Company Name: NatWest
Company Ticker: NWG LN
Date: 2018-04-27
Event Description: Q1 2018 Royal Bank of Scotland Group PLC Interim Management Statement Call

Market Cap: 32276.2546622
Current PX: 268.4
YTD Change($): -8.9
YTD Change(%): -3.21

Bloomberg Estimates - EPS
Current Quarter: 0.071
Current Year: 0.255
Bloomberg Estimates - Sales
Current Quarter: 3171.5
Current Year: 12988.286

Q1 2018 Royal Bank of Scotland Group PLC Interim Management Statement Call

Company Participants

- Ewen James Stevenson, CFO & Executive Director
- Ross Maxwell McEwan, CEO & Executive Director

Other Participants

- Andrew Philip Coombs, Analyst
- Christopher Cant, Analyst, United Kingdom and Irish Banks
- Christopher Robert Manners, Analyst
- Claire Kane, Research Analyst
- David John Lock, Analyst
- Jason Clive Napier, Analyst
- Jennifer Cook, Analyst
- John Cronin, Analyst
- Jonathan Richard Kuczynski Pierce, Analyst
- Joseph Dickerson, Analyst
- Martin Leitgeb, Analyst
- Michael Francis Helsby, Analyst
- Raul Sinha, Analyst

Presentation

Operator

Ladies and gentlemen, you are on hold for the RBS Q1 results analyst call. I would like to remind you that the call today will be recorded. (Operator Instructions) Good morning, ladies and gentlemen. Today's conference call will be hosted by Ross McEwan, Chief Executive of RBS. Thank you. Please go ahead, sir.

Ross Maxwell McEwan, CEO & Executive Director

Thanks very much Rose. Good morning, everyone. Thanks for joining Ewen and I. Today, I'll give you an overview of that progress in the First Quarter and then we're happy to take questions. And you're not restricted to 1.

In the first three months of 2018, we've made a pretax profit of GBP 1.2 billion, that's up 70% on the same period last year. This contributed to a bottom line profit in the period of GBP 792 million, that's exceeding the full year 2017 profit we reported back in February. With a return on tangible equity of 9.3%, it's a good set of results showing the progress we are making despite a more competitive market. Our income is up. Costs are down and we've maintained robust capital strength. Some of that key financials for the First Quarter are; income up 2.8% to GBP 3.3 billion. Underlying expenses are down 2.1% to GBP 1.8 billion. And this has generated positive operating JAWS of 4.9%. Cost to income ratio was 60.5% in Q1. And this is 15.6percentage points lower than Q1 2017.

Our capital position is stronger. CET1 ratio was 16.4% at the end of Q1. And that's up from 15.9% at the end of the year. And we continue to target end of year RWAs to be GBP 5 billion to GBP 10 billion lower than Q4 2017. You have also noted the action we took earlier in this month to address the historic weakness in our Main Scheme pension fund. The pro forma impact of this on our Q1 2018 Common Equity Tier 1 capital ratio would be a reduction of 80 basis points.

This quarter's performance takes us another step closer to achieving our 2020 targets of a sub 50% cost to income ratio and 12% plus return on equity. As Q1 is usually our strongest quarter, I don't think you should extrapolate all of these trends for the full year. We also remain cautious in our outlook, continuing to de-risk the balance sheet.

Turning to the financial highlights of our largest franchises. The U.K. mortgage market is undergoing a period of intense competition despite the rate rise in November, average rates have actually fallen. Against this backdrop, our mortgage lending growth slowed in the First Quarter as we prioritize risk and pricing discipline.

Given this our flow share reduced to 9.8% in the First Quarter, down from 11.7% in Q4 2017. Despite the challenging conditions, our Personal and Business Banking franchise delivered GBP 698 million in operating profit in the quarter and the mortgage approvals in the First Quarter are stronger with a flow share of around 12%. Commercial banking continues to refocus its lending on those areas where we see longer term sustainable return with an average risk appetite and as you look at the commercial business, please remember that we have moved assets across to both RBSI and NatWest markets.

The impact of this on the Q4 2017 balance sheet would have been to reduce net loans and advances by about GBP 4.8 billion. Then the First Quarter, the commercial business witnessed lower impairments helping the business more than double its return on equity when compared with the First Quarter of 2017.

Customer activity was down on Q1 2017 in NatWest markets. Despite this, the business generated total income of GBP 437 million and continues to work towards a lower cost base. These results include legacy capital resolution assets. In the quarter, we reduced legacy risk weighted assets to GBP 17.5 billion compared to GBP 30.5 billion in Q1 2017.

Q1 also saw our customers continue to migrate from physical to digital channels at pace. Some of the trends we're seeing include check usage is down 17% on Q1 2017. ATM transactions are down 17% on Q1 2017. Branch counter transactions are down 7% on Q1 2017. And at the same time customers sent GBP 10.7 million mobile payments in Q1 2018, that's up 36% on Q1 2017 volumes. 356,000 customers have downloaded our mobile app in Q1 2018 alone, bringing the total mobile users to 5.75 million users.

Volumes, of course, to our contact centers reduced 7% on Q1 2017. And finally, Cora AI chatbot held close to 360,000 conversations in the quarter, of which 35% required no hand over to a colleague. This shift reflects a change in customer behavior to digital channels. So we are responding to this by building our business model around how customers want to bank with us in the future.

Turning briefly to our legacy issues, we know many of you'll be looking for an update on our DOJ investigation. Unfortunately, we have no further update to provide today. You all have seen that we took action last week to substantially address this historical funding weakness in our Main pension fund. This is an important moment for the bank. There's also good news for the trustees and members of the scheme, as it facilitates a material reduction on the level of investment risk in the Main Fund, importantly though for shareholders, it gives certainty and brings the prospect of dividend payments, another step closer.

We'll also continue to make strong progress towards meeting the 2019 ring-fencing deadline. Today, we have announced a number of board appointments in preparation for this. And with that, Ewen and I are now happy to take any of your questions.

Questions And Answers

Operator

(Operator Instructions) We will take our first question comes from the line of Michael Helsby at Bank of America.

Michael Francis Helsby, Analyst

So I want to focus on the mortgage book, if that's okay. Obviously you mentioned, increased competition impact in your flow in Q1. So this 3 areas, I'd love to explore. First of all, I was wondering if you could talk about what you did to improve the share of your applications back to 12% in the quarter. Second, I was wondering if you could update us on the front book, back book gap that you're seeing at the moment. And finally, on redemptions clearly starting to pick up as you run into the second half '15, First Quarter '16 vintages which was of course when you really started to boost your share of flow in the mortgage market. So I was wondering how we should think about your appetite for mortgages here as the share of growth flow that you need to deliver the same growth increased to above 12% to 13% or is that still the level that you're happy with? And if the mortgage pricing in the market doesn't improve, what will you do? Will you shrink the book again or you look to protect mortgage spreads so you look to compete, get back in and look to compensate that with improved deposit spreads hopefully as rates rise? Sorry a lot in there. But I think it's all important questions.

Ross Maxwell McEwan, CEO & Executive Director

Yes, Michael. I'll start and then hand over to Ewen. With mortgage market is important for us. We've said, we do want to grow in this. We've built really good distribution. Final quarter of last year, we did try to nudge up the pricing in the marketplace. Unsuccessfully which shows that we -- a 10% market share, don't have the pricing power that probably some of the bigger players do. But it did as you're saying affect our flow into the First Quarter, because what you write, fix [ph] the applications in one quarter flows into the next. We have put our pricing back into the market. We've moved also a lot, processing around the 5-year and we're now seeing close to 50% of business hitting into a 5-year part of the book. So this being quite a shift, there is customers themselves see interest rates going up and front lock in. Around 12% look -- anything greater than now 10%, I'd be happy with, as long as you got the discipline on the credit and on the pricing, there's still reasonable profitability in this book. But if we do get or find ourselves as low profitability, yes, we will quietly back out of this. Front book, back book spread is going after -- difference is going after 70 to 80 basis points. So it's big. And what we have seen in this quarter is a couple of the bigger players actually start to move the pricing up a bit. We had seen that last year, actually one of them moved the pricing down, we'll look who went the other way which we found interesting. But they have started to move the pricing up a bit in this quarter. So we're doing okay. Back up the 12% market share, still profitable business. So you do it, be careful on the credit. Ewen, comments from you?

Ewen James Stevenson, CFO & Executive Director

Yes, I mean I guess just a couple of other things Michael that, as you saw on U.K. PBB, NIM in the quarter, it was actually up by basis points if you strip out the one-offs, it was up about 1, I know young lad surprised us all with his NIM forecast for the year as part of full year results. And I think if he was here on the call, he would probably tell you, he is still comfortable with his forecast for the year. So what that implies obviously is we are getting some benefit coming through from liabilities for H2. So I will see what happens in May. But certainly part of the answer for us is we do expect there to be re-balancing between asset and liability spreads as the interest rate environment begins to improve.

Ross Maxwell McEwan, CEO & Executive Director

The other point you made, Michael just around redemptions, we did have a big redemption flow in the final quarter last year, beginning of this year which knocked us around a bit. But that's workings of how much we put on the book to years prior. And we are starting to take just a little bit more action around holding on to some of this business as well. Particularly the brighter [ph] flow business. So I still interested in this market if we can grow greater than our stock, I am happy 12% for this quarter on applications. But it's very competitive. But still making money out of them.

Operator

Your next question comes from the line of David Lock of Deutsche Bank.

David John Lock, Analyst

I've got 2 please. The first one's on costs. I think they are little bit higher than where consensus was expecting today and I just wondered if you could perhaps comment on the consensus cost figure for this year, which I think is sitting at about GBP 6.2 billion excluding the strategic items and the litigation income, I mean do you think that's a fair number to be driving towards for this year? Then I have a second question which is on the non-interest income. I appreciate you've moved a few things around this quarter. It looks like certainly versus my numbers that market was a bit better. You have a lower disposal losses. But I'm struggling a little bit with the final piece of non-interest income performance. I just wonder, if you could comment on whether that element is an underlying improvement and where do you think you can sustain that kind of performance in the non-interest income x than NatWest markets performance this quarter?

Ross Maxwell McEwan, CEO & Executive Director

Yes. So on costs. So I think you were out by about a GBP 1 billion. David. So we will be delighted if our costs were on track to be GBP 6.2 billion this year. But I think you'll see consensus is GBP 7.3 billion -- GBP 7.2 billion. That does feel a little bit low to us. We're not trying to change these on 2020. But as we talked about as part of full-year results, we don't expect cost reduction this year to be linear. We've got substantially higher investment in innovation spend going in, in the order of about GBP 300 million higher than last year and most of that's getting expensed through the P&L. We've got a few large legacy remediation projects ongoing. So that GBP 7.2 billion number to us feels a little bit low based on the trajectory we're on. But just as a reminder, the Q1 on Q1 comparison headline was about a 2% reduction. But if you back out GBP 50 million odd of that recovery we had in Q1 of last year, would have been closer to a 5% reduction (inaudible), which we've always talked about is being a good indicator, real underlying cost reduction was down 7% year-on-year. So it feels 2018 at the moment in consensus, a little bit low. But we're not trying to change the 2020 views. On non-interest income, it's a bit hard to comment, because we don't really know what's sitting in your model. We were, I guess in terms of NatWest markets, we thought it was a pretty good quarter. Obviously it was a tougher market for rights than we had a year ago. And some of the comparisons versus peers, we obviously report in sterling as opposed to dollars. But overall, the core NatWest markets income was down about GBP 100 million on the year before. But we still feel very comfortable with the overall guidance we've been giving generally, that we're targeting at about GBP 1.5 billion of income. Again, over the last three years, we had GBP 1.4 billion, GBP 1.5 billion and GBP 1.6 billion. There were very low capital resolution disposal losses in the quarter. And again, we've talked about having another GBP 300 million or so cap rates disposable losses coming through at some point. Some of which you'll see obviously coming through the commercial, which is now brought shipping book sitting in it.

Operator

Next question comes from the line of Raul Sinha of JPMorgan.

Raul Sinha, Analyst

Can I have 2, please. Pretty straightforward ones and then maybe just an invite for Ross to talk about the digital bank as well. So in terms of the straightforward ones, I was wondering if you could give us an update on your residual shipping exposure. I couldn't quite spot it, I don't know if that's available. And if you could give us on that. Then secondly, I was wondering if you could talk a little about discontinuing from your comments in GBM -- in currencies. If I look at the supplement and the product disclosures that you have provided, I agree that rates obviously is down. But I was surprised to see currencies as well. Any particular comment, is there on FX? I was not assuming that there will be an FX impact. But I would have hoped that you would have done better this quarter in some of those product lines. Is there anything else you should be reading into that? Then lastly, let's say, if Ross can give us some thoughts on the digital bank that we read a lot about, that would be quite useful.

Ewen James Stevenson, CFO & Executive Director

Yes. So on the first question on shipping where you'll find that if you look on Page 26 of the financial supplement, we've actually provided a different breakdown now of commercial, which will be the same breakdown we'll provide going forward, very much centered around customer groupings which we thought was more helpful. And the way that we look at the business. But in the other line, you'll see that jumped up from GBP 0.5 billion to GBP 3.4 billion in exposure in Q4 of last year, which was shipping in some project finance plans that came across on cap rise [ph]. So -- and that numbers now down to GBP 3 billion. So we would expect that just to continue to roll off over the coming years. But overall, I think when you look at the transfers in and the transfers out with commercial transfers out on the context of ring-fencing into private, into RBS International. It has overall about a 2% drag on the returns in commercial. On the question on GBM, I don't think we were surprised, disappointed at all by the performance of currencies. Overall, in terms of the income for the quarter of GBP 412 million, is an overall mix of business. We thought it was an okay quarter. January started out very well. February was okay, March was weaker. I think the other thing to call out as you will see that market risk RWAs, I think similar to what we seen with others spiked up a bit in March. We would expect those to roll off during Q2. I think substantially. So one of the reasons RWAs were up in the quarter was about GBP 2.6 billion of higher market risk RWAs, overall slightly higher than that in NatWest markets and we also had some modeling changes in commercial which had about a GBP 4 billion uplift.

Ross Maxwell McEwan, CEO & Executive Director

Just a commentary on the digital activity inside the bank. We are doing quite a bit, we signaled that at in February that we would spend more money this year and next on digital technology across the bank. It's not specifically related to one part of the bank. And we've got a number of activities going on there. We see that the investment in this area will be good from some activities that will get into the market. But also the learning across the entire bank. So we're doing lots of work, not just in the businesses. But in HR, we have an artificial intelligence shape up that our staff use now to get answers through the bank. We're doing a lot of work in the finance team and area around, good move into the cloud. We signaled we're going to move to the cloud on some of our core banking activities. But we are looking at other opportunities in this marketplace that as we choose to launch them, we'll let the market know. But I think it'd be fair to say we are doing a lot of quite innovative activity inside the bank, some of which you are seeing, others, we may choose not to actually put into the marketplace.

Raul Sinha, Analyst

The speculation, Ross about this new digital bank in Q3 though, is that something that is totally separate or is that add on to the current systems or is this an enhancement in terms of the mobile bank?

Ross Maxwell McEwan, CEO & Executive Director

Can I say bit of all things, things that we're doing, we are learning across the bank. We're doing outside the bank. But doing it for the bank and other things that we may consider doing quite separately and as I said, will have you to chat about them when we decide to launch them. But I think people are getting fixated about a digital bank when we are actually thinking more broadly than that across a number of areas that would be really good for our customer groupings.

Operator

Your next question comes from the line of Claire Kane of Credit Suisse.

Claire Kane, Research Analyst

Good morning. And so could I have a follow-up on your -- the mortgage margin point you made. And also then one on impairments. You mentioned that the pump it [ph] backward differential is 70 to 80 bps. Do you think that's going to improve given the commentary around the 5-year becoming more popular product and also the recent rate hikes in the market. And also given that's kind of double the 40 bps, I think you previously said, are you just a bit more comforting on the deposit spread outlook, particularly with some higher rates coming. So just a bit more clarity there please around the stable NIM outlook for U.K. P

BB. Then secondly on impairments, I think it was, obviously low impairments across the board all divisions. So could you maybe just talk through some of the trends or if there's any impacts from IFRS 9 and how that's impacted the charge this quarter?

Ross Maxwell McEwan, CEO & Executive Director

First on the mortgage market, I mean, as I said, we have a price tag from this marketplace, we can only respond to what's going on in the market. It has been very, very competitive. But what as I said, we've seen a couple of the larger players, they would have pushed the pricing back up again, because I think we will suffer from the same issue, if I am down 70 to 80 bps on the front book, pretty much everybody else would be exactly the same, some slightly better and some slightly worse. So I think you've just got a number of people with lots of liquidity wanting to get into the marketplace to supply and demand situation. And everyone sees mortgages is a great place to be at the moment. So I think it will get back to a more normal level. But not too sure where, we're just is going to be competitive. But only right, we believe we can actually make some money out of it and be careful on the credit side of it as well. So now about the comment on that, we're a price taker, not a price maker on this part of the market. On impairments, look we did have a good quarter compared to the same quarter last year. We weren't involved in a number of larger businesses that had some difficulty, I'll go with 1 or 2 but not across the board. But you've got to expect us to be there when we are 25% to 30% of the SME and mid-market business. But some of these we didn't end up catching on our book this quarter, which was good. It would probably stay with us sort of more normalized in payment outlook longer term of 30 to 40 basis points. But we've had a good quarter.

Ewen James Stevenson, CFO & Executive Director

Other thing, Claire, I mean let's go back to what I said earlier, I mean overall on margins, I think we are comfortable with the fact that we're going to be able to continue to sort of preserving them around the sort of levels through combination of both liability spreads and some of the spreads we're getting on other product so.

Ross Maxwell McEwan, CEO & Executive Director

IFRS 9, Ewen?

Ewen James Stevenson, CFO & Executive Director

IFRS 9 -- I mean I think IFRS 9 impairments will probably slightly higher than they would have been, had they been under as high as 39. But no real things to call out in relation to our IFRS 9 at this point. 10 basis points is lower than what we would have expected as a trend at this point. As Ross said, we weren't involved in any of the large single 9 defaults that happened in the quarter. But we certainly wouldn't see that as a consistent trend given our market shares in both commercial at 25% and businesses of 30%.

Operator

Our next question comes from the line of Chris Cant of Autonomous.

Christopher Cant, Analyst, United Kingdom and Irish Banks

I have 2, please. One just follow up. I didn't catch what you said on further non-core losses this year, could you repeat the figure you gave in terms of the further non-core losses still to come through the operating divisions this year? Then my other question was on RWAs. You've got this GBP 191 billion to GBP 196 billion guided range which you've reiterated from full year obviously, RWAs were up in the quarter. What's determining where you land in that GBP 191 billion to GBP 196 billion range, I know consensus is towards the bottom end of that and your RWAs were, a negative surprise on the quarter. If there are any more to come on these commercial model uplift? Or is that's it for the year? And would your loans coming down as well, with that factored in when you gave that RWA guidance like we were expecting your loan book to be shrinking when you gave that RWA guidance or does that actually push you towards the bottom end of the range, if your loan book is going backwards slightly.

Ross Maxwell McEwan, CEO & Executive Director

Yes, on the non-core losses, I didn't actually give a figure for this year. I just said that capital resolution what we went up into last year, still had about GBP 300 million of losses to go to get to the GBP 2 billion, a decent amount of that should come through this year. But some of it will depend on timing of disposals. So if it's not in this year, it will be in next year. But I have a figure of around GBP 300 million of (inaudible) losses that come through in your models.

Christopher Cant, Analyst, United Kingdom and Irish Banks

But you did have a couple of business losses, I think in the first -- disposal losses in the First Quarter. I'm not sure whether those are separate to or part of that GBP 300 million?

Ewen James Stevenson, CFO & Executive Director

Yes. That was relatively minimal and --

Ross Maxwell McEwan, CEO & Executive Director

GBP 16 million in the quarter first.

Ewen James Stevenson, CFO & Executive Director

So it's put in GBP 184 million payment to your models for the remainder of the disposal losses. On RWA. So we obviously knew when we came out with that guidance of full year that we were going to see some uplift in commercial and we actually flagged it as part of full-year results. Be any surprise, I think, we have 2 surprises in Q1 where, firstly the market risk RWA uplift that we saw, as I said, we expect that to sort of largely back out and hopefully back out in Q2. And because of the weakness in flow share and mortgages and the high redemptions we saw that loans were weaker. But remember the average RWAs risk weighting is about 7% on mortgages. So I'm not sure that we'll have a huge impact on RWAs. In terms of the delta between sort of 5 and 10 down off 201 [ph]. I think big swing item in that is Alawwal Bank. Alawwal is still in major discussions and the outcome of those discussions, I think, will determine whether you're at the top or bottom end of that range. We know consensus is currently sitting at about GBP 192 billion, I think it is for the full year. So I guess, within that number is an assumption that Alawwal happens and those deemed consolidated.

Operator

Next question comes from the line of Joseph Dickerson of Jefferies.

Joseph Dickerson, Analyst

Firstly loving the 15 page IMF early in the morning. It's fantastic. I guess, second, just following on from Michael's question at the beginning around the mortgage growth and then also what's happening on the commercial book, can you give us some color on, I know it's early in the year. But what we can think about for loan growth or lack there are I think [ph] it's quite an important dynamic now so you become a more normal bank. So any color there would be appreciated. Particularly in the Business Banking segment where when I was looking at your NPS scores in the NatWest branded business, it seem like we turned the corner in Q4 and that notched back down again. So any color on what you're doing there? There must be a link to loan growth and NPS scores in business banking unlike personnel. Then also Ross, you mentioned a couple of times be careful on the credit side, with reference to retail, is that a general comment, just around the risk-based pricing or is there anything in the underlying environment that you're seeing that makes you make those comments?

Ross Maxwell McEwan, CEO & Executive Director

Yes. Look, just a quickie on the NPS and commercial, they dropped off one. It's a 12-month rolling average. So they dropped off a very large month, which did pull down their average, they're still sitting at #1 in the market place on net promoter score in the commercial space. The net promoter score for our business banking has been getting knocked around, because we've been changing the model quite dramatically. And also branch closures does impact that. But we've got some plans in place to start. So I think by the end of this year, you'll start seeing that, NPS starting to come back much more positively than its demand. But a good, good connectivity point chosen between service delivery and outcome of growth. In the commercial book, I would say, it will be reasonably static this year, Joseph. So we are going to -- we have moved some business out to RBS that needed to be outside the ring fence. You'll see some drop-off and what characterizes other, because the shipping book coming off and we made a sale I think in the First Quarter of a bit of a book that we thought was probably better off in somebody else's hands than their own. And caution, we have been picking and choosing where we have been risk on versus risk off from that portfolio and I think as you've seen in our First Quarter NIM, chosen quite rightly so far. But we will get it all right. But we do want to see growth longer term in the commercial book as we do in the mortgage book. Mortgages was chatted about, it is severe competition, we will be there, if we can grow greater than our normal stock, I'd be happy. Will it be -- it's 12% in the First Quarter, will stay that way. Lot of it depends on (inaudible), others want to be in that market. But again, after, I've said to the team, I don't want growth for growth sake of things. We did that sometime ago and blew up. And banks have a terrible way of forgetting their history. So we are being a little bit cautious, still want to do business. But we are -- it's not within our credit criteria, relating it to somebody else. Now I could comment on 15 pages, do you want it shorter or longer is the question from the finance team, because we have that debate internally. Should I (technical difficulty).

Joseph Dickerson, Analyst

I think it's like Goldilocks, just right.

Ross Maxwell McEwan, CEO & Executive Director

Right. I'll tell the finance team that. But what we are trying to do on the first and Third Quarters are just making the conversation as opposed to a big, thick document. So I thought we had it about right at this time around as well. But look, I think just cautious, yet there are uncertain times in this country. We're going through Brexit, lot of uncertainty around that, that's impacted more of the topping of business than it had the smaller, medium-size, they're still borrowing. We're doing quite well on the business. Banking SME unsecured, one we're very good at it and we've got big market shares. But we are doing quite well there. Net market we're holding market share. It's in the GDP, you see coming out today, it's like you'd expected given the whether we had in the First Quarter of the year. But you know, it's 1.5 odd %. We hope to grow the bank by about that, as we are a long term. And would be around GDP.

Operator

Your next question comes from the line of Andrew Coombs of Citi.

Andrew Philip Coombs, Analyst

Two questions please. First, since in your comment about almost 50% of new mortgage flow being on 5-year fixed, could you give the same number of the outstanding balance. Then more broadly, what do you think that means for the industry in terms of rate sensitivity, given the more of the industry is now on 5 year, do you think that industry will be more disciplined around deposit pricing as well? Then secondly, I appreciate your capital return statements linked to the outstanding litigation issues. Perhaps I could just ask you a few thoughts on your preference for dividends, whether it's for a quarterly or half yearly and annual dividend. And can you just talk us through the process you go through with the PRA about reinstating that dividend as and when you have more color.

Ewen James Stevenson, CFO & Executive Director

Yes, maybe I can start out on capital distribution. Yes. We've talked about in the past. Getting pension solved a couple of weeks ago, I think, I don't underestimate the importance of that. It provides -- we think a substantial amount of clarity -- additional clarity to roll forward capital position and because we're taking to this year and linking 3 to dividends. I think Ross owed to some other peers too. It will be in our numbers rather than dragging against us for the next decade. Secondly, we have to resolve RMBS, Ross and I -- given that every single call we do externally get asked about this, understand the importance of that.

Andrew Philip Coombs, Analyst

Not too sure, we'll chat about that when it is resolved.

Ross Maxwell McEwan, CEO & Executive Director

Then, on the back of that, I think we have to demonstrate the fact that we can pass the stress test. But obviously getting RMBS and pensions resolved go hand in hand. We're doing much better in stress testing. Then will be a period of engagement with the PRI, they obviously quite a high degree of familiarity with our capital plan. We talked regularly to them about. But you can see what today's results, the core Tier 1 up to 16.4%. You take about 80 basis points of that for the GBP 2 billion pension settlement, it's still sitting at 15.6%. I think every additional billion dollars of RMBS provisions is about 35 basis points of core Tier 1. So you can, I know you all have your own numbers on that. In terms of dividend payments, when we do get back, I mean I guess, it's still a theoretical discussion at this point. But I think our thinking would be a combination of interim and final dividends when we get to that point. That we would seek to set a dividend payout ratio that we would have a degree of confidence in that we could meet through most parts of the cycle. I think the one thing we're having to give some consideration to is the impact of IFRS 9 and whether that introduces a higher degree of earnings volatility over time and therefore we should set a sort of lower regular payout ratio as a result of that. Then on top of that, we would expect to do specials and buybacks to continue to optimize our capital base. Remember that, I did say at full year results that we intend to run our core Tier 1 ratio for the time being above 13%. So please bear that in mind as you think about capital returns. But I think once we get RMBS resolved, we will pretty quickly be back engaging with the PRI at that point. But it may take some time from that point to get to a point before we can agree capital distributions.

Ewen James Stevenson, CFO & Executive Director

Just to see the other question you had, just look at, we were doing about 65% to 75% of the book on 2 year, it's one more towards 50% on the 5-year, the impact on deposit pricing, I think it'll have very little, given the structural hedging we do. And the also high drop [ph] pricing of deposit side. I don't see much impact at all on that, Andy. But you are just seeing customers wanting longer-term, security about the pricing of the mortgage given the talk of price hikes.

Andrew Philip Coombs, Analyst

I guess the issue for the year is most of your rate sensitivity comes for your liberty spreads. But because you have a much bigger current account franchise that appears which are more savings funded. If they are not seeing the same churn on the asset side, does that mean, they have to have lower deposit betas in order to justify the economics and that was that benefit for you?

Ross Maxwell McEwan, CEO & Executive Director

Well I guess that's a question that you should ask them Andy. But from our perspective, we do think obviously in a rising rate environment, we do disproportionately benefit relative to peers because of the structure of our funding branches you pointed out.

Operator

Our next question comes from the line of Jason Napier of UBS.

Jason Clive Napier, Analyst

Two quick ones, never missing an opportunity to flood [ph] the net interest margin dead horse. I appreciate we are dividing results into a very short period of time. But just looking at the breakdown, you provide on gross yield, funding costs and return on free funds. I just noticed the free funds number somewhat volatile in the last quarter. And I'm just wondering within the sort of broadly stable margin that you've delivered and that you're guiding towards what role the hedge might have in that, whether there is any changes. And what that's returning and how you see those pieces evolving in future? Then secondly, I wonder whether you wouldn't mind just giving us a sense of your current thinking on the timing of Williams & Glyn and the attrition there. And just reminding us of what revenues are at stake as far as that process is concerned?

Ewen James Stevenson, CFO & Executive Director

Yes, on the Williams & Glyn, there's -- just as a reminder. There's about GBP 200 million of revenue that is at risk, from a sort of modeling perspective because -- we're continuing obviously to keep that revenue for the time being. But the offset to that is obviously a delay in the reintegration of Williams & Glyn. So that should broadly net each other out, I think. The good news with the delay obviously is we're a lot more prepared at this point. And fully ready to start addressing the remedy as and when the independent body is announced and we're able to move forward.

Ross Maxwell McEwan, CEO & Executive Director

We have started writing out to Williams & Glyn SME customers, just letting them know that they're likely to get an offer this year to move across the attrition rights and that much higher than anywhere else in the banks. So a pretty stable book, after eight years of being told the game rules [ph] I have all sort of different directions. But we getting ourselves ready to make those offers. So when the independent body is up and ready, we will certainly be ready. But it's been a 120,000 SME customers that we will have to move and also has a big impact on the branch network of totaled 75 branches that haven't been rationalized for now nine years and you've seen the decline in branch usage and then added to that 120,000 customers of SME, that won't be using them more, or won't need to use them. It's quite a shift that we're going to have to take a process, take our papers throughout this year.

Ewen James Stevenson, CFO & Executive Director

Yes. And on that hedge, Jason, just to give everyone some comfort, we don't try and play around with the tool, we've been pretty open and transparent with what we do, which is -- it's a rolling hedge. And we roll it every month. So that current account and on-demand deposits on a 5-year basis and then equity on a 10-year basis. So we don't try and guess where interest rates are moving and adjusted. So I mean anything that does just occasionally is some changes in our views on customer behavior, characteristics. But they -- apart from that, there is everyone should just expect that there was some volatility as interest rates moved around a bit. But we're certainly not trying to play around with that.

Operator

And your next question comes from the line of Martin Leitgeb of Goldman Sachs.

Martin Leitgeb, Analyst

Could I first of all get back to the mortgage strategy and I'm just trying to understand your comments because obviously looking at the number. So RBS has probably one of the strongest funding positions in the market, GBP 20 billion excess deposits within U.K. PBB alone, probably a meaningful part of DFS also within that division. On top of that, the funding costs. So the deposit funding cost are probably towards the lower end of the whole market. And the strategy or the number we see today of lower growth in a mortgage basis, there is more to do with your preference to retain margin. So do you see front book pricing at this stage such that you're getting quite close to your cost of equity, or you kind of where you decide -- let's that probably make sense or we hold on to it. And that would obviously almost imply that there is some other players out there, which would price mortgages, which was probably a bit more optimistic view on risk cost or et cetera. Then if the scenario would be that mortgages would not be the predominant focus for growth, would you see other areas for growth, the SME lending or out-of-pockets of the market, or would you come to potentially a situation where you could say actually we could be more aggressive on the deposit side. And try to pass on a lower amount of potential future rate hikes going forward and try to bring -- and to optimize the asset liability structure a little bit more on the deposit side there. The second question is just looking at your divisional disclosure. And the divisional return on tangibles on Slide 11. And you essentially making enough of cost of equity pretty much everywhere except Ulster and Northwest markets. In Northwest markets you clearly laid out the puff of costs and how do will come down over time and that essentially addresses the profitability. I was just wondering if you could give us an update on Ulster Bank's performance this quarter and your strategy on improving returns there?

Ross Maxwell McEwan, CEO & Executive Director

Can I just pick up on the mortgage piece, then it would be quite clear, we like mortgages, right. What happened in the last quarter of last year, the team did try to balance out the pricing points with volume points. And again we proved to ourselves we have no pricing power or very, very limited pricing power, nobody followed or did anything, which shows a highly competitive marketplace. We didn't get down to a point where we didn't see that the pricing we had would now make us money, it's still did. But we just saw that longer-term we needed we thought we should see if we couldn't move the pricing back up to a better rate, it didn't work. You're seeing the flow in the First Quarter of 12%, that's good. We've gone back to a normal pricing points, we're not the leaders in the market. But we have -- we just competitive. So it's nothing more or less to that, it is a balance. And I ask the team to balance that. But just don't play around with the credit side, thank you very much. There are parts of that mortgage market that we think we can do better rate and we'll have a go-ahead. But it's just a sheer balancing act of the teamwork, trying to work on find a quarter of last year that flow through, nothing more or less. And on the Slide 11, you're quite right, NatWest Markets is a full year plan to get back to an 8% to 10% return on equity, the 2.25 years into that plan doing a very good job. We are re-platforming that business. We've said we're spending about GBP 200 million a year on its restructuring, it all goes to the cost line, because we can't capitalize any of that and it's not playing. So Chris on the team I think, he is doing a very good job in markets that we have a strategic position and costs too high and they are working that through with new platforms which will reduce down our cost of operating over the next couple of years as we get into 2020. Ulster Bank, it is one of the areas that we are now -- are very concentrated on. It's quite a difficult market in Ireland to operate in from a -- there is a regulatory framework. But also the government have put a lot of pressure on banks and is a number of reviews going across the banking sector, it doesn't matter whether it's mortgages, doesn't matter it's SME, lot of reviews were being done from a conduct perspective over there. We also want to get that book back into appetite as far as the non-performing loans are concerned. And we sit at the end of last year, we took just over GBP 100 million charge on couple of books we want to sell. Those have been in the market in the next six months. So lots of work going on. Lots of focus on Ireland at this point in time. Front books okay. Back book, a very big track of mortgage book, we don't make any money out of it. So work in progress. And over the next 12 to 24 months, that is a business that we do. So we will give us better returns. But it's been slower than we'd liked. And we had a lot of other bigger issues to focus on, this is now getting our full focus.

Ewen James Stevenson, CFO & Executive Director

I think, just well I think Mark, that's part of your first question was the parts I'm sorry, we are seeing good growth actually. I mean over the last year, one of the pleasing things that we're seeing in the business is growth actually starts spreading out beyond mortgages. So if you look at year-on-year growth rates in current accounts, savings, business banking, even for our own customers now in personal advances, one change that we've made on the mobile app in the first few months ago, that's what we call an always-on features that allows us to effectively personally credit score you as a customer. Because we know your data has seen a decent uptick in unsecured lending to our end customers, because we know you, we can credit score you, we're very comfortable with the risk. So overall, I think we are now seeing growth in segments we want to grow and we're comfortable that we, if we choose to, can grow about market growth rates. And just on mortgages, even at current spreads, returns on capital comfortably above cost of capital returns. We think you should or want us to continue to grow the mortgage book, even at this spreads given where we see returns. We think it's a very sensible use of our capital.

Ross Maxwell McEwan, CEO & Executive Director

We fully priced against all of our products. There is not a marginal pricing activity that we undertake, we fully priced against all of our products and services.

Martin Leitgeb, Analyst

And just one follow-up on the deposits. So if the Bank of England have to hike rates again in May as anticipated, would you expect a similar personal rate as you had in the last hike or has anything changed in terms of your assessment there?

Ewen James Stevenson, CFO & Executive Director

I mean, I think we are always just like to have competition responds, certainly a big chunk of our book is current accounts and on-demand deposits, there we get full pass through and on savings accounts, it's a competitive market and we will respond competitively.

Operator

Your next question comes from the line of John Cronin of Goodbody.

John Cronin, Analyst

Just a couple of questions, one in relation to the underlying impairment trends in the commercial banking book. Appreciate that the 4Q number was elevated. But the GBP 23 million reported impairments charge in the First Quarter was the lowest since I think 3rd quarter of 2016. So any commentary you can make around the underlying trends in that book including a rarest [ph] experience would be helpful. Then secondly just on the medium to longer-term point on the RWA intensity. And just looking at the PRA's comment and its business plan for 2018-2019 published in early April, around the considerations pertaining to the implementation days for the Basel III reforms package, have you any concerns at this point that there could be a potentially swifter timetable imposed by the regulator in terms of those in terms of the risk weighting recalibrations and then thirdly just a clarification on the strategic costs that you disclosed separately. Is it your intention to continue to report in that format? Let's suppose what I'm getting out there is how easy is it to segregate the actual costs with respect to the digital transformation program. How is it -- is it separate those from the overall operating cost of the business?

Ross Maxwell McEwan, CEO & Executive Director

Just on the RWA [ph] side, I don't think there is any -- we haven't noted anything from the regulators that there's going to be any swifter implementation. I think that might have the plan and that's what we're working towards and the timing of it. So I don't think there is any changing to that.

Ewen James Stevenson, CFO & Executive Director

In terms of what we talked about to the market is just for planning purposes and assumption that Apple [ph] impact us from the end of 2021.

Ross Maxwell McEwan, CEO & Executive Director

On the strategic costs formatting, we just do -- put the items, there's one-off items into that bucket. We are going to restore some pretty big transformation of this bank as we move from physical bricks and mortar and physical distribution to much more mobile and digital distribution. And how we operate the business, that quite a big strategic cost changes. And we're there of one-off nature, they will fall into a strategic costs.

Ewen James Stevenson, CFO & Executive Director

But I do think, philosophically as you seeing in these results, we're trying very hard going forward as to move from adjusting all of our numbers to just reporting unadjusted numbers. So we're trying not to say here's one bucket of cost and here's another bucket of costs, look at the total cost line item, 2020 cost target is not an adjusted cost target, it's to get actual cost, total cost of the low 50% of our actual impact. So I think we're going to view the 2 sort of hand in hand increasingly. Then the last question on commercial impairments. I wouldn't look at Q1 as a (inaudible). We do think it was low and we've previously guided overall, 30 to 40 basis points of impairment costs across the portfolio. And we don't see any reason to change that.

Operator

Your next question comes from the line of Jennifer Cook of Mediobanca.

Jennifer Cook, Analyst

Your strategic spend came in a little bit. But I think it was a consensus, is that just implying that a bit more back-end loaded maybe this year? Then second question, you had debt sale in U.K. PBB, any guidance around debt sales for the rest of year?

Ross Maxwell McEwan, CEO & Executive Director

Just on the strategic cost, they will be lumpy, depending upon when we activate certain things, that was 209 [ph] in the quarter. It did have a couple of -- you had one property in there. But we've got several other things that will clearly targeted to do this year and next. So I would suspect it will be lumpy. But I'd stay around that guidance of GBP 2.5 billion over 2018 and 2019. There is still our closest estimates of the strategic cost over that period of time. But it will be lumpy.

Ewen James Stevenson, CFO & Executive Director

Maybe 1 or 2. But nothing of any particular note, I think that we're planning the one debt sale off note is obviously we previously talked about selling a significant portion of the NPL book in Ireland, we're sort of planning to sell about a 3rd of the book this year and that process continues.

Operator

Your next question comes from the line of Jonathan Pierce of Exane.

Jonathan Richard Kuczynski Pierce, Analyst

Three quick ones. Firstly, Could you give us an updates on the actual size of the structural hedge in the yield in Q1. The second question is the RWA is benefited from GBP 700 million, GBP 800 million [ph] credit in the quarter from prior cyclicality. Just checking repeat that sort of run rate moving forward is not factored into your RWA guidance, because obviously that's still GBP 3 billion credit. Thirdly and may be most importantly, most of the price cyclicality coming through in the mortgage books. So back of envelope, it looks like your mortgage risk right now is actually about 6.1%. So just wanted a bit of an update on the RWA inflation expectation in 2020 when the PRI rules change on mortgages. And also just to check, particularly on the context, you're writing on 5-year business, how are you thinking about pricing now, are you capturing fully over this RWA step change in 2021. You're thinking about margins today?

Ross Maxwell McEwan, CEO & Executive Director

Yes. To the latter. In order to deploy, they have to fully price it including cost of capital. And as it runs for five years, it's going to pick up the increase RWAs from 2021 onwards. So we are fully processing on that, probably a good question to ask other banks of the discipline and here to make sure that each product and service stands on its own. And we're not cross-subsidizing across the bank the (inaudible) we have, we know what we are tackling. I'll leave [ph] other interesting pro-cyclicality questions to my CFO, though strictly around the mortgage book.

Ewen James Stevenson, CFO & Executive Director

Thanks, Ross. On the structural hedging Jonathan, we haven't disclosed that, I don't think it's moved to whole lot since two months ago, either in size or rate. So I think you can still lot of the assumptions you had from a couple of months ago on RWAs. So I haven't got figures in front of me, where the average risk weighting is for (inaudible) which both in the U.K., whether it's going from 7 to 6. But it was slightly below 7 full year. But yes, the GBP 12 billion pound of uplift I think was on an assumption that we'd get to about a 15%, overall risk wipe at the time we got out of the back-end of 2020. And within that there was an assumption of 6% or 7% wherever it is would tick-up slightly ahead of that. So that price cyclical benefit should back out I think.

Jonathan Richard Kuczynski Pierce, Analyst

Okay. So it's a choice the sort of GBP 12 billion odd number could be a few billion heighten as the risk rate stays down at just north of 6 which is what appears at the moment.

Ross Maxwell McEwan, CEO & Executive Director

Yes. But then you'll get the benefit through the 6 being lower than what we would have anticipated. So the net impact going otherwise shouldn't change.

Operator

And your last question comes from the line of Chris Manners of Barclays.

Christopher Robert Manners, Analyst

And so just 2 questions, if I may. And I was just looking at PPI. So I guess and your last quarter you've utilized a GBP 100 million of provision, this quarter you stepped up about GBP 150 million. So as you got around 6 quarters left until the time bar GBP 900 million provision. So you sort of cover just the run rate stays stable in terms of provision utilization. And also it would be helpful given that we've seen some of the other banks. And provides more -- just maybe you could give us a little bit of a color around what you're seeing and how well provided you think you are? And the second one was just to return on also deposit base (inaudible) the GDP print this morning, that's, the chance of may rate hikes come down at 25%. But I suppose it would be interesting, if you could just tell us a little bit about how you think about deposit beta and what your past 3 was on the first rate hike. When I look to U.K. RBB, it seems that your funding cost -- the deposit cost was around 15 basis points in September, stepped up to around 27 basis points last quarter. So with a 25 base rate hike. So it look like it cost [ph] to about half to your customers or 12 basis points. So I just still want to ask you how you think about that?

Ross Maxwell McEwan, CEO & Executive Director

Yes. So if you look at the PPI, off the GBP 152 million cash charge that we took in Q1, about GBP 100 million of that was real cash run rate and the residual was (inaudible) related. So when we look at that 100 run rate. And there's probably about another 100 of the 900 remaining provision that relates to one-offs. So roughly we think we've got 7 plus quarters of coverage from here at the current run rate. Yes. We appreciate that some other banks, some quite close to high (inaudible) took some additional provisions and few one we obviously didn't feel that we needed to do that and we continue to think that we are reasonably, considerably provide it relative to peers. But, yes, the second half it has in [ph] campaign just started. But there wasn't anything in our model in Q1 that surprises, I guess is the point to take away. It does seem to have surprised some others.

Christopher Robert Manners, Analyst

And we'll have another look into this Q2, the way you --

Ewen James Stevenson, CFO & Executive Director

Yes, on the deposit base, just as a reminder to everyone, when we set 2020 targets, we'd put into our IFRS 9 transitional document what our interest rate assumptions were, there were only 2 base rate rises built in and at full year when we announced our current consensus was about 5. I assume obviously the GDP figures have come out, what we've been on the call. So we're sort of adjusting live to changes and assumptions. But we're still pretty confident that those 2 base rate rises look pretty conservative relative to even current interest rate assumptions at this point. So we do did think that there is some upside in our income forecast, which were based on our 2020 targets. On the deposit beta, I mean as I said earlier to margin and [ph] it's going to depend very much on competitive response at the time. But certainly we'll get a full pass through to current accounts and on-demand deposits and how we react in the savings market will be both competition around base rate rises. But frankly also how people are going to respond to the roll-off of the TFS, which was a GBP 140 billion of funding to the market.

Christopher Robert Manners, Analyst

Could I ask you and sort of rate hike we just had to your deposit base was?

Ross Maxwell McEwan, CEO & Executive Director

We retained, I think somewhere around 30% to 40% EBITDA, it was the about number I think we had.

Christopher Robert Manners, Analyst

It's just interesting. So that we can sit and at least try and make a judgment about whether that number should come up or down, depending on competitive environment. So that's helpful.

Ross Maxwell McEwan, CEO & Executive Director

Yes, I think definitely across different products.

Ewen James Stevenson, CFO & Executive Director

Products, yes, some of you get (inaudible) and others you get nothing.

Ross Maxwell McEwan, CEO & Executive Director

But I think it was around that 30% to 40%, Chris that we retained.

Operator

Thank you, there are no further...

Ross Maxwell McEwan, CEO & Executive Director

Well thank you very much for hosting the call. I'll sort of make a just couple of comments, key takeaways. First off, we've had a good start to 2018, income is up, costs are down. And as you begin seeing our capital has strengthened, bottom line profit for the First Quarter exceeds the amount we reported for the full year 2017. Secondly, customers continue to migrate to our digital channels. At the same time, we are investing to accelerate our transformation from high cost fixed physical assets to a lower cost more flexible and technology-led operating model. And thirdly, we do remain cautious in our outlook. And continue to de-risk which significantly address the deficit in our pension plan. And we now have only one significant issue left to resolve before we can be in a position to consider the resumption of dividend payments. Thanks for joining us on the call and have a great day.

Operator

Thank you. That does conclude your conference for today. Thank you for your participation, you may now disconnect.