NatWest Group plc
Bank of America Conference Fireside Chat 21st September 2021

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Moderator: Good morning, everybody. Thank you very much for joining us. Before we move on to NatWest, I'd like to ask you three questions on domestic UK banks. You can see them on your screen and please do respond online. I'll just run through them very briefly. The first one is expecting UK domestic banks to distribute over £20 billion of capital in the three years to 2023 compared to £13 billion in the three years to 2019 is (1) reasonable, (2) optimistic, or (3) pessimistic.

The second is on volume growth. Question number 2, UK mortgage growth is currently 5% a year. That compares to 2% in the decade post-financial crisis, at 10% pre-financial crisis. This pace of growth is (1) sustainable, (2) can accelerate, we're only just beginning, (3) all slow, current demand is temporary.

The final question on profitability, a 10% ROTE for domestic UK banks is that (1) realistic, near-term, and sustainable, (2) will be reached in the medium-term, (3) can be achieved, but only after further restructuring, or the fourth option is competition and interest rate expectations make it too hard to get there.

Do please respond to those. You can see them on your screen. Please also submit any questions that you'd like to ask in this session with NatWest. With that, I'm very pleased to welcome back Alison Rose, CEO of NatWest Group. Morning, Alison. It's a pleasure to have you with us again.

Alison: Morning, nice to see you.

Moderator: Perhaps we could just kick off with strategy. The strategy that you outlined last year is focused on growth, balanced risk, and cost in capital efficiency, with a target of delivering a 9 to 10% ROTE by 2023, along with attractive capital distribution. I guess since you set the targets, the outlook for both lending volumes and rates has improved, but there's also more competition around now than there was back then. I wondered how much your confidence in reaching or perhaps even exceeding that level of profitability has changed.

Alison: Thank you. Look, we remain comfortable with the full year target of 9 to 10%, and I think it's worth sort of remembering the assumptions that we have in terms of how we're going to achieve that. We're continuing to target above market growth, lending growth in our UK and RBS international, retail and commercial businesses. You can see from our Q2 results, we are continuing to deliver that.

Continued cost reduction of around 4% as we reengineer the business and invest in digital and innovation and technology to make sure that we're creating that digital transformation as well. I've been clear that although we had a very strong performance at the half year, 5.9% in cost reduction, our target remains 4% as we continue to invest in the business.

We will, over time, reduce our strategic costs to a normalised level, and of course, you're going to get a normalisation of impairments as well as the economy and the businesses come out of the impact of COVID. And then an important part is our CET1 ratio of 13 to 14%. I think we remain – those are the component parts that sort of drive that strategy.

Clearly, I think interest rate rises and the forecasts there are helpful, so I think that could give us more confidence around our 9 to 10%, but the market continues to remain competitive. I think my guidance remains pretty much at the 9 to 10 and supported by the good progress [break in audio]

Moderator: I think we may have lost Alison there. Sorry, Alison, I think you cut out slightly right at the end.

Alison: Sorry. Hopefully you heard my final comment, which is I think we're delivering on our plan, and we remain comfortable.

Moderator: That was sort of the profitability part. You mentioned reducing the CET1 ratio. I think compared to a lot of other banks you've got a very clear capital distribution policy, and with the share buyback that's currently underway, that should deliver at least £7 billion of capital back to shareholders over the three years through 2023, potentially with more depending on how you decide to use surplus capital.

I was wondering, in terms of what informs the decision of how you decide to use surplus capital to get that CET1 ratio down, and what sort of hurdle rates do you think about when deciding to either invest capital in the business or distribute it to shareholders?

Alison: One of the advantages we have is we've shaped a very capital generative business and I'm very comfortable with the risk diversification we have within our business. If you look at the different components in terms of a predominantly secure book, comfortable LTVs on our mortgage side, strong capital management in terms of risk distribution across our commercial business, and some of the decisions we've made around reshaping parts of our business to be less volatile.

A good capital generative business and very strong excess capital, as you can see. The 13 to 14% I think still gives us a very, the right shape for a business with our risk diversification. I think in terms of how we're thinking about it, those robust capital levels, anywhere between 420 to 520 basis points, or around £7 billion of excess capital above those headlines.

My clear – hopefully I've been very clear – my clear intention continues to be to distribute capital back to shareholders. We've given clear guidance and updated that recently at the half year that we look to distribute a minimum of £800 to £1 billion over '21, '22, and '23. We also want to continue to participate in any activities around government sell-downs, so if there are

further directed buybacks, we would look to take part in those and we think that is a good use of our capital.

Obviously, I can only do 4.99% of that in any 12-month period, so obviously just recently announced a share buyback as well of the 750. A clear intent and hopefully a clear path to the use of our capital and distributions, but also in terms of continuing to support the sell-down of the government stake, which is in their hands, but we would look to participate.

I think then, in terms of what we want to do with the excess capital above and beyond that, we would look at acquisitions and to the extent that they were in line with our strategic ambitions and make sure that we could manage and integrate those in the right way, and they would be adding shareholder value. Inorganic growth we would consider, but they would need to be compelling shareholder value.

I think preference for capital distributions, we obviously want to help the government to continue to sell down and normalise our shareholding structure and then any inorganic if that was a good use of our strong capital position.

Moderator: The 13 to 14% CET1 ratio is a very clear target by 2023. Feels still like a long way off, but as we get beyond 2023, do you think that's still the right ratio? Some of your peers are talking about reducing their capital targets.

Alison: I think we would review at that time. I think clearly getting to that level is a good stage to get from where we are, and we continue the strong capital we have. I'm always going to make sure that we've got a very robust and safe balance sheet. I think that's really important, and that sort of management of risk distribution in a good way, but certainly we would continue to [audio interference] evaluate that as we go forward.

Moderator: In terms of the above market growth that you mentioned as one of the pillars of profitability, to what degree do you think that growth can drop through to the bottom line given some of the margin pressure that we're seeing from competition and also the cost base?

Alison: One of the questions I get asked quite a lot is on the dynamic between sort of volume and revenue. I think the position, the way I would look at it is we have capacity to grow within our business, very strong franchises, but room to grow, and I think that's a good position to be in.

What we will, particularly as the economy recovers and ramps back up as we are coming out of COVID and lockdown in various jurisdictions, I think a lot of that lending growth will be delivered by economic confidences as things come back, and we see continuing strong growth in mortgages. The way I would think about it through a volume lens, on mortgages we would expect volumes to continue to be robust through to 2022, and as you know, we have capacity to grow and continue to show increases in that market.

On unsecured, we are, we have very low market share there and starting to grow in that market. Certainly, what we're seeing, demand there will be driven by consumer behavior, and I think in particular, pick up in travel as well. There's a lot of liquidity that's sitting on personal balance sheets, but we are seeing spending levels come back.

In commercial banking, where we would continue to grow, I think that is largely going to be driven by a demand side issue. There's a lot of liquidity that's been put it and support and as this business confidence comes back, we will see growth come back. That's on the volume side. How that translates into revenues, I think we manage very carefully the interplay between volumes and margins and risk.

I think you can see there's a lot of competitor pressure in the mortgage market at the moment. We don't see that easing, but we're very comfortable that we can compete effectively and manage that volume pricing risk dynamic. The average LTV on our book is around 57%. We manage it very much through that lens and we also target retention, which is sitting up at 80%.

In terms of fees and commissions income, we have a number of initiatives where we're seeing growth there. Certainly, as more customers become active and transaction volumes are coming back, travel comes back, we'll see growth in fees of commissions and also new initiatives that we have coming online, like Tyl, our merchant acquiring or Payit or our strategy on affluence where our digital advisory journey is plugged into our app. All of those elements will support and drop into the revenue line as well. Those are sort of the interplay between volumes and pricing across the market, we think.

Moderator: I wonder if we could maybe dig into some of those dynamics in a bit more detail, perhaps starting with mortgages. You mentioned you think, you expect volumes to be robust and I guess the recent approvals data, even with stamp duty tapering, what we're seeing in house prices is quite supportive. I guess, what would your response be to that question about the level of mortgage growth in terms of if sustainable at these levels can go up or might fade a little bit?

On pricing, we're seeing continued price competition I guess over the last few months. How much further do you think that has to run if you've got a crystal ball? I guess the final piece of that is, I guess one of the newer things that you're doing is expanding into new market segments of which Buy to Let is one. How much can that help both on the volume, but also on the margin side of things?

Alison: I mean, the fact that there's so much competition in the mortgage market tells you how attractive the market continues to be from a return perspective. I think in terms of customer behaviour dynamics, the stamp duty holiday has

absolutely been a stimulus for demand, and we've, like a lot of banks, have put extra resource in to cope with the volumes and we've had some record volumes coming through as that demand has been triggered, and we can see that demand continuing through the rest of the year in terms of volumes.

I think the big question, which is your crystal ball question to some extent as well, is how much of that demand is brought forward demand because of stamp duty from last year and will we get a bit of a lull, I think it's really hard to predict that. Certainly, we're continuing to see strong demand. I think the improved economic outlook continues to provide support to that market and the volumes in the mortgage markets.

I think robust through to 2022 is where we would expect that to see, to go. Again, I think from our perspective at NatWest, we have capacity to grow in the mortgage market. We're only at around 11% share and our current account share is 16%, and we have capital to be able to grow. We haven't done as much as we could with our existing customers, so that's an opportunity in that market which continues to be active.

On the Buy to Let side, we've only got around 3% of balances in that today, so that is a market which has higher margins and we have made some improvements to our product offering there, continue to be within our risk appetite, but capacity to grow. I think there are areas that we can continue to be competitive.

Your other crystal ball question of what's going to happen with margins, I would expect them to continue to remain competitive. We've seen new business margins weaken a little bit over the year and that's, I think, a combination of higher swap rates and increased pricing competition. We're seeing the second quarter margins obviously reduced, which I talked about in our half year results.

Look, I think mortgage margins will continue to be competitive. There's nothing that I can see we'll see that suggests that will slow down. There's still a lot of liquidity in the market to be put to use, so I'm comfortable we'll continue to grow above market, but we're going to grow balancing that with the right risk discipline. We're not just going to chase volume. We want to manage that balance, and as I said, we're really focused on retention with our existing customers as well.

I think from that perspective, we're comfortable we'll continue to grow above market. We're comfortable the volumes are going to stay robust, and it will continue to be an aggressive market. Equally, we're investing in things like our mortgage journey, our digital journey, which actually reduce the cost and increase the productivity of us delivering in that space, so those dynamics we're willing to play […] as we look at that space.

Moderator: You mentioned the 11% market share in mortgages, and you touched on the very low market shares, particularly in credit cards which have been a little over 6% now. From NatWest, a recovery in the credit card market, where balances are down about a quarter from their 2019 levels plus increased customer penetration could be quite a strong driver of growth there. Wonder if you could help us frame that in terms of your expectations for growth in credit cards.

Alison: I mean, I'm not, coming into the crisis, I wasn't unhappy at this point in the cycle that I didn't have huge balances on unsecured, so I think it really is an area of growth for us. You can see our sort of share as we've been rebuilding our proposition in the unsecured has increased to 6.4%, a half one, but from much lower levels in '19. That's still a very low level, so as you say, there's real capacity to grow in the right way and we think there's a significant opportunity with our existing customers.

We're making David Lindberg and his team who are in retail are really closing the gaps in our product range as we develop it. We've recently launched a purchase and balance transfer card that's been very positive with our customers, which is offering sort of a matched introductory offer. That's positive and we are definitely seeing debit and credit card spending come back.

I think from a balance perspective, obviously what you saw during COVID was consumers managing very well their own personal balance sheets, so that big paydown in credit card spending, the […] credit card balances during COVID. What we're seeing is those balances coming back a little bit, but there's still quite a lot of deposits sitting on accounts, so there's an interesting dynamic as well, which also goes to one of our other areas of growth which is on savings and investments as we encourage consumers to save for the future.

We've seen a big increase in the number of people saving and obviously our "robo advisory" that's supported out of our Coutts funds. We saw an 8% increase in our AUM balances. Both sides of both the investment and saving and unsecured side we see as areas of growth.

I think what you'll see as we come out of COVID and that customer dynamic travel coming back, is going to be quite an interesting dynamic because typically, from a behavioural perspective, we see credit cards being used when people travel on holidays. That reopening as debit and credit card spending comes back will help on the balance side as well as us benefit on the affluent side.

Moderator: In commercial banking, you mentioned that's going to be demand-driven in terms of lending. I guess as we think about commercial banking revenues, to what degree is the fee piece, so transactional activity, payments, that side of things as are more important than the balance sheet growth.

Alison: I mean, it is important, and I think you've got a few dynamics going on in the commercial lending space, which are very much macroeconomic driven. The current conditions in the commercial market are really driven by a lack of demand rather than supply, and that is a feature, the sort of extraordinary levels of liquidity that were put in to support the economy during the lockdown period.

I think, from our perspective, we've got the capacity to lend and the willingness to lend within our credit risk appetite. It very much is demand side as things remain subdued. I would say you have to look at it across small, medium, and large end of the market. At the large end of the market, we're seeing more activity and more demand, particularly in spaces like infrastructure finance, ESG financing, that side of things.

At the small end, it's really a feature of absorbing the government lending schemes, a lot of which is still cash sitting on balance sheets. I think as confidence continues to rise with businesses, as they start ramping their supply chains back up, which is really largely at the moment being funded from cash and working capital, we'll see demand coming back a little bit and hopefully more into the second half of next year. That's the demand side issue.

On the fee and commission side, I think more of customer needs in lending, working capital, trade finance, we're definitely seeing a behavioural element that businesses really ramped down their supply chain and now they're ramping back up again, so more demand for working capital. We're continuing to invest in our payments infrastructure and products, so things like Tyl, which is our merchant acquiring, or Payit, which is our payment platform. We'll see those contributing more as well.

Obviously as NatWest Markets is refocused in deepening relationships on the FX side and into supporting particularly the ESG financing where that business is performing very well. We'll see more fees and commissions coming through from the side. What's encouraging is we are seeing transaction fees coming back as businesses have reopened. Businesses are trading and those volumes are coming back as they ramp up.

I think the degree of growth that we'll see in commercial is going to really depend on both that speed of economic recovery, increase and ramp up the working capital requirements, the business confidence to invest the growth, and obviously the customer behaviour in paying down government schemes. And then, of course, you can see the huge growth happening in green financing and green and sustainable bonds, which we're playing a leading part of.

Moderator: You touched on NatWest Markets there, and that business is having a more difficult year from a revenue perspective, partly driven by markets, partly driven by the fact that you're just completing the repositioning of that

business. From here, what is it that you see or what initiatives are the most important in terms of delivering the .8 to £1 billion in revenues that you target over time?

Alison: I think NatWest Markets is making good progress on its transformation and if you recall, we're transforming that into a much simpler, much more strategically aligned capital intensive position, and that reshaping has pushed us to focus much more in corporate and institutional customers in those areas of interest rate management, foreign exchange, and capital markets.

I think the transformation is going well, and largely by the end of this year, the capital reshaping of that business will be complete. It's worth remembering why we started out on that strategy. That business was absorbing too much capital, over 25% of the group's capital. Its costs were too high and its returns, its income too volatile and was never going to make the right level of returns.

The reshape now is pushing that much more to a sort of sustainable business and really starting to position for growth, particularly in the capital markets and the currencies business and we see the great job the team are doing, particularly on the ESG expertise is driving a really strong performance in our capital market side now. It had a tough Q2, largely driven by market, lower market activity on the fixed income side and also that was the business, the rates business is the business we were restructuring most significantly.

Over time, we expect the rates business to stabilise as that normalises, and the business in our capital markets and currencies and FX is now positioned for growth. We think a much simpler platform, much more strategic, and less volatile gives us confidence over the medium-term. That will reshape into the right contribution.

Moderator: If we move on to costs, NatWest has a strong track record of delivering consistent cost reductions, but I guess the focus is different now. You've moved from a de-risking and repositioning of the business and downsizing to more of a growth footing, as you've just been discussing. A lot of the cost initiatives seem to be around process improvement and shared services. Wondering if you could give us a bit of a flavor of the types of things that will deliver that 4% annual cost reduction.

Alison: You're right, we do have a good track record in this space and very much the cost efficiency we're driving out of the business is really an output of the investment that we're making rather than a de-risking story. We're continuing to invest quite significantly in the business, so we have £3 billion of investments over three years, and that is, 80% of that is going into data, digital, and technology. Increasingly, we are using automation, increasing use of investment in digital.

Over 60% of our retail customers, for example, now only interact with us through our digital channel, so increasingly investing there. Also investing in

things like APIs as we integrate with third parties. It's those key areas and making sure we're reusing our technology across the bank. A great example to bring that to life a little bit for people is when we stood up the government lending schemes, like the Bounce Back Loan scheme, that was a fully automated end-to-end journey that we stood up in a matter of days using our automation and digital tools to enable us to do that. It's in those sorts of areas.

As we reengineer our customer journeys, we're removing manual processes, creating much more digitisation and end-to-end journeys. Across the bank, we have seven different connected workstreams which have clear deliverables and multi-year strategic investment program that allows us to invest strategically in reengineering the business which drives cost out on a more sustainable basis and drives, enables us to get greater productivity.

The investment that we're making in digital – just to give you a sense – customer journeys account for around a third of our cost base, so investing in, simplifying, and automating and digitising those end-to-end and reusing our technologies is a big part of the cost reduction program. Those are some of the areas that underpin costs and obviously the added benefit is its lower cost per unit, increased productivity.

Our mortgage end-to-end journey, for example, when you renewed a mortgage, it used to take you maybe two to three weeks. You can now do it in 14 minutes because it's entirely digital and end-to-end. That's the type of investment and cost out that's driven from that.

Moderator: Two to three weeks to 14 minutes is certainly quite a change. Credit quality looks extraordinarily benign at the moment – I guess some recent concerns around the energy supply industry perhaps. Wondering, number one, how you're thinking about that, and generally what are you seeing? What are the pinch points and the key metrics that you'll be looking at in terms of government support coming off, et cetera as you think about credit quality? Also, this £4.9 billion of provision reserves, almost a quarter of those are post-model adjustments, so additional conservatism on top of the IFRS 9 models. You've got quite a big buffer there. Just wondering how you think about credit quality and when you might think about releasing some of that additional prudence if you like.

Alison: I think what we see in the market is, and it is a feature of, I think, the huge amount of support that was put into the economy to bridge during the lockdown periods that we went through, we continue to see a very benign environment from the perspective of defaults and bad debts. What we've seen is a lot of the support measures or actions that particularly consumers and businesses took around repayment holidays, mortgage repayment holidays, personal loan holidays have all tapered off, and the majority of that has gone back to normal payment terms, which is a very good sign.

Unemployment remains very low. A lot of additional debt was put into small businesses through things like the Bounce Back claim, and the government schemes, those are starting to fall due for repayment because we're at the 12-month anniversary. We've seen around 6% of our customers repay in full on the Bounce Back claims and around 92% are starting to meet or exceed their regular payment.

Lots of good trends in terms of what's going on. However, until, I talk a lot about the economy recovering and good trends coming through, I think until we see all of the measures taper off, you've got things like stamp duty which is […] which is a stimulus, but the government schemes have come to an end. Repayments starting to come through, but until all the measures are tapered off, I think you're not really going to see what level of scarring there is in the underlying economy. […] Furlough coming to an end is an important step as well.

We have seen very, very low levels of pro-cyclicality, but I would like to see the economy to continue to recover and all of those measures, those measures come off. We'll continue to take a very prudent view and careful view, particularly in terms of risk management and as we support our customers through this and hopefully the recovery and the growth as demand comes back. That's what we're seeing on the ground at the moment.

In terms of our post-model adjustments, we updated our economics at the half year and we're certainly more positive about the outlook. Certainly, our ECL provision at the end of Q2 was down as well. The post-model adjustment that we have now is largely related to economic uncertainty, and it's a larger proportion of our sort of ECL. I think as we go forward and look at that potential unwind of the PMA, the driver for us is effectively going to be how the wider economy recovers and those continuing trends, and how our customers react to the unwind of government support.

We will, obviously, we're watching that very closely and keeping a very close eye on that, but we want to see all of those mechanisms come off and a bit more of a tailwind in that side of things. And don't forget, although businesses have bridged incredibly well during this period, there's a huge amount of additional debt that has been put into businesses, albeit at cheaper rates and able to pay back over long periods, but there is that additional debt that's put into businesses. We'll keep a close eye on it and monitor it from that perspective.

Moderator: In terms of some of the supply chain issues that have begun emerging, how do you see that in terms – I guess there are two perspectives on that. One is a potential credit quality issue. The other is more demand for working capital. A balance of those two, which would you see is more important in terms of how that's evolving?

Alison: I think – what you'll see is a couple of dynamics. I think it's really as supply chains ramp back up again. Certainly, after the third lockdown, what we saw was a lot of businesses contract their working capital down quite significantly and what you're seeing is it's trying to ramp back up again. Now the positive is there's a lot of the borrowing that was drawn down under the government schemes and under support is sitting in the system and sitting on balance sheets, and that's funding a lot of the working capital ramp back up.

There's no lack of supply from that perspective. I think it really is supply chains ramping back up again. When I talk to businesses up and down the country, I was in Coventry last week and Edinburgh the week before talking to roundtables of businesses, the things they cite are access to skills, access to workers and getting their supply chain moving again as the biggest challenges they're facing, as well as any perspective continued uncertainty. I think giving business confidence is important, and then just getting those supply chains ramped back up. There's no lack of liquidity or working capital to fund them.

Moderator: On Ulster Bank, I guess if we think about capital allocation, you've been very disciplined in NatWest Markets we talked about. Ulster Bank, you've actually made very quick progress in terms of, I guess, agreeing or working on agreements for around 60% of the loans there and about a third of staff and branches. Do you have a sense, in terms of the total, the overall exit, do you have a sense of how long that might take? I know you talked about it being a multi-year process. Linked to that, when do you, do you have a view on when we might start to see capital being released from The Republic of Ireland?

Alison: I've always said our withdrawal from Ireland would be a phased withdrawal over a multi-year period, and we're very mindful of doing that in a thoughtful and considered way, but we would expect that to be capital accretive during the life of doing that. As you say, I'm pleased with the progress to date which will help us accelerate that withdrawal and end up with positive positions for our customers in terms of where they're going and also for the Irish market.

I think the binding agreement with AIB, which is for our commercial loans, I think that's very positive. The non-binding with PTSB that we're working on, that's around 60% of the book together. The AIB deal, we wouldn't expect to complete this year. I think the transfer will take place in phases during the course of 2022 and there are a number of conditions to that sale, but obviously we're managing those very carefully.

I would hope with PTSB we would reach terms before the end of the year, and then completion would take maybe 12 to 18 months after that. With the remaining 40% of the book, we'll aim to sell bits of that, and we'll update the market as and when appropriate. I think as transactions complete; we would look to restart dividend payments back to the group, but I would continue to think of this as a multi-year phased withdrawal to be capital accretive.

Moderator: I guess speaking on capital allocation, there's an ongoing program, I guess, within the commercial bank to improve capital efficiency. Are there other pockets of capital efficiency in the business that you've identified and will be working on, or is that pretty much it?

Alison: I think obviously the big capital efficiency, in commercial, that's an ongoing active capital management where the team will work very carefully in terms of managing capital risk in the portfolio, risk on the book. I always very cautiously say we haven't had any tall trees in Q2. We're not in a zero-risk game, but we are actively managing the risk. The big capital decisions around Ulster and NatWest Markets, NatWest Markets will largely have finished its capital reshaping this year, and I think the team have made good progress.

Broadly, I think all the strategic capital choices have been made and then it's really just BAU management of efficiency of capital and managing for returns, and then very much turning to growth.

Moderator: That's been great, Alison. We are sadly out of time but thank you very much for your time this morning.

Alison: Thank you very much. Nice to see you.

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