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Bank of America Conference 22nd September 2020 – NatWest Group Fireside Chat

Rohith Chandra-Rajan, BofA: Good morning, everybody. Thank you for joining us. I'd like to ask you three quick questions before we move on to NatWest. You can see them on your screen. And please do respond, and we'll collate them and come back to them later in the day.

The first one, sadly, we are asking this question again on Brexit. So there are options A through D. The first one, there will be a deal, I'm not worried, there will probably be a deal, thirdly, there will be a deal, but it's so limited that a bad outcome is likely anyway, or D, we're heading for no deal. So that's the Brexit question.

The second one, on domestic UK bank profitability, A, ROE targets will be met, the second option, ROE returns can get to a good level, but only after restructuring, and the third option, interest rates make it too hard to get to a decent ROE.

And then the final question, on capital distribution. Firstly, the Bank of England will lift the ban, normal distributions can restart with full-year results. Secondly, Bank of England will lift the ban, but distributions will restart small. Thirdly, banks can't afford distributions, they need the money for bad debts and restructuring, and then finally, the dividend ban will be extended.

So those are the polling questions. Do please respond. There's also a box at the bottom of your screen if you'd like to ask questions in this session, which we will certainly come onto. So please feel free to ask questions in the box at the bottom of the screen.

So, with that out of the way, I'm very pleased to welcome Alison Rose, chief executive of NatWest Group. Good morning, Alison. Thank you very much for joining us.

Alison Rose: Morning. Nice to be here.

Rohith Chandra-Rajan, BofA: Perhaps we can make a start on strategy. You set out your vision for the bank back in February, including a substantial refocusing of NatWest Markets and broader efficiency improvements. Coronavirus doesn't seem to have impacted your ability to execute on those. In fact, you've accelerated some of your plans. So, what are your priorities for the business as we stand today?

Alison Rose: Thank you. When we announced in February, we set out a number of priorities supporting our customers at every stage of their life, being simple to deal with, so reengineering and continuing to simplify, focusing on innovation and partnerships, and obviously, sharpening our customer and capital efficiency. I think that the areas that I'm focused on today is really continuing to execute that strategy. But obviously, we've had the COVID pandemic sort of happen just a few weeks after I announced that strategy.

So, my key areas of focus, first is operational resilience. We've built very strong customer franchises, and those have been very important as we've responded to the period of disruption. And making sure that our business can continue to support effectively and efficiently and leverage that operational resilience during this period has been key. Our investment programme and the investment that we've made in technology is not just supporting the 50,000 people I have working from home to continue to support the business, but also to allow us to accelerate our digital services to meet customer needs, so you know increasingly supporting them through digital channels.

Secondly, it's been supporting our customers. Obviously, the strong customer base, but also making sure that we can support them through this period, participating in the government's lending schemes, as well as putting in supports such as mortgage repayment holidays and capital repayment holidays. We've extended mortgage holidays to about 20% of our customers in the initial onslaught of the COVID pandemic. And for our commercial customers, at the end of June, we've seen £8.3 billion drawn down under the government's schemes. And I've been very clear we've been supporting our existing customers during this period. So that's how we've been participating in those schemes.

Thirdly, a key focus and priority is making sure we continue to have a balanced and consistent approach to risk. I'm very comfortable with the level of risk and diversification I have on our books. Our UK personal banking represents just over half of our total loans and advances. And within our personal banking, 7% of our book is unsecured. Wholesale lending is well-diversified across large corporates, small and mid-sized businesses. And we monitor a number of those sectors very closely, particularly the ones that we think will be impacted from the COVID situation.

Our fourth focus is on continuing that execution, as you mentioned, around simplification and costs out. As you'll recall, when I announced my strategy in February, refocusing NatWest Markets was a key strategic initiative. And we've continued to make progress on that. We set a target to reduce risk-weighted assets in NatWest Markets to £32 billion in 2020. To date, we've reduced RWAs by £2.8 billion, and we're making good progress on that 2020 target. And we now expect to achieve the majority of the restructuring to around £20 billion by the end of next year.

And on costs, although I've had to change the shape of them a little bit in terms of timing, we're still on track to deliver the £250 million that I set out as a target for this year. And then finally as an area of priority, our robust capital position, despite that significant increase in impairments in half one, where we took a prudent and measured approach, we have very strong CET1 at 17.2%, and our liquidity portfolio of £243 million, which is a coverage ratio of 166%.

So, we continue to believe the shape and mix of the business is good and appropriate, our target of a CET1 of 13% to 14% over the medium to long term, which gives me headroom of around £6 to 8 billion pounds. So that allows me to continue my focus on making sure we can return capital to shareholders, manage the uncertain outlook, and consider other options as we move forward.

Rohith Chandra-Rajan, BofA: Thank you. And on NatWest Markets, the goal is to consume less capital within the group, as you just mentioned, and then, from a profitability perspective, to be break-even. So how do you see NatWest Markets' role within the broader group?

Alison Rose: Restructuring has really been centred around making it more strategically aligned to our core corporate and institutional customers, and making it a much simpler bank, less complex and, obviously, less volatile. So, it's a simpler product suite served on focusing to support our core customers across financing, risk management, and an operating model that's better integrated. So, it's really bringing that group to be much more closely aligned strategically, where we have very strong positions to deliver. We will continue to do that and invest in that and reduce volatility.

Obviously, the model was unsustainable in its current form, and consuming too much capital of the group. So, bringing it down to around 10%, which is that £20 billion which I've accelerated. So, I think you think of it as much more closely aligned to the group supporting that core customer base in products that are going to be less volatile, but also core to our corporate franchise.

Rohith Chandra-Rajan, BofA: And then the operating outlook has changed very substantially in the seven or so months since you announced your strategy, particularly the interest rate environment, as well as the growth outlook. Is the ROTE target that you set out back in February, is that still achievable in this operating environment, given what you see today?

Alison Rose: What I would say is that the plan I announced in February was really designed for lower for longer interest rates. And we'd structured a case with the mix of business we had to assume at that point 1 rate cut, and then lower for longer for the whole period. So, as you quite rightly say, the environment and the rate environment has become much tougher, with a 65 basis points cut in April.

So clearly, these are substantially lower rates and a much more uncertain economic outlook. So, it makes those targets more difficult to achieve. However, I think there are a number of offsets against those revenue headwinds that we have within the mix and shape of our business and opportunities as that evolved. So, for example, we have capacity to grow in mortgages. And you've seen the strong performance we had both in terms of stock and share in Q4 and Q1, and then obviously, as we're coming out of COVID, what's happening in that market.

We're repositioning our wealth offering. I made some announcements over the last few weeks where we see an opportunity to grow in that business, leveraging the strength of our Coutts franchise. And we also see an opportunity to grow based on our recent re-entry into the merchant acquiring market by NatWest Tyl, where we've seen good take-up with high customer advocacy. And we'll continue to roll that out, and currently hitting 5 million transactions in June. So, I think there are some offsets there.

We remain very disciplined and we continue to simplify the bank and improve the customer journey. And some of the evidence that you've seen in how we responded to COVID and how we've leveraged our technology and our assets to scale up digital-only propositions, for example the bounce-back loan scheme, we were able to scale that up very quickly using our digital and automation and robotics tools to deliver a fully end-to-end journey. So, we will continue to simplify and focus on that, and continue to remove the manual processes.

On the digital side, in our retail bank, we now have over 7.2 million active mobile users. And whilst 3/4 of our current account customers in the UK are on there and also in commercial banking, they're regularly using digital. So an acceleration on some of those trends. So I think clearly the economic outlook has become tougher, but there are opportunities on both revenue and costs.

We continue to focus on taking out costs in the business, 3% to 4% of our annual ongoing cost base every year, and then the refocus of NatWest Markets and more discipline on capital. So, I think, in summary, yes, a much tougher outlook, but the strength of our business combined with our ability to grow, whilst being disciplined on costs and capital will drive and support our ability to drive higher returns over time.

Rohith Chandra-Rajan, BofA: And on the cost side of things, you mentioned the changes in customer behaviour, the growth of digital. Just in terms of ways of working, which I guess is the other potential cost lever, you've announced the acceleration of some of the property closures that you have planned. Are there any other more substantial changes down the line in terms of ways of working that you have sort of come to light over the last few months?

Alison Rose: I mean, look, I think if you'd asked me in February whether I could shift 50,000 colleagues to working from home in a fully agile workforce, then that would had been a challenging question. But what we've demonstrated is an ability to do that. And I think that the whole working from home environment, we've seen our productivity remain very strong, our continuity of service to customer very good. Our staff engagement and support during this period has been very strong. And I think the way colleagues are working together, and it's busted a few of the myths of you needing to be physically present.

So, I think you'll see an evolution in the ways of working. The fact that I brought forward a property closure gives you a sense of some of the evolution that is happening, and the increased use of our digital tools for our customers.

So what you're seeing is an acceleration of those underlying trends. We're already moving to a more flexible workforce. That's accelerated in terms of the opportunity it offers for colleagues which has implications for footprints and how we will work in the future. But also customer behaviour is shifting, and accelerating, and that won't bounce back to how it was before.

So we're readying further simplification strategies based on what we're learning, and what we're seeing, and what we're continuing to evolve, and we're continuing to develop on our technology and IT to do this. So, I think it's an evolution, and we'll certainly learn and evolve from this. So it's about thinking what the new model will be going forward, rather than reverting back to the old.

Rohith Chandra-Rajan, BofA: And are there further opportunities to improve capital allocation over and above what you're doing with NatWest Markets?

Alison Rose: Yeah, as you say we're applying a very disciplined approach to NatWest Markets from a capital perspective and we will continue to do that. I think if you look at what I did in the commercial bank, we took a very disciplined approach to capital, and you've seen a reallocation, and a recycling of that capital. And we worked pretty hard to exit those parts of the book in the portfolio that would flare under stress and absorb more capital.

So, we will continue to have that active recycling methodology in terms of capital as we move forwards, and continue to do that based on a name-by-name basis, but also in terms of a portfolio allocation of where I allocate our capital. So it's about balancing that, but that discipline on capital allocation is definitely more that we can do and will continue to apply some of the trends you saw me apply in the commercial business across the whole group as we think about our capital. So, I think there are more opportunities to do that.

Rohith Chandra-Rajan, BofA: Thank you, and then in terms of thinking about capital distributions, the capital position is clearly very strong and there's also a clear focus on distributing surplus capital to shareholders. How do you balance investing for sustainable profitability with capital distributions, and then following on from that, once the regulator gives the green light for distributions to restart, how do you think about the balance between ordinary dividend, specials and share buybacks?

Alison Rose: As you say, we've entered this crisis in a position of strength in terms of our capital base and significant headroom above the regulatory capital requirements, and it is a case of making sure that we balance that position going forward. So, our priorities as I've set the strategy for the group are designed really to deliver sustainable returns for shareholders over the long term. And we've invested a significant amount of money, £8 billion over the last six years transforming the bank and continuing to invest over a billion a year going forward to make sure that we can continue to evolve and drive a competitive business.

And a good example of that is if you look at our mortgage market and our mortgage business, we've been investing to digitise that. Our paperless mortgage is market leading. It's done incredibly well moving to really simplify our new save and retrieve functionality. The customer's single sign-on, all of those investments in innovation mean that we're doing very well in that product, which is value accretive, which will grow value for shareholders. So, investing to make sure our business stays capital generative with headroom with good balanced risk is really how we think about our investment envelope of where we reinvest in the business.

The key consideration when we think about distribution-- and I've been very clear that it is my clear intention to restart dividends as soon as it is appropriate-- is thinking about making sure the bank stays well capitalised, and strong, and secure, but also making sure we have real clarity over the scale of the impairment charges and the economic outlook, so that that safe and secure remains very robust, that the investment is continuing to drive valuable returns for shareholders, and then a steady and safe return.

So, in terms of the form that distribution will take. I'm very open to all options of returning capital. We've guided to a payout ratio of 40% over time, and that remains, but we'll look at all options to consider how we do that. In terms of other uses of capital, I've said that we would consider small acquisitions and opportunities only to the extent that they offer compelling shareholder value and strategic rationale. So, I look to balance all of those considerations together to make sure that I can continue to support that sustainable return profile as we go forward.

Rohith Chandra-Rajan, BofA: Thank you. Then moving on to income, perhaps, and we sort of touched on it right at the beginning. But the interest rate environment looks set to remain near zero for multiple years from here. We were already starting to see an impact of that in the Q2 net interest margin. How do you see that evolving over the next couple of years from a margin perspective?

Alison Rose: Clearly there are a number of impacts from the low rate environment and that's a challenge. Clearly the other margin drivers are a little bit more difficult to predict given that they're dependent on pricing and their competitive dynamic, but if you look at our business, and if you look at the outlook, obviously you have the interest rate cuts in the outlook for that, but you know we were building a business that would be in a lower for longer environment.

As you know, our structural hedge is designed to reduce our sensitivity to moves in the short-term, however, the ongoing reinvestment of this portfolio means the impact for low rates continues for the next few years, but we give disclosure on that. On the competitive side, in mortgages if we look at what's happening there, we talked about improved margin in Q2 and in respect of applications largely driven by lower swap rates.

So, although the fact that margin is still below the back book, we see that gap closing towards the end of the year and good growth in mortgage and value accretive business. On the commercial side, one of the short term considerations in terms of what's happening there is we're writing a lot of volume in that business but obviously the rates are lower than back book mainly for Government lending schemes because they're benefiting from the nature of those loans and the government guarantee.

So, there's a number of dynamics happening now and pricing on the mortgage looking forwards. It's against a back book of strong volume growth driven in part by pent up demand, from the pre lockdown and the stimulus from lower stamp duty. On the commercial side it's really about the government schemes at the moment and then future growth in that book, and what will happen there is really dependent on business confidence.

Rohith Chandra-Rajan, BofA: Thank you and how would that outlook change if I mean, negative rates still seem to be under consideration by the Bank of England, you know, work being done on that in Q4 in terms of how that might be implemented. How would that change the outlook for revenues?

Alison Rose: Look, our central assumption is still that negative rates are a hypothetical point at the moment and are under discussion and review. I think the Bank of England has been clear, it's one of a number of things in that toolkit. Clearly if negative rates come in, that would present a further challenge to our revenue outlook on top of the recent cutting rates, and also, the impact of the high cost of credit, which we talked about earlier in the year.

So if lower rates come in or negative rates that is a negative impact. We've obviously adjusted our deposit rates down in most cases to one basis points for a significant majority of our retail savings. I think there is a question of how negative rates would be introduced if they did come here and certainly, there is mixed experience of that across European markets where they have been introduced.

We have experience of dealing with negative rates in our commercial business, in our international businesses, RBSI and our Ulster business, but there's clearly a revenue impact but I think then how it would be introduced if you look at, for example, in Europe - Spain, they banned negative rates for retail customers; in Sweden, they reversed them. So they've just stayed at 0%. So there's a long way to go but clearly, we were obviously thinking about that and how we were prepare for it.

Rohith Chandra-Rajan, BofA: And then the other piece which you touched on earlier in terms of the revenue outlook is growth and mortgages clearly have been a great success in terms of the growth that you've driven there. Is that still an area of focus particularly, I guess with spreads improving recently? And then on commercial banking, we'll see a lot of lending being done currently under the government backed schemes, but how do you see them-- is that just a pull forward of future demand, and do you see much growth in that business once the government schemes expire?

Alison Rose: So on the mortgage side, our appetite remains very strong. They are key offering to our clients, and we have capacity to grow and we've invested in that to make the journey very smooth for our customers with some of the innovations, and you can see those coming through in terms of things like us being the winner of best mortgage provider for the second year in a row, and that tells you that some of the investment is working really well there.

So that remains an attractive growth area and an area where we have capacity to grow and where it is value accretive for us in terms of returns for our business. So, we'll continue to apply a very strong and consistent risk culture in terms of our mortgage appetite that capacity to grow. And our performance in that, you can see we are continuing to grow that business safely.

I terms of the growth that we're seeing, the volumes are up 30% for example on June levels, almost back to pre-COVID level on volumes and mortgages. And part of that is the pent up demand from the lockdown, part of it is the stamp duty, which I talked about. I would at this point say it's too early to predict whether that is a sustainable level of growth going forward, you may have some sort of broad forward demand from next year coming in through those volumes but the growth is positive, and we're really committed to making sure we continue to grow that business very well.

On with the commercial banking side what you're seeing there is the strong growth in the government schemes, which as I said, we're advancing to our existing customers. So very strong focus on balanced risk and demand. What you saw in the starting period of the crisis was a steep increase in the amount of revolving credit drawings at the start of the crisis, those have now normalised and you can see the capital markets have been very active and very open for our customers.

So current revolving credit utilization is about 30%, which I would say is sort of normalised down from the sort of COVID peaks and also 40%. And we've seen issuance in debt capital markets as people at the corporate end diversify their lending. So I think at the moment, it's really demand for the government schemes and the support. On a more look forward basis around sort of lending for investments in business, that's really around business confidence and certainty and whether that will come back.

But we're continuing to see demand for the government schemes at much lower levels than they were the peak of COVID, bounce backs of average around 2,000 applications a day, bounce back average loan size is 30,000 to 37,000 pounds. But it's about 2,000 applications a day, down from the peak of 20,000 per day when they were at their peak and 48,000 on day one. So , demand is trickling down, deposits remain elevated, but looking forward, it's really about what business confidence is as we come through this economic cycle and the impact of climate.

Rohith Chandra-Rajan, BofA: So then moving on to credit quality, the impairment charge was high in the first half close to 160 basis points. Could you talk a little bit about your assessment of risks across different parts of the book, so where you see particular pockets of risk, where you're more comfortable, and how that's reflected in current coverage levels?

Alison Rose: So I would start with I remain comfortable with the level of risk and diversification on our books, I think there is a good balance risk position across our books, and obviously, we've been very thoughtful and considered about our approach to both what we're bringing onto the book and also our management of that book, and our forecasting of impairments as we go forward.

If I look across the shape of the book on, lending in the UK personal banking, that represents just over half of our total loans and advances, and we have a relatively low proportion of that that is unsecured, only 7%. As a result of the provisions that we took in half one, our provision coverage across credit cards, which again is just 1% of group loans, that increased from 6% to 10%, so I'm pretty comfortable with those coverage ratios.

And then if I look at all secured book and our UK mortgage book, our average loan to value in that book is 57% with just 12% on an LTV above 80%. So in terms of diversification, I'm feeling comfortable with that. On the wholesale lending side, again, good diversification across corporate small and mid-sized businesses and obviously, we benefit from that active capital management program we've been running for the last four to five years in the commercial side.

Of the sectors that we are keeping under high watch that we are most concerned about because of the impact of the outlook, that represents about 8% of our total loans and advances. We've significantly de-risked on lending in those sectors in recent years and we've used synthetic trades or capital sell-downs to manage our exposure.

Of that book just 3.6% to a billion pounds of these loans are in stage 3, and we're comfortable that the coverage level there is 55%. So, I think that's important. If I take a snapshot of one sector say, leisure, we've reduced our exposure to high risk subsectors and our lending is generally secured against property and assets. And oil and gas, as you know, is just 1% of our book. So, diversification and coverage, I'm comfortable and I think we've taken a very prudent approach to how we get to this.

Rohith Chandra-Rajan, BofA: And a reflection of that comfort is the guidance that the charge, well, the impairment charge will fall materially in the second half of the year, but I guess that there are still lots of uncertainties in terms of economic outlook, the roll off of the government support schemes, and the evolution of the virus. When do you think you start to be able to get a better assessment of what the ultimate provisions will be and what appropriate levels of coverage are? And can you help us understand the sensitivity to different economic outcomes?

Alison Rose: As you can all see the outlook continues to remain uncertain and clearly the challenge that we're all looking at is what is the shape of the economic cycle and both the underlying scarring to the economy created by the pandemic and then also the ongoing cycle of the pandemic and what that does. So there remains a high degree of uncertainty.

What we've done is very much to take a very prudent approach but also apply expert credit judgment. And that half one impairment number that we gave you is really taking into account a wide range of factors, and we shared with you, with the market underlying macroeconomic factors, as well as, the expert views we've taken on risk and what that would mean.

So, we think that the impairments for the full year based on the four macroeconomic scenarios and the weighting assumptions that we apply plus our judgment on key sectors and the underlying government schemes is a range of £3.5 to 4.5 billion. So that's the 100 to 130 basis points of gross loans and advances based on that half one balance sheet.

That implies for the second half, a charge of between £0.6 and 1.6 billion, and that's going to be driven by a combination of the developing economic outlook for the UK and the Republic of Ireland along with the effectiveness of the government schemes, and also any delay in underlying economic stress. So, there are a number of factors that are there. And clearly, decisions around the end of the Furlough scheme and the government schemes are things that we've taken judgments on.

From what we can see today, it may not be until Q4 or after that you actually start to see stage migration happening in the underlying portfolio, and I think, the key triggers are going to be the end of Furlough and that coming to an end, and what that means for employment and how that feeds through.

Just to give you a sense of the weighting that we applied and sensitivity to our upside and downside scenarios, and you can see the detail there. If we applied 100% weighting to the half one downside scenario, that would add £1.9 billion extra provisions. And if you went 100% to the upside, then you would have a positive variance of £1.4 billion on the provisions put today. So that's quite a big range of potential outcomes, which I think, talks to the uncertainty, which is why we try to give you a very measured approach to how we're getting there.

Rohith Chandra-Rajan, BofA: And an area of increasing uncertainty and sadly, we are still talking about Brexit, is that Brexit process. How do you think about the different potential Brexit outcomes their impact on credit quality, but also on revenues?

Alison Rose: Brexit is back on the agenda and , well, obviously from our perspective, we had like all banks prepared operationally for our hard Brexit, and so that planning was done some time ago. I think possibly, as a more UK focused bank, the future relationship of the European Union is less important to us than some of our peers but we are operationally structured to be able to support our customers and be able to deal with that, regardless of what the outcome of those Brexit relationships are.

We established a banking entity in the Netherlands, NatWest Markets NV since March 2019, and we have a branch in Frankfurt, as well, that allows continued access to the financial markets infrastructure to support your payments. So operationally prepared and dealt with that. We obviously, have a wide range of scenarios in terms of what the impact of Brexit will be, so I think it's really about as a UK centric retail and commercial bank, it's a reflection of the economy we operate in and what the impact of Brexit will be on the UK economy.

So I would say if you were thinking about the economic impact of Brexit for us, have a look at the macro scenarios because it would play into the GDP forecast and you can see some assumptions around GDP. So, that's where you would play in. But operationally prepared, focus on supporting our customers, and that's the main issue for us at this point.

Rohith Chandra-Rajan, BofA: Thank you. And maybe we can take a-- we've got time to take a couple questions that have come in from the audience. One is in the context of negative rates, the opportunity for structural change in UK banking in terms of fee structures, are there areas where a lack of net interest income can be offset to some degree, at least, by charging fees, account fees for example or you talked before about growing the wealth side of the business, what sort of opportunities do you see there?

Alison Rose: I think in the first instance, negative rates, we need to understand if they're going to happen and how they will be applied, and I would look to the retail sort of experience in Europe as you know some examples there. In terms of response, it's a little bit about some of the income growth opportunities we have in our business and the opportunities to grow across capacity to grow and the changes we've made in wealth, as well, around that. So, I think good income opportunities and benefit from NatWest Markets being more closely aligned.

I think more broadly, the nature of how banking is charged and structured obviously, the UK has a very different model and free of credit model compared to some other jurisdictions and obviously, we would continue to look at how we provide service to our customers and the value that we get. But predominantly, if we went to negative rates obviously, that would be a challenge to revenue and we would look to how we would respond to that and I'd given you some examples of where we think we can grow and continue to perform, which we're already advancing on.

Rohith Chandra-Rajan, BofA: Thank you. And then Ulster bank, there's also been a lot of press commentary recently, be keen to get your thoughts on that please.

Alison Rose: On Ulster, our strategy for Ulster is unchanged. We've said that we would continue to grow that business safely, you've seen we've had dividends out of that business and we continue to grow and had some success in growing the mortgage business there and some of the commercial, and Jane and her team are doing an excellent job. Obviously, with all of our business, with the Covid headwinds and the economic outlook, that presents we will continue to look at that business and look at all options but there's no change to strategy of that business.

Rohith Chandra-Rajan, BofA: Thank you Alison. Sadly, I think we are now out of time. So, I'd like to thank you very much for your time this morning. It's been a really interesting conversation.

Alison Rose: Thank you very much, I appreciate your time.