H1 2020 Debt Sell-Side Update

Tuesday 25th August 2020

Hosts Katie Murray (CFO) and Donal Quaid (Treasurer)

Operator

Welcome to the H1 results Sell-Side update. If you wish to ask a question today, you can use the raise hand feature on your screen and you'll be introduced when it is your turn. If you're joining by the phone line, you can also ask a question by pressing *9, you should then unmute yourself by pressing *6, you'll be introduced using the last 4 digits of your phone number, so you will need to listen carefully for your turn.

Please do introduce yourself and your company. I'll now hand over to our host Katie Murray. Katie please go ahead.

Katie Murray (KM)

Lovely thank you very much Dave, good afternoon and good morning everybody.

So, thank you all for taking the time to come to join us this afternoon. I'm joined today by Donal Quaid, our Natwest Group Treasurer, and also by Paul Pybus from Investor Relations. I'll just say a few opening comments and then we'll move quickly into Q&A.

Many of you will of course be aware that we've also launched today a Tier 2 transaction that has just gone live in the last couple of hours. Clearly we will not answer any questions or have any discussions around this transaction on this call.

I know that capital is a key focus for our fixed income investors and we're very comfortable with our level of capital at 17.2%. Obviously, including the IFRS9 adjustments, 16.3% excluding that. And that level of capital leaves us with significant head room above our minimum requirements.

We continue to operate with significant levels of excess liquidity, with reported LCR of 166%, reflecting the strong deposit growth across both our corporate and retail franchises.

Looking at the P&L and revenue, we've confirmed at this point that we're pretty comfortable where consensus was sitting in terms of revenue and we didn't really need to see any changes in that in the round.

On impairment we're also pleased with the approach that we've taken on the ECL. If I was to draw a continuum of where we'd like our approach from conservative to aggressive, Natwest Group would always be closer to the conservative end rather than the other, so slightly to the right of the middle, if you were to think of it as a line, and we feel that we've continued to do that as part of our process during H1.

We also share a number of points for guidance for 2020; so we confirmed the 250 million pounds of cost savings, our impairments we expect for the full year to be in the range of 3.5 – 4.5 billion pounds. Our RWAs, again we're expecting to see between 185 – 195 billion pounds. Obviously remember that, that includes a reduction in terms of Natwest Markets where we seek to get to the 32 billion pounds of RWAs this year.

We've also talked about the progression of RWAs for Natwest Markets and that they'll be largely compete by next year from the 32 billion pounds from the end of this year, down to an end state of 20 billion pounds that we talked about in February and that will be largely done. You will of course, all remember that we do still have a small book of legacy assets within which will take a bit more time, but for the reshaping of the business we're comfortable we will complete by then.

On disposal costs within Natwest Markets, we're expecting 200 million pounds this year and 400 million pounds in 2021. We've always said that's our plan and how we do the NatWest restructuring is to make it capital accretive and there's been no change to that as an approach.

And then finally, our medium to long term CET1 level of 13-14%, we're comfortable with that being the position that we're working towards, our message to our equity investors is that our preference is to return capital when we can and when it's appropriate to do so. And that's a conversation we'll have both internally and with the regulator later this year.

And with that, I'm very happy to move to Q&A.

Operator

As a reminder, if you would like to ask a question please do use the raise hand function and we'll bring you through for your questions.

Our first question comes from Lee Street from Citi. Lee would you please unmute yourself and go ahead.

Lee Street, Citi

Hello, thanks for taking the call, I've been asked this question before but I just have to get a bit more perspective on it now we've seen all the other banks report. When I look at the balance of Natwest Stage 2 loans, it looks very high relative to the UK and continental peers, now I know you have a different definition used when you put it into Stage 2, but I'm just trying to wonder, how should we really interpret this or is the message that we should not really look at Stage 2 loans at all, I'm just trying to understand to think about it, if I just put it down on face value, it does just look very high versus the UK but also very much, even more so versus continental European piers, so, beyond the different definitions, what else would you, what other colour would you give us to help us get more comfortable with that please?

Katie Murray

Yeah no, absolutely, obviously we won't comment too much on our pier group in terms of what they have done, but what I can say, is that, when you look at our Stage 2 loans, we do have this process where for a significant increase in credit risk or SICR as we call it internally, once that moves by more than 10 basis points, you will then start to see the loan move into Stage 2.

Now in Q2 what happened there, what you saw as a result of that treatment, we saw a significant number of loans, it was about 24 billion pounds I believe, that moved into Stage 2, but interestingly on those loans, although we've seen an increase in their PD of above 10 basis points, what we haven't seen is a significant level of impairment taken against them yet.

So, you see, as a result of this, a higher level of, of loans in Stage 2 but not necessarily higher levels of impairments on those loans and then they basically will get treated for a heightened attention, heightened monitoring as we go through them in the next, as we work through this quarter and into next.

But, certainly the amount of loans that go through is really important. Within the accounts, we do have some very helpful analysis which shows you of the loans that have gone through, how much of them are fully up to date and how much are paid and how much have now got payments which are beyond 30 days and then make the other classifications as well, I think that's round about Page 37, Page 39.

Lee Street, Citi

Okay. So the message is, obviously don't look at Stage 2 in isolation, look at it relative to impairments, but I suppose what you're basically saying is we shouldn't be looking just at Stage 2, as a leading indicator of impairment at all, is really what your message is.

Katie Murray

Yeah, so if I look for example at the gross loans within the commercial banking and I'm looking at Page 39 of the accounts if you can have a look at it later. We've got gross loans of 114 million, but what you can see is of that Stage 2 balance, there's 58 billion of 114 billion that have gone into Stage 2, but of that 58, 55 billion is not yet passed through, so they're still being well serviced, but they are in areas that we are more concerned about.

Lee Street, Citi

And one final question linked to that, obviously, different banks are given different amounts of disclosure relating to the amount of loans benefiting from moratorium and alike. Is there any way, would you consider whether it's worthwhile maybe giving a monthly update on that, because obviously it is a moving target and that to me, as we see those come out and how they evolve is a key leading indicator of our asset qualities so, I suppose it's more of a request, of something to maybe consider that we could get something more frequently than just getting the big reveal each quarter as to what you're actually seeing on those loans would be most helpful.

Katie Murray

You know I would probably, unfortunately I'm going to say I'm going to disappoint you on that, that we won't move to monthly reporting on that basis, just because as we start to get involved in monthly reporting, we get into complexity of we're telling you this but we're not telling you something else, does that mean that everything is alright with consensus and it's such a level of, look, if there's anything that happens that's materially different from what we said at Q2, we would obviously make a statement at that stage, so I think, the absence of comments probably confirms that things are performing in line with more or less what we said at Q2.

Lee Street, Citi

Alright, thanks for your comments today.

Katie Murray

Okay lovely, thanks for joining.

Operator

As a reminder, if you would like to ask a question please do use the raise hand function or please press *9 if you've dialled in to the phone.   We'll now pause whilst we wait for our next question to come through.

And once more, if you would like to ask a question, please do use the raise hand function on your device or please press *9 on your keypad and we'll bring you through. We have had our next question which comes from a number ending in X, could you please unmute and ask your question? You'll need to press *6 to unmute yourself on your device. That was X, if you could please unmute and ask your question.

Paul Fenner-Leitao, Societe Generale

Hi, it's Paul Fener-Leitao here from Soc Gen Credit Research, hi, thank you also very much. Hi, thank you for holding the call. I guess I've got a follow on from Lee's question which is obviously we're no, scary but we are getting close to the end of Q3, obviously we had colour on migration, a month ago, whenever it was, what can you tell us about what's happened in terms of migration since then and a business update around what you're seeing in terms of activity, mortgage lending and also payment holidays, that's question number 1.

Question no. 2 is around funding, can you just give us a brief update, I guess you're done on sub debt AT1 and Tier 2 - what else have you got to do for the remainder of the year, just an update on that? and associated with funding, I'd actually like to know, given that Natwest Markets is getting so much smaller, are you still going to be requiring Natwest Markets Legal Entity to fund on it's own and if so, why? It's always confused me, it seems like a little bit of a value destroying thing to ask it to do given its funds are so much more expensive, so a little bit of colour around that…

and then the final one was on ratings, just to know, obviously your ratings are a little bit all over the place, you've got a positive outlook at Moody's, you've got a negative outlook at the other guys, I just wanted to know what your sense around, you know your conversation with the rating agencies upside/downside is there and what your priority is around that, thank you.

Katie Murray

Thanks very much Paul. Donal, I'll take the first one and then I'll hand the rest of them over to you, ok. If I look at colour on activity and I'm just working my way through the business, what we're seeing if mortgage lending is really up to pre-COVID levels, we think there's two things that are driving that, you'll obviously be aware that, as we all went into our, actually I've no idea how long it really was when we were in lockdown but it was about a 12 week lockdown, there were a significant number of transactions that would have been in play at that time and so there has certainly been a boost as those things have then come through to their natural conclusion. In addition, here in the UK, the concessions that have been given on stamp duty have also brought us a significant amount of benefit and activity into the market. So, we are seeing levels back to where we were.

If I look at unsecured, we can see that spending is increasing, but at the same time, people are also continuing to pay down their debt as they continue to prepare themselves for what could be some more difficult times as we see government support start to come to the end.

Looking at corporates in relatively simplistic terms, people are still drawing down on government lending schemes but again we see corporates are continuing to build up cash deposits to make sure that they are also well prepared as things start to get more difficult.

So, I think the way that we would probably characterise this time is a bit of a phony war, or a calm before the storm, where people are suring themselves up, there's a little bit more activity happening, some companies doing well, some obviously really quite worried, but actually what will happen during Q4 much moreso than Q3 in reality and into Q1 and Q2 into next year, will be far greater insight into who the winners and losers are in this.

Donal do you want to take the next few?

Donal Quaid

I will do. So, I think in order on sub-debt, I think it's probably fair to say, in terms of what we guided for, calendar year 2020 post todays transaction on tier 2 we're pretty much done in our requirements for tier 2 and additional tier 1. Saying that we do have a large call, additional tier 1 call next year, 2.6 billion dollars in August of next year, so we could I suppose look at funding some of that call at some stage between now and the end of the year given where spreads have moved to, that's something we will just keep our options open on.

On the Natwest Markets funding piece, there are restrictions in terms of the funding that can be provided, so from a Natwest Bank ring fence bank entity obviously we're sitting on significant amounts of purpose liquidity but under Ring Fencing there are restrictions around how that can be used to fund our investment banks, so, they will be required to continue to fund themselves going forward. Obviously…

Paul Fennner-Leitao, Societe Generale

Well I meant out of NatWest Group really…

Donal Quaid

I suppose out of NatWest Group as well, we still face similar restrictions with the exception of downstream capital obviously which we can look at, but on an unsecured funding basis there is still other restrictions in terms of clean HoldCo that we would need to look at as well. So, they will continue to access markets however their annual requirements should fall in line with the reduction of RWAs over the next 18 months.

And final question on rating agencies, it's just very, very hard to second guess how the rating agencies will move over coming months, we're starting the process of annual reviews, there is ongoing dialogue there, but I suppose there's never any guidance or indication of what they're thinking, though we're definitely looking for more clarity on how the macro environment will play out and they'll probably need a little bit more time to get more comfortable on that fact as well so very, very hard to give a view on that.

Paul Fenner-Leitao, Societe Generale

Thank you all.

Katie Murray

Thanks Paul.

Operator

Our next question comes from the number ending in X would you please unmute and go ahead. That is number X, if you could unmute and go ahead thank you.

Jackie Ineke, Morgan Stanley

Hello, it's Jackie Ineke calling from Morgan Stanley. Thanks for doing the call.

I'm sorry I did get on a little bit late so, apologies if this has been asked already, but it's a question about LIBOR transition. So, I think you have a number of legacy bonds outstanding that are under New York law so, I guess we're going to get a legal solution there. But elsewhere, you have a number of bonds under English Law that would theoretically qualify as these kind of tough legacy bonds that the Bank of England is talking about. And I was just wondering if you could give us any kind of idea of time framing, thinking about any changes to the underlying docs, any consent solicitations that may well come as, obviously a fix to the LIBOR transition? Thank you.

Katie Murray

Donal that feels like one for you?

Donal Quaid

Thanks Jackie, yeah I think one thing to say is, we will I suppose wait to see how the whole conversation around legislation pans out over coming months, I think there has been a clear identification from the authorities that there is a touch legacy as you said on the New York law where consent solicitations just aren't feasible, so there are a small number of securities but there still is an outstanding I suppose requirement for legislation to solve.

I'll probably just say, from the LIBOR transition perspective we've done a full due diligence exercise on a security by security from our perspective, and the one advantage we have is that there is, we do hold a lot of optionality around outstanding securities either in terms of BAU par calls or in terms of regulatory par calls, at the end of next year, so even though I'm not saying we would look to use them, but it is another option available as we wait for the outcome of where legislation lands and how they define tough legacy I suppose on that degree as well.

So, it is something we keep under constant review. Not too sure if that's answered your question?

Jackie Ineke, Morgan Stanley

Okay, but just on that, they're kind of saying, the message was, even if you can theoretically call these things at the end of next year, you still have to change the language to make sure these are potentially functioning instruments, if you don't call them. You see what I mean so you would have, even if you were fully expecting to call them at the end of next year and of course we don't know if you are, you would still have to change the language before that call for the back end.

Donal Quaid

That is not guidance we have been given today, so I'm not saying that's not something that, overcoming weeks and months, in terms of conversations but it's not something that's explicitly been stated to us at this stage.

Jackie Ineke, Morgan Stanley

Right. Okay, great, thanks a lot.

Katie Murray

Thanks Jackie.

Operator

Thank you. As a reminder, if you would like to ask a question please do use the raise hand function if you're using Zoom or please press *9 on your key pad if you've dialled in to a device. We'll just pause to see if you have any further questions coming through.

Katie, we have no further questions, so I shall hand back to you to carry on.

Katie Murray

Gosh that's great, thank you very much for your time this afternoon. Obviously if you do have any other questions, Paul is always available and myself and Donal are always happy to do calls and questions with you as well. But, as ever, thank you for your support, we look forward to your support this afternoon in the Issuance that's currently underway. Thanks very much and enjoy the rest of your day.