



NatWest Group plc

Q3 2022 Results – Sell-Side Update

8th November 2022

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Alexander Holcroft, Head of Investor Relations (AH)

So, thank you very much for coming. Good afternoon to all of you. Welcome to the Q3 results 2022 Sell Side Update. Katie will kindly give us a few words to begin with. We'll then come to questions within the room and then some of your colleagues on Zoom, we will switch over to them at that point. So, with that...

Katie Murray, Group CFO (KM)

Perfect. Lovely. Thank you very much. And good afternoon, everybody. It's lovely to see you all in person as well. And also, happy to have those on Zoom joining us as well. So, joining me today, I think familiar faces to all of you. Donal Quaid our Group Treasurer, Matt Waymark is on the line as Director of Commercial and Institutional. I've also got Peter Norton, Director of Finance and then it's Stuart Nimmo also on the line as Director of Retail Bank.

Just before we open up for questions, I'm just going to remind you of the updated guidance that we shared the other Friday. First 2022 income, we told you that based on the faster rate of UK rate rises up to 2.25, we expected income to be 12.8 billion, excluding the notable items of about 300 million, and so excluding notable items, about 300 million higher than we spoke about previously.

We also guided that our guidance, the full year NIM to be greater than 270 basis points to reflect the net interest margin at 273 basis points for the first nine months and the ongoing momentum into the fourth quarter. So, moving from above 270, to above 280. Clearly, obviously, since then, life's moved on a little bit as we expected it would increase rates by 75 basis points to 3%.

Since then, obviously from the Bank of England, which means Donal was right and I was wrong, I thought it would only be a 50 basis points increase, but that's okay. And we said we did expect the increase in interest rates, and we do expect more impact over the coming months in terms of obviously the November statements, which will bring us more news. You're obviously all familiar with the interest rate sensitivity that we share with you.

And I think that that works well, for you to take any views for any impact on income that would have. If we look to 2023, we are increasingly confident on our plans to deliver a return on tangible equity of 14 to 16%. The makeup of returns has changed given the evolving macroeconomic outlook, and we now expect income, cost and impairments all to be higher than we expected at H1.

Importantly, we do continue to see a favourable operating outlook with income growth more than offsetting any cost growth. The extent, of positive jaws will depend primarily upon where interest rates settle and how they behave during 2023. Inflation is putting upward pressure on our cost base. There are no major restructuring charges coming. As you know, Ulster is progressing well.

And we have given you guidance on the exit costs associated with that. We are two years into our three-year investment programme which continues to drive efficiencies and we remain committed to delivering on this. On impairments, as you know, we adjusted our weightings to the downside which drove the impairment charge in the quarter. We continue to hold £545 million of PMS for economic uncertainty and remain comfortable with our coverage levels.

Given the deterioration in the macroeconomic outlook and the current performance of the group, which is excellent. We do, however, expect impairments to be within our 20 to 30 basis points through the upcycle, average rather than below as we originally had been talking about. Now we're very happy to move on to questions.

James Invine, Societe Generale

On credit quality please - so we've got 3.5 billion provision sitting on the book at the moment. You said that in your extreme downside scenario, you have to add a billion or so to that. Can you contrast that with the stress test where you were showing kind of nearly 10 billion of impairments? I know that the stress test is a tougher test, but it still seems like there is some kind of big difference now.

KM

Yes. So, I guess in terms of the stress test, and I have to say, you're challenging my memory a little bit of this stress test, but I'd ask you to bear in mind that I've probably done the 20 stress tests internally since we published that one over 18 months ago. We're obviously in the middle of finalising our submission on the current stress test, so I won't probably give you the exact comparison, but I think there's a couple of things to remember.

So, in terms of that, moving a 100% to the downside, the extra billion, that's only stage one and stage two, you would then obviously have an amount on stage three. We don't seek to try to estimate what that would be, because it would inevitably be tall trees that are coming through on the commercial side. And so, they they're by their nature, very hard for us to estimate because they're very the very industry and clients specific in terms of that piece.

But you could assume that there would be some further down sides that that will account for some. I actually can't remember how the ten billion is made up, so apologies for that. But that's an important differentiating factor in terms of that piece. I suspect the 10 billion is a multi-year number rather than a single year, so I'm giving you a single year number.

So, in terms of that year, if you took my impairments over the next five years, then you can get to a number that would be significantly above in that 20 to 30% than of through the cycle kind of guidance. But the main differentiators will be and stage threes which we don't give you estimation of and...

Alexander Holcroft, Head of Investor Relations (AH)

And there was also you remember quite a lot of RWA inflation within that number and where we stand today, we're still seeing a little bit of positive procyclicality.

KM

Yes. I mean, that would obviously impact on the impairment charge, but the positive procyclicality is important as well.

James Invine, Societe Generale

But I mean, given the macro inputs, you didn't have a particular problem with the outcome that came to the impairments?

KM

No. I mean so we, we recognised, you could assume that we debated long and hard about the ten basis points for this year. And you've heard me say that based on the book and how it is performing today and then I'm comfortable on that ten basis points. You know, I've been pushing the bank Exco team this morning, and there's 29 kind of real working days until the end of this year, assuming we all kind of stop on the 16th of December.

That just happens to be my last board meeting. So, I think you often get a lot of gifts in December if things are really, really tight. That's when you start to see things moving. But at this point today, based on what we see today, I'm incredibly comfortable. So, what we do need to see is obviously made.com went last week, but we're not exposed to that.

But you can read in the paper murmurings from others. We are a whole of country lender. Eventually one of them will be ours in terms of that piece as they come. That's the thing, that sort of moves it, but based on performance of the book today comfortable with that kind of ten basis point number in terms of 2022 and then expecting that number to increase as we move into 2023. Because of the macroeconomics, you will see more things fall. We're just not seeing it in our books yet.

Otto, Stifel

Thank you. Could I just raise a follow on to that. I mean, there's many, you know if you open any newspaper these days. It's doom and gloom out there. I'm just curious, I mean, why it is because I mean, the message you give, I think is consistent also with most of your competitors and even around Europe by and large. I mean, how do you explain that?

I mean, because I mean, you know, you read about potentially severe recession coming the Bank of England this morning, consumers are in stress, etc., etc. I mean, you know, companies are starting to default even. How do you explain that? There's no visible stress in your books yet.

KM

The piece, if I was to be flippant on the press is misery sells newspapers in terms of that. It was interesting Alison and I hosted a dinner with some of the top financial journalists in the country a few months ago and you know I kind of felt, their narrative and I don't want this written up in your notes but their narrative was a desperate search for stories of bad news, you know, in terms of that piece.

And that for me is part of the problem in terms of that piece. However, the Bank of England sits in a different position, obviously. And so, they're not trying to sell their newspapers in terms of that piece. So, I do look at that. And we if you look at our own expectation, that also does talk to us of a shallow recession. The Bank of England commentary of last week was more was more severe on that.

And that's I guess, the way that I can explain it is cost of living crisis don't affect everybody in the in the same way in terms of that, you all know that. If I look to our more higher earning retail customers, we still see them saving 30 to 35% of their salary every month. So that means actually, as things become more difficult, your cushion, which you already have, is continuing to grow in the run up into this period.

You know, we don't bank, we're a prime book across all of our all of our products. And so, we don't bank those are going to be kind of hardest hit. And even in people's ongoing activity in terms of inputs, you can see going through their current accounts and their debit card, and their credit card spends. We think that you could maybe start to see, and I mean, Stuart, I'll get you to jump in the start.

The first kind of maybe people are kind of pulling back - it's interesting. I was listening to Ryanair's results yesterday morning, know one of the things that they said that they're expecting great continuing profit growth into 2023 because what they said is that all those that used to fly British Airways will move down to Ryanair. And so, so you seek alternatives rather than kind of stop activity.

So actually, it's how do people continue? So, in terms of that piece, so I do think as we look at the activity of people, they're not yet feeling the pinch. Stuart, you want to jump in?

Stuart Nimmo (SN)

Yeah, sure. Thank you. Katie, just a quick note that the Zoom camera has done something strange on the main focus in London, but nevertheless, we can see in thumbnail. Yes. So, on payments data, if I take credit card data by, by example (oh we're back) if I take Summer, so June to September as an illustration and try to look through seasonality around travel in particular, we are beginning to see just the first signs of consumer spending reducing in discretionary categories down low single digit percentage points. It's not perfect because it's hard to isolate that travel factor. But we are starting to see that which is, you know, is a new trend, following things opening up post-COVID. You know, on the flip side, it's a nuanced picture on the flip side of payments data on debit in October was quite strong and up a little bit on what we've seen.

And that included domestic spend and international spend. We've got October break for parents and families. I travel abroad, no doubt a factor in there. But I think overall we are starting to see just a little bit of sign of belt tightening on discretionary spend. You can start to you can see also, if we look at the market level on things like loans and mortgages, clearly you can see a slowdown in those markets as well.

KM

Thank you, Stuart.

Perlie Mong, KBW

It's Perlie from KBW, so sort of slightly following on from it. But obviously we'll have to wait and see. But the Autumn statement looks like it's going to take 50 billion out of the economy. And on top of, obviously, interest rates going up, so mortgage payments going up. So that's going to be like the 70, 80 billion out of the economy.

That's significant even in the UK context. So where do you think that's going to come through in the numbers as it were? So that's one and second, you mentioned the investment programme. So, I think you previously said a 3 billion spent across 2021 to 23. How much have you spent and is there scope for anymore, next year or obviously because income and borrowing is very healthy and just wondered how that plays with your cost guidance.

KM

So, it works out 2 billion a year, 1 billion a year, forgive my maths went to hell there, about a billion a year we spent. We we're two years in. It's about 2 billion that we spent might be 2.1 to 1.96, but it is about 2 billion in terms of that piece. Look, I think one of the debates that we'll certainly be having at the moment, is obviously, as you see, improving income it is an opportunity to make sure that you take the opportunity to invest some of that in terms of that piece.

And that's something, like your organisations we're finalising our plans at the moment and that would certainly be debate that we're having, we're having internally but no change to the 3 billion a year kind of guidance. I think the important thing with the Autumn Statement is so the statement is on November 17th, it doesn't all leave the economy by November 18th, many of the things that they give will be multi, multi-year.

You know, if I look at some of the testing that they're doing, they seem to be giving quite a few things that would then really kick in post the next general election, so maybe leave it to their successors to have to deal with some of those issues. So, I think what's going to be interesting is for me, what do they do on public sector salaries? How do they fund that? And what do they do on the highest rate taxpayers. So, the higher rate taxpayer, obviously, if you're at the margins of the band, it impacts you if it goes from 45 to 50. If you're further up, it impacts your savings. You're saving 34% of your salary sort of thing, so therefore, you've been saving 30 in terms of that piece, so how does that kind of come through?

So, I think it's one of those things. What we know is if they're taking money out of the pockets of the retail customers, then they are having to manage electricity going up, mortgages going up, food going up, income kind of going down. That's where I think we'd start to see a much bigger trend on the debit / credit cards picture we see that we see just now. If they're doing something on the commercial side, I think the news flow seems to be well it will be quite targeted.

It seems mainly at energy companies, let's see if they look wider to other sectors as well. And we'll see how that kind of comes through. And then it says, obviously, as you then think, it's how do they actually deliver their tax cuts in terms of that piece, but it is a multi-year thing rather than a single year, so they will take a lot out.

But it's also some of it's reversing of plans which've never gone in. So, you get into a bit of a circuitous kind of route in terms of what might actually happen. I think for us what we look at a lot is what's happening on M4, of what's happening on unemployment and actually what happens on both GDP, which at the moment we think it falls, but it will be low going forward, but not necessarily negative for multi-year periods.

Guy Stebbings, BNP Paribas

These are two questions. First one is just on IFRS9 what you actually did in Q3, because I think you updated the individual scenarios at half year and full year and on this occasion, you changed the weightings. I don't know whether you effectively come to the same conclusion that you would come to, had you done, played around with individual ratings or whether it wasn't quite as detailed as that.

So just how to think about what you've done versus what you'll do at a full year. When you go through a full process of updating individual assumptions of how that might look differently. And then the second question is on the mortgage market, just a sense of...

KM

Why don't you hold that one? And I'll do the first one. They'll come back. To save me, I've stupidly not got a pen don't so I won't remember, to write down your 16 point powerpoint on the mortgage market, thank you very much Donal. So, if you look at what we did on IFRS9, so we only do economics twice a year. We do believe that's what things do because I think otherwise you just get an awful lot of noise kind of going through it kind of gets there.

But I guess where we got to, we were a little bit uncomfortable with the level of movement there was, so, we decided this time to change the weightings. We've got some. So, we ran those changed weightings through the models. So, it would be a kind of bottom up build-up of those results. We then over the last couple of years, we built quite a nice little sensitivity tool, so said, well, what if this happened or if economics got much worse there?

What would happen here? Are we kind of comfortable that we sought to kind of capture most of it? I would say at that stage we were I would also, you know, we're so comfortable on the ten basis points, you kind of think actually they've kind of built in as much as they have. Internally, I probably have a slightly bigger charge than I had previously in Q4 because I thought it would take six of the ten basis points but on my own kind of forecasts, thinking a little bit more is going to come in as we do because of the sensitivities that we ran.

But we kind of sought to try to replicate it. We're now in the process and I had my first meeting on it on Friday of what are the economics we are going to use for the year end. But obviously waiting till after the November statement before we absolutely cut them, you know, and how much have they moved. You know, one of the things where you know, when you look at it, you think our extreme downside, we probably normally we dispatch that to the ACS scenario very aware that the Bank of England whose set of forecasts no longer match their own ACS scenario.

So how are you going to deal with that? So, we're kind of dealing with all of those kinds of fates. But what I would say is what we did is probably no less robust than any of the other banks, we just did it by our weightings and it is a bottom-up kind of build that comes through.

And we would run sensitivities on the side to make sure, particularly for that piece of guidance I gave you, that would be quite well tested, now if when we cut them after October, if our economics are worse than what we're imaging at the moment, they clearly will have a different outcome. But you'll be able to see that in the economics.

Okay. Mortgages

Guy Stebbings, BNP Paribas

On the mortgage market, just to get a sense as to what you're seeing at the moment in terms from a volume picture. So, I would assume prepayments are going up, repayments going up because people what we're hearing anecdotally have been pretty sensible in trying to manage down debt, ahead of

having a repricing on the mortgage, which obviously comes with a headwind from a volume perspective, and it looks like house buyer approvals are obviously drying up quite a lot.

I'm just trying to get a sense of how much of a drop we going to see. Is it too conservative to think mortgage growth could be flat in 2023? How you're thinking about those trends, you're seeing right now?

KM

Yeah, no, absolutely. Do you want to start Stuart, and then I'll add on.

SN

Sure, look obviously looking forward into the market and it's a bit of a crystal ball but I'm going to start with the final point. I think flat is too conservative. And from where I stand at the moment and it's probably worth remembering that into the beginning of 2023, we've started to build a pipeline into the last part of Q3 and into Q4 and we've had a very strong October from a trading perspective, given the actions taken to support our customer base and the UK economy by keeping our products on sale.

Looking forward, what we'd be expecting. We've had an incredibly strong mortgage market year to date in 2022, probably consistent with the, on the year-to-date completions up to the end of Q3 certainly a market in and around the 300 billion territory, similar to 2021. From here if I give you the flavour of some weekly applications CACI data to maybe give you an idea average apps, weekly apps in Q2 were 8.6 billion - 7.9 billion in Q3. And the last week I have is 5.1. So quite a big reduction following the turmoil from the end of September and increases in market pricing. So, whether that's a number that should be extrapolated or not, it probably is a result of where we are at this point in time. But we're certainly looking at a market lower level than we've seen so far in 2021, probably somewhere below what we saw, more like below what we saw in 2022. So far and below 2021, maybe 10%.

KM

And then Stuart in terms of the repayment income that we've seen, I mean, it's obviously a feature, but I don't think we're seeing it moving particularly.

SN

It's a feature. It's not a material feature. You know, we haven't really seen any material pickup in that so far, to be honest.

KM

I think one of the things I'm kind of interested is actually so because I hear it anecdotally around the dinner tables of businesses that are repaying as well, what people are often doing as they come to their remortgage point, is that they're looking to see do they have any extra cash to put to it at that point to bring to bring down their payments rather than necessarily actively seeking to pay the upfront charge?

Because if you're on a low rate, they kind of accelerate coming off that rate, to go on to more expensive rate, unless you're making a very substantial repayment, which people wouldn't have the capacity for isn't that sensible. So, I think because I hear the same narrative but we're not seeing a movement

particularly in our early repayment pieces, I think one of things we will look at as we go into the year end is we seeing a moment where people have the opportunity to kind of charge free?

Do we see that kind of movement as we come through, but we have it's not become a different feature of our income. But if it did, we'd call it out.

In a moment we're go to go to the phone to Robin and then we'll come back to the room. Hi, Robin. Nice to see you.

Robin Down - HSBC

Hi. Yeah, and thanks for taking the questions. I've got a couple of small ones. And then another question on costs, the dreaded cost subject. Just a couple of small ones. I don't know if you could give us some indication of what the structural hedge did in Q3. It's just very useful for forecasting going forwards to have a kind of actual baseline, I know you've only given us kind of the numbers back from 22 H1.

So, any kind of indication as to what the number might have been in Q3 would be great? The second question, just maybe one for Stuart, I don't know, but on the mortgage side, I think the UK Finance tell us that the average remortgaging customer has a household income of about 83,000, and an average mortgage of 150,000. I would guess given the size of NatWest books that you're broadly in line with that.

So, I just want to kind of confirm is that is that nodding to say yes, you're probably in line with that. Yeah, okay great. The third question really on the dreaded cost base, I mean it looks like you're going to see double digit revenue growth next year and you're obviously originally being looking for kind of flat costs. And we all appreciate inflation has picked up, but has it picked up enough to like sort of materially alter the picture such that you're going to end up with high single digit cost growth?

Personally, I can't see it because half your costs are staff costs. I'm assuming we're talking about kind of, you know, 5-6% kind of pay rises going through there. But is there anything particularly you know, you want to call out on the cost side where you have seen kind of pretty dramatic inflation that might get you into that kind of high single digit bracket.

KM

So, I'll start with costs, then I'll come to you Donal on the structural hedge. Right. So, no, we're not expecting high single digits. I think that's what we had said around our guidance for next year. We saw significant improvements in our operating leverage. We saw improving cost income ratio and to have both of them means costs need to be kind of contained or else that we wouldn't be able to get to that kind of level of confidence on that side of piece.

And you're absolutely right. Half of our costs are our staff costs. We're obviously in the in the point of kind of having the discussions around what next year's pay review might look like. But I would agree with you the don't think it's likely to be at the peak given inflation just higher, so it's not there but I mean definitely I guess we never suggested we'd be high and we try to guide you away from that.

So that can be kind of re-emphasise that. What I would say, if you look at the cost base 50% of our costs are staff costs – they will be, are whatever the wage rate is. You can see what wage settlements are at

happening at this time? We're not going to be out of line with that. And then 20% of the other admin costs.

And in there you do see some higher numbers coming through on some specific contracts. The example that your finance departments will all be moaning about recently is the 10% increase on Bloomberg costs that were put across the board. You all have more terminals than I do. Probably in that space, that one, maybe hurts you a little more than it does me.

But it's an example of actually there are some big costs coming through on that side. And it all depends on what contracts are up for negotiation. Now rather than next year or the year after, what be due see them coming through. We've obviously then got property related costs. You can see what we're trying to manage our footprint and then depreciation and amortisation kind of coming through. But no changes on depreciation from what we knew in June. So again, there's nothing, nothing coming through there. I think one of the conversations that was going around was, is there some large restructuring costs? We're not telling you about the reasons. You know our restructuring costs in terms of that piece, what we are confident about and increasingly confident about is on our 14 to 16% return.

In terms of where we're there, so 14 to 16% return, improving kind of operating leverage and an improving cost income ratio as we move forward, Donal.

Donal Quaid, Group Treasurer

Structural Hedge in Q2, not a lot to be honest. So, it grew by about 1 billion, you see that disclosure from 230 to 231. Again, quite mechanistic. So, about 10 billion of maturities per quarter rolling off roughly 70 basis points, rolling back on average five-year rate of above 3%. I think about 305 is the average five-year rate for Q3.

As Katie said, at Q2 results we had previously got a better income upside of about 600 million to structure for that full year. We now have, are saying 700 million given the higher rate profile we've seen through Q3. And then as we look forward, we expect probably growth of 5 billion and the structural hedge over the next 3 to 6 months if our balances remain static.

Robin Down - HSBC

Brilliant. Thank you.

KM

Thanks, Robin.

Omar Keenan - Credit Suisse

I've got two questions, Omar Keenan Credit Suisse. So, the first one is on total payouts. So, I guess what we're looking for the fourth quarter. It's some reduction in the Ulster RWAs.

KM

We'll see that happening, yeah.

Omar Keenan - Credit Suisse

Which should lead to a nice uplift in the core tier 1. Can you talk about how you're thinking about you know further in-market buybacks (IBB) vs maintaining capacity for the directed buyback at some point early next year and how the evolving macroeconomic scenario affects your thinking on how far you want to pay down the core tier 1 ratio, so we can get a figure out there in market buyback.

And the second question is, I guess we're looking at these corporate insolvency statistics. I was wondering if you could help us think about whether there's any noise in there from stuff that's been going on in the press? And I guess one related to that, on the corporate book, we've discussed the stressed interest rates and mortgages quite a lot. Can you help us think about the interest rates in the corporate book and maybe what revenue stresses you put on there.

KM

Yeah sure, I'll start with the capital and then I'll touch a bit on corporate insolvency. And then Matt I'll come to you on the stress distressing of book. Okay, so when we look at it, so 13 to 14% its important to remember what's in there. We've built into our guidance the fact that CCyB buffer will go to 2% on terms days, that's already thought about as we move forward.

It's also based on our stress testing, both the historic ACS, the one that we're working through just now. The various ones we do kind of internally as well. And that 13 to 14% is designed to be able to withstand the stresses that we're seeing in the market just now. So, there's not an internal narrative of we're not going to try to get to 14% by the end of the year, because we do believe that 13 to 14% is the right place to run our bank in both good times and bad times in terms of that piece.

So then when you think of the kind of the IBB we obviously, we've been very public about this, we don't want to go above 50%. I think the advantage of us not being in the market over the last kind of half since summer is there it has allowed to government to kind of get their percentage down. You know that they just issued a TR1 form a little while ago to say they'd gone below 47 - they continued to trade a bit after that. So, I mean, they're sitting about 46 and half at the moment in terms of piece. That gives us some nice capacity to go at actually. If we decided to do an IBB, we can do it without... what I don't want to do is get into a horrible stop start, that we're always pulling out because I think that would just absolutely mess up the kind of the stock prices as well in terms of that piece.

So, as we approach into the end of the year the conversation which will initially have in December with the board, is sort of to say you know, we've been very public on our ordinary payout policy is 40% - you can work out your own reasons as to what that would be. You're right that should give us some capacity and we're very clear that we always want to maintain capacity to take part in a directed buy back. It is the early part of next year. You won't watch this as closely as I do, Omar. But I think it was sort of the evening of the 27th, that we did it last time round. So that means you've basically, I think got about the 28th, the 29 to actually execute it in Q1. So, it's actually it's a very small window that you could actually do that execution and it's quite late to the quarter as well.

So, you've also got benefits of it being later. So, it could easily slip into being a post Q1 transaction depending on what happens. You'll be familiar with the issues of open periods and closed periods, not just for us but also for the government in terms of this is only a very small window in terms of that piece. Always let's make sure we maintain capacity to be able to do that.

And you know, if there's any excess at the end of the year then things we'll debate is whether it's time to do and to do a further IBB. Comfortable with where the government's got to. But the 13 to 14% is designed for good times and bad.

In terms of corporate insolvency. When you look at the PMAs in our accounts and you can see how they are kind of split across each other, you can see that. 355 million of that sits within Commercial and Institutional - that number is split over two bases. One is a kind of cost of living build up where we looked at companies that we thought would be most impacted by energy supply chain type issues. There is still a little bit of legacy COVID in there. And that relates to the insolvency piece, because what we felt was that there would be more insolvencies coming through. Although we see and we observe when we do the investigation ourselves in the press, what we're not seeing is actually coming through in our underlying numbers.

So, it's kind of hard to know. But unlike in retail, where all COVID provisions have now been released in Commercial, there's still about half of that, which is kind of in relation to COVID, which was to deal specifically with that kind of points. We'll continue to look at it as we as we move forward in terms of that piece. But I don't think there's anything particularly that we're seeing. Matt, I don't know if you want to add to.

Matt Waymark (MW)

You are bang on, on the insolvency point. So again, in terms of how we, I suppose stress the book is we're doing new transactions. So, it probably flexes depending where in the sort of segments you are. But for the lower end, your SME, mid-corporate, we do an unhedged interest rate sensitivity where we apply the margin plus a number broadly that's sitting at around 3%, but we can flex that.

So, we stress test as we go through the approval process. We'll also include for specific sectors if you're a hotel or CRE we'll include energy rate sensitivities and so on. As you get into the bigger and project finances, they're much more bespoke and we will always do base and downside sensitivities whenever we're going through transaction approval. So, I think we do a fairly good range of key sensitivities and they are probably not so much defined by regulators their more stuff that we've built up over the years that we feel are appropriate, but it's very much driven by sectors and size of the book and so on.

KM

Thanks very much, Matt. I think we're going to go to Chris on the call. Hi, Chris.

Chris Cant, Autonomous

Good afternoon. Thanks for taking my question. I just wanted to come back to Ulster, please. I was wondering if you could just give us an update as to what to expect there. I think when I've looked at consensus in recent quarters, it's been an area that I guess we're all modelling somewhat inconsistently. So, could you remind us, what's come through in terms of the exit cost and how we should expect that to come through?

Or is it more charges through the discontinued operations line or is it is it now? I think it's now more running costs in terms of exiting. And in terms of timings, I think last time I asked you about Ulster. You were talking about potentially being able to switch the lights off in 2025. Given how transactions have

progressed to date, what, is that still your current expectation or might we see a complete exit a bit sooner than that? Thank you.

KM

Thanks very much, Chris. We can see that you're modelling it slightly differently. I don't think that's actually that surprising because there's kind of there are ranges of outcomes, that will be dependent on a on some of the decisions that we have. What we said is that the majority of the transactions with PTSB and AIB will be off the books this year.

They continue to progress well. We're pleased with how they are progressing through and then they'll go into 2023. So, then what we're kind of left with is we have to do some small book sales for remaining, some non-performing loans and some mortgage offset product, but they are pretty de minimis at that stage.

But they still need to go, in terms of what that piece about much more the focus of kind of 2023. We're pleased with how deposits are moving. I think something like 45% of the book is either moved or nearly moved. And we say that nearly moved is because they moved their salary, they've moved a lot of their direct debits. You can see that they're well they're well on the way.

We did target activity at the most active customers first. So, you would naturally expect them to have better traction in terms of that movement. So, we do think that most if I go through to 2023 that with most of the kind of assets and liabilities, we then will have the kind of costs and kind of people exit and staff kind of exit, branch closures and all those kind of things that we that we need to do, we've got to do to 900 million.

That's still broadly the right number. In terms of that, I think we've had about 550 (YTD). I think Chris, the slight challenge will be is over the next few weeks we'll make some decisions and that you get into the kind of is it and other than going concern kind of type entity and things like that. And if that is, allows you to make slightly greater provision in terms of the provisions you can make at the year-end versus how long you've got to implement that, you know, normally when you do restructure positions that has to happen within 12 months of that moment.

But if you go to other than going concern organisation and you actually can look a little bit further forward. So, we're having some of those debates now as how far forward are we on that piece. So, the 900 million is still good guidance. Annoyingly, it comes slightly lumpy. So, kind of when it sort of comes, it feels like a bit of surprise its landed in that quarter, though it is in of itself it just kind of takes a little bit of time but so, but they will come during 2022 and into 2023.

I would hope, I might close the door before 2025 and we've never given a definitive date, but certainly hope that we were well on our way and we're progressing well in that space. So, I guess it's kind of good progress and it's guidance is unchanged. You know, we might need to make a few decisions at the end of the year, which could change the shape very slightly. But given how much we've already recognised, it's obviously a smaller amount left to kind of to be dependent upon.

Chris Cant, Autonomous

Sorry just to clarify, maybe I misheard, I just want to get the number right. Did you say it's 550 of the 900 is being spent?

KM

Sorry yes, €517 in Q3 (550 YTD)

Chris Cant –Autonomous

€517 out of the 900.

KM

900. Yes.

Chris Cant, Autonomous

Thank you.

KM

So, a bit into this year, bit into next year, the exact split of that will depend. But given you've got less left than we've already spent, the movement around, it's not going to be significant.

Chris Cant - Autonomous

Thank you.

KM

Thanks, Chris.

Omar Keenan - Credit Suisse

I was going to ask what you think of the non-interest income piece at NatWest and how that kind of behaves in a high inflation, low real growth environment. I mean, we're sort of debating the lending book and whether that goes to zero. But can you help us think about what proportion of your non-interest in fees might be pretty much indexed to inflation and actually talk payments, interchange fees. So, I think also that the number of fees that were frozen this this year.

KM

So, we we've done, and I'll come to Matt and Stuart to talk in a little bit more detail. So just kind of as an opening piece we give you, it's on Slide 15 this time, I give you this kind of split between, you know, payment services, lending, credit, debit card fees and investment management fees. The rest of management fees, they're obviously very impacted by the value of the AUM.

So vis-a-vis, you can see some sort of movement on there and so that's going to vary depending on what AUM went from 36 down to 33, that's going to have an impact on that fee. So that will improve as those prices improve. You'll all have your views as to when that might be. It is a pretty, it's a particularly vanilla portfolio. It's not going to do something particular different from what else is happening through there.

I think then as you look at some of the other lines, what we're trying to do, if I look at things like Tyl and Payit, with some of the payment services fees we have there to actually get them much more embedded. So, it's less about inflation and more about kind of continuing use and embedding within our kind of customer base. But rather than me going through all and then having over to Matt and Stuart, left saying she said everything, Matt can I come to you first and just think about how the inflation impacts on that.

Matt Waymark (MW)

Yeah, I think you're spot on in terms of the majority of the non-interest income will be driven by economic activity. So, as you say, the lending credit card, debit card fees, etc., we're trying to do more on payment services, I'd say so Tyl and Metal and so on. The other big angle for C&I obviously is NatWest Markets, which is around 800 million to a billion gross revenue over in the medium term.

So those are probably the main three buckets I like to think about. Broadly economic activity growing in non-interest income in payment services. And then NatWest Markets and all of that is about bringing more of the cost, more of the bank seamlessly to the customer across the C&I franchise.

KM

Stuart, anything you'd add on the inflation aspect of, I guess mainly for you it's credit and debit card use

SN

Yeah, exactly. So, I think, again, linked to activity and it's the interrelationship between potentially reduced consumer spending and consumer activity verses inflationary pressure on the unit pound of spend, if you like, you know, the inflation impact on the goods fee of goods and services being bought. I guess the big driver of our interchange playing the balance of that equation I guess is a subject to the exact pressures on the economy.

The other the other big fee driver for us would be packaged income. On that one we continue to see a recovery in utilisation of certain benefits from the customer base. So, as we look forward, we expect that to continue to normalise all else equal. That would go a little bit down downward pressure onto our fee line.

KM

Thank you.

AH

Can we take a moment from the telephone line, there won't be a picture, but I understand it's audio only. Dave, can we take Aman Rakkar please.

Aman Rakkar, Barclays

Hi guy can you hear me?

KM

Good lord Aman, we definitely can.

Aman Rakkar - Barclays

Do you know what. I'm sorry I can't be there in person. Sorry, you can't see my face and sorry if my sound is not quite right. Thank you for taking the questions. I guess I just had one to kick things off on mortgages and I guess there is an argument for banks like yourself operating with a greater degree of flexibility with your mortgage customers around like forbearance.

You know, we might even potentially get to a point where people are talking about payment holidays. There seems to be scope for a behavioural shift in the way that your customers transact with you on the mortgage side. And I was interested if you could help us understand some of the assumptions that sit behind your ARA income recognition specifically around how long do you assume that your mortgage customers stay on a variable rate, for example, at the end of the fixed?

And if that was the change going forward, is that the kind of income adjustment that that could manifest in the future would be the first question. The second was around the resiliency of your income beyond 23. I think we can all basically take a view on your income trajectory next year and it's a pretty constructive one and I think we can arrive at RoE outcome, which is also pretty constructive.

If you were to potentially to face the prospect of rate cuts or some normalisation in the rate environment in 24. And do you see kind of the same risk to your net interest income, for example on the downside as the kind of upward trajectory that you're currently enjoying or, you know, is there support for, you know, things like the hedge and other bits and pieces which mean that maybe we can be a bit more confident you can sustain this level of revenue.

KM

Stuart, do you want to deal with those first ones around SVR, etc., then I'll do income.

SN

Yeah, absolutely. So, look a really, really interesting question. So, thank you. I guess as I think about our effective interest rate treatment, we essentially do this in quite some detail as you can imagine and go through all the different fees receivable and payable on the mortgage product. Some of those are related to more closely to the product life or the, you know, the behavioural life of the product.

And I would put into that the key receivable which is that is the product fee that accompanies the, accompanies the product. And then some others for example where we do a valuation on the property is more appropriately thought of over the customer life with us because we will value that property once we don't revalue it at the point of a remortgage, etc. But cut to cut a long story short, I guess, our you know, we don't see any major shifts in SVR behaviour.

We've got a fairly short term SVR book, a small book overall typically as customers roll off, you know, 50% of them have refixed within two months. So, at the moment we don't, we don't see any significant change or lengthening in the behavioural behaviour life. I think from a forbearance perspective, the initial part of, of your question, something like payment holidays would have to be, from my perspective, would have to be an industry wide approach when that happened under COVID it was clearly an industry wide approach with very consistent treatment, for example, of staging and how we think about that, that customer from a good book vs bad book perspective.

So that's something that's difficult to do unilaterally from my perspective. More generally and this would be consistent with what we've heard elsewhere. But over the course of this year, actually, our three months in arrears statistics have actually improved a little bit. And on the ground in our financial health and support function, we are not yet seeing increased calls or flows into collections. Hopefully that's helpful Aman in trying to provide some colour.

KM

And I think Stuart, the only thing I would add on to that is we've worked incredibly hard on our SVR book over the last few years to make it a much less dominant part of our portfolio. I mean, it sort of sits around about kind of 5 to 7%, depending on where you are. Some of the things we've done on that is that we allow our customers to fix their rate six months ahead of when their SVR comes.

In terms, and that's been really important for us. So actually, I don't think that the big move in terms of customer behaviour on SVR is something we were particularly looking at because it's been a) not a big part of our book and b) We've put so much into it and strategically we decided to actually we'd rather have people on fixed contracts rolling in for another 2 to 5 years rather than having them sitting on SVR for an extended period of time.

While in the short term, that's obviously could be more valuable. Interesting, it isn't necessarily today where rates are? But we didn't feel that was the right thing to be doing. So actually, that is a different way of behaviour. I guess I would add Stuart, clearly if someone's in trouble, we want them to talk to us now and then we put them on a payment holiday state. Nothing stops us doing that.

It's only what we saw of the kind of industry wide COVID type issue where people did the much more proactively when they didn't necessarily need to but as a kind of defence mechanism. But clearly if people were struggling today, that would already happen. If I go then onto income, we all know in terms of the NII when the rates going up, the NII is always want more positive - we all know that.

I think I probably almost Aman bring you back to the comment. I don't know if you look at Q3, what was rolling off, was rolling off about 78 basis points. It was going back on an average of 302. When you look at our sensitivity, you can see it kind of goes 50 million in the first, 150 million in the second year, 250 million in the next year.

So, you have this kind of real kind of benefit, that kind of grows up and that's going for every 25 basis point increase. So, you can see from 78 basis points in 302.

There's quite a lot of 25 basis point movements within there. We've also seen the hedge kind of grow. So, I actually, I guess I feel probably just the maths of following that through gives us a projection that when as rates start to fall, you'll still have that benefit of the interest rate coming through for a relatively good period of time, which kind of gives you some protection as you go into go into 2024.

Donal Quaid

And for some of the other guys, we tend to take a conservative view on the terminal base rate as well from a UK perspective in terms of our guidance we've done historically. So, we never fully bake in what markets pricing in, again in terms of the end state for base rates.

Rohith Chandra-Rajan, Bank of America

Thanks. Just a quick follow up on NatWest Markets. So, I guess that's probably running towards the top end of the 800 to a billion revenue range, on current quarter analysis.

KM

So, 526 within year to date. So, in terms of their income, so I don't think I'd get to the top end. You'd have to have a hell of a good last quarter. I'd maybe worry about the risk appetite at that point. So, I would give you a Q2, but actually the year-to-date number. I think it's 526 at the end, nodding from Matt in terms of that piece.

So, they'll be a bit shy I would suspect for this year. But what are we talking about? We talked about 800 to a billion, that wasn't for this year. It was for more the kind of longer term.

Rohith Chandra-Rajan, Bank of America

Yeah, so sorry. I was just thinking of the latest quarter, which also benefited a lot from extreme volatility in rates in effect. So that where your clients will be needing the most help. So just wondering if you could help us think about, I guess, there's two things going on. There's market volatility, but then there's also trying to build out that your, that your at in capacity, that you, your adding to that business and how we should think about the interplay of the two.

KM

Yeah. So, I think, as I sorry, I'm just putting reminding myself of the right numbers, as I'm talking. As I kind of look at their income piece, I think of kind of so fixed income. So fixed income for the quarter for the nine months ended was 35 in terms of that piece. So, I think actually when I look at the quarter and how you they dealt will with volatility?

I didn't see volatility in the rate side delivering big upside. I think what we managed is of course the downside of that. So actually, the fact that it's positive income is good, but in that last quarter, I think the quarter number was 6-7 million. It wasn't it wasn't a big number in terms of the income that kind of came in from that.

I think where you see the managing volatility really well and where we're getting the benefit of that volatility is on currency side. So, like nine months last year it was 306, but 394 this this time round. And I think that for me is a real kind of success story within NatWest Markets.

You've heard me speak historically of the utter frustration that we've got this really good FX capability in NatWest Markets is not used well by across the business and what we've seen this year is it getting it much more into the businesses to be used and I think so there you see the benefit of extra usage and also the good management of volatility on the currency side. You know, similarly Capital Markets 256 last year, 305 in nine months this year. So again, nice, nice improvement on that piece. I do think the volatility of benefit comes more rule based on currencies rather than rates, because I think we try to manage the downsides quite tightly on the rates piece.

We don't... so by doing that, obviously you don't get the upside on that either.

Rohith Chandra-Rajan, Bank of America

Doesn't rates volatility mean that that increases the attractiveness of hedging to your clients, so you just do more business?

KM

It does. It does. I think at the moment it's just we're trying to make sure we get the right balance. I think to make sure that business is operating well. What I would expect, and hope is that we move into next year that we start to see more of that income benefit. But if I look at this year, the guidance we gave them because things have been so extreme, was we wanted you to keep your risk limits very low.

And I think if we go back to the conversations, we were having around some of the performance in 2021, it was more show that you could manage the risk properly before we kind of go much further in terms of opening that door. But clearly to get to that kind of 800 to a billion number you need to see stronger performance in the rates piece.

Peter Norton

I think just to add on the on the composition of that business, I think what we're getting into now is what you're seeing is the I guess, the sort of countercyclical cyclical nature of the different components going to coming together. So, if you think about kind of capital markets in the early part of the year a very strong performance when capital markets were open and highly active.

And that's kind of offsetting in later periods where you've seen very high volatility and stronger FX performance because of wider bid offers, etc., that you've seen quieter capital markets. So, I think there's a there's a quite good balance that you starting to see emerging in terms of that earnings for different types of periods depending on capital markets activity versus market making FX versus market making and fixed income, all of which have slightly different characteristics depending on the market vibe

Speaker Unidentified

So, it's a smaller more focused business but still diversified.

Peter Norton

Diversified but in quite well defensible income compositions.

KM

I guess and take it we are satisfied with those three product ranges. Just so you know.

AH

Dan, can we take one more from the line and then I think we might to sneak one final one in Dan.

Operator - Dan

Absolutely. Our next question comes from Jackie Ineke from Morgan Stanley. Jackie, please press star six to unmute yourself on the keypad on your phone.

Jackie Ineke, Morgan Stanley

Just a quick question actually from more from the debt side. Looking at your funding plan for 2022, it looks like you're all done with that. And I'm talking about capital instruments and general funding instruments. Is that a correct assumption to make, because we are seeing a lot of other banks in the market opportunistically prefunding 23. So yeah, just wanted to know if we should expect anything more from you in the in the debt markets this year. Thanks.

Donal Quad

Do you want me to, hi Jackie. How are you doing? You know, so I'd say from probably guided to from 2022 we'd say we're complete across Holdco and OpCo. You know, I think there is flexibility that we can look if there is a positive market dynamic between now and year end, we could look to bring forward some of our 2023 requirements, but we'll just keep that flexible for now.

Jackie Ineke, Morgan Stanley

Okay. Thanks a lot.

AH

Is there a final question in the room? If not, I think we have Rob Noble on the phone Dan. Are you able to put Rob through?

Rob Noble, Deutsche Bank

Heya, I just wanted to ask about mostly mortgages. I think we've heard banks talk about the reduction in LTV of their portfolios over the last 10, 15 years and loans being lent with stressed interest rates. But presumably when you were lending with stressed interest rates, you didn't take into account the level of inflation we're seeing. So, I just wondered why you are not more concerned about the affordability of the portfolio and whether I presume you look at things from a loan to income perspective, why don't we have disclosure, or could you give us an idea of what the loan to income split of your portfolio is?

And then on the same sort of question, when you're lending now, what do you take into account for customers in terms of interest rates that you apply and affordability criteria?

And just a normal, smaller one. Why do you think rates haven't come down yet with swaps. Do you think that they should be coming, do you think they should, they will come down just a bit of a lag effect so far?

KM

Sure. I'll start and Stuart jump in at the end if I miss anything. So, I guess the first thing I'd say we actually put through a rate reduction on the 18th, that's nonsense on the 28th of October. And basically, the day that we did our results was our first rate reduction. And that was very much affecting the fact that suddenly we had this massive movement in swap curves coming down.

So, I think we'll continue to monitor that. But I guess one of the things, as we said on the way up, we don't completely keep time with the swap curves as they move up. But for me it was very pleasing to see that rate reduction coming through pretty quickly, in terms of the customer, the customer base on that. So, we'll expect to see that continue to through and Stuart can probably add some other colour in terms of if we see any other activity, but in terms of market.

So, when we look today, the people that are renewing their mortgages today would have been tested two / five years ago, SVR plus 3%. So, actually at that point, still at levels lower than the rate that they're they would be going on to just now. But you're absolutely right, I'd say historically we didn't test as much on inflation and on what the impact of that might do.

We obviously did test on affordability at the time of granting the loans. But now what we're doing now is we test you on at the stress level that you're at, which will be somewhere between kind of seven and 9%, depending on your kind of LTV and the size of the mortgage that you're looking at taking. And then we'll also do more of a test in terms of affordability and looking at it plus inflation, which obviously is one and a bit plus 10% just now.

So, we do consider that, I guess we don't do any loan to income disclosure. That's not something we're planning at this stage in line with others. If it becomes more accepted practise we will obviously happily, happily do that as well, but Stuart are you able to give any colour to what we're seeing in the market on the kind of what others are doing on their rates?

SN

Yeah, absolutely. So, peers have priced down largely, we saw Halifax went live yesterday actually on from book pricing purchase and re-mortgage and some others went last week. We were a little bit slower on the pricing down, we've just been managing some of our operations. We were going to price down on Thursday essentially.

So as Katie says, we've priced down switcher. So existing customer rates, on the 28th and we will price down on Thursday for new business. So, see for new business purchase and remortgage to similar levels. I think just a couple of builds on the historic affordability. You know, as we look at upcoming roll offs at rates around 6.25, those are below where we were stressing people too.

So that gives us some comfort to your point. Absolutely. We didn't anticipate the inflationary pressures, but we also taken account of any income increases in that period as we look at the maths on that. So that gives us a little bit more comfort as does the reduction in prevailing mortgage pricing from those sort of mid 6% levels.

Affordability today, Katie, absolutely right. We stress some customers in excess of 9% depending on the term. And anyway, I am not going to give the exact stress rates, but they are not a million miles away from where the Bank of England you know, the regulatory requirement was previously.

KM

Lovely, thanks very much. As ever thank you very much for the support and the challenges. They are appreciated in equal measure, and we look forward to talking to you again when we get together in February, when we will we'll talk more about what we feel like 2023 will do. Of course, I will also speak to some of your base and sales force meetings and things over the next the next 29 days until the end of the year. So, I look forward to that. Thank you very much. Thanks for coming in. Thanks guys. See you later.