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Martin Leitgeb - Goldman Sachs:

Thank you very much for joining us to this session, second session of the third day of our European Financials Conference here in Rome. I'm very pleased to announce the next speaker, Alison Rose, Chief Executive of NatWest Group. Alison, I'm sure no particular introduction is needed. She has been appointed the CEO of NatWest in November 2019. Obviously, interesting period with the pandemic and now with the conflict in Ukraine. Thank you very much for making time to speak to investors, and coming to Rome.

Alison Rose:

Pleasure.

Martin:

Maybe let me start with a broader question just on the inflationary environment in the UK, and the potential implications of monetary policy response. How do you see inflation essentially playing through in the UK? How impacted is the customer base?

Alison:

Yeah. What you've seen with inflation... We've been talking about inflation coming off the back of the pandemic since Q3/ Q4 last year. And obviously, the Bank of England is taking measures to keep inflation under control with their interest rate rises. But certainly we're expecting that inflationary pressure to continue. I think the view is, it will continue to rise, peak around 10%, and then take a few years to level back down to within where the Bank of England would like it to be.

So there are clearly inflationary pressures, interest rate rises, supply chain issues affecting UK business and consumers. And those trends are playing out. I think one of the challenges for a lot of business owners and a lot of households, they haven't operated in an inflationary environment or a rising interest rate environment for over 10 years. So a lot of our activity is focused on supporting and helping manage them through that.

What we're seeing at the moment with how that's impacting consumers, and households, and businesses is, it's not really driving through into a credit event. A lot of the questions I get are, are you seeing that impacting spend behavior, are you seeing it impacting business demand or deterioration. And we're not seeing that. But clearly it's an issue, and it's an issue that we have to manage through. I think, with where interest rates are at the moment, there's another MPC on the 16th of June. Let's see what the Bank of England do. I think the assumptions in the yield curve at the moment are forecasting rates going up to 230 [basis points].

There's been a bit of volatility in that, our assumption that underpins our business plan at this stage is 125 [basis points] by Q4. So, a lot of challenges. Certainly, the fuel prices are a big issue. They're really not going to come in to bite until Q3 for businesses, but we have a predominantly secure book. We're not seeing any signs of distress. And so a lot of what we

are doing is actively managing knowledge, and support, and help for businesses and consumers deal with what are different trends for them.

Martin:

Yeah. Let's move to revenues. You've recently improved the revenue guidance for this year, now comfortably above GBP 11 billion for this year. I was just wondering, could you elaborate what's driving this improved revenue outlook, to what extent high interest rates play a part, and how to think about is going forward?

Alison:

Yeah. So when you look at our guidance comfortably above GBP 11 billion, a big driver of that is clearly the interest rate rise. Our assumptions are based on getting to 1.25% by Q4, so there's an element of that. But there are also the strength of our franchise and underlying growth that we're seeing in our business as well. But that comfortably above... You can see that's a positive for us in terms of interest rate rises coming through. And what we've seen is a relatively low pass through of that in terms of the early rate rises that we've seen come through so far. But in our underlying business, we're seeing continued strong mortgage growth and capacity to grow. On that side of the book are reentry into unsecured in a very measured and sensible way.

Our market shares now up at 6.4%. So it's still relatively low, but growing. Our wealth division is generating good results. In Q1, we saw 17% increase in assets under management and administration. That continues to be positive, and with a very strong... We are the largest business bank in the UK, a bit demand side issues at the moment, but we are seeing growth coming back and particularly in core areas. So it’s all of those dynamics. We're not assuming massive volume growth, but definitely the interest rates are positive for us.

Martin:

And in terms of potential for offsetting factors, so if rates go at 225 [basis points], if rates go to 210 [basis points], where market imply this, could there be a potential offset from lower loan growth? Could the housing market slow and to what extent could this essentially offset the beneficial impact we have on the rate side?

Alison:

Yeah. We don't have an enormous... that comfortably above GBP 11 billion doesn't have an enormous dependence on volume growth in terms of loan growth. So we're not concerned from that perspective. I think when you look at those rates... If you say ends up at those higher forecasts of 230, 240, the majority of our book is on fixed rate mortgages at the moment. So for consumers, it's not affecting their outgoings as they sit here today. Demanding in mortgages in the housing market in UK continues to be strong. We're continuing to see good growth there. And I guess from our perspective at NatWest, we still have capacity to grow which is a positive. I think, on the loan growth side really, when I look at the business side of things, it really is demand constrained at the moment.

Coming out of the pandemic, we've seen a lot of small businesses have taken on a lot of liquidity through government lending schemes and different supports. So there's not a lot of demand coming there, and we're not expecting that to come back very significantly. But commercial and large corporate, and particularly in areas like ESG financing where we have a really strong position, there is good demand. So I think, growth in the economy and the management of how much growth will come through with those higher rates, and the inflationary pressure is obviously something we're keeping a close eye on.

But we're not concerned that there's a huge volume assumption underpinning our comfortably above GBP 11 billion. And obviously one of the things about the UK economy which I didn't touch on is, employment remains very high, and that's quite an important element of the dynamics of the economy.

Martin:

Let's move to grow ambitions. And I was just wondering which growth opportunity you're excited most about. I mean, looking at NatWest historically, mortgages obviously was the key focus. Strong progress in improving and expanding origination flow share capabilities. How important is credit card offering for you and what do you think about wealth? Some of your competitors are building out the wealth capabilities. How do you see you NatWest positioned there?

Alison:

I'm pretty excited about the potential of the group. We start from a very strong position, really strong core franchises. In our retail business, we are two years into a GBP 3 billion investment programme, really investing in our digital, and data, and technology capabilities. If I look at our retail business, that business is now growing from a customer acquisition perspective. We can see that NPS customer improvement statistics are improving and now on a positive trend for the first time in a long time.

We've invested in our digital mortgage which means that if you are renewing your mortgage, you can do it in anywhere between seven and fourteen minutes, so that's a huge positive. And we have capacity to grow in that space. So we see continued growth in mortgages, obviously going back into unsecured, now 6.4% of the market. We saw 33% increase in the number of applications of new credit cards. That business is growing, but in a very safe way with our own customers, and our retail bank is now 60% entirely digital.

That investment in our app, in our capabilities has really seen potential there. With going into customer life cycle and growth, things like youth are an area where we've really seen an increase in market share. We now have just under 16% market share things like Rooster Money, which was an acquisition we made, brings in 130,000 new customers. We think in retail, continuing growth, continuing capacity to grow, and a more diversified income story there as we've gone back in. On the business side with the creation of commercial and institutional, we are obviously the number one bank in the UK, both in terms of market share and NPS customer satisfaction for business. That is a very strong franchise for us. As

businesses recover post pandemic, as they continue to grow, we will benefit from that as a result of the capacity that we have.

New product areas that we've gone into and new initiatives like Tyl, which is back into merchant acquiring. Mettle, our entirely digital bank, now has more than 50,000 customers. The SME ecosystem that we are creating is really embedding and deepening relationships. Particularly in ESG financing, that is a strong area of growth for us. We've committed a hundred billion pounds of climate funding and sustainable financing to really fund the transition to a low carbon economy and that is very strong.

Then I'm really excited about the potential for growth in our wealth division. Coutts is the number one wealth bank, strong asset manager. We've seen that business grow from GBP 15 billion in asset under management business to now just under GBP 37 billion. As we've launched our robo-advisory, cross selling into our affluent customer base, we've seen an increase of almost 30% in the number of our affluent customers. We saw 17% increase in assets under management, particularly strong growth in our digital acquisition. I think there's real capacity to grow. Then obviously with NatWest's markets now restructured, we have a market leading FX ESG capability, which we can support our customers with. I see really strong potential for growth across. I'm excited about all of those opportunities as you can tell.

Martin:

Perfect. Thank you. Let's move to cost. NatWest is one of the banks out there, at least from what I cover, was one of the most ambitious cost targets in cost reduction in absolute terms of 3% per year. Given inflation surprising on the higher side for right now, do you see risk that it could become increasingly more difficult to achieve this cost target and could have been an incentive at some point to move to a more operating jaws kind of target?

Alison:

Yeah. I'm really pleased with our discipline on cost and what we're really driving is improving the operating leverage and that positive jaws is exactly what we're aiming for. We're very comfortable with our guidance of 3% cost reduction for this year. You saw in Q1, we took out 4.6%, of course non-linear, it will be 3% for the year. We have factored in obviously inflation. We put through pay increases for our staff, which was supported by our social partners. We've targeted that very much to lower grades and low income. Then obviously the hot skills that we're all targeting. So when I look at our cost reduction programme and that positive jaws dynamic, for this year, the three billion investment we're making is really investing in the efficiency, digitisation, automation of our business.

I think I talked about an example in our Q1 to sort of bring that to life. Our account opening has gone from 17% straight through processing in 2019 to 70%. That gives you a sense of where we are driving efficiency through the business. That continuing investment in customer journeys, automation, the creation of the commercial and institutional business will allow us to drive more efficiency through our back office and infrastructure support. There's still some benefits coming through from our property portfolio, particularly in a post COVID

world. That cost reduction for this year is largely driven by that. But absolutely we're targeting operating jaws and continuing to drive operating efficiency through the benefit of that investment.

Martin:

To what extent do you see inflationary pressures in your cost base? If so, where do you see inflation starting to come through?

Alison:

Yeah, people are one of our strongest assets and one of our biggest cost base. We are always making sure we're attracting and retaining talent. You see inflation there, not just market inflation, but skills inflation. We can see that coming through. In terms of our cost base around energy prices, one of our strategies was to ensure that we were net zero in our own operations. 99% of our energy is bought from renewable and so we're focused on that. It's really through people and energy that we'd see that, but we've obviously factored that in as part of our planning, but we keep a very close eye on that and think about how we can hedge and optimise from that perspective.

Martin:

There's a lot of focus out there on whether monetary policy could lead to a next credit cycle, pronounced credit cycle, whether that's in the UK or other markets. Do you see the risk that... you mentioned unemployment before it being very low at the moment, but going forward in a year, do you see risk that the UK could have a significant credit cycle? are there any early warning signs you pick up at the moment?

Alison:

When I look at our book, we're predominantly... the way I would think about it, we've actively managed our risk. I've always talked about in our business about active management of our capital and risk diversification. We're predominantly a secure book, 94% of our [personal] loans are secured. We are what I would describe as a prime lending book. What you can see is through our active capital management over the last three to five years, we've been actively managing our capital to make sure that we're managing our RWA intensity. Our reentry into unsecured has been very measured from that perspective. As I look at the data today, I'm not seeing any signs of stress in our book, both in terms of actual stress or early warning indicators. For those, I would look at things like: are overdrafts becoming hardened, are revolving credit drawings starting to increase to show that people are drawing liquidity because of concern. We're not seeing that. It continues to be below pre COVID levels. We're not seeing requests coming in for deferments or help in terms of that support and no calls coming in at higher volume to our financial health and support line. Predominantly secure book, we actively manage risk. We're very well diversified from a risk perspective. We will continue to do that as we go forward. We are very mindful of inflation. In things like our mortgages and our appetite, we have built in affordability to reflect inflation so that we're making sure people can manage affordability. Things like our financial health check that we put out with our customers helps actively manage their own balance sheets to really be proactive in supporting people with some of the headwinds coming. We don't see that as a concern in the data that we're seeing today or the early warning indicators.

As the interest rate rises, I mentioned, I think for a lot of consumers and businesses, they haven't managed an inflationary environment. That's where our business model and structure is incredibly helpful because we have sector specialized relationship managers who can actively work with customers on the trends that they need to manage in their sector, how they hedge, how they think about it. We've, for example, a couple of months ago we wrote to 50,000 of our smallest businesses to help them think about supply chain management and risk management. On the consumer side, we're a prime book. We're predominantly secured. We're at the right end of the curve. Even at the 2.3% interest rate rises, we don't see that as a credit event.

Yes, of course, it's much higher than the very, very low rates that we've been operating in, but that is not a credit events interest rate, right. So, we're proactive, we're prudent, but we're not seeing any signs of distress or concerns in our early warning indicators.

Martin:

Then maybe, I mean if we look back to the global financial crisis, I was just wondering how much has the UK lending market changed since? Is there a point to be made that financial gearing of the consumer is much less this time around?

Alison:

Yeah. I mean, I think the consumer balance sheets and the business balance sheets are very different compared to pre-financial crisis, and also the banks are very different. If I look at our own bank, we're in very different shape, core tier one at 15%, you can see our liquidity in the strength of our book. But if you look in the consumer, on the mortgage side, when you look at the leverage significantly lower, we've seen in the post-pandemic period, almost GBP 25 billion pay down on credit card lending, so consumer debt is lower. So I think consumer and corporate balance sheet is in much better shape.

Coming off a period of QE, there's a huge amount of liquidity sitting on balance sheet in consumer, so I think household debt and leverages is lower from ... If I think from our perspective as a bank, pre-financial crisis, we were a significantly larger bank. We're a predominantly UK retail and commercial bank, strong core tier one, just to give you a sense, our commercial real estate book pre-financial crisis was loan to value above a hundred percent, it's now closer to 46%.

So I think it's a much more risk diversified, well managed, and consumer balance sheet, and banking balance sheets in a very different place.

Martin:

Let's move to capital return, and one of the key attractions of NatWest always has been the scope for capital return, and NatWest has made significant progress from the recommencement of the dividend, and directed buyback, in market buyback, special dividend. I was just wondering if you could comment on the scope for capital return from here, and just also adding back to previous question, the rate sensitivity, and kind of the

revenue tailwind coming from rates. Could this lead to a scenario where one can think more constructively about the payout ratio going forward?

Alison:

My starting point would say we've built a capital generative business, so with the strength of our franchises, we will continue to generate capital clearly, with capital ratios at 15.2%. That's very strong capital, our guidance for the shape and risk diversification of our business, we're aiming to be between 13 to 14% CET1 by 2023, and around 14%, by the end of this year. You can see we've got significant excess capital, therefore, sitting on our balance sheet. I've been very clear that my preference is to distribute capital to shareholders and we've given guidance that we would expect to pay a minimum of a billion in distributions to our shareholders. Obviously, as we did recently, we would want to continue to support any pay down of the government shareholding we participated in the directed buyback, the next window for that will be March next year if they choose to do that.

And obviously on our on market buybacks we have made good progress, we're three quarters of the way through the GBP 750 million that we mentioned. So we will continue to look at distributing our capital through a mixture of ordinaries and specials, on market buybacks, directed buybacks, and a commitment to distributions. I've also said we would look at M&A if it is going to drive compelling shareholder value and our business continues to generate capital. So I think there is a strong capital story here, and hopefully a clear path that you can see to around 14%, and then 13 to 14% by the end of next year.

I think that's a positive story, clearly with the guidance I've given you around our revenue of comfortably above GBP 11 billion, that's based on a 1.25% interest rate assumption by Q4. We'll update our economics at the half year, but you can see there is where we are versus where market guidance is. As more interest rate rises come through, we would expect to pass more on to our consumers as we go through that, but we would look at that at the time as we go through. So I think strong capital generative business, excess capital, and a number of different mechanisms of how we will use that capital to distribute and to continue to invest in the business.

Martin:

Yeah. Final question for my side before opening up to the audience for question, I was just wondering how important is the exit of Ulster Bank to your capital return plans? How should we think about that? And obviously, given the recent announcement of the agreed sale of yet another book of, almost the last large book within Ulster. How do you feel about that?

Alison:

Yeah, I'm pleased with the progress with Ulster. I said we wanted to manage a gradual withdrawal from that market clearly with the announcement that we made. Recently, that's around 90% of the asset sales now agreed, and so we're making good progress on executing that, so I'm pleased with the plan, and as we exit that will continue to be capital accretive. Our distribution plans are not dependent on Ulster, and clearly as we complete some of these asset transactions, we would look to restart dividends out of Ulster, and we would

consult at that point, but our distribution plans are not dependent on that, but I'm very pleased with the progress we're making.

Martin:

Yeah. Perfect. Let's open up for Q and A from the audience. We have the first one here in the fourth row, and then we go in the third row.

Speaker 1:

Hello, Sophie [inaudible]. Thank you a lot for your presentation. I have a question on the climate stress test because so UK is probably at the front point of climate stress test, and it's only the beginning, I guess. So I want to know what we are learning from this exercise, and given that climate change and is a very long term structural topis, I just want to see how you assess, you manage, and you evaluate on one hand the physical risk, what matters for you guys, it flows, or I don't know. And on the other end transition risk with the risk of ending up with stranded assets. Thank you.

Alison:

Yeah. So, climate we've made part of our strategic priority, and I've made some very clear commitments in terms of being part of helping transition the UK economy to a low carbon economy. I think in terms of the stress tests, I think these are early days in terms of the stress tests, but what it ... and it's looking out trying to predict 30 years of what will happen. So I think that's a helpful exercise, just in looking at what we've been doing in terms of our own balance sheet, NatWest has made climate a clear strategic priority, and what we've committed to do is across three dimensions. One, get our own house in order so to be net zero, which we already are in our own operations, moving to net positive to end harmful activity.

So we have committed to not lending to coal and phasing out our lending to coal, and with oil and gas fossil fuels only to lend to companies who have a transition plan aligned with Paris. Just to give you context, oil and gas is only 0.8% of the lending on our balance sheet. So it is not a significant part. And then thirdly, play our role in the climate transition. So we've committed to half the emissions from our financing on our balance sheet over the next decade, and we have committed a hundred billion pounds to fund and finance the climate transition. So, we see climate transition as not just a strategic priority, but also significant business opportunity. We did some research recently, obviously, as I mentioned, with the largest business bank in the UK, we produced a report last October, I think it was, which was on banking on a sustainable recovery. And we think for SMEs in the UK, there is 160 billion revenue opportunity from them playing their role in the transition. We're very mindful of that transition. So your question around stranded assets, we've been very clear. We'll only work with those companies who are going to transition. And I think a lot of the big oil and gas majors are committing to transition. So it's better to work with them, with those assets on our balance sheet rather than exiting them. And then, you are not solving the problem, which is getting emissions out of the atmosphere for our mortgages and our housing stock and the different sectors we lend to, we have now measured 12 of our core sectors so that's around 56% of our balance sheets. So we can measure the emissions that we have, which means then we can track the progression in those emissions. And for example, on housing,

we've set a target to get to around 40% of our housing stock to EPC rated A, B or C we're currently in around 36%. So, things like incentives around green mortgages to encourage people to invest in transition. So we're comfortable that we are going to migrate our balance sheet. We've started measuring it. Obviously that transparency is very important and we're putting the funding behind that to help transition. Hopefully that addresses all your-

Martin:

Yes, that's good. Front row.

Speaker 2:

I'd just like to understand a bit more, you talked about potential M&A and what the opportunities might be, what you would be looking for. Maybe you could just provide a bit more insight into what you're seeing that is out there.

Alison:

Yeah. Look, I mean, M&A, I think is an option for us, but I think my starting point would say, it's got to have compelling shareholder value and it's not going to be disruptive to our transformation plans. I think as we look at our business, you can see that we have got capacity to grow in our retail business, particularly in unsecured; in our wealth business, which is growing very strongly, I think there are opportunities to look at acquisitions in that space if they are compelling. And obviously as we continue to invest and build in our digital and data capability, we would look at that. We've made a number of small acquisitions. So Metro mortgage book, that's a good example. It's aligned with our risk appetite. It sort of gives us a bit of volume acceleration, Rooster Money, which was a FinTech, which has allowed us to accelerate some of our youth capability in terms of our strategy. It's those types of things that we would think of. So that's the type of thing we would look at, but with very significant discipline in applying that.

Martin:

Maybe I take one. I was just wondering on a competitive landscape in the UK, how do you see it evolving? On one end, it seems like banks increasingly start to pass on in full increases in swap rates on a mortgage side, as an example. On the other hand, there is new entrants such as Chase UK with a fairly competitive deposit offering. How do you see the overall landscape overall?

Alison:

Yeah, I mean, the UK has always been a very competitive market and the way, particularly with the shape of our business, we are competing with global banks, local banks, challenger banks, FinTech, startups across the piece. And what I'm very comfortable with is that we can compete effectively across all of those paradigms. In terms of the new digital startups and Chase being one of them, our bank retail bank is now 60% digital. So 60% of our customers only interact with us digitally. So that is the digital bank. And I'm very comfortable that we are able to compete effectively. We cover a broad waterfront. So we go from the vulnerable, most simple customers up to the most sophisticated customers.

And so we are offering a much more fully integrated ecosystem. So I'm comfortable we can compete. With FinTechs I've always taken the approach that we'll also partner. I think partnership is a really important element of what we do. Some of the things we've developed such as Rapid Cash, which is a cloud-based invoice financing business. We partnered with an Australian FinTech to do that, Tyl which is our merchant acquiring. Again, we partnered with a FinTech and then we've leveraged that. Carbon Place, which is our initiative around carbon trading. We've partnered with global banks and built that on blockchain to be able to offer that internationally. So I think we will partner with big players and FinTechs and compete effectively. So I never underestimate the competition. I'm just very used to dealing with it. The UK remains a very competitive and attractive market, rightly so, but we're continuing to grow, share, improve customer returns, and actively manage our risk.

Martin:

Let's pause for a moment, just see if there's any other questions.

Speaker 3:

Thank you. You mentioned that most of your book, on your mortgage book is fixed rate. Can you talk about the duration of that fix? And then also you said that the leading indicators still of consumer stress are pretty low, but as that book renews onto the new rate, whether you see that continuing.

Alison:

Yeah. So around 92% of our [mortgage] book is on fixed and the average duration is around three years. Average loan to value is around 54%. So, and what we've seen is an increasing trend is more of a shift onto five years. So that's the way the book has shaped. What we have targeted with our mortgage strategy, obviously to grow because we have capacity to grow. We've invested in our digital mortgage, which is really targeting retention. So our retention levels are around 70 to 80%. That's exactly what we're targeting. And that gives us an ability to build a broader relationship rather than just the mortgage relationship. So we're very mindful of that churn as people roll off, but actually average duration, three years predominantly fixed good loan to values, prime, we're pretty comfortable with the affordability. And then obviously as we look forward, we've built in sort of inflationary trends into our affordability calculators for mortgages. So we're sort of making sure we are keeping that responsible lending and affordability up front of mind as we go forward.

Martin:

Are there any further questions? Otherwise, thank you very much again, Alison, for coming to Rome and making time to speak to investors, we appreciate it, thank you.

Alison:

Pleasure. Thank you.