



**NatWest Group Plc**

**Q3 Results 2021 Treasurer Q&A**

**1pm, Friday 29<sup>th</sup> October 2021**

**Hosted by Donal Quaid (Treasurer) and Katie Murray (CFO)**

Donal Quaid (DQ)

Good afternoon and thank you for joining today's call.

I will share some of our highlights from Q3 before moving into more detail on capital and liquidity and progress on our funding plans for 2021 and then open up for questions.

Starting with slide 3.

We're reporting an operating profit of 1.1 billion, up from 400 million for the same quarter last year. This includes an impairment release of 242 million as underlying credit metrics improved and defaults remained low, resulting in an attributable profit of 674 million.

We continue to make good progress on our targets. Net lending was up 3.1% on an annualised basis driven by growth in mortgage lending; costs were down 4.3% for the first nine months compared to the same period in 2020; and we're reporting a CET1 ratio of 18.7%.

Our liquidity position remains strong, with an LCR ratio of 166% and we have made excellent progress against our issuance plans. With market conditions being very favourable for issuer's year to date, we have met our capital requirements for the year, leaving an opportunity for senior MREL and OpCo transactions during the remainder of 2021 as we start to consider 2022 funding requirements.

Looking at business activity more closely on slide 4.

Net lending across our retail and commercial businesses is up 3.1% on an annualised basis to 305 billion, excluding government lending schemes. This growth has been driven by mortgage lending as commercial demand continues to be relatively muted across the market.

UK Mortgage growth of £2.5 billion or 1.4%, reflects continued robust demand following the first deadline for stamp duty relief at the end of June.

In unsecured lending we are seeing good momentum. Issuance of new credit cards has almost doubled year on year, and we have brought new products to the market. Spending on credit cards is up 20% on last September, to pre-Covid levels, and while credit card balances remain slightly down, this trend is gradually reversing.

Turning to Commercial banking, demand remains relatively muted from smaller businesses, but we are seeing more activity in our corporate and specialised businesses.

Revolving credit facility utilisation remains broadly stable at 19% compared to a peak of 40% in April last year.

Looking at government lending schemes since the first anniversary of these schemes, when repayments started, about 7% of our Bounce Back loans have been repaid in full. And around 90% of customers due to start repayments are repaying on or ahead of schedule.

Whilst all these trends are positive, we continue to monitor customer behaviour closely in the light of recent supply chain challenges and inflationary cost pressures.

Turning now to slide 5.

Given the increasing expectation of interest rate rises here in the UK, including the material move in swap rates during October, we've provided an indication of the potential impact that rate rises may have on NII in 2022.

We revised our economic assumptions and rate sensitivity at the half year results and they will not be updated until the year end in line with our usual process though we note the improved consensus rate outlook.

At the half year the yield curve suggested that UK base rates would remain at 10 basis points until Q4'22 before rising to 25 basis points. A further hike to 50 basis points was expected in Q4'23.

You will see the majority of our sensitivity comes from our managed margin, or the unhedged balance sheet. This shows a benefit of £414m for an upward shift in the yield curve from 10 to 35 basis points. This reduces in Years 2 and 3 reflecting higher pass through assumptions as base rates increase.

The overall benefit from a 100 basis point increase would be £1.3 billion in Year 1, which shows you the sensitivity is not linear.

Looking at mortgage rates, margins are returning to levels seen pre-COVID. Average application margins in the third quarter reduced by 37 basis points to 115 basis points, and they continued to reduce towards the end of the quarter to around 105 basis points, reflecting higher swap rates. This is broadly in line with January 2020.

Front book margins on mortgages that completed in the third quarter decreased from 165 to 143 basis points, below the back book. Lower margin roll-offs resulted in the back book margin improving by 1 basis point to 164.

The increase in swap rates in Q3 was followed by a further sharp rise in October and, like other lenders, we have taken action to increase customer rates across a selection of our products.

Of course the other side of the equation is the benefit we derive from higher swap rates through our structural hedge.

We have said that the majority of the £250m year-on-year decline in our hedge income was in the first half and the hedge impact in the third quarter relative to the second quarter was negligible. We also expect the hedge impact on Net Interest Margin to be broadly neutral in Q4.

Turning now to impairments on slide 6.

We are reporting a third quarter net impairment release of £242m, or 26 basis points of gross customer loans. This brings the overall release for the first nine months to £949 million. The Q3 release was driven by improved underlying risk metrics in our performing book and a continued low level of defaults.

We continue to expect a net release for the full year with three key variables affecting the outcome:

First and foremost, economic performance versus the weighted economic outlook we use in our scenarios. We update these every 6 months so the consensus economic outlook as we approach the end of the year will be critical.

Second, credit performance - while we see a low level of defaults and no tall trees at the moment, we will monitor credit conditions carefully as Covid support continues to roll off; and third, our Post Model Adjustments.

Our ECL provision at the end of Q3 was £4.5 billion, down from £4.9 billion at Q2. This includes £1.1bn of Post Model Adjustments, of which £729 million relates to economic uncertainty. If economic and credit conditions continue to trend in-line with the third quarter there could be some unwind of this PMA later this year and into 2022.

Turning to our capital and liquidity positions on slide 7.

Our CET1 ratio is now between 470 and 570 basis points above our 13-14% target range at 18.7%. This is more than double our Maximum Distributable Amount.

We still expect to operate within a range of 13% to 14% CET1 by FY'23 and you will find more details of the CET1 ratio drivers in our appendix on page 22.

Our UK leverage ratio of 5.9% is 265 basis points above the Bank of England minimum requirement.

We have also maintained strong liquidity levels, with a high-quality liquid asset pool and a stable diverse funding base.

Our liquidity coverage ratio increased in the quarter to 166% due to deposit inflows, and headroom above our minimum requirement is now £79 billion.

Moving to slide 8 and our quarterly movements in CET1 and RWA's.

We ended the quarter with a Common Equity Tier 1 ratio of 18.7% on a transitional basis under IFRS 9, up 50 basis points over the second quarter.

RWAs decreased £3.2 billion in the quarter to £160 billion.

This was driven by lower market risk, which decreased by £2.9 billion reflecting the £2.4 billion model update following the upcoming cessation of LIBOR.

As we look to the year end, for NatWest Markets we no longer expect to achieve the majority of the remaining RWA reduction towards the medium-term target of £20 billion this year. However, we now expect Group RWAs to be below our previously guided range of £185-195 billion on 1 January 2022.

Earlier this month, the PRA announced that they have deferred the Other Systemically Important Institution (OSII) buffer review for a further year with no new rates set until December 2023, barring any unforeseen changes in circumstances. In effect any change in the buffer in December 2023 would not take effect until January 2025.

In addition, the Financial Policy Committee announced its intention to consult on a proposal to change the metric used to determine the OSII buffer rate from total assets to the UK leverage exposure measure.

The FPC had previously stated they expect to maintain the countercyclical buffer at 0% until at least the end of this year. Any increase would not be expected to take effect until the end of 2022 at the earliest in line with the standard implementation period.

On slide 9 you can see that deposit levels remained elevated during the quarter, although the rate of growth across our retail and commercial banking businesses is slowing compared to earlier in the year. Customer deposits increased £9bn during the quarter with a £2.2bn increase in Retail and a £2.3bn increase in Commercial. Retail banking deposits are now £186bn and commercial banking are at £178bn as at the end of Q3.

Our loan to deposit ratio is 76%, underpinning our strong liquidity and funding position as well as our strong ability to lend. We continue to look at all options available to us to assess the optimal blend and most cost-effective means of funding.

Finally, looking back at our issuance year to date on slide 10.

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

On MREL, we've made excellent progress toward our end state requirements and in September we issued a €1bn senior MREL from the holding company, taking our total issuance for the year to approximately £3bn, at the lower end of our £3-5bn guidance.

On capital, we completed our Tier 2 requirements in September with issuance of €750m, taking total Tier 2 issuance to approximately £1.7bn for the year versus our guidance of approximately £2bn. And we continued our capital optimisation actions, calling our \$2.65 AT1 in August.

And from the NatWest Markets OpCo, we issued a \$1.3bn 5yr under our s144a programme with total issuance of approximately £3.4bn completed by the end of Q3.

Looking ahead to Q4 and subject to market conditions, we could look at some pre-financing of 2022 MREL and NWM OpCo requirements.

So, Katie has joined me in the room for questions and with that we can open up for Q&A.

Operator

And our first question asks, can you elaborate on the potential for Q4 issuance, currency and tenor? Are you looking to do anything in ESG format?

DQ

Thanks yeah, I shall take that question. We'll consider currency and tenor at the time of any issuance subject to market conditions, liquidity, and pricing in each currency as per normal. I would say that the rate moves over recent weeks in sterling have made sterling look attractive at present. As I mentioned in my opening remarks, we have completed our requirements for AT1 and Tier 2 for the US and no further requirements in this space, it will be senior MREL from the holding company, so I do expect at least one more transaction of senior MREL, subject to continued favourable market conditions.

We've also previously stated our ambition for at least 25% of our MREL issuance to be in green, social and sustainable format and this year we've issued 3 senior MREL deals in total, of which one was our Euro social bond, so to date we have GSS issuance of approximately 30% so to meet our 25% target, if we do another MREL deal, it is likely to be in green, social and sustainable format.

And then in addition, as I said, subject to market conditions we may look at additional OpCo transactions for Natwest Markets.

Operator

Thank you very much.

Our next question asks. Capital continues to increase quarter on quarter and moves further away from your 13-14% target. Are you still confident of getting to your target by 2023?

DQ

Want to kick off on that one Katie?

Katie Murray (KM)

Yeah, I'll start with that one Donal thanks very much. So, absolutely right, it's a great position to be in, to be in a bank that's so capital generative. I would say that we are confident on the 13-14%, and if you look at the analysts slides, I think it was even in the back of the equity slides as well. There's a very nice slide that takes you through all of the things that will come off as we go through and in there, there's an important part of regulatory impacts as mortgage floors hit us next week, as long as some smaller adjustments around IFRS9 and software capitalisation.

But the other piece as well of course, we've been very strong in capital distribution this year, we would expect to continue to do that as we move into next year using a combination of dividends, directed buybacks, and the recent in market buyback that is going well for us, is certainly something we would look at again, so, overall comfortable at this stage, it will get down 13-14%. Thanks Dave.

Operator

Our next question asks...

Thank you for the rate sensitivity disclosure which is very clear. Can I ask, what are the key drivers of movement in the rate sensitivity and how could actual income differ from disclosure?

KM

Donal, why don't you take that.

DQ

I'll take that one, I know you've had enough of those questions this morning Katie.

So, in terms of rate sensitivity, it's sensitive to both our pass through assumptions and the level of deposits we have on the balance sheets, so a change in either will impact the sensitivity, so actual income can differ from what is outlined in the sensitivity disclosure.

In terms of pass through assumptions, they are subject to the competitive environment at the time and they'll need to be reviewed and adjusted subject to the prevailing market conditions and as rates move higher.

In addition, decisions on pass through assumptions also influence the underlying deposit balances as rates move higher as well and as you know our sensitivity has increased over the last 18 months, as we've seen significantly higher deposit balances.

And then, the last point to note is that the sensitivity is based on the parallel shift in the yield curve which we rarely see, however that's less of an issue for the managed margin component and more of an influence on the structural hedge.

Operator

Thank you very much.

Our next question asks,

Can you give me an update on where you are with legacy securities, what's left to do?

KM

Donal, feels like one for you?

DQ

Yes, thank you. So, we continue to make good progress on legacy securities and as you've seen actions we've taken earlier on the in the year, less so in Q2 but more so in H1 through security calls and liability management exercises, so that will continue in a proactive manner as we move into 2022.

At the end of Q3 I think we have approximately about £2.5-£2.6Bn of legacy securities outstanding. Out of that total there's about £600Mn regulatory calls post the end of this year and a further £1.5Bn of securities that are either callable and mature over 2022/2023, so I think the way to look at it is, post the end of 2023 we expect to have less than £500Mn outstanding, so very, very comfortable where we sit today.

Operator

Thank you very much. As a reminder, if you would like to ask a question, please do type it into the Q&A box, raise a hand or press \*9 if you are dialled in.

Next question asks, following the PRA's climate change adaption report, do you expect a climate capital requirement in the future and if so, over what timeframe?

DQ

Do you want me to take that?

KM

I think we both have a view, you start and I can always add.

DQ

Obviously, still working through the release from the PRA as well, but I think the piece that came out of it was, that they see the capital framework as useful to address consequences of climate change, such as material changes to financial risks associated with specific assets so, I think that probably makes sense in terms of first view, that, if there is an increase in terms of financial risk, you're holding your balance sheets that, that is reflected through capital requirements.

However, from a timing perspective, I think its early stages and we will liaise with the PRA and the Bank of England over coming months and into 2022. Katie if you have any strong view?

KM

Yeah, look I think the BES was an important step forward. I think ultimately, we'll get there, I think that's inevitable and those with greener balance sheets will be rewarded, but it's going to take some time, so I think we just continue to work and all of us collectively understand how it may ultimately be structured.

Operator

Thank you. Our next question asks, can you provide any guidance or indication of future plans to address Ulster Bank related bond issuance including legacy old First Active debt in light of commentary in regard to winding down Ulster Bank over a 2 year time period?

DQ

Yeah, let me take that one. So, you will have seen that there was a recent consent solicitation on some of the outstanding UBI Dac, RMBS issuance so that was successful a couple of weeks ago as well, so in terms of outside of that, there is very, very little market issuance outstanding and I think in terms of the low notions that do remain, we'll just look to address them over the time of the withdrawal as well.

Operator

And Donal at this stage we have no further questions, I'll hand back to you for any concluding remarks. I'll let you know if anymore do come through in the meantime.

DQ

Perfect, thank you Dave. Just thank you to everyone for taking the time to join and I'm sure we'll be in contact soon, thank you very much.

KM

Thank you.