NatWest Group plc
Q3 Results 2021 – Management Presentation

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Operator: Welcome everyone. Today's presentation will be hosted by CEO, Alison Rose, and CFO, Katie Murray. After the presentation we will open up for questions.

Alison Rose: Good morning. And thank you for joining us today. As usual I'll start with a brief update before handing over to Katie to take you through the Q3 results. We'll then take your questions.

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

We continue to make good progress on our targets. Net lending was up 3.1 percent on an annualised basis driven primarily by growth in mortgage lending. Costs were down 4.3 percent for the first nine months compared to the same period in 2020. And we are reporting a CET1 ratio of 18.7 percent.

As you know, this capital strength has enabled us to increase our annual dividend distribution to a minimum of a billion pounds for 2021, ‘22 and ‘23. It has also allowed us to make an initial on-market buyback of up to GBP 750 million this year of which GBP 402 million has been executed to date.

Taking into account the GBP 1.1 billion directed buyback in March, this brings total distributions for 2021 to around GBP 2.9 billion of which we have already booked GBP 2.6 billion.

As you'd expect our focus is very much on executing our strategic priorities in order to drive shareholder returns and deliver on our 2023 targets. These priorities are all about generating income growth, reducing operating costs, investing to make our business more customer friendly and efficient through digitization, and allocating our capital wisely in order to maximise returns.

I won't dwell on this slide but I would like to underline our commitment to play a leading role in relation to Climate Change. We have already exceeded our initial target of delivering GBP 20 billion of climate and sustainable

funding and financing. So we have recently announced a new target to deliver a further GBP 100 billion by the end of 2025.

Turning to Slide 5, I'd like to talk in more detail about how we are supporting our customers to drive growth. Net lending across our retail and commercial businesses is up 3.1 percent on an annualised basis to GBP 305 billion, GBP 7 billion up since the year end, excluding government lending schemes.

This growth has been driven by mortgage lending whilst commercial demand continues to be relatively muted as the economy reopens.

I've spoken in the past that we see an opportunity to grow our share of mortgage and unsecured lending. And during the year we have launched a range of initiatives to achieve this.

We're making good progress in Buy to Let Mortgages, where application volumes in the third quarter more than doubled compared to the second as a result of simplifying our policy and aligning our lending criteria more closely to the market, whilst maintaining firm pricing discipline.

We're also seeing good momentum in unsecured lending. The issuance of new credit cards has almost doubled year on year and we have brought new products to the market. Around a third of this growth has been in the last four months following the launch of a new Purchase and Balance Transfer Card in June.

Spending on credit cards is up 20 percent on last September to pre-COVID levels and whilst credit card balances remain slightly down, this trend is gradually reversing.

As you would expect we are growing unsecured lending in a thoughtful and disciplined manner. We have made our new Purchase and Balance Transfer Card available only for existing customers just as we did with the government lending schemes and our mobile app helps customers both to track and set limits on their card spending.

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 percent compared to a peak of 40 percent in April last year.

Looking at government lending and particular Bounce Back Loans, since the first anniversary of the scheme when repayment started about 7 percent of these loans have been repaid in full and around 90 percent of customers due to start repayments are repaying on or ahead of schedule.

In NatWest Markets our currency and capital markets businesses are performing in line with expectations whilst we continue to reshape our rates business to better serve corporate and institutional clients.

And finally, we are benefiting from having brought all our wealth management businesses together in Private Banking in order to make better use of our asset management expertise right across the Group.

Year to date we have delivered strong growth of around 11 percent in assets under management and administration. This includes growth of GBP 1 billion in the third quarter bringing assets under management and administration to GBP 35.7 billion. Just over half our growth in the first nine months was net new inflows of which about 30 percent was via our digital platforms.

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. At the same time as expanding our products and services to meet customer needs, we continue to accelerate our digital transformation as you'll see on Slide 6.

About 7 million of our retail current account customers now use digital means only to interact with us allowing them to access our services at any time of the day from any place they want.

We are using data and analytics to deepen customer engagement in Retail Banking through increasingly personalised messaging. Tailored messages have grown from 72 million in the first nine months last year to 318 million in

the first nine months this year, and they have resulted in a significant improvement in customer engagement.

Meanwhile branch transactions remain below pre-COVID levels, whilst mobile payments, and video banking have grown year on year.

We've also been investing in technology-led payment solutions for Commercial Banking customers through our merchant acquiring platform, Tyl, and online payment service Payit. Tyl has processed over GBP 1.5 billion-worth of transactions since inception, of which around GBP 500 million took place during the third quarter.

I want to turn now to Capital Management on Slide 7. Let me start with our multi-year withdrawal from Ulster Bank. We continue to work through our agreements to accelerate our withdrawal. We have now reclassified EUR 3.7 billion of commercial loans.

The vast majority of those we are selling to Allied Irish Bank as assets held for sale. And we're working with Permanent TSB on the sale of EUR 7.6 billion of performing retail and small business loans along with the transfer of associated colleagues. If completed, we expect these two transactions to be capital accretive.

We are also reviewing options for other elements of the portfolio and will continue to keep you updated on our progress. Actively managing our capital in Commercial Banking has contributed to a £700m reduction in RWAs during the quarter.

We expect the impact of this capital management in Commercial Banking, together with disposal costs in NatWest Markets to amount to a £150m in 2021, down from our estimate of GBP 300 million of which GBP 70 million has been realised to date.

As you know, our focus on capital allocation is about maximising returns to shareholders. This is a capital generative business and our CET1 ratio at 18.7 percent is well above our target ratio of 13 to 14 percent.

As I said earlier this has enabled us to commit to an annual distribution of at least a billion pounds for 2021, ‘22 and ‘23. We expect to complete our initial on-market share buyback program of up to GBP 750 million in the first quarter of 2022, and have already executed on GBP 402 million.

Taking into account the directed buyback of GBP 1.1 billion last March, this brings total distributions for 2021 to around GBP 2.9 billion. With that I'll hand over to Katie, to take you through our financial performance in more detail.

Katie Murray: Thank you, Alison. And good morning everyone. I will start with the Group income statement. We reported total income of GBP 2.8 billion for the third quarter, up 4.3 percent from the second quarter. Within this, net interest income was down 2 percent at GBP 2 billion, and non-interest income was up 21 percent to GBP 820 million.

This increase reflects a number of notable items including a £79m share of gains from our collaboration with the Business Growth Fund, and gains of GBP 45 million on the liquid asset bond sales in the quarter. Excluding all notable items, income was in line with the second quarter.

Operating expenses increased 14 percent to GBP 1.9 billion driven by litigation and conduct costs. This means we are reporting an operating profit before impairments of GBP 832 million down 13 percent on the second quarter.

The net impairment release of GBP 242 million represents 26 basis points of gross customer loans, and compares the release of GBP 605 million or 66 basis points in the second quarter.

This reflects improvements in underlying credit metrics and a low level of defaults. Taking all of this together, we reported operating profit before tax of GBP 1.1 billion. Attributable profits to ordinary shareholders were GBP 674 million, equivalent to a return on tangible equity of 8.5 percent.

I'll move on now to net interest income on Slide 10. Banking net interest income for the third quarter was GBP 6 million higher than the second, excluding the one-off tax adjustment in the second quarter.

This increase reflects continued mortgage growth, a return to net growth in unsecured balances, and one extra day in the quarter. It was partly offset by the reclassification of AT1 from equity to subordinated debt for the period before redemption in August. This accounted for a £14m decrease.

Turning to bank net interest margin, excluding the liquid asset buffer, this reduced by 3 basis points to 234 basis points after adjusting for the one-off tax adjustment in the second quarter. This reduction was driven by AT1 classification and a full quarter of debt costs following new issuance in Q2.

Business trends were broadly stable in the quarter which you can see in our yield, and cost data on Slide 11.

On the asset or lending side, gross yield for the Group fell by 3 basis points to 178 reflecting further growth in lower-yielding liquid assets.

There was moderate pressure on the Retail Banking loan yields due to lower mortgage rates while Commercial Banking yields were broadly stable excluding the one-off tax adjustment.

On the liability or deposit side Group funding costs at 34 basis points were impacted by the AT1 reclassification. There was a small reduction in both retail and commercial deposit costs due to the mix.

There are two key factors to consider in relation to net interest margin in 2022, excluding the liquid asset buffer. First, the yield curve. And second, price and mix. I will talk more about these factors on Slide 12.

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

Front-book margins on mortgages that competed in the third quarter decreased from 165 basis points 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 basis points.

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 GBP 250 million 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 and into 2022.

Turning to our interest rate sensitivity which we updated at the first half, we revised our economic assumptions at the half year and they will not be updated until the year end in line with our usual practice. So we welcome the improved consensus rate outlook.

At the half year the yield curve suggested that U.K. base rates would remain at 10 basis points until Q4 ‘22 before rising to 25 basis points and a further hike to 50 basis points was expected in Q4 ’23.

You will see that the majority of our sensitivity comes from our managed margin or the unhedged balance sheet. This shows a benefit of GBP 414 million for an upward shift in the yield curve, from 10 basis points to 35 basis points. This reduces in year two and three reflecting higher pass-through assumptions as base rates increase.

The overall benefit from 100 basis point increase in the Sterling curve would be GBP 1.3 billion in year one which shows you the sensitivity is not linear.

Moving on now to look at volumes on Slide 13. Gross banking loans decreased by GBP 2.9 billion or 0.8 percent in the quarter to GBP 358 billion.

This includes growth of GBP 2.7 billion in our U.K. and RBSI retail and commercial businesses, excluding government schemes which was more than offset by the reclassification of Ulster Bank loans that we have agreed to sell to Allied Irish Bank as assets held for sale.

U.K. mortgage growth of GBP 2.5 billion or 1.4 percent reflects continued robust demand following the first deadline for stamp duty relief at the end of June. U.K. unsecured balances grew by GBP 300 million, the first increase since the fourth quarter in 2019.

We were pleased to see growth in personal loans of GBP 200 million or 2 percent and continued growth of credit card balances up a further 3 percent in the quarter.

In Commercial Banking, gross customer loans fell by GBP 1.3 billion reflecting continued repayments on government schemes, and targeted sector reductions, mainly across Real Estate and Retail. And this was partially offset by growth in specialised business.

Average interest earning banking assets, excluding the liquid asset buffer, increased by a billion pounds to GBP 331 billion. I'd like to now turn to non-interest income on Slide 14.

Non-interest income excluding notable items was in line with the second quarter at GBP 667 million. Within this, income from trading and other activities decreased by 7 percent to £137m

Our currencies and capital markets business in NatWest Markets performed in line with expectations but there was continued weakness in fixed income as a result of subdued customer activity and ongoing reshaping of the business. We are taking action to address this performance and expect an improvement into 2022.

Fees and commissions in the retail and commercial businesses grew by GBP 20 million to GBP 504 million. This was driven by higher payments due to increased corporate activity as well as card and lending fees as consumer activity increased. I will move on now to look at costs on Slide 15.

Other expenses excluding operating lease depreciation, and the direct cost base of Ulster, were GBP 1.5 billion for the third quarter. That's down GBP 13 million on the third quarter last year and reflects ongoing cost reduction partly offset by higher investment spend as expected.

This takes our year-to-date cost savings to 4.3 percent. And we continue to expect to deliver savings of around 4 percent for the full year. Strategic costs in Q3 were GBP 77 million bringing the total for the first nine months to GBP 409 million. Turning now to impairments on Slide 16.

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

We still expect a net release for the full year and the outcome will be affected by three key variables. First and foremost is the economic performance versus the weighted economic outlook we use in our scenarios. As you know, we update these each half. So the consensus economic outlook as we approach the end of the year will be critical.

Second, credit performance. While we see a lower 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 GBP 4.5 billion, down from GBP 4.9 billion at Q2. This includes GBP 1.1 billion of post-model adjustments, of which GBP 729 million relates to economic uncertainty.

This is down by £105m in the quarter reflecting a £54m reclassification of the PMA held against the Ulster portfolio we have agreed to sell to Allied Irish Bank, and the end of the payment holiday support for a number of our customers.

If the economic and credit conditions continue to trend in line with the third quarter, there could be some further unwind of this PMA later this year and into 2022. We are comfortable with our ECL coverage of 1.19 percent. Turning now to look at capital and risk weighted assets on Slide 17.

We ended the quarter with a Common Equity Tier 1 ratio of 18.7 percent on a transitional basis under IFRS 9, up 50 basis points over the second quarter. This increase reflects a 28 basis-point increase from attributable profit, net of changes to IFRS 9 transitional relief.

And a 37 basis point benefit due to lower RWAs. This was partially offset by the updated dividend accrual and linked pension contribution which together reduced the ratio by 26 basis points.

Our IFRS 9 transitional relief reduced by 13 basis points in the quarter to 60 basis points. This reflects the release of Stage 1 and Stage 2 expected credit loss which would previously have been added back to our capital position.

RWA fell by GBP 3.2 billion in the quarter to GBP 160 billion. This was driven by lower market risk which decreased by GBP 2.9 billion reflecting the GBP 2.4 billion impact of our updated model following the transition from LIBOR to SONIA.

There was a small decrease in RWAs of £100m from positive procyclicality which reflects a positive GBP 600 million in Commercial Banking offset by a negative in Retail Banking.

As we look to the year end in NatWest Markets we no longer expect to achieve the majority of the remaining RWA reduction towards the medium term target of GBP 20 billion this year.

However we now expect Group RWAs to be below our previously guided range of £185-£195on 1 January 2022. You will find more details of the various regulatory impacts in our appendix. Turning to my final slide which shows the strength of our balance sheet.

Our CET1 ratio of 18.7% is now between 470 and 570 basis points above our 13 to 14 percent target range and is more than double our maximum distributable amount. We continue to expect to operate within a range of 13 to 14 percent CET1 by full-year '23. And you will find more details of the CET1 ratio drivers in our appendix.

Our U.K. leverage ratio of 5.9 percent is down from 6.2 percent in the prior quarter and 265 basis points above the Bank of England minimum requirements. The reduction was driven by the redemption of one of our most expensive U.S. dollar AT1s following successful issuance during the first half for which we recognised a gain of £150m through reserves in the quarter.

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 percent due to ongoing deposit inflows. And headroom above our minimum requirement is now GBP 79 billion.

So to conclude, we have delivered a strong operating performance in the third quarter. And we are pleased to see the growth in unsecured balances and fee income. We are also making good progress on cost reduction and capital optimisation. And with that, I'll hand back to Alison.

Alison Rose: Thank you Katie. So to sum up before we open up for questions. We're reporting operating profit of GBP 1.1 billion which includes an impairment release of GBP 242 million as a result of low levels of default, though we are mindful of the current operating environment and are monitoring customer activity closely.

We're continuing to make progress in the execution of our strategy and delivery of our three-year targets. Lending is up 3.1 percent on an annualised basis. We're on track to reduce costs by around 4 percent per annum. And we continue to work towards a CET1 ratio of 13 to 14 percent with the aim of delivering return on equity of 9 to 10 percent by 2023.

We're pleased that our capital strength enables us to continue investing in our digital transformation, and to consider other options for creating shareholder value, at the same time as committing to total distributions of around GBP 2.9

billion for 2021. Thank you very much. And we're happy to take your questions.

Operator: We will take our first question from the line of Omar Keenan from Credit Suisse. Please ask your question.

Omar Keenan: Good morning. Thank you very much for taking the questions. I've got two questions please. One on rate sensitivity. And then just one on mortgages and mortgage margins.

So firstly on rate sensitivity, on the GBP 450 million for 25 basis points, is there any color that you could add around what deposit beta assumptions are behind that number?

And then secondly, on mortgage margins. So the application margins were 105basis points in September versus a back book of 1.64. I think kind of historically you know, the level of around 100 bps we've seen in 2019 is quite low. And a few peers like Nationwide at the time made comments that some of the levels didn't meet their hurdles.

So my questions on mortgage margins, so firstly how do you get comfort that your internal ROE metrics that drive the business really reflect economic reality?

And then secondly, how do you get comfort that mortgage margins and volumes are being balanced in the most optimal way you know, considering price elasticities, for example? Thank you.

Alison Rose: OK. Katie, do you want to pick up the question on the rate pass through in mortgages?

Katie Murray: Yes. Sure. Absolutely. Thanks very much. So morning Omar. Good to hear you. So, let me try to give you a little bit of colour on this. So our economic assumptions they're based off H1. They're not updated in Q3 in line with our usual process.

So just to remind you, at H1 the yield curve suggested that base rates would remain at 10 basis points until Q4 2022 before rising to 15 basis points -- rising sorry by 15 basis points to 25 with a further hike to 50 basis points was expected in Q4 ‘23.

Clearly consensus rate expectations have increased significantly since then. So on the managed margin slide as you look at it in terms of the Q3, the GBP 414 million for a twenty five basis-point shift in the base rate. Within there- that's around 90 percent of that number, is sterling based.

The sensitivity is built bottom up, incorporating different pass through assumptions for products across all franchises. The actual pass through rates will be reviewed and adjusted subject to prevailing market conditions and upcoming capital charges etc., including expectations of the pace, and the number of rate increases that we might see.

Omar, you'll be a bit disappointed to hear that I'm not going to get into the finer details of the pass through rates today but this is built up from the bottom, a number that we're giving you.

You can see from the interest rate sensitivity disclosure that the managed margin benefit decreases in year two, and three. This reflects a higher pass through assumptions that come as we get to those higher base rates.

You can also see from our disclosure that 100 basis points shift in the sterling GDP yield curve would be GBP 1.3 billion income benefit. So the sensitivity incorporates higher pass through rates and it is not as simple as a multiplication of the twenty five basis-point level. But clearly from this you can see that any rate rise is very positive for us.

And then if I go to the mortgage margin question. So you're right. Again, on that Slide 12, September at 105 basis points. The back book at 164 basis points. What I would say is that we continue to meet hurdles but clearly what's happened in that level and then with the rate increases that you saw coming through from swaps into October, and then we've accompanied those with some customer rate rises as well from our own side. So that gets us comfortable. We're still okay on the internal ROE.

We do a lot of analysis internally to make sure that we are clear on the elasticity of pricing and that we're comfortable in terms of how we do all the extra charging over the cost of this business. So very comfortable that it makes sense.

And I think it's important also to look at the whole book. And I think that's what I was really trying to demonstrate to you on Slide 12, is actually the movement we've seen in pricing. Obviously one helps compensate for the other but overall we're very comfortable on this book and that's seen in the very strong ROE that you see for the retail business as a whole.

Katie Murray: Thanks, Omar.

Omar Keenan: Thank you.

Operator: Your next question comes from the line of Fahed Kunwar from Redburn.

Fahed Kunwar: Morning Alison. Morning Katie. a couple of questions and they're kind of related. If I think about the kind of revenue and costs in isolation, they do make sense.

But when I look at the jaws coming through for the next few years given the cost reductions, they're one of the most ambitious in Europe. And I guess given the cost inflation we're seeing across the market right now, how confident are you, you know, you can see you know, revenue growth while cutting costs 4 percent per annum.

And then just specifically on -- it feels like NatWest Markets is a real kind of microcosm of that point. When you look at the kind of annualised quarterly number it's kind of annualising at around GBP 400 million. The guidance I think you talked about being GBP 800 to a billion in the medium term.

How much of that is actual growth expected is kind of rates improvement, currency improvement, capital market improvement? And how much is just mechanically if you've got any negative funding drag still running in the

business from the old non-core and that just kind of rolling off would just move that kind of GBP 400 million up towards GBP 800 million?

Just interested to know you know, how much do we need to kind of make an assumption on growth and how much is mechanical? That would be very helpful.

And then just a final question on NatWest Markets. The kind of GBP 25 billion or the kind of delay in cutting the risk weighted assets. I think that was to do with a particular position that you have on your balance that you're going to keep on. When that rolls off next year what would be the revenue loss that you would see when that little bit of balance sheet comes off? Thank you.

Alison Rose: Thank you. Well look let me start and see if I can help you with some of that. So on costs, you can see we've got very good trajectory on our costs.

As Katie and I both said it won't be linear but we're very confident about the 4 percent and we see opportunities to continue to reduce costs within the business as we continue to invest in digitisation, and technology, and our customer journeys.

And we also see continued revenue opportunities across different parts of our business. You can see the strong performance in mortgages.

You can see our unsecured growth is very strong and coming back. You know, we've doubled the number of new credit cards issued as we've launched new products, and you can see the strong growth in our AUMA, in our Private Bank with a billion of assets under management, and almost 11 percent year-to-date growth.

So we see continuing growth trajectory from the strength of our franchises, and with our continued investment in technology and digitalisation, which is where 80 percent of our investment is going, opportunities across there.
So I think probably that's all I'll say there.

On NatWest Markets specifically, and just to sort of talk through that and give you some help on that. I mean, looking at the Q3 performance I think the capital markets and currency businesses which are serving our core client base are performing well and remain in line with our expectations. Obviously a disappointing performance in our rates business as we continue to reshape that.

But what we expect is that as we continue to grow in our capital markets and currency business, and you can see the strong performance in ESG, that will continue to perform very well on the back of our strong franchise, we'll have the benefit from improved funding costs which will come through, and I think we'll see a stabilisation of fixed income revenues into 2022 from the improved trading, the lower funding costs, and the completion of the refocus which is largely on the rates business.

So in the medium term we're comfortable that business is you know, a £0.8bn-£1bn revenue business and we would expect that to stay the same and as that restructuring continue. So I think that's where we remain.

On your specific point on the RWAs, you know, the reshaping of the business is going well.

We are running a strong syndicated loan pipeline as a result of strong activity across our corporate business, and our specialised business, and so that's giving us a little bit more RWA but we'll continue to restructure that business in the right way on the RWAs. So again trajectory we're comfortable with.

Fahed Kunwar: Thank you very much.

Could I just ask one quick follow up? I guess...

Alison Rose: Course.

Fahed Kunwar: I understand in isolation how the costs can come down and you know, RBS, sorry NatWest has done a great job over the years of doing that but the issue has always been the revenues have followed.

I guess where I struggle a bit is, if you're cutting capital and costs in a wholesale business, without any kind of mechanical benefit, how -- what really is going to be driving the growth when you are kind of cutting costs and capital which is a big part of the story on NatWest Markets?

Alison Rose: So you're talking about growth in NatWest Markets specifically? Your question?

Fahed Kunwar: Yes.

Alison Rose: Yes. So on NatWest Markets again, you know, if I remind you where we started with NatWest Markets, too much of the capital was deployed into our rates business and therefore not focused around our key strategic priorities.

Where that capital is focused, and you can see that through the strong performance in the capital markets business and also currency and FX, that business is growing very well. So the capital is being deployed to the areas that are growing and we're shrinking it in our rate business which was outside.

So overall we're very comfortable that the size of the capital deployed to our markets business will deliver the sort of £0.8-£1bn revenue business.

And we're also investing in the underlying business as well so more digitalisation, more technology which drives more efficiency in terms of our productivity and also our revenue growth.

So I think we're very happy with that balance between investment and where the capital is deployed for growth.

Fahed Kunwar: Very helpful. Thank you very much.

Alison Rose: Thank you.

Operator: Our next question comes from the line of Alvaro Serrano from Morgan Stanley. Please ask your question.

Katie Murray: Hi Alvaro.

Alvaro Serrano: Hi Katie. Hi Alison. I've got -- I think a question, one for each. And they're both follow ups. First on the managed margin, the rate sensitivity.

I know you don't want to be drawn into the exact deposit beta but the way I'm thinking about it, and the question is I'm thinking, is if I'm thinking about it correctly, if I take your product hedge, a £146bn disclosed in the first half and deduct it from your deposits, from your total deposits, that you get to GBP 320 billion or so remaining, sort of unhedged deposits, which is basically if I -- 25 basis points and 50% beta gets you to GBP 400 million, which sounds very, very familiar -- rate similar to the figure you've got in that slide in Page 12.

Am I missing that some of those deposits might be tracking base rate or is it roughly the very sort of -- is it -- not that simple? That's -- that's the first question.

And the other follow up is on the costs and inflation. Alison, I hear your reply. But maybe you can give a bit more colour as to why you're so confident around the 4 percent in subsequent years? Because presumably when you laid out the plan sort of inflation you wouldn't have expected this kind of inflation.

Is it more about the fact that you're reducing the headcount, that you're not, the inflation pressures are less intense given your -- the reduction of the headcount?

Is it the fact that you --as a good manager you were building a buffer? You've got other sort of efficiency plans to offset it? Or you didn't have Ireland in there? Just a bit more colour that can help us gain confidence or reassure us on that target. Thank you.

Alison Rose: Thanks. Well look on the costs. And then Katie can pick up the managed margin. As you can see in our quarterly results this quarter the continuing strong trajectory on costs and that's very much focused on largely our customer journeys as we create, benefits from the investment that we're making in our customer journeys, and as we simplify those and more use of automation and digitisation, and the subsequent impacts on that.

I think as we roll forward obviously we're mindful of the inflationary situation that we may be looking at but as I look at our customer journeys, as I look at the return on the investment that we're making, we still think there is efficiency that can be delivered across the business from that.

And if I look at the benefits that we get from our customer journeys, the reduced throughput, and the use of automation that that does help us.

I'm not going to comment as I never do on FTE and headcount going forward but clearly that is an element of how we'll drive costs out going forward through that benefit of the investment that we're making.

Katie, managed margin?

Katie Murray: Yes. Alvaro, look it's not a bad proxy. I'd say it's probably not quite as simple as that, as you would expect. You need to consider the asset and the liability side. So, if I think a little bit in terms of on deposits, almost all of our retail and corporate deposits are managed rates.

They do not have an automatic price change due to the external reference rate change. So, if you look at Retail, £186bn in Q3, around 40 percent of that's current account, 60 percent is savings account, with an average cost of 5 basis points and no explicit link to that external base rate.

So it's what I said in that assumption we've given you is, we've obviously gone through product by product and saying we'd move this, we'd move that. The exact moves will depend a little bit on the environment in that moment.

You see the same sort of dynamic in the commercial book where there's minimal balance that's linked to that external reference rate. So you have a bit of flexibility.

But then consider what will happen on the -- on the asset side in terms of the lending. So Retail Bank, 90 percent fixed book so you have an impact because of the SVR immediately, and that's less than 10 percent of the book.

In Commercial Bank, there is a bit more linking to reference rates so you'd see that come through much, much more quickly. But look I'd say your proxy is not a bad one but inevitably as you can imagine, the devil on this one is in the detail.

Alvaro Serrano: That's great. Thank you very much.

Katie Murray: Thanks Alvaro.

Operator: And your next question comes from the line of Andrew Coombs from Citi. Please ask your question.

Andrew Coombs: Morning. I'm going to flog a dead horse, I'm afraid so if we come to the rate sensitivity. I guess what intrigued me when you look at your sensitivity and you compare it to peers, is that for peers, there's a much bigger multiplier effect in year two and year three. For you in your sensitivity it's almost relatively static over that time period.

Now one of the things you do provide which your peers don't, which is quite helpful is the split between the structural hedge in the managed margin. And what's quite noticeable here is the decline in the managed margin over time. Whereas when you gave this guidance at the full year, in the end 2020 sensitivity you didn't see that same decline.

So I'd love a bit more colour on what's driving the decline in the managed margin from year one, year two, to year three - it's clearly the pass through, and the churn presumably on the time deposit book. But you also not assuming static balances. Are you assuming dynamic balances within your sensitivity? So just a bit more colour there on the sensitivity analysis.

My other one, on NatWest Markets as well. You've still reiterated the GBP 0.8 billion to GBP 1 billion revenue guidance, I think. Can you just confirm that the break-even guidance for that business is still in force as well in the medium term?

Katie Murray: I'll plunge myself in there. Thanks. Morning, morning Andrew. No. Look it's interesting. I smiled when you said it's relatively static. And I guess at the headline level of the GBP 450 billion, GBP 492, and GBP 502, it's relatively static, though I smile sometimes that the pain you give me when I move by GBP 50 million on one line so I'm delighted to get the feedback that is seen as a static movement.

The details -- the devil is absolutely in there. Look, the managed margin, this is a disclosure we gave you at H1. What we talked about at H1, and you've got to remember where your base sensitivity was.

It was 10 basis points going through, and this is a twenty-five basis-point increase on that. And then in the outer year it was then a further 25 basis points. So you get the change in that movement.

So, what you can see from there is that clearly the beta -- the pass through is lower in the earlier years and higher in the later years. You're obviously -- the structural hedge continues to strengthen.

If you cast your mind back to year end when we had this slide here, what we were all talking about actually was going into negative territory. So therefore you had the market curve that was assuming a negative journey, and so therefore the increase in the later years was in relation to coming out of negative. So therefore the pass through assumption was probably lower if you could assume in that case, and that's why you see this kind of convert.

So it's rather going -- we are now going into a rising rate, whereas we were actually going into a falling rate. And you'll remember that we also floored some of them, at zero because there would be flooring happening at that point.

So you've got to look at the disclosure and think what was in their assumptions at that time, and how does the shape change. So that's what's driving you there.

Probably won't comment on how others have done their sensitivity. We've done ours bottom up, product by product, to try to give you the kind of the

best view. If this was to happen now this is what would happen in terms of the movement going forward on that.

Alison Rose: And on your NatWest Markets questions, yes. We remain comfortable with the medium-term guidance we've given you on that. And we're pleased with the refocusing and the restructuring of that business.

We're making good progress. In October NatWest Markets, paid a further GBP 250 million dividend, bringing the total year to date to GBP 1 billion. But our guidance remains the same in terms of our confidence on the medium-term outlook.

Katie Murray: Sorry Andrew, I didn't answer your question on static balances. They are static, so they -- we kind of leave them flat from this point with obviously movements in balances will have movements as well. Sorry. I missed that off.

Andrew Coombs: Thank you.

Katie Murray: Thanks Andrew.

Operator: Your next question comes from the line of Jonathan Pierce from Numis. Please ask your question.

Jonathan Pierce: Hey, good morning both. Got a couple of questions on the hedge, I'm afraid. First question is, could you just clarify what you've done on the scale of the hedge in the third quarter and what the remaining capacity is to build the hedge any further from here? Maybe we'll deal with that one first before I come onto the second on the hedge, if that's okay?

Katie Murray: Sure, absolutely. That's one for me. So, if I look at the hedge, we added on GBP 7 billion in the first quarter so it's now £197bn and that we believe that we've got, over the next 12 months, assuming balances do not grow, and I think that's important, it would be a £15bn growth that we would do over the next -- the next 12 months.
I'm very conscious that the same thing as I said at Q2. And then I added on GBP 7 billion in the next quarter and that is because balances grew.

Jonathan Pierce: OK. That’s very clear. Thanks for that.
Second question is, I think I heard you correctly in your comments Katie, where you said that the contribution from the hedge in 2022 would be broadly neutral on 2021. Is that correct? Did I hear that right?

Katie Murray: I think broadly neutral may even slip into slight positive, but I would think about it in that level. I think it really depends what happens on rates in the next -- where this movement settles, in terms of that. But yes. We’d expect to be broadly neutral.

Jonathan Pierce: I mean I suppose coming into 2021 the hedge revenue was higher than where it's ending. So that leaves scope maybe for some incremental, quarter-on-quarter growth in hedge income as we move through 2022. But I’m -- I’m still just slightly surprised that you're not more positive on the potential outlook for the hedge.
Because if I go back five years, the five-year swap rate in 2017 was you know, sort of 65 basis points, on average, and we're now at a hundred. So all those hedges you had pre-pandemic have presumably -- well certainly the five-year part of it rolling onto to higher yields through 2022.
But maybe more importantly than that, you -- you've loaded on a huge amount of net-new hedge over the course of the last you know, 12 to 18 months and a lot of it was done, I think at the sort of one-year part of the curve as you feathered it. And you know, earlier this year the one-year part of the curve was next to nothing.
And those will be rolling out onto the five-year part of the curve which is now around about a percentage point. I’m just slightly surprise that the comments on the outlook for hedge income are not more positive than you seem to be pointing to. Interested in your view on that.

Katie Murray: And so Jonathan we’ll talk as ever more about ‘22 in February, so let's see what happens in the next little while. But I think the important thing is to remember, it’s an average life of 2.8 years.

So we roll about GBP 9 billion a quarter. In terms of what's going to be coming off, we added GBP 7 billion on there. You know, the impact in '21 was circa GBP 250 million, which was down from earlier in the year.

We expected it to be GBP 300 million down so it's definitely improved quite a bit. And we've gone from that down compared to prior year, to flat, and neutral to slightly positive into 2022

I think what I'm really interested in seeing is, this movement that we've seen in the last -- literally only in the last sort of six or seven weeks in terms of the particular spike, let's see how that balances out and we'll take it from there. But I think neutral to slightly positive feels the right balance sitting here today.

Jonathan Pierce: But I am right. Just -- sorry, just to finish on this point. I am right in saying that for instance, the £32bn net-new hedges that were put on -- that were put on in the 12 months to June, you know, a lot of those were put on at shorter duration, right, to ensure that there's no cliff-edge in five years.
And you know, as I say back then that the short-duration yields were very, very low. But directionally that's correct, isn't it? That's how you've done this?

Katie Murray: That's about it. It is correct. Yes.

Jonathan Pierce: OK. Great. Thanks for all that.

Alison Rose: Lovely. Thanks Jonathan.

Operator: And our next question comes from the line of Guy Stebbings from Exane. Please ask your question.

Guy Stebbings: Hi, good morning. Thanks for taking the questions. The first one was on Commercial, both from a volume and margins perspective, a bit more colour. So NIM fell in the Commercial Division I think by about 11 basis points this quarter. I think you said tax was having distortion there.

So I don't know if you can say whether that sort of fully explains it. And then as we look forward excluding anything from rates, how we should think about the dynamics of government guaranteed lending rolling of to new lending in terms of whether it's margin accretive or not.

And then also whether this de-risking that you're -- you're doing within Commercial, does that have a negative NIM impact at all? Any comments there and then more broadly how you're thinking about growth in the Commercial Division as you still have those headwinds but then hopefully areas like invoice finance et cetera, start to -- start to come through?

And then the second question was just a point of clarification really on strategic cost. So you're -- your tracking quite a bit below the full year guidance so I just want to check should we expect quite a big step up in the fourth quarter there? Thank you.

Alison Rose: Great thank you. Well on Commercial let me talk a little bit about that and particularly on what we're seeing in the government guarantee lending. So you can see we gave you some detail on how those loans are performing. So we've had GBP 1.1 billion of those Bounce Back Loans repaid.

The environment continues to remain benign. We think around 30 percent of the balances from the Bounce Back Loans are still sitting in current accounts of businesses. And around 90 percent of them are repaying on time or ahead of schedule.

Clearly at the moment demand for new lending, particularly at the small end. It's a different story in the mid- and larger-end in the specialised end of our businesses. But at the small end, demand is relatively muted. And we would expect, that growth and lending to come back over coming quarters as the economy continues to recover and particularly as all the support schemes taper.

Any new lending that comes on will be more accretive than the Bounce Back Loans which obviously are at lower rates because they benefit from the government guarantee.

So I think as you look forward, the degree of commercial lending growth is going to depend on a number of things. Firstly, the degree and speed of the economic recovery, and the resultant increase in working capital requirements.

We are seeing good signs of that with, invoice financing, and working capital lines increasingly being used and we would expect that to continue. I think business confidence is obviously a key driver and that will be a driver of investment spend. And then this continuing behaviour of customers paying down the government scheme.

So I think that's the dynamic between the government lending and the margin accretive. I think at the larger end of Commercial, we're seeing much higher levels of activity, particularly in specialised finance, infrastructure, and larger mid corporates. Those tend to be low RWAs so returns again remain positive on that side. So that's how I would think about it from that perspective.

Strategic costs, Katie?

Katie Murray: Can I just finish off on the NIM point, you remember on the tax -- the tax point I make. So if I can cast your mind back to a Q2, Guy, when we had the enactment of the corporation tax change that came through and so that required us to change the tax treatment in our operating lease, leases that we do with the customer base.

So we had a benefit that came through on that. Then what you've seen is the reversal of that as it's come through into this quarter. So NIM looks down. When you take that tax out it's flat. So there’s nothing -- there's nothing in there that we're concerned about.

Guy Stebbings: OK.

Katie Murray: Look, if you look back over strategic costs for the last number of years. I got the team actually to run it for me the other day just to completely confirm that I was comfortable in this, is that Q4 is always a bigger strategic cost number that comes through, as we kind of push towards the end of the year to get decisions made on property and things like that.

So what you can see is there's always a little bit of a ramp up in there so not changing our guidance on strategic costs as we know that Q4 is often -- it's a quarter where you get the last things done and put through, so it's often a higher quarter. And that's looking over the last number of years, that's exactly what's happened. So I think just stick with the guidance as you got just now. Thanks, Alison.

Guy Stebbings: Thanks. And thank you very much for the colour on Commercial. I don't suppose I could just quickly fish out some facts on - appreciate, really difficult. There's lots of puts and takes in but in terms of Commercial when you expect to see balances growth from here or is it still a bit too soon to that, given some of the headwinds?

Alison Rose: Happy to cover. I mean look I think we really expect the demand to start coming back. I think one of the dynamics -- and we can see the signs of that demand businesses are trading and we can see those indicators in working capital and invoice financing.

There is still a lot of liquidity. So, average revolving credit facilities are around 19 percent so there's still a lot of liquidity but we are seeing demand coming back.

I think the big question which is the one you're pushing on is business confidence. That's a big, big dynamic. And I think at the smaller end the SMEs and they're the ones who've absorbed a lot of the lending on the government scheme. So they're more indebted and business confidence you know, is certainly affected by some of the short-term issues.

But we are expecting commercial lending demand to come back. At the moment it's a demand issue. We've got the capacity to lend and we are lending at the upper end and in those specialised areas you know, and across the business.

So I would expect that to demand to come back subject to confidence levels remaining not too much knocked by things like supply chain issues.

Operator: Our next question comes from the line of Chris Cant from Autonomous. Please ask your question.

Chris Cant: Good morning both. Thanks for taking my questions. One on targets and then one on Ulster, please.

So on your target, if I think back to your 2023 guidance that you gave at full-year ‘20 results. You were saying 9 1/2 -- 9 to 10 percent ROTE 2023 and that was on a zero percent base rate.

And if we look at the curve now, it's probably going to be a hundred bps base rate, accepting that that might change again but you know, that's where the rates market is. So if I take your sensitivity post-tax, it's about GBP 900 million.

And I think your guidance back in February implied a net income of maybe GBP 2.6 billion to GBP 2.7 billion. So it’s quite a big uplift that we're talking about here proportionately for you in terms of where the rates market is. You know, that would be implying a ROTE of maybe 12 to 13 percent.

So, what is it that's offsetting that do you think? You know, are you going to be revisiting that target? Should we be thinking about something in low double-digits now given where the curve is?

I mean NatWest Market has obviously been a problem area in recent quarters but I know you're reiterating that medium-term revenue guidance. It doesn't feel like that's a big change in your thinking. What is it if anything that's offsetting that big change in the rates outlook, please, when we're thinking about your medium-term ROTE target?

And then on Ulster Bank, I understand you don't necessarily want to comment too much on ongoing transactions but given that you've moved the AIB book to held-for-sale now and that's at fair value or where you -- where you think you're going to clear that transaction, including any costs to sell.

Could you please guide on the expected capital impact of that transaction? I know you said capital accretive but I presume you now have a number for that transaction given you reclassified it?

And on a related point, given the progress you're making with the Ulster Bank transactions, looking at your current consensus, Ulster Bank direct costs of a few hundred plus million in 2023, how should we be thinking about that number?

I would have thought that the direct costs would have dropped away rather more sharply than that, given the transactions are likely to close. But maybe I'm misunderstanding the dynamics there. Thank you.

Alison Rose: Thanks, Chris. So I think I'm going to disappoint you on my answer on Ulster. I'm afraid just from the perspective of -- I mean clearly we're happy with the progress we're making.

I've always said it's going to be a phased withdrawal over a number of years. But progress is being made. And yes, absolutely moving those assets gives you comfort in terms of how we're doing.

And as we complete those transactions we will look to update you and we'll probably update you in our full-year results in February, around the costs and the disposals. We do expect it to be capital accretive over the multi-year period that we've always talked about.

On your specific point on costs. I mean clearly cost reduction will lag because we need to support the exit of our customers as we migrate those and we complete the sales. But we'll update you in February.

But I would just reaffirm we're positive about the progress. We're pleased with the direction of travel on the transactions. We remain confident this is capital accretive and it will be phased. And we'll give you some more specific guidance in in February as we conclude some of these elements. And obviously we'll keep you updated on other transactions as and when they happen. Katie, do you want to pick up the ROTE

Katie Murray: Yes. Absolutely. So Chris probably a bit frustrating set of answers for you. Look, as I look at 2023 guidance, clearly rates are very helpful to us.

You can see where that is and let's all see where the excitement of consensus lands. I think by the time we get to February, we'll certainly look at it at that stage. But, in terms of that with our cautious optimism, I think that that's good.

If there were offsets I think the mortgage completion which we've talked about you can see where those rates are just now, a little bit about some of the muted commercial loan growth though we feel we are at the pivot point of that coming kind of back on.

But certainly very -- sorry cautiously -- optimistic as we move forward from here. And this rates increase is a very different picture from when we announced them. So that will certainly be helpful. And we'll talk more about it in February.

Chris Kant: OK. Thanks.

Operator: Our next question comes from the line of Aman Rakkar from Barclays. Please ask your question.

Aman Rakkar: Good morning. Good morning Katie. Good morning Alison. Couple of questions if I might. Could I come back to net interest margin please? So, thanks very much for the disclosure around the application spread.

It looks like you've got about 60 basis points of refinancing pressure to digest on a book that's a hundred and eighty odd-billion pounds. If I had to run the math on that, that does look like that could offset quite a significant chunk of your deposit beta rate hike benefit.

I guess coupled with the comment that the structural hedge is not necessarily a tailwind could I trouble you for your view on -- you know, do you think net interest margin can actually rise from here, given the various moving parts that you can see on the horizon?

And second, would be on NatWest Markets. Just interested in a trading update actually, how are -- how are conditions through October, how is that performing relative to Q3? That would be really helpful.

And then I guess just the final one. I guess we've -- kind of probed costs a fair amount. I do note that your current cost target at the moment is to reduce the cost base 4 percent per annum ex Ulster. Should we wait until February for you to kind of merge those kind of two comments together? I mean is it a case that you know, given the inflationary pressure that we're expecting, 4 percent is probably the best that we can expect or do you think Ulster can be incremental to your cost reduction target? Thank you.

Alison Rose: Thank you. So on costs, yes. I suggest we wait till February to address that in terms of the Ulster position.

On NatWest Markets -- I mean in terms of how it's performing I think we're still seeing a very strong performance in our currencies and capital markets business.

In terms of October there's no real change to the trends we're seeing in Q3. So continued weakness in the fixed income performance in Q4 as we finish the reshaping of that business. I think that's what I'd say.

But both our currencies, capital markets are performing well. Our new pipeline in terms of syndicated lending, and corporate remains very strong, so that is continuing to Q4 but you still see weakness in the fixed income business. NIM, Katie?

Katie Murray: Sure. Absolutely. So as we look at it what you've got to look at, it's not just the point in time but obviously on that graph as you've got, on Page 12 is you've got the higher rates that we wrote. They will continue to flow through as well. But certainly look, this recent fall down to 105 is significant.

And the way that we can offset that, a couple of things. One is obviously continued focus on volume which we've been doing in the past of margin and

-- volume and margin kind of offsetting. We've had nice progress in the Buy to Let, which will help.

But I do think as I look at mortgage income that the level of rate where that is, is hard, which is why you've seen us and others do a number of price increases in the last couple of weeks. We did another one yesterday to look to offset it.

Clearly the structural hedge also will provide some offset particularly you can see that it does grow into year two, and year three. And obviously the volume that will go into that will help as we go forward as well.

Other things as I look at margin for the whole Group. We're pleased to see the growth that we've seen in the unsecured space, both across personal loans in this quarter and now for the second quarter on the row in terms of credit cards.

And then in Commercial as we start to see the growth coming back there, we hope that that would be some benefit as we move forward as well.

And then you heard me talk about the kind of the AT1 reclassification from debt in Q3. It won't repeat. But look I do think, Aman, that the mortgage spread clearly that does have an impact as we go through and we need to focus on the offset of that through the price rise and to make sure that we add volume.

You know, and as I say every call, the NIM is really important. What the NII is generating and the ROE for the business, which continues to be strong, is also very important as well. So don't get too focused on that one metric. Thanks, Aman.

Oh, sorry. You also asked on February cost reduction. We will talk about it more in February as we do that. Thank you. Alison has obviously covered that already. She's nodding at me across the table. Forgive me. Thank you, Aman.

Aman Rakkar: Thank you.

Operator: We have time for one last question. The question comes from the line of Martin Leitgeb from Goldman Sachs.

Martin Leitgeb: Hey. Hey Katie. Hey Alison. Just one question on capital, please. I mean the capital print today is better than expected in terms of quarter one. And also I believe some of the headwinds you have previously guided for seemed to have shrunk a little bit, I guess partly due to obviously the strong impairment print today.

I was just wondering how should we interpret this stronger capital print today? Does this mean there's increased scope for capital return? Or do you see some of these changes and drivers see as more temporary in terms of nature?

And just in terms of next key dates. I think in the presentation that you state that the whole in market program is expected to complete early in 1Q ’22. Could be a scenario that there is an update on this potentially ahead of full-year results? Is that an interval you frequently assess scope? Or should we really wait here for F.Y. ‘21 for any update? Thank you.

Alison Rose: Thank you. Well look I mean obviously we are very pleased with the capital build. We've shaped a capital generative business, so you know, 50 basis points up.

You've got very clear guidance around our -- and very clear that my intention is to return capital to shareholders. We're investing the businesses, growing in the areas that we have targeted to strategically grow. So, we're pleased with performance and continuing to generate capital. So, I think that should be very positive.

Obviously we've given you guidance on, the billion pounds that we want to distribute as a minimum, as well as any other opportunities that may arise.

So, I think we're pleased with the capital generative nature of our business and that's positive. In terms of share buyback. We'll talk about that in February. And we see it as an important tool that we have at our disposal.

Martin Leitgeb: Thank you very much.

Operator: I would now like to hand the call back to Alison for any closing comments.

Alison Rose: Great. Thank you very much. Well, look thank you for your questions and time today. I mean obviously we think this is a good, good performance, as strong delivery operating profit, GBP 1.1 billion, capital generative business, and growing in the key areas that we've targeted, in mortgages, in unsecured, you know, strong performance in our AUMA. And strong commitment in terms of the targets that we've set out.

So pleased with the performance and good to see the resilience in the underlying customer base as we move forward. So, thank you again for your time. And look forward to catching up with all of you soon.

Katie Murray: Thanks very much.

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