



NatWest
Group

NatWest Group plc
Q1 2025 Results Call Transcript
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Hosts: Paul Thwaite, CEO, and Katie Murray, CFO

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Management Presentation

Paul Thwaite

Good morning and thank you for joining us today. As usual, I'll start with a brief introduction before Katie takes you through the financial performance and then we'll open it up for questions.

Against a background of heightened global economic uncertainty, we continue to focus on advancing our strategy through three key priorities: disciplined growth; bank-wide simplification; and active balance sheet and risk management. Examples of our recent progress include the completion of our Sainsbury's bank transaction yesterday, which adds around a million new customer accounts with about £2.5 billion of unsecured lending and £2.7 billion of savings.

We launched a new mortgage enabling first-time buyers to combine incomes with a family member or friend while retaining independent ownership to help them get on the property ladder sooner.

In business banking, we marked the 10th anniversary of our Accelerator Programme, which has helped to grow and scale 10,000 small businesses across the UK by setting a new ambition to support a further 10,000 businesses in 2025. We also upgraded our ambition to lend £7.5 billion to the UK social housing sector between 2024 and 2026 and announced that we're deploying £500 million to retrofit social housing stock supported by a financial guarantee from the National Wealth Fund.

On bank-wide simplification, we are the first UK headquartered bank to collaborate with OpenAI in order to meet customer needs faster and increase productivity. And as we simplify the organisation, we are moving our Private Banking investment operations from Switzerland to the UK and relocating their data and technology teams to the UK and India.

On active balance sheet and risk management, we made further progress, optimising RWAs in the quarter. And in an uncertain environment, our prudent risk management gives us a competitive advantage.

So, let's turn to the financial headlines for the first quarter. We made a strong start to the year. Customer lending grew 0.9% to £375 billion. Customer deposits increased 0.5% to £433 billion, with growth in both Retail Banking and Commercial and Institutional. Assets Under

Management and Administration of £48.5 billion included net AUM inflows in the quarter of £0.8 billion. We also provided £8 billion of Climate and Sustainable Funding and Financing, bringing the total to £101 billion since July 2021, exceeding our £100 billion 2025 target.

This activity clearly underpins our financial performance. Income increased 15.8% year-on-year to £4 billion, and costs were £1.9 billion, resulting in operating profit of £1.8 billion and attributable profit of £1.3 billion. Our Return on Tangible Equity was 18.5%, driving strong capital generation of 49 basis points before shareholder distributions. Earnings per share were up 48% at 15.5p, and Tangible Net Asset Value per share was 347 pence, up 15% year-on-year.

We continue to maintain a strong balance sheet with a CET1 ratio of 13.8%. And the Government shareholding has reduced to less than 2% in line with their stated intention to exit fully by 2025/26. Given the strength of the first quarter, we are updating our 2025 guidance we now expect to be at the upper end of the range for both income and returns. And with that, I'll now hand over to Katie.

Katie Murray

Thank you, Paul. I'll start with our performance for the first quarter using the fourth quarter as a comparator. Income excluding all notable items was up 2.1% at £4 billion. Operating expenses were 12.7% lower at £2 billion, and the impairment charge was £189 million, or 19 basis points of loans. Taking this together, we delivered operating profit before tax of £1.8 billion. Profit attributable to ordinary shareholders was £1.3 billion and return on tangible equity was 18.5%.

Turning now to our income performance. Overall income excluding notable items grew 2.1% to £4 billion. Excluding the impact of two fewer days in the quarter, income across our three businesses increased 3.7%, or £143 million. Volume growth was also supported by margin expansion, as tailwinds from the product structural hedge more than offset the impact of the base rate cut in February.

Net interest margin was up 8 basis points at 227, mainly reflecting deposit margin expansion. We continue to assume three further base rate cuts this year, with rates reaching 3.75% by the year end.

Expectations for the UK Bank Rate moved down in April, closer to our base case. But we recognise that uncertainty remains, and the actual outcome may differ. Non-interest income across the three businesses

increased 8% compared with the first quarter last year and was broadly stable when compared with a strong fourth quarter. This reflected another strong quarter of customer activity in our Commercial and Institutional business, in particular in Capital Markets, Currencies and Fixed Income. We were pleased with the strength of non-interest income, but the first quarter performance should not be taken as a run rate. Given the strength of total income in the first quarter, we now expect 2025 income to be at the upper end of our £15.2 to 15.7 billion range. Moving now to lending.

We continue to be disciplined in our approach and in deploying capital where returns are attractive. We were pleased to see a stronger mortgage market together with ongoing demand from larger corporates and financial institutions. Gross loans to customers across our three businesses increased by £3.5 billion to £375 billion. Taking Retail Banking together with Private Banking, mortgage balances grew by £2.1 billion, with strong gross new lending reflecting some pull forward of second quarter completions, ahead of the stamp duty changes for First-Time Buyers on April 1st. Our stock share remained stable at 12.6%. Unsecured balances increased slightly to £16.9 billion, driven by higher personal loans to our Retail customers. Our unsecured portfolio will benefit in the second quarter from the completion of our transaction with Sainsbury's Bank, which I'll talk about shortly.

In Commercial and Institutional, gross customer loans excluding government schemes increased by £1.6 billion. Within this, loans to Corporates and Institutions grew by £1.5 billion, mainly driven by infrastructure and project finance. You will also see in the appendix that we have shown the split of our Corporate lending exposure by sector as presented in our year-end Pillar 3 disclosures.

I'll now turn to deposits. These were up £2.1 billion across our three businesses to £433 billion, continuing the quarterly growth trend of 2024. In Retail Banking, an increase in current account and term balances was partly offset by a reduction in instant access savings due to annual tax payments. This also drove a reduction in Private Banking balances of £1.2 billion. The increase in Commercial and Institutional of £2.4 billion was mainly from larger customers in Corporate and Institutions. Migration from non-interest bearing to interest bearing deposits was insignificant, and we have not seen any material change in customer behaviour following base rate cuts, nor since the onset of

recent market volatility. Non-interest-bearing balances remain 31% of the total, and term accounts are still around 16%.

I'd like to turn now to our Sainsbury's Bank transaction, which completed yesterday. This transaction presents an opportunity to scale our customer base, adding a million new customer accounts, which deliver incremental income at low marginal costs through our digital platform, offering sustainable growth. It also accelerates our strategy to grow our share of unsecured credit in a disciplined way, by increasing our credit card stock share to around 11% and improving profitability. The transaction is self-funded, bringing £2.7 billion of savings, which increases retail banking deposits by 1.4%. We expect these portfolios to add income of around £100 million this year, and we will incur one-time integration costs of around £100 million this year. The unsecured portfolio attracts a Day 1 charge for expected credit losses of around £80 million.

In terms of capital, the portfolios add around £1.8 billion of risk-weighted assets, with total Day 1 impacts reducing the CET1 ratio by around 16 basis points. Sainsbury's customers will move to NatWest branded products over the coming months, with access to all our products through digital, in-person contact and our branches. And we are engaging with our new customers to ensure a smooth transition as they migrate.

Turning now to costs. First quarter costs of £1.9 billion were down 8.5% on the fourth quarter, mainly as a result of seasonality and lower severance and property exit costs. As you know, our cost profile can be lumpy, and you should not take this as the run rate. Our annual wage awards and higher national insurance contributions both take effect from April 1st. We incurred just £7 million of our guided one-time integration costs in the first quarter, so you can expect these to increase from the second quarter onwards. We remain on track for other operating expenses to be around £8 billion for the full year, plus around £100 million of one-time integration costs. And we continue to focus on delivering cost savings from our investment programmes to create capacity for further investment to accelerate our bank-wide simplification.

I'd like to turn now to impairments. Our diversified prime loan book continues to perform well. We are reporting a net impairment charge of £189 million for the first quarter, equivalent to 19 basis points of loans on an annualised basis. In light of heightened global economic

uncertainty, we have maintained our post-model adjustments at around £300 million, despite our book performance indicating a small release. We have reviewed our macroeconomic assumptions, and whilst uncertainty has increased, we are comfortable with them at this stage, having embedded a combined weighting of 32% to both our downside scenarios.

Our moderate downside scenario is closest to the modelled scenarios we have run and is worse than the latest economic consensus. We have no significant concerns about the credit portfolio at this time, and it is worth remembering that customer borrowing rates have been coming down in recent months, together with inflation. Given the current performance of the book, we continue to expect a loan impairment rate below 20 basis points for the full year.

Turning now to capital. We ended the first quarter with a common equity tier 1 ratio of 13.8%, up 20 basis points. We generated 49 basis points of capital before distributions, including 68 basis points from earnings, and 10 basis points from CET1 capital improvements. This was partly offset by RWA growth, which consumed 28 basis points. As you know, we increased our ordinary dividend payout ratio from around 40% to around 50% this year. Accruing 50% of attributable profits was equivalent to 33 basis points. RWAs increased by £3.8 billion to £187 billion. This includes £2.2 billion from the annual update to operational risk, £0.8 billion from initial CRD4 model updates, and £2 billion of business movements, which broadly reflects our lending growth. This was partly offset by another strong quarter of RWA management, which included two successful Significant Risk Transfers, and resulted in a reduction of £1.2 billion. We continue to expect between £190 and 195 billion of RWAs at the year end. Where the figure lands exactly within this range will largely depend on CRD4 model outcomes. Our target CET1 ratio remains 13 to 14%.

Turning now to total capital and issuance. We have a robust capital position, supported by strong capital generation from earnings, and well-timed issuance over 2024 and 2025. Our total capital position comfortably exceeds minimum requirements for CET1, AT1 and Tier 2. You can see on the right the consistency of our capital generation from earnings each quarter. You can also see that our 2025 AT1 and Tier 2 issuance is well-progressed as we took advantage of market conditions in the first quarter. Overall, this puts us in a very strong position to deal with any changes in market conditions.

Turning now to guidance for 2025. We now expect income excluding notable items to be at the upper end of our previously guided range of £15.2 to 15.7 billion, other operating expenses to be around £8 billion, plus around £100 million of one-time integration costs, and the loan impairment rate to be below 20 basis points. RWAs are expected to be between £190 and 195 billion and based on the strength of income, we now anticipate a Return on Tangible Equity at the upper end of our 15 to 16% range. Looking beyond 2025, we believe the business is well-positioned to continue to grow income, control costs, and maintain strong capital and risk management, supporting our 2027 target for Return on Tangible Equity of greater than 15%. And with that, I'll hand back to the operator for Q&A.

Operator Today's call is scheduled for one hour, so we ask that you limit yourself to two questions to allow more of you a chance to ask a question. We'll now pause for a moment to give everyone an opportunity to signal for questions. We will now take our first question from Sheel Shah from J.P. Morgan. If you'd like to unmute, then go ahead to ask your question.

Sheel Great, thanks for the presentation. I've just got two questions, please, both on the income outlook. If we annualise the first quarter, we're running well above the target range you've indicated. So, my question is more around the non-interest income. How much of the strength in the quarter do you think is sustainable? And if you can disaggregate between the various segments within there, that would be helpful. Then secondly, on the lending margins, they've increased two bps in the quarter. Can I ask what was driving that and whether we should expect that same pace going forward? Thanks.

Paul Thanks, Sheel. Katie, both of you.

Katie Thanks very much, Sheel. So, a really good, strong start to the year in terms of the quarter one performance. So very much expecting to land at the upper end of our guided range as we've spoken about in the call already. We don't expect Q1 to be the run rate, I'd say particularly for non-interest income. There are a good few positives as we move forward from here. Obviously, we've had continued good growth in Q1.

We've got 80% of our structural hedge tailwind already locked in for the year, and we've also got that additional benefit of £100 million from the Sainsbury's portfolio coming through.

There are a few things that offset that. We've got three Bank of England rate cuts we expect to start with the next one on Thursday of next week. The overall impact of that will be subject to deposit pass-through and customer and competitor behaviour. We do also recognise, as you all do, that there is heightened global economic uncertainty. That may lead to a little bit of customer and consumer delay in borrowing and investment decisions.

Then on non-interest income, there are a number of factors there that influence the level from here, very much around customer activity. If I look at your NIM point. So NIM, eight basis points up in the first quarter, lending margin plus two, that was very much pointing to mix in terms of a little bit of pressure on mortgages, but then unsecured and corporate lending growing. Also, there was a non-repeat of a mortgage EIR that we had in Q4. Then deposit margin strong, four basis points coming through, and then funding and other, plus one basis point. That's driven by the ongoing repositioning of our liquidity portfolio and also AT1 issuances, plus some non-repeat of Q4 tax charges.

I know we seem to spend a lot of time chatting around funding and other with you on these calls, but I would say I don't really see it as a key driver going forward of our NIM outcome. There is some volatility in that line quarter to quarter. We do seek to take advantage of market conditions when they're appropriate. Overall, I think it's a good quarter for NIM, pleased with the performance from the start of the year, and that supports us guiding you to the top of the range for income. As you know, we don't give you specific NIM guidance on different component parts. Thanks very much, Sheel.

Paul Thanks, Katie. Thanks, Shiel.

Operator Our next question comes from Benjamin Caven-Roberts from Goldman Sachs. Benjamin, if you'd like to unmute and ask your questions.

Paul & Katie Hey, Ben.

Benjamin Morning. Thanks very much for taking my questions. So first, just on the backdrop for asset quality and a read across from tariffs, could you share a bit more detail on your thought process for the Q1 impairment charge and the 0.3 billion PMA you currently hold? I recognise the UK is, of course, impacted differently versus other countries in respects of tariffs, but I wonder how you're thinking around the more holistic impact of the slowdown in growth from global trade tensions.

And then secondly, just on capital allocation a bit more broadly, where do you see the most attractive area of your business currently to allocate incremental capital, and has this evolved at all over recent months? Thank you.

Paul Thanks, Ben. Katie, I'll take those two.

Katie Perfect.

Paul On the asset quality side, pleased with the quarter. Asset quality remains, Ben, strong. You'll have seen the charge for the quarter 19 basis points that's inside our 20 bps guidance. Higher than quarter 4 last year, but there was a release in quarter 4 and lower, though, than quarter 3 last year. So, we're encouraged that there's no underlying deterioration. I guess to your wider observations, we're obviously monitoring and very vigilant in terms of the portfolio, looking through the different asset books and ensuring we understand any emerging trends, but there's nothing material to report yet. Customers are certainly resilient. I would say that they've proven their resilience over a number of shocks, arguably over the last decade, from Brexit through COVID, through energy shocks and interest rates.

We've got a PMA, as you mentioned, a total PMA of around 330. About 300 of that is for economic uncertainty. We feel that positions us well, given you do have to acknowledge that there is obviously more global uncertainty, certainly that has emerged since the end of the quarter. If you look at our book, given the size of our corporate and commercial business, we reflect the UK economy at 70% services. We've given you some hopefully helpful disclosures in the documents today around

different sector concentrations. About 2% is manufacturing, for example. Low single digits from a US perspective and mainly investment grade. So, we're vigilant, we're monitoring, but we feel very reassured by the asset quality as it stands, and we think our clients are insulated from some of the impacts.

On capital allocation, your second question, strong position at the end of the quarter, 13.8%, represents around 50 basis points, 49 to be exact, around capital generation before the ordinary dividend. I think it's important to see that that's come from both earnings and from good RWA management, so strong position there. I think that allows us to capture demand when it's there from customers, and you'll see that we've obviously grown our asset books in Retail and Commercial during the first quarter. We haven't fundamentally changed our capital allocation. We've been pleased with the growth and returns we can capture in mortgages and unsecured, and the same on the Corporate and Institutional side, which mainly came through our CIB business. So, no change in our, I guess, philosophy of capital allocation, but as ever, I'm driven by our returns, so we see that there's better risk-reward. We will deploy differently, but we haven't done that yet. Thanks, Ben.

Benjamin

Very clear. Thank you.

Operator

Our next question comes from Chris Cant of Bernstein Autonomous. If you'd like to unmute and ask your question, Chris.

Katie

Hey, Chris.

Paul

Hey.

Chris

Good morning. Thanks for taking my questions. I just wanted to ask about the headlines we've had in respect of ring fencing, please. And just to understand, obviously, your signatory to the letter of the press asking for a review. What would you like to happen in respect of ring fencing? And if you could explain a little bit your motivations for wanting to change this. Obviously, one of your competitors has argued we shouldn't get rid of ring fencing because it's good for customer

protection. What is it that you feel this is doing that's adverse for the business? What are the restrictions? Is it about costs? And if it is about costs in part, could you give us an indication of the rough quantum of duplicated costs for the Group? Thank you.

Paul

Thanks, Chris. I'll take the ring-fencing question. So where am I on this topic? So I've been consistent since I've been in this role around how important it is to have high-quality regulation. I do actually think it can be a source of competitive strength for the UK sector. What I've also said is it's important we get the right balance between risk and protection. The regulatory architecture is very different since the time of the financial crisis, and it's also evolved a lot since the financial crisis. So, if you think of recent introductions on the conduct side of consumer duty, recovery and resolution obviously followed ring fencing. So, it's in that context, I guess, I've signed the letter. And I do think there is more scope for further progress on ring fencing and for further reform. I did welcome publicly the changes that came through earlier in the year in February.

Why do I think there's more chance for reform, Chris, which I guess gets to the heart of your question? A couple of reasons. One is one of the big drivers was obviously around financial stability, but the Skeoch review itself concluded that the recovery and resolution regime that followed ring fencing is arguably a more effective driver of that stability. So that's one reason. And then the consequence of that is it's driving cost and friction into, I guess, how we serve our customers. So, I wouldn't just highlight that it is a cost-driven argument. Arguably, most importantly, it's a customer-driven argument. It does impact our customers. It adds to the cost and complexity of serving customers across the ring fence. That includes UK Commercial and SMEs. So, it can distort decisions, it can distort pricing and arguably limit banks' ability to support the economy and the growth agenda. So, I guess that's my rationale. I'm not going to put a cost number on it. I know you asked that, but you wouldn't expect me to. I'm not going to do that. But that's not the primary driver.

I think the other question we need to ask ourselves as well, really, from a nation perspective, is we are the only jurisdiction to have this particular regime. So, where I am is it just feels timely and appropriate to review it. I think it is beholden on us to make sure that the prudential framework maximises banks' and the sector's ability to support UK

business. So that's why I've called for a timely review. So hopefully that's clear, Chris, and gives you a sense of how I think about it. And actually, the one point I didn't cover, just thinking through your various, I guess, sub-questions, is obviously depositor protection is important. And I wouldn't be advocating for anything that jeopardised this, but I think there's a lot of existing embedded protections through the FSCS scheme, the capital and liquidity we hold through MREL, etc. So I think there's a lot of depositor protection. So, I'm not looking to weaken that. Thanks, Chris.

Chris Thank you.

Operator Our next question comes from Andrew Coombs from Citi. Andrew, if you'd like to ask your question and unmute.

Andrew Morning, a couple, please. One strategic, one numbers. On the strategic one, given that Sainsbury's Bank has now closed, perhaps you can comment on the strategy for that business from here, your ability to derive synergies, to tap into the Sainsbury's customer base and potentially more broadly, the Nectar rewards customer base.

And then second on the numbers, the cash flow hedge. Thanks for the extra disclosure on slide 9. You talk about a 3p positive decay in the quarter, offset by yield curve steepening. Should we assume that quarterly decay run rate going forward? Is that fair?

Paul Great, thanks, Andrew. Katie, I'll take Sainsbury's, and you follow up on cash flow hedge. On Sainsbury's, Andrew, delighted to close that yesterday, brings a million customer accounts to NatWest. Also strategically, it improves our market share in unsecured prime credit card market share, goes up to 11% on the back of the transaction. So, I think strategically, it's compelling. It's not really a synergies-led deal because we've taken the customers and the assets and the liabilities, we haven't taken in effect the infrastructure of Sainsbury's Bank. We do see opportunity there within, obviously within the million customer accounts that are coming across. We have the ability to offer the breadth of our products, services, channels, mobile app functionality. We think we can deliver to that customer base a very attractive

proposition. And obviously that will be a key focus of ours as we migrate the customers over the course of the next six months.

We have a very good and healthy working relationship with Sainsbury's on multiple points, on multiple areas. So, we do have the potential to think about the proposition and targeted offers using loyalty and Nectar points, but we'll be very targeted and thoughtful about that and make sure it drives customer value and utility. But you can obviously expect to see that across not just the cards portfolio, across the opportunities we have. So that's where we are on Sainsbury's, pleased and excited by it. Katie?

Katie Lovely, thanks. Hi, Andrew. So just in terms of the cash flow hedge, there's no change to my previous comments that I've made on this. We do expect the majority of the hedge to unwind over the next two years. So that 3p that you see on slide 19 is from that decay. It is a little bit offset as we've seen the yield curve changes kind of move around, but I wouldn't probably guide you to quarter to quarter, but it certainly is over the next two years. We expect that to be fully kind of matured out.

Andrew Thank you. And just, sorry, just to follow up on that, a bit of a pointed question, but do you think that's reflected in consensus in the tangible NAV? Because you've again beaten this quarter on tangible NAV per share.

Katie Yeah, so I guess when we look at consensus, I do note that our average consensus is sitting around 27.8 for 2025. It's a better place than it was, but I would say it's broadly in consensus, but maybe not everybody. So maybe it's a useful wee reminder this morning for those that might want to look at it again.

Paul Well said. Thank you, Katie. Thank you, Andrew.

Operator Our next question comes from Aman Rakkar of Barclays. Aman, if you'd like to unmute and ask your question.

Aman

Hello, guys. Yeah, good morning, Paul. Good morning, Katie. Thanks very much for the presentation and the questions. I guess I've got two questions. One is around just deposit income, and you're delivering pretty impressive deposit margin expansion despite base rate cuts. And my ultimate question is just around the sustainability of this deposit margin expansion, because you've got so many moving parts. You've got the structural hedge. You've got base rate cuts, but then you've got pass-throughs and the various delays that come through. So, is this the kind of run rate for deposit margin expansion in coming quarters? And if there's part of that, you can lift the lid on what is the structural hedge contribution versus the other bit, because it is impressive, and I just want to kind of get an understanding of how enduring this is. So yeah, if you could kind of lift the lid on that. And as part of that, I think you're executing pass-throughs pretty robustly from here. I think the stuff that we're kind of monitoring, I can see kind of 60 to 70%. Do you think you can continue doing that from here with the three rate cuts you've got coming? Should we kind of continue to factor that as a glide path?

And then, yeah, I mean, the only other comment or kind of question is, we really don't know what to do with any of your guidance this year, because there is just such a clear upside risk to your guidance that we're inclined to just completely disregard it upon arrival. So, I guess there's not really a question there. It's more of a statement, right? But the net interest income is clearly compounding higher. The margin is better. The volume has tailwinds. To even hit the £15.7 billion, I think the non-net interest income would basically have to drop off a cliff. So yeah, you can comment on that, or you can just accept my observation. Thank you so much.

Paul

Hi. Observation/hypothesis, I think, Okay. Right, three questions. Katie, I'll come back to you for deposit income. On pass-throughs, simple and quick answer, Aman, I agree with you. Yeah, we've executed well in terms of the current reductions. We've given you some sensitivities. The numbers you quoted around the past interest rates are accurate. You can see that in the data. Ultimately, it will be a function of funding needs, competitive behaviour, customer reaction. But we feel confident from a pricing perspective. We understand the elasticity in the customer base, and we're getting the balance right. So that's where we are on pass-throughs. And we're very thoughtful, both on the level of pass-through and the timing.

Let me address the bigger question or your observation on guidance. I guess, where are we? We've obviously had a very strong start to the year. We've said we expect to be at the upper end for both returns and income. We're pleased with the income trajectory. We've given you pretty granular guidance on other lines in the P&L. Obviously, there are scenarios which would get you to a higher return. My view is, what is it, six, seven weeks on since we last spoke to you. There's obviously wider uncertainty. As ever, I'll update you as we go through the year. But we feel pleased with the quarter one that we've had. Katie?

Katie

Perfect. Thanks very much. On your deposit question, I'm probably going to take you a little bit back up Aman. I think it might be easier. So, we don't guide on NIM, as you know. But we have seen steady improvement in the deposit margin. And that's really as a result of the strong hedge that we've got in place. You understand that well. So, I'm not going to take you through that in a huge amount of detail. I'm not going to break it down. You've definitely got all the details that you need on that hedge to enable you to model that.

I think, as you talk about, there are different factors coming through. And it really comes on to, as we get into the rate cuts, which we expect to see coming one a quarter for the rest of the year. The level of pass-through that happens there, we model it on 60%, as you know. And that's been pretty accurate in terms of our recent experiences we've gone through. And then what happens on the competition, as well as the evolving trends that we see on household M4 particularly, as to what happens to those deposit margins. But overall, thanks very much for the question. And I think you've got all the bits to form your own conclusions.

Paul

Thanks, Aman.

Operator

Our next question comes from Amit Goel of Mediobanca. Amit, if you'd like to unmute and ask your question.

Amit

Hi. Thank you. Hopefully you can hear me OK.

Paul Yeah, we can, Amit. Good to hear.

Amit Great, thank you. So, one is actually on the costs on slide 10. So maybe you don't want me to completely unpack it. But when I look at the underlying costs in the quarter, kind of annualise those, and then add on the items, the integration, the NIC, 3.3% wage growth, the levies, etc., I still come to a number about £150 million shy of the £8.1 billion target, or guidance for the year. So, I'm just wondering whether that's potentially some higher admin expense, or the premises, or depreciation, or is there also a bit more potential upside coming through on the cost line? And/or was there any other reason why cost was particularly good in Q1 and why that wouldn't necessarily repeat in the future quarters?

And then secondly, just coming back on the ring-fencing question, I appreciate commentary on the cost piece. So, I was just wondering if you were able to deploy more capital outside of the ring fence, to what extent would that help you from a kind of a growth or volume perspective and or kind of yield perspective, if you can deploy liquidity? I don't know. Would you be able to deploy it to slightly better yields if we were to see some softening of the regime? Thank you.

Paul Thanks, Amit. Do you want to take costs, and I'll do ring fencing?

Katie Yeah, absolutely. Thanks, Amit. When we look at costs, our guidance is really unchanged from that. We are on track to deliver our full year cost guidance of around that £8 billion, plus £100 million of the one-time integration costs. And of that one-time integration costs, we spent 7 in the first quarter. So, you're going to see that ramp up in the next few quarters as you go through. But you understand as well, the costs are lumpy. And so, I wouldn't expect Q1 to kind of happily feed through on the other quarters. But you've clearly got the component parts in terms of NIC comes in in April, our staff pay award of 3.3% comes in from April as well. So, you see them kind of coming through.

What Paul and I are really focused on as we go towards that 8.1 number is to really kind of focus on creating capacity so that we can then

reinvest that in the business. So, I would really encourage you to take the 8.1, accept that it's lumpy in different quarters. And I know that's frustrating for you with your models, but that's certainly the number that we're aiming for and we have every intention of hitting. And in doing so, make sure that we can drive the business to create capacity, continue to reinvest in our development. Paul, I'll hand back to you.

Paul

Yeah, thanks, Katie. So, on ring fencing, relatively simple, Amit, as in, I guess, should there be any change? And I guess the premise is that it is currently not as efficient as it could be from a funding, from a liquidity and capital perspective. So, if there were to be any changes, that does present opportunities in terms of choices around how we would deploy that capital and liquidity. What wouldn't change is kind of, I guess, our capital discipline and the way we think about allocating capital to the best returning opportunities. But ultimately, it could lead to more support of customers and better utilisation and optimisation of the capital and liquidity across the whole group. Thanks, Amit.

Operator

Our next question comes from Ed Firth at KBW. Ed, if you'd like to unmute and ask your question.

Ed

Yes, good morning everybody. I just wondered if I could just bring you back to your interest rate sensitivity. I think you put it in the appendix. I think it's a couple of hundred million for 25 basis points, something like that, of cuts. Because if I look over the last 12 months, your margin is up almost 30 basis points, give or take a bit. And I know you're going to say, well, look at the structural hedge. But the structural hedge, you've given us good disclosure on that. That's 15 to 20 basis points of that at most. So, you've probably got another 10 basis points of margin expansion in a falling interest rate environment. And so, I'm just trying to understand how that works. I guess I get that the 25-basis point sensitivity is like a theoretical exercise you do. But I guess what that means is you're able to adjust product pricing to basically more or offset that pressure.

And so, I suppose the question is, it's a bit like what Aman was talking. I mean, is there a world where, I mean, could we safely suggest now to ignore that interest rate sensitivity and assume that you can continue to

do that going forward, firstly? And then secondly, is there a level of interest rates at which that doesn't, you won't be able to do that anymore? Because I mean, I guess interest rate expectations are falling quite rapidly at the moment. So, I mean, if we get down to sort of 2.5% or something, is that the level at which suddenly you can't reprice enough because you start to hit deposit floors, etc.? So that would be, any comments you've got around that would be very helpful.

Paul

Thanks, Ed. Katie, why don't I just, I'll say a couple of quick words on pricing developments generally, then you maybe talk to some of the specifics. Yeah, so Ed, the comment I'd make is we've, since the second half, well mid-2023, we've invested a lot of time and money in terms of understanding our deposit pricing, our elasticity, and we're much, we've been much better able to price dynamically, to understand different segments and elasticity. We've extended the product range, both the range of products, but also the tiers within those products. So that probably talks to just a greater dynamic use of our pricing insights around how we price the book. It's worth bearing that in mind, as well as the observations you have around the structural hedge. Katie?

Katie

Yeah, sure, absolutely. So, I mean, Ed, clearly, we put a lot of effort into that sensitivity, so I'd really encourage you not to ignore it. And you can see it's something that we evolve each kind of half year and year end for you to kind of see within there. But as you look at it, there are things, obviously, you need to bear in mind about it. It's on a static balance sheet. So as things evolve in the year, you can see changes. And what we have seen in different quarters is the mix does move a little bit from where we were in terms of fixed term accounts and where we were in non-interest bearing. And we've seen a bit more coming into instant access, which obviously that for us is good for the deposit margin as that kind of comes through.

The other thing I would look to see is actually to consider what's happening on some of the customer pricing, as well as that hedge tailwind. You know that our mortgage headwind has abated in terms of the effort there, so it's kind of going through. You heard my comments earlier in the funding and other where we try to eke out margin by taking advantage of different positions within the market. But overall, if you think of what we've said about the hedge, we expect it to be stable

in terms of its size and then the deposit margins, the percentages in terms of the different deposit accounts have been quite stable as well. So that helps us offset some of the rate cuts as we move through. So overall, have a look at the different component parts, but I'd really encourage you to use that sensitivity and think of how it comes through on different timings of different rate cuts. Thanks, Ed.

Ed Sorry, just as a follow up, is there a rate at which that dynamic pricing becomes more challenging? And I guess one thinking about deposit floors.

Katie I mean, I think what we need to do is look through, obviously, the history we've all lived through over the last five, 10 years. You know, as you kind of go back through a few years ago, in five, six years ago, none of us thought we'd ever get paid anything for our deposits ever again. You know, as a receiver side, and that's obviously changed. I think what's happened is both the consumer and ourselves have all got much more sophisticated, more flexibility in terms of where we want to hold our deposits, the kind of re-emergence of the term account as a place to get better interest rates. So I think even if we were to go down to those levels, which, I mean, isn't a level that's being proposed, I'd say it's not something we certainly see in our own economics, there would still be movement and flexibility on that, but that very much mirrors what's happened in the past as well.

Ed Great. Thanks so much.

Paul & Katie Thanks, Ed.

Operator Our next question comes from Jonathan Pierce of Jefferies. Jonathan, if you'd like to unmute and ask your question.

Paul & Katie Hey, Jonathan.

Jonathan

Hello. Hi, both. Good morning. Two questions, please. The first, I suppose, demonstration of how clear and concise much of this is, AT1 costs I'm having to focus in on. The AT1 stock, I think, is about 6 billion quid now, which is 3.2% of your RWAs. Just wondering where we go from here, because based on what you've got at the moment, the annualised cost is about £400 million, which is quite a bit above consensus, but you have got some pretty big potential calls later in the year. Your slide 13, I think it was, suggested that you probably are largely done for the year and hence you'll just let those other AT1s later in the year disappear without replacement. Is that the way to think about it? Because I'd just like to get a better handle on what we should be putting in for AT1 coupons moving forward.

The second question is a bit bigger picture. Capital intentions, 13.8% equity tier one. You're generating a lot every quarter. The directed buyback opportunity feels like it's receding by the day. How are you thinking about this? Are you keeping capital back for potential inorganic opportunities? When we get to the interims, should we be expecting in-market buybacks to be announced, these kind of things? And maybe connected to that, the risk-weighted asset optimisation, it'd be helpful if you could give us a sense as to what the cost to the income is of that. Because accepting you want to hit your RWA guidance for the year, given the capital position, it doesn't necessarily feel like you need to be doing this if it's coming as an income cost. So, as a rule of thumb, what's the income hit from a billion of RWA optimisation would be useful to know. Thanks a lot.

Paul

Right. Thanks, Jonathan. Katie, I'll take capital and then come back to you. Oh, you take the specific on AT1.

Katie

Sure, thank you.

Paul

OK. So, Jonathan, on capital, as you say, strong print, 13.8%, upper end of our range. We've been consistent. We're happy to operate anywhere within the range, 13 to 14%. It gives us a material buffer on our minimum, which is 11.7%. There is the potential. As you say, the size of it is getting smaller, but there still is the potential for a directed buyback, should we have the chance to participate. So, it's worth

bearing that in mind. We will review other buybacks, as you'd expect, with the board and update at the half year and at the full year. That's when we tend to do that. Nothing's changed around my philosophy, our philosophy, in terms of capital allocation. We know how important capital return is to shareholders. So hopefully that's given you a very clear view of where we are.

On RWAs and the specific, I guess the way we think about that is about the cost of capital on the trade. So, we don't disclose the number on the cost of that, but what we ensure, any trades that we write, we ensure that we're very happy with the return, and then obviously we can redeploy that capital at a higher return. So, in effect, we look at those trades through the returns lens, as in return accretive at a trade level, but also redeployment of the capital, rather than just thinking about the income impact. AT1s, Katie?

Katie

Sure, absolutely, and thanks for bringing it up, Jonathan. So, you're right, we issued some AT1 in November and March, and I would say some of the cost probably isn't completely in all of the models, so it's worth having another look at as well. The coupon cost is booked through profit attributable to paid-in equity holders, just to remind you. That is about 100 million per quarter, and then the income obviously comes in, proceeds of that is included with income. We do, as you can see on slide 14, we're sitting a little bit higher than our regulatory requirement on AT1. The regulatory requirement is 2.1 versus the 3.2% that we're sitting at just now. That's really a reflection of some of the early issuance we did to take advantage of good markets. Look, Jonathan, as you know, I can't comment on future calls as we go through from here, so I'm not going to comment on that specifically today, but I guess that excess gives you some kind of indicator, but comfortable with where we're sitting and really pleased that we did do some of our issuance earlier in the year as well. Hope that helps.

Paul

More broadly, Jonathan, just to close it off, we remain obviously very focused on capital allocation and distribution. Thanks.

Jonathan

Thank you. Are you willing to give us a very rough rule of thumb, though, on the income impact of the RWA optimisation? Because, you

know, there was £1.2 billion in Q1, I guess there's a bit more coming later in the year. It's obviously a bit of a headwind against income.

Katie So, I mean, not looking to give you a specific number on that. I mean, obviously, as you know, we guide to total income and that would be a small number as part of that piece. It is one of the things when we look to the second half of the year, the kind of the headwinds that you have, where you do see as you ramp that up, you'll see some kind of action come through. I'll just remind you there are various bits of RWA action we do, whether it's SRTs or credit insurance or obviously asset sales, as well as kind of the data management activities we go. They all come at very different costs in terms of RWA, but as Paul said earlier, very committed to the cost of equity on those things and also where we can redeploy it. So, overall, we see it as very beneficial for the shape of the balance sheet and the income statement. Thanks, Jonathan.

Jonathan Thank you.

Paul Thanks, Jonathan.

Operator Our next question comes from Guy Stebbings of BNP Paribas Exane. Guy, if you'd like to go ahead and ask your question.

Katie Hey, Guy.

Guy Hi. Good morning, both.

Paul Good morning.

Guy Thanks for taking the questions. A couple of follow-ups, I guess. So, the first one was just going back to lending margin. And then, firstly, what are you seeing on new mortgage spreads today versus prior quarters and the 70 basis points you saw for much of 2024? I mean, is it right to

think that may have drifted down into sort of 60s on application spreads today? And then on asset mix, how much sort of seeing support on the corporate book in particular, and if that's a trend you would expect to persist?

And then the final question was back on risk transfer market, but really in the context of the recent PRA comments, I think seemingly the concern is centred more on risk in the system from funding of banks to acquirers of SRTs rather than the size of the market itself. But a peer of yours downplayed any exposure to this earlier in the week, so I just wondered if that was something you would sort of echo those remarks. Thank you.

Paul

Thanks, Guy. Katie?

Katie

Sure, absolutely. So, when we look at the mortgage margin, you know, our book margin remains around 70 basis points in line with our previous guidance. That's a good indicator of the front book margin that we aim to write up for our risk appetite. We do know, and clearly you can see, that the front book margins do vary week to week, given the dynamic pricing and hedging that we have, with good returns obviously available below that 70-basis point level, particularly when you look at the kind of lower LTVs. What I would say on kind of margins overall, you do expect us to be thoughtful on volume of new business as we continue to write and to flex our appetite at different times as some of the returns vary at different points on the pricing charts. You know, on mortgages and assets in general, our focus is very much on returns and not on the margins.

And then if I look to your question on the asset book within the corporate book, you can see within our NIM walk this time around that we actually had a little bit of a positive in there, a slight negative on mortgages, as I mentioned earlier, and the positive coming through from the corporate book and a little bit on secured as well. Then in terms of your second question, the Dear CFO letter, it was very focused on the financing of Significant Risk Transfers in the trading book, and that has no read across for us on the execution of our SRT transaction of our own assets as part of our capital optimisation activities. And we do not, of course, finance any of our SRT transactions.

Paul Thanks, Katie, thanks, Guy.

Guy Thank you very much.

Operator Our next question comes from Robin Down of HSBC. Robin, if you'd like to unmute and ask your question.

Robin Good morning, and thanks for taking the questions. Can I just build a little bit on your comment there about mortgage spreads and appetite for writing business? I think you mentioned earlier that Q1 you felt was influenced by stamp duty on the mortgage side. But if we look at the Bank of England approval numbers for March, they didn't really fall a great deal versus prior months. And certainly, on a non-seasonally adjusted basis, they looked actually quite strong at the end of March. So I just wonder if you could give us an indication of where your kind of approval numbers were and what you're thinking about lending into Q2. And then maybe somebody on the...

Paul Robin, we've lost you.

Operator Yes, unfortunately, we can't hear Robin anymore, but maybe you'd like to answer...

Robin What are your expectations?

Paul Oh, Robin, we lost you there, mid-question.

Robin Oh, which question? The mortgage approval question?

Paul Yeah, you haven't quite got to the end of your mortgage question.

Robin

Ah, okay. It's probably because I've got Bloomberg running in the background. Yeah, it was just really a question of whether you could give us a sort of indication of where your mortgage approvals were at the end of March and what your kind of thoughts are in terms of mortgage growth in kind of Q2. Because it just feels to me like there's more underlying demand there rather than necessarily it just being a stamp duty issue.

And then the second question was around deposits. Obviously, Q1 seasonally is normally a very weak quarter for deposits. You've seen growth coming through, including in personal current accounts. So just wondering what your thoughts are there in terms of growth in Q2 and beyond, and whether or not we should expect to see your structural hedge growing. I know you've talked about stability in the past, but whether we should actually be factoring in growth there.

Paul

Great. Thanks, Robin. So, Katie, I'll come to you on deposits. On the mortgage side, we agree with you. Application levels through the quarter remained robust. There was a pull forward of some of the first-time buyer transactions because of the stamp duty change. We can see in the data that our market share increased there from 8% a year ago to 11%, and we've kept our overall mortgage market stock share steady. So, yeah, application volumes remain strong. We don't see that as a kind of cliff edge moment in terms of the stamp duty change. Katie, deposits?

Katie

Yeah, sure. Absolutely. So if we look at the deposits, if we think of our own economic data, we do expect the deposits to continue to grow in line with that. We're very much moving in line with market in that space. And then you can also see that the savings rate has continued to improve as well, which is obviously beneficial. Now, in terms of your comments and queries on the structural hedge, we have seen a little bit of growth in this quarter on the non-interest bearings, particularly within retail banking as we move forward from there.

So, Robin, I think what's helpful to do is to think back of how do we do our structural hedge. So, we do a 12-month loop back. So that small amount of growth that we've seen coming through in terms of its

eligible balances, you could in theory see that start to come through over the 12-month look back. But I would say at the moment we're kind of guiding you to pretty stable for this year, around that 170. So, I wouldn't expect it to deliver growth immediately into the size of that structural hedge. But it's something that certainly if we continue to see it grow and it became more meaningful, then it would go through. But it does come onto your kind of eligible balances. And that's certainly where our non-interest bearing are important within there. Hope that helps.

Robin All right. Thank you.

Paul Thanks, Robin.

Operator Our next and final question, it comes from Alvaro at Morgan Stanley. Alvaro, please unmute and go ahead.

Alvaro Hi. Just a couple of quick follow-ups, really. Just on the deposit mix, term deposits have come down slightly. Katie, you just referred to some of that. As rates come lower, do you think we could see more of that or is just a seasonal blip? I guess people might not want to start not to bother to roll over some of the term deposits. Could we see that effect if we get closer to three or what level of rates do you think that could happen more at a bigger scale? And second, just to make sure that's still the intention, when you talk about your 13 to 14%, now that the Government is sort of quickly going to come out, do you still intend to stay within that range and distribute anything above that range on an interim basis? Thank you. i.e. every six months, the mid-year and the full year. Thank you.

Paul Thanks, Alvaro. Last but not least, I'll take the second question, Katie, then flip back to you on the deposit side. On the capital question, Alvaro, we're very happy to operate anywhere within the target range of 13 to 14%. We consider the bottom end to be a strong capital level, but as you probably heard me say earlier, we'll decide at the half year and the full year with the board around capital distribution, but we

know how important that is to shareholders. So no change in our philosophy at all from that perspective. Katie.

Katie

Sure. In terms of deposit mix, when I look at that term number, it was like 17%, now it's 16%. It's all kind of in the roundings of where those numbers are. I think one of the things to think about, as well is the fixed rate ISA, so April was ISA season, and we did see both in the sector data and in our own data that it was a strong season, so you see some nice pickup from there. So, I think how you see how it flows from here. What we look at a lot is in terms of when people's accounts are coming up to maturity, how much do they retain and how much do they either move into instant access, and then we see it coming back into fixed as it goes through, and that kind of percentage has been pretty strong and is quite a high proportion of that. So, in my own mind, one of the ways to think about it, you have the ISA season, which brings more money in, and then you have people that are kind of managing their term deposits as to where they are.

Obviously, it varies in terms of different sectors. Private is a little bit different as well, as people are looking sometimes for alternative investment, and then C&I, as you know, the numbers are much chunkier, and it's a different kind of theme that you have in there, but overall, I think we're happy with how it's progressing. We expect it to continue to progress relatively well, but we'll move very much in line with market flow, so let's see how it plays out from here. Thanks very much, Alvaro.

Alvaro

Thank you.

Paul

Thanks, Alvaro, and I guess I'll wrap things up if that's the last question. So, I guess to conclude, we're pleased with the performance in quarter one. It's strong, and it shows the continued momentum in the business. We continue to believe the business is very well positioned to deliver strong shareholder returns, and to that end we've updated our returns guidance to the upper end of the 15 to 16% range for 2025. We will be holding a spotlight on our private banking business on June the 25th, so I hope most of you will get the chance to join that, and also the

spotlight we held on our commercial business is available on the website. So, wishing you all a good weekend. Thank you.