NatWest Group plc
Q3 2020 Results - Analyst Call

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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 for our third-quarter results announcement. I'll start with the headlines and an update on our strategic priorities before handing over to Katie to take you through the results in more detail. We'll then open it up for questions.

So starting with the headlines.

Whilst the economic outlook remains uncertain as a result of the pandemic, our primary focus has been on supporting our customers and protecting the business whilst continuing to make good progress against our strategic priorities. Against this backdrop, we have delivered a resilient performance. Taking into account impairments, we're reporting an operating profit before tax of GBP 355 million and an attributable profit of GBP 61 million for the third quarter. Impairments in the third quarter were low compared to the second at GBP 254 million.

Turning to look at the first 9 months of the year, we're reporting a pre-impairment operating profit of GBP 2.7 billion, an attributable loss of GBP 644 million. Impairment charges for this period stand at GBP 3.1 billion.

Our strategic execution remains strong, and we are on track to meet our 2020 cost reduction target of GBP 250 million. Excluding operating lease depreciation, expenses for the first 9 months were GBP 4.8 billion, down from GBP 5 billion for the same period last year.

Importantly, we continue to operate with one of the strongest capital ratios among our European peers at 18.2 percent and with a liquidity coverage ratio of 157 percent. We take comfort from this capital strength which gives us flexibility to navigate an uncertain environment.

I want to talk briefly about the strategic priorities I set out in February on Slide 4. These priorities underpin our purpose of helping people, families and

businesses to thrive, and we have been putting this into operation in challenging times.

Our branch network has remained open in order to support customers up and down the country, and I'd like to thank all my colleagues who are working hard on behalf of our customers, whether that is face-to-face in branches or our offices, working from home or via digital and video channels. I'll talk more about each of our priorities in turn, starting on Slide 5 with supporting our customers. Inevitably, our main focus this year has been on helping customers manage through the pandemic. Activity levels have increased across both our retail and commercial businesses, and gross lending grew GBP 31 billion to GBP 371 billion for the first 9 months.

In retail banking, mortgage activity has grown since July, with applications up 91 percent and new lending up 10 percent on the second quarter. Debit and credit card spending has also continued to increase, with debit card spending now above pre-COVID-19 levels. The number of customers taking mortgage repayment holiday has been steadily decreasing and trends suggest they acted through caution at the start of the pandemic rather than need. Initial mortgage holidays have declined from GBP 33.6 billion or 22 percent of the book to GBP 6.2 billion or 4 percent of the book in the third quarter.

85 percent of mortgage holidays have now ended, and almost all these customers have returned to normal payments with just a small number in arrears. I would however caution that it is early days in an ongoing pandemic and we continue to monitor this closely. You can see on Slide 6 that commercial banking activity levels are also starting to normalize. Revolving credit facility utilization is now 26 percent, down from a peak of about 40 percent as government lending schemes kicked in and customers access capital markets.

We're also seeing the number of customers on payment holidays decline in commercial banking. They now represent about 8 percent of the book with a value of around GBP 9.5 billion, down from 11 percent and GBP 12.9 billion in the second quarter. We continue to support businesses through the government support schemes, though demand has tapered from about 48,000

applications on the first day to an average of 800 a day in September and 700 a day in October. We approved lending of GBP 2.8 billion during the quarter, taking our total lending to GBP 12.8 billion for the first 9 months, in line with our share of commercial customers.

As you know, there have been significant changes to the support schemes announced, allowing more time and flexibility in repayments, and we are working closely with customers to understand their response to these changes.

We remain comfortable with the risk and diversification of our lending books. In retail, just 7 percent of our lending is unsecured and stage migrations remain low. In commercial, you will recall there were several sectors we monitor closely including retail, leisure, and transport. GBP 900 million of loans in these sectors are Stage 3 and we are comfortable with our coverage ratio of 52 percent.

Our priority has rightly been on helping customers to manage during the pandemic, but you'll see on Slide 7 that we are also focused on meeting evolving customer needs in order to generate future growth. We continue to have capacity to grow across our sizable franchises in retail, commercial and private banking.

For example, in retail banking, we have a 16 percent share of current accounts, but just 10.6 percent stock share of overall mortgage lending. This is an attractive area where we have added resource to support our strong performance.

We have also a low share of unsecured lending with a relatively small cards business, giving us scope to grow carefully within the limits of our current risk appetite.

We announced in August that we are bringing our wealth businesses together under Peter Flavel, our CEO of private banking. By combining the expertise of our premier and private banking team, we can fully leverage our asset management expertise to support saving and investment needs for customers across the group. In commercial banking, our investment in innovation and

fee-based products continues with our merchant acquiring platform, Tyl, and our new payment platform, Payit.

And in NatWest markets, the refocused business is now better placed to support our strong corporate and commercial business with foreign exchange and access to financing. So we see plenty of scope to serve our customers more effectively and grow by extending the full capabilities within the bank across our business.

I'd like to move on now to our next priority on Slide 8. Our focus on simplification and leveraging our technology and digital investments has been supported by accelerating change in customer behavior this year.

We now have 9.3 million active digital users, and we added almost 0.25 million newly active mobile users during the third quarter, taking the total to 7.6 million. Use of our chatbot, Cora, has accelerated with over 6 million interactions from both retail and business customers. And video banking is now available across our entire network with interactions up from less than 100 a week in January to almost 9,000 a week now. Digital acceleration makes it easier for customers to access our services and for us to serve them cost efficiently.

It is one reason we have been able to reduce costs. We remain on track to achieve our 2020 cost reduction target of GBP 250 million and continue to expect strategic costs in the region of GBP 800 million to GBP 1 billion.

I've touched briefly on some of our innovations, but we are also continuing to develop partnerships with others. We recently announced a new agreement with BlackRock, who will support our wealth management activities with their investment management processing.

This delivers two major benefits for our customers. First, we make savings we can pass on to them. And secondly, our wealth managers can put greater focus on asset allocation. Agreements like this allow us to concentrate on activities where we are able to excel while, at the same time, benefiting from the expertise of others.

On Slide 9, I want to talk about capital allocation which is key to ensuring we maintain discipline on returns. We continue to refocus net worth markets to better align it with the needs of our corporate and institutional customers. And we are now ahead of our plan on our RWA reduction target.

Our year-end target was initially GBP 32 billion, and as a result of disciplined execution, we have exceeded this.

RWAs were GBP 30 billion at the end of the third quarter, and we expect to end the year at around this level and to achieve most of the reduction to our GBP 20 billion medium-term target by the end of 2021, with associated disposal losses of around GBP 600 million over the two years. We have been able to do this by continuing to simplify the business in order to focus on fixed income, currencies and capital markets.

So in summary, our third-quarter results represent a resilient performance, and we continue to execute on our strategic priorities. We are taking advantage of our strong franchises to support customers, simplifying our business to make it more effective and efficient, powering our organization through innovation and partnerships and sharpening our capital allocation to allow us to drive sustainable returns over time.

With that, I'll hand over to Katie to take you through the results.

Katie Murray: Thank you, Alison. And good morning, everyone.

I will start today with the group income statement. We reported total income of GBP 2.4 billion for the third quarter, down 9.5 percent from the second quarter.

Within this, net interest income was up 1 percent at GBP 1.9 billion, and non-interest income was down 35 percent to GBP 500 million. This decrease reflects a number of notable items including a loss of GBP 324 million on the liability management exercise carried out in September which we have already announced. Excluding all notable items, income was down 3 percent on the second quarter, mainly driven by the normalization of market conditions in NatWest markets.

We reduced overall operating costs by 5 percent in the quarter to GBP 1.8 billion. And we are reporting operating profit before impairments of GBP 609 million, down 21 percent from the second quarter as a result of the notable items I referred to earlier. The impairment charge for the third quarter was significantly below the second at GBP 254 million which represents 28 basis points of gross customer loans. Taking all of this together, we reported an operating profit before tax of GBP 355 million and attributable profit to ordinary shareholders of GBP 61 million.

I'll move on now to net interest income on Slide 13.

Group's net interest income for the third quarter was GBP 16 million higher than the second. If you look at the columns for the second quarter on the left, and the third quarter on the right, you can see that bank net interest income grew GBP 43 million or 2 percent. This is the result of higher volumes and one extra day in the quarter.

Turning to bank net interest margin. This decreased 2 basis points in the third quarter to 165 basis points. This is the result of three factors: First, the lower yield curve accounted for 3 basis points, the majority of which is due to the structural hedge, in line with guidance; second, increased central liquidity accounted for a 1 basis point fall; and third, change in mix of lending and pricing competition added 2 basis points to the net interest margin.

Moving on now to look at the drivers of net interest margin.

On Slide 14, we show customer loan and deposit rates for retail and commercial banking which together account for around 85 percent of group net interest income. We also show the overall group gross yield and cost of interest-earning banking assets which includes the rest of the balance sheet. Notably, the lower-yielding liquidity portfolio and the higher cost wholesale funding. On the asset or lending side, yields across the group have continued to fall reflecting the pass-through of lower interest rates.

However, the pace of reduction has slowed during the third quarter. Gross yield declined by 13 basis points to 194 basis points versus a 20 basis point

decline in Q2. On the liability or deposit side, costs reduced by a further 8 basis points in the third quarter to 67 basis points. We have now repriced most of our deposits to the floor, and I did not expect much further benefit from this going forward.

Looking to the fourth quarter, there are four main factors to consider. First, ongoing pressure from a lower yield curve through our structural hedge. Our guidance of around 2 basis points per quarter is unchanged. Second, a change in liquidity which, as you know, affects average interest earning assets and therefore, NIM.

Third, mix and pricing. Mortgage margins on the front book improved to 140 basis points, in line with the back book. Application margins in Q3 averaged 160 basis points, close to bank net interest margin of 165 basis points. As a result, mortgage lending will be less dilutive to bank NIM in the fourth quarter.

However, our expectation is that as high demand tapers, current applications' margins may not be sustainable. Finally, on mix and pricing. Naturally, customer behavior will impact higher-margin unsecured and commercial balances. Moving on now to look at volumes.

Gross banking loans increased by GBP 1.5 billion in the third quarter driven by mortgages which grew by GBP 2.4 billion or 1.3 percent reflecting increased demand after the easing of lockdown. Our flow share in the third quarter was 11 percent, down from 14 percent in Q2 reflecting our temporary absence from the 80 percent to 85 percent loan-to-value segment. Nevertheless, it averaged 14 percent for the first 9 months of 2020, well above our stock share which has further improved to 10.6 percent.

Secured personnel balances make up 50 percent of total customer loans across the bank. Unsecured balances in aggregates declined in the third quarter. But as you can see, we saw some small growth in our credit card book.

In commercial banking, demand for government schemes has slowed from the second quarter, but this still accounted for GBP 2.9 billion of additional

lending. However, this was countered by the repayment of RCFs which now sit at around 26 percent utilization, broadly in line with our pre-COVID levels.

Average interest-earning banking assets grew by GBP 10 million in the quarter as a result of the averaging effect of strong loan growth in the second quarter, and further liquidity build in the third. Moving on now to look at non-interest income on Slide 16. Third-quarter non-interest income excluding notable items, was 18 percent lower than the same period last year and 11 percent down on the second quarter this year. There are 2 different trends to highlight.

First, fees and commissions. The reduction from last year mainly reflects regulatory changes in retail banking. We maintain our guidance over GBP 200 million impact on group income for 2020, rising to GBP 300 million for 2021. In addition, customer activity levels have been subdued as a result of COVID-19.

You can see this in our fee and commission receivables breakdown. We have seen a noticeable reduction in payment services and credit and debit card fees year on year due to lower spending levels. However, relative to the second quarter this year, customer activity levels have increased resulting in growth in these segments as well as lending fees. The second trend to highlight is trading income.

NatWest markets has had a strong first 9 months of 2020 although we saw a return to more normalized customer activity and volatility levels in the third quarter. Looking ahead, we expect the ongoing refocus of NatWest markets and the reduction in RWAs down to our GBP 20 billion medium term target to weigh on trading income. The outlook for fees and commissions is more uncertain, given changing government measures to restrict COVID-19. However, we would expect these to grow as the economy recovers.

Moving on now to look at costs on Slide 17. Other expenses excluding operating lease depreciation, were GBP 1.5 billion for the third quarter. That's GBP 78 million lower than the second and GBP 152 million lower than the

third quarter of last year. This brings our total cost reduction to GBP 193 million for the first 9 months.

And we are on track to achieve a GBP 250 million target for the full year. It is worth reminding you that these cost savings are net of inflation. In the fourth quarter, we will incur the U.K. bank levy, which we expect to be around GBP 160 million.

Strategic costs in Q3 were GBP 223 million which includes GBP 90 million of redundancy costs across the group.

Moving on now to look at impairments on Slide 18. We reported an impairment charge of GBP 254 million for Q3 or 28 basis points of gross customer loans. This is substantially lower than the first half as we have made no changes to the economic assumptions presented in July, and there has been a very limited number of customer defaults or stage migrations.

We now expect the impairment charge for full year 2020 to be at the lower end of our GBP 3.5 billion to GBP 4.5 billion range.

Expected credit loss provisions were broadly stable in the quarter reflecting additional Stage 1 and Stage 2 provisions which were partially offset by the utilization of Stage 3. So let me show you how our loan book is performing on Slide 19. There was a little change in the quarter reflecting ongoing government support measures and corporate's healthy cash balances. Ninety percent of our loan book is in Stage 1 and Stage 2, not past due, where customers remain up-to-date on payments. Stage 2, past due, is 0.9 percent of the book, down from 1.3 percent at Q2. And Stage 3 is 1.8 percent, down from 1.9 percent at Q2. Our ECL coverage ratio is stable at 1.7 percent, with Stage 3 coverage of 41 percent.

As Alison mentioned, we have a small proportion of wholesale loans in sectors that we monitor closely. These amounted to GBP 28.8 billion in Q3 which represents 8 percent of gross loans. In these sectors, similar to the trend at group level, Stage 3 gross loans were broadly stable at around GBP 900 million, and we remain comfortable with coverage at 52 percent. Turning now to look at risk-weighted assets and capital on Slide 20.

Risk-weighted assets decreased GBP 7.6 billion in Q3, with reductions across credit, counterparty and market risk. Credit risk-weighted assets decreased GBP 3.3 billion. This includes a GBP 1.8 billion benefit from the infrastructure and SME factors and an impact from pro-cyclicality of GBP 0.9 billion. The largest decrease by business was in NatWest markets, where we reduced RWAs by GBP 5.1 billion, bringing them down to GBP 30 billion which is ahead of our full-year reduction targets.

Looking forward, we now expect RWAs to be below our previously guided range of GBP 185 billion to GBP 195 billion at the end of 2020. This is due to the acceleration in NatWest markets and a relatively low level of procyclical inflation. We ended the quarter with a common equity Tier 1 ratio of 18.2 percent on a transitional basis under IFRS 9. This is 100 basis points higher than Q2 due to lower RWAs, which added 58 basis points; infrastructure and SME factors, which added 17 basis points; and IFRS 9 transitional relief which added 8 basis points.

We expect the software intangibles benefit to be around 20 basis points in the fourth quarter.

Moving on to my final slide, which demonstrates the strength of our balance sheet, our CET1 ratio is now 420 to 520 basis points, above our 13 percent to 14 percent target range and more than double our maximum distributable amounts.

Our U.K. leverage ratio of 6.2 percent is 295 basis points above the Bank of England minimum requirements. We have also maintained strong liquidity levels with a high-quality liquid asset pool and a stable, diverse funding base.

Our liquidity coverage ratio decreased in the quarter to 157 percent as we repaid a further GBP 5 billion of TFS. Headroom above our minimum requirement is GBP 62 billion.

So to conclude, we have delivered a resilient operating performance in the third quarter, with higher net interest income and continued progress on both

cost and RWA reductions. As we've made limited change to our guidance, this is summarized in the appendix. And with that, I'll hand back to Alison.

Alison Rose: Thank you, Katie.

Before we open it up for questions, let me wrap up with a brief conclusion.

Whilst the economic outlook remains uncertain, our focus continues to be on supporting our customers at the same time as protecting the business. We are making good progress on our strategic priorities.

In particular, I want to highlight the refocusing of NatWest markets where we were ahead of plan on our RWA reduction target. Most importantly, we have a capital-generative business with a strong CET1 ratio of 18.2 percent, well above our target ratio of 13 percent to 14 percent over the medium to long term. This capital strength gives us the flexibility to navigate an uncertain outlook to resume dividend payments as soon as this is possible and to consider options that create compelling shareholder value. Thank you very much, and we're now happy to open it up to questions.

Operator: Your first question comes from the line of Rohith Chandra-Rajan from Bank of America.

Rohith Chandra-Rajan: Thank you. Good morning.

I had a couple of questions please. So from income, and the first on the net interest margin where moving parts are a little different this quarter and you talked about the mix and competition impacts for Q4, I was just wondering how you're seeing the margin evolving in Q4, please?

And then the second was just more broadly on revenues. I think consensus has total revenues of just under GBP 10.9 billion for this year and GBP 10.6 billion for 2021. How does that compare to your expectations, if you're willing to comment on that please?

Alison Rose: Great. Thanks very much.

Katie, can I ask you to pick those up?

Katie Murray: Yes, sure. Thanks very much, Alison.

If we look at revenue, and starting with the current 2020 guidance. Just to remind you all, that includes the GBP 200 million reduction for regulatory events including the high cost of credit. We expect the disposal losses in the income line in NatWest markets to be GBP 200 million for the full-year 2020.

When we look at NIM, what I'd remind you is to look at it in terms of three buckets. So there's your liquidity, and, you know, Q4 will remain sensitive to the movements in liquidity, and that will be very dependent upon customer activity as well. I'll let you decide as to what you think the impact of that might be.

Of course, the yield curve which would be a 2 basis points decrease in Q4 from the lower hedge and also in terms of mix. I expect that probably to be relatively broadly neutral. And from the mix, when I look at the volume as part of that, from mortgages, we have seen a really big strong surge in volumes, in part driven by the temporary reduction in the property taxes. And as that deadline nears which is at the end of Q1, we would expect to see some of that surge certainly start to fall off.

It’s important to remember we are getting currently elevated application margins. We were 140 basis points for the quarter in terms of what we completed, but by the end of September, it was up at 160 basis points as well. So we'll see a little bit of a benefit of that.

The 160 is obviously sitting below the 165 of our NIM as well.

In terms of commercial volumes, our RCFs have now normalized which we've mentioned already. But we do expect still to see some growth in the government schemes as the cutoff date nears us as well. In terms of the 2021 consensus, look, I think we're all very well aware of those global macro events and lockdowns which are happening very quickly at the moment, and particularly in terms of the lockdown scenario.

It's now even harder to estimate the impact of factors, such as what these new lockdowns will do on the U.K. economy in 2021. But it's probably just worth reminding you of the things that we've already said. For 2021, we expect the full GBP 300 million impact of the high cost of credit review and associated regulations, a further GBP 400 million of disposal losses in NatWest markets and the reduction in NatWest markets income as we reduce the RWAs.

And I'll leave you to think about how those factors might impact on income. And certainly, the NIM fourth-quarter impacts will just roll through into the first quarter as well. Thanks Rohith.

Rohith Chandra-Rajan: Thank you.

Operator: Thank you. Your next question comes from the line of Jonathan Pierce from Numis. Please go ahead. Your line is open.

Jonathan Pierce: Yes. Good morning both.

Alison Rose: Good morning.

Jonathan Pierce: Actually, I did have just one question, but I may now make it two after the comments on income.

I appreciate that there is considerable uncertainty out there. But what I'm taking away from the answers about last question on income is you're maybe slightly less confident of hitting GBP 10.6 billion, GBP 10.7 billion revenue number next year than maybe you've sounded over the last few months. Is that – am I reading that language correctly?

Katie Murray: None of us have the clarity about what's coming next. So I think it's really best to roll back to what we know, and that's very much around the GBP 300 million, the disposal losses and the NatWest markets income as we reduce those RWAs.

Jonathan Pierce: OK. All right. On capital then, I mean, as we hope to get a bit closer to distributions being allowed on again, it'd be good to hear your latest thoughts on the mix of potential distributions and, in particular, whether you'd be – I

think two questions really within this. But firstly, whether you'd be prepared to declare an ordinary dividend despite what probably the statutory loss for this year? And also whether you'd be prepared to do a buyback in the absence of UKGI participation? So just some thoughts around the mix of distribution, the bigger things.

Alison Rose: Thanks, Jonathan. Well, let me start by saying– I'm very happy to have the strong capital ratios that we do at 18.2 percent. And I've been clear that it is my clear intent to start paying dividends as soon as possible. I think it's too early to make predictions about that and the shape and nature of them.

Clearly, the Bank of England will update their guidance in Q4, and then we would look to evaluate returning capital to shareholders which remains a core part of the strategy and something I want to resume as soon as possible. We have, in the past, said that we would look at a number of different options of how we would do that, but we'll evaluate that at the time.

Jonathan Pierce: OK, thank you.

Alison Rose: Thank you.

Operator: Thank you. Your next question comes from the line of Martin Leitgeb from Goldman Sachs. Please go ahead. Your line is open.

Martin Leitgeb: Yes. Good morning. Good morning from my side. Just two questions, please.

The first one on the potential for negative rates obviously given the various comments over the recent months and given I think the regulators' questions on whether banks are prepared for that. Could you just comment on whether NatWest Group is ready for negative rates? And if you think the market is ready?

And if negative rates were to come, what further levers would NatWest have to offset the adverse impact of negative rates? I think you mentioned in your earlier remarks that on the deposit side, we're pretty much there on the zero level at this stage.

And secondly, I was just wondering if you could shed a bit of light on how broad the strategic review is you're undertaking at Ulster Bank. I think in the report, you stated the current strategy is to grow that business.

Is that the right strategy at this time in – at this moment in time, just given how comparatively lower the profitability of larger banks is in Ireland at present? And are there any accruals you need to upstream some of the excess capital you're holding at Ulster in order to have that available at group level? Thank you.

Alison Rose: Great. Thanks for the question. Well, why don't I start with Ulster and then Katie can talk you through negative rates. So as we sit here today, the strategy for Ulster is unchanged.

And you've seen Jane and the team doing a good job in terms of continuing to safely grow that business and reduce costs. At this current time, our priority is supporting our customers and making sure that we support them during this period. But as you would expect, I am evaluating the impact of COVID and the challenges on the economy, and we're reviewing our strategy appropriately and responsibly in light of that. In the event of any changes being made to our strategy, these would be undertaken with full consideration of any impact on customer colleagues and shareholders.

We clearly have restrictions on dividends that are in place at the moment. So we are evaluating our positions, but no decisions that have been made, but we are carrying out to review. Katie, do you want to pick up the negative rates question?

Katie Murray: In terms of negative rates, we are ready to deal with negative rates as an organization given that that we've got negative rate experience in our RBSI and our Ulster business. So it's something that we're more familiar with.

In terms of the levers, if you look at the cost of funding just now, it's about 13 basis points within the retail business. We'll see that start to come down a little bit further next year, but you're absolutely right on the deposit side. I'd like to move in to the world of some of the actions you see our European

counterparts taking on negative rates, but there's not a lot of levers there. So it really becomes a question of making sure that you're absolutely looking after the core. And so I think some of the benefits that we've seen in the increased mortgage margins will help us.

It'll obviously come down a bit further, once you get into negative rates however, they're still very helpful. Martin, you didn't ask, but I'm sure somebody else would, so I'll just also give you the impact of the negative rates. When you look at what would the 25 basis point fall in the market consensus curve do, when we talked about that in December 2019, that was a GBP 280 million impact by year 3. What we would see is, if you saw that 25 basis point fall from the curve as it sits today, by year 3, that would get to about GBP 450 million impact on that.

And that number will obviously evolve a bit by year 3, depending on what happens on consumer behavior. The one thing I would remind you of though is in our economic consensus we don't have a negative base rate fall as our base case.

We still see that that's something to the downside.

Thanks, Martin.

Martin Leitgeb: Thank you very much.

Operator: Thank you. Your next question comes from the line of Andrew Coombs from Citi. Please go ahead. Your line is open.

Alison Rose: Hi, Andrew.

Andrew Coombs: Yes. Good morning.

First, if I could just ask you to revisit your guidance on NatWest markets disposal losses. You've obviously talked about the RWAs coming down faster than expected.

You reiterated the GBP 200 million for the full year. That still implies GBP 400 million for next year. So just wondering if that could potentially be lower

than you previously guided to. And then secondly, just coming back to this point on mortgage pricing, it's obviously a key focus.

I appreciate your comments about the stamp duty and what that might mean for supply beyond – or sorry, for demand beyond the end of March, but I think the pricing is also a function of supply. So perhaps, if you could just talk a bit about what you're seeing in the market there given the number of lenders have pulled back on particularly some of the higher LTV products, given the current uncertainty and whether you think some of those products will come back? Thanks.

Alison Rose: Thanks very much.

Why don't I pick up NatWest markets and Katie can talk you through the mortgage question. We're clearly making good progress on executing the NatWest markets plan, and we are ahead of schedule on the RWA reduction in terms of the GBP 32 billion by the end of 2020. RWAs at this point are around GBP 30 billion, and our intention is to be around GBP 20 billion by the end of next year.

Look, what I've always said is that we will be careful in terms of how we reduce the RWAs and we refocus that business. We will do that sensibly and carefully. We think the guidance we've given you on the GBP 600 million, the GBP 400 million next year is appropriate, but we will evaluate that as we go through. Clearly, there's more counterparty risk that we're looking at next year.

So I'm comfortable with the guidance, but we are obviously being sensible and careful to ensure that we get appropriate returns on any assets that we reduce. So I think that guidance remains the same.

Katie, do you want to pick up the mortgage question?

Katie Murray: Yes, sure. Absolutely. So if I look at it in terms of the mortgages, we were at 11 percent in terms of completion. A little bit lower than you would normally expect us to see, Andrew, but that's very much as a result of the decision that we took during July and August to not be offering 85 percent product.

We came back into that at the end of August. And you can see that coming through as our application levels were back up to sort of 15 percent by the end of August. So I think there is certainly a lot of demand out there. I think some of it is the post lockdown peak coming through and also the transaction taxes.

You can see that there is still a lot of supply to meet the demand. So when we look at it, we can see that we're benefiting from sort of strongest basis points in terms of the pricing. So for the quarter, we were 140 basis points, so back book and front book equally which is very pleasing to see. What was interesting, the application volume by the end of September was actually getting up to 160 basis points, so a slight strengthening of that.

And we can see that strengthening again as we look through the October numbers, up to about 180 basis points which is helpful to us. And we do think that that level of margin is probably relatively sustainable for Q4 and into Q1. But at that point, I think you'll start to see it move off because I think demand will fall and so therefore, you'll see greater price competition happening in the market. We've seen a tiny bit of that happen this week already with one of our peers taking some of their prices down the way.

So I think that's something we wanted to see.

Andrew Coombs: And just to be clear, when you say that level is sustainable into Q4. Do you mean the 160 basis points or the 180 that you had in October?

Katie Murray: I think what you have approved in one quarter is what comes onto the book the following quarter. If you think that a completion has a two to three month average cycle. So we were at 160 basis points in Q3 by the end, so that's the benefit you'll see coming into Q4. What we're seeing in October is that's gone up a little bit, in October, to about 180.

Some of those will complete at the very tail end of this quarter, and some of them will move more into completion in Q1. And then I think you'll start to see it coming through, coming down a little bit after that because I do think demand will fall and so therefore, you'll start to see a little bit market dynamic

going on, on pricing as well. But for the short-term piece, I think that that's helpful. Which is why we say for Q4, broadly flat, but some of those better ones will complete at the tail end of the quarter as well.

Andrew Coombs: So Q4 flat, Q1 up, Q2 potentially down the end?

Katie Murray: I'll leave you to draw your own conclusions on Q1 and Q2 because obviously, there's more other market dynamics that will be going on that stage as well in terms of customer activity. But I think we're all heading in the right direction.

Andrew Coombs: Right. Thanks very much.

Katie Murray: Thanks very much.

Operator: Thank you. Your next question comes from the line of Ed Firth from KBW. Please go ahead. Your line is open.

Alison Rose: Hi, Ed.

Ed Firth: Good morning everybody. Hi. Can I just ask you about risk-weighted assets? And in particular, not really so much focused on this year, particularly, but if you look at the group longer term, like 2021, '22, '23, what sort of risk-weighted asset level do you think you need to run the business that you envisage I guess is my question. Because it seems to me that – and just to give you the context.

I mean, you're looking at, what, about GBP 165 billion today. I mean, it's GBP 175 billion less to turn off for NatWest markets. And I get the procyclicality, it'll come. But by the end of the next year, it could have gone again.

So that's like a short-term thing. I mean, I can't really see where the growth is going to come from on that GBP 165 billion. So is that a sort of fair feeling? Fair analysis?

Alison Rose: Katie, do you want to go ahead?

Katie Murray: So as you look at it, you're absolutely right. We'll lose GBP 10 billion from NatWest markets which will pull you down. There's a couple of things that are coming toward us obviously in terms of inflation, Ed.

There's the mortgage floors which come in at 1st January 2022. We've always guided you that number as to GBP 10.5 billion. Our book is a little bit bigger. Procyclicality will probably pull a little bit of that in a little bit earlier than that.

So it'll be a number in that order, but the shape of it will move very slightly. And we'll talk more about that at the year-end. You've obviously got Basel 3 coming in. I think there's lots of opinions as to when it comes and how much it comes.

We've guided to 5 percent to 10 percent, and we guided you to the lower of that 5 percent. So that piece will come through. I'm not sure that you'd see procyclicality come up and disappear by the end of 2021, and I'd like to think that would be the case. But I think that would be a bit quick.

So I do think you'll see a bit of the procyclicality continuing into the years after that. But I don't think it's out to 2023.

When we look at our guidance that we had this year of GBP 185 billion to GBP 195 billion, we'd expect to be at the lower end of that. And what I would say is we think that it’s timing.

So we do expect pre-mortgage floors and pre-Basel, that we will see inflation coming through. And so that range is more pushed out rather than actually not there. And again, we'll talk to you in February about what our view is as to where the range might be for the end of 2021.

But it's definitely timing delay on procyclicality rather than anything else. I hope that helps.

Ed Firth: So where – very helpful, but just to clarify, so where the market's thinking around for 2021, you're not hugely uncomfortable with that based on what you

know today? And I know we've got a strategic review coming up, but just broadly speaking?

Katie Murray: Look, I mean, broadly speaking, I mean, I think it all depends on timing and customer behavior…

Ed Firth: Sure.

Katie Murray: But I'm not hugely uncomfortable with it. And we'll talk more about it when we get together in February.

Ed Firth: Great. Thanks very much.

Operator: Thank you. Your next question comes from the line of Guy Stebbings, Exane BNP Paribas. Please go ahead. Your line is open.

Alison Rose: Good morning, Guy.

Guy Stebbings: Good morning. Thanks for taking the question. Good morning. The first question was just on average interest-earning assets.

I think it was GBP 468 billion on average for the quarter, but presumably ended the quarter some way above that level, and you're talking to healthy mortgage volumes into Q4 or even into Q1 next year. So I just want to check, it's reasonable to assume that you'll be entering 2021 with probably something north of GBP 470 billion, conscious consensus is somewhere below that level? So I just want to check I'm not missing anything on that line.

Secondly, just on costs obviously a very good performance in Q3. And if we step back and look at the total savings out of the recent years, I mean, it's quite a staggering amount that's come out of the business. I guess, as analysts, we tend to like to see that.

But if I just play devil's advocate, I presume there must be some negatives that come alongside that in terms of the pressure in your particular business, especially in the current environment, staffing route, things like that or does it really not have any negative connotations having taken out that cost?

Alison Rose: OK. Why don't I pick up the cost question and Katie can pick up the first one. Look, we're pleased with the progress on costs, GBP 193 million lower for the first 9 months. And what we have been doing is continuing – I talk about in the business, good costs and bad costs.

So we continue doing – invest in the business and then very much as we are shaping the business around customer behavior, use of our new technology. That will change the experience for customers and colleagues. Actually, if you look at what the impact of that is on colleagues which was the sort of second part of your question, we've just completed our usual annual survey with staff, and we've been talking to them on a regular basis. Our staff engagement scores are the highest they've ever been.

In most cases, we're above the global financial norm in terms of staff engagements. We're investing also huge amount in our colleagues' experience in the same way that our customers are learning about new technology and new behavior. We're also investing in our colleagues. We have something that we call the NatWest Academy that I launched earlier this year which is investing in people's training, reskilling, development so that they can evolve their roles as well.

So I think the cost that is coming out is largely through customer journeys, through improving the experience. As our processes get better, as our customers benefit from using more digital tools, actually, our colleagues' experience gets better as well because there's much more automation, allowing them to spend time on more of the value-add aspects as well. So actually, we've seen engagement go up from that perspective. Katie?

Katie Murray: With interest-earning assets, it really will depend on the deposit flows that go through into the liquidity buffer. It will also depend a little bit on the amount of lending that happens in the next quarter as well. And I think I'll leave it up to you to think about what the systemic liquidity activity of the market might be on it and how that develops over the next quarter. Thanks Guy.

Guy Stebbings: OK. OK. Thanks. Can I just very quickly come back on the interest-earning assets? I mean most banks are talking to expectations on sort of healthy flows on the deposit side into Q4.

So it doesn't feel like that side of it should reverse enormously. Obviously, it's a bit harder to call out further into 2021 but it still feels like you're in a good shape into next year versus expectations.

Katie Murray: We're certainly in a very good shape in terms of liquidity, 157 percent LCR, GBP 10.1 billion of flows this quarter. I would say that was probably stronger than I think we would expect. And I think what we've got to think about which is the level of QE that's in the system, what you'll actually start to see as well, I think you have seen individual customer flows. Actually, they're going to flow around system until that QE starts to reverse.

So I would be aligning my view to those of other banks.

Guy Stebbings: OK. Thanks very much.

Katie Murray: Thanks Guy.

Operator: Thank you. Your next question comes from the line of Chris Cant from Autonomous. Please go ahead. Your line is open.

Alison Rose: Good morning, Chris.

Katie Murray: Good morning, Chris.

Chris Cant: Thank you for – good morning. Thank you for taking my question. Two, please. If I could just come back on Jonathan's question on 2021 consensus revenues.

And I also feel like you've sort of softened your commentary in terms of your level of comfort with where consensus is there. So if I park NatWest Market disposal losses to one side, given that that's a bit choppy, I understand consensus has in GBP 335 million of disposal losses for next year. So clean of that, the market's expecting just shy of GBP 11 billion of sort of BAU income, I suppose, ex the disposal losses.

If I look at your 3Q print, ex all of the notable items you call out and annualize it, I get GBP 10.9 billion.

And if I think about your regulatory change guidance, I'm guessing we don't have quite the full GBP 200 million drag in the 3Q run rate. So I should probably be knocking GBP 100 million, GBP 150 million off that to get to your GBP 300 million full impact by 2021 which would take you down to sub GBP 10.8 billion before we get into the debates around how volumes play off against structural hedge drag and all of that good stuff. It does feel like there's a little bit of a disconnect there. So could I again invite you to comment? I mean it feels like that there is a risk to the downside, unless you have very big mortgage volume support going into next year.

And on the mortgages, you've previously talked about 80 to 100 bps front book spreads being a mid-teens return, even factoring in pending mortgage risk weight floor changes. What do you think the ROEs on the business you're writing right now are? I guess, the view on the long-term cost of risk, cost allocations, the tax, broadly unchanged which would suggest a very meaningful improvement to maybe something more like 30 percent to 40 percent.

So if you could comment on that that would be appreciated. Just trying to understand how sustainable this pricing environment may be.

Thank you.

Katie Murray: Chris, thanks for that detailed question. And I think what I would say, it confirms to me that we have given you of the building blocks that you need to work out, the 2021 sort of income. So I mean, the GBP 300 million coming in, I would say that probably most of that GBP 200 million is in the Q3 run rate in terms of what's there, GBP 400 million NatWest disposal losses. I think it's important to think about what the RWA reduction is doing some NatWest markets' income as well.

So just make sure that you have a look at that. I think the NIM factors that we've talked about for 2020 are very much in there. So I think the customer

behavior that we have and what's happening in terms of government support, it feels that we're all a little bit in the right ballpark. We maybe suggest your number that you have a little bit more customer behavior to build in, in terms of that, but you've definitely got the building blocks in there for you to make your own conclusions on what happens.

Then if I just go on through mortgages. We talked about 80 to 100 basis points. And you'll remember that that was in relation to the new mortgage business.

And that would have been earning low teens. You can do the math as I can in terms of the ROEs that we're earning on there. I do think we need to think a little bit about the risk adjusting of that, but we have gone in very cautiously in terms of just opening up our 85 percent, just in August, to make sure that we are managing the risk appropriately. But the returns, they would be close to the bottom end of your range, so still very good quality returning products in terms of the ROE on mortgages and really helped by this significant increase that we're seeing in the blended rate of the 160 that we're ending at in Q3 and growing a little bit from there.

Chris Cant: OK, thank you very much.

Katie Murray: Thanks Chris.

Operator: Thank you. Your next question comes from the line of Robert Noble from Deutsche Bank. Please go ahead. Your line is open.

Alison Rose: Hi, Robert.

Robert Noble: Good morning. I just wanted to ask – good morning. What went into the decision to pull out of the 85 percent LTV market? And then what changed your mind to go back into it? Is it purely the prices in the market or was there some sort of change there, flipped between July and August that you pull out and get back in?

And then secondly, what proportion of the book is in the commercial loans is now guaranteed? And what's the duration of the debt that's not guaranteed?

And should expect the nonguaranteed stuff to start declining when all of these – when we get to the year-end and we're finally got a bit of the guarantees, assuming that they get extended?

Alison Rose: OK. Thank you.

Well, in terms of the government guarantee scheme, we have GBP 13 billion of lending that is out on the guarantee scheme. We've had GBP 2.9 billion increase this quarter.

So the bounce back loans are 100 percent guaranteed, and the CBILS loans are 80 percent guaranteed. And obviously, there are some changes that have been announced to those schemes at the moment in terms of how customers can interact on those going forward. So I think that's the nature of those schemes. Obviously, the customers are 100 percent liable for those loans.

Those are loans that the customers pay that the guarantee obviously sits against our side. On the mortgage question, in terms of our decisions around the 85 percent, clearly, at the start of the crisis and the pandemic, we took a very clear decision around how we were both supporting customers, but also protecting the business as well. We felt it was appropriate to tighten our risk appetite in certain areas, and that was really the decision we made at that time to make sure we were taking a very balanced risk process. We felt comfortable going back into that, but we will always evaluate every decision we make on mortgages with our mortgage underwriters, really looking at affordability.

We were comfortable going back into that market. We felt there was more uncertainty in terms of the outlook, but we were maintaining our strong risk appetite standards and approach to doing that. So that gives you a sense of the decision-making which is always been very risk based.

Robert Noble: Thank you very much.

Alison Rose: Thank you.

Katie Murray: Thanks Robert.

Operator: Thank you. We will now take a question from the webcast.

Male: Thanks very much. Our question comes from Raul Sinha of J.P. Morgan.

There's two parts to this question. The first part asks, could you discuss the retail banking NII which is down 4 percent in Q3 versus Q2? It looks like it's driven by lower income on deposits. Could you discuss the moving parts here?

And for question two, income from U.K. mortgages improved 4 percent in quarter three versus quarter two. Does this fully capture the improved pricing and volume trends in the market or should we expect further acceleration from here?

Alison Rose: So look, the main impact on retail NII in Q3 is the lower yield curve on deposits. Looking forward, a bit of help from slightly lower customer funding rates a full quarter of overdrafts and no repeat a big fall on deposits in Q3, but a little pressure.

Katie Murray: And I would just say, Alison, an answer to the second part of that question in terms of the U.K. mortgages improving 4 percent, no, that doesn't fully capture the improved pricing. So if you think about it, as you approve a mortgage, it's two to three months before it comes on to the books. So therefore a lot of what will be coming on at the beginning of Q3 would have been things that have been approved in Q2.

So we had basically 140 basis points coming on. Our application volumes at the end of the quarter are up there at 160 basis points. So you should see more of that coming through into Q4. And then it will just depend where we actually land on completions from there.

Thanks, Rohith.

Operator: Thank you.

Your next question comes from the line of John Cronin from Goodbody. Please go ahead. Your line is open.

Alison Rose: Good morning, John.

John Cronin: Hi there and thanks for taking my questions. And look, coming back to Chris' question on mortgage price and sustainability. You've talked a bit about the potential impact of demand reduction in early 2021 and just touched on supply. I guess, I'm just a bit more interested from a supply perspective in how you think about that in the context of your own products' royalties currently, your own flow share ambitions or stock share ambitions over the medium term.

And whether or not you think spreads could end up back to where they were pre-COVID pretty quickly, given wider sectoral capital and liquidity strength. So any comments on that would be helpful. And then secondly, look, just I'll have another go on the Ulster Bank one. What degree of rightsizing do you need to see in terms of the capital base to deliver a return that was I guess support retention in the context of the strategic review? And in the event, you don't want to be drawn on particular numbers there, I mean, how big a factor is that in the decision-making process? Thank you.

Alison Rose: Thanks very much. Well, look, I'll get Katie to pick up the mortgage question. On Ulster, I mean, our CET1 ratio in Ulster is currently 28.5 percent. Clearly, we've been working very hard with that business.

And as you know, my strategy is very much focused around ensuring we apply strong capital discipline in terms of where we're allocating our capital to make sure that we're driving the right balance of returns for shareholders overall, as well as supporting customers. With the outlook of COVID and the economic uncertainty, as you would expect, I am considering and evaluating the impacts of that on the business, and we're reviewing our strategy appropriately and also responsibly. Right now, the most important thing is we're focusing on supporting our customers in Ireland. These are very challenging times, clearly.

And any changes that I make, I'm going do with a very full consideration of all of our stakeholders. So that probably gives you a sense of how we're

looking at that business. No decisions have been made. We're carrying out a review, and we'll obviously consult with all stakeholders in due course.

Katie?

Katie Murray: Sure. Thanks, Alison.

So as we look at mortgages and the sustainability, it feels that these prices, as said, will be sustainable for the next couple of quarters just given the demand. We're continuing to grow the book.

We're at 14 percent application volume over the year, and that's cooled down by our decision to come out of the LTV at 85 percent which we've talked about already. We're at 15 percent by the end of the quarter. So comfortable that we'll still see growth. Our stock share has grown in the year from 10.1 percent to 10.6 percent.

That 50 basis points doesn't feel like a big number, but that's a lot of mortgages given the size of the market. So we've seen good growth. We'd expect 15 percent application volumes that you continue to see good growth. The thing in terms of spreads going back down to where they were pre-COVID, I think the really important thing about pre-COVID obviously John, is that that was when rates were still at 75 basis points in terms of the bank base rate.

And actually, what happened is that they fell and we didn't pass that through. I think given where the base rate is, it would be highly unlikely that we would go into pricing that would take us back down to those levels of spreads, just given the challenges that we have elsewhere. So we feel that if it went back down to a front-to-back being equal, then that feels more appropriate. So that's 140 basis points.

But I would probably guide you not to take that as a hard prediction because there's going to be so much customer dynamics, market dynamics that will happen, but it certainly doesn't feel that we'll go back to pre-COVID levels. Thanks John.

John Cronin: OK, thank you.

Katie Murray: Thank you.

Operator: Thank you. Your next question comes from the line of Joseph Dickerson from Jefferies. Please go ahead. Your line is open.

Alison Rose: Hi, Joe.

Joseph Dickerson: Hi, good morning. Good morning. Just a couple of questions.

I don't need the crystal ball on consensus, but some more I guess longer-range strategic questions which is you've got this huge amount of excess capital, and you're generating more.

We all know you want to return it. But I – the one thing 2020 has done is make us all think differently and adapt and then look forward in different ways. So in that context, how do things like M&A figure into your thought process for the future? I'm not talking something transformational. But generally speaking, you have a lot of capital.

You could do a lot of interesting things, and you have a fair amount of operational expertise following the various restructurings you've done and the cost take up. So any thoughts there would be useful. Secondly, one of your competitors said yesterday, there were nascent signals of a structural shift in mortgage demand, in addition to what you're seeing in terms of the demand related to the stamp duty changes. It sounds like you're not quite seeing those nascent signals.

If you could just comment on that that would be helpful too. Thank you.

Alison Rose: Thanks.

In terms of capital, clearly, I'm very comfortable with the strong capital that we have in the business and the business that continues to generate capital. And I think that gives us the flexibility, both to navigate the uncertain outlook, as I've said. But also, my priority is to resume dividend payments as soon as possible.

We will consider other options that offer compelling shareholder value. You've seen in the past, for example, we've made an acquisition such as Free Agent which offers free accounting services and is – to our business and commercial customers which has been very successful. We're also increasingly looking at innovation and partnerships, things such as Tyl which was our reentry into merchant acquiring was done in partnership with innovative and fintech partners as with Esme with Israeli companies. And we recently announced an agreement with BlackRock to support the changes we've made.

So we will look at all options that we think will add shareholder value at this point. I think having the flexibility to navigate the uncertain environment, but my clear intent is to return to paying dividends as soon as possible. And we've given you an indication of our target CET1 of 13 percent to 14 percent over time. So we will consider that.

On your point on mortgages, and Katie has covered that in quite a lot of detail, this continues to be a very attractive area for us, and we have capacity to grow in this space. As you're aware, in relation to our stock share and our mortgage flow, share has averaged 14 percent for the last 9 months. We definitely think the change in stamp duty has acted as a stimulus to demand. But we think that that market continues to remain attractive and one that we will grow.

Katie Murray: I think that's fair, Alison. I don't really think there's anything more to add where mortgage applications are going well, and they continue to increase at the moment I think really as a result of that stimulus. And the challenge is the nascent things they can think about to actually work through to the real data. So nothing really to add.

Alison Rose: Thank you.

Joseph Dickerson: Thank you.

Katie Murray: Thanks, Joe.

Operator: Thank you. Your next question comes from the line of Jason Napier, UBS. Please go ahead. Your line is open.

Alison Rose: Good morning, Jason.

Jason Napier: Good morning. Thank you for taking my question. I really only have one. And I appreciate that it's an area of huge uncertainty, and that's really around loan losses.

Consensus for next year is running at nearly 10 times what you've just printed in the third quarter. And clearly, Stage 2 and Stage 3 balances in pound terms were actually down sort of stunningly, but you're not the only one in the industry to have shown that sort of performance at present. I wonder whether you could talk a little bit about the sort of stress testing and intelligence that the Board suggest when it thinks about the outlook from a credit quality standpoint.

We all understand the uncertainties around vaccines and Brexit and what have you, but there must be a vast amount of material that you're considering when you think about how the business might fare going forward, and that'll obviously feed through to dividend and buyback questions as well.

So I wonder what color you could provide on how you think about the potential range of outcomes on a 12 to 18-month view. Thanks.

Katie Murray: Jason, I'll give you a little bit of color. And then, Alison and I will give you more views on it when we get together in February which will be benefiting from four or five months more of activity of real data as well. We as a bank have always talked about this 30 to 40 basis points of through the cycle coverage. Now you need to take your own views in terms of where we are in that cycle, but we still think that that guidance is quite valid in terms of trying to work at how we work our way through that.

We do think that procyclicality will come. I mean, you're incredibly familiar with the standard as well. It's meant to be forward-looking. So in theory, we've built a lot of that in.

And it really is what we're waiting for is the actual default to move so that you can see the Stage 2 to Stage 3 migration coming through. And I think the government protection has done a lot to sort of delay that piece. One of the things we get asked a lot about is in terms of how do we compare to some of the stress testing and the comments the Bank of England have done. And if I look at some of the Bank of England desktop exercises, I think what we – quite notable in there is that that didn't envisage the scale or the impact of the government schemes that we've seen so far, and that's where we're all really in quite uncharted territory.

But I think what gives us comfort is the level of deposits that we can see happening, we can see people coming off payment holidays. Those are all really important activities. While we do see moves in our heightened monitoring, it's not significant enough to drive anything, other than a small amount of sort of GBP 0.9 billion or procyclicality we saw in Q3. So there's a lot of data there to what's actually happening on the ground and in the numbers.

Risks are not migrating. So I think we're waiting for that. But I would pull you to the 30 to 40 basis points through the cycle, and we can all debate privately about where we think the cycle might be. And I'm probably not going to be drawn on my own views on that.

I think it's good guidance in terms for you to work through what 2021 and '22 might look like. Thanks, Jason.

Jason Napier: Thank you. Can I – just as a follow-up to that point, given the intelligence you have around all of the commercial customers that you have, is it your sense that they're in a period of drawing down on liquidity? Is their health deteriorating over time and it's really about how long can you sort of tread water? Because at the high level, stats across balance sheets within the banking sector just keep getting stronger. Liquidity keeps growing, risk keeps ebbing away. So I just wonder whether you can share any sense as to whether the customers are at sort of par or whether things are getting weaker on an underlying basis, given all the conversations you'll be having with those customers.

Alison Rose: Yes. And look, we spent a lot of time talking to our customers. As Katie said, when you look at the level of support that's been put in place, it is really providing a strong buffer for particularly businesses and customers to navigate through this period. And they're also pivoting their own business model.

My team and myself spend a lot of time talking to customers up and down the country. It is clear that in some of the initial measures where people took payment holidays, they were doing certain constraints, and I covered a few in my presentation of the shift where people are normalizing I think an interesting element on particularly revolving credit facility utilization that peaked at 40 percent. That's now down at 26 percent. That's pre-COVID levels.

So I think businesses are well capitalized. We have a lot of deposits on our balance sheet. But it is a very uncertain environment. And I would say when we talk to commercial and SME customers, that uncertainty is very stressful and very difficult.

Some of the research and some of the conversations that we've had, just to share with you, 71 percent of smaller businesses have reported a drop in demand during this period. And 30 percent of SME think COVID will impact their business for more than six months. So the uncertain outlook is definitely weighing on them. And I think reality is in these economic circumstances, not all companies will survive.

There's been a lot of support measures being put in place. I think what you will see over the coming months, sort of in May, around 1 million bounce back loan customers are due to start repaying their loans and I think then you'll get some degree of indication of what the underlying issues are. But right now, I would echo my comments I made that at the moment, we're seeing a lot of resilience, but ongoing uncertainty is something I would sound a notion of caution on for businesses as they try and navigate through this.

Jason Napier: Thank you very much.

Katie Murray: Thanks, Jason.

Operator: Thank you. Your next question comes from the line of Aman Rakkar from Barclays. Please go ahead. Your line is open.

Katie Murray: Hi, Aman.

Aman Rakkar: Good morning, Alison. Good morning, Katie. Good morning. Just two questions, actually.

Firstly, on net interest income. So the outperformance in the quarter versus expectations looks to have been driven by central. And from your earlier comments, it looks like that was probably driven by excess liquidity. I was just – probably for Katie, is this a run rate for central while you do have this elevated liquidity position or is there something kind of volatile and one-off in that division that we should call out? The second was on costs.

Can you just help me understand the kind of – they were clearly really strong in Q3, but you stuck with the guidance for full year. So I know that the bank levy is going to be a touch higher year on year. But I think you're still basically guiding for GBP 100 million Q-on-Q step-up in costs in Q4. So can you just help us understand exactly why it was so low in Q3 and perhaps what was coming back into the cost base in Q4?

Alison Rose: Sure. So let me pick up the cost question. So you'll recall at the half year, I said, I would be rephasing our costs, and they would be largely back-ended as we responded to COVID. And obviously, we were spending more money in terms of things like standing up the government schemes, the bounce back loan scheme, for example, and necessarily, as we pivoted the business to make sure that we could respond to support customers.

I think what you've seen in Q3 is the strong performance in terms of our cost delivery, costs GBP 193 million lower for the first 9 months of 2019. And our plans have not changed. So we are continuing to execute on our cost plans. I naturally had to rephase them to deal with the COVID situation, but we remain on track for the GBP 250 million cost-out that I committed to in February this year.

So I think I'm comfortable with that guidance, and you've seen a stronger performance in Q3. Katie, do you want to pick up?

Katie Murray: Yes. On NII, and you see it very much on Slide 13, that kind of GBP 80 million that's there in the central piece. Look, it's not a continuing trend.

It really is a question of timing in terms of the rates are falling and the timing of which we adjust our internal transfer funding. It meant that we ended up with a greater benefit in the center. That will have resolved itself, and you'll see the center go back to its usual levels as we move forward from there, Aman. So I wouldn't get distracted by it, particularly.

Thanks, Aman.

Aman Rakkar: OK, cool. Just on the cost there, one quick follow-up then. Are you able to give us a sense of what the temporary COVID-related costs that you're currently incurring in the cost base 9 months to date? Are you able to quantify that? It might just help us understand what might naturally slip out the cost base next year if things normalize.

Katie Murray: I could give you a number for that, but I'm going to be slightly unhelpful and not. The reason for that is because we've got some additional costs of COVID. I think one of my personal favorite stats is we've delivered 11,000 chairs to our staff across the country, and we've done desktop setups and all sorts of things like that. But there's also other costs that we haven't incurred for instance we normally have a relatively significant travel budget.

That's completely gone away this year. That's something that would kind of come back up. So I think it's important not to get too distracted because actually, those sorts of things all sort themselves out in the round in terms of where we are. What we had said at the beginning of the year is our cost takeout would be more back-ended, and that's what – that's very much what we're seeing just now.

And we're kind of comfortable with the guidance we're giving you for the year.

Aman Rakkar: OK, thank you.

Katie Murray: Thanks, Aman.

Alison Rose: Thank you.

Operator: Thank you. Your next question comes from the line of Fahed Kunwar from Redburn. Please go ahead. Your line is open.

Alison Rose: Good morning, Fahed.

Fahed Kunwar: Hi – morning. Good morning.

Thanks for taking the question. Just one really quick follow-up.

On the retail review, how much is incrementally left now of the GBP 300 million going forward in 4Q and 2021? That's one building block question. Then a couple of just strategic questions. Alison, you mentioned looking at things inorganically. Everything you mentioned seems to be on the non-interest income side or merchant services and kind of accounting services as well.

If you were to look – as you look at potential M&A, is there a cap on how big you would look? And is there anything – would you sort of think about the net interest income as well as non-interest income or is the focus purely non-interest income? That was question one. And question two is on the loan guarantee scheme, you talked about the bounce back loan being paid back in May.

Can I ask, like how does it actually work? And so do you – if people don't pay back, do you then incur the loss and go to the government and ask for the money back? How does that transfer work with the government on those bounce-back and see the loans – when – if and when you start incurring losses on those? Thank you.

Alison Rose: Great. Thank you. Right. Well, let me take the first question in terms of inorganic growth.

And what I would say to you is, actually, we have more potential to grow organically our business. So that remains my first priority. And particularly, I think there are opportunities where we can grow our business. You can see in our retail business with our share of mortgages and our stock share, that we have capacity to grow, and that remains attractive.

We have very strong franchises in retail, commercial and private. So leveraging those relationships remains a significant opportunity for us. In particular, you know that we have a very low share in unsecured. I think at the appropriate time, that is an area that remains attractive.

In commercial banking, things like Tyl and Payit are more fee-based businesses. That allows us to grow those businesses and benefit from the innovation that we've made. And bringing together premier and private which I announced in August under Peter Flavel and the strength we have in our asset management and wealth business and extending that across the group I think is an area of growth. And the refocus of NatWest markets allows us to unlock the strength of our FX and financing business more to areas of the business.

So I would say in terms of as we grow our business and the opportunity to grow revenues and fees, those exist within our existing business, our focus is on making sure that we remain safe and secure. And then my priority is to return capital to shareholders as soon as possible and as appropriate. So I think that would be where I would address that. On the government schemes obviously there have been a number of changes that have been announced, and we're talking to our customers to that.

But essentially, the way that the scheme works, under the bounce back loan scheme, as I mentioned just earlier, of which we have, at Q3, GBP 7.1 billion in bounce back loans, that benefits from 100 percent guarantee. In – when customers start repaying that loan, they have an extended period to repay. If they are unable to pay and then go into default, we would look to work with the customer to collect back from them in terms of seeing where they are. And in the event that they are unable to pay, then we go to the government and claim on the guarantee.

So the guarantee, as you know, is for the bank. On the bounce back loans, it's 100 percent. On the CBILS loan, it is for 80 percent. So that is how those schemes work.

Clearly, we're working very closely to make sure that we work in a sympathetic and supportive way with our customers to help them navigate through this period. Katie, did you want to pick up the first question?

Katie Murray: Yes. So basically, if you look at the third quarter, the GBP 200 million is, in essence, in there because various activities have kind of come through. So you've got an extra GBP 100 million further that will come into next year.

I think that the third-party market dynamics are going to be important in terms of customer activity, but what we've had in terms of that third quarter this year is a pretty good run rate of the GBP 200 million all being through. And then if you just consider an additional 100 into next year. Thanks Fahed.

Operator: Thank you. Our final question today comes from the webcast. The question comes from Robin Down of HSBC. It says, thank you for the comments on mortgage pricing. But can I ask some additional detail? There's three parts to this question.

The first, NatWest has pushed mortgage pricing up in recent weeks. Could you give us an indication of front book spreads and applications in October? The second part, you talk about back book spread of 140 basis points, but presumably, this indicates a relatively stable SBR component.

Would a more reasonable estimate of customers who are transferring internally on to new fixed-rate mortgages be close to 110 to 120 basis points? And for the final part, can you give us any indication of how quickly the book is rolling over gross lending/internal transfers? The industry average is 3.5 to four years. Is that a reasonable estimate for NatWest Group? Thank you.

Katie Murray: Hi. Morning, Robin, I'll take this.

So just in order of your questions.

The front book and back book gap has closed. So that's 140 basis points. Then what I've said to you in terms of your indication on your front book mortgage spreads. In October, we talked about that being around 180 at that point.

So an improvement again, on application. And remember that will then complete a little bit later. In terms of the estimate of the loans in the book, we did about 54 percent two year, about 46 percent five year and just this last quarter, those numbers moved around a bit. But basically, what that gets us through is the group repricing every three years in terms of that – of the repricing of the book.

I just want to be clear on your second point, so I'm just rereading your question, where you say whether a more reasonable estimate of customers who are transferring internally onto a new fixed-rate mortgage be closer to 110 to 120 basis points. So I'd work with a blended rate. That number certainly feels a bit low. So we're blending at 140 for the quarter, and you'll see that improve a little bit as we get to the application rates.

Hope that helps, Robin. Thanks very much.

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

Alison Rose: Thank you very much. Well, thank you very much for your time and your questions. Hopefully, what you've seen today is an underlying very resilient performance. I think these results demonstrate the bank's resilient performance in the face of significant and ongoing uncertainty.

We've been working very hard, not just to support our customers and to help them navigate through this crisis, but the bank remains in a safe and secure position. We're comfortable with the risk diversification on our book and also confident that we have capacity to grow with the investments that we have made in the business.

We continue to benefit from sector-leading capital strength. And our strategy remains the right one as we continue to deliver against our promise and ensure

that we're driving to sustainable returns, but importantly, supporting customers and protecting the business during these times.

Thank you very much.

Operator: Ladies and gentlemen, that will conclude today's call. Thank you for the participation. You may now disconnect.

END