NatWest Group plc
Q4 2023 Sell-Side Update Transcript
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Claire Good morning, everyone. Thank you very much for making it in early Monday morning straight after our results. So we thought, given we only spoke on Friday, that we'd go straight to Q&A. So off you go, Guy.

Guy Thank you. Sorry for my technical incompetence on Friday.

Katie Sorry, we missed you.

Guy So on Friday, you talked to growth in the second half of 2024 and the first half for total income. I mean, given the timing and quantum of rate assumptions the plan is based off, it seems to imply incredibly strong sort of underlying ex-policy rate move dynamics working through.

Can I just check that is what you meant, what you expect? And in order to deliver that, I guess if you assume some volume growth, some other opportunity growth, it doesn't preclude NIM falling sequentially during the year, but it would have to be pretty negligible to get there. So can I check that sort of broad thinking appropriate, which does imply very strong, I have to say, sort of underlying dynamics ex those policy rate moves?

Katie So I think, well, a couple of dynamics that we're expecting. So rates, you're absolutely right, start in May.

Time will tell whether, you know, how we've got that one, whether it's May, June, it's not going to make huge differences in terms of just one difference on the rate cut. So what we're expecting to see is on terms of deposits is the kind of stabilisation of that movement through into term. I would say that in Private we've largely seen that already.

And so that's kind of, it's already kind of happened. Commercial, it's a bit harder to see because we also manage those rates much more in terms of where they are, which is why you sort of saw that fall off. So it's really the story is about Retail.

And we've seen that kind of slow down in the fourth quarter. And then we sort of see that trend kind of continuing into the first quarter, accepting that January is quite difficult because you have all these tax payments that come in and out. So to actually really see what's kind of happening, it messes up, but nonetheless, kind of slowing down in that piece.

Mortgages then also sort of stabilising, which you'd expect given they're at about 80 basis points already, there would have to be something very dramatic to really change the total value of the book in that space. And then what we see is that kind of a better half in the second of the year as a result of many of those dynamics coming through.

You don't look like I've answered your question though.

Guy No, I do. It's just to really get a sense because I mean, to offset those policy rate headwinds, it really does suggest that there's some very strong underlying momentum, if you like. Obviously, the structural hedge, I take the point that we should be there with mortgages probably by the second quarter.

Hopefully, we're there in terms of deposit mix. In terms of that underlying dynamic, I just want to get a sense, are we really confident NIM can be stable even with five policy rate cuts with most of that hit coming in the second half of the year?

Katie Yeah, so I guess I'm not guiding on NIM. So, but what I mean, I guess what I am thinking of is income as it kind of does, it goes down and then it recovers. So the second half is stronger than the first half. I'm not sure that I'm expecting it to be quite as dramatic as your question maybe suggests. So it is stronger in the second half and it continues to improve into 2025 and 2026.

Guy Okay, thank you.

Aman Thanks. Related to that, but maybe more beyond the second half and linking it to your 13% target in 2026, a possible explanation is deposit balances and deposit mix and structural hedge.

Can you maybe talk through what your expectations are around deposit balances, sort of the reduction you've already pulled down in Q1? Can we get any substantial growth? And are you baking in after the structural hedge falls down to 170 with all the caveats that you made, are you expecting that to grow back up to mix improve over the three-year targets?

Katie I guess what we're expecting is we start to see that stabilisation. So we know where we are just now at 185, a fifth of it will roll off this year. So… it will go to 170 if you took that maths.

And then a fifth would roll off the net following year. But at that point, because of the stabilisation, I'd expect it to be almost fully invested. If you were then to see some growth in deposits, normally what you expect is deposits come down in the first quarter and then there's a kind of a gentle recovery.

That's what we've seen in the market over time. I would say if I looked at retail last year, they started at 188 and they ended at 188.4. That might even be the other way around, I can't quite remember. But whatever, it was pretty flat…

So I think what's interesting as we now move through is does that history hold? Because we do still know that people's balance sheets are still stronger than they were because of the COVID savings and things like that. But I think we'll move in line with whatever market does. But that stabilisation, so you get that full reinvestment of the hedge, is the thing that's important.

And then this year we've said 310 level of investment. Given what we're seeing on rates, I wouldn't expect that 310 to be so much lower as you went into the later years. But the reinvestment rate – sorry, the roll-off

rate has stepped down as well. So you still get that kind of benefit coming through.

Aman But you're not expecting any material growth?

Katie I mean, no. I think – so I'm not expecting the market to materially grow. So you can see what M4 is doing. That is improving. But remember, we'll manage those balances very much for liquidity and for value.

So I think we'll – but it's not – there won't actually be some growth because history has always said that there has been. But then given our 12-month lookback, obviously that will roll in slightly lower.

Aman I'm thinking more of a 13% RoTE in 2026. Maybe one possible thing we're missing is…

Katie Yeah. So I mean, there would certainly be – you'd expect there to be some growth because income is clearly growing. And it has the benefit of the yield variance on the hedge. But it's also kind of what balances are doing. But we're kind of – we're expecting us to move in line with market. So M4 is our guide for on C&I. So you can do the estimates on there and there's plenty of projections around what's happened in Retail.

Aman Thank you.

Katie Morning [inaudible]

Aman Thanks, morning. Similar topics, actually, that shift too. So the retail deposit outflows in Q1 – in fact, those Q1 last year, the outflows were very big. So I wonder if you could help us scale what you think the outflows might look like?

Katie It's really hard. So our outflows were big last year. There were lots of different things going on. You remember it was 11 billion, of which 8 billion was tax, which is – and 3 billion was kind of other things as well. What's been quite interesting as we look at the tax payments, they're not so different from last year, which has surprised me because I would have expected them to be bigger if you think of all of the narrative that's come out of the revenue about the number of additional tax returns that have come in and the sort of greater sort of tax payments that people have seen. So they're not so different.

I think there are some other differences, though, for ourselves in terms of our suite of products that we have within the retail space. So I don't want to get called in too much into the Q1 number, but at this stage, I'm not expecting this to be quite the drop-off that we saw last Q1, but I think that's also connected to other factors that we had going on in Q1 last year, like if you think we only launched our term deposit account in Q1 in mid-January last year.

Rohith So we're projecting this year.

Katie It's a different kind of place that we're in. So I think the tax numbers are still significant, but we need a quarter to go through. But what's been really interesting is they have not been as big as they were – sorry, not been bigger than they were last year. They're very much in line. What we have seen is people pay a little bit more out of their investment accounts. So if you think the wealthy people pay more tax, so we have seen in Coutts that there is a flow-through of people paying direct from the investment account. So it doesn't come out of their deposits. It's coming out of the other side.

Rohith Okay, thanks. And then the corporate, management of the corporate and institutional deposit, you flagged that was going on in December, I think.

Katie Yeah.

Rohith Does that continue into this year, or is that…

Katie So in December, we're always very mindful to manage to make sure that we're not paying bank levy on things that we don't want to pay bank levy on, so that aren't valuable to us in the longer term, while they might be valuable in the short term. You will see that kind of continue. We'll continue to manage it actively. I wouldn't read into that that that means the balance will reduce.

Rohith Okay. And then linked to all of that, and you touched on it a bit on Friday, just the downsizing of the hedge. There's obviously, I guess, because you've had to downsize it quite a lot, and you've had to manage the duration, there's been some feathering, which impacts the yield on the hedge.

Katie Yes, absolutely.

Rohith How much more, if you will, now reduce it from 185 to 170?

Katie You'll see a bit more feathering coming through.

Rohith So how should we think about the yield…

Katie So I would think about the yield shrinking quite significantly over 24 of the roll-off yield.

Rohith Maturing yield.

Katie Yeah, the maturing yield shrinking quite significantly over 24 and 25.

Rohith Okay, but when we – I guess when we think about this half-two, strong and half-one revenues, is the hedge having a maturing impact there?

Katie When you look at the 12-month rollback, it's certainly the hedge that's helping us have the second half being slightly stronger than the first half in terms of their part of that. And our hedge is not so lumpy, so I guess the feathering has a flow-through on that, but it comes to stabilisation. So if you think of how much I'll reinvest in the first half, it's going to be lower than I'll reinvest in the second half because of that 12-month lookback.

Rohith Thank you.

Jonathan I'll ask a couple of questions on the balance sheet. The first is, back on this cash flow hedge point, there's obviously a 1.9 billion negative in there at the moment, but I'm assuming, given the shape of the curve, that by the time we get a couple of years out, we're going to have a block of hedges that have been written more recently that are above water. And the stuff that's causing this negative at the moment is probably closer to maturity than those other pieces. So I think in the past, there's been a tendency for ease just to amortise it over four or five years.

But is it right to suggest that what we'll see if the yield curve holds where we are today, the cash flow hedge reserve negative dropping appreciably over maybe two years, possibly turning positive in 2026 before then pulling back to par in the later years? So that's the first question, how quickly will this 1.9 billion amortise? I'm assuming it's probably two years rather than five.

The second question is on the DTA. There's quite a big increase in the DTA, a big top-up in the fourth quarter. It looked to me as though it was to do with the five-year recovery plan and RBS being rolled forward another year. Is that something we're potentially going to see moving forward as you continue to add another year on?

Katie Yeah.

Jonathan Because it was quite big.

Katie It was quite big. And you're absolutely right. It was mainly in Royal Bank of Scotland. So I think there's a couple of things within there. And Donal, I'll give you the one on the cash flow hedge. Shame not to use you as you're here.

So we did a bit of a kind of re-examination of where those positions were, what that balance sheet was shaped like. So that probably caused a little bit of a catch-up in this year. I would expect each year – we do over seven years. So each year, you get a new seventh year coming in. So as long as our view next year for their plan is still pretty profitable, you'd see another bit coming in. But I'd expect it to be smaller next year because we did a little bit of analysis of that.

I think the one that's quite interesting – and sorry, just to close that out. So Royal Bank of Scotland now, if I look at the level of DTAs that they've still got left that we haven't recognised, they are much lower. I think we do – did we publish that?

Claire No.

Katie No, so I do know the numbers. But they're much smaller in terms of what's still accessible for us there. And you have to go back to when we had to do all the ring fencing and we moved all the companies around. What happens is the DTAs stick with the legal entity that they're in. They don't move.

So then you go, well, that must mean, Katie, you've got an awful lot of DTAs in what was your old Royal Bank of Scotland, which is now NatWest Markets. So now that NatWest Markets have got kind of a glimmer that they're going to start to become positive, you might start to see us in a couple of years start to recognise some of their DTA numbers. But they're always going to be smaller because that entity in itself is smaller generating.

But that's where most of my DTAs now sit. There's still a bit left in RBS. That will come through over the next couple of years, a little bit each

year I would hope for, as long as our profitability kind of stays on the same sort of trajectory.

And then the NatWest Markets piece will be the next kind of DTA within there. And there was also, we changed, there was some movement going on with one of the tax provisions that we had as well.

Jonathan But it could potentially be a couple of hundred million, could it, a year for the next couple of years as well?

Katie I don't think it would be as much as that a year is what I'm trying to say. So I think that would be a bit less, but it would be the next couple of years, but it would be a little bit less, the number would be lower than that. Just because of what we've got left. And you're only adding on, if you look at Royal Bank of Scotland for an extra year of their profitability, it's not, you've already terminal valued it this year. So you have a bit of a benefit of that, but it's in and of itself not so profitable that it would be that at that level.

Donal Cashflow hedge reserve. So a number of things that I'd probably lay out is one is what actually makes up that reserve. So it's obviously our externally executed derivatives. It's not just the structural product hedge, the five-year, it's also the equity hedge in there, which in effect has 10-year swaps that will obviously be a longer decay and will obviously take a while to roll down as well. And then there's also some pain that we would have for one-year, two-year fixed rate liabilities that would be hedging too.

So I think a lot of it will be driven by how that evolves and the extent of the external hedges that are put in over the next year or two. But I think what you're saying is over a 24-month period, given if you did see a kind of a continued fall in rates and a decay, you could see kind of a decent similar move that we saw, if not more, in Q4. Probably one thing to point out though is given the backup, the big move you saw in Q4 is really rates driven as opposed to decay. And you've seen pretty much a 50% reversal of that in Q1 alone with swap rates back up, five-year swap rates back up above 4%. So I wouldn't assume that it's kind of a

straight line. It will be primarily probably driven by what swap rates do with the benefit of decay obviously that comes through.

Jonathan Is your expectation though if the base rate does drop down to the 3% level you're assuming at the end of next year, then this cash flow hedge reserve negative would have completely gone in 2026?

Donal By the end of '26. I suppose it probably linked into what kind of yield do I expect on the reinvestment of the hedge over that period. And I think what you're saying there is probably not too far away from what we would have modelled.

Katie But I mean it is Jonathan quarter to quarter. It is staggering how much it moves and frustratingly so in terms of the valuation of it. I think having seen so much roll off at the end of the year to see so much come back on again by the end of January because of those swap movements.

Jonathan It's just significant TNAV tailwinds coming from a number of sources. And when you look at consensus TNAV at the end of '26, it looks very low.

Katie Yeah. And I think that's one of the things we talked about on Friday as well. Chris, as you've just taken a whistle, sorry. You timed that badly.

Chris I timed that perfectly. Apologies. I just wanted to ask on DTAs actually.

Katie Yeah.

Chris So you've done something with NatWest markets in terms of the transfer pricing arrangement?

Katie We've done a profit share arrangement with them, yeah.

Chris So that's going to be persistent?

Katie It will be. It went through in Q4. But what I would hope, we haven't quite got the accounting to work out yet, that it would go through quarterly rather than as a bullet at the end of the year, which is what we did this year. It's a very standard kind of piece of sort of a tax ruling within a Group. And so it's something we were working on for much of last year.

Chris The 177 we see as the year-over-year for Q3'23…

Katie So that's a new profit.

Chris That's a full year?

Katie That's a full year.

Chris So we shouldn't expect that quarterly?

Katie No, no. Divide that by four.

Chris Divide it by four, OK, fine. That makes the rest of my question kind of irrelevant because I was going to ask whether you were actually able to recognise additional DTAs in NatWest Markets plc, because that's where you have this huge…

Katie I'm hoping we're going to get there. So what I'd like to see is a year of profitability. And then you start to get there. What you also get when they start to be profitable, at the moment we don't recognise any software intangibles. So then you can start to recognise a little bit of that, which obviously helps you in the first years before amorts kind of catches you up again as well. So at the moment, everything in that entity is expensed. So you will see. So you recognise a bit of that, then you can recognise a little bit more DTA. But clearly, just given, we've

always said that that business in and of itself is only ever going to be mid-single digits RoTE. And that there are fairly substantial deferred tax losses in that business. So, John's children could still be recognising them, I reckon, if not even their children. But it will be a nice little way to kind of start to bring those through.

Chris And just to round up…

Katie And whether that happens in 2024 or we wait to 2025, I think that's going to be quite key.

Chris Just to round up the DTA, are you assuming anything within RoTE in terms of these re-recognition amounts?

Katie That's a very good question, actually. Not particularly, no. But the numbers are not so significant. But it's one of these things that gives you a nice little 10 or 20 basis points as you do it. It's not going to be the catch up that we saw this year.

Chris And then the other thing I just wanted to touch on, as of 3Q, when we had this session, you talked about the 3Q call, rather. You talked about the spread you were adding on your interest-bearing sight book of being 250 bps. I don't think you put through many pricing changes in the fourth quarter. Is that still the spread…

Katie That's probably still fair. You can work that yourself anyway by pulling our balances. But that's probably about fair. Not pulling our balances, but pulling our rates.

Chris Okay. Thank you.

Raul I've got a few questions, actually. Hopefully relatively straightforward. So if we go to slide 34, where you show the movements in NII, I think relating to the question you just answered around the transfer pricing

changes, there's quite a big delta in central items and other in NII. It seems like all of the delta within the quarter has come in central and other because of your transfer pricing changes. You can see basically Retail banking NII down, Private banking down, Commercial down, and a big positive in central and other.

Katie Yeah, perfect.

Raul Is that going to continue because of the ongoing transfer pricing shifts that's going to happen?

Katie No, no. It's not really driven by that. So, as you know, we try not to operate a large corporate centre. We have this philosophy of charging things out, which you can imagine is always a conversation within the businesses as well, that they would rather we had more in the centre at times. But we do aim to fully allocate that out.

When the number is – Donal and I work through the numbers and if the number is kind of less than 200, I might not bash them in the last quarter by charging it out to them. So sometimes you might see slightly bigger numbers in there. But the way that I think about it is to try to think about it as you go forward as a zero kind of level.

And if you look back at the central for the last number of quarters, you can see that it has kind of transitioned down and in fact moved a little bit into slightly positive rather than negative on different kind of lines. But it's where we have the balance sheet management activity that comes in Treasury. So sometimes we have volatility that just naturally kind of comes through on there. And I guess we don't consider that to be a notable item, so we don't call it out. It's just a feature of what we do. So it is a regular feature of our balance sheet and income statement. Year on year just the number will vary, which is why we don't call it out separately. But that's very much what that last…

Raul Do you think it's Q4 rated or…

Katie No, it will be timing of decisions that we will have made on different treasury activities. Occasionally I might take some costs in the centre for a particular reason. They would generally be – you know that Ireland at the moment kind of all kind of rolls through there. But no, no, it's not particularly Q4 rated.

Raul Okay. And then just on the slide on the rate sensitivity where you've obviously got a few caveats in there. For the managed margin downward shift. Just a couple of questions on that.

Katie On slide 17, yeah.

Raul So I guess this doesn't assume pass-through lags in terms of product pricing.

Katie On the rate sensitivity we have assumed some transfer lags…

Raul Is that going to reflect what you normally do in terms of…

Katie Well, it's very interesting what do we normally do? In other words, we've taken our rates down for quite some time. So I think what's really interesting, you have to look at what does the regulation demand. And the regulation is generally about 14 days. It can be 60, depending on where you are. But for us, I think of it within Retail as closer to the 14, just given where the bulk of our balances are rather than... But in commercial there are some that it's probably closer to that 60.

So then you have to think about – I can't flick a switch in retail and say, right, you're all down tomorrow. Your 14 days start now. We need to give you notification. About a million of our customers still require me to send them letters. So I need to get the letter printed. I need to check it. I need to post it. I need to assume – I've always worked on contract law. The moment I posted the letter it was delivered. It seems I've got to assume it takes two days… sort of thing. So that all of a sudden the lag can get quite a bit longer. But the most important part in all of that is deciding to actually make the change.

So when you decide to make it, there's probably a slight element of looking to see what others do. And the thing that intrigues me – so we're talking about rates falling from May. So you can see that we almost have a rate cut every single time the MPC meet, given the time lag I've got and how I get those messages out.

Raul It's a lot of letters.

Katie Well, it's a lot of letters. Two and a half million pounds per letter is kind of – every time I send an additional letter. So do I put some letters together and actually say I'll do two cuts and things like that? What this sensitivity does is put in some time lag. It's done at a 60% pass-through. It hasn't considered any theories of I'll do two cuts at once or I'll wait. I'll let the first one go through and I'll wait to see what others do. So I think how it actually plays out is going to be quite interesting. And then we are – there's a couple of things I look at deposits that are on the kind of the horizon.

You sort of think, well, what really happens with ring fencing? Do they move that rate from 25% to 35%? Has all the hot money gone anyway? Or is there more to kind of go? Markets can do it overnight in terms because the way they've set it up, they'll give you a notification and it's an investment account, not a payment account. So it's almost instant in terms of their impact of their changes. So how does that all kind of play out now? It's not a big feature of our deposits, but it is a feature. So I think how we kind of see those movements.

Raul And why is 60 a good number? Just your thought process behind the 60…

Katie Because it's the same number we gave you on the way up.

Raul Right.

Katie So it's not a lot of thought process. There's not a lot of thought process. So we thought if we deviated from the number we gave you on the way up... But admittedly, we did start at 50 and then we moved it to 60 as we got further through. But we kind of thought if we deviated, you'd think more of it than we did.

Raul You would have thought because your deposit base is more commercial rated, you probably have a little bit more room to cut rates on the way down.

Katie You would have thought so. We did see one of our competitors put their commercial deposit rates up quite significantly in the last two weeks. So it's to kind of have a look at that. Now, clearly, some of them, because they're linked, they'll go immediately on the commercial side. But for those that are in the managed rates, we can do very quickly that there is a bulk that you can't do as quickly.

Raul I've got a couple of more questions if you don't mind.

Katie Sure.

Raul The fact that you're not guiding on NIM or talking about the trajectory.

Katie Yeah, Jason thought it was a good idea. Good idea to drop the NIM guidance. That way there's a call into my board report on Friday night!

Raul I completely agree with him on this. But I guess the question I'm really trying to get to is, are you preparing for a bigger mix shift within the NIM in 2024 versus what you would have normally had?

Katie No, it's not. I wouldn't read into that. That's why we're not guiding on NIM. I think we've just chosen that we've given you income, we've given RoTE, you've got everything you need to kind of make your own pieces. And I'm trying to give you good guidance as to how the income behaves during the year. But that's not why we're not guiding on NIM.

Raul Right. And then the last one is just on consumer duty. Obviously, there's a big debate and there are various trends coming out in different areas. But in terms of your business. And when you think about the way the rules are changing this year, you know, off-shelf and kind of historical products as well, the pricing. Has anything changed materially in the background?

Katie Let me bring Stuart in, in Edinburgh on that piece. I can see him shaking his head already to give you his answer. But Stuart, do you want to talk a little bit to consumer duty as you're much more involved on a day-to-day basis?

Stuart Yeah, sure. It's a good question. I think on our off-sale, which needs to be remediated by the 31st of July or reviewed and any repaired items called out. We're quite clean, actually, particularly when it comes to deposits. We've got a reasonably straightforward deposit book. We essentially have very, very little on what you would term back book rates. So there's pros and cons to that, but certainly within the realms of consumer duty, that's a positive.

And I think you can say the same really on the asset side. We've got some closed book legacy mortgage products, but it's a really small percentage of the book. So as I sit here today, I'm not expecting any dramatic impact on us, any first order impacts on us of the consumer duty repair activity going on with regard to the back book.

Now, as you look across the industry, it's very clear that particularly on the deposit side, that's not the case for all of our competitors. There are other peers that have and other incumbents that have larger back book balances that attract differential and usually more rates. So I guess as we go into the rate cycle that we're going into with other funding and liquidity pressures from things like TFSME, it'll be interesting to see how our peers react around the actions that they might need to take on that back book. But we are fairly straightforward in that regard.

Katie Lovely, thanks Stuart. Matt, can I just check, are there any questions on the line at all?

Matt (Operator) We have no raised hands at the moment, but if anyone does have a question, please just use the raise hand function on your screen.

Katie Lovely. Thanks very much.

Andy If I could just follow up on mortgages, the structural hedge of the deposits. I know we were at this meeting Q3, you were saying it was one of the most challenging mortgage markets for some time. Fast forward to today, a lot's changed. We've seen the forward curve come off.

Subsequently, yourselves and majority of others have dramatically cut mortgage pricing. And now the curve is back up again. So in terms of where we are on completion spreads today, it doesn't look like we're any closer to getting to that kind of 70 to 80 bps, kind of aspirational number that was always out there through the cycle.

I guess my question would be, I fully appreciate that the roll over pressure eases, but in terms of the end game, what's embedded into your revenue targets, the RoTE, is it still that completion spread that you're looking for or have you kind of accepted now that actually the new normal is going to be slightly lower than that?

Katie Yes, I mean, we're probably, whether we've accepted or just, so I guess the book is at 80 basis points just now. When we said that we were writing, you know, around about 70 at the moment, I mean, it's important when the swap curve moves, we don't necessarily get hit by that in the moment because we will have done some kind of forward hedging and things like that. And I guess what one of the things that you said about people cutting, what we also see is that prices are beginning to go up again as well.

So, you know, whether we're actually at that 80 or whether it stabilises closer to the 70 to 80, I think that that might be something that we're looking at as we move forward from here. So I still expect a little bit of drift below the 80 as we kind of work through this year. I mean, Stuart, this is obviously your bread and butter.

Stuart Yeah, look, I think that's all fair. Clearly, you can see what's happened at the beginning of the year. I can understand the question because the market has been incredibly competitive, and in turn, that's probably led to a market recovery. So we're seeing weekly application volumes above 8 billion. That's up for the first few weeks of the year, cumulatively a market that's something like 30% bigger than last year. I think what you've seen us do within that market is be disciplined around our pricing, and that's why we are able to say that we're writing around 70 bps, as Katie's outlined.

I know you can look at swap rates and prevailing market prices in the market overall and see that that's probably not the case, driven by that competitiveness. I guess just taking a step back and thinking about the kind of medium-term outlook in this market, there's definitely a cyclical factor that we've seen going back to pre-COVID through COVID, obviously, supply issues, it drove margins up. And then with the rate cycle, a shift in income and profitability drivers and Retail banking across to the liability side of the balance sheet.

So as we get into a downward rate cycle, I'll bring you back to the comments around the rate cycle and pressure on the liability side of the book. What happens in the mortgage and asset side of the book in terms of spreads will be interesting, actually to see if there's any softening. But as it stands right now, an incredibly competitive market, pleasing to see us and peers pricing up in response to swaps, but right now about 70 basis points right now.

Andy I guess the 70 basis points, just to be clear, was that a Q4 phenomenon because of what happened with the move in the swap curve, and therefore it's somewhat temporary in nature, or you're saying it's 70 basis points today as it stands?

Stuart As it stands. So we've been racing pretty consistently at that level for the last few weeks.

Katie That's why you can see us also managing our market flow more than we would have done historically.

Andy I'm just trying to get to 70…but I'll go back…

Katie You've got to also think it's not just new mortgages, what's sitting on Tracker, what's sitting on SVR. It's a blended rate. There's lots of other bits and pieces that go into there. And so where one will be lower and different ones are often lower at different times, it's not as simple as it's always one or the other, how you kind of get there. But I mean, it's something I test with Stuart a lot because I'm conscious I'm very public about the number. And it's like, Stuart, don't let me be embarrassed.

Andy Just a minute, I guess I have a question. How do you see more people moving to Tracker on the assumption that rates are coming down?

Katie It's interesting. I think Tracker works. Stuart, do you want to talk? I'll let you answer.

Stuart Not particularly. There's probably a little bit, particularly on product transfers or switcher, a little bit more tendency towards two-year, a little bit more tendency across new business towards two-year, less so on Tracker. It's not like we saw, for example, post mini-budget just over a year ago where there was quite a bit of movement towards Tracker. We're not seeing that. It's fairly small in our mix.

Katie Are we ending up there on that? It's up to me.

Claire Yeah, of course.

Aman Yeah, just a few questions. On the structural hedge. We did probe it the other day, but I don't think you came in line with your stated guidance for the structural hedge notion.

Katie You're right. I did [190 billion] on a static balance sheet, so my balance sheet was not static, and so therefore, clearly, my number was a little bit different.

Aman Okay. So 170 billion for year end.

Katie If it's a static balance sheet. If I took today.

Aman There's more migration in Q4.

Katie Exactly you'll see it move.

Aman I think previously you talked about it potentially stabilising middle of this year.

Katie Yeah.

Aman So in terms of the shape of that 170, is it a kind of step off in H1 and then? What is that?

Katie I don't know. Donal well you're here, why you take it?

Donal Because it's a 12-month look back, it's probably smoother, right? I think if you look at the evolution, you know we hedge a high portion of our non-interest bearing and a smaller portion of our interest bearing. If you go back and model the movements there it's quite clear in terms of what that trajectory is on a look forward basis.

Aman Cool, cool. Thank you very much. Can I just ask you about growth then? Clearly, you know, you've made revenue guidance this year. You'll be assuming something for loan growth, volume growth this year. So any pointers on growth in average interest earning assets this year and next? Relatedly then, you know your RWA guidance of 200 billion. Can you give us a breakdown of growth versus other? Maybe you don't want to break down the other in terms of the reg inflation, but how much of that other?

Katie I'm probably going to disappoint you in all of your questions there. So if we look at the 200, so we're at 183 and we sort of said take the 200 linear into the end of 2025. And then remember, it's lumpy.

Aman Yeah, so that means that's not going to happen though, right? It's like you're kind of telling us to ignore that…

Katie No, what I'm telling you is to make sure you take the end ‘25 number and make sure you recognise it in July. But don't do straight line from here to July or your end of 2024 is going to be too high.

Aman Yes, yes. But I guess the element that is volume growth is quite important though, because it has a kind of earnings and revenue implications.

Katie Yes, I think from there you could assume that the regulatory impact is a greater portion of the growth than volume growth is.

Aman Okay, cool. And then this final one is, so you know, the open market buyback is obviously great to see it at full year. It's not obvious that you've got much additional capacity for open market buybacks. If the directed happens in May, your CET1 ratio will kind of be hovering.

Katie Yeah.

Aman It's not obvious that you'll have a surplus position to kind of pay out thereafter. So I guess my question is, is that it? You know, the open market buyback that we've had, given the RWA inflation that's coming, should we not budget for?..

Katie So I guess what I would say is obviously a decision for the Board, but it's a conversation I'm expecting to have with them in June and July.

Aman Yeah. So maybe.

Katie I think 'maybe' it's a good place to go for it. Certainly I'm trying not to get you to a no, but to get you to a maybe. Yeah, yeah. So it's a conversation I'm expecting to have. Ed, sorry, yeah sorry!

Ed No it's fine. Picking up on Raul's question really, I guess on the way up, the first few rate rises, you saw a lot of benefit on the margin. And then much less once you got to the higher levels. And I guess I'm just trying to think in my mind on the way down. Should we assume that because you didn't get much pressure for the last few, we shouldn't get much pressure for the first few? Or is it that the first ones, because there's this delay of 30 days to 60 days, we should see a bigger pressure, which will then ease off as you catch up with the deposit repricing? Does that make sense? I'm just trying to think how we should look at the sort of evolution as to change, because it was very, very marked on the way up.

Katie And we always sort of said that, you know, when rate rises came through, that there'd be less impact on the pass-through in the early stages, and it would increase as the rates went up. So that's exactly what we saw. I would probably have said that we said that we didn't expect the rates to go up to 5.25. But nonetheless, we knew that the pass-through would be more. I mean, the best guidance I've given you is the 60% pass-through that's in our sensitivity.

We haven't obviously moved over different rates and numbers. I do think there will be an element of, because of the time to notify, what we don't want to do is to send people letters every month. You know,

obviously, it's a small portion that still get letters. Most people would be, far more people, would be sort of electronically communicated with. But even just that constant communication of 'I'm cutting your rate, I'm cutting your rate, I'm cutting your rate', that's not, that won't be great for any of us. So how it actually happens will vary. I mean, this is a huge conversation, Stuart, within your business, obviously. Do you want to just share a little bit of colour?

Stuart Yeah, I mean, I would just, I would agree with everything you've said. There'll be several aspects of this. We consider what our competitors do, the customer communication point, and the disruption, because if you, even if you, to bring this to life, if you decide to move one price point, so you're aware we've got tiers, if you decide to move one price point on one of those tiers, you have to write or communicate to the entirety of the customer base that holds the product, which back to my consumer duty point, means a lot of people for us, because they basically all have that product. So we need to think very carefully about that customer communication slash disruption point as we work through it. So look, I think the points you've outlined, Katie, are absolutely the conversations that we're having.

Katie And that point around, so if you're someone who's sitting above £250,000 and you're getting a letter to say your rate's changing, but you're still getting the letter if you only have £15,000 in that account, or £5,000, I mean, that makes life hell of confusing from a communication perspective. So how do you deal with it, I think is going to be very interesting. James, sorry, I keep managing to jump around. You'll forgive me. That's fine.

James I mean, it's on a similar topic, really. I guess a year ago, the politics started to get quite heated around deposit betas. We had CEOs in a treasury select committee. And I guess it went away because betas went up. We saw some switching from NIBBs to IBBs. But I think you're painting a picture where that really starts to stabilise. But you're still going to have 60 to 70 billion of retail balances not earning any interest. What do you think you have to do to kind of keep the politicians happy that you are treating your customers fairly?

Katie So I mean, I think the thing for me, the other reason why it went away a little bit as well as I think the mortgage pricing came down. I think when you could see that they were at five and heading towards six, that's where people got really anxious. But then you can kind of point to sort of two-year money and two-year mortgages. And actually, you're getting much more parity in terms of those matching. And I do think part of the challenge is, and we've done a lot of work, and I think they've got a lot of understanding that actually, you know, a mortgage is two-year money. So you wouldn't pay the same on an instant access, you know, interest-bearing account and things like that. But I do expect there will be some noise.

What we do is, what we try to work on is what do we think is the right thing to do for our customers in the competitive market that we're in today. We try not to be too influenced by what's happening at Westminster. And that's where, with things like the savings charter and things like that that are out there kind of meant to help guide us. But I do think if the banks were particularly aggressive and whip them all down really quickly, that would certainly create some noise. I think it's highly unlikely that you'll see that mainly because I don't think it's the right thing to do. But also I think the market dynamics wouldn't support that.

James And how often do you kind of push all that information to your customers that are sat there with £20,000 in a current account or something?

Katie So, I mean, in terms of what their rates are, I mean, Stuart, do you want to just talk about what it feels like if you're a kind of £20,000 kind of customer?

Stuart Yeah, in terms of current account balances. I guess it's changed over the course of last year. It depends on our strategy at the time. But what I would say for that generic example is that customer will receive, if they're opted into marketing permissions, et cetera, they'll receive prompts and emails alongside the rest of the customer base around products that are available to them. And they'll also see offers within the mobile app, et cetera, that are open to them. I would say over the

course of the last, certainly 18 months, we've done quite a lot of customer communications in relation to savings and savings products and rates available.

And look, there is a portion of the customer base that as you've outlined, do keep £20,000 or in some cases, quite a lot more. And it would seem that that's a liquidity preference based on wealth, but they do still get, as long as they're opted in, marketing, communications, et cetera, pointing them to better returning products for them.

Katie The fair market question is a really difficult one in terms of the customer duty, because what is, if you want to keep yourself completely liquid in your current account, you're making a very strategic, particularly you're at that level of, you're making a decision. You're not unaware, because you are pretty financially literate at that point. So therefore you're very happy to do where that is rather than to tie it up for a year for whatever reason that you might have.

James Okay, thanks.

Katie Ed, and then Jason, I'll come to you.

Ed Sorry. Just two questions. One was, there are quite a few businesses available for sale at the moment, seem to be kicking around, you know, supermarket bids, private banks and stuff like that. What's your sort of general attitude to those? You know, I mean, I assume you look at them, but can you give us some idea of what, where you may or may not be interested in them?

Katie We do look at them, and we look at them very actively. I have a team of about, I think it's about 15 to 20 of them that are in that, I'm not sure they're all very packed together, sort of thing, so there's about 15 to 20 of them. So it's a very active examination, you know, and when we kind of look at it, there's a couple of things we look at, is do they do something that we can't do? So therefore, does that make them attractive? Do they have the right kind of risk profile? Do they have a lot of legacy tech that we would need to kind of deal with? We're very

conscious that we're, if things, if I'm looking at a credit card book, that we're a prime lender, we don't want to become a subprime lender because it's very difficult as a major bank to be a subprime lender. So I think you end up in lots of different kind of challenges within there. So what I say to the team, first of all, I say, can you go and look at it and see strategically this is something that we want to buy? And then I say to them, don't do the numbers too quickly, because if you do the numbers quickly and you put a counterfactual of a directed or a non-market buyback beside them, you'd never do anything.

And we're really conscious that actually over a long, extended period of time, that means that you don't build or you don't add. And what you probably have seen in our activity is that what we have kind of picked up is small bits of tech that we really like and that can really be additive to us and can accelerate our own development. So something like Rooster, I think it's been really important for us. It was very small, didn't spend a lot of money on it, but we were building internally and accelerated us by about eight months by making that acquisition. So not huge numbers involved in terms of what we did spend, but actually just really kind of move kind of things forward. So we do, we look at all of them. We're very pleased this year that, you know, AUM has gone up above 40 billion for the first time, but we'd like it to be quite a bit bigger. So we do look at those businesses, but then we want to make sure that they're in jurisdictions that we want to operate with a client base that we believe is the right client base for us. And also we look a little bit at distribution model as well, but they are all very actively looked at. Great. Jason.

Jason Oh, did you have another one?

Ed I did actually.

Katie Oh, well go on you go and then...

Ed Sorry, I'm not sharing this thing. I just had one just here too. I have another one, but I guess the other thing, it's not directly related to you, but more broadly, I guess we've all got used to now that the ombudsman is perhaps more important than we realised three months

ago. And I'm just trying to get a sense. If you look across your book, I guess there are various things going on in terms of the ombudsman, not motor finance, obviously, because I know that's not you.

Katie We're not in that.

Ed But which of the areas? I mean, I can look through your legal declarations, etc. But are there other cases going through the ombudsman at the moment, which we should be thinking about in relation to NatWest?

Katie Yeah, and it's interesting, the legal ones wouldn't necessarily help you just because the legal ones are ones that really are live issues today. So clearly, if we'd had motor finance, you'd have seen a whole new paragraph kind of come in on that, which we don't and we're very pleased not to have. I mean, I think probably some of the themes for me are actually around customer duty. So that back book, front book piece, I think that we see more focus on and we've seen, you know, obviously, the asset managers have been challenged first on that because of their kind of pricing and how they move on that.

I think that they'll work their way around to us on that piece. But I think we've already done a lot in the last few years, if I look at what we did on overdraft pricing a few years ago, that was very directed by the regulators as well. But I mean, Stuart, I don't know if there's anything you would think of in, I'm not sure there's a particular thing that I'm thinking of within there, but is there anything?

Stuart No, no particular thing. What I would say is our, probably the biggest area of interaction from retail is either, you know, day-to-day complaints and dealings with the ombudsman and in particular fraud and for us, the cost of a FOS overturn and the customer ending up with the FOS, I would probably point in that space to PSR legislation coming later in the year around treatment of customers that fall victim to app scams. That will take those kind of FOS volumes down further, I would say. But nothing particular in the spirit or theme that you would think of the motor finance.

Katie Yeah, and I think, you know, we haven't given you particular guidance on conduct and litigation. What we said last year was it was flat, so we were a little bit down. You can see our legal section at the back of the document continues to shrink. So I would hope that we continue to see that kind of a little bit down as we move forward from here. But there's nothing at the moment that I'm thinking, oh gosh, that's going to be a hit that's coming towards us that's not reflected in that just kind of continuing cooling down of that number. Jason?

Jason In pursuit of a fifth way to try and forecast NII, the product income numbers in retail are a bit weird in the sense that deposit income is down 1% last quarter and NII is down six. And all year it's been mortgages that have been killing you. So could you talk a little bit about how those numbers are calculated and what information we can actually draw from that kind of segmentation?

Katie So I've tried to give you guidance on 13-13.5 a few times over the last few days. I'm going to let Stuart have a look. If you were looking at retail, how would you think about it?

Stuart Yeah, that's a good question. So a little bit of noise in the fourth quarter to begin with between what we disclose as other and loans in particular, so personal advances. So that move down in loans is largely a flip around how we fund non-performing assets. So it's a bit of a tidy up there. So I would look through that. What I would say is just go product by product. Loans has been fairly flat the second half of the year. You will have seen that our headline rate pricing was basically at the top of the market. So the most highly priced. We did that in response to funding cost pressure in particular. So we've seen stability there. We have just cut in response to fall in swap rates and market dynamics. I would say you should expect general stability in that line for about 15% market share. And we're really happy with that. So loans fairly stable.

Deposits, the step down really was ongoing. Mixed shift happening across the book. This led to the step down in the fourth quarter. I guess the dynamics that Katie and the team have outlined apply there for us. You've got the seasonality of the January tax payments, as Katie said, in

line with last year. So you will see a drop in current accounts in particular. And we have seen that in our January numbers and we expect some recovery from here depending on the overall market. The overall market is certainly more supportive than it has been previously. We're seeing fairly consistent growth in the Bank of England numbers for the personal deposit sector. And if I look at CACI data, we're seeing the same, but interestingly, were seeing much lower weekly flows for fixed balances, which I interpret as being a lot more already invested that will go into auto reinvestment. And as long as us and peers price for that appropriately, you would expect to see less flows between banks. So from a sort of gross flow in that market, an instant access has been positive for the last few weeks as well. So that's a positive.

The one thing I would outline as well on the 12 months look back is as that washes through, more of our balances become exposed to SONIA, which also provides a benefit as we go through the year. Because if you can look at our current account balance stress rate, it's gone down 10 billion in the last 12 months. And that needs to play through from a hedge perspective. So on a 12 month look back basis, we're obviously appropriately hedged, but from a stock perspective, when you get outflows like you get in January, it takes a little bit of time for that to wash through. And as a result, there's more exposed to the hedge than is our target level and that plays through and actually provides some tailwind into the second half of the year.

Mortgages we've covered. Q1, the roll on roll off, we expect to be much closer in terms of delta. However, there's a wash through of what rolled off and rolled on in Q4, including some reasonably sizeable roll offs. And as a result, you expect that margin to go down a bit in Q1 and then stabilise in Q2. And then on credit cards, a fairly downward trajectory quarter on quarter. That product is convention hedged. So think about it like the structural hedge, but exposed to different tenures depending on the behaviour of the book. But even though it's got some protection from that, because some of the tenure of that hedge is shorter, we have seen significant funding pressure in that book. Obviously, us and peers have taken action around terms coming in, a little bit of APR pricing going up. But the APRs are in such a level the ability to increase them by the amount of the funding cost is not as possible. What I would say on that is now that we've reached the top of the cycle and we've seen swaps go the other way, you should expect to see that line much more stable in the near term. And then looking further out into the

second half of 2024, start to see a bit of an uplift as we see more balances maturing and coming off of promo rates and those that stay will start to attract a little bit more interest. And of course, we expect funding pressures to continue to abate and reverse based on the economics that we've provided. So that's the overall shape of the retail income. And hopefully that's helpful, Jason.

Katie Lovely, thanks very much, Stuart. I'm just going to go to the line with Gary and then I'll just come back and do one more in the room. So Raul, I'll come back to you. Gary?

Gary Hi, thanks. I was just interested in the comments you made around M&A and sort of comparing acquisitions to the alternative of buybacks. And it was just a more broad question, really, in terms of how you think about cost of equity, especially given where the stock and the broader sector, I suppose, is trading at the moment with a sort of discount to book value. So it sort of feels like the market's implying a cost of equity that's probably sort of in the 15% to 20% range for the industry, which is, I guess, quite high relative to what people would have assumed historically. So just from a planning perspective, really, how do you think about cost of equity over the sort of medium term? And I guess, what do you target in terms of the hurdle rate when you're making sort of your marginal capital investments?

Katie They'll vary a little bit depending on what investment it is that we're looking at and their kind of consumption within there. We give you in some of the disclosures how we calculate the ROEs by the different businesses as well. That kind of gives you a view of that number. What I would say is we don't really use market implied to the same extent. We would say that some of you are a bit toppy in terms of those cost of equities that you do use. We don't think they're necessarily run the whole time. But what we will do is test is at various different levels, whether it's the way that we do the ROE per the segment that it's going into, or also our in-house one, which we've always talked about in that 11 to 12 kind of range. I'm very conscious we've got an above 13, greater than 13 from 2026.

So what we have to know is that it's going to get to the right kind of level. Certainly over time, it doesn't need to be necessarily at that at the point of acquisition, given all the integration kind of costs. But we will test them across different measures. We have in the past occasionally gone and we bought something that's been a little bit below on the face of it because we knew that over the lifetime, it would give us the right kind of value. But we test it at lots of different levels. But internally, it's a kind of 11 to 12-ish type number as a minimum kind of hurdle. But you can see the ROEs that we use. You can see the factors that we use in the ROEs for the different businesses. So it'll be looked at, at that level as well.

But for me, the big thing, and that's why we say to the team is, work out strategically if this is something that really makes sense, that is something that will really be additive for this business in the medium to longer term. And if you can't answer that question positively, then let's not get into the maths. Otherwise, you could do brilliant engineering for something that makes no sense at all.

Gary Okay, thank you.

Katie I'll go here and then Jonathan, I'll give you a last one. Just as you've both get your hands up, I don't want to pick a favourite.

Raul Sorry to keep you here. I have a couple of questions just to follow up. First one is just on UBIDAC. If you look at the annual report, you've got 43% CET1 there. Obviously, you're getting towards the end of the process of rundown. And this is where the regulator and the timing probably starts to matter quite a bit. So, just your thoughts on things about 900 million of equity still in UBIDAC. How do we think about that coming back?

Katie I mean, our views will come back in time. You know, at 1.1, we got back 800 and 300 euros that we got back last year…

Donal 1.1 euros.

Katie 1.1 euros, which was pleased, that's what we asked for. In terms of getting that back, it's got to pull the last balances down. It then goes from being a bank to a, what's it called?

Peter Retail credit.

Katie Retail credit institution. Thank you very much, board member there. Thank you very much. So, we will see it kind of come back, but it's going to take a little bit of time. But, you know, we'll continue to work our way through it with the regulator.

Raul And it doesn't matter in terms of how much capital you have in the Holdco versus the subsidiary, just given how conscious you've got 40 basis points over the 13% [at the Group level].

Katie So, we're not cash constrained or capital. So, in terms of that, I'm not uncomfortable about where it's sitting. I think what's important is just continue to make sure we continue on the wind down, which I do think we've done a superb job on it. If the numbers, obviously, we gave you numbers, but the fact they worked out as well as they did in matching those numbers, I was delighted with. I think the team have been superb.

Raul And just it would be a shame to let you go without asking kind of your thoughts on the size of any retail placing. How are you preparing internally in terms of what you might get?

Katie So, this is our boardroom. And so, last week, we had the board training on directors duties in the middle of which Linklater has handed me the draft of the prospectus to review over the weekend, which I was particularly grateful for. I haven't actually done it, so I'm going to have to do it tonight. So, I just couldn't quite get myself there.

But, look, in terms of the size, they'll have some view on what the size would be, whether they do it up with the institution or whichever. We're very supportive. I've got a draft already of the prospectus, you know, we're very much making it our job is to make sure that we're ready to kind of work with them as they move forward on that. So, if we can get it to work, and then the narrative has been really strong, I guess, probably stronger than I would have expected, because we're still quite early in the process. So, that's really positive. So, you know, if we can get it to work, I'm very happy and supportive of that. Obviously, ultimately, discounting, sizing, all of those things for them is a decision for the government. In the end, I think Friday was helpful for them, which was good, and we just need to make sure that we continue to have helpful [boundaries]. Jonathan, just to end with you.

Jonathan Thanks. Yeah, just two final ones. First, checking the maths on the op-risk, I think the pillar three, you actually give us the business indicator revenues. And if we take the 2023 spot, it's pointing to an op-risk that's about 3 billion higher than the average three-year lookback, which is obviously the basis of the op-risk at the moment. Is that the sort of operational risk, RWA inflation you're looking at in the next couple of years, a billion and a half a year?

Katie I mean, it's all built into the guidance that we've given you. It comes through Q1 in terms of the actual mechanics of the number. So, a portion of that journey to 200 will be part of op-risk. I'm not going to confirm that initial number, but you can see from the pillar three kind of a guidance towards it. So, yeah, I would say you're not a million miles away.

Jonathan Okay, thanks. And then maybe more importantly, the non-interest income, I know you want to focus us on total income, but the sort of fungibility between net and non-interest income and your business is pretty low. So, on the non-interest income specifically, it looks like our fees and commissions are bouncing around the 600 million with a bit of growth.

This trading revenue piece though, the interims you suggested was weaker than you would normally expect to see in the second quarter, came back in Q3, dropped off again in Q4, about 177 million.

Katie They've had a nice Q1 so far…

Jonathan So, what sort of level should we be? Because consensus is up at 3.35 billion for this year on non-interest income. And if the fees and commissions are circa 2.3, 2.4, that would require quite a big…

Katie I would probably take you a little bit back almost to Raul's question of earlier when we looked at the centre. And I would probably encourage you to think of that centre in your modelling as a kind of more or less a zero number. So, I would think at the minute you've got, as I look at that, is to think about, well, if that's zero, have I got a little bit more than I might want to have in non-interest income than I have in NII? But in the same way, I'd kind of guide you to the 13 to 13.5 number in that space. But I do think if you have a look at your centre numbers, it might help you a little bit.

Jonathan Okay, all right, thank you.

Katie Perfect.

Claire Yeah, no, that's great. And just before we all go, and for those in the room, you can see Nick Gough obviously joined us last Monday. Terrific first week. But obviously he's looking forward to getting to know you all. Many of you know him already, but just wanted to introduce him.

Katie Apologies, Nick. I should have done that at the beginning. So, it's been lovely to have you here. This is a baptism of fire week, certainly. Perfect. Lovely. Thanks so much. Thanks for your time and your ongoing questions and support. Take care and have a good week. I know you have a busy one.