] basis points differential. So you can see the NIM will contract because of it.

Operator: The next question comes from the line of Ibrahim Sahid from Deutsche Bank.

Ibrahim Sahid: I just had a question with respect to your legacy Tier 1. And just on call policy, obviously, you provided some clarity at the Q2. And on the equity accounting instruments, is it fair to assume that for those that aren't sterling-denominated, you would potentially not call those till you have settled DOJ? i.e. if anything had a sort of negative impact in your CET1, you would not be calling it till you've resolved DOJ?

Ewen Stevenson: The legacy capital – with our legacy securities, I don't think it's DOJ related at this point. I mean it's still very much driven by all of the things that we've talked about previously in terms of what the right economic decision is for us, whether carry ongoing regulatory benefit for us, et cetera, the currency (therein), but it's not DOJ-related.

Operator: The next question comes from the line of Robert Noble from RBC.

Robert Noble: Can I just ask about the U.K. mortgage book; it's growing at around about 8 percent year-on-year. And I was wondering, your LTVs on your front book is 70 percent, I think you say it's much higher than the back book. So should I expect RWAs to increase relative to loans over time? Or is it captured by the add-on and the mortgage floor that you're going to put on in 2020?

Ross McEwan: LTVs has actually been I thought coming down. So we just need to get you the numbers on that, but if you have to look at the LTV, it's been pretty stable or down.

Ewen Stevenson: Yes. I mean the LTV has been about 70 percent year-on-year. The stock is in the sort of mid-50s, nothing's really been changed there. Because I mean, you have -- continued to have price inflation, continued paydown, but those metrics are being relatively stable. I think if you look on the Bank of England stress test results, you can see that there's relatively low levels of stress in the mortgage portfolio. When we look at the risk adjusted returns that we're getting on them even on lower front book rates, we still think its a very attractive business to put on even if you overlay mortgage flows on top of that, we think its in the shareholders interest that we continue to grow market share in mortgages given the returns we're getting on it.

Robert Noble: Okay. And then just one question on the commercial loan growth. I see that's one negative obviously I presume due to your RWA reduction plan, so I'm just wondering if you can comment on corporate demand in general in U.K. is it slowing? Any impacts from sort of weaker economics? That's all.

Ross McEwan: We took a part of the book off in the last quarter, so that would have damaged to see the outstanding. It's been I'd say I described as okay. It hasn't been outstanding. The growth, that's been okay, and we've been quite comfortable in the market we want to operate, still some growth there have been.

Ewen Stevenson: Yes. And we think in terms of the markets that we want to grow in with either keeping or taking share. But after GBP 10 billion of RWA reduction that's come out of the core, GBP 6.3 billion out of CPB. So that's why that overall book is shrinking. But I think you can see again if you look at sort of pre-impairment returns that that shift out of legacy positions that we've got on commercial into higher returning new business is actually benefiting returns overall.

Operator: The next question comes from the line of Fahed Kunwar from Redburn.

Fahed Kunwar: Just a couple of questions there. So a really interesting point on the margin. Just for the next quarter, I think consensus has your NII falling in the fourth quarter, I mean does that sound about right considering the margin hit you're taking? And then also I just want to get your view on the TFS. So clearly, the challenger banks can no longer access the lower cheap fundings, the drawdown periods pending.

Do you think this time considering you've stepped up mortgage rates again, there's a higher probability in the market policy where it didn't in the third quarter? And then my second point, on Natwest Markets, thanks for the extra disclosure, but I take a kind of GBP 300 million you talked about in terms of remediation and investment. There's still a 10 percent cut in the cost base with flat revenues and Barclays was saying yesterday that and you can't cut your way to growth either [inaudible]. How do you think you managed to cut costs 10 percent from here and still kind of keep a flattish revenue outlook?

Ross McEwan: I'll take on the last one, You can carry again on the margin which seems to be your forte. You've got to remember, when the markets start, this business had multiple layers of systems applications, data levels and all sorts and we completely replatforming this business, so there has 1 core system and 1 core database which takes a lot of the back end out of this business. So there will be more than a 10 percent reduction in the cost base out of this business or out of its core. And Chris and the team have shown it. So I'm pleased Ewen talked about there is last -- this year, we have seen over GBP 200 million on it. And next year, we'll pretty much the same to actually replatform this business, and that's all being expensed. So we are confident that this business will get its cost out quite dramatically and do better service, 70-plus percent of the business being done now in the Rates and FX, are all electronics. So you've got to be there and spending the money on the technology, and it will be over time become less and less people involved in it.

Ewen Stevenson: Yes, so just to sort of add to what Ross was saying, and I don't think you should see any dramatic change in the front office structure other than what's happening in the markets in terms of the shift from people being involved, [inaudible] at current trading. But we are very comfortable with the numbers. We've been talking about for a long time. And I guess, this question you should address to others why they're not able to take costs out of their investment bank. On net interest income for Q4, I guess we've never been in the business of forecasting net interest income one quarter forward. We've given you the guidance on where we expect NIM to go. You can do your own assumptions on volumes and come up with your own views.

Fahed Kunwar: And just on the TFS point, and how you think mortgage rates kind of progressed from here?

Ewen Stevenson: Yes, I mean, look, I have said previously that TFS we view as a net negative for us, while we've obviously drawn down on it, it has, I think empowered some competition around us. That competition, I think, as we talked about earlier on this call, is going to struggle to raise funding at 25 basis points. So we -- that could have some benefit. Equally, some of the larger banks are signaling greater interest and competing more actively in the mortgage market than they were previously. So we are not expecting or forecasting any dramatic difference in competitive pressures in the mortgage market.

Operator: The next question comes from the line of Raul Sinha, JPMorgan.

Raul Sinha: Just 2 to finish off then. Firstly, on asset quality, these are small numbers, but UK retail impairment has been going up steadily for the last 6 quarters now. And obviously, this quarter was a bit higher than what I was thinking about. So could you maybe elaborate a little bit on both U.K. retail and commercial in terms of what are the trends you're seeing, if they're just normalization given the amount of loan growth you're putting onto the balance sheet? Are there sort of trends that you did call out initially that you are watching very closely now? And related to that, I think on the commercial side, we've seen 3 kind of banks, yourselves, Lloyd's I think Handelsbanken take a big spike -- big charge on commercial. So I was wondering, given you're usually more helpful than some of the other banks, could you give us some indication of what sector or what area was that something of a trend?

And would you also have some thoughts on IFRS 9 and the implication for the impairment on the ongoing business as they develop from here? That's the first one. The second one, just very quickly, I promise it won't be long. Well, just the secondary on the consumer credit. Obviously, you've also been quite open about the issues in the market, especially in the credit card space. But now we've had the PRA do its review, and we've seen some of the headline implications of that. I guess you guys are closer to it on the implementation side. So I was just wondering if you can talk a little bit about your strategy on cards. It does look to me like you might be entering or reentering the market in your own way, so some color on that will be useful.

Ross McEwan: I'll take the last one and we'll go back to the asset quality. On the consumer credit, look, we stay out of the 0 balance credit because of customers not really understanding when they end up back on the higher interest rate. So many of them are not paying down any of the principal on these loans nowadays. I think has some worrying effects from my perspective. We did look at the market with quite a different way, got a very tidy product set, he was looking to go into the market. And with such growth in credit cards at 10 percent, we just sort of pause until we get that, and we have a look at the first quarter of next year. And consumer credit, and then you're 10 percent, and I think we've got to be very careful when a market grows at 10 percent, rates are growing at 2, so that's the worrying factor. On asset quality…

Ewen Stevenson: Yes. On asset quality, a few things - firstly, on U.K. PBB, there is something going on gross vs net, the difference. We've obviously did a debt sale in Q3. That was GBP 168 million benefit in the numbers going forward, that will mean that the impairment costs will be about GBP 12 million higher per quarter. So there is nothing -- if you look at the underlying gross inflow into U.K. PBB, nothing's really changed. But going forward, those impairments you should model in extra GBP 12 million a quarter. On commercial, you probably haven't had the chance yet to get into our financial supplement, but we do provide industry disclosure in there where you can look at where those impairments have been.

As Ross said earlier, really driven by a single name impairment. We don't think anything that we can see represent a trend at this point. Obviously, the economy is slow. But equally, there's a lot of other things going on at the moment and pleading the increasing impact of technology disruption going on across various sectors, and sort of areas and issues about the impact of minimum wages, but nothing that we would call out particularly. On IFRS 9, we've obviously given you the day 1 impact. No reasons to change that view at this point. In terms of as we get into next year, yes, we do expect you will see increased volatility, as we talked about earlier, previously, on earnings, given that the cyclical impact of IFRS 9, yet for us, I think portfolio is probably more sensitive to that are our small business portfolios. And for others, I would say, portfolios like consumer credit and the emerging market credit probably given how they perform in cycles.

Ross McEwan: Okay. That I think that's all the callers. Maybe I'll just wrap up. First off, thanks Ewen for joining me on the call today. And I just reiterate, we do what we said we would. We've grown income. We've reduced costs. We've improved the capital efficiency. And we've continued to focus on resolving our legacy issues. We are confident that we have the right strategy to deliver both good returns for shareholders and a better experience for our customers. So thanks very much for joining us, and enjoy the rest of the day. Cheers.

Ewen Stevenson: Thank you.

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

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