



NatWest Group plc Q1 2021 Results Treasurer Q&A

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Donal Quaid (DQ)

Good afternoon and thank you for joining today’s call. I’m joined today by Paul Pybus, Head of Fixed Income Investor Relations and by Scott Forest the Head of Treasury Debt Capital Markets.

I’ll share some of the headlines from the quarter before moving into more detail on capital and liquidity, before concluding on an update of our issuance progress for 2021.

Starting with slide 3 on Q1 performance, we reported an operating profit before impairments of £844Mn for the quarter with an impairment release of £102Mn. As defaults continue to remain low with little change in stage migration.

Taking the impairment release into account, this resulted in attributable profit of £620Mn for the quarter.

We continue to benefit from a strong capital position which gave us capacity to participate in the directed buy back from the government in March.

We re-purchased £1.1Bn worth of shares, which reduced the government shareholding from 62% to just under 60%.

Our CET1 ratio ended the quarter at 18.2%.

Looking at impairments on slide 4.

We reported a net impairment release for the quarter of £102Mn or 11 basis points of gross customer loans.

This compares to a charge of £130Mn or 14 basis points in Q4. The release was driven by continuing low levels of defaults in the commercial book and for the retail bank.

Stage 3 defaults are broadly in line with our historic experience, coupled with further positive migration of stage 2 loans back to stage 1, following an improvement in the underlying credit metrics.

The economic assumptions we presented in February are unchanged and our post model adjustments for economic uncertainty are also broadly stable since Q4.

Our guidance for impairments for 2021 is unchanged and we expect these to be at or below, or through the cycle range of 30-40 basis points. Though clearly if the economic outlook continues to be favourable then we will be below 30.

Moving on to look at our credit risk profile on slide 5.

There has been some positive migration during the quarter, reflecting improved credit metrics as government support measures continue and customers build healthy cash balances.

80% of our loan book is in stage 1, up from 77% at year end, reflecting migration of stage 2 loans back to stage 1, primarily in the retail bank.

Over 98% of loans are in stage 1 or stage 2. Stage 3 loans are down slightly to £6.1Bn or 1.6% of gross loans. ECL coverage of 1.6% is down slightly due to right offs with stage 3 coverage of 39%.

As you know, some of our wholesale loans are in sectors that we monitor particularly closely. These amounted to £27Bn in Q1 which represents 7% of gross loans.

In these sectors similar to the trend at Group level, stage 3 gross loans were down slightly at around £700Mn and we remain comfortable with coverage at 47%.

Slide 6 covers customer support measures.

Throughout the pandemic we have provided mortgage and capital repayment holidays and approved over £14Bn of loans under government lending schemes.

Demand for government support schemes continues to taper and almost all those who asked for payment holidays have now returned to normal payments in both retail and commercial banking.

Two new government schemes were introduced in early April - Pay as you Grow and the Recovery Loan Scheme.

Pay as you Grow, enables businesses which have drawn down bounce back loans to request an extension of their term from 6 to 10 years, to take a repayment holiday or pay interest only for 6 months.

We have received around 14,000 applications to date, the majority of which are to extend the term of the loan, but this number could increase, as we've recently contacted over 100,000 customers to advise that it's 60 days or less to their first repayment date.

On the Recovery Loan Scheme, we received about 3,000 applications in the first week, although demand has dropped since the launch to between 100 and 150 applications a day.

Turning to our capital and leverage position on slide 7.

Our CET1 ratio at the quarter end was 18.2%, that includes the benefit of IFRS9 transitional relief of 100 basis points. Our total capital ratio was 24% and this leaves us comfortably above our minimum regulatory requirements on our capital metrics.

Our maximum distributable amount is at 9% reflecting head room of between 420 and 520 basis points above our 13-14% CET1 target.

And the UK leverage ratio was 6.2% leaving 295 basis points of headroom above the UKs minimum requirements of 3.25%.

Moving to slide 8 and our quarterly movements in CET1 and risk rated assets.

Our CET1 ratio for the quarter was 30 basis points lower than full year 20 at 18.2% driven by the £1.1Bn directed buy back and the dividend accrual of £200Mn, offset by lower RWAs.

RWAs decreased £5.6Bn in Q1, including a £1.3Bn benefit from FX and a £900Mn benefit from the annual Operational Risk recalibration.

The credit risk reduction of £4.8Bn was driven by lower commercial and unsecured retail balances as well as the benefit from procyclicality of £1Bn.

NatWest Markets RWAs reduced slightly to £26.5Bn, and we still expect to achieve the majority of our target reduction to around £20Bn this year.

Our guidance on RWAs remains unchanged and we expect them to be in the range of £185-195Bn at the end of 2021, including all regulatory impacts affective on January 1st 2022.

Where we land within this range will depend on procyclicality and loan growth throughout the remainder of the year.

Moving onto liquidity and funding on slide 9.

We have maintained strong liquidity levels with a high-quality liquid asset pool and our total liquidity portfolio is £263Bn.

Our LCR ratio decreased to 158% during the quarter, due to a £5Bn TFSME repayment, settlement of the Metro mortgage purchase of £3Bn, the directed buy back of £1.1Bn and a liability management exercise of £1.6Bn. All drawings under the TFS and TFSME schemes are now fully repaid and our surplus of prime liquidity above minimum requirements is £65Bn.

We continue to see strong deposit growth in the quarter, where retail banking deposits growing by £7Bn to £179Bn. Commercial banking deposits remained at similar levels to the 4th quarter at £169Bn.

Our loan to deposit ratio is 79% underpinning our strong liquidity and funding position and our deposit base is well balanced across our commercial and retail franchises.

Finally, turning to slide 10, and our issuance during the quarter.

In February we set out our 2021 issuance expectations from the Holding Company of £3-5Bn in Senior MREL, approximately £2Bn in Tier 2 and £1Bn in Additional Tier 1.

I'm very pleased with the transactions we've executed during the quarter and again thank you all for your continued participation in the transactions.

In February we issued a €1Bn senior MREL social bond under our Green, Social and Sustainability Bond framework. We announced plans to do more issuance in GSS format and this is our third transaction bringing our total GSS issuance to approximately £2Bn, supporting the groups ESG commitments by providing dedicated funding for loans and investment that bring a positive, environmental or social impact in the UK.

In March we returned to the sterling market with a £400Mn Additional Tier 1. This is our second sterling AT1 transaction since November and ensures we are well placed when considering re-financing requirements this year.

We continued to proactively take opportunities to optimise our capital stack and during the quarter, we completed a £1.6Bn liability management exercise that targeted legacy Tier 1 and bullet Tier 2 securities with less than 5 years to maturity, reducing inefficient capital and generating ongoing reductions in our interest expense.

In April we called a NatWest Bank discounted perpetual Tier 2, in-line with our strategy to reduce legacy securities that do not provide capital benefit beyond the end of this year.

So, in summary, we have delivered a good operating performance in the quarter and we continue to build enough weight with strong levels of capital and liquidity.

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With that, I will open up to Q&A

Operator

Thank you, Donal. Just as a reminder, to ask a question today, please use the Raise Hand function found in Zoom and we'll bring you into the meeting to ask your question. Questions will be audio only and you will not appear on camera. If you are dialling in on a phone, you can press *9 to raise your hand and *6 to unmute once you're prompted.

You will be introduced by myself using the last 4 digits of your phone number so you'll need to listen carefully for your turn.

You can also type your question into the Q&A box.

Joining Donal to answer your questions today we have Katie Murray.

Our first question comes from Robert Montague at Wells Fargo and it asks, could Management give an indication of size of stage 1 and 2 micro economic overlay provisions which might be released at H1 when economic scenarios are updated?

Katie Murray (KM)

Thanks very much Dave, I'll take that and good afternoon everybody.

So, in terms of the macro economic overlay that we have with the PMAs we also call it the post model adjustment. It's £878Mn that we've got, that clearly straddles over stage 1 and 2. At this stage I would separate it, in terms of your question from, you wouldn't automatically see an upgrade in our economics and then this one would be released.

If you look, think about the economics piece, that will impact the core of our provisions and then as a secondary event we'll look at the PMA and think, what other things might trigger. Some of them will be things like unemployment, arrears trends, high risk sectors, if I'm in wholesale it would be looking more at how those wholesale schemes are performing, what's happening on the government scheme debt performance, how people are behaving with that, so I would almost separate the two core provisions and then there's PMA.

And what you will see us doing in H1, thank you very much Donal, is to see the release coming I think more from economics upgrade if they continue as they are today, and then PMA we'll have a look at, I suspect that, that will roll on for quite a few quarters to come from there.

Today we updated our guidance a little bit to say that we were very comfortable that we would be below the 30 basis points, rather than in that range of the 30-40 basis points as we go through the year. Thanks Rob.

Operator

And our next question comes from Lee Street, Citigroup. It asks, it appears that stage 2 loans have peaked, is that fair? In your current planning do you expect stage 3 loans to peak this year?

There's 2 other parts to the question which ask, why are the economic assumptions unchanged given the improved outlook, is this not overly conservative and finally, what is your capacity to issue further green or social bonds and I can read those back, as you need, as you go through them.

KM

Lovely thanks very much, I'll take the first couple and then Donal you can speak that piece. Look, I think it would be fair to say that, what we'd expect to be happening on stage 2, as we go through the year, is that, either things will migrate back into stage 1 and so therefore you'll see the improvement or they'll move more into stage 3. We have guided our impairment rate will be below 30 basis points, but I think it's important to remember that's still a charge. That charge is

going to be made up of things moving more into stage 3, there'll be a little bit of migration between stage 1 and 2 depending on what's happening on different customers but we would expect there to be a charge.

In terms of economics, I've got a very strong view. In terms of the economics piece, we give you really good disclosure of what different economics might be, we prefer to update them at H1 and year end rather than do each and every quarter because I think that could bring more volatility into the number. Others have different views and those views are also completely valid as well, but we're comfortable we'll look at that as we look at Q2.

If you looked at the disclosure we gave you, if you were to 100% weight the upside which clearly you would not do, that would be a release of a maximum of £800Mn, our economics aren't quite as good as the upside. So, there will be, if things continue as they are today, a piece of a release but we're kind of happy to go, steadily with cautious optimism as we go towards that.

Donal do you want to talk...

DQ

Yeah, hi Lee, on green bonds, we have capacity to increase it as we've said this year, we want to do minimum 25% of our MREL issuance and what we've said is in green social and sustainable format. We don't specifically break that down into green or social but as we continue to write loans that will further support issuance, we expect that 25% to increase over the next few years as well and it fully supports our group ESG strategy too.

Scott Forrest (SF)

And Donal I'll just add onto that one, Lee, we expanded our green social and sustainability bond framework late last year, so we included additional eligible products under the green sector to include energy efficient buildings, clean transportation, pollution, prevention and control and on the social side, we added female led enterprises and social housing loans. So, we've got quite an expansive list of eligible projects to support the assets as Donal mentioned already baked into the framework so we're in a good position on that side.

Operator

Otherwise, we'll move onto one of our other questions which has come through. So, our next question asks. Thinking of the August AT1 call, if not called, that would leave you well above your minimum requirements.

DQ

Yeah, I'll take that one, that is correct, as you are aware, we've issued £1.4Bn of additional Tier 1 over two transactions since last November. We did a £1Bn sterling AT1 in November and another £400Mn follow on transaction last month, so that has brought our Additional Tier 1 percentage to about 3.3% which is considerably above our requirement of closer to 2.2%. But as you mentioned we've a large transaction up for call in August \$2.6Bn with a coupon of 8.625% and a reset of

760 basis points, so we're in a very good position and we will make a decision on that instrument later in the year taking the same economic approach we take with all call decisions.

Operator

We're going to move onto our next question, which asks, are you placing more deposits volume into your product hedge? What happens if you see large deposit overflows?

DQ

Do you want me to take this one Katie....

KM

I've talked a lot about the structural hedge so far today, you have a crack at it.

DQ

It's definitely been the topic of the last 2 days.

Yes, so as Katie mentioned this morning, the structural hedge has grown by £8Bn in the quarter to £177Bn and it's grown by approximately about £20Bn since the end of 2019, primarily reflecting the deposit growth that we've seen over the last 12 months.

Generally, we include the increased deposit growth on a hedge note, on a rolling 12-month average basis, so the deposit growth you've seen in H2 of last year, will continue to feed into our balance and we would expect that to increase by approximately £15Bn over the next 12 months, if our deposit balances remain stable.

Now, we also haircut that rolling 12-month average to account for unexpected volatility in the balance too, so that gives us some comfort and I suppose given that we do hedge on a rolling 12 month average, if deposit outflows were experienced over the next 6-12 months, then that would also feed in over time too.

Operator

Thank you very much, so as a reminder if you would like to ask a question today you can use the Raise Hand function found in Zoom, we'll bring you into the meeting to ask your question. If you are dialling in on a phone, you can press *9 to raise your hand and *6 to unmute once you're prompted.

You can also type your question into the Q&A box.

We're going to move onto our next typed question which asks, RWAs continue to fall, does this impact future MREL requirements, you're well above approximately 25% requirement?

DQ

Yeah, I'll take that one, so it doesn't impact MREL requirements per say, but if we're operating at lower levels of RWAs it will reduce the notional MREL requirements that we have, but, it's a good question given that we've printed £165Bn RWAs at the end of Q1, and we do I suppose guide to our issuance plan based on an indicative £200Bn of RWA.

But we've still put our guidance for year 21 of RWAs in the region of £185-195Bn inclusive of the regulatory impacts that take affect on the 1st January 2022. So, for now, obviously we're comfortable where we are, we can also take, if RWAs do trend on the lower side, we just take that into our refinancing as we go forward into next year.

Operator

We're going to try Paul Fenners line, Paul if you could also press *6 to unmute.

Robert Smally UBS – QUESTION

Hi this is Robert Smally from UBS, how are you?

KM

Hi Robert, good to hear from you.

Robert Smalley, UBS

Hi and thanks for doing the call. A lot has been answered on asset quality so, just to sum up, we can assume for the next couple of quarters, that provisioning and any reversals will be pretty smooth, driven by changes in the economic outlook, I guess that's just to sum up all of that number 1; and then number 2, looking out further, it's been a very different type of cycle here, where we've had a huge economic drop in recovery while asset quality has stayed pretty firm, how does this inform or potentially distort your models going forward around provisioning given that we're in a much more model driven world, thanks?

KM

Yeah thanks very much. Look, as I look at impairments, we'll review economics in Q2, we won't do it in Q3 so we'll do it Q2 and year end, that's important to remember, but I think it's not just all our economics gain, it will be what's really happening on the ground and I think in the UK we're just coming out of lockdown, we've still got good government support, but in the second half of the year it will start to diminish and I think that's when you'll start to see some more impairment activity.

I think we've all been surprised actually by the economic crisis we've had, but actually how well impairments have performed and when we do our models we've obviously had to do, as an industry, quite a lot of adaptation to those models to cope with the level of government support that we've seen globally and the impact of that, so I think understanding what you've done there and understanding the impact on that will be very much how you keep your models up to date as you roll this forward into the crisis.

But I think it will be, a couple of years before we really understand what the impact of it has been on the models and how we take them forward, to be able to inform the next crisis as it comes through, which is why I think you see us and many other European banks particularly holding these post model adjustments, to sort of say, look we understand what the economics are doing, we understand what the models are doing, but we also understand what's going on in the greater world...

And what we can see kind of happening in terms of government support, so I think those are the things that drive a lot of those adjustments, so look, it's a complicated standard, and I think as it comes through, I don't think it will be as simple as maybe this season's quarterly reporting suggests it might be, because behind all of this is real loans with people that we need to kind of work our way through, in terms of how they continue to develop over this year and I think well into next at this rate as well.

Robert Smalley, UBS

That's great, that makes a lot of sense, thank you.

KM

You're welcome.

Operator

Our next question asks, what drove your decision to call the NatWest Bank disco in April? Was it PRA driven after the disco submissions and how do you think about the remaining discos?

DQ

Happy to take that one, no, the decision was not based on any conversations with the regulator, it's a decision in line with our preference to clean up our capital stack which we've been quite clear on over the last couple of years, and it's probably fair to say in terms of disco, security had a relatively small notional outstanding, and we are running significant amounts of excess liquidity at present.

Another factor that we took into consideration was the fact that security references LIBOR, and that would require a consent solicitation to change the benchmark rate at some stage in the future a well.

But in terms of the Dear CFO letter as people are aware, we submitted that to the regulator at the end of March but we haven't had any follow-up discussions on it to date.

Operator

Thank you and our last question asks, can you talk about the recent LME, in particular, why these particular securities were targeted, how do you think about priorities?

DQ

Yeah, happy to take that one, quite similar to the last answer to be honest, part of our drive to clean up the capital stack and have a cleaner stack as possible by the end of this year as we go into 2022. So the securities targeted through that were either a potential barrier to resolution, did not qualify as capital beyond the end of this year, or we're inefficient due to the amortising regulatory capital value, so it was two legacy Tier 1's and four bullet Tier 2 securities that were within 5 years to maturity and our amortising down 20% per annum, so really a capital efficiency play.

Operator

Thank you very much and Donal we're going to hand back to yourself to close the call.

DQ

Perfect, well thank you all for your time this morning and I hope to catch up with you all in a one-to-one format in a one to one format in the near future, thank you.