NatWest Group plc Annual Results 2021 Fixed Income Presentation
Hosted by Katie Murray (CFO) and Donal Quaid (Treasurer)
1pm-1.45pm on Friday 17th February 2023

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Katie Murray Good afternoon everyone - thank you for joining our 2022 Fixed Income results presentation. I'm joined today by Donal Quaid, our Treasurer, and Paul Pybus, Head of Debt IR. I will take you through the headlines for the year, give an update on our strategic priorities and then move onto some of the detail. Donal will then take you through the balance sheet, capital and liquidity and then we'll open up for questions.

So starting with the headlines on slide 3.

We delivered operating profit for the full year of 5.1 billion, up 34% on the prior year, with attributable profit of 3.3 billion.
We are reporting income of 13.1 billion and we have continued our tight cost discipline, reducing expenses by 2.9%, in line with our target. This resulted in a much improved cost income ratio of 55.5%, down from 70% for 2021.
During the year we distributed or accrued a total of 5.1 billion to shareholders which comprised £1.3 billion in ordinary dividends – above our committed distribution of at least a billion pounds, a special dividend of 1.75 billion announced at the half year, the directed buyback of 1.2 billion completed last March.
And our third on market buy back announced today of 800 million.
As a result, our Common Equity Tier One ratio was 14.2%, in line with our target.

Turning to slide 4.

We have made excellent progress on the strategic priorities we set out three years ago and we have remained focused on supporting our customers and delivering on our commitments.
We have delivered organic growth as we improved both our offering and service for customers.
We have maintained tight cost discipline yet continued to invest for the future in our digital transformation.
We have refocused our Markets business and made significant progress on our phased withdrawal from Ulster Bank in the Republic of Ireland, so we are now much more capital efficient.
This has delivered a return on tangible equity of 12.3%, well above our initial target.

Turning to slide 5.

Given the uncertain economic outlook our purpose led strategy has never been more relevant.
We have continued to support customers by lending responsibly and helping them save for the future, with lending across our three business segments up 6.7% year on year.
We have also proactively contacted customers with advice on managing the cost of living, carried out free financial health checks, delivered hardship funding through charities and offered targeted support for those in need.

We have supported colleagues with targeted pay rises for the lowest paid, as well as enhanced parental leave and ongoing training and development.

Turning now to slide 6 and the performance in the fourth quarter, using the third quarter as a comparator.

Total income increased 14.8% to £3.7bn. Income excluding all notable items was 3.8 billion, up 10.9%. Within this, Net interest income was up 10.2% at £2.9 billion and Non-interest income was up 13.2% at £857 million.
Operating expenses rose 12.8% to £2.1bn including Ulster exit costs and the annual UK bank levy. The impairment charge decreased to £144 million or 16 basis points of loans.

Taking all of this together, we delivered operating profit before tax of £1.4 billion.
Profit attributable to ordinary shareholders was £1.3 billion, after the benefit of deferred and other tax credits.

And return on tangible equity was 20.6%, including a 6 percentage point benefit from tax credits.

Before I take you through our performance in more detail, I'd like to share some of our assumptions about the economic outlook on slide 7.

We are showing you here our current expectations for interest rates and economic activity.
Clearly the backdrop of low economic growth and high inflation makes this a challenging time for our customers. However there are signs that inflation peaked in October last year, though it remains high at around 10%.

Our base case assumption is that this will fall to the Bank of England 2% target by mid-2024, resulting in interest rates reducing from the second quarter of that year to 3.25% by the end of 2024.

We have not modelled any further increase in interest rates since the Bank of England's decision earlier this month to increase them to 4%.

All-in – our outlook is aligned to the consensus of economists' forecasts with both upside and downside risks.

I'll move on now to net interest income on slide 8.

As I said earlier, we saw continued strong momentum in Net interest income and Net Interest Margin, excluding notable items, increased 26 basis points to 325 basis points

The increase was driven by wider deposit margins reflecting - the benefit from higher UK base rates, net of pass-through to our customers; and higher swap rates on our structural hedge. This increase was partly offset by lower mortgage margins on the front book and by Commercial & Institutional fixed rate lending.

Net interest margin of 285 basis points for the full year, is in line with our guidance of more than 280 basis points. If the current UK base rate of 4% continues throughout 2023 we expect NIM to be 320 basis points for the full year.

Turning to loans on slide 9

We've delivered a strong year of balanced growth across the Group. Gross loans to customers across our three franchises increased by 6.7% to £350 billion, of which £3 billion was in the fourth quarter.

Taking Retail Banking together with Private Banking, Mortgage balances grew by £4.7 billion or 2.4%. Gross new mortgage lending for the full year 2022 was a record £45 billion, representing flow share of 14%. Our stock share is 12.3% up from 11.8% at the end of 2021.

Unsecured balances increased by a further 200 million in the quarter, to £14.2 billion, driven by higher spending on credit cards.

In Commercial & Institutional, gross customer loans decreased by £2.0 billion, driven by continued repayment of government lending schemes.

I'd like to turn now to non-interest income on slide 10.

Non-interest income, excluding notable items, was £857 million, up £100 million on the third quarter. This was driven by fees and commissions, which increased £62 million to 615 million, due to higher lending fees, increased investment fee income and the end of our no fee Foreign Exchange offer for Retail customers.

There was a more stable trading performance in 2022 following the completion of our Markets restructuring. And net fees and commissions grew 8% year on year as a result of increased customer activity, combined with the impact of inflation on nominal spending.

Turning now to Costs on slide 11

Other operating expenses for the go-forward group were £6.6 billion for the full year. That's down £201 million or 2.9% on the prior year, in line with our guidance. This was driven by continued automation of customer journeys.

Now that Ulster is in central and other items, on this slide we show the walk from £6.6 billion go-forward group expenses to Group other operating expenses of £7.3 billion, as per the Income Statement.

Turning to 2023 costs on slide 12.

We start with 6.9 billion of operating expenses for 2022 excluding Ulster direct costs. Pro-forma for acquisitions, 2022 costs are around £7 billion, which I view as the business-as-usual cost base of the group.

In 2023 we expect this to grow by around 5 per cent to about £7.3 billion. And with another £300 million of Ulster direct costs, we expect operating expenses of £7.6 billion, excluding litigation and conduct costs. We also expect a further improvement in operational leverage with a reduction in the cost income ratio from 56% to below 52% for the year

Litigation and conduct costs were £385 million for 2022, and we expect them to be broadly in line with this in 2023, though these can fluctuate.

Turning now to credit risk on slide 13.

We have a well-diversified prime loan book. Over 50% of our Group lending consists of mortgages, where the average Loan to Value is 53% or 69% on new business.
Overall, we have low levels of arrears and forbearance in our mortgage book.
92% of our book is at fixed rate, 4% on trackers and 4% on the Standard Variable Rate or SVR.

Our personal unsecured credit exposure is less than 4% of group lending and is performing in line with expectations.

Our corporate book is well-diversified and we have brought down concentration risk over the past decade. For example, our Commercial Real Estate exposure represents less than 5% of group loans, with an average loan to value of 47%.

Whilst we have a well-diversified, high quality loan book with a low level of defaults we are mindful of the economic outlook, so let me tell you how we have addressed this on slide 14.

We have four economic scenarios where we have updated our forecasts and relative weightings.

For 2023, this has driven a slight improvement in our weighted-average expectations for GDP but a deterioration in levels of employment, the key drivers of expected loss.

In terms of sensitivity, 100% weighting to the Extreme Downside scenario would increase Stage 1 and 2 Expected Credit Loss by a further £1.6 billion or around 40 basis points of loans. In this scenario, Stage 3 Expected Credit Loss would also increase though this is not modelled here.

The net effect of changes to economic forecasts in Q4 is an increase of £171 million in the good book Expected Credit Loss provisions

Overall, Expected Credit Loss reduced during 2022, reflecting the phased withdrawal of Ulster Bank Republic of Ireland, stable trends in portfolio performance and a related net release of post model adjustments and write-offs.

The Post Model Adjustment for economic uncertainty reduced by £193 million in the quarter to £352 million.

We continue to be cautious on the release of these provisions as we have yet to see the full impact of the economic challenges play out.

Turning now to look at impairments on slide 15.

The net impairment charge for the Group of £144 million in the fourth quarter took our charge for the full year to £337 million, equivalent to 9 basis points of loans.

You can see that our impairment charge has largely been driven by unsecured lending and commercial property, where we have relatively small exposure.

Our through-the-cycle impairment guidance is 20-30 basis points, and I continue to see this as an appropriate level for 2023, given both the economic outlook and relatively benign trends in our book.

With that I'll hand over to Donal.

Donal Quaid Thanks Katie

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

I will start by sharing some highlights from the full year before moving into more detail on capital, funding and liquidity. I will then give an update on our funding plans for 2023 before we open for questions.

Starting with the highlights on slide 17.

We ended the year with strong capital, MREL and leverage positions; comfortably above the regulatory minima with a CET1 ratio of 14.2%, Leverage ratio of 5.4% and a total loss absorbing capacity ratio of 31.5%.

We continue to operate with a robust liquidity position - with a Liquidity Coverage Ratio of 145% coupled with a strong deposit franchise.

We successfully completed our wholesale funding requirements for the year, and saw an opportunity in early December to pre-fund some of our 2023 Tier 2 requirements.

We continued to reduce our legacy capital stack via calls and Liability Management Exercises. At the end of 2021, we had £3bn of outstanding legacy securities, which had no regulatory value from 1-Jan-22. Our capital actions and maturities during the year reduced the outstanding balance to below £600m and this will reduce to approximately £300m by year end with further maturities this year.

I was very pleased with the Bank of England's first assessment under the Resolvability Assessment Framework in June, with no shortcomings or deficiencies identified in NatWest Group's preparations for Resolution.

Turning to our capital and leverage position on slide 18.

Our CET1 ratio at the end of the year was 14.2%, including the full impact of the £800m share buy-back announced this morning. The CET1 ratio is well above the current Maximum Distributable Amount of 9.5% and well positioned versus our 13-14% medium term CET1 target.

In December, the UK countercyclical buffer rate increased from 0% to 1%, in-line with the Financial Policy Committee announcement in 2021 and this equates to a requirement of 80bps for NatWest Group.

A further increase in the countercyclical buffer to 2% is expected to take effect in July 2023. A 2% countercyclical buffer will translate to a requirement of approximately 170bps for the Group.

Our Maximum Distributable Amount and Supervisory Minimum requirements increased in the second half of the year as increases in the countercyclical buffer took effect. However, these changes, in addition to the changes expected in July this year, will have no impact on our medium term CET1 target of 13%-14% as they are already built into our capital forecasts and plans.

Our UK leverage ratio was 5.4%, leaving around 185bps of headroom above the minimum requirement. The leverage ratio minimum requirement also moved higher in the second half of the year as the increase in the countercyclical buffer took effect.

The slide also shows the impact of the Other Systemically Important Institution Group risk add-on which, although not part of minimum regulatory requirements or combined buffer requirement, is included in our minimum supervisory requirements

Moving to slide 19 and our quarterly movements in CET1 and Risk Weighted Asset's.

We ended the fourth quarter with a CET1 ratio of 14.2%, down 10 basis points on the third quarter. We generated 59 basis points of capital from earnings, net of deferred tax credits, which are not recognised in CET1 capital, and changes to IFRS 9 transitional relief.

This was offset by accruals for shareholder distributions of 79 basis points including the share buyback and final pension accrual of 5 basis points.

Given the strong funding position of the pension fund we have reached an agreement with the trustees not to make a final £500 million dividend linked contribution payable in 2023, but have set it aside in case of future need.

While we view this as a low probability, we have prudently deducted the potential impact from our CET1 ratio and we do not expect any further capital deductions for pension contributions going forward.

In addition, we have received regulatory approval to participate in a Directed Buy Back from the UK Government for up to £1.5bn which equates to 4.99% of our issued share capital.

The 14.2% CET1 ratio includes IFRS 9 benefit of 20bps.

Risk Weighted Assets decreased by £2.4bn in the quarter to £176.1bn due to reductions in counterparty credit risk and market risk and the progress on our phased withdrawal from the Republic of Ireland.

Procyclicality has remained positive throughout 2022 across the Group leading to a reduction in RWA of £4bn.

We have incorporated our expectation of a normalisation of risk parameters into our medium term RWA guidance.

We now expect RWAs could increase by 5-10% by the end of 2025, which includes the day 1 impact of Basel 3.1.

Turning now to our total capital and MREL positions on slide 20.

Our total capital ratio at the full year is 19.3% with an AT1 ratio of 2.2%, and a Tier 2 ratio of 2.9%. Given our medium term 13-14% CET1 target range, we expect to operate with optimal levels of AT1 relative to minimum requirements, and our future AT1 and Tier 2 requirements will be subject to the evolution of RWAs.

Our total loss absorbing capacity ratio continues to look healthy at 31.5%, significantly higher than our risk weighted asset requirement.

The total loss absorbing capacity ratio has reduced from 39.8% at full year 2021. That reduction has been driven by the increase of Risk Weighted Assets on 1-Jan-2022 due to the impact of regulatory uplifts, the removal of approximately £600m of legacy Tier 1 and Tier 2 capital from

loss absorbing capacity resources and a reduction in our CET1 ratio for share buybacks and capital distributions.

Turning to our liquidity position on slide 21.

We have maintained strong liquidity levels during the year, although we are now seeing a reduction from elevated levels, with an LCR ratio at 145%, reflecting over £52bn of surplus primary liquidity above minimum requirements.

The decrease in the ratio since FY2021 was primarily due to growth in lending, reduced customer deposits and shareholder distributions during the year.

We continue to manage a high-quality liquid asset pool with primary liquidity of £162bn and secondary liquidity of £64bn.

Looking at customer deposits on slide 22.

Customer deposits at the end of 2022 were £450bn, resulting in a loan to deposit ratio of 79%.

During 2022, balances reduced from the elevated position built up during the pandemic, reducing by approximately £30bn

There are two key drivers to note here - a £12.2 billion reduction from UBIDAC due to our phased withdrawal from the Republic of Ireland and a £14.2 billion reduction in Commercial & Institutional, due to seasonality; an overall market liquidity contraction in the second half of the year, including a reduction in foreign currency balances, and a disciplined pricing approach with a focus on customer relationship, margin and liquidity value.

Looking at the deposit mix excluding UBIDAC and Treasury, around 60% of our balances are interest bearing and 40% are non-interest bearing, and while this has remained stable during the year, we have seen some migration within interest-bearing balances as customers move from instant access into term accounts.

Turning to slide 23 and the impact of deposit volumes on income derived from the structural hedge.

Our total structural hedge notional balance at the end of the year was £230bn, of which around £184bn is allocated to the product hedge. Although the hedge notional was stable during the quarter, deposit balances reduced into year end and we do not expect to reinvest all the balances maturing during 2023, which is approximately 40 billion.

If there was no change to deposit volumes or mix from the end of year position, I would expect the product hedge notional to steadily reduce by 5 billion over the next 12 months.

Looking at income, as you can see in the chart, product hedges already written will deliver income of £2bn in 2023, that is before we consider any reinvestment of maturing hedges.

The actual amount of reinvestment will be driven by changes in the flow and mix of deposits going forward. We assume an average 5Yr reinvestment yield of 3.3% for 2023 compared to the current 5 year swap rate of 3.75% and relative to an average redemption yield on maturities of around 1.1%.

Moving to funding on slide 24.

We operate with stable and diverse sources of funding. Customer deposits represent approximately 86% of our total funding. Our wholesale funding is £74bn and around 40% of that figure is to meet our senior MREL and non-equity regulatory capital requirements at the Group Holding Company.

We continue to look at all options available to us to assess the optimal blend and most cost-efficient means of funding.

Looking back at our issuance during 2022 on slide 25

I'm very pleased with the transactions we executed during the year, particularly in light of challenging market conditions, and again thank you for your continued support for NatWest Group and NatWest Markets. We have ended 2022 well positioned from both a HoldCo and OpCo perspective.

From NatWest Group, we issued around £3.7bn equivalent in senior MREL format across GBP, USD and EUR markets. including, a €1bn 6NC5 Green bond, demonstrating our continued focus on issuances in Green, Social and Sustainable format. We also took the opportunity to pre-fund a portion of our 2023 Tier 2 requirement with a £650m issuance in December.

From NatWest Markets plc, we issued approximately £4.6bn in benchmark transactions across GBP, USD, EUR, Swiss francs and our inaugural Aussie dollar deal.

Looking at our 2023 funding requirements on slide 26

From NatWest Group HoldCo, our issuance is expected to be in the range of £3-5bn, primarily to refinance maturing senior MREL and we aim to issue approximately 25% of this in GSS format.

On capital, we will look to raise Tier 2 again this year with anticipated volume of up to £1bn. We have no AT1 requirement, given our next call is in 2025, although that will of course be subject to the evolution of risk weighted assets.

We will be active in the USD, GBP and Euro markets and also look for opportunities to diversify into other currencies.

Turning to our operating companies, NatWest Markets will have senior unsecured funding requirements of £3-5bn in 2023, primarily to refinance maturing legacy debt and we expect to be active with an inaugural benchmark public issuance from our Eurozone operating entity, NatWest Markets NV.

Turning to credit ratings on slide 27.

It was pleasing to see progress in our credit ratings during the year.

In September, Moody's upgraded the rating of NatWest Group plc to A3 from Baa1 and upgraded the ratings of NatWest Markets Plc and NatWest Markets N.V. to A1 from A2, with Stable outlook for all three entities.

Moody's also upgraded the deposit rating of RBSI to A1 and the issuer rating to A2.

S&P and Fitch assigned a rating to our ring-fenced subsidiary NatWest Bank Europe in January, which is aligned to the ratings of our UK ring-fenced banks.

Ratings outlook from S&P and Fitch are Stable across all group entities.

Our ESG ratings, including Sustainalytics, continue to remain strong, with MSCI at AA and ISS ESG upgrading us to C+ in 2022.

We will continue to proactively engage with the agencies to support ongoing progress in our credit and ESG ratings.

With that I'll hand back to Katie.

Katie Murray Thank you Donal.

I'd like to finish on slide 29 and our guidance for 2023.

We expect income excluding notable items to be around £14.8 billion, Net Interest Margin of about 3.2%, and group operating costs, excluding litigation and conduct, to be around £7.6 billion, delivering an improvement on the Cost income ratio to below 52%.

We anticipate a loan impairment rate in the range of 20-30 basis points, and together we expect this to lead to a Return on Tangible Equity of 14 to 16%, and to be at the upper end of this range.

With that I would like to open the line for questions.

Q&A

Operator Ladies and gentlemen, if you would like to ask a question today, you may do so by using the Raise Hand function on the Zoom app. If you are dialing in by phone, you can press Star Nine to raise your hand, then Star Six to unmute once prompted. We'll pause for a moment to give everyone an opportunity to signal for questions.

Our first question comes from Lee Street.

Lee, If you want to press Star Six to unmute and you can ask your question.

Lee Street, Citi Hello, it's Lee Street from Citi here. A couple of questions, please.

Firstly, just on the funding plan for NatWest Markets, it's sort of 3 to 5 billion, is that the run rate we should just be expecting every year and I suppose I have expected to come down a bit given the restructuring, so any comments there.
And secondly, on the risk weighted asset guidance of 5 to 10%, obviously, it's got the Basel and I presume there is loan growth in there, what else would be encapsulated in that 5 to 10% guidance, please.

Katie Murray Thanks, hi Lee. Let me let me take the RWA and then I'll hand over to Donal on the funding question. So when you look at our RWAs, we ended the year 176, within that there's 6 billion of Ulster RWAs, you would expect them to come down materially as the rest of the books kind of move off next year. I don't think they'll completely disappear in one year. There'll be a little bit left over because of Op risk and things like that.

And then the guidance, we've given you of + 5 to 10% is on the 176 number. So therefore, kind of loan growth would be dealt with in terms of an offset kind of Ulster. And then as we look at that 5 to 10% increase there's two things going on within there. One is any pro-cyclicality that might come through. It's been positive the last couple of years, but we'd expect as impairments increase, that we'd start to see a little bit of that. And then the impact of Basel 3.1 as well. And across both of them, we think the 5 to 10% would cover it.
Clearly the consultation document is still out in draft, but it's that kind of gives you a little bit of a guide and Donal do you want to take the funding plan?

Donal Quaid Yeah sure, Hi Lee. So, NatWest Markets, yeah. 3 to 5 is not a bad run-rate for the next few years. As you know, it's a non-ringfenced bank, primarily wholesale funded. So, in effect that requirement is really purely refinancing the maturing benchmark issuance. And if I look at kind of over the next three years, we've 4.3 billion maturing this year, 3.7 in '24 and about 5.2 in '25. So that 3 to 5 gives us a bit of flexibility within that range. But it's a good run rate for the years ahead.

Lee Street Alright, very clear on both. Thank you very much.

Katie Murray Thanks very much.

Operator Thank you. Our next question comes from Robert Smalley from UBS. Robert, do you want to unmute and go ahead.

Robert Smalley, UBS Hi. Thanks for doing the call and taking my questions. I have two. First, you mentioned the post model release on reserves. Could you talk about what your thinking will be on that going forward, what you'll be looking for in the environment, etc., to do more? Can we expect this to be consistent over quarters or will it be lumpier?

And then secondly, on deposits, last year we saw outflows of Commercial and Institutional deposits. That makes sense. As I'm assuming most are non-interest bearing, but Retail held up pretty well, which is notable given digitalisation in the bank. So would you expect these retail deposits to stay or as rates change, will we see a migration of those into either interest bearing or out of the bank? Thanks.

Katie Murray Yeah, sure. Thanks, Robert. Nice to hear your voice. As I look at the PMA, you know, we did do a release within the year on that. And I think as I look at it, it's something we look at kind of multi quarter. I'd probably expect some movements each quarter, but nothing… it's not a question of, you know, there's 352 left. I don't have a plan that there'd be 80 each quarter for the next four quarters. We'll just assess it as it comes through. We've been quite conservative on kind of holding it back and we're comfortable with that. I think we'll just continue to assess that as we go through.

What's been good is it basically is now a PMA for economic uncertainty. I mean, that's 352 of the 412 that we've got. And if you look at the analysis in the accounts or it's also in the main area and 192, you can see that it split quite well over Commercial, Institutional and Retail Banking. So, I think retail banking is very cost of living focused and I mean as is a kind of energy and gas kind of pressures on the commercial institutional space. So we'll just see, see how that kind of rolls through.

If we look to deposits. I think it's probably worth just spending a couple of minutes on C&I. So deposits went down 15 billion in the last quarter. 12 billion of that was from C&I. The way I look at them, there's kind of three more or less equal reasons for that.

First one, year end balances, you know, in some just natural kind of liquidity kind of actions going on. The second was around foreign exchange balances that left the UK at the time of the kind of mini-Budget, so they were making more of a statement on UK Plc. And then the third is us very much managing our book. We're not looking to pay up for deposits that are kind of pot money or of pure income or liquidity value or by paying we'd end up kind of capitalizing the book.
Very comfortable with what we lost. Overall, the 12 billion had about 4 billion liquidity value. Given our very strong liquidity position that wasn't that wasn't a big kind of story.

I think when I look at the retail piece, what we've seen is that the balance between IBs and NIBs has been quite standard even from the end of 2021.

And I think one of the important things, Robert, that you have in the States that we don't have here is a very active money market investment process. And that's not a feature of our kind of savings environments. So I think what we'll see in what we have seen and it started very much in November, is customers beginning to look much more for interest return.

And I think at that point we didn't have a term deposit account. We've now got one. It's in place. It's been up since January and that's really kind of helped, we think, any kind of particular migration. So the way I look at balances is probably over the year that they'll be relatively steady, they'll move around on quarters.

January is taxpaying season. So that has a bit of an impact on it as well. But kind of that's probably how we're viewing it. And then we need to manage what we're rewarding on that as we move forward. And that's probably the bit that we're learning more and more about as we work out customer behaviour and kind of market dynamics.

Robert Smalley That's great. Thanks for all the detail.

Katie Murray You're welcome, Robert. Take care.

Operator Thank you. Our next question has been emailed into us from Paul Fenner-Leitao of Société Générale. It is split into three sections, and the first section asks, what are you seeing in forward-looking metrics like debit card activity, spending, or deposits that signal potential weaknesses or yellow flags in asset quality?

The second part asks: Are you seeing any change in behaviour for mortgage borrowers coming off fixed rates and into new higher rates?

And the last part is for Tier 2 supply, what currency is most likely, Euro?

Katie Murray Okay, perfect. Let me take the first couple. So as we look at asset quality, I would say at this stage, we're really seeing very little when I look to those customers that are in arrears or what we call kind of heightened monitoring on the commercial side, those numbers aren't really yet back up to what they were pre-COVID. So there's not any real kind of flags in there what we can see, and it was confirmed again with some of the UK spend that came out today is that people are continuing to spend and continue to kind of use their use their funds. So although there's a lot of narrative about the concern of the cost of living, the reality is we're also we're not really seeing that coming through in our in our numbers.

I think in terms of change of behaviour. So when we look at our mortgage portfolio, it's 66% five-year and then 25% two-year and then balances on sort of tracker and SVR. What's been quite interesting as people with mortgages maturing last year, particularly when they were maturing into an environment where the rates were getting up into the five point something, in the very low six point something, that's when we launched our tracker book, so what we saw as people moving on to tracker to kind of wait until rates start to fall.

Now, if you look at rates, you can see that they're much more kind of low four point something. And so we can see people kind of moving back into those rates. So definitely people leaving it as long as they could, or taking a different product. And with us, if you go onto tracker, you can move on to a fixed within three months free of charge. So I think that that is also kind of help them kind of take opportunities there.

Donal Quaid And then I'll take the one on Tier 2 Supply. So I think we've guided up to a billion. I think probably see that over two deals and we'll keep our options open I think across EURO, starting on dollar.

Operator Thank you very much. Our next question comes from Alexander Latter of PGIM. Alexander, do you want to unmute and go ahead.

Alexander Latter, PGIM Hi there. Um, just a couple of questions from me. So firstly, just wanted to ask about kind of stage 2 balances. So you haven't had a big increase in kind of total provisioning as you've kind of flagged, but the actual stage 2 balances have gone up quite significantly sort of quarter over quarter. It seems like you've added about 9 billion in retail and 4 billion in Commercial and Institutional. And given that the IFRS9 scenario hasn't changed massively, what exactly is driving that increase in stage 2 loans?

And then the second question is, with your plans to issue from NatWest markets N.V., what exactly is the rationale for issuing out of that particular entity? Why not just issue it all from NatWest markets PLC, keep the kind of structure simple then add more boxes to issue out of, it's kind of much easier to understand and then just pass it down internally.

Katie Murray Yeah, sure. I'll take the first one and then Donal you can jump in on the N.V.

So if we look at the NatWest group loans, they decreased by 8 billion, Q3 to Q4, driven by the significant reductions in centre, which was obviously the withdrawal of Ulster Bank. And then that's also offset by growth. Then when you look at the stage 2 balances, they are up overall 12.8 billion or sort of 37% to 47 billion, and that's 12% of the group loans.

I would probably highlight two items in there. The first one is retail mortgages. That move was driven by our low SICR, which is a significant increase in credit risk threshold that we have. And it makes it very sensitive to model changes in the probability of default, which is caused by the update that we did on our economic assumptions in the quarter.

What I would say it's very high-quality movement within there, so it's not really a sign of an underlying problem. It's just that as you made those economic changes and when you look at this stage to mortgage the actual ECL, although you had movement in the balances, the ECL decreased by £19 million. I'm not concerned about that migration.

And then if I look at the unsecured much, much smaller book, but there was a 0.4 billion increase there and that again was our unsecured balances moving up. And given that it's a smaller level of the book we're kind of covered, very comfortable with the coverage levels and arrears trends that we've seen there. So it's more, I guess, a sensitivity rather than an underlying problem. Donal.

Donal Quaid Yeah, let me take the N.V. question. So just in terms of rationale for that, entity, as you know, it's our European non ringfence bank entity is there to support our UK clients operating in Europe and also some European clients as well.

So the reason why we're looking to issue out of that entity obviously as the balance sheet grows, it is again similar to NatWest Markets PLC going to be wholesale funded, but the restrictions that we would have is issuing more unsecured out of NatWest Markets PLC is there would be intergroup lending constraints just given the low capital base of those entities. So that's really the primary reason why we'll go directly from the N.V. entity.

Operator Thank you. If you would like to ask questions today you may do so by using the Raise Hand function on the Zoom app. If you are dialing in by phone, you can press Star Nine

to raise your hand and Star Six to unmute once prompted.

Next question comes from Corinne Cunningham from Autonomous. If you could please unmute and ask your question.

Corrine Cunningham, Autonomous Good afternoon, everyone. Thank you for the call. Just a follow up on the RWA increase. On the credit side we've been used to you running with very high ratios of late and so in 2022, your payout ratio, if you include buybacks, etc., was over 100%.

So how should we think about the 5 to 10% growth, in RWAs against the distribution policy. Is it coming down below the 100%? I think understanding the glide path from here with that kind of RWA headwind would be would be very helpful. And then the other one was on the NIM trajectory or I should say the NII trajectory. So you going to a flat margin over the course of the year, but in terms of quarterly NII, when would you expect that to actually peak if rates stay flat as you forecast at 4%? Thank you.

Katie Murray Hi, thanks. Thanks for your question. So, I think on distribution, it's important to remember a little bit of the journey that we've been on. So if I go back we were sitting at sort of 18.4% CET1 with a target to get into 13 to 14%. So we're now at 14.2. So clearly the significant payout of last year and this year, we've paid over the last few years 10.9 billion of distributions out via a variety of mechanisms, whether they're dividends, directed buybacks.

So that's been a lot of that story is about getting from that 18% plus number down to the 14.2. What you would expect going forward from here is the 40% payout ratio in terms of our dividends. We've also said that we are we will maintain capacity to take part in buybacks. Our principal focus is the directed buyback, which we can buy up to 5% of the company from the U.K. Government in any one year.

And then this morning, we also announced a further £800 million buyback. But I'd say the next few years are much more about using the capital generated rather than trying to run down the excess capital. So comparatively, we'll see slightly smaller number, but still an excellent payout ratio which will be in addition to that 40% piece.

In terms of the NII, what I would we probably guide you on revenue. There's lots of different things that are obviously going on in that line. The interest rate is just one of them. And we've guided you to around about 3.2 for the year. I think it's important also to think of what's happening in volume growth around the business is clearly a really strong growth last year at 6.7%.

We don't expect to be quite as strong in mortgages this year just given that that that's a bit that market is a little bit smaller. And then Commercial, obviously, the level of growth will depend on the macro environment and we're comfortable with, I guess, how the year has started.

And then we've also talked quite a lot this morning on the equity call around things like the structural hedge and how that will be reinvested. Obviously, that's being considered in them. But if I if I look at that in terms of where the five year swap rate is, that something else to kind of have a think about. So we're not calling out quarterly NII at this stage we what we're guiding you to is £14.8 billion total income for the year.

CorrineCunningham Okay. Thank you.

Katie Murray Lovely. Thanks.

Operator Thank you very much. There are no further questions about yourself, Katie, for any closing comments.

Katie Murray Lovely. Thanks very much. Thanks, Dave, and thanks, everyone, for the for your time this afternoon. We really do appreciate you getting on the call and having a chat with us. As ever, Paul Pybus from our Debt IR is very happy to take any questions. And Donal and I look forward to meeting with you over the coming months. And then again when we talk again at H1, one more formally. Thanks very much for your continued support. It really is appreciated.