NatWest Group plc
H1 2020 Results
Analyst Call

Hosts: Howard Davies, Alison Rose & Katie Murray
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Operator: Welcome, everyone. We will now play a pre-recorded audio presentation of our H1 results. This will be followed by a live Q&A session with Howard Davies, Alison Rose and Katie Murray.

Alison Rose: Good morning, everyone. Thank you for joining us today for our first half results presentation. Our agenda for the call is as follows. I will start with the first-half headlines, then update you on how we have been managing the business through the COVID-19 pandemic, the progress we have made on our strategic priorities during the first half and then Katie will take you through the numbers in more detail before I wrap up and we open it up for questions.

So let me start with the headlines. As you know, we had a strong start to the year before the impact of COVID-19 and our pre-impairment operating profit for the first half was GBP 2.1 billion. Since we spoke in May, however, the economic outlook has worsened and as a result, we are announcing a first-half net impairment charge of GBP 2.9 billion. This is based on extensive modeling carried out during the second quarter which I'll talk about on the next slide.

Costs were slightly lower year-on-year and taking into account impairments, we made an operating loss of GBP 770 million and an attributable loss of GBP 705 million. Given the ongoing economic uncertainty, we are pleased to be operating from a position of strength in terms of liquidity, funding and capital even after absorbing prudent provisions through impairments. This is a sign of the strength of our franchise. Our Common Equity Tier 1 ratio for the first half was 17.2 percent and our liquidity coverage ratio was 166 percent.

I'll talk about impairments and capital on slide five. Given the current level of economic uncertainty, we are managing impairments carefully. Our impairment charge for the second quarter was GBP 2.1 billion, an increase from GBP 802 million in the first quarter. This charge is based on modeling that takes into account a wide range of macroeconomic factors as well as expert views on risk and reflects the deterioration in economic indicators.

We have provided you with a lot of detailed information on our approach which Katie will take you through later. As a result of this modeling, the majority of provisions have been taken in the first half, providing coverage of 1.72 percent. We anticipate a significantly lower charge in the second half with full year charge in the range of GBP 3.5 billion to GBP 4.5 billion based on current economic assumptions.

Despite this increase in provisions, we have a CET1 ratio of 17.2 percent, one of the strongest capital ratios in Europe. Now, of course this ratio partly reflects the cancellation of dividends earlier in the year in consultation with the regulator and we plan to return to paying dividends as soon as it is possible.

We continue to believe with the current shape and mix of our business that we should be operating with a CET1 ratio of 13 to 14 percent over the medium to long term, which means we have clear headroom of somewhere between GBP 6 billion to GBP 8 billion above our target capital ratio and GBP 15 billion above the maximum distributable amount. This gives us the flexibility to return capital to shareholders as soon as that is possible, to manage an uncertain outlook and to consider other options that offer compelling shareholder value.

So having given you the headlines let me move on to talk about how we have been running the business during the pandemic. We set out a new purpose in February to champion potential by helping people, families and businesses to thrive. What you will hear today is how we are taking advantage of our strong customer franchise and market positions to advance that purpose. We have supported our customers in difficult circumstances and we have done so safely with a prudent approach to risk and impairments and with careful deployment of our balance sheet.

We have taken swift action to address COVID-19, but we have also focused on the key strategic priorities I set out in February. For example, we have made real progress refocusing NatWest Markets onto the needs of our core customers and expect to complete the majority of our targeted RWA reduction by the end of 2021. We are also on track to deliver our GBP 250 million cost

reduction target despite the disruption of COVID-19. Finally, we remain focused on maintaining a strong balance sheet which, as I said, gives us significant advantage in this environment and will allow us to resume dividend payments to shareholders when it is appropriate to do so.

Putting purpose into action has entailed making a very significant change to the way we work in order to support our customers during the pandemic, as you will see on slide seven. We have kept 95 percent of our branch network open for customers who need help and we have over 50,000 people working from home, including more than three quarters of our call center colleagues. The swift action we have taken to help customers has contributed to increased net promoter scores which are up 18 points in our branches and 20 points in Business Banking since March.

We are proud of the strength of our customer franchise and our response during this period of disruption is an important part of deepening relationships with customers and positioning us well for growth as the economy recovers. We have leveraged our investment in technology not just to support working from home, but also to accelerate new digital services in order to meet customer needs.

Our customers are increasingly engaging with us via digital channels. We now have 7.2 million active mobile users, whilst three-quarters of our current account customers in personal banking and almost all commercial banking customers regularly use digital banking. Sales via digital channels have also grown rapidly. Eighty percent of personal banking sales were digital in the second quarter compared to 55 percent in the first. In addition, there were over half a million new downloads of our app during the first half and we added more than 485,000 new online banking customers.

A good example of our focus on innovation and partnership is our re-entry into merchant acquiring via our new digital payment solution for small businesses called Tyl. Tyl has become even more important for these customers, with a move to contactless payments during the pandemic and it's progressing well. It has now processed over 4.5 million transactions, up from 1 million in February. These examples are an illustration of how our

investment is enabling us to scale up and increase speed of delivery both effectively and efficiently.

I'll talk on slide eight about how we have also been supporting customers through lending. Across the retail and commercial businesses, net lending increased by GBP 16 billion in total during the first half, approximately half of which relates to government scheme drawdowns. You can see here the impact of the pandemic on customer behavior in the second quarter. In personal banking, there was a fall-off in demand in April, but we are now seeing signs of recovery as lockdown eases.

New mortgage applications in July are nearing pre-COVID-19 levels and are 30 percent higher than June, spurred on partly by a reduction in stamp duty. Debit and credit card spending is also growing and is 10 percent higher than the levels we saw in June with debit card spending back to the same level as January. Of course it is still early days and we are watching this closely given the uncertain outlook.

In commercial banking, there was a steep increase in the use of revolving credit facilities in March, but customers are now making significant repayments as government lending schemes have kicked in. The current RCF usage is about 30 percent, down from the COVID-19 peak of 40 percent. Weekly commercial card and cash transactions have more than doubled by volume from a low point in April and we have also seen record issuance in debt capital markets.

Turning now to government support scheme lending on slide nine. As you would expect, we have done all we can to support our customers during this period of uncertainty, including providing them with access to all the government support schemes, but we have only supported existing customers, customers we know and whose risk profile we understand. We have also maintained a consistent approach to risk, due diligence and underwriting standards with the exception of bounce back loans which are 100 percent guaranteed by the government.

In order to help people and families in the U.K., we have extended 240,000 initial mortgage repayment holidays which represents 20 percent of our book and 72,000 payment holidays on personal loan. With an easing of lockdown, our focus has shifted to helping customers as they start to resume normal repayments. What is clear is that many people who ask for repayment holidays did so through prudence rather than constraints.

At this stage, about 70 percent of U.K. customers who have come to the end of a repayment holiday have recommenced payments, and this could clearly change when the furlough system starts to roll off and all mortgage holidays run to their full three months.

We have also played our full part in government-backed loan schemes for large and small businesses. At the end of June, we had received applications under these schemes amounting to GBP 13 billion, for which we have approved lending of GBP 10 billion to existing customers which is broadly in line with our market share. Of that GBP 10 billion, GBP 8.3 billion has been drawn down. Demand for these schemes is now tapering off from initial peaks. For example, in July, we have received up to 2,000 applications a day for bounce back loans compared to an average of 20,000 a day in the week they were launched and about 48,000 on the first day.

We also remain comfortable with the level of risk and diversification of our books which I will talk about on slide 10. Lending in U.K. personal banking represents just over half our total loans and advances. Within personal banking, it's important to remember that just 7 percent of our book is unsecured and looking at our U.K. mortgage book, our average loan to value is 57 percent. Just 12 percent of the book has an LTV above 80 percent.

I'll talk about commercial lending on slide 11. Wholesale lending is well diversified across large corporates, small and mid-sized businesses, real estate and others. There are of course some sectors that we monitor closely which represent 8 percent of total loans and advances. We have significantly de-risked our lending in these sectors in recent years by using synthetic trades and capital reduction to manage our exposure.

We have also skewed our lending to lower risk, better performing sub-sectors. For example, in retail, the majority of our exposure is to food and convenience retailers who continue to perform well in the current market. In leisure, we have reduced our exposure to high-risk sub-sectors and our lending is typically secured against property assets, while oil and gas represents just 1 percent of our wholesale book.

Since the start of COVID-19, we have continued to proactively manage our risk in these sectors by reducing limits, increasing oversight of new business and making a series of controlled exits and structured risk mitigation trades. Just 3.6 percent or GBP 1 billion of these loans are stage three and we are comfortable with our coverage ratios.

You'll see on slide 12 that our lending growth has been more than outweighed by deposit growth as customers continue to see NatWest Group as a safe place to keep their money. Total customer deposits grew by GBP 39 billion during the first half. Just under a third of that growth was in retail banking, mostly in current accounts as consumers spent less during lockdown. About two-thirds was in commercial banking as customers built up liquidity and retained a significant amount of borrowings from government lending schemes. This inflow of deposits has helped to maintain a healthy loan to deposit ratio of 86 percent.

Whilst we were quick to respond to the pandemic, we have also continued to focus on executing our four key strategic priorities and slide 13 is a reminder of them. In addition to these priorities, we set out some ambitious targets for supporting U.K. enterprise by helping to create new businesses, promoting financial capability and well-being and helping to address climate change.

Today, I want to focus on the second and fourth priorities shown here, starting with NatWest Markets on slide 14. Refocusing NatWest Markets is one of my key strategic initiatives and we have continued to adapt the business to better suit the needs of our corporate and institutional customers. Our aim is to create a business that is both simpler and more strategically aligned with a product suite focused on financing, currencies and risk management.

I'm pleased with the progress we have made executing our plan. We set a target to reduce risk-rated assets in NatWest Markets to GBP 32 billion in 2020 and to almost halve them to GBP 20 billion over time. To-date, we have reduced RWAs by GBP 2.8 billion, making good progress towards our 2020 target and we expect to achieve the majority of our GBP 20 billion target by the end of 2021. We are managing the associated disposal losses to about GBP 600 million over the two years.

Since February, we have appointed a new management team in NatWest Markets, confirming Robert Begbie in his post as CEO and bringing in David King as CFO. Direct costs in the second quarter were 13 percent lower than the first, we are refocusing the business in the U.S. and Asia Pacific by reducing our footprint and we have started aligning the business to a one-bank model by centralizing technology within the group. We have also formed a new partnership with BNP Paribas for both the execution and clearing of listed derivatives. We expect strategic costs to be in the region of GBP 200 million in NatWest Markets for 2020.

Moving on now to simplification and cost reductions. We have made good progress on simplification in other areas and we are on track to deliver a cost reduction of GBP 250 million in 2020. As a result of COVID-19, the shape and timing of these cost reductions has been rephased and we have also incurred additional COVID-19 related costs of GBP 25 million. This has led to a cost reduction of GBP 41 million compared to the first half last year and we expect to see most of the execution impact falling in the second half.

We remain firmly focused on execution and I have accelerated a planned exit from one of our London properties into 2020. Our strategic costs, however, will still be in the range of GBP 800 million to GBP 1 billion.

Before I hand over to Katie, I want to talk on slide 16 about our progress on enterprise, learning and climate change. Our initiatives here are more important than ever as we start to rebuild the economy which is why we have accelerated our digital offering during the pandemic. On enterprise, we are supporting people who want to become entrepreneurs through our 12 U.K. Accelerator hubs around the country and we have migrated these hubs to

digital delivery. As a result, we welcomed 1,200 new entrepreneurs to virtual Accelerator programs in April and we extended our Dream Bigger program, which encourages young women, aged 16 to 18, to become entrepreneurs by offering it online.

On learning, the need for financial education and capability has also become ever more important as people look to manage their own personal balance sheet. We have now completed financial health checks for over half a million customers and we reached 2 million people in the first half through MoneySense, our free financial education program for five to 18-year-olds which we made available online when schools closed down.

We also launched the first ever financial education console game, Island Saver, which has had over a million downloads. We continue to invest in the next generation and we have committed to growing talents by creating 1,000 intern, graduate and apprenticeship roles over the next 15 months.

On climate change, we remain focused on making our own operations climate positive over the next five years and halving the climate impacts of our financing activity by 2030. During the first half, we issued a $600 million green bond with all proceeds allocated to renewable energy assets across the U.K. NatWest Markets was ranked number one bookrunner for U.K. corporate green and sustainable bonds by Dealogic and we helped raise about GBP 4 billion of new sustainable financing and funding. Since 2019, the business has helped 33 clients issue green, social and sustainable bonds, totaling about GBP 29 billion.

So in summary, our first half results demonstrate that we have a strong business franchise and have supported our customers well at a time of uncertainty. We are managing risk carefully and providing for impairments thoughtfully. We continue to execute on our strategic priorities and even after absorbing increased provisions, we have a robust capital position and resilient capital generative business. This gives us the flexibility to return capital to shareholders as soon as that is possible, to manage an uncertain outlook and to consider other options that offer compelling shareholder value.

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

Katie Murray: Thank you, Alison, and good morning, everyone. There are three main areas I will spend time on this morning. Naturally, I'll start with the group income statement and I'll be using the first half last year as a comparator. For the businesses, I'll also show the income progression from the first to second quarter this year and as Alison mentioned, I'll give you a detailed breakdown of the impairment charge and the scenarios we have used to predict our model expected credit losses under IFRS 9 and finally, I will cover our capital and liquidity position in a little more detail.

So starting with the group income statement. We reported total income of GBP 5.8 billion for the first half, a decrease of 5 percent year-on-year, excluding the impact of last year's disposal of Alawwal. Within this, net interest income decreased 4 percent to GBP 3.8 billion and non-interest income reduced by 6 percent to just under GBP 2 billion. These reductions were driven by a fall in rates, the impact of regulatory changes discussed in the last two quarters and the effect of COVID-19 trading.

We reduced overall operating costs by 9 percent to GBP 3.75 billion. Within this, other expenses, excluding operating lease depreciation, decreased by 1 percent, while strategic costs were 26 percent lower at GBP 464 million. Litigation and conduct costs for the first half were an GBP 89 million release, reflecting a PPI release of GBP 250 million, offset by some other historical litigation matters.

We are reporting operating profit before impairment of GBP 2.1 billion, up 3 percent from last year, mainly as a result of lower strategic and conduct costs. The impairment charge for the first half was GBP 2.9 billion which represents 159 basis points of gross customer loans. I'll talk about this in more detail later.

Taking all of this together, we reported an operating loss before tax of GBP 770 million and an attributable loss of GBP 705 million. On tax, the credit of 27 percent is higher than the standard rate of 19 percent due to the rate impact of FX recycling, the tax surcharge and other tax adjusting items.

I'll move on now to take you through the income by business line. Total income for the second quarter was GBP 486 million lower than the first, reflecting the contraction of the yield curve, reduced business activity and lower customer spending resulting from government measures in response to COVID-19. In U.K. personal banking, total income decreased by GBP 115 million due to lower overdraft fees and significantly reduced card spend which resulted in reduced fee income and lower unsecured balances.

Total commercial banking income was down slightly as a result of lower deposit funding benefits and reduced business activity. This was partially offset by strong balance sheet growth as government lending initiatives helped to increase net interest income, albeit at a lower margin given the agreed government rates.

Finally, NatWest Markets income was down GBP 270 million, but excluding own credit adjustments and asset disposals, revenue grew by GBP 50 million. Income from financing increased as the credit market stabilized with support from central banks, while rates and currencies decreased as market volatility towards the end of the first quarter eased.

Moving on now to look at net interest margin. Bank net interest margin decreased 22 basis points in the second quarter to 167 basis points. This is the result of three factors. You will recall we talked about interest rates and margin pressure in May. Lower interest rates accounted for 10 basis points, while five basis points was the result of the impact of a change in mix of lending. I would note, of course, that the level of lending has been beneficial to income, particularly in the commercial area.

The high level of liquidity we're holding accounted for a further 7 basis point reduction as average interest earning assets grew by over GBP 35 billion. This, of course, had a negative impact on net interest margin, though it had no impact on income or ROE. Looking to the second half, there are two main factors to consider. One, the impact of holding excess liquidity and of course the ongoing pressure from the fall in hedge income.

Moving on now to look at costs. Other expenses for the second quarter were GBP 54 million lower than the first, excluding operating lease depreciation. As Alison mentioned, the shape and timing of our cost reduction program has changed as a result of COVID-19. Fixed costs will be higher as we have delayed some of our restructuring plans. Our change spend will be lower as we prioritize a smaller number of key programs to focus on maintaining critical services for customers. Some Run the Bank costs will also be lower such as travel and the cost of running buildings.

Though we have, of course, encountered additional costs in our response to COVID-19, Alison and I both believe it's absolutely critical we remain very disciplined so that we continue making sustainable strategic change where we can. Strategic costs in Q2 were GBP 333 million. This includes GBP 86 million as a result of restructuring NatWest Markets, GBP 44 million on technology spend and GBP 148 million related to our London property charges, which includes an additional property exit.

This building was already part of our longer term property rationalization plan, so it did not make economic sense to make it COVID-19 compliant. This will be beneficial for us in the long run, but it means strategic costs will now be within our projected range of GBP 800 to GBP 1 billion rather than at the lower end of that range as guided in May.

Litigation and conduct costs were GBP 85 million release for the second quarter. We have made an additional PPI release of GBP 150 million in the quarter as we have now substantially completed the complaints process and settlement of claims. Looking forward, as you heard from Alison, we remain committed to our cost reduction target of GBP 250 million for 2020.

Moving on now to look at impairments. Over the next couple of slides, I want to give you a more detailed explanation of how we've arrived at the impairment charge, the treatment of COVID-19 support measures under IFRS 9 and our approach to stage migration. I'll start with the impairment movement on the balance sheet shown at the top. We reported an impairment charge of GBP 2.9 billion for H1 or 159 basis points of gross customer loans.

This charge includes total stage three charges of commercial of GBP 236 million, including a small number of single-name charges.

This compares to ECL increases of GBP 6 million to GBP 8 million in mortgages and GBP 0.4 billion in personal unsecured over the same period in H1. The economic outlook has deteriorated during the second quarter and under current economic assumptions, impairment charge for the full year is likely to be in the range of GBP 3.5 billion to GBP 4.5 billion. This increase is expected to be made up of migrations to stage three as customers move into default and of course any further economic movements.

The Q1 overlay of GBP 798 million has been absorbed into our provisioning, so we're no longer holding an economic uncertainty overlay in our numbers.

So let me take you through our approach on the next slide. In order to arrive at the impairment charge, we have broadly taken a three-step approach. First, we developed four different economic scenarios based on a wide range of future economic indicators and made an assessment of their respective probabilities. After applying probability weightings to these scenarios and given the continued uncertainty, we are using two central scenarios to reflect NatWest Group's expected outlook. They both have a 35 percent weighting applied, while the upside scenario has a 20 percent weighting and the downside has 10 percent.

Over the four scenarios, our assumptions for 2020 included a drop in GDP growth ranging from 8.9 percent to 16.9 percent, U.K. unemployment rates between 7.4 percent and 14.4 percent and a fall in house prices of 0.1 percent to 11.5 percent. They all assume a return to GDP growth and lower levels of unemployment from 2021 onwards, as you can see from the table on this slide. As a second step, we've made model adjustments to reflect the effect of government support aimed at delaying impairment and reducing the likelihood of default. We also applied expert judgment on specific sectors. The third step was to apply further judgment, specifically for high-risk customers and other uncaptured risks.

I also want to cover our approach to stage migration. As a starting point, our approach to payment holidays and government lending schemes has continued in the second quarter. New or extended payment holidays will not, on their own, trigger a stage migration. The key trigger for a stage two migration in H1 is the deterioration in probability of default driven by the adoption of the four new macroeconomic scenarios.

In wholesale, we use a conservative threshold for a significant increase in credit risk or SICR of just 10 basis points increase in PD. This has led to a large migration of high quality, up-to-date balances from stage one to stage two. These will have a lower ECL coverage than past due stage two balances. Were our SICR threshold to be 75 basis points rather than 10 basis points, this would reduce our stage two exposure by GBP 16 billion. However, ECL would reduce by just GBP 60 million.

For a stage two loan to migrate back to stage one, it must revert back to the PD threshold for a three-month period. Assets only move to stage three in the event of default, typically once the account is 90 days past due.

On the next slide, I will cover stage migration and expected credit loss coverage in more detail. Before going into the detail, I want to reiterate the fact that the vast majority of the movements I will be discussing in the following two slides are anticipatory and not in response to observed defaults. Our starting point is that we've continued to use an appropriately conservative approach to stage migration and ECL and personal. Our trigger criteria includes persistence where we keep balances in stage three typically for at least 12 months.

For mortgages, 13.5 percent of mortgage loans now sit in stage two which are not past due against 5.6 percent in December. The majority of these are up to date as of the balance sheet date. In fact, of our total mortgage book, only 0.9 percent is past due and 1.6 percent in stage three. Similarly, 30 percent of total loans and credit cards and personal advances now sit in stage two not past due against 24 percent at December and you see a similar pattern repeating in credit cards and personal advances in terms of payments being up to date.

Looking at our defaulted balances across personal, we have 1.9 percent in stage three at June against 2.1 percent in December. However, given our guidance, we expect this to change over Q3 and Q4 as we see defaults start to come through.

Turning now to wholesale migration on the next slide. As you would expect, there's clearly been a larger migration here with 38 percent of total loans at stage two driven by forward-looking PDs. Across wholesale, 36 percent of loans now sit in stage two not past due, while 1.7 is stage two past due and 1.9 stage three. Our overall coverage for wholesale increases from 1.13 to 2.16 percent, reflecting the mix of PD migration across the good book and staging with a slight offset from a small reduction in our stage three coverage.

From what we can see today, it may not be until Q4 that we start seeing event-based stage migration as furlough ends on 31st of October and the various government lending schemes close. These movements will combine to deliver our expected GBP 3.5 billion to GBP 4.5 billion of 2020 impairment charge expectations, subject, of course, to the economics being as we see them today.

Moving on now to look at risk-weighted assets. Risk-weighted assets decreased GBP 3.7 billion in Q2 as counterparty and market risk were both down GBP 1.5 billion, while credit risk was down GBP 700 million. Counterparty and market risk deductions were driven by NatWest Markets where RWAs decreased by GBP 3.8 billion as the business works towards its full-year reduction target. Counterparty risk in NatWest Markets decreased by GBP 1.5 billion, reflecting the exit of specific positions and market risk also decreased by GBP 1.5 billion as markets normalized during the second quarter.

Credit risk reduction was mainly driven by personal banking where lower spending by credit card customers resulted in reduced undrawn RWAs. For drawn balances, new lending under government schemes offset general credit risk migration. Looking forward, RWAs at end 2020 are expected to be in the range of GBP 185 billion to GBP 195 billion. We have seen little pro-

cyclicality in RWAs in the quarter, in line with the low level of overdue payments we are seeing.

Moving on to capital, liquidity and funding. We ended the quarter with Common Equity Tier 1 ratio of 17.2 percent on a transitional basis under IFRS 9. This is 60 basis points higher than Q1. We are benefiting from 70 basis points of transitional relief in Q2 as well as a reduction in RWAs of 30 basis points. Following a change in the rules, the banks are now required to take 100 percent IFRS 9 transitional relief on expected credit loss movements in stage one and stage two provisions from the 1st January 2020.

The movement in ECL from 2020 is subject to a full add-back in 2020 and 2021 and then unwinds over the following three years to 2024. This change aims to reduce the pro-cyclicality impact caused by increasing ECL and on a fully loaded IFRS 9 basis, our CET1 ratio was 16.3 percent. This gives us a strong position both in transitional and fully loaded basis terms.

Moving on now to capital and leverage on the next slide. In terms of capital headroom, our CET1 ratio was 830 basis points above the maximum distributable amount of 8.9 percent. Our total loss absorbing capital was 36.8 percent, well above the minimum requirements. This headroom reflects our progress issuing senior debt that's eligible for MREL purposes. Our U.K. leverage was 6 percent, which is 275 basis points above the Bank of England's minimum requirements.

We believe that this excess capital position means that we can manage through the economic downturn and also gives us options in the long term. As Alison said earlier, given the shape and mix of our business, we believe that we should be operating with a CET1 ratio of 13 to 14 percent over the medium to longer term.

We have also maintained strong liquidity levels with a high quality liquid asset pool and a stable diverse funding base as you will see on the next slide. Our liquidity coverage ratio for the first half was 166 percent, reflecting about GBP 68 billion of surplus primary liquidity above minimum requirements.

Elevated liquidity levels were mainly driven by deposit inflows as customer deposits increased by GBP 39 billion.

Our U.K. personal banking deposits grew GBP 11 billion to GBP 161 billion with most of the growth in current accounts as a result of lower consumer spending in the face of both lockdown and increased economic uncertainty. Commercial banking deposits grew GBP 25 billion to GBP 160 billion as customers built up liquidity and retained drawdowns from the government lending schemes.

This significant growth in deposits is driving the 7 basis point decline in net interest margin that I spoke about earlier. Our deposit base is well balanced across commercial and retail and our wholesale funding mix reflects a range of sources and maturities. Our short-term wholesale funding is GBP 22 billion. During H1, we took a decision to repay GBP 5 billion to the term funding scheme and draw GBP 5 billion from the new term funding SME scheme. This leaves us with GBP 5 billion of TFS and an additional GBP 5 billion of TFSME.

Moving on to my final slide, an update on targets and guidance. We continue to expect that regulatory change will have an adverse impact of around GBP 200 million on personal banking income in 2020. We maintain our cost reduction target of GBP 250 million for the year. As we decided on an additional property exit this year, strategic costs are expected to be in our original guidance range of GBP 0.8 billion to GBP 1 billion rather than the bottom end as we guided at Q1.

On impairment, subject to economic conditions as we see them today, our full year charge is likely to be in the range of GBP 3.5 billion to GBP 4.5 billion and RWAs at end 2020 are expected to be in the range of GBP 185 billion to GBP 195 billion. As you have heard, we're making good progress in restructuring NatWest Markets and we are now intending to achieve the majority of the expected medium-term reduction in NatWest Markets RWAs by the end of 2021 while managing the associated income disposal losses to around GBP 200 million this year and a further GBP 400 million in 2021, subject, of course, to market conditions.

And with that, I'll hand back to Alison.

Alison Rose: Thank you, Katie. So in conclusion, as the impact of the pandemic on the economic outlook remains uncertain, our focus is on continuing to support our customers whilst protecting the performance of our business. The strength of our franchise is clear. During the first half, we have supported customers and accelerated our digital offering to deepen relationships, whilst also taking a prudent approach to risk and deploying our balance sheet carefully.

We have taken swift action to address COVID-19, but also maintain focus on our key strategic priorities. We have made good progress refocusing NatWest Markets and expect to achieve the majority of our RWA reduction by the end of 2021 and we remain on track to deliver our cost reduction target of GBP 250 million for this year.

Most importantly, we have a capital generative business with a strong CET1 ratio, giving us headroom that is somewhere between GBP 6 billion to GBP 8 billion above our target ratio of 13 to 14 percent over the medium to long term. This capital strength gives us flexibility to navigate the uncertain outlook, to resume dividend payments to shareholders as soon as it is appropriate to do so and to consider options that deliver compelling shareholder value.

Thank you very much and we're very happy to open it up to questions now.

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

Rohith Chandra-Rajan: Hi. Thank you very much. Good morning. Was wondering if I could ask on a couple of areas please, income and capital. So firstly on income, be really helpful actually to get some color on your revenue expectations for the second half of the year. I guess I'm thinking in terms of volume growth and then the margin drivers, so the hedge, loan and deposit pricing, but also mix as well.

And then the second question on capital, you've given us a risk-weighted asset range which is very helpful, but I was wondering if you could help us with the drivers of the numerator of the CET1 ratio. There's obviously earnings, but also in terms of what your expectations are for beginnings of the reversal of the IFRS 9 impact, anything you're expecting on software intangibles if that comes through and anything else that we should bear in mind for the CET1 progression. Thank you.

Katie Murray: Rohith, I think that might be six questions in one you tried to get through there. So if we go with revenue outlook for the rest of year, I think at the beginning of the year we gave some quite fulsome guidance. So we've obviously confirmed the GBP 200 million in relation to the HCCR (High Cost of Credit Review). I'm sure we'll talk more about our NIM outlook as we're moving forward, but certainly as we look at where consensus is sitting, at the end of the year at the moment, we're very comfortable with that in the round.

In terms of revenue opportunities, if I take personal first, what we'll see as the economy begins to recover, we will see an element of increased retail sales which will drive our customer fee income, our NII which relates to our unsecured balances, credit cards, that's obviously fallen off quite a bit in Q2 and we'll also see new demand for lending.

Our H1 mortgage lending was GBP 16 billion, but it was very much split GBP 10 billion and GBP 6 billion and so it's good to see that activity seems to be increasing again which we're very pleased about as well. In commercial, while the business – all of the government lending and the business bounce back loans, they themselves are lower margin. Given the volume we've done, that also helps income which will help us in the tail end of this year as well. So overall, relatively comfortable on income, accepting, of course, it is in the face of what's been a big rate drop.

On capital, if I take the software intangibles piece and there's also a small bit to come through on SME regulation as well, we would estimate that would be 20 to 30 basis points of positive impact in the next quarter, so you should see that coming through.

When we look at how IFRS 9 might unwind, so we've got 90 basis points for the first half. We've given you guidance today around RWAs as to how they might look for the end of the year, GBP 185 to 195 billion; we've also given you GBP 3.5 to 4.5 billion of impairment guidance. If I was to look at those in the round and if you were to say let's assume you hit the middle of the RWAs and you hit the middle of the impairment range, about 20 basis points would come off on IFRS 9 and then you'd obviously lose on capital about an extra 70 basis points in terms of that RWA uplift. Then you've got to decide what your thoughts are around that, but I'd say head into that middle of that range probably gives you a fair enough guidance. So clearly it will have an impact as it unwinds. Thanks, Rohith.

Rohith Chandra-Rajan: That's very helpful. Thank you.

Operator: Your next question comes from the line of Martin Leitgeb at Goldman Sachs.

Martin Leitgeb: Yes. Good morning and thank you – thank you very much for the – for the presentation. I just wanted to follow up on kind of a question tied to revenue and revenue outlook and just in terms of the growth opportunity. So very strong growth in mortgages during the half-year despite, obviously, the impact of the lockdown and I was just thinking how should we think about mortgage growth in particular going forward?

Could you just update us on where you see pricing at the moment, how that compares to your pricing target and if you potentially see scope here for increased grow opportunity or where else you could see grow opportunities for the group as the year progresses and maybe into next year, just considering obviously your strong capital and funding position at this moment in time?

And secondly, I just wanted to ask with regards to rate outlook and structural hedge and has anything changed in terms of how you approach the structural hedge at these levels just given where swap rate – swap rates have moved? And if you could update us on your thoughts about the potential introduction of negative rates from here. Thank you.

Alison Rose: Thank you. Well, let me start a little bit on the mortgage side. You obviously saw pre-COVID our strong pre-provision profit performance and a good

performance in mortgages. We expect to continue to grow market share in mortgages consistent with prior years with new business share ahead of our stock share that has now grown to 10.5 percent. Our retention levels continue to improve and that is key to supporting improving mortgage margin and overall profitability going forward.

Clearly, we've shared with you the impact of COVID as obviously the market went into lockdown and we're now seeing strong recovery with mortgages coming back, but our retention levels are running around 55 percent.

Katie Murray: It's 79 percent on retention level and our flow share is about 15 percent. So Martin, we always talk about how long it takes to move your share of group, so it's nice to see the growth from 10.2 percent up to 10.5 percent in this first half of the year. So we're pleased with that.

If I just pick up your comments around pricing in there, the back book is rolling off at 138 basis points. Our blended rate is 124 basis points. What you would see is given the mix of that GBP 6 billion, it was much more remortgage business rather than new mortgages, so therefore that helps lift your blended rate up a little bit. I would expect and hope that as we move into the year, probably more into Q4 I would say, that you'll see the new mortgages grow a bit more significantly as the activity of today feeds through into the system which of course is great for income. Slows down your margin a little bit, but great for income. So we're very happy with that.

In terms of rate outlook and the structural hedge, so in terms of the structural hedge, it's rolling off about 115 basis points at the moment and it's coming on at around 13 basis points. So clearly that's a big disparity, people often say, why do you still do the hedge? If we look at the average of what we added on and where spot rates were, average rate for the first six months, 48 basis points, but compared to where it is today. So it certainly helped us at this stage.

Negative rates, look, it's a great question. In our own economic scenarios, we've only got a 10 percent likelihood of negative rates coming in. So we don't see that as something that's particularly impactful. We've given you our

usual disclosure and it's on page 74 and 75 of the accounts, Martin. You can see what the earnings would be if we had a 25 basis point fall. That 25 basis point fall is structured with rates flooring out at zero, in line with a lot of what our contracts would actually have at this moment and that would be minus GBP 162 million in year one. Hopefully I got them all there.

Martin Leitgeb: Perfect. Thank you. Thank you very much.

Operator: Your next question comes from the line of Jonathan Pierce at Numis.

Jonathan Pierce: Hello, both. I've got two questions, the first actually is just clarifying what you were just saying, Katie, on consensus for this year. Can I – can I just confirm, were you talking about net interest income forecasts for full year 2020 look in the right place or was it more broadly on income or the second half? Just clarify that for us.

Katie Murray: So total income consensus, we are very comfortable with in the round.

Jonathan Pierce: OK. The second question's on risk-weighted assets. I got to confess, I'm slightly confused as to what's going on generally with RWAs at the moment. I think in the second quarter for you in the credit books, it was actually about a GBP 1 billion pro cyclical benefit to the risk-weighted assets and I guess it's just slightly at odds with what's happening on the provision side of things.

The IFRS 9 forward-looking provisions are clearly building very substantially, but the RWA movements, which I thought were also supposed to be forward-looking, particularly in the point-in-time books, are going the other way. I mean, if I look at your excellent disclosure on IFRS 9, I think the IFRS 9 PDs on, say, the retail book were up about 65 percent in the first half, but the Basel PD only moved by 10 percent.

So I guess the question really is do these models actually need to see genuine defaults going up before the pro-cyclicality in the risk-weighted assets comes through and does that mean that we're likely to see a further build in RWAs for pro-cyclical purposes into next year as well?

Katie Murray: The simple answer to that, Jonathan, is yes. I mean, changes in RWAs in H2 will be driven – obviously we've got RWA reduction in NatWest Markets, but you have accounted for that already. The level of pro-cyclicality is driven by the economy. What we need to see is the downgrades in the credit quality and the ratings in the commercial group and also the move through into default coming through as well on the mortgage book. So I do think that there is a risk and we haven't seeked to quantify it yet into next year because it really is very dependent upon how the next half happens and the speed at which we see the deterioration, but you could continue to see some RWA inflation into 2021. You're absolutely right.

Jonathan Pierce: OK. And the point on the forward look though, just to come back on that, again, in the other retail book, the IFRS 9 default assumption is 4.9 percent and it's 4.1 percent in the Basel models, even though they're supposed to be 12 months forward-looking on the same basis as IFRS 9. Why is there such a – such a big gap? Why is the RWAs taking time to come through versus the IFRS 9 builds?

Katie Murray: So I think part of the clue for that is as we move things into stage two, where you see our stage two build up quite quickly. Across our group of the movement to stage two more than 90 percent of it is still performing, it's still being serviced. So I think you're seeing that gap magnified given our relatively early move into stage two that you see coming through. I think that will explain your gap between the two elements.

Jonathan Pierce: OK. All right. Thanks very much.

Operator: Your next question comes from the line of Jenny Cook at Exane.

Jenny Cook: Thank you. Morning, guys. Couple of questions on clearly the kind of two themes in this reporting season. Firstly, I'm trying to get a sense of the underlying revenue expectations because if I adjust for the disposal losses and the own credit, it gives me about GBP 5.9 billion of underlying income for H1, but you've told us today you're broadly happy with consensus this year.

If I then plug in the revised disposal losses you gave us, it points to just over GBP 5.1 billion of underlying income for H2. Clearly an annualization of H2

would give me an FY21 income some distance below consensus. So I just wanted to ask kind of which of those half-yearly revenue run rates you're more comfortable with?

And then secondly just on RWAs and I'm trying to bridge between where you've printed today and your full-year guidance. So assuming that a large component of your lending in H2 will be government guaranteed, NatWest Markets' RWAs should reduce a further GBP 3 billion by year-end and you'd assume some of that commercial RTF utilization will unwind as well. Are you trying to tell us that you could potentially have GBP 17 billion of RWA pro-cyclicality just in H2? So that's about 10 percent inflation in six months. Thank you.

Katie Murray: Let me take those in turn. So you're absolutely right, we're comfortable with consensus in the round. If I were to look at 2021 consensus, I would say there's quite a lot of moving parts that have to happen. We've got to see actually how much of these impairments flow through because obviously you're familiar that when they move to default, we stop recognizing interest on them into the income statement, so that will have a little bit of an impact on it.

So at the moment, I would say, look, we're broadly comfortable as it stands. I think there's lots of pressure, there's lots of headwinds, there's uncertainty, but it doesn't feel like it's in a ridiculous place at this stage and we'll inevitably talk much more about it at Q3 and Q4 as we get into that.

But in terms of the RWA guidance, it's going to be a build of a couple of different things. You've hit most of their highlights – NatWest Markets coming off, the government lending growth and if I look at the government lending on the CBIL side, it's got about a 50 percent RWA intensity. So it's sometimes more, I think, than people realize in that space.

We'll obviously have some more mortgages going on, obviously much lower intensity, but in essence, then the balance will be made up of some level of pro-cyclicality that will come through, but we're comfortable with the GBP 185 to 195 billion range that we've given you.

Jenny Cook: OK. And just wanted to clarify on the first question, happy with 2020 at this point and then we'll hear more in 2021 income with Q3, Q4 results?

Katie Murray: Yes. So I mean, look, 2021 there's lots of things going on. Obviously it will happen in the next six months. I think none of us could have predicted the last six months, so I wouldn't attempt to predict the next six months, but as we look at where it's sitting on 2021, I'm broadly comfortable. Not trying to move you around dramatically at this stage.

Jenny Cook: Thank you.

Operator: We have two questions from Raul Sinha of JPMorgan via the web. The first question, could you discuss the outlook for loan growth for the rest of 2020, in particular unsecured balances which fell significantly in H1? And the second, can you discuss how the franchise within NatWest Markets is performing in the context of the strong industry-wide trends? Would you consider making refinements to the plan for NatWest Markets if demand for hedging activities improves relative to your expectations?

Alison Rose: Thank you. Well let me talk about NatWest Markets. Let me remind you why we are refocusing NatWest Markets. We're clearly very pleased with the performance of the business, a strong performance as it's responded to volatility in the market and activity around financing and balance sheet restructure, but that business needed to be refocused and so we're very comfortable with the plans and, as you can see, we're accelerating those plans.

Clearly the performance has been better in response to market needs and as we have refocused that business around our core clients who are strategically aligned, we would expect the products and services that we would provide would benefit from the activity of our customers in those segments, but the plans for restructuring and refocusing that business remain appropriate.

In terms of the unsecured question, largely I think that will partly depend on the recovery of the economy and just to remind you, we're lending to our own customers, but it will depend on the economy. But what we're seeing in July

is improving trends as we're seeing some growth come back in the economy and some of the details we covered there.

Katie Murray: Yes. And the only thing I would remind you on, Raul, is obviously we've got a very small unsecured book at GBP 3.7 billion. It's shrunk by GBP 0.6 billion over the last six months, so it's not a big driver of either our income or our impairments obviously which is important at this time.

Operator: And your next question on the phone comes from the line of Andrew Coombs at Citi.

Andrew Coombs: Yes. Morning. I think my questions have pretty much just been asked actually, but perhaps just a further clarification on NatWest Markets. I mean, the outlook was always for it to be a break-even business. As you alluded to, the first half's been particularly strong. The restructuring is actually going ahead of plan. Is the expectation that this will still be a break-even business in the medium term and predominantly used to support other areas of the bank like the commercial bank? Thanks.

Alison Rose: Yes. Absolutely.

Katie Murray: No change in that strategy.

Operator: And your next question comes from the line of Fahed Kunwar at Redburn.

Fahed Kunwar: Hi, Alison. Hi, Katie. Thanks for taking the questions. Just a couple. The first one on impairments. If I look at particularly your stage three coverage and your GDP assumptions, they're a lot stronger or a lot more conservative than your peers. If I'm thinking out to kind of 2021 loan losses, what's the kind of natural run rate you're seeing, ex the provisions, just so we can think about that 2021 number?

And also when you set those provisions for this half, how much does the fact that you've got a very, very strong capital position make you be a bit more prudent in your forecast? Because your unemployment forecast is even more prudent than the Bank of England's desktop stress test.

So that's my first question and my second question is on margins as well. Obviously thanks for your answers on negative rates earlier, but we saw in Europe, a lot of the European banks were willing to charge corporates for deposits. If we got into negative rate territory, I appreciate the sensitivity you called out, but is there any headroom to actually cut corporate deposits, so they get charged for having deposits at the bank or is that something that you wouldn't do? Thank you.

Alison Rose: Thank you. Well, let me start on the impairments. My philosophy is very much to take a prudent and considered approach to provisions and you've seen the scenarios that Katie walked you through in terms of our assumptions. Now, clearly what I would also point you to is even after absorbing those provisions, we have a very strong balance sheet and very strong capital strength. So we think we've taken an appropriate view of the outcome.

In terms of what we're actually seeing in impairments and in our underlying book, the government schemes and the support that has been put into the economy has actually done its job in terms of supporting businesses navigate and bridge through this period. We do have some small impairments in our commercial book, but very limited spike risk, but my approach is to be prudent and considered and thoughtful on our impairments. But I would point you to, even notwithstanding that, the strength of our capital.

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

Katie Murray: Yes. Just to finish off that impairments one, I wouldn't like a suggestion that we've gone big because we had plenty of capital. So I mean it's done consistently in terms of the approach that we take there. In terms of the questions around margin, obviously we've got a couple of jurisdictions in terms of Ulster and RBSI who already charge in terms of negative rates. We do see them making charges to corporates.

I can imagine, as you see in Europe, if you go out there, you would end up on that journey in time and it has taken time for them to get there as well, but it's not something that we're actively planning for at this stage given we don't see it as a big likelihood as we move forward.

Fahed Kunwar: Great. Thank you. Can I just ask one follow-up if I may? Sorry. Just when you think about that capital position that you mentioned, when you speak to the PRA on dividend, is there any acknowledgement for just how well capitalized you are versus your peers and if that influences when you can pay or what size you can pay on dividends once the regulator allows them at the end of 2020? Thank you.

Howard Davies: Yes. It's Howard Davies here. Let me try to pick that up. The PRA came out with a statement earlier this week to the effect that they would be reconsidering their policy on dividends in the fourth quarter and that means that, for the moment, this is all a rather theoretical question, but they are fully aware that we are very strongly capitalized, that we have surplus capital and of course before we came into this highly unusual period, they were very comfortable with us making a buyback and paying a special dividend.

So at the moment, the position is frozen as it was at the end of March. There won't be any movement in the fourth quarter, but I'm sure that when they do reconsider, they will take account of our strong capital position.

Fahed Kunwar: Thank you. Cheers.

Operator: Your next question comes from the line of Ed Firth at KBW.

Edward Firth: Morning, everybody. Yes. Sorry. I've got a number of questions, but they're really quick ones. So on the margin, you highlighted a 10 basis point headwind from the yield curve. Is that a sort of quarterly run rate that we should expect for the rest of the year? So I guess that's question number one.

Question number two, in UKPB; you obviously had a big fall off in fees which I guess you'd expect from the shutdown, et cetera. Can you give us some idea of what the run rate is now, what sort of recovery we've seen in that in terms of payments and how that might progress?

And then the third one was just on financing income. You've got this huge swing in financing income in NatWest Markets, almost GBP 200 million, and that's always been a very stable line in the past. I'm just trying to get a sense as to how we should be thinking of that into the second half.

And then very final question, could you give us some sort of sensitivity to your impairment charge to GDP assumptions? I mean, I heard the previous question, but if I've got it right, your weighted forecast for next year is a 12 percent growth in GDP in the U.K. which feels quite punchy relative to what other people are – well, certainly relative to consensus. So I'm just – how does that change if it was 10 percent or 8 percent? Can you just give us some idea of how that – how that number moves around? Thanks very much.

Katie Murray: Shall I start and then you pick up, Alison, what I have missed out? In terms of the margin, the 10 basis point cut, you reflect it one time in your margin numbers, so you wouldn't expect to see that fall next quarter coming through again.

Edward Firth: OK.

Katie Murray: Obviously you'll see a little bit coming through from the hedge as that moves through. I'd call that a couple of basis points, so in that space.

Edward Firth: OK.

Katie Murray: PB recovery, Alison talked about it earlier in her speech that we're beginning to see the recovery coming through. July numbers are positive in that space. Alison will add a bit more on that at the end. Financing income, you're absolutely right, it is generally a relatively stable set of results, but bear in mind what happened in Q1, you had this massive movement in the credit markets and so therefore what you were seeing in that space is a revaluation of a lot of the positions that you've got which then started to unwind.

So I would almost encourage you that, absent another massive market volatility piece, that's not something we would see and I would take the previous relatively stable income coming from that business as a good guide to the future rather than that volatility that we've got.

Edward Firth: Perfect.

Katie Murray: And sensitivity to GDP, we haven't given you single metrics in terms of what it would mean by moving one metric or another, but you'll have seen, Ed, I'm sure, on page 34, we give you a blend and what you can see if we were to move all of our metrics down to either, say, the upside, you would see our impairment charge would have reduced by GBP 1.4 billion in this half. If you were to move 100 percent to the downside, you would see that increasing by GBP 1.9 billion, but I haven't given you any guidance on single metrics.

Edward Firth: OK. No, that's really helpful.

Alison Rose: In terms of the recovery, obviously during the lockdown we saw a really significant drop off in spending and actually consumers behaviorally doing the right thing, paying down their more expensive debt, so paying down their credit cards and activity dropped. We've seen debit and credit card spending now up 10 percent on June levels and coming back quite quickly. Actually cash transactions have still remained very low, but debit and credit cards are going up.

We've seen mortgage volumes obviously increasing, which I mentioned, and commercial card and cash transactions have more than doubled by the low point in volume. So I think a lot of it is behavioral and we'll see what happens as the economy recovers, but we are seeing those volumes and fees coming back.

Edward Firth: Great. OK. Thanks so much.

Operator: Your next question comes from the line of Ben Toms at RBC.

Benjamin Toms: Morning, both. Thank you for taking my questions. Two from me, please. Firstly, on PPI. There was a release today in the numbers. Can you remind us what the stock provisions left is for this and how much more you have to work through on this topic? Could we see potentially more releases in coming quarters? And secondly, on mortgage prisoners. There was a consultation out this week from the FCA. Can you just confirm that you don't have any of this type of customer?

And linked to this topic, there's been discussions from activists on an SVR cap which was discussed in a report and whilst it wasn't ruled in, it also wasn't ruled out and the FCA said that they need to think about the potential impacts and have dialogue with the banks. Have you had any discussions about the topic of the cap with the regulator and do you have any sensitivity on what the impact would be on the financials if a 2 percent SVR cap was implemented? Thank you.

Katie Murray: Sure. PPI, GBP 506 million is left on the balance sheet on that. Look, we are substantially done on PPI. We've dealt with our claims; we're rolling people off the projects. We've just got to the last drip through of things going through. So I think for us, never say never, but it's a topic that is really behind us where we are at the level of completion we're very happy with.

In terms of the mortgage prisoners, this is not a big topic for us. We've done things in the past to help and have tried to deal with that and I think at this stage, we haven't had any some substantive conversations with the regulator in terms of that item. That's fair, Alison?

Alison Rose: Yes, that's right.

Benjamin Toms: Thank you.

Operator: Your next question comes from the line of Chris Cant at Autonomous.

Christopher Cant: Good morning. Thank you for taking my questions. Just a quick follow-up and then one on mortgages, please. Katie, you mentioned the SME support factor and software and you mentioned 20 to 30 bps of benefit. Was that a combined benefit or was that for each of them, please?

Katie Murray: Combined.

Christopher Cant: That was combined? OK. Thank you. I just wanted to confirm.

Katie Murray: Combined. Yes.

Christopher Cant: And then on mortgages, you mentioned some numbers in terms of 138 bps rolling off on the back book and you gave 124, I think it was, as a blended, I

guess, first-half average? If I think about what some of your peers have been saying, they've been talking about much, much higher front book margins, 160 to 170 basis points. Is that just a 1H average versus sort of July issue?

And related to that, in the past, you've talked about 80 to 100 bps being a circa 15 percent ROE even allowing for pending mortgage risk weight changes. If we look at where front book spreads are for the industry, they're obviously substantially above that. Could you just give us an update on where you think front book mortgage ROEs are at the moment? I guess they're up significantly and how does that play into your thinking about whether you want to actually start leading the market on pricing there and take more volume given that you are so well capitalized? Thank you.

Katie Murray: Sure. So look, I'll leave other peers to comment on what they're doing. It could well be it's an average of the closing in July. Our July would certainly have been a bit stronger, but I do think that 124 blended is the right way to think about it and bear in mind that in Q2, most of us would be doing any – we'd be doing re-mortgages, which would be at a slightly higher basis point level, so that could be pushing some of their numbers up as well.

Then in terms of the ROEs, we've probably not changed our guidance on that particularly. Obviously pricing has more or less held which is good, while rates have come down. So you'd expect to see those ROEs continue to improve. We're not keen at this point to do a race through to take a lot of market share. We've done some slight variations on pricing. You may have noticed last week, Chris, that we've started to now just move slowly back into the 85 percent LTV space where we had pulled out for the last three months.

But I think it's the best way to manage the mortgage book to make sure that we do the right thing for customers, we're able to deliver the right kind of service levels as well, which we've been pleased about with the volume that we've been doing. I'm very comfortable in the ROEs we continue to earn on this business.

Christopher Cant: If I maybe ask the question slightly differently, in the event that the market does present you with an opportunity for something like 160 to 170 basis

point front book spreads, would that be enough to get you to compete more aggressively given how far above your previous expectation of 80 to 100 that would be? I'm just trying to understand how the competitive dynamics might play out into the second part.

Katie Murray: So let's bear in mind that 80 to 100 is purely new mortgage business. So I would compare the 124 basis points to that 160. We view ourselves as quite competitive in this market. We're not looking to become more competitive because ultimately you end up pulling the margins down, but we do expect to continue to be competitive in that space. So I think if we were looking at something and failed to earn 160 basis points, we'd certainly continue to pursue it, but not at the point of then dragging that margin all the way back down again, which of course is what you would actually do. We're happy to continue to be as competitive as we have been.

Christopher Cant: OK. Thank you.

Operator: Your next question comes from the line of Aman Rakkar at Barclays.

Aman Rakkar: Morning, Katie. Morning, Alison. Yes. I just – could I – just two questions, please. I'm asking another theoretical question on distributions. Consensus had you loss-making prior to today's results for full-year 2020. I think given the impairment guidance, that's probably still going to be the case. On that basis, being loss-making, stat loss-making, does that preclude you from paying the ordinary dividend this year given your policy's based on the attributable profit?

And then in the – in the instance that you're not going to pay an ordinary, would you look to pursue, in theory, if you're allowed to, paying a special dividend in that scenario? And I guess what would be really helpful to understand is is there any way that you'd need to seek approval from the regulator around paying a special dividend in a way that perhaps you don't have to if it's the ordinary? That'd be really helpful.

And then the second is just on Ulster. Obviously quite heavily loss-making in the quarter, but even if I look through the impairment charge, loss-making on a pre-provision profit basis. I mean, how long do you expect that business to

be loss-making on a pre-prov basis and is it reasonable to expect that that could be part of some broader restructuring perhaps next year? I guess, has coronavirus accelerated your thoughts in that regard? Thank you.

Howard Davies: Let me pick up on distributions again, but I'm not sure that we're going to be able to be enormously helpful to you on this because there are a lot of hypotheticals built into your question. Let me just say a couple of things. One is that in the normal way, you don't ask the regulator for approval to pay a dividend, ordinary or special. You ensure that you are meeting all of the capital requirements and that the regulator is comfortable with your overall financial position.

And that would be – that's the normal case and as you know for the last year, we plan to pay an ordinary and, indeed, a special and you may take it that the regulators were content with that. As for where we go from here, however, they have essentially put a block on capital distributions which includes ordinary, specials and buybacks at this point and they said they will reconsider in the fourth quarter and frankly, I think it's not particularly helpful to anybody to speculate on what the situation might be in the fourth quarter and what we might be able to distribute at that point.

Alison Rose: Let me pick up the Ulster question. So as you know, our strategy was and is to grow that business organically and safely and we have been successful in growing both the personal mortgage and some of the commercial share in 2019. That strategy hasn't changed. Clearly COVID-19 presents different challenges to the economy and we will continue to consider all strategic options in relation to that business.

Operator: This next question is a three-part question and comes from Gary Greenwood of Shore Capital (via the web). First part, can you expand on your comment around using surplus capital to explore other options that offer compelling shareholder value? Are you considering acquisitions and if so, what areas of the business do you think need bolstering?

Then the second question, can you explain again the mechanical changes to IFRS 9 transitional relief and how these unwind? The final part, do you need

to see greater economic clarity to resume dividend payments/buybacks or is your capital position so strong that you don't need to wait?

Alison Rose: Great. Thank you. Well, I think we probably answered three and I'll get Katie to answer the IFRS 9 transitional relief, but let me start with the first question. Clearly we are very pleased to operate with the sector-leading capital strengths that we have and as I mentioned and let me reiterate, we see our medium to long-term CET1 ratio of 13 to 14 percent as being appropriate for the nature of our business.

It is our clear intention to return to our dividend policy as soon as possible and when it is appropriate and returning capital to our shareholders is our clear preference. Acquisitions have not changed in our priority list. We have very strong client franchises, as you can see in our personal and commercial bank, and we see significant opportunities to increase our share closer to our prevailing market share, so opportunity to grow.

You have seen that we have made small acquisitions like FreeAgent and looked at mortgage books in the past if we think that they add shareholder value, but let me come back to the point that it's our clear intention and our clear preference to return capital to our shareholders when it is appropriate to do.

Katie, can I give you the IFRS 9 transitional?

Katie Murray: Absolutely. Gary, I'm conscious it is a complicated adjustment. So if you wind back, you're basically getting relief on things that are stage one and stage two. Once things move into stage three, you take the hit on them. So we are sitting at the moment with GBP 1.6 billion of relief which equates to about 90 basis points of CET1.

If I were to take you to a midpoint of our range, what you would have seen happening as we got to the midpoint is you'd see a natural migration of things into stage three at quite a specific level. So I would have expected at that point your transitional relief, rather than being GBP 1.6 billion falls to about GBP 1.2 billion. The math is relatively complicated behind how much you do

that, but let's assume you see quite a lot of migration into stage three, that's why you lose such a portion of that and then that would have a cost of 20 basis points in terms of your CET1 if you got to that midpoint on your impairment summary. Hope that that helps.

Operator: Thank you and your next question comes from the line of Rob Noble at Deutsche Bank.

Robert Noble: Morning, all. If I could just explore the range on impairments here that you've given, what's the underlying impairment at the moment? And if I look at your guidance now, there's maybe GBP 321 million per quarter. Is that – is that an elevated level? And at the top end of your guidance, is that just assuming more stage three migration or is there macro assumption changes assumed at the top end of your impairment level?

And then secondly, on the structural hedge. I think we talked mostly about this, but you've seen quite a lot of deposit growth, but no growth in the hedge, is there a particular reason for that? Thank you.

Katie Murray: Sure. So if you look at your ECL charge for the half, it was split GBP 308 million in terms of stage one, GBP 2.1 billion in terms of stage two and GBP 400 million in terms of stage three. When you look at what's in stage two, about 90 plus percent of that is debts are continuing to be serviced which is why you are where you are on that number.

When I take it up to the range, I would say that stage three migration of GBP 400 million for a half, it's not a bad number. It's not particularly elevated for us. It's actually slightly lower than we've seen occasionally. So it really is a modeled output. The GBP 3.5 billion to the GBP 4.5 billion number is very much guided on stage migration. If we see a significant move on macroeconomic assumptions, that's where that number would come under threat, obviously both positively and negatively in terms of what happens within there and we talked on one of the earlier answers around some of the sensitivities which we've given you for H1.

Structural hedge and deposit growth, no, you're absolutely right. We haven't converted all of that at this stage into our structural hedge. Given the speed at

which the deposits have grown, we're happy to just wait a little bit and look at the behavioral life of that, but that's something that we will look through at the next couple of quarters.

Robert Noble: Great. Thank you very much.

Operator: And those are all the questions we have time for today. I would now like to hand the call back to Alison for any closing comments.

Alison Rose: Thank you very much and thank you, everyone, for joining and for all of your questions. So just to conclude our call this morning, you hopefully have seen the strength of our franchise is very clear. We've supported our customers well during the first half, whilst also taking a prudent approach to risk and impairments and deploying our balance sheet carefully. We've taken swift action to address COVID-19, but also maintain focus on our key strategic priorities.

We expect to achieve the majority of our RWA reduction in NatWest Markets by the end of 2021 and we're on track to deliver our cost reduction target of GBP 250 million for this year. More importantly, we have a capital generative business with a strong CET1 ratio, giving us headroom of GBP 6 billion to GBP 8 billion above our medium to long-term target ratio of 13 to 14 percent. I'll reiterate this capital strength gives us flexibility to navigate the uncertain outlook, to resume dividend payments to shareholders when it is appropriate to do so and to consider options that deliver compelling shareholder value. Thank you again for joining us today.

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