RBS

Katie Murray – Sell-Side Roundtable

22nd February 2019

Alexander Holcroft, Head of Investor Relations
Good morning and thank you very much indeed for coming along. It's always a good opportunity, I think, these roundtables for you to ask some questions after a few days of reflection. So with that I'll hand over to Katie.

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Katie Murray, Chief Financial Officer
Perfect thanks. It will be interesting how much time you've had for reflections because I know you've had a busy week. I personally took the advantage of you all having a busy week to actually go down to India for a few days, to spend some time with the team there, who have done a lot to help to us deliver the results. So I got back late last night.

Look, overall we are pleased with the results. What I said to the team internally is you know the reaction on the day is interesting, you know, I think RBS's style is more up first, down by the end of the day and it was nice to see a slightly different shape this time. But I think the fact that we've kind of maintained the price through the week relatively well is helpful.

So a good set of results, the market is very competitive, we're very comfortable with our capital return in terms of the 240 bps of growth and 130 of that being from profit I think is particularly comfortable.

The full year dividend payout, I think we sort of surprised everybody on the upside in terms of how large that payment was. And that was really - the reason behind that was very much to send a message of intent, of actually look we are intending to make the capital return and it's not that we're going to hold it back all the time. But I am conscious that we still have a lot of capital return to do in what is kind of slightly choppier kind of markets.

We do remain comfortable with the 2020 target of the 12 plus return. And we talked a bit about that we do see income and costs challenging as we move towards that. But we sort of feel that in the round we've got the right kind of comfort to be able to still be comfortable overall on the return, recognising of course that a lot of it is dependent upon the speed at which we deliver capital back out to yourselves, or it becomes an increasingly hard kind of place to work.

So this morning I've brought Richard Lawrence with me, who Heads up our Accounting Policy team, so all question IFRS 9 by the time we get into the bowels our page 122 if any of you want to go there he'll happily go there with you and we'll applaud from the side lines.

But I think you will also be comparing all of the IFRS 9 disclosures and actually saying - what are they telling us? And we're kind of very much going through that process at the moment. It will be interesting when it comes to some of your questions and your reflections on what you think they're telling us. So with that very happy to open to questions as we go around.

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Question
I've only been looking at it a few months, but you were a bit more cautious on your cost income target, whereas the other banks, said they could flex investment cost - investment in the business and still hit there targets. So can I just understand the reason why you're not going to compromise on the costs?

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Katie Murray, Chief Financial Officer
So I mean I think what we're say is we're still very much driving towards the cost targets. I would say that we probably have, I think, slightly more ambitious targets out than others in the bank.

You know one of the things that - look we could definitely flex investment, but I think if we dip to the line and you see that in the second half of 2020 that we hold back our investment number, actually you'll give me very little credit for that, when in the first of 2021 it will go up again. So we're very keen not to dip to the line to get to that piece.

But you know we've got the £300m number out this year, we're doing a lot of activity this year that we know delivers benefits in 2020, but we are - it is more comfortable, obviously cost income - there's two parts to the equation and the income line, we're all familiar with the market and the general environment, which has caused us some concern.

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Question
Can I just continue on from that point, strategic costs, I mean I think that was a bit of a negative surprise, the guidance there - is there now - how much more of this are we going to have beyond what you have guided, you know could you spend another £5bn on top of what you've told us, or is it something that will just drop out of the numbers?

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Katie Murray, Chief Financial Officer
Yes, if we look at the guidance we gave you, we sort of said we'd spend £2.5bn over '18 and '19 and what we're saying is we spent a billion this year, we're saying in 2019 we reckon it will be £1.2bn to £1.5bn. So quite possibly still up to the £2.5bn.

I think the thing is though the capacity of an organisation in my own experience is not about spending the cash, it's about actually having the resources that can implement the change that you're spending. You know and certainly the conversation internally is guys, look we're not committing to have enormous amounts of strategic spend in this organisation, we already spend about 1 billion a year in terms of investment. So that means that this year there is about £2.5bn that's on the table. That's like a lot for an entity to spend. So I think our guidance was, you know, one of actually will we get all the way to the £2.5bn in total, or whether it's closer to the £2.2bn.

You know as I look at what we're looking to spend and the things that will deliver the kind of savings into next year, there are some big chunks within that. So I think we're comfortable. And I wouldn't see it that we're suggesting there is going to be another £5bn, because we certainly didn't guide you that we'd be spending more, we guided that we'd be spending less.

And a lot of the conversations I have on it is like how can you go from £1.2bn to £1.5bn in 2019 and then down to a kind of £0.5m all in number of conduct and litigation and strategic costs?

And the reason why I'm comfortable on that is because of the shape on some of those expenses. You know if you look at closing off 10 buildings will us about £0.5bn in one year, you don't close the buildings every year, you close them and they're closed sort of thing, you can't keep spending that kind of level of money.

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Question
What are you spending the money on though; I mean could you give us some examples so we have an idea?

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Katie Murray, Chief Financial Officer
Absolutely, I mean if I look at it, I mean in terms of property there's about £500m, that's being spend on the kind of property change. We're making a couple of hundred million in our technology and transforming that. And both of those deliver real kind of benefits as we move into the next year.

You'll be aware in terms of how we've organised our business is very much kind of the customer journey aspect and actually taking out paper, making home buying - that whole kind of customer journey piece. I mean Ross and I have spent an hour and a half this morning with PBB and CPB to say actually that of your investment spend, where is it really going and how do I measure it, not as have you spent the spend, but have you taken out the paper, have you put more product onto the digital piece.

And even just - you know things like telephony, the amount of money we spend on telephony, what are we really doing on telephony? One of the things that was causing a huge issue in our telephony cost was the fact that people couldn't see their pending transactions. So now you can see your pending transaction on the NatWest app and as a result of that immediately your telephony costs go down. So what is it that you need to change to make sure that you're taking those things?

So it's those kinds of things. And also this year we're still spending money on the Williams & Glyn initiative, we're spending quite a lot of money on Brexit, we're spending a lot of money on Libor, we're told that those would close off this year as well.

And that's kind of how you can get yourself closer to a kind of £1.2bn number.

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Question
If I follow up on some of that. The pending transactions piece is only because you don't - you the banks, most of the big ones are not real time in terms of transactions, there are quite a few FinTech companies who do real time now. So I guess you know underlying that the £200m investment in technology looks really low compared to the overall budget.

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Katie Murray, Chief Financial Officer
So I think that's what we're spending as part of strategic costs. In terms of our kind of ongoing billion that we have within our core cost base, a huge amount of that would go on technology as well.

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Question
Could you give us a sense of that maybe?

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Katie Murray, Chief Financial Officer

I think - so if I look at it and I don't think we traditionally shared the number, but you could in your mind sort of assume that it's a great proportion of that number is spent on technology change, you know.

And then within things like transforming the customer end to end journeys, a large portion of that spend also will have a technology piece related to it.

I mean the reality is that technology is kind of everywhere, so when I talk to that couple of hundred million of technology, it's really ripping out the final old bits of old infrastructure, rather than being a total number in terms of the total technology spend.

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Question
Can I just ask as a follow up to that, I mean first of all what's the risk that - I guess it's at the heart of these questions, which is that you spend a lot of money on technology and transformation, but it's an ongoing never ending process because mobile and tech is getting more and more advanced. So is there a risk that there's something new and shiny in two years' time that you need to spend a lot of money on? And then I've got a second one on IFRS 9.

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Katie Murray, Chief Financial Officer
So let's do that and then we'll go to IFRS 9. So as we look at it, we've talked about there's our £1bn of investments that go on within the core piece of our business, you know for a bank that's trying to get to a cost base all in, that's around the £6.9bn - £7bn number, that represents a fairly large proportion of that number. So I think we have quite a lot of capacity in that space.

What we know is as we replace and get rid of our old applications, which you know we've taken out a couple of thousand in the last number of years, that means our ability to continue to change on the technology piece.

But I think it would be a brave person that would say I'm never going to come back to you and say, actually I'm now making this investment and it's got a £300m or £400m price tag on. But I feel that that's the kind of - I'm not going to be coming back to say it's a 20 - or a £2bn kind of price tag that you have to continue to change.

But that ongoing investment is something that I think is a reality for all of us. But it's actually how to get the core as simple as you can so that you can add in the technology aspects as that point.

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Question
And the question on IFRS 9, so there's now three banks that have taken a charge for Brexit overlay, they've not liked to call it that, but a UK economic uncertainty overlay, can you talk a little bit about what the triggers are about when that might reverse if there was, say a soft Brexit, or we do get a deal at the end of this month. I mean how quickly do you think you can reverse that …?

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Katie Murray, Chief Financial Officer
So what I would say is you'll never see the £101m reverse - in our there was £101m and now I'm giving you a credit back of £101m. Because what we've obviously done since

we did Q3 is to actually build those assumptions into the models. We take different probabilities of what scenarios we think will come out.

So as you see the general economic mood and the economic environment improve you'll see that number reverse, but it will never be something that's - and today we've written back the Brexit overlay that we took in Q3, because it just doesn't happen like that.

You know already there will have been small movements around about it, as we did the Q4 modelling, and not big enough to talk about. But it's not something that you'll see.

And I think particularly for us when we're sitting at the level of impairments that we have, you know they're so low for the whole year that it would be very hard to kind of see that number ever kind of reverse.

We'll do one more on this side and then we'll come to that side of the room.

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Question
Just on the cost - going back to the cost piece again, I guess within your £1.4bn of opex, so I guess within the BAU versus the change the back cost, can you talk to us about how to think about how much of the BAU costs you've been able to successfully rundown over time as you invest more on simplifying the business and how much more then is obviously going to go into change the bank cost?

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Katie Murray, Chief Financial Officer
Yes, I think we've always talked about it in terms of change the bank and there is about £1bn in the number, so you could assume the balance of that is BAU rundown in terms of that number.

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Question
You've previously talked about a £1bn cost base target in NatWest Markets in 2020, but I couldn't see any reference to that in the latest set of results. I just to check if that's still a live target?

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Katie Murray, Chief Financial Officer
That is still there, yeah, that is still there in terms of the target of that number.

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Question
And just a follow up. In terms of your 2019 RWA target range, I just want to understand the drivers between 185 versus 190, because that's about a 40bp impact on capital. As far as I can tell Alawwal variability and disposal there has gone, we know that's going in H1, mortgage growth of between 2 and 3% wouldn't account for the difference. Is it perhaps whether you might have a portfolio sale in Ulster that's going to drive you between the lower versus upper range?

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Katie Murray, Chief Financial Officer

So you will be aware that we have launched a portfolio sale process within Ulster, in terms of that was launched in Q3, a second follow up one from the one that they did last year. So that is going on as well, so that will have a little bit of an impact. And it will be how much it pulls it down in terms of the size of the portfolio sale that we ultimately get away.

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Question
Could I just ask maybe a bit of a broader question on Brexit and the kind of gap, the near term outlook for the bank. So under the assumption that a hold in the charge and obviously there's a couple of economic tailwinds in terms of order of demand, as we discussed last week on interest rates and so forth. Is there anything specific on RBS's balance sheet, what you will have in terms of prudence, which you could reverse and help in terms of performance, excess liquidity as an example?

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Katie Murray, Chief Financial Officer
So I mean I think excess liquidity is the easiest example, you know we did a TFS repayment in Q4, we would look to continue to do that. I think we've been very open that we're carrying a lot of excess liquidity at this stage. At the same time through we have to more MREL raising this year, which kind of will accentuate that.

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Question
Would that have a P&L impact or is it more on the margin side?

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Katie Murray, Chief Financial Officer
I would have a little bit of an impact on the P&L but not - if you get an orderly Brexit you would imagine the P&L would be more in line with that we imagined, if it's disorderly then actually the cost of that will go up obviously, so that will get more of an impact on that side.

So I mean for us we're very clear that an orderly Brexit is good, because it stops the kind of uncertainty and the nervousness and actually you'll see customers kind of where they have been delaying kind of moving more into action, which will only help our business.

In terms of the balance sheet, whether it has some impact on impairments in reality is not going to be that material, given the level of impairments that we're at. So it does kind of come down to your liquidity.

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Question
Would it change your appetite, your underwriting criteria, so look at unsecured and certain pockets of loans?

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Katie Murray, Chief Financial Officer
I don't think it would change our appetite particularly, but maybe I think we would see potentially greater take up of some of that. We certainly have capacity already to, I

think, move it further into that space and kind of - you know I think what we signalled with our personal loan growth that we were very comfortable with actually moving a bit further into that space a bit more aggressively.

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Question
I just wanted to re-ask a first question from last week really on capital return. You actually missed my number by 2p, but maybe I'm on my own with the 2018.

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Katie Murray, Chief Financial Officer
Sorry.

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Question
But in terms of back solving your 2020 12%, obviously I can stick in a £1.5bn buyback this year, I can try hard and do another £1.5bn on the first of January 2020, but on my maths, possibly defective, I still need a material pay down of shareholders' equity to occur in H1 '19. Now you ruled everything in and nothing out, you're not waiting for stress test to tick the box, like Barclays pretended they were yesterday, so I think you should be specifically ruling in a material distribution at H1 '19.

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Katie Murray, Chief Financial Officer
So I think what - so I'm not going to do that this morning, because clearly my words last week were quite well practised and rehearsed as well. But I think what we've tried to do is to give you the guidance and comfort of the 12, and you know comfort of the circa 14 by 2021 that we're anticipating some material paybacks.

I think the thing that we talk about internally is what if the Government doesn’t sell and there's no sign of selling, if they don't sell by H1, well that's probably okay, but if we're sitting in December and they haven't sold and in fact you could see scenarios where our CET1 is heading towards 17% at that point without too much of a challenge that you'd expect to see some material pay down. But I can't tell you what they are or when they come. I can tell you they will be lumpy and non-linear, but we're all working to get to 12% [RoTE 2020 target].

And I think it was Ed that said in one of the questions, you're not going to do one of these banking things where you show that actually - if I had the perfect number in my denominator I'd have the perfect result on top. So we're not aiming to do that. I don't rule it out if we can't quite get there, but it will be at the margin, rather than in the round.

So I mean there has to be material payback, we're very clear, the Board is very clear on that as well.

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Question
And you're not ruling out i.e. normal buyback in the market?

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Katie Murray, Chief Financial Officer
No we're not and we spend a lot of time talking to our various investors on this, that the challenge with a normal buyback of course is that we increase the Government's stake. So - and that's not something that our wider investor base wants us to do, specifically it's not something the Government wants us to do at this point either and they've been probably more clear on that as well. So we don't rule it out.

I personally would hope that we do a nice big chunky directed buyback this year, I think you're all as close to the ABB market as I am and actually to get a really chunky one away would be quite an achievement. So you could see a couple and then maybe we might move into a dribble out and then we'd happily play along in terms of the dribble out space.

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Question
Hi, I just wanted to come back on the cost points …

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Katie Murray, Chief Financial Officer
Chris can I ask you - the air conditioning is incredibly loud in here, sorry.

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Question
It's hasn't got the best acoustics. On costs again you talked about a £0.5bn all in litigation, conduct, restructuring number from 2020 onwards. And then you also referenced gunning for a sort of £6.9bn to £7bn all in cost number, which is I guess getting you back down to the sort of £6.4bn we used to think about as the opex number for 2020. But just in terms of the glide path from here to there, I'm a bit surprised that you're still sort of pointing to that number given that you're only expecting to take out £300m in '19, it would imply quite a bit step down into 2020?

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Katie Murray, Chief Financial Officer
No and it does suggest a big step down. And I guess as I look at some of the things we're doing this year you can see why that step is believable. But I think what we said was - I'm not looking to kind of reset consensus or reset that kind of £7bn number, but it's just to sort of say look actually it is hard and we need to continue to drive towards it, which we are absolutely doing.

But the reality is we are also carrying extra costs, which just - you know if you're taking about £600m and now you have to take our £700m, those are - in a UK domestic bank that's a real number to take out. It's not - I think what we used to have at our fingertips where we'd say well actually let's close this entire region, or this entire business. So it is the grinding out of the costs that come through. So it is challenging.

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Question
I suppose that's the point to the extent that it's a grinding out rather than some lumpy cost items dropping out in specific quarters. I would expect a more linear trend down I guess to the type of number you're talking about. Whereas it does still look like you've got quite a bit step into '20.

Is this to do with - I mean one of the things that you're doing different to Lloyds I suppose …

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Katie Murray, Chief Financial Officer
I'm sorry; I'm really struggling to hear you forgive me.

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Question
One of the things that you're doing differently to Lloyds I suppose is that you're expensing a lot of your investment. And therefore - to what extent is it the £1bn of investment spending that you're doing normalising and not being replaced by amortisation which is what's going to happen in their case …?

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Katie Murray, Chief Financial Officer
Definitely there is an element of that which is important and that within UB DAC, which doesn't have a huge amount of spend happening in it, it's got more conduct kind of spend. But within NatWest Markets there's a significant amount of spend that happens which is due to end at the end of this year that doesn't then repeat into 2020, because all of their investment spend gets expensed.

In the PBB and CPB we're at a much more kind of normalised level, which wouldn't probably be too dissimilar from the guidance I heard Lloyds give this week. But NatWest Markets is quite impactful in terms of their strategic costs.

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Question
So should we be assuming then within the mix there, £1.2bn NatWest Markets opex this time, is that then flattish into '19 within the number you're implying with the £300m takeout and then essentially a £200m step down into 2020. Is that what is helping you get that kind of lumpy profile …?

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Katie Murray, Chief Financial Officer
Yes, so in terms of the shape of NatWest Markets that would be a more appropriate kind of shape.

Pause and Chat

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Question
Could I ask you, how much do you think you need to play a role in helping the Government get their stake down when you think about the capital distribution, because part of you just thinks couldn't you just say, maybe if Brexit is okay, half year got 16%, just cut it to 14%, that's your target, you're done, the Government sells when they sell and that's up to them. How much do you have to help them and wouldn't it be just better for everyone, they manage the sell down, you manage the bank, don't worry about it?

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Katie Murray, Chief Financial Officer
So what I would say is …

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Question
Is that too simplistic, I'm just trying to work out …

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Katie Murray, Chief Financial Officer
I think it probably is and I think I would be interested in the mechanics of how we might do that. So it is a question of we say well actually so to get from 16 to 14, sort of £3.5bn to £4bn depending on what kind of assumptions you might make, so do we hand that to the Government and just say, give us the stock. They would never get that through their fair price, you know.

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Question
No I mean could you not just do a special dividend, £3.5bn, your capital is in the right place, they've got a big chunk of cash back to take of their in price, they sell in the market when they do it, you don't have to worry about that.

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Katie Murray, Chief Financial Officer
So I think what I would say is we probably don't spend a huge amount of time worrying about it. I think what we worry about is how can we create some momentum in the share price. Those two things are inextricably linked, you know as they start to sell down we will naturally start to get some momentum in the share price, one hopes, but you know so there is a huge amount of linkage.

But I think they are keen, as the Board is, to kind of take that shareholding down, to do a massive dividend and assume the market will take care of 62% of their stock doesn't feel like it's a safe assumption.

I think once they get down to a 40% kind of level, then you can sort of - or 40 to 50 and I'm kind of making that number up, it's a personal view rather than the government's view, but that you could start to see that kind of happen. But at the moment I think what we really like to do the supercharge impact of as they sell we then take half of whatever they issue and they can kind of accelerate it at that point.

I'm not sure if I'd put £3.5bn in share buyback - I mean in special and then you'd all necessarily give me the credit for it.

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Question
But you're trading below book; it comes as cash straight away …

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Katie Murray, Chief Financial Officer
Yeah I'm still not convinced I would see it kind of float its way through, but that's maybe just how - well we'll see, but that's not something that we're looking at at the moment.

But look I think we will look at lots of different things, particularly if they're not selling, so you know we're very clear that we want to return capital and we're very clear that we want to take back in a directed buyback as soon as that moment comes available.

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Question
And how do you think about what's a fair price, because obviously they don't want to sell because the price is too low, maybe they only want to sell when you think it's too high?

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Katie Murray, Chief Financial Officer
Yes, I mean the way the mechanics happen is as we do any purchase we would get a view from our brokers that we're paying a fair price. I think it's easier for us because actually to buy in when your TNAV is less then your - you know sorry when we're greater than the stock price actually it's a very easy kind of conversation for us to have.

They have a more interesting conversation in that it has to go through the National Audit Office and about a year later they get a view as to whether it was a fair price. And you know in the interim they've had the Daily Mail headlines of they bought at £5.10 and they've sold at £2.70 if I look at the last one, what a shocking great loss. So I don't think they'll ever get a headline unless they wait for a very long time, you know, that will get them to the place. But they have a more challenging time.

And I think each time they sell that sets a new benchmark and you know I debate will they sell today because obviously the price has got the dividend built it, you can get a nicer headline and still quite a lot of the cash. But you know those are my own personal musings and not ones unfortunately I am able to have with them.

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Question
I suppose for that price you'd say well we know more about the value of the bank than anyone else, so we're not going to buyback back at bad price, don't worry guys.

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Katie Murray, Chief Financial Officer
You know as I said on the call I'm a very willing buyer, so if they call me at 5.30 one evening I'm very willing to do the deal at that moment.

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Question
I wanted to come back to your points on the questions on NatWest. So if you're taking 15% out of the cost base a year in NatWest, should we still be comfortable that you can get to the £1.4bn to £1.6bn revenue target?

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Katie Murray, Chief Financial Officer
On the revenue target the way that I talk about it is if we look at their numbers over the last numbers of year, it's kind of been 1.3, 1.4, 1.5, 6, 7 - so 1.4 to 1.6 doesn't feel like a bad guidance in terms of it. I don't think the reduction in that cost I don't think is having a direct revenue impact in terms of how we continue to grow that number.

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Richard Lawrence, Head of Accounting Policy
I think it's worth making the point that the cost takeout will largely be back and middle office, as we renew that …

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Question
Back and middle office?

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Richard Lawrence, Head of Accounting Policy
Yes, that front office has been set for a while now, for a number of years. So at the moment we say we currently have about four back office to every one in the front and we're saying that we need to bring that number down. And that is largely where the cost takeout will come.

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Question
Just on NII, I was wondering if you could give us a little bit more sort of colour on the divisional outlook as we kind of look into next year based on what happened in Q4, how do you see the underlying trends because from what I can see the pressures are obviously still quite high in PBB and I think Commercial is slightly better, but it was below where I thought it was going to be. So I'm just wondering if you've got some thoughts on those two?

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Katie Murray, Chief Financial Officer
Yeah I mean obviously we tried to do that at the most recent showcase days that we did with those two businesses. You know I think we - as we look at it we tie it more to the lending growth and why would you believe the lending growth, and then it comes to what's your view on margins in terms of how you can kind of maximise that.

So if we look at PBB where, you know, where it is primarily mortgages, though obviously we've moved a bit more into the unsecured space, you could probably assume that we continue to do a little bit more of that move. But the mismatch between the volumes of those two pieces - a bit more in unsecured doesn't necessarily change your income line.

So there it's about - we're comfortable we can do the volume, we had a really - we had a strong Q4, you know 14% in terms of approvals, we're pleased with the way that they are converting into actual deals and then adding a little bit more on for the unsecured space.

But I mean particularly once you take our kind of notable items out of there I'm not sure that we see a huge move forward in the immediate within …

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Question
Just on unsecured?

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Katie Murray, Chief Financial Officer
No I mean the margin piece I think we're kind of holding our heads - sorry in the mortgage piece we're holding our head kind of where it is just because of the pressure on margins. And I don't think we've got really a lot of indication that that's going to change in the short term.

Commercial Banking, their income this year benefitted by a number of fair value moves that we had in the earlier part of the year, those have been kind of dealt with. They did have nice underlying growth in their book and we'll see that continue to come through. But the challenge with them is that people are getting facilities ready, paying fees, and then we're waiting for them to actually move forward.

So I think on the - you know our caution on those two books of business probably is not changing at the moment from the guidance that we gave you. We have an interest rate rise coming through in our view in the second half of this year. That will have obviously some natural benefits if it comes, if it doesn't come then it doesn't have the benefit. So I think that kind of explains why we are kind of cautious on income.

I think we're comfortable around maintenance and we're comfortable we can grow the lending, but we're concerned around the margin that we'll be able to grow that at.

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Question
Just on how cautious you are on the income, is that because you're not certain about the rate hike coming through in the second half of the year and clearly around Brexit. So let's say we had an extension or delay to Brexit, which caused rates to remain where they are, then is there anything else you could so with the business to …?

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Katie Murray, Chief Financial Officer
So I think the debate that you have within the businesses - so I think we're quite clear that we don't want to move out of our kind of risk appetite space. But we actually have - we've got capacity within that space anyway, so that doesn't necessarily hold us back.

You know I think we look to see how can we extend the mortgage piece, is it by touching books that we don't touch today? And how might you do it. But I mean we are sensitive to rates, so if the rates didn't come and then it would certainly have an impact on the growth of those numbers, I mean that is absolutely clear.

. . . .

Question
Can I just clarify on your MREL target, so I see that your MREL buffer is I think 3.3% I remember it used to be 4%. What has driven that and how do you plan to do that, I'm asking you because I believe you're probably the only one with …?

. . . .

Katie Murray, Chief Financial Officer
Yes, we've given a sort of £3bn to £5bn of MREL guidance for this year. I mean we overshot last year and very purposefully because we were worried about markets being tight and difficult for sort of Q1 and Q2 this year, so that really is just the re-pitching of actually having taken an extra £700m last next year - last year, we had less to do this year.

. . . .

Question
Just to follow that up because 3.3% out of your requirement is at 15% so just in principle how do you do that - is it something - so say the PRA is asking you to hold as a management buffer?

. . . .

Katie Murray, Chief Financial Officer
No, no absolutely not, so I mean our PRA guidance is obviously quite some distance below the 14% so just in terms of that headroom it's what we feel comfortable with, it's nothing to do with the PRA sorry.

. . . .

Question
Could I just ask on mortgages, could you talk a little bit about - just putting next year in the context of the last few years and some of the things that are tailwinds and headwinds, because obviously the margin piece we know where, where front book pricing is versus back book. But you obviously ramped up the volume quite a lot three years ago, so could you talk a little bit about how big the redemption pipeline is looking like and is it skewed, because it was really skewed last year?

. . . .

Katie Murray, Chief Financial Officer
So I would say that '19 has got a natural benefit on redemption and quite a significant one in that space, so that is helpful. We've seen obviously the move in terms of the two to the five year rate, that it's almost completely inverted in terms of the numbers that are at five years. And that almost gives us more benefit in 2020. So that as the '18s, that you expect to roll off they are not going to because it was during '18 that we saw a lot more of that skewing coming through. So there is a natural benefit on retention.

I think we're also doing better on retention than we used to, so I mean at the end of the year we were kind of running much at the 70% and we're kind of more or less comfortable with that percentage, because we feel that to get to the 80 to 85% retention than actually you're taking a bigger hit on margin so it's not worth kind of going into that space.

And I think also we've done a lot in the last year in terms of the digital and IT investment to actually mean that the whole process is much faster and very much more slick for our customers, which has helped the retention piece, but it has also helped in terms of getting the right offers out in the right time. And you would only expect that that would continue to yield kind of benefits for us.

So where I sit I'm very comfortable that we can grow volume in absolute terms and then it's a question of actually what's the margin piece. But if I look at where we are on the ROE side, we're kind of comfortable that we're hurdling.

. . . .

Question
And then I guess two follow ups on that. So in terms of the redemption profile, because it has been very lumpy from quarter to quarter, is Q1 particularly different, or is it - I

mean I remember last year your mortgage book went back a lot because you had a wave of redemptions I think particularly in Q4 …

. . . .

Katie Murray, Chief Financial Officer
… No, no.

. . . .

Question
Q4, Q1 last year.

. . . .

Katie Murray, Chief Financial Officer
I think Q4 actually.

. . . .

Question
Q4 '17.

. . . .

Katie Murray, Chief Financial Officer
Yeah but if I look at - I think Alexander - but I mean I think Q4 this year was worse than Q1 would be, so I wouldn't necessarily expect that to repeat itself at this point.

. . . .

Question
And then the front book, back book, it's obviously great that you give that disclosure because I don't think many people do, but obviously there is a mix effect within that because of the shifting products from two year to five year. Is there a big difference between the margins you're writing on either of those products?

. . . .

Katie Murray, Chief Financial Officer
So I mean the five year is obviously a bit better but it's not a dramatic difference, it doesn't skew it as much as you might hope it might.

. . . .

Question
Can I come back to Chris's question on costs, just to clarify what's going on in terms of this investment spend. You're suggesting in 2020 we'll have a removal of a chunk of that …

. . . .

Katie Murray, Chief Financial Officer
Of the strategic costs, yeah, yeah.

. . . .

Question
I think at the moment - part of the problem I think has been the profitability hurdle regards whether you capitalise versus directly expense through the P&L …

. . . .

Katie Murray, Chief Financial Officer
… For NatWest Markets and yeah …

. . . .

Question
Just to clarify we're not in 2020 going to see essentially a shift from - so the capitalised spend isn't going to pop up …?

. . . .

Katie Murray, Chief Financial Officer
No, no, no you're not, no - no sorry. So NatWest Markets isn't going to continue with its level of investment but all of a sudden they've magically got to above, I'd actually love to have that problem and say to you, yeah, they're above 10% cost of return and so therefore actually I'm happy to - I'd say if they actually came with that I'd happily give them an extra couple of hundred million to spend on investment sort of thing.

But no, no that's not - we're not doing it because of clever trickery in the background. It really is - when I look at the investment portfolio I mean we talk about the billion, internally I'm managing both a cash and a P&L number, and that will kind of continue as it goes on. But the £2.5bn is a cash number. And when it's gone it will revert to this kind of £500m.

. . . .

Question
That's great, can I ask a question maybe to Richard on IFRS 9, we've obviously had a lot of disclosure now from the domestics, of which I think yours is almost certainly the best, I wondered if you had any sort of high level comments on the relative prudency of your provisioning on stage 1 and 2 versus the others, without necessarily being specific about those others.

I think the thing that struck me most within the disclosures is the sensitivity of the stage 1, 2 stock to downside scenarios, it looks very low. Again, you talk a lot in the accounts about your modelling and mean reversion and these sorts of things, the other banks are very standoffish when you ask them about this. So maybe if you could help us understand what you're doing in terms of mean reversion and the like, that would be helpful?

. . . .

Richard Lawrence, Head of Accounting Policy
Okay, so I think looking at the UK banks subs results, I think is more interesting because I think you get more direct comparability on things like - obviously on mortgages and cards and stuff. And I think that has reinforced for us that we are relatively conservative against peers.

I think what we are working through at the moment and what we're looking at is the trade off in terms of size of our stage 2 population versus the coverage, because the natural expectation would be that if you have a higher stage 2 population you would expect to have a lower coverage. And we're just seeing a few areas where we are high on stage 2 percentage and then relatively high on coverage and therefore that would indicate a face value greater conservatism. What we're therefore wanting to look at is actually is that just conservatism or do we think there are other things that we're seeing which might pull us back from that.

But I think certainly we've always maintained that we think we were in the pack and in some areas we thought we were top end of the pack and in some areas we thought we were bottom end of the pack. I think what we're now seeing is that we're now more consistently sort of top end …

. . . .

Katie Murray, Chief Financial Officer
Slightly more conservative …

. . . .

Richard Lawrence, Head of Accounting Policy
… Of the pack. I think it certainly means that obviously one of the big questions that we've often had from regulators and stuff like that, is when you look at say credit cards should we use a proper behavioural view rather than our three year lifecycle. And again, you look at the credit card numbers, I see we don't - we actually look at those and go well there's no need for us to carry more provision there. So I think that is certainly true.

I think in terms of the forecast as well, again, it's always difficult because obviously all the banks put out average numbers and you never quite see the profile. And whether or not you're V shaped or L shaped makes a difference, because L shaped will typically have a much bigger impact on ECL carry. But our averages again look slightly more conservative to peers. And again we are sort of beginning unpick in terms of if you look at the sensitivities do those indicate whether people have taken L shape or V shape in terms of how that works.

We obviously, particularly in the wholesale side, we do use mean reversion, so that's - and that mean reversion is basically a natural pull of our forecast back to effectively a through a cycle view. And we do that more because I think we do see the conditions being quite benign. And I think from a credit positon I think we feel that it's inappropriate to just let that run and we feel more comfortable bringing that back to a more through the cycle number, which - it's not obvious whether others have done that.

So I think that would come in and again that would tend to give us a level of conservatism. Obviously we're the only bank that has given a view around through the cycle, so we can't see a direct comparison of that.

And then in terms of the sensitivities, I think the one that - at first view gives us most interest is the mortgages one. And I can't do it without naming the bank, is that Lloyds have a very high shift on mortgages for HPI, if you compare Barclays and ourselves, we're much more similar. And given that generally speaking Lloyds aren't that high on their mortgage coverage anyway it seems a bit strange that they have the jump that they're showing, because while we did see and we call the fact that you do have non-linearity, so if you were to double that - we show 5% if we were to double that to 10% you would see a more than doubling of our number. But even if you more than double our number you're not going to get anywhere close to that hundred. So I don't know what else Lloyds did to get to that. So I think that's something that we will be looking to unpick a bit more. I think that's the other interesting one.

I think otherwise the wider sensitivities, given that most - if you look at the comparative weightings of the scenarios that people have given the sensitivity on, a lot of them are at 30% and we're at 15%, so therefore that fact that our number is a bit higher than everyone else's doesn't necessarily give any particular cause for concern.

But I think that sort of feels like where we're coming out, but as I said I think credit cards are something that we may look at in terms of you know actually why is it that our staging comes out quite so high compared to everyone else, because we're double some.

I think on the others there's probably less that we'd look at and do we need to change anything. I think it just is - as I said we'd suggest that we are just being suitably conservative.

. . . .

Question
Come I come back to the income line please, I think one of the things that's - I'm trying to find it, but is trial balance sheet basing become a pretty sort of thankless task in this sort of rate and credit environment and obviously I'm just wondering, your peers are talking about things like insurance and wealth management, or sort of transactional or payment based revenues streams. So I guess from your point of view are there sort of any meaningful things that you can do that would help that part of your revenue stream would be my question?

. . . .

Katie Murray, Chief Financial Officer
So I think there are things that we could do in that space, but the reality is that they would probably require quite a significant level of investment or acquisition activity, because that's not something that we have in our kind of arsenal today.

So I mean obviously we continue to look at the opportunity to increase that fee income space, but it's not a lever that we could pull very simply in terms of what we could do.

. . . .

Question
Maybe to follow up on your digital offerings, you announced a digital only SME bank last year, obviously you have got plans on the personal side, could you give us an update on how these are running and how material can they become in the context of the wider Group?

. . . .

Katie Murray, Chief Financial Officer
So in terms of - what I would say is they are going well in terms of where we are, we're in beta testing on the personal bank side of things, and that's - actually I think I get my own card next week, so we'll see. But it's at the kind of first stage. We are quite excited about it, we think it will be something that is quite good, but we need to get through the beta testing and actually get to launch.

So could they become material? I think - certainly from a valuation perspective you could see that they become more material and what we need to decide is actually how much of our customer base would we try to push those at different times.

You know Mettle I think is interesting - as maybe in terms of actually pooling the customer - sorry pooling the activity in the core and really advancing that. So it's almost as you flip these things into the core than actually that's where you start to see the real kind of build on them. But we've not got much more of an update than we've said that we can give at this point. But you know watch this space.

. . . .

Question
On Williams & Glyn, could you give us a sense of how the P&L would … ?

. . . .

Katie Murray, Chief Financial Officer
What we've sort of said if you recall that in terms of their income it was about £800m income, obviously a large portion of that was to do with personal as well. What we have said is if it was to go away as planned that would be about a £200m loss that you would see kind of coming through from the income line throughout this year and into 2020.

. . . .

Question
So when does it come - so obviously the scheme has gone live today in terms of … ?

. . . .

Katie Murray, Chief Financial Officer
So when does it come, I'd love to be able to tell you. I think it's a fascinating scheme.

. . . .

Question
Is it a Q2 thing?

. . . .

Katie Murray, Chief Financial Officer
I don't think - we think it will go throughout the year and into the early part of next year.

. . . .

Question
Right, because the challenger banks are saying there has been a change in the way the scheme is set up in the sense that they can all go, they can go after the entire customer base upfront rather than on a phased manner. So that would imply that there's more of an upfront hit to income?

. . . .

Katie Murray, Chief Financial Officer
Whether it comes in you know Q2 or later, we're personally probably more - we'd obviously like it to be later, but we're kind of more relaxed about it. I mean I think it will really depend just actually what happens.

So obviously the customers that you've got that have registered, they, I imagine will move much more quickly. I don't think there are sufficient customers registered to be able to meet the totality of the scheme. And that's the bit why we say actually it will take a bit longer. So if you're registered if the offer is good, if you've not, after all of this time registered, I think it will become more of a challenge.

. . . .

Question
And what proportion are registered, could you give us a sense?

. . . .

Alexander Holcroft, Head of Investor Relations
No, but we've said that there was a total of 200; we've said that around 120 will need to go and it will be a small proportion of that number, but we haven't ever disclosed what that is. And there are obvious reasons for that because of our competitors and pricing they may offer. So yeah that's why it's not disclosed.

. . . .

Question
But is it in your interest to get this over quickly, or is it you know - there's no point in dragging this out?

. . . .

Katie Murray, Chief Financial Officer
No, no from our perspective - look I think the teams have done an amazingly good job for actually getting a relationship manager to do that exact antithesis of all that you train him to do in terms of actually you know encouraging our customers to register. And then when the various opportunities are announced our relationship managers will talk to our customers. You know we've made commitments to do this and we'll put our whole kind of efforts behind it, we're definitely doing that.

You know and also for us - you'll be aware as much as we are that the next stage after this, if we don't get the right number of Williams & Glyn that actually we could open our NatWest books. We clearly do not want to do that in terms of saying, well actually here's our core customer base and access to that space is not something that we would be interested in doing.

So our interest is definitely in helping it happen and we'll wait and see. We've talked about these customers many times, they've been through a tremendously interesting kind of journey over the last number of years and yet they remain.

You know if you looked at the book now the book itself is smaller than it was, so as people have come up for natural refinancing they've maybe gone elsewhere.

. . . .

Question
It's very hard to move, that's the sense of the point that these customers - it's not easy to switch.

. . . .

Katie Murray, Chief Financial Officer
It's not easy to switch and if you're a small business, or a small/medium sized business the thought of switching and then dealing with all of your customers to get them to switch is - you're just going to like I just want to keep running my business and actually

this might make a smaller input in my income in this one year, but actually I'm diverting myself from what I do which is actually running this business.

So look I'm sure there will be interesting papers written over many years in terms of actually how to do you incentivise different behaviour. But we are really committed; we want it to happen, we think it will take over this year and into 2020 for it to happen. But you know if we could do it all quickly, while we would take our short term hit on profit it would be helpful not to have the distraction in terms of it.

. . . .

Question
Can I just ask on your updated guidance on RWA inflation, can you just say how much of that was perhaps initial conservatism versus better visibility of the rules, versus …?

. . . .

Katie Murray, Chief Financial Officer
I think it's just more better - we don't try to be particularly conservative on it it's just better visibility on the rules and as we kind of keep modelling it through. You know and we'll continue to update you on that from now until 2021 and as it's happening. Our aim is to get you as accurate as we can on the RWA number, not to you know - not to kind of - we did beat guidance that's not our intention, you know.

. . . .

Question
Can I just confirm on Williams & Glyn, the 200,000 customers, you've said 120,000 are subject to the Remedies package, does it actually mean that 120,000 need to leave or is it a lower number than that?

. . . .

Alexander Holcroft, Head of Investor Relations
That was the original number that was put out, but as Katie was saying some of those customers haven't renewed, but they've largely stayed. But that was the number that was put out.

. . . .

Question
So if 120,000 don't leave, that's when you start getting fined and - ?

. . . .

Katie Murray, Chief Financial Officer
So that's when I think we would then get to the point that we would open up the NatWest book, so we'd obviously have to work out how we did that and where we did it and what that meant. And then ultimately there is, I think after two years if we haven't got to that point, there's a sanction of the fine. I would say the fine is not as impactful as the amount of lost income.

So we're not trying to get there because we have to really show that we've done it, because we really don't want to open up the NatWest books. But that could be a place that we get to in the end.

. . . .

Question
I was going to ask on mortgage strategy, Les mentioned last week that there are a couple of areas you're either not in or very underweight in mortgages. I'm just wondering if you could share with us what those areas are?

. . . .

Katie Murray, Chief Financial Officer
I think you can probably see from our various disclosures as much as I'll probably tell you today, but I mean there are areas that we haven't competitive in, the same sort of set, I mean something like a buy to let would be the very obvious choice, I mean we're very low in terms of our market share in that space.

. . . .

Question
And on unsecured, if I went back a year, two years ago, you were probably the more conservative end of the spectrum in terms of appetite for growth in unsecured and it feels like that's changed quite a bit in the last - what's driving it, is it what you're seeing in pricing in that market, or what you're actually seeing in say the secured market, which has led you to think that unsecured makes a better return at this point?

. . . .

Katie Murray, Chief Financial Officer
I think one of the main things that has driven us is also been that it's a real I think outcome from the investment in technology. So I mean when we look at that growth it's mainly all been driven by actually how we use the app and this whole - what we talk about as always on. So there's always a kind of offer that's available to you in terms of lending. And the take up on that has been really good.

So now one of the - that makes it very nice unsecured business because you've pre-approved people based on the data that you know of them. As we kind of move out into unsecured, it's not now of our own customer base to the same extent, that's still attractive, but obviously you move a bit more slowly in that space, because you just don't have as much information on them.

But there's certainly, as I say some more growth that we could get from our own customer base, and then how do we continue to kind of expand that. And it really is about how do we make sure that we can continue with income, growth and wherever we move that too. So I think we'll see us continuing to have a bit more of a look at that market than we have done historically.

. . . .

Question
If I could just come back on Williams & Glyn and the remarks you just gave about customers being quite inert and you know people aren't really moving. Obviously we've seen the pool A funding awards this morning and looking at some of the documents that have come out there are some very punchy customer numbers in there. So Metro says it's going to get an extra 211,000 SME customers by 2025, Starling says it's going to have an extra - or it's targeting rather, I don't know whether this is extra, but 450,000 SME customers by 2023. In light of what you've just said about potentially …

. . . .

Katie Murray, Chief Financial Officer
The size of our customer base …

Laughter

. . . .

Question
… incentivise, I mean how customers do you have I guess would be one questions to understand, what would be the equivalent number for you if Starling says it's going to have 450,000 SME customers in four and a half, five years' time, what is your SME customer number if you were to compare to that?

. . . .

Katie Murray, Chief Financial Officer
About a million.

. . . .

Question
So you've got about a million, so they're going to be half your size by 2023?

. . . .

Katie Murray, Chief Financial Officer
And we would say that we get good acquisition of SME customers as well in terms of what we do around the whole entrepreneurial hubs and things like that, which is where you get a lot of the - particularly the S in the SME, yeah so we would say that those numbers would feel quite punchy.

. . . .

Question
They feel quite punchy, okay fair enough. And on opening up the …

. . . .

Katie Murray, Chief Financial Officer
Particularly if you add them altogether, it suggests enormous growth in the entrepreneurial end of our economy.

. . . .

Question
That's what I was doing and I was quite surprised by some of the numbers, but I guess that may have helped them win some money. In terms of the 120K and not hitting that threshold, is there a risk with opening up the NatWest Markets, or the broader NatWest book …

. . . .

Katie Murray, Chief Financial Officer
NatWest Bank, yeah.

. . . .

Question
… That you sort of undershoot the 120 and then you broaden it to a range of customers who haven't been told they are about to leave RBS for the last decade and all of a sudden you then suddenly end up overshooting where you're current expecting this revenue drag to come from. I mean is there - how would that work practically in terms of do the funds just become exhausted, or do you have to top it up?

. . . .

Katie Murray, Chief Financial Officer
I think we need to do more work to work out how it would work practically at that point. And that's something we will continue to do with the kind of EU.

As I look at it for it to go from a material undershoot, which is what it would need to be, so to a material overshoot would suggest that the customer inertia in the NatWest Bank customers is completely different to the customer inertia in the Williams & Glyn customer base. That doesn't feel terribly likely or else we would be seeing far more activity in those customers today anyway.

You know if you were a very active customer and you wanted to move in NatWest bank, what you should have done is move to Williams & Glyn about a year ago, get yourself into the pool that was moving, and then be encouraged to move again, to kind of create a completely different kind of behaviour. So I'm not sure that we would see them as particularly - as different in their approach to moving.

. . . .

Question
Okay, just one minor clarification …

. . . .

Katie Murray, Chief Financial Officer
… And I think bear in mind that - sorry - in the Williams & Glyn customer base they've had a lot less investment than the equivalent customer have had within the NatWest Bank space. So what our customers have, they now have the pre-approved loans up to £750,000, they have Bankline as a tool they can use on their mobile and things like that. So they are already well served. You know we have in our corporate base, we have very high - that's our kind of success story in the whole NPS space.

So they would be moving in theory if you believed all of those things to a lesser customer proposition more actively than the others. I think that kind of hard to believe that that would be where you would find yourself.

. . . .

Question
A very minor point of clarification, when you gave the million SME customer number was that inclusive or exclusive of any of the …

. . . .

Alexander Holcroft, Head of Investor Relations
I'm finding that out, I will come back to you.

. . . .

Katie Murray, Chief Financial Officer
Well confirm it.

. . . .

Alexander Holcroft, Head of Investor Relations
Because also remember we're moving business then as well. So we'll get back to you.

. . . .

Question
Can I just come back to costs sorry? This is obviously before you were - you weren't long in this, but last year obviously at full year results RBS came out and sort of missed the cost guidance. And Ewen at that time said that there we probably underestimated some of the cost …

. . . .

Katie Murray, Chief Financial Officer
Did we miss the cost guidance, or did we not beat it as much as you would like us to?

. . . .

Question
It was a slight tweak. And then obviously this year there was a slight tweak as well. So I guess your cost targets are very challenging when you put them in the context of the sector, because obviously you're holding - you probably haven't managed to invest as much as some of the other banks have, but you've got a very, very sharp cost reduction plan that is coming through.

So I guess the question is how much predictability is there within the 2020 cost base that gives you comfort, especially around the step up in cost reduction in the latter years?

. . . .

Katie Murray, Chief Financial Officer
So I think there are a few things that give me comfort. Property I have mentioned already, because you do it once, the cost is gone, the building is empty. For the building to empty there has to be a fair number of people who have also gone, so that I think is important.

We do a huge amount of work on tightness of recruitment; in terms of that to get someone recruited at the moment is a hard thing to achieve. You have to have gone through a fair amount of approvals, to the point that I sign off all non-customer facing recruitment and they have to bring it once a week and it is a very tortuous process. So the torture of it is helpful, because actually people think well could I use a different strategy to avoid the torture. So I think there are those.

So property you look at, I look at what we're doing on the whole - the kind of customer end to end journey piece. And that I think gives us quite a lot of comfort in terms of that space.

Ultimately it becomes the managing your FET, because that's actually the core of your costs, of we can really manage that FET space. What we've been doing on telephony I think is really interesting and actually how well our telephony centres really run, are we managing some of the core disciplines.

So look I think we have historically put out very tight kind of targets in terms of where we're going and we're looking and certainly working towards the delivery of those. And once we get there, what I talk about internally and now more increasingly externally is we should assume that the 2020 cost base is the end cost base. So you should assume that we will continue to manage it.

What I would think though is it is the end of massive kind of management of that kind of cost base, and there will be - we will be right sized.

. . . .

Question
Could I come back to excess capital, is there a plausible argument for using that excess capital inorganically, and would you ever consider that?

. . . .

Katie Murray, Chief Financial Officer
I think we do - look I mean obviously we've done some very small inorganic things which have been tiny. But I think that there is an argument to say that you know we constantly scan and see what might make sense to come into us. So I think while we've got that piece there is a scenario if the right thing came along we would be interested in looking at it.

I think that given our own history of the level of inorganic acquisition we have historically done then actually you would - I don't think we would necessarily get a great belief from the market if we did something that was very dramatic. But we would certainly - we continue to look at things.

And I think that that would help us on the - if we could do something that would help us on the income line, particularly, as well that would be something that we would be more interested in. But I don't want you to go away and think that we've move into a widely acquisitive phase, I think our recent small acquisitions would confirm that that is not the phase that we're in.

. . . .

Question
Just a small point, your £700m PPI provision in hand, is that a unique provision as in when we get to the end of the year is there is any left does that get reversed out or lumped into a different pot?

. . . .

Katie Murray, Chief Financial Officer
No so it is a unique provision, we don't - it's quite hard to move from one pot to another, I mean you're see it as a release and another one would go up and they would both kind of move through the P&L.

So for me what I'm interested in is to say, right claims close at the end of August, let's assume there is a huge ramp up, but we're kind of geared up for big ramp ups for these. It was interesting for me in January 28th when there was a focus in PPI; we got 5,000 claims that night. So the ramp up is massive, you know when we get a ramp up it's thousands that come through. But we're there.

So if there was a dramatic ramp up how long would that take for us to get through? But even in that ramp up would you assume that actually there was a percentage change in ones which were real and ones which were the kind of have a go claims. You know and it's interesting the number of people I hear talking about - oh I might just have a go and see what I can find, which is quite interesting.

So look I wouldn't like to say that there would be a release in there, we think we are there. I'd love to write a bit back and you know if we did that would be great. But it would be a small number I would think at this point rather than anything more substantial. And hopefully it's that rather than the reverse of adding on another kind of £100m because actually the ramp up was so much in August.

. . . .

Question
A bit of a geeky one, could you talk us through your post model adjustments, because I think you've got about £90m of post model adjustments on the book, incremental to your Brexit overlay and about £60m of those were due to changes in the data since year end, can you talk us through what the changes and what the circumstances are that we need to see for post model adjustments and their reversal?

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Richard Lawrence, Head of Accounting Policy
If you put …

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Katie Murray, Chief Financial Officer
I would encourage you to stay a very high level Richard …

All talking together

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Richard Lawrence, Head of Accounting Policy
In terms of the total quantum I think I will. I think - I mean clearly there are three sort of key drivers in terms of the post model adjustment. One, is model predictability, so if we are seeing a difference in the predicted outcomes of the models then we will make an adjustment to correct for that. So part of the adjustments that you have there were dealing with under prediction in some of the PD models.

Again that is something which is then filtered through and as the models recalibrate and refresh then those PMAs would disappear.

We will then have model adjustments for data, so if we're worried around some of the data quality pieces that we have, then we will make adjustment for those. Those will tend to be conservative, so we will basically take override prudence assumptions. And the issue for that is simple because we are trying to pool the data through central systems you may have null fields come through, but you need to population those to do it.

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Question
I guess the changes in data were due to that rather than changes in the macro data?

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Richard Lawrence, Head of Accounting Policy
Correct. And then the third area is out of model risks. So I think the one that's highlighted in our commentary is obviously the interest only, so we have an overlay for interest only because that's essentially a risk that is not actually covered within the model that we're running. So those are the three areas that we're running.

Clearly, as our data capture improves through systems then that will tend to lead those to fall away and we had a number of those fall away last year. We will also have - there are always going to be something in model calibration coming through because essentially we have to make - the moment we spot something we have to adjust for it. And it takes maybe another six months for the model to catch up.

And then the final one is just in terms of if we - it's more of an expert credit judgement, if we suddenly think there's a risk out there that we're not capturing through the model process then we would adjust for that.

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Alexander Holcroft, Head of Investor Relations
Any more questions?

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Question
Can I ask one quick one again, sorry, on impairment - is there any reason Richard why we can't just take these IFRS 9 12 month PD numbers in the accounts for each loan portfolio and multiply them by the coverage that we're seeing in stage 3 to get your impairment charge expectation for this year? It seems like we've got the numbers there to tell us what's in your budget for 2019?

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Richard Lawrence, Head of Accounting Policy
So I think - I think - so I think in terms of what would go to default I haven't looked in terms of could you take on numbers or our 12 month numbers and multiple that by stage 3 coverage, that's an idea I'll have to take away and have a look at.

I think the one piece that it wouldn't pick up is the general - is the macro shift because the - so the core part of our provision number is actual default, so therefore that's why that might work I've not looked at it in terms of the natural flow through. It probably works better on Retail where you have a faster path to write off than on the wholesale piece.

But the macro shift will tend to lead to - if you have a deterioration or a migration upwards in terms of PD that pushes the whole lot up, so that would actually naturally increase coverage as well. So that change in economics would actually lead to a change in your coverage, that would shift your coverage overall I think. So that's the piece that you wouldn't get from a straight flow through of the 12 month number.

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Katie Murray, Chief Financial Officer
Okay. Thank you very much for your time.

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END

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