VIRGIN MONEY UK PLC FY20 RESULTS – Analyst Call

Hosted by David Duffy (CEO); Enda Johnson (Interim CFO) and Mark Thundercliffe (CRO)

David Duffy, Virgin Money UK PLC

Good morning everybody, and welcome to our annual results presentation. Thank you for taking the time to join. I hope you are all managing well in this complex operating environment. Our presentation today will be split into four sections and will take approximately an hour. It will be followed by a live Q&A session, which we expect to finish at around 10:30 a.m. I will walk you through some of the key themes of the past year before handing over to Enda Johnson, who will take you through the detailed financial results. I will then return to share my views on the outlook for the business in the years ahead before opening for questions on the conference call. Mark Thundercliffe, our Chief Risk Officer, will also join us.

Turn to slide four, 2020 has been an unprecedented year. The macro-economic backdrop has been, and will continue to be, challenging and uncertain. I think the business and our employees have responded well to the crisis. I am happy to observe that we are living our purpose in everything that we are doing, and this has been evidenced by customer feedback and by the fact that our colleague engagement is at an all-time high. The challenges are a reality, which all banks and businesses are facing across every sector. And whilst there has been some optimism expressed recently given the vaccine news around the world, we have not factored this into our near-term outlook yet and we remain cautious about the ultimate impact of COVID-19. The economic benefits of vaccines are a long way off; whereas the impact of a second lockdown is our current reality. Enda will share a more detailed perspective on our conservative assumptions in his section.

Our ambition to ‘Disrupt the status quo’ and our purpose of ‘Making you happier about money’ are shaping the way we differentiate Virgin Money in the marketplace. Our strategy and purpose are even more relevant today given the challenges created by the pandemic. In particular, we are more convinced than ever that the digital agenda in our strategy is core to our future, and we intend to accelerate our efforts in this space. Our philosophy continues to be one of self-help through these uncertain times and we will be relentless when pursuing our digital agenda, delivering our cost efficiencies and optimizing our balance sheet.

Our transformation ambitions have also be validated by COVID, and whilst implementation was delayed as a result of the pandemic, we have now resumed our integration, rebranding, and digital transformation programs. We have also allocated the investments required to take out additional costs and to launch new customer propositions. Ultimately, as you would expect, our goal during this period has been to protect our balance sheet, and to support our customers, employees, and communities and at the same time, we are actively pursuing our post-COVID objective of being the most agile, innovative, and disruptive bank in the U.K.

Turning to slide five. To deliver the support required, we had to completely change our delivery models and we believe that one of the benefits that will come from this period is that our new ways of working will be much more efficient and cost-effective than those of the past. Our participation in the various government-guaranteed lending schemes has seen us lend c.£1.2 billion to businesses, and our rapid implementation of payment holiday provided relief to customers at a time of great uncertainty and need. And as a result of the remarkable commitment and resilience of our employees, we have been able to keep 95 percent of our branches and all of our call centers open.

We have enabled most of our colleagues to work from home by providing cloud-based technology. And whilst the majority of our staff are enjoying this new way of working, we recognize that for some it is an unsettling time, so we are continuing to offer well-being support, a diverse range of virtual engagement opportunities and a much more frequent leadership communications. That being said, I believe that our future operating model will seek to maintain the positives of a remote working structure which offers greater flexibility and choice. Our goal is to allow our employees to live their best lives by identifying the benefits of remote working practices and combining them with the best of our historical practices. We will innovate constantly when designing this go-forward operating model.

We have also continued to play a positive role in the communities where we operate. We have provided critical financial support to communities, volunteer groups, and charities through our fundraising platform, Virgin Money Giving, and also by providing grants directly from our Virgin Money Foundation.

Turning to slide six. Whilst managing the bank through the pandemic, we have continued to deliver on our strategy, and to lay the foundations of the future. The steps we had already taken to transform and simplify our business mean that we are really well positioned to take advantage of the change in customer behaviors being driven by the pandemic. Despite the restricted nature of the environment, we have continued to roll out products and propositions and campaigns, for example, we launched Money on Your Mind, our customer support initiative, which has received over 10 million views since April, and we have rebranded 37 of our largest stores in key locations across the country. In addition, we launched the Virgin Money Arena concerts in Newcastle's Gosforth Park, which attracted 52,000 visitors and our coverage across TV and social media channels reached approximately 2 billion people, demonstrating the power of social media is extraordinary.

We also launched the first ever Digital Virgin Money personal current account with a linked savings product. This account has been rated Outstanding by Moneyfacts with a perfect Five Star score. And this innovation has been complimented by our better than basic bank account, the M account, which is a core part of our financial inclusion strategy. We have continued our digital journey in Mortgages, by launching our innovating Home Buying Coach app and have invested in our broker channel by delivering API connectivity across the main mortgage broker sourcing systems. Finally, we were successful, at our third attempt, at being awarded a grant of £35 million by the BCR Capability and Innovation Fund and I'll touch on our plans for the business bank in more details later in the presentation.

So, let me turn to slide seven on our financial performance and the impact of COVID on our full year results. While our first-half financial performance was resilient, the second half has been impacted by the market-wide effects of the COVID pandemic as follows:

In our lending book, we saw a muted lending growth overall for the year, but with strong growth in Business lending, up nearly 14 percent due to the customer take up of £1.2 billion of Government-guaranteed lending, while Personal lending growth was dampened by the lockdown impacts, and the small contraction of our Mortgage book reflects the combined impact of our pricing discipline as well as the market shutdown.

Deposits have grown really strongly during the period, with relationship deposits increasing 20 percent due to consumer and business's savings behaviors under lockdown. Despite the challenges this year, we have delivered a net interest margin of 1.56%, which was within guidance, and remain focused on our delivery of our self-help efficiency opportunities, with net cost reductions of £30 million achieved during the year.

Our asset quality remains resilient, and importantly, we have seen no material deterioration in arrears or asset quality measures across any of our portfolios. However, given the uncertain economic outlook and the yet-to-materialize impacts of COVID, we have chosen to apply additional conservatism to our economic scenarios and weightings as we assess our impairment provision. This has led us to an increase our on-balance-sheet credit provisions to £735 million with enhanced coverage across all portfolios, and this resulted in a significant impairment charge of £501 million and a statutory loss after tax of £141 million. We do, however, retain a significant CET1 management buffer of c.£950 million above our minimum regulatory requirements, and continue to operate with strong liquidity and funding positions.

I will now hand over to Enda, who will take us through a balance sheet update and the Financial Results in detail, I will then return at the end to outline my thoughts on 2021 and beyond, before returning to our Q&A session. Over to you, Enda.

Enda Johnson, Virgin Money UK PLC

Thanks, David. Good morning to those of you in Europe, and good evening to those watching in Australia. I hope you're all keeping safe and well in what continues to be challenging times.

There is a lot to cover here today, so please make yourselves very comfortable. There are three things I want to emphasize upfront in this section. Firstly, we have not seen any material deterioration in observed asset quality, nor have we been required to take any material specific COVID-related provisions. Secondly, we have taken a deliberately conservative approach to the economic inputs for our ECL assessment. And finally, we remain robustly capitalised for the potential challenges ahead.

This is a uniquely difficult point in the pandemic to be making predictions for the future. On the one hand, there is observed and evidential significant economic disruption, coupled with unprecedented government support. On the other, there is the potential there is the potential for highly positive developments on vaccines which have the potential to manifest quite quickly. The former is evident today, the latter is as of yet unproven so we are positioning our judgements and guidance cautiously for now but recognise there may be potential for upside in the future.

As David has outlined already, our financial results were impacted by the significant impairment provision charges we have recognised this year, as well as the base rate change and customer demand impacts in the second half. Before we go through those results in detail though I wanted to walk through what we are seeing across our balance sheet and explain the conservative economic assumptions that underpin our provision.

Moving now to slide nine. I'll start with a high-level overview of where we stand today. Firstly, as a reminder, we have a defensively positioned lending book that is primarily made up of secured, low-average LTV mortgages accounting for 81 percent of the portfolio, with prudently underwritten Business and Personal lending books making up the rest. We have today seen no material deterioration in asset quality and haven't taken any material specific provisions in relation to COVID. In fact, our arrears have reduced across most of the portfolios as a function of the Government support and the forbearance measures such as payment holidays. Additionally, our experience with payment holidays has been in line with, or actually better than, our expectations, but it is very early days on that front.

Notwithstanding that picture on asset quality, we have adopted a deliberately cautious and conservative position on the forward-looking economic environment. We have applied an updated set of economic scenarios and weightings in assessing our current ECL provision, which reflects what we continue to believe is a highly uncertain economic outlook with an assessment that further restrictions to economic activity are likely over the coming period. It is important to note we've not yet factored in any near-term mitigation from the recent vaccine news pending greater clarity on timelines and outcomes. These conservative economics and weightings have therefore increased provision coverage across all of our portfolios, with a total coverage ratio of 102 basis points.

Stage migration is still largely model-driven as a result of the conservative economic weightings driving more into stage two with stage three loans remaining stable. Our capital position, as David has said, remains robust with a transitional CET1 ratio of 13.4 percent, leaving us with a significant CET1 management buffer in excess of our minimum regulatory requirements.

On the right-hand slide of this slide, you can see the key asset quality metrics across our portfolios, which to reiterate.

Our current and historically prudent underwriting criteria and sector focus; the low arrears levels across all of the portfolios, and the good levels of collateral on the secured lending in Mortgages and Business. So, in short, we have not experienced any actual deterioration in portfolio strength, arrears levels remain low and stable, and payment holiday experience has been in-line or better than our expectations. However, what has changed is our assessment and view of the forward economic environment and our year-end impairment charge, stage migrations, and coverage levels reflect this position.

Turning now to the portfolios in detail, starting on slide 10.
As you know, we have a prime mortgage book that is being built up primarily over the last few years under the strict affordability requirements of the Mortgage Market Review regime and therefore originated to very high standards, with no sub-prime, self-cert, or other specialist categories. Our portfolio arrears stand at 0.4 percent, which is half of the industry average, albeit modestly higher than the 0.3 percent at the end of last year. This is mainly due to payment holidays and the repossession moratorium extending how long customers spend in arrears before lender actions are taken and so therefore, not really a change in underlying asset quality.

Owner-occupiers, as a reminder, makes up 75 percent of our book and has strong credit metrics. It is a low LTV book with an average of 57 percent. Just 17 percent of the book has an LTV greater than 75 percent, and only 2 percent has an LTV greater than 90 percent. We also have good affordability, with an average loan-to-income of three times. Importantly, the proportion of the book that is highly leveraged through a combination of a high LTV and high LTI is negligible at 0.1 percent.

Our buy-to-let business is primarily focused on non-professional landlords with small portfolios and higher levels of borrower income to ensure resilience under stress, and the portfolio has an average LTV of 56 percent.

We have always underwritten the book with conservative rental and borrower income requirements and have consistently maintained a maximum LTV of 80 percent for new business. To date, we have seen no material asset quality concerns. Our owner-occupied interest-only exposure is 13 percent of the total portfolio, where our focus is primarily on affluent customers with larger deposits, and this is reflected in the low average LTV of 49 percent in this book.

In terms of payment holidays, our early experience is similar to our peers. We've granted payment holidays to about 20 percent of the portfolio by balances to date, but have only 4 percent that are on an active payment holiday currently, with 98 percent of those who have matured from their payment holiday returning to payments. The average LTV of those who have taken payment holidays to date has been 61 percent, so not markedly different to the portfolio average of 57 percent.

For the 2 percent of customers requiring further support, the average LTV is low, at around 52 percent, and as part of our impairment provision, we have assigned coverage of circa 300 basis points to this cohort, primarily through post-model adjustments. Finally, we have not seen any material spike in payment holiday requests following the FCA's recently announced industry-wide payment holiday extension measures but we will, of course, keep an eye on how this evolves over the coming months. While the portfolio has remained resilient thus far, we are cautious about the future outlook for key metrics such as unemployment and house prices, which is reflected in the modelled economic outcomes and the overlays.

Turning now to business on slide 11. At the interim results, we outlined how we thought about our business portfolio in four classification buckets and I thought it would be helpful to update you on those. Obviously, almost every business has been impacted by COVID in some way, whether that's revenues, costs, or logistical difficulties, some for the better, some for the worse. What this slide shows is how those day-to-day impacts have flowed through to our view of the impact on our lending exposure.

I am going to split our business portfolio into our BAU book, which is the £7.8 billion of lending we originated under our usual relationship manager led processes and where we retain all of the credit risk, with a further £1.2 billion of lending that has been originated through the government backed schemes where the credit risk is primarily insured under the government guarantee. We split the BAU portfolio into four classifications for exposure to COVID-19: least exposed, lower impacted, more immediately exposed, and finally, higher impacted businesses. Forty-seven percent of our BAU book remains in sectors that we believe are least exposed to damage from the COVID pandemic. And this is reflected in our relationship manager discussions and asset quality experienced to date.

As you know, agriculture is our largest single sector concentration at 16 percent, where we are very well diversified and collateralized across different subsets of agriculture and performance in this book remains resilient. In health and social housing, around 17 percent in total, our principal exposure is care homes and specialist care. Revenues are resilient as beds continue to be needed in this crisis, and while there have been well documented industry-wide operational issues early in the pandemic, performance is broadly stable to date.

Thirty-one percent of our BAU book is in lower impacted sectors. This has increased from 22 percent at the interim results. This is because we have moved both the Wholesale and Professional Practice sectors down from least exposed owing to lending requests under the government lending schemes. Although performance remains resilient here, we are being cautious in case this higher level of requests are an indicator of potential future stress.

Specialist hotels remain stable, with our book primarily major city centers and around two-thirds in central London. While clearly impacted, the strength of location and brands mean we are positive about their future relevance and ability to trade profitably, and the exposures are underpinned by good levels of collateral and committed professional equity backing. Around 13 percent of our BAU lending is to sectors more immediately exposed in this stress. Eight percent of this is in business services and the degree of impact depends on the type of businesses supported - supermarket service providers are less impacted, while entertainment firms more so. Our legacy CRE portfolio is small, well collateralized, with low arrears, and accounts for only 3 percent of the book.

Finally, we have around 9 percent in what we have designated higher impacted sectors. Whilst we are not materially in high street retail, we have some exposure to smaller retail businesses and legacy entertainment, with substantial government support being provided currently and risks of further lockdowns a possible ongoing threat. Just to reiterate, though, we don't have any meaningful exposures to the most impacted sectors, such as airlines, oil and gas, travel, high street retail, or speculative development CRE. In addition, with a very low number of customers on payment holidays in business, with only 1 percent of customers on an active payment holiday, with 98 percent of those who have matured from their payment holiday returning to payments.

Asset quality remains stable here, with arrears of 0.3 percent at year end compared to 0.5 percent in 2019. Linked to this low level of payment holidays and arrears, we have been supporting customers with lending facilities through the Government-guaranteed lending schemes, with around £1.2 billion dispersed at the end of September. Around £800 million of this is the 100 percent guaranteed bounceback loans, with two-thirds of these to existing deposit-only customers who had not previously borrowed from us and reflective of the targeted loan size for much smaller businesses, while our smaller volume of CBILS of around £400 million was primarily to existing medium-sized customers who make up 90 percent of borrowers here.

However, it is worth flagging that we have to date taken lower than our natural market share of lending against the schemes, which is not through having turned valid applicants away, but more a function of the cash flow resilience amongst our targeted sectors, and we believe an early vindication of our underwriting approach.

Looking into the outlook for this portfolio, the speed of recovery into 2021 and the impact of the final Brexit outcome will be the key drivers in terms of portfolio resilience. We have previously done a lot of work to assess the risks of Brexit and have made changes to our risk appetite, but any potential trade and economic disruptions do remain a possible headwind for some at an individual customer level.

Turning now to credit cards on slide 12, you know the quality of our credit card portfolio, so I won't dwell too long on this here. Our card exposure is conservatively underwritten and well-positioned for a period of economic uncertainty, owing to our focus on more affluent customers who typically have more resources to call on in times of stress, with the customer profile table on the slide demonstrating the quality of the customers we lend to. Our arrears remain low at 0.8 percent, which is reduced from 1.1 percent at the end of 2019. However, as with other portfolios, the arrears levels are being suppressed owing to government support and payment holidays, but it is nonetheless pleasing to see our portfolio arrears have moved down in step with the industry and continue to be around half the industry average of 1.6 percent.

We've also reduced our risk appetite through the year for new lending, in particular with a further tightening of criteria for self-employed and with more stringent affordability tests for a stressed income on a fully drawn line at over 30 percent APR. On the right-hand side of the slide are charts we have shown before, but which we have updated for 2020, and the third party benchmarking reaffirms both the better quality of the business we have written relative to the wider market and the historical performance of the transfer credit card balances under stress, which we are of course more weighted to, at around 68 percent of our cards portfolio.

Turning now to our payment holiday experience in personal on slide 13. Sticking with credit cards, our payment holiday experience is again typical of the broader industry with payment holidays granted to around 5 percent of credit card balances to date, 1 percent of balances currently on an active payment holiday, and 92 percent of those customers who have matured from a payment holiday returning to payments.

For those payment holiday customers who have required further support, we have a coverage ratio of around 20 percent embedded within our provision through our post-model adjustments. Our personal loan book of circa £1 billion is small and has been carefully originated. It is a mix of longstanding banking customers and more recent digital customer acquisition in higher quality, keenly priced business, with lower debt to income, higher affluence, and lower self-employed characteristics. The average life of the personal loan book is around two years. So turnover in the book is actually rapid. We've significantly tightened our credit cutoffs for new lending in March by circa 40 percent and therefore around half of the book will be on this tightened risk appetite by March 2021.

Portfolio arrears also remain very low at 0.4 percent and have reduced year-on-year owing to the various support measures. The early payment holiday story is similar to cards, with 11 percent of balances having had a payment holiday to date, 3 percent currently on an active payment holiday, and only 5 percent of customers who have matured requiring further support, with 19 percent coverage allocated for this cohort through our PMAs. So overall, the personal portfolio remains resilient, however, we are cautious on unemployment rate and, in particular, different customer types who may be disproportionately impacted, which is reflected in the coverage we are holding.

So that's our lending portfolios now we'll spend some time talking about our impairment provisions, starting on slide 14. I'm going to focus now on how we've assessed our ECL provisions and explain the rationale for the top-up we have taken in Q4. Firstly, I cannot reiterate strongly enough that we have not yet seen any material deterioration in observed asset quality given the range of economic stimulus and support measures in place, nor have we been required to take any material COVID-related specific provisions to date. So the impairment provision we have taken is driven by a conservative view of the future macroeconomic outlook and has been developed using a combination of economic scenarios and expert judgment, following a comprehensive internal governance and challenge process.

We have updated our models based on IFRS9 economic scenarios sourced from Oxford Economics, which, relative to the scenarios we used at Q3, were more conservative across the key credit loss sensitive measures of GDP, unemployment, and HPI. In addition to considering the economic scenarios and shape relative to our own assessment and external benchmarks, the key estimation we as a management team have to then make is the probability weightings, where we have conservatively applied significantly more weighting to the base and downside scenarios which now account for 95 percent of the total weighting.

As you can see, the output of this is a significant downward shift from the weightings we used at Q3 and reflects our preference to be cautiously positioned in the face of the uncertain economic outlook. These weighted average outcomes acknowledge the likelihood of further restrictions and further potential COVID and economic headwinds, the impact of which are as yet unclear despite the extension of Government support. So, the combination of more conservative scenarios and weightings means that our weighted average economic assumptions have deteriorated quite significantly since Q3 -- the black dotted line relative to the gray dotted line on the three graphs on the right. With a weighted average 15 percent year-on-year U.K. GDP declined, now assumed in 2020, average unemployment of 8.6 percent in 2021, a peak of 10 percent unemployment in calendar Q1 2021, and a prudent peak-to-trough house price index fall of 22 percent.

We accept these assumptions are conservative when compared to current market forecasts and also when compared to some of our peers' last reported scenarios, but we would prefer to err on the side of caution given the uncertain outlook. We also recognize that house prices at the moment are trending positively in the market, rather than negatively ,but we are positioning for a peak-to-trough outcome over the coming years, rather than responding to the latest month to month movement, and clearly, the outturn over the medium-term is much more important than the short-term in driving expected losses.

We've also reassessed our expert judgment credit risk overlays, which I will talk through on slide 15. The more conservative scenarios and weightings selected have resulted in circa 70 percent year-on-year increase in the group's modeled and individual ECL to £549 million at the end of September. In addition, the group then set aside a further £186 million in provisions through post-model adjustments, up from £49 million a year ago. Post-model adjustments, or PMAs, are used to incorporate new or emerging risks not captured in modeled outcomes, such as payment holidays or the roll-off of Government support, as well as to address potential limitations in model sensitivities where they may not be reflective of the unique economic stress scenarios we are currently experiencing or forecasting.

Following our internal processes, PMAs were judged to be required in our mortgages and personal books, with £75 million and £111 million respectively. In Mortgages, the PMAs primarily reflect potential longer term implications for customers who have taken a payment holiday. While in Personal, the PMAs relate to payment holiday assumptions, credit bureau data adjustments reflecting temporary improvements we don't believe are sustainable, and for our personal loan book specifically, a PMA to be unprecedented unemployment shock we are assuming, which is difficult for the models to fully capture.

We did not assess that any PMAs were required in our Business portfolio, as we believe the policies and frameworks in place to identify business customers experiencing financial difficulty are operating effectively given the more granular, customer-specific assessments we are able to undertake, meaning our internal rating systems respond more dynamically as levels of customer difficulty potentially increase. It is also worth remembering that we have assessed that 78 percent of our Business book is in the least exposed, or lower impacted, sectors.

The overall level of model provision and coverage for Business was assessed as sufficient in the context of the portfolio shape and strength, and has been supplemented by the extensive number of customer and segment reviews undertaken in recent months. So, bringing it all together, we believe that the approach we have taken has led to an appropriate assessment of ECL for the conservative economic scenarios and weightings we have applied, with £735 million of on-balance sheet credit provisions in total at the end of September.

While we do recognize the recent positive news in relation to the various potential vaccines, they do remain subject to approval, and the timing of when, or even if, they can be successfully rolled out at scale globally in a way that allows for a return in normal economic activity, remains unclear. Most economic forecasts, including ours, had always assumed a way out from the pandemic at some stage, and so, this news therefore provides clarity on that exit at some point in the future. If rapid adoption of vaccines or other measures improves the economic outcomes, then as and when that becomes clear, it will be reflected in our modeling and provisions. However, it still remains unclear what the ultimate economic impact of the likely 12 plus month period of disruption will be, the impacts of which are only likely to emerge next year.

Our assessment has been through extensive Board engagement and internal governance and is based on experience in a variety of different crises in different jurisdictions, which informs our decision to adopt a cautious approach. In addition, as you would expect, we've tightened our risk appetite on new lending to reflect the changed environment. This has included tools such as raising credit cut-off levels, reducing origination in potentially less resilient segments of the market, and ensuring our BAU business lending is focused on cash generative businesses.

Finally, we've also been beefing up both our resourcing and processes so that we are operationally ready for an expected increase in credit losses, with a more than doubling in the size of our collections and workout teams already secured for when required in 2021. The increased costs of this are, of course then, reflected in our 2021 cost guidance.

Turning now to what this has all meant for stage migration on slide 16. As you can see on the chart on the left, the impact of the modeling and PMAs we have applied has been to nearly triple the proportion of loans in stage two, to around 18 percent, with a consequent reduction in stage one loans. And this again is because we have not yet seen any material specific credit losses from COVID, and therefore, the majority of the migration is driven by the assessment of the economic landscape, with our proportion of stage three loans remaining stable.

As you would expect, given our portfolio weightings, the majority of the movement in stage two loans is from mortgages, at 76 percent of the increase, with business accounting for 19 percent, which reflect the conservative economic scenarios and the weightings applied. On the right hand side of the slide, you can see the split of stage two loans by credit trigger point, with 82 percent of loans classified as stage two because of PD migration due of our modeling outputs. Importantly, the proportion of loans in stage two that are more than 30 days past due is only 2 percent at present.

I will now return to what this means for our provision coverage levels on slide 17. As you can see from the table, the application of our more conservative economic scenarios and weightings have increased our provision coverage across all portfolios with total group provision coverage of 102 basis points.

In Mortgages, we've increased our provision coverage to 23 basis points, a relatively sharp pickup relative to Q3, which reflects the more conservative weighted economics, especially unemployment and HPI, that resulted in a migration of around £6 billion of mortgage lending into stage two and the subsequent recognition of ECLs.

In Personal, we've broken down the portfolio here into our credit cards and personal loans and overdraft books to reflect the different characteristics of the portfolio. In credit cards, we modestly increased the coverage to 537 basis points, where the lower relative scale of that change is reflective of the high quality customer profile of our book, which is less sensitive to the more conservative economic scenarios we have used.

In our much smaller personal loan and overdraft books, we've nearly doubled the coverage ratio since Q3. The relative size of the movement partly reflects the law of small numbers, but also reflects the more prudent approach to our PMAs, and in particular post-model recalibrations on some of the model output sensitivities, as previously discussed. At 824 basis points, we believe our coverage here is appropriate for the uncertain environment and reflects our conservative economic assumptions and weightings, in particular, this includes at 8.6 percent average unemployment rate in 2021 and a peak unemployment rate of 10 percent. Finally, in business, we've also increased our coverage since Q3 to 391 basis points, reflective of the increase in stage two loans, as previously discussed.

So, in summary, the comprehensive approach we have taken here at what must be remembered are our full year results incorporates more conservative economic inputs and expert judgment overlays and this has resulted in increased coverage across all the portfolios and positions us with £735 million of on-balance sheet provisions as we enter what could be a highly uncertain 2021. However, the recent news on vaccine development clearly has the potential to improve the economic output. And the operational transformation we have been delivering does leave us well positioned to capitalize in a more buoyant scenario. And David will talk about that more later.

Turning now to capital on slide 18. The group's traditional CET1 ratio remains robust at 13.4 percent, which means we retain a significant CET1 management buffer of circa £950 million, in excess of our minimum regulatory requirements, or MDA, of 9.5 percent. And this is in addition to the £735 million of on-balance sheet provisions I have just talked you through. Our fully loaded CET1 ratio is 12.2 percent after removing the IFRS9 transitional relief, and while it is expected that the difference between transitional and fully loaded may narrow somewhat during 2021 if the migration of loans into stage three increases, we do not expect it to completely narrow anytime soon, assuming, of course, no material deterioration in the outlook relative to assumptions.

I will talk in detail later on about our expectations for capital and RWAs into 2021. And there are potentially some uneven movements on RWAs expected. But the key message for now is that we remain well capitalized going into this uncertain period. This is underpinned by a defensive lending portfolio with appropriate provision coverage across our portfolios that is reflective of conservative economic assumptions and weightings.

I hope you found that detail on our balance sheet helpful. I'll now move on to discuss the key points in the full-year results before handing back to David to talk through the outlook for 2021 and beyond.

Turning now to slide 20. In what was a very challenging second half environment, the Group delivered a pre-provision underlying operating performance down 10 percent year-on-year. Against that tough backdrop, the group saw income decline 6 percent year-on-year. NII was down 6 percent as NIM reduced to 156bps, in line with our previous guidance, whilst other income was down 7 percent given the reduced activity levels during the second half of the year. Underlying costs declined 3 percent even after absorbing incremental COVID related expenses, mitigating some of the income pressure, but our cost-income ratio did increase 2 percentage points year-on-year to 59 percent.

As I just outlined in detail, we have taken a more cautious view on the outlook given the risks that persist in the current environment. And that prudence resulted in a significant impairment charge of £501 million a year, equivalent to 68 basis points cost of risk, over three times higher than 2019. Underlying profits before tax of £124 million was therefore substantially lower year-on-year, driven by the elevated impairment charges with our underlying return on tangible equity and earnings per share both similarly impacted.

Turning to statutory performance on slide 21. We returned at statutory loss after tax of £141 million to the year. Exceptional charges in 2020 totaled £292 million and were primarily driven by integration and transformation costs of £139 million, and £113 million of continued acquisition accounting unwind charges. There are c.£150 million of acquisition accounting unwind charges remaining over the next five years, with more material weightings to '21 and '22. Pleasingly, there was no PPI charge required in 2020 and we remain on track to complete our program in line with our current provision assessment, however, we were required to take a £26 million charge related to several, much smaller legacy conduct matters, none of which were material in their own right. As a consequence of the above, TNAV per share declined 5 pence year on year, primarily reflecting the statutory loss. We do expect to see a substantial reduction in exceptional costs over time to drive the underpin of future statutory profitability.

Turning to our funding position on slide 22. As with most across the market, we have seen exceptionally strong growth in deposits, which were up nearly 6 percent across the year owing to the impact of the pandemic on savings behaviors amongst both businesses and consumers. With our personal customers saving more during lockdown and businesses holding prudent liquidity level as they focus on cash flow, we saw balances grow strongly in financial Q3, and those balances were largely maintained through Q4. A large proportion of that growth was in current accounts, and as a result, relationship deposits increased 20 percent year on year. However, given the uncertain trajectory of the economic recovery, we are thoughtful about how sustainable these balances will be, recognizing that businesses and consumers may either have a greater need for access to their savings in the future economic downturn to come, or quickly increase spending if economic conditions improve rapidly.

Elsewhere, we have sought to reduce the rates on our savings book and have taken the opportunity to optimize our mix with a proactive reduction in more expensive term deposits. Given the sharp reductions in base rates, we reduced our deposit rates with much of the repricing activity taking place in Q4. As a result, we saw an 8 basis point improvement in the cost of deposits for the full year, with the full impact of that continuing into 2021, all other things being equal. Importantly for us, given the shape of our portfolio, this most materially benefits both front book TD business and the average £1 billion in monthly back book TD maturities across the year and will therefore be an important underpin to margin over the next several years.

Finally, due to our much higher customer deposit balances, we have taken the opportunity to optimize our wholesale funding stack through net repayment of nearly £2 billion of TFS-related balances, and have been less active in the secured markets, but we continue to maintain our funding flexibility as needed. Our average wholesale funding costs reduced six basis points, but largely as a result of base rate changes.

Looking now at our lending, on slide 23. I have talked at length already about the asset quality of our books, so here I will focus solely on the balance movements in the year, where we have clearly seen a game of two halves. At our interim results in May, we reported good growth in Business and Personal balances, while we continued to optimize for value in Mortgages in line with our stated balance sheet strategy. However, the second half of the year has obviously been impacted by the market-wide effects of the pandemic across the portfolios.

In Mortgages, we continue to maintain our pricing discipline and optimize for margin over the course of the year, but in the second half, like all banks, we were impacted by the property market shutdown during the first lockdown. The combination of these two factors meant our book contracted by around 3 percent in the year. There has of course been much market commentary about the rebound in property market activity and pricing, and I will touch on what this means for the outlook shortly, but just to note that given the timing of our financial year-end the majority of that market activity will only be seen in our financial H1 next year due to the completion time for mortgages.

In contrast, our business lending grew nearly 14 percent in the period = we saw good BAU volume in the first half before the pandemic really hit, but over the course of the second half, that BAU lending fell away and was replaced by the take-up of £1.2 billion of Government-guaranteed lending. You will see here we have separated this as a distinct sub-segment and we will continue to do so as the dynamics here are likely to evolve differently to our BAU lending in 2021 and beyond.

Lending growth in Personal increased by about 4 percent in the year, primarily driven by strong growth in Credit Cards in the first half, while our relatively stable book also outperformed the market in the second half, where our high proportion of balance transfer card balances mitigated the impact of the wider market lending decline. 2021 lending growth will be dependent on the backdrop and how the environment evolves. However, based on what we're seeing currently, there are some things I wanted to flag.

In mortgages, the current stamp duty holiday, structural reassessment of housing requirements, and the exit from lockdown all saw increased activity in our fiscal Q4, which will be completing in our fiscal Q1 and Q2. We expect elevated activity levels to persist in the short-term as we approach the stamp duty holiday expiry, however, beyond March the outlook becomes much tougher to call, with the potential for a much slower second half market. We are, therefore, adopting a cautious approach to volume assumption in H2 in as a result.

The strong Business growth through Government-guaranteed lending in 2020 is anticipated to largely be a pull forward of future volumes, which means we expect BAU demand to remain quite muted in 2021. In addition, the dynamics of borrower behavior on Government-guaranteed schemes, as interest becomes stable next year, could result in some well-performing businesses simply repaying the loans, some beginning to service them, and others potentially going into arrears. Therefore, taking these factors together, it is likely that our Business book will contract next year, although as with everything at the moment, making predictions is a bit of a challenge.

Finally, in Personal, there is likely to be subdued spending in the early part of year given the second lockdown we are currently in, but we do see continued opportunities for growth in 2021 as the recovery begins to take shape. Balance transfer volumes are more stable driven by a stock of existing debt that needs refinancing, and we expect to continue to be a leading player in that market. Our personal loan book also has opportunities given the recent launch of our rebranded Virgin Money Personal loan. Clearly, we will remain very focused on underwriting criteria and asset quality in this environment.

Turning now to NIM on slide 24. Overall net interest margin declined 10 basis points to 156 bps, which was importantly delivered within our guidance range despite the additional challenges and many moving parts. The year-on-year decline reflects the final wave of margin compression from the repricing of our mortgage backbook allied to the base rate cuts that happened in March, and the excess liquidity costs we incurred in the second half.

The second half dynamics largely played out as anticipated. In Q3 following the 65 basis points base rate reduction in March, we saw NIM decline of 16 basis points as the impact of loan repricing and liquidity costs had an immediate impact with no benefit from the repricing of deposits given the typical 60 day+ notice periods.

In Q4, NIM improved 5 basis points as the benefit of repricing activity on the deposit book took effect. Lending was adversely impacted by mix during the period, as lowering yielding Government-backed business lending drove a reduction in overall business yields. Loan pricing also remained competitive in Personal, and our mortgages completions in our financial Q4. As we look at into FY21, we currently expect a broadly stable NIM relative to the FY20 level of 156bps. This is primarily underpinned by improved mortgage spreads in FY21, which we are already seeing. Those spreads have improved due to the significant reduction in swaps with customer pricing reducing at a much lower rate, meaning the spreads on new business and retained lending is accretive relative to maturing balances.

However, our guidance on margin includes an assumption that the current improvements in spread are unlikely to be fully maintained, particularly in the second half. Beyond that, our deposit spreads remain largely stable under the current markedly lower swap rate environment.

However, as ever, our quarterly profile is likely to be a little uneven in 2021 with a broadly flat NIM into Q1, from our Q4 exit rate, and then a step up in Q2 that is broadly maintained through the year as we see the benefits come through from mortgage completions and deposit pricing actions. Our guidance assumes no changes in base rates and no repeat of 2020 performance in terms of the severity and length of lockdowns, with the other usual caveats here that there are always potential opportunities and risks to any guidance, but based on the current outlook, we think it is more weighted to the potential opportunities at present.

One quick point on our structural hedge to avoid us going down any rabbit holes in the Q&A. Given the action we took in Q3 to unwind our structural hedging position, we are now, of course, more rate sensitive both positively and negatively. Our decision to unwind the hedge was based on our view that the lower bound of interest rates had largely been reached, which continues to be our base case, but we accept that there is some heightened risk embedded in the current rate outlook. Our action did however lock in the existing NII contribution from our previous hedges, and so there is no incremental impact in FY21 from the decision, with the impact of lower yields on the maturing hedges simply not being locked in for five years at current rates.

Turning now to non-interest income on slide 25. Non-interest income was down 7 percent year on year, with that weakness skewed much more to the second half as lower activity levels impacted all our divisions. Personal saw the biggest decline in the second half, due to the continued impacts of the “high costs of credit review” and lower credit card transaction fees as spending reducing significantly under lockdown.

Business was a bit more resilient in the second half, but still lower owing to reduced activity levels, and was flattered in Q4 by a one-off £4 million participation fee in relation to a growth finance business sale. Mortgages income, naturally, was also reduced by the housing market shutdown, and the investment business income remained low as the ASI JV continues to get up and running.

In terms of the outlook, we remain cautious here and our current expectation is that the subdued non-interest income environment persists with the impact of the second lockdown in Q1 and lower activity levels across our key segments likely to continue. Clearly there is a potential for upside here if economic activity rebounds more quickly than current trends would suggest, aligned to vaccine rollouts for example.

Turning now to costs on slide 26. Despite the challenges presented by the pandemic, we continue to execute on our efficiency programmes, which delivered net costs savings of £30 million in the year, reducing our underlying cost base 3 percent year-on-year to £917 million, in line with our guidance. The majority of these savings came from lower headcount with personnel costs down 8 percent as the group continued with its integration programmes to reduce headcount and remove duplicative costs. However, it is important to note that this reduction includes the absorption of around £14 million of unplanned, incremental COVID-related costs, including £7 million of investment in systems to accommodate payment holidays and Government-scheme applications, with the remainder being extra resource to support customers.

You will recall that having announced significant restructuring proposals in February, we postponed that activity in response to the pandemic. However, as the environment stabilized, we partially restarted our efficiency programs in July, with the benefit of those initiatives to come next year. For FY21, we expect to deliver a cost base of less than £875 million, representing a further 5 percent or more of net cost savings, which is inclusive of absorbing a currently expected £10 to 15 million of COVID costs in 2021. The phasing of savings is also expected to be more weighted to the second half as our run-rate synergies accumulate.

We do expect to incur a further £75 million transformation costs next year to loan the programmes and to deliver our rebrand activity, which is slightly above the £360 million we have originally planned for by the end of 2021. This will not fully deliver our originally targeted cost savings in FY22 given the expense of closing and restarting our programs, as well as the impact of COVID costs in the short term.

However, we remain fully committed to delivering our previous cost target over the medium term and are evaluating opportunity to deliver further incremental longer-term cost reductions arising from the change in customer behaviors and evolving ways of working post-COVID, but do expect that we would need to incur some modest additional transformation costs in 2022 and beyond to deliver this.

Finally, I do just want to flag that we will be incurring some incremental costs relative to our previous guidance in relation to our match funding of the BCR grant, primarily in 2022.

Turning now to capital generation on slide 27, we delivered underlying capital generation of 116 basis points during the year, but after absorption of exceptional and non-operating items during the period, our transitional CET1 ratio finished 10 bps higher at 13.4 percent.

Our transitional CET1 ratio has not been materially impacted by the impairment charge, as a combination of the excess expected loss deduction and IFRS 9 transitional relief meant the net impact was just two basis points. RWAs absorbed 19bps of CET1 in the impairment period with AT1 coupons, exceptional costs and other items making up the rest.

Total capital of 20.2 percent and a U.K. leverage ratio of 4.9 percent remained robust, and at 28.4 percent, we remain comfortably ahead of our expected 1st Jan 2022 end-state MREL requirements of 27.3 percent, and therefore, any future MREL issuance will only be for the purpose of building a prudent buffer.

Turning to next year's capital trajectory on slide 28, we start the year in a robust position with CET1 of 13.4 percent, and it is worth flagging that as we look into 2021, there are going to be several drivers to keep in mind when it comes to our capital trajectory.

Firstly, on RWA's we do expect to see credit-risk RWA inflation begin to materialize in 2021 as Government support starts to recede and the actual economic effects of COVID begin to materialize. However, the timing of this remains very uncertain and will depend on how the environment evolves, with the impact likely to have been pushed further out into 2021 given the recent extension of Government support measures and recent increases in house prices.

It is important to note that our forecast guidance for the scale of credit risks RWA inflation is also based on conservative economic scenarios. And, so, to the extent the economic outlook differs from that, it will impact how our indicative guidance plays out here, as well as the timing point I have already referenced.

Offsetting the expected headwinds from RWA inflation, we continue to expect a reduction in RWA's from the initiatives we outlined in our interim results. Updates to our suite of business models and the move to IRB for our credit cards portfolio are expected to deliver modest benefits in the first half of our financial year, while the larger expected benefits from the adoption of hybrid mortgage models is now being targeted for approval in the summer.

However, as they occur with each source of initiatives, they do remain strictly subject to regulatory approval, but, as you know, we have a strong track record here. If they are approved as planned though, then taken together with our current expectations for credit risk RWA inflation, we would expect our RWA's to increase only modestly in FY21.

In terms of the trajectory for our transitional CET1 ratio therefore, while we anticipate the key drivers during the year broadly netting out, such that we are still around 13 percent at the end of the year, the in-year trajectory could be a little uneven, given: (i) the moving parts in our RWA's I have described, (ii) as well as the implementation of the EBA software intangible changes that we estimate will increase our CET1 ratio by around 40 basis points in fiscal Q1, and (iii) some unwind of the IFRS 9 transitional relief if stage migration increases.

Finally, I want to finish our 2021 guidance and the medium-term outlook on slide 29. So, just to summarize, the FY21 targets that I have outlined throughout the presentation already, we are expecting a broadly stable NIM relative to the FY20 level of 156 basis points with more opportunities than risks at present. Underlying operating costs of less than 875 million which includes, which includes c£10 to 15 million of COVID-costs, and a cost of risk that is lower than the FY20 level of 68 basis points.

It would be wrong not to recognize that due to the unprecedented nature of COVID-19, the exact economic outlook for the U.K. is clearly still evolving and remains hard to predict with any high degree of confidence at this stage. And, there are, as a consequence, opportunities and risks around our 2021 guidance as outlined, including a potentially accelerated return to normalization if the possible vaccines that can be rolled out quickly enough, but which we have not yet factored into our near-term assumptions at present.

Looking to the medium term, given the economic uncertainties that persist, we do not believe it is appropriate, at this time, to give firm medium term guidance, and so we have withdrawn the Group's 2022 targets pending more certainty on that forward economic trajectory.

However, we do continue to believe that Virgin Money has a clear path to delivering double-digit statutory returns on tangible equity over the medium term, assuming no significant further deterioration in expectations to the economic outlook or changes in interest rates.

The improvement in returns will be built on the core pillars of the strategy as David spoke to earlier, with the most material near-term returns drivers being:

> (a) the normalization of impairments as the environment stabilizes and the reduction in exceptional costs as we complete our integration and transformation activity; and
> (b) ensuring we can continue to reduce our cost base to further digitization to reflect the future operating environment and as we evaluate the future opportunities arising from changing customer and colleague behaviors post-COVID.

In addition, as part of that path to double digit returns, we are currently ascribing further but more modest benefits from delivering a more efficient capital base over time and optimizing our balance sheet mix in the medium term to grow a better balance of margin accretive lending and a reduction in our deposit costs.

We fully understand the importance of capital returns to our shareholders, and we believe that the delivery of our strategy will allow Virgin Money to consistently generate significant capital over time that can be redeployed into both returns accretive growth and dividends to shareholders.

So, thank you for listening. I realize it's been a long session, but there are three things I want to leave you with before I finish.

Firstly, in 2021 we are expecting a stable NIM that is more weighted to opportunities than risks at present. Secondly, we believe we have a very clear path to both double digit statutory returns on tangible equity over the medium term and distributing dividends to shareholders over time. And finally, when the environment does return to a new normal, we are very well positioned to deliver sustainable growth. I will now hand back to David, who will take us through the outlook for 2021 and beyond.

David Duffy, Virgin Money UK PLC

Thanks, Enda. That is a lot of detail to process, but I think given the unusual circumstances, we felt it was appropriate to provide this amount of disclosure. I will now spend the reminder of the presentation focusing on our post-COVID strategy and how we will deliver on our ambitions for Virgin Money.

Turning to slide 31, I would like to be very clear at the outset, that in 2021 we will continue to remain very focused on protecting the balance sheet and supporting our customers, colleagues, and communities, with the same discipline as we have done this year.

However, it is also important that we deliver on the products and propositions that will ensure that we are competitive in a post-COVID environment. Therefore, in 2021, you will see us deliver a fully integrated retail and business platform for our customers. This platform will offer all products under a single brand and will include a variety of innovative new products and propositions with an experience that matches the best in the market.

Critically, this platform is also designed as a Plug and Play platform for FinTech's and Partnerships. We believe that this combination of the Virgin brand, a unique proposition model, and a best-in-class service model will allow us to offer customers real value and convenience that will be hard for our competitors to replicate.

We have already started to see some tangible evidence of just how powerful the brand is. For example, we saw a 30 percent increase in personal loan applications following the rebrand to Virgin Money. There was also a clear shift in the customer profile to a younger, more affluent customers and a more national geographic distribution than we had seen before.

As you will see with some of the images on the slide, we have recently launched our Brighter Money Bundle proposition. With this offer, we are incentivizing customers to switch for value by deeply discounting Virgin Wine and Virgin Media offers and combining these with a competitive savings interest rate.

This value-based proposition model partnering with Virgin Group companies, is the catalyst to unlocking our Virgin brand lifestyle ecosystem. Also, we will enhance these propositions with our Virgin Red group loyalty program to offer integrated products and services for both Retail and Business customers that are relevant, reward loyalty, and offer a best-in-class experience.

This is another unique element of our consumer proposition; loyalty points are earned through the use of different group products and these can be deployed across many different companies. Also, in the spring, we will launch the national Virgin Money Business brand with a new Business Current Account and linked savings account.

Let me now turn to slide 32 and some of the details that we are launching. We are going to deliver the first new national business bank brand in decades, by combining our risk and sector expertise with our integrated iB platform a new partner ecosystem.

This technology and partner ecosystem, combined with our successful BCR grant award of £35 million, presents us with an unparalleled opportunity to help business owners to realize their potential and to grow further business. We will match fund the BCR award and this combined investment will allow us to build this unique offering in a market that is poorly served by banks in general. Initially, we will launch a digital Virgin Money business current account with a range of new customer features. As the product evolves, powered by advanced data analytics, this current account will be the most advanced digital offering in the market and will include automated credit decisioning capabilities.

We will introduce our unique Working Capital Health Proposition which will provide business owners with rich insights into the running of their business, allowing them to optimize their financial performance and also provide access to a wide variety of working capital solutions through a Fintech marketplace accessed via the cloud and our customers will be supported by our highly valued relationship management team as we deliver this ecosystem.

As you can see, we are delivering what we promised, an integrated Fintech and partnership-friendly platform, under a single brand, with innovative new products which will deliver a unique value-based series of propositions, and many of these are available in our Virgin app today.

In the year ahead, we will deliver constant innovation and value for customers in our Personal and Mortgage divisions, as well as our nationally-branded business bank. We are operating in a difficult environment, we will keep our discipline, as I have said, but as we move into a new normal, my ambition is for Virgin Money to be viewed as the most agile and innovative bank in the U.K. and to deliver on our ambition to disrupt the status quo.

Turning to slide 33 - it is not just about products and propositions. We have always felt that the Virgin brand is a disruptive brand but is also a force for good. The work of the Virgin Money Foundation and the founding of the not-for-profit Virgin Money Giving platform are just some of the examples of the positive DNA that exists in the brand.

Our ambition is to drive positive social and environmental impacts to everything we do, and rather than speak in generalities, we've developed four specific big goals in the ESG space that are aligned to our Group strategic goals.

Alongside each of our new goals, we're setting out bold aspirations, including the strengthening and extending of our net zero commitments across our financing activities. This includes setting the ambition to reduce the carbon emissions in our lending book by at least 50 percent by 2030. We are also taking action to tackle the challenges of diversity, the Poverty Premium, and are significantly enhancing our ESG disclosure and KPIs.

We are also committed to working with leading industry forums which you may be familiar with, such as the Partnership for Carbon Accounting Financials and the United Nations Principals for Responsible Banking, these partnerships will help us to accelerate this agenda and to align with the 2015 Paris Agreement. This is a significant agenda, but we are starting from a strong place, with lending to carbon-related assets at only 0.1 percent of our total customer lending. Let me now turn to slide 34.

I would like to conclude with a few comments on how the plans I have outlined will support us in creating shareholder value. Firstly, we will continue to deliver a stable and resilient bank in the next phase of this pandemic, by applying precisely the same focus and discipline that we did in the first phase. However, as Enda has outlined, this unprecedented economic uncertainty means that the pace of our programs will be carefully balanced with the reality of the pandemic impact as it unfolds. Like many other companies, this uncertainty has led us to withdrawing our 2022 target, pending more certainty on the economic outlook. However, as I have said, we remain focused on delivering the core self-help pillars of our strategy. And just as a reminder, these are:

- Delivering a lower and more efficient cost base,
- Accelerating our digital transformation and delivering you digital products and propositions,
- Carefully maintaining our discipline list profile and continuing to optimize our capital base,
- And, over time, returning to growth as we seek to optimize the mix of our balance sheet.

The board and I believe that the implementation of this strategy will allow Virgin Money to return to statutory profitability, and to deliver double digit statutory returns on tangible equity over time.

Equally, I know how important capital returns are for our investors, and I am confident that the delivery of our strategy will allow us to generate significant capital over time that will support us in our ambition to implement a progressive and sustainable dividend policy.

We will now turn to Q&A, so if you haven't dialed in to the Q&A conference call yet, please can I ask you to do so. And if I can ask the operator to see if we can have some initial questions please. Thank you.

Rohith Chandra-Rajan, BAML

Hi, good morning, thank you very much for a very comprehensive presentation today. I was wondering if I could ask on a couple of issues please, one's, a few on margin and then briefly on credit quality. The 10% RoTE medium term aspiration, could you sort of give us some detail as to what margin is consistent with that 10% RoTE? And then just in terms of some of the nearer term drivers, mortgage pricing you talked about new business spreads being above what's maturing, I was wondering if you could give us the gap there. And then in terms of the outlook, you seem to be a little more cautious than some of your peers post the stamp duty holiday, so where do you -- what's your best case expectation of where mortgage new business spreads move to post March? And then on deposits, term deposit costs in second half were 153 basis points. Could you tell us where you're currently writing new term deposits, and I guess that takes a couple of years to roll through to the balance sheet?

And then briefly, credit quality. So lower impairments in 2021, appreciate it's highly uncertain, but if there were no changes to your macro assumptions, can you give us a rough idea of where you'd expect the impairments to come in? And then briefly on the credit card book, coverage there of 537 basis points, I guess that primarily reflects the balance transfer business, but it is quite a bit lower than peers, so if you could give us a little bit of detail on why you're comfortable with that level of coverage on the cards book, that would really helpful. Sorry, I appreciate there's quite a lot there.

David Duffy, Virgin Money UK PLC

Right, thanks for that - it's David here. Appreciate that, we'll go through all those points and Enda will pick up on the - starting with your RoTE point and take us from there, and then if you have any follow up let us know. Thanks. Hand over to you.

Enda Johnson, Virgin Money UK PLC

Thanks Rohith. A lot in that so forgive me if I miss any of it. Just maybe starting on, on the medium term target. Obviously, you wouldn't expect me maybe to give longer term or medium term margin guidance. I would say that, as I said in the presentation, we are ascribing relatively modest value right now to capital efficiency and balance sheet mix evolution. So that includes margin as a component of that, so we see the much more fundamental blocks on that build being in the cost agenda, exceptional costs coming down and then impairment normalization. So that's probably how I would answer that one.

In terms of mortgage spreads more generally, and kind of taking it in terms of what we're seeing now, what we're seeing in second half and how we think about that. So, I guess in the last kind of -- let's call it 6 to 8 weeks -- spreads have moved higher again. We're not assuming in our guidance here that that is maintained for any particular period of time across the remainder of the year. So, to the extent that those spreads currently being written are sustained then, you know, there's potential upside there in terms of our margin, but we're not calling that right now. We do think that the market dynamics in second half potentially could lead to, kind of, a reduction in volume which then potentially leads to a reduction in price. So that's kind of how we're positioning ourselves there.

I would say that, recent spreads clearly are at a spread higher than our back book, and we do expect that to continue. So that's how we're thinking about spreads in general. From a TD perspective, you're right, our back books, our pricing is elevated, and we are taking actions to bring that back down. I'd say that kind of on a, on a rough guide TD spreads are coming in at 100 basis points or lower, and we continue to look at that in the context of opportunities going forward. Again, not all of those opportunities are baked into our margin guidance of broadly stable here. In terms of credit quality, well it's very, very early to be calling next year. I think we're -- we've deliberately set out here that we're taking a very conservative view on the economics and the weightings that we've attached. In the absence of economic changes, either positively or negatively in terms of that outlook, it really then does start to come down to specifics and when those start to materialize in terms of then how we think about the evolution of cost of risk into next year.

And at the moment what we're seeing is that with the furlough being extended and kind of government support measures in place until the end of March, we don't expect that specific flow to start materializing in any volume into next year. So that's how we're thinking about that at the moment.

And then final one on your point around coverage on the credit cards at 537. I think that, you know, we would go back to kind of the underlying quality that we believe is in that portfolio. If I take you back to slide 12. The vintages across all of the business that we've written over the last number of years we think to be of very high quality are arrears data is consistently running better than the market and currently running at about half of what we can see externally. Our payment holiday data is giving us confidence in terms of the return to payment profile of the customers and how that ultimately came through.

And then in terms of the BT balance as you said, we've lots of historical data that gives us confidence in terms of how that type of customer and balance behaved in a stress relative to the broader market. That's, overall, giving us the confidence here in the context of where we think we're positioned for May from a provision perspective.

Rohith Chandra-Rajan

Thank you, and can I just come back on, on the mortgage pricing. So it looks like current mortgage spreads in the market are around 180, 185 basis points, so I wondered if that's similar to what you're writing and that's come from a sort of 100 basis points at the end of last year. So, in terms of your sort of planning assumptions, where do you think that 180 basis points goes to post, and, you know, from the second half of your fiscal year onwards?

Enda Johnson

Yeah, sure. We haven't started to really talk about our spreads or given those numbers out. You know I would just say that, as it stands right now, our front book spreads are comfortably ahead of back book. But we're not giving kind of specific spread figures and we haven't done that historically.

Operator

We now have a question from Ed Henning from CLSA. Ed, please ask your question.

Ed Henning, CLSA

Thanks for taking my questions. First one just following on from the NIM question from before. Are you assuming a very sharp increase in mortgage prices that is currently happening in your new guidance up until today, or a recent point? And then, going forward, you also talked about before on a credit growth some roll off of the Government-guaranteed loans, are you assuming that in your new guidance as well?

Enda Johnson

Hi, Ed. Yeah, thanks for that. So, Ed, in terms of the most recent pricing that we've seen, over the last -- let's call it 6 to 8 weeks -- that has not factored into our NIM guidance. And we don't see that being sustained over the remainder of the year, particularly in the second half. So that's how I'd answer that one. And in terms of the Government roll off, yes, in terms of how we think about the evolution of the portfolio over the course of the year, that is all part of how we think about the components driving NIM for the year.

Ed Henning

And can you shed any light on, you know, what percentage or how much of an impact that is on your NIM or whether, you know, that will be coming through in the second half? Is it substantial or just a small component?

Enda Johnson

I would say, Ed, more of a small component if you take the overall portfolio size that we're talking about here in terms of overall contribution. I think from a '21 perspective, I think that the mortgage spread and the deposit actions we're taking are much more material in the context of NIM support and NIM evolution.

Ed Henning

That's great. And just a second question on non-interest income, you've talked about it being subdued in '21, but obviously there's a very strong first half. Should we be more taking this second half and, you know, and either flat lining it from there, how should we think about that?

Enda Johnson

Yeah thanks, thanks Ed. So there's a couple of things in the second half that came through. One was the high cost of credit review, so the full impact of that came through in the numbers in the second half. And then, obviously, at an overall kind of activity level in the economy, then that overall activity level, that really came through in terms of the second half. So I think the proxy in terms of how the shape of the OOI had evolved over the course of the year. I think the second half is a more reasonable reflection of a subdued environment and that also incorporates the high cost credit review numbers are out of the second half numbers.

The one point I would say is that, you know, clearly to the extent that the economic activity picked up, we would expect those numbers to improve on a kind of a run-rate basis once consumers are back in, kind of, broadly normal spending habits.

Operator

We now have a question from Chris Cant from Autonomous. Chris, please ask your question.

Chris Cant, Autonomous

Thank you for taking my questions. Three please, if I can. You mentioned restructuring charges in 2022 and beyond. Should I take that to imply that your £780m cost target, which you're saying is still going for over the medium term, that's now a 2024 target or beyond if you're still taking charge of it in 2023? And related just in terms of understanding this cost glide, you've flagged that you've got some recurring COVID costs in 2021, but you've also mentioned that you're going to have some BCR related costs in the P&L in 2022,are we talking £15 to 20 million going through the cost line there, given your match funding of the £35m grant? And then, thinking about your CET1 guidance for the circuit 13 percent. And obviously you've got these pretty conservative looking assumptions for your ECL, are your RWA pro-cyclicality assumptions based on the same macro assumptions? So are you assuming to get to your FY21, c.13%, are you assuming big RWA pro-cyclicality from a big HPI decline?

And then, finally, rate sensitivity. What's your current rate sensitivity, please? You've talked in the past about having an £8- to £10 million sensitivity to a 25 bps move. What is that, now given you've unhedged the balance sheet? And as a more broad, strategic point, do you think playing the rates market is something that investors are looking for you to do? I understand you've got your logic on the zero lower-bound but obviously you are taking a risk if we move to negative rates. Thank you.

Enda Johnson

Thanks, Chris. So just on restructuring charges and cost targets. So, on that one, what I'm flagging there is modest restructuring charges, in '22 and '23, and also, you know, we are absolutely committed to delivering our previous cost guidance. We just think it's going to take a little bit longer than we had anticipated, rather than it's going to take a long time to deliver, is maybe how I would answer that one.

In terms of flagging the COVID costs, and the BCR costs, we want it to be helpful on the trajectory as we see things today. So the COVID costs are very much aligned to resource costs that we have built into our business already today, to gear up for the potential increase in customer difficulty and customer support requirements that we see maybe required, depending on how ultimately the specific provisions play out over the coming period.

So those costs, we have deliberately pulled them out here, and we've ringfenced them internally in terms of how we think of them effectively falling out of the cost base, over the medium term. I can't figure today and tell you when that's ultimately going to happen, but we see those as, kind of, temporary costs, rather than part of the underlying base, and wanted to kind of flag the magnitude of that to help with that.

On the BCR funding, I think the numbers you flagged there are probably a little high. I think in terms of our match funding, there will be an element of capitalization versus underlying opex that would come through, and we are looking to create a sustainable business model and additional assets as a result of BCR, rather than necessarily spending money on, let's call it, a lot of marketing, et cetera, et cetera. I think in terms of the uplift and flagging there, I would encourage you to think of it in capitalization terms rather than necessarily in terms of pure opex.

In terms of CET1 and pro-cyclicality, not quite a one-for-one match, Chris, but we are taking, as a firm, a broadly cautious approach to how we think about the economic environment next year. And therefore, your point around, are we being conservative in our economics underpinning, kind of, the pro-cyclicality point, I would say yes. We are adopting a conservative approach across the board in terms of how we think, but RWA inflation and therefore the guidance that underpins that, for capital.

And then -- look, Chris, on, playing the markets and playing interest rates. Look, we took the view, in the summer, on the fact that we believed rates had reached, or approached, near the lower bound. The go-forward environment does leave us more rate-sensitive, both positively and negatively. And we have triggers to consider the potentials for movements in either direction, that we would then put into place.

Our view in terms of the current environment is that, the yield curves are very flat. And therefore, we didn't think it made a whole lot of sense to extend that out to five years, when short-term rates and long-term rates are very closely linked. To the extent that that moves, we will obviously consider hedging options in that context.

The final point, I would say in answer to your question, I think I got them all, Chris, is just in terms of rate sensitivity. We had provided that previously, when I guess we were in a more straightforward interest rate environment. Given we are at very low and/or zero rate environment at the moment, a kind of straight P&L impact is not how we think about this. Typically, if it was negative, our deposit costs today are relatively elevated, compared to some of our peers. And we think that we have a lot of option there, to the extent that interest rates go negative for a period.

Chris Cant

If I could just follow up on that. I mean, I think the previous guidance you gave, which was obviously quite muted in the £8-10m range, relative to large peers, would have also presumably captured the fact you had higher than average deposit costs, and more room to maneuver to pass anything through. So, if I'm thinking about bridging off that 8-10, you know, previously, in terms of your year one sensitivity, you had, roughly £24/25 billion hedge on. Just multiplying that through, say, a 25 bps move, that would be protecting you from more than £60 million of additional negative pressure, when thinking about the whole 8-10s.

So, I mean, should we be thinking of £60- to £70 million of sensitivity the direction now, or a 25 bps move, given that you don't have that hedge protection or, kind of, resistance, I guess, in a positive scenario. We've got the right quantum or am I missing something?

Enda Johnson

So, Chris, that's the straight max, broadly speaking, if you take a £24 billion notional on that, but -- I would say, relative to, kind of, previous estimations, I think that either the deposit market is very different now, in terms of competitive pressures and optionality. And, I think the way that we look at it internally is there would be significant scope to offset, kind of, a mathematical calculation in the context, would work.

I think the other point that's very important here is that there are multiple ways that the Bank of England could transmit negative rates into the market, and that would also be a key determinant in terms of how all of this would ultimately play out. For example, they could come in tiering on TFSME rather than moving straight on base rates.

Chris Cant

Okay. Thank you.

Operator

We now have a question from John Cronin from Goodbody. John, you may ask your question.

John Cronin, Goodbody

Morning, David. Morning, Enda. And thanks for taking my question. If I can just come back to the cost structure again. I appreciate this target has been pushed out but what kind of -- can I get your thoughts on the end state cost structure and what it can support, in terms of balance sheet size. And I guess, interrelated with that, there are a lot of moving parts from a capital perspective that both of you emphasized on various occasions this morning, your belief that you've been conservative in your estimates.

So some potential tailwinds then to your 13 percent transitional end-'21 guidance, and how that might influence your perspective on potential inorganic expansion opportunities, particularly maybe in the business lending domain. But look, a lot in there, the underpinnings of that, the cost structure, and how you can leverage that in the future, and whether M&A would present substantial scale benefits in that context.

My second question is short on current accounts, first on growth and relationships positive to 20 percent year on year this year. If you were -- if I could press you to give some numbers in terms of how that might evolve on a one to two-year view, in terms of further build there. What kinds of opportunities do you see to grow that significantly further?

And then thirdly, on the balance transfers, now 68 percent of the cards portfolio, and that's up a bit slightly from where it was earlier this year, in my understanding. Just wondering why that's still so high. Are you refinancing your own customers, or extending effectively interest-free periods for a portion of those balances? Thank you.

David Duffy

Good morning, John. It's David. I'll just cover a couple things and also Enda will follow on some of those latter points that you raised.

So, if I take a look at the costs, just to give you a bit of perspective, what we're looking at, in terms of your definition of end-state, is kind of how we think about it. We are looking to go through the next six months or so of the new COVID operating model, on the one level, and determine what cost opportunity that gives us, because we do think that in the various practices that we've implemented over the past six months, we think a lot of them will be sustainable long-term, and will give us an opportunity, and we just can't size it yet. We expect there'll be some further opportunity to go after there.

I think there's also, thinking in our minds is that the COVID environment has given us a real impetus behind our digitization drive, and we think that there will be a lot of opportunity there to further accelerate those programs, and that will give us some cost opportunity as well. So, I would take a view that we're considering the end stage, and see opportunity, but not yet ready to give a quantum of opportunity, and we'll do that as soon as we can.

On the separate issue relating to what our thinking might be about anything inorganic, to your question on that, I think we have a pretty laser-like focus at the moment. We see the time has come for us to be able to complete transformation and rebranding, and to invest in the customer solutions, and prove the value of the brand. And that is our mission, and we have also the factors we've said before, that we're implementing a nationwide first-decade, kind of, business plank, with all of the Fintech opportunity and ecosystem that we're building on that.

So I think our priority focus has to be, get through, in a stable way, the next year of what we see coming, and then at the same time, build for post-COVID, a really fantastically efficient and digitally oriented bank, with the full capability that you would expect.

So, I think the inorganic is -- there's always a situation where something happens in the market that affects you and you have to think about it, but it's not part of our thinking at the moment. We're very focused on delivering on the promises with regard to the Virgin brand, and the growth of our business post-COVID.

So I'll pause there, and hand it to Enda to pick up on the other couple points you raised.

Enda Johnson

Sure. Thanks David. So, John, just coming back to you on the relationship deposits. So, look, I think there's an element, John, in terms of the balance build in 2020 that we are thoughtful about how that might evolve into 2021 in the context of consumer spending, potentially businesses spending may increase into '21. So that is one element that we are thoughtful about in terms of how that portfolio, if you want to call it, may behave into '21.

But medium, longer-term, I think you've kind of hit the nail on the head, that the cost of those deposits is 26 basis points on an average basis versus an overall cost of deposits 90 basis points. You can see clearly from the strategic perspective that is why we are so focused on our PCA proposition build, and our BCA proposition build. We think that BCR, in particular, will be very helpful in the context of what we are trying to do there.

So, in terms of go-forward, and in terms of how we think about value creation to the business, that is clearly the key element of how we think about the strategic build of our deposit base, and therefore, an element that we will be very focused on in terms of looking to grow over time, notwithstanding the point I said, on how we think '21 might behave from a volatility perspective.

In terms of BTs, John, that's probably a more straightforward one, just in that the BT balances are much more stable in this environment, in the context of paydown, I think you've probably seen the peers, that they've seen a more significant reduction in the overall cards balances rather than relative to ourselves. And that's largely thanks to the BT balances that we have. So it's not a change in strategic focus, it's is just a function of the nature of the balance that underpin those products.

John Cronin

Okay, thank you.

Operator

We now have a question from Martin Leitgeb form Goldman Sachs. Martin, please ask your question.

Martin Leitgeb, Goldman Sachs

Yes, good morning from my side. Just one question on how should we think about the composition of the loan book going forward? And at the beginning of the year, the indication was that the mortgages overall will shrink somewhat as a percentage of the total mix. And I was just wondering in light of the current environment, on the one end, obviously, there's a marked improvement in mortgage pricing here today. But on the other hand, probably also maybe a better opportunity in cards in terms of how competition seems to have evolved. How do you see the overall loan book mix shift over the next couple of years? And the second question just related to that, I was just wondering, in other segments of your loan book, outside of mortgages, have you also seen signs of kind of pricing discipline? Thank you.

Enda Johnson

Sure. Martin, thanks for that. And I'll take both of those. So in terms of the compensation, I think you're probably -- I'll probably break your question into short term and medium/long term. In medium/long term where, you know, we very much are aligned to our previous strategic intent to arrange a kind of gradual diversification of the portfolio with higher ultimate balance on the personal and business side relative to mortgages, in terms of where things sit today, you know, having gone through the strategic review and analysis over the last few months, our position on that hasn't changed. But that is probably a medium longer term view. I would kind of point to, the dynamics of the portfolios at the moment in '21. It is quite difficult to call in terms of how customer behavior will evolve. Clearly, we're seeing very strong activity in the mortgage market and we expect that to come through in our first half. There's a lot of volume on the business side that we think is a pull forward from '21 in terms of how 2020 ultimately played out. And then we do see that there are continued pockets for growth in the Personal side notwithstanding our putting material underwriting tightening that we did, that we did in the second half. So I think we'll need to kind of keep talking about the portfolio shape over the course of 2021. But in the medium term should absolutely align to what we talked about in terms of Capital Markets Day delivery.

And Martin, sorry -- excuse me -- your second question again...

Martin Leitgeb

I was just wondering what you have seen in terms of pricing within the other loan categories outside of mortgages. You know, mortgages had a sharp improvement, do you have a similar impact in other loan segments or is it more stable there? Thank you.

Enda Johnson

I think more stable, Martin. And also aligned just to our risk appetite as well in terms of particularly on personal and credit cards where we very, very much tightened our risk appetite by kind of 30 and 40 percent, respectively. So the pricing there, if it continues to be attractive from a returns perspective, but we haven't seen kind of any movements like we have in the mortgage space.

Operator

We now have a question from Grace Dargan from Barclays. Grace, please ask your question.

Grace Dargan, Barclays

Good morning. Thank you for taking my questions. Just a couple from me. So firstly, would you be able to quantify the benefit from the deposit repricing that you think has yet to come through? And then secondly, on impairments, it's good to see the increase in the coverage ratios. And I was wondering, would you be able to give us some detail on your loan write off policies? And so, for example, how quickly do you write off your non-performing loans? And so, for example, as indicated, they tend to write off their loans more quickly, which then obviously is impacting the total coverage ratio that we see. Thank you.

Enda Johnson

Sure. Thank you, Grace. In terms of the deposit question and the contribution, I'm not going to give relative contribution components to this. The way I would maybe talk about it to be helpful is, you know, we did see Q4 NIM at 152, as I said in the presentation, I'd expect Q1 to be broadly flat on that. And then you do get the contribution from both the deposit pricing and the mortgage spread increase coming through from Q2 onwards. So that's maybe how I would think about the relative contribution there. They're both important to as an underpin to the 2021 NIM guidance that we've given.

Mark, do want to come in on that write off policy piece?

Mark Thundercliffe, Virgin Money UK PLC

Yeah, we earlier adopted the EBA rules in 2014-15 when we enhanced the prudentially tightened our forbearance and pre-forbearance policies for business. And we felt it important to preempt the EBA rules and avoid implementing enhanced policies to only change again in the future. We write off on our retail portfolios at 180-day, which is different to some others. And hence we are seeing, therefore, just a stability around stage three at the minute.

Operator

We now have a question from Guy Stebbings from Exane BNP Paribas. Guy, please ask your question.

Guy Stebbings, Exane

Good morning, everyone. Thanks for taking my questions. First, can I come back to the macro assumptions? I think a lot of us would have -- the various developments on lockdowns, government support, vaccine development and perhaps thought they might broadly balance out versus prior expectations, maybe with slightly more -- slightly worse base case scenario but with a lower probability to a prolonged pandemic, but given you're not reflecting latest vaccine news in your assumptions, clearly what we're seeing in your book is slightly different.

So can I firstly just check that your ECL provisions, which don't give any benefit on the recent vaccine use, does capture the latest lockdowns, whereas most peers at their Q3 results have attempted to capture either. So you're, perhaps, being more conservative there.

And secondly, associated with that, are these assumptions and the sort of broader conservatism actually impacting how you manage the business? I ask because it seems surprising the mortgage book went backwards last quarter, given where volumes and spreads were even with the lag on completions.

And just a quick follow-up question. On the PMAs adjustment. Thanks for the disclosure on where they sit by book, are you able to say kind of from a staging point of view, do they predominantly sit within stage two, et cetera? Any color there would be very helpful. Thank you.

Enda Johnson

Yeah, sure, I'll takes those, Guy. On the economics, the way that we had thought about setting these was in the context of -- on the forward look, we had viewed that additional disruption was likely, whether that came from additional restrictions in the economy or potential disruption as a consequence of Brexit deal or no deal.

I think that until we obviously go through the full extent of the of the lockdown and consider the economic impacts of that, it's difficult for me to be definitively saying that the economics assume the second lockdown. What I would I say, though, is that based on everything we've seen to date in terms of the economic impact that's assumed for the November lockdown relative to kind of what was talked about in terms of March, April, I think it would be fair to say that the level of disruption is incorporated into our economics and our weightings here. So that's probably how I would answer that one.

And on the PMAs, yes. As you can see from our -- from the breakdown of our staging, the PMAs are very much weighted towards stage two in terms of how we've allocated them. Stage three loans continue to be very low percentage of the overall portfolio.

And, Guy, sorry, what was the third question again?

Guy Stebbings

Well, it was kind of in reference to some of the ECL assumptions and how that impacts how you manage the business. I guess if we look at pricing behavior and volumes in Q3 for how other banks report, you know, some banks were prepared be -- do a lot more volumes given where pricing was and even with elevated risk, presumably pricing gives you an extra buffer. I just wonder whether you're slightly more conservative stance is impacting how you actually manage the business.

Enda Johnson

You know, I'll bring Mark on this as well, and I would say, though, no. What you will see in our Q1 and hopefully Q2 results that I think there is an element of timing around our mortgage volume. You know, when I think about what we've assumed for next year relative to 2020, there is a reasonably significant uptick in terms of the volumes that we're looking to do. We have tightened criteria on the personal lending side on the business side and on the mortgage sides – indeed across the boards, but I don't think that is kind of putting a handbrake on our front book volume and front book activity. I think there's just an element on the mortgage side where there's a little bit of timing that you'll start to see coming through in our first half results.

Mark - I don't know if you wanted to add anything to that?

Mark Thundercliffe

No. Well, I'd agree with all of that. I think as you'd expect, RAS was tightened rapidly in relation to COVID and it remains under constant review. I'm not worried. I'm more watchful. The asset quality across the bank at the minute is in really good shape. But just as an example, we immediately removed about 26 credit RAS measures and they were replaced with 35 new measures to tighten and refocus appetite and response. Interestingly, the market itself has allowed us to get some flight for quality. So there's been activity around quality still needed. A number of retained measures were also adjusted to recalibrate to the new environment. So it's not impairing our ability to be able to compete even around price. So there's no adverse selection. We've been able to lean into the opportunity as we've tightened, as we found some of our competitors are actually exiting with little or no appetite to certain sectors. So we've been quite selective, but very prudent as you'd expect.

Guy Stebbings

Okay. Thanks very much.

Operator

We now have a question from Ed Firth from KBW. Ed, please ask your question.

Edward Firth, KBW

Good morning, everybody. I'll be super quick. I'm conscious of the time. Just two things. I just wanted to check my understanding of what you mean by locking in the hedge, because as I understand it, what that means is that you're not replacing it and that over the next five years, the contribution from the hedge will effectively amortize. So I guess my first question is, is that understanding correct? And then my second question, I guess, related to that is if that is correct, what assumptions have you made about that in your double-digit RoTE in medium term targets? Because I don't see a block there for that hedge income disappearing. It’s a reasonably chunky number in the context of great returns. So could you just clarify those two points? Thanks.

Enda Johnson, Virgin Money UK PLC

Yes, sure. On your first point, it is -- that is broadly correct, Ed, it will amortize over time just in terms of, you know, how we ultimately did this at the time. And the hedge was unwound by transacting offsetting swaps rather than terminating the individual trades. And so your characterization of that, in terms of how that is then embedded, is correct.

In terms of our contribution then, the overall contribution, the unwind of that over time is embedded in our assignments of value in terms of the balance sheet mix and margin point, and in terms of the build to 10 percent or more over the medium term.

Edward Firth

But that's an almost 4- to 500 basis points of return headwind?

Enda Johnson

No, Ed, I'm not sure on that number. I don't I don't recognize that number in the context of how..

Edward Firth

One percent yield on £24 billion of swaps?

Enda Johnson

Yeah. So Ed, I think it might make more sense to -- if we maybe took this one specifically offline and there's a broader balance sheet mix in aggregate point here that I think we should probably just work through in the context of how we see the hedge unwind coming through the embedded NII that is that is still there. And then also, I guess it depends on how you think about the interest rate lines going forward, too. So we might take that one offline with you if that's okay with the team.

Edward Firth

Yes, of course. Yeah, that's all right.

Enda Johnson

And just to be clear on that, we have assumed flat rates in that RoTE target. So that's an element, I guess, in terms of how I might be thinking differently in terms of how you are about how that plays through. So let's pick that one up offline.

Operator

We now have a question from Rob Noble from Deutsche Bank. Rob, please ask your question.

Robert Noble, Deutsche Bank

Morning, all. Thanks for taking my question. I just wanted to ask about the COVID costs in 2021. So the £10 to 15 million, is that purely collection costs? I think I heard you say that you you've nearly doubled the number of staff there. How many staff do you have for collections and is there a difference in how much it costs between collecting on a mortgage versus a personal loan, versus a business loan? Thanks.

Enda Johnson

Sure. So it is largely -- it is largely people costs associated with collections, and yes, we have already kind of doubled our requirements in that space. I'm not going to kind of get into specific numbers as they follow through, but we've already built those people in. And there's an element, of conservatism in terms of what we've done there and given the fact that these specifics are not coming through. But as I said, that population is clear and identifiable in terms of how we think about that going forward. I guess you know we have different approaches to different customer cohorts, some of which are all done in-house, and then some we use some external support as well. And probably the largest concentration in terms of complexity sits within our business bank and the work that we do there, we have a long established team that is fluid between our normal BAU business and then customers that need support. And we've definitely beefed that one up as a material component in terms of how we think about that cost going forward.

Robert Noble

Great. Thank you. I was going to ask on this year's you've said that there's an incremental of £14 million of COVID costs. Is that -- I mean, you must have saved -- you must have made some savings from that low marketing or travel and entertainment like many other banks have as well. Is that in that £14 million or is it within the underlying net cost savings?

Enda Johnson

Yeah, savings have been relatively limited, but it's in underlying, but it's not -- they weren't particularly mature, we don't have kind of -- we didn't have significant travel costs, that type of thing, as a core component of our cost base. So the actual cost savings in year were relatively limited. As David said, we do think there are more medium term opportunities as we go forward in terms of how we think about property and other footprint elements there. But in terms of 2020, relatively limited cost savings.

Robert Noble

And did you maintain your marketing spend as well then - I don’t think you split that one out?

Enda Johnson

We don't split it out. We continue to be active from a from a marketing perspective last year. But we don't split that out separately.

Robert Noble

All right, thank you. Thanks a lot.

Operator

We now have a question from Victor German from Macquarie. Victor, please ask your question.

Victor German, Macquarie

Thank you. A couple of questions from me, if possible, as well. The first one -- I might just actually follow up on Ed's question on the structure hedges. Appreciate you trying to give us a bit of clarity, but it seems like there's still a bit of confusion. In the past you used to provide us a chart or a slide which shows contribution from structural change to net interest income. So last time you reported was that £111 million. Are you able to tell us how that income is progressing to this half and what the expectation is for next year? That's a question.

Enda Johnson

Sure. And your second question. Sorry, Victor.

Victor German

Okay. All right, sure, I'll ask all of them. The second question is on non-interest income. And so if I look at your slide 25, you -- it's a useful chart where you actually show us by quarter how non-interest income progressed. I note in the fourth quarter it was £36 million with the £4 million gain, which you call this one off, which sort of looks like a run rate in the fourth quarter is close to have been £32 million if we annualize if you annualize that comes at a very low number. I sort of feel like I'm missing something there. If you can maybe give us a kind of a bridge as to how we should think about drivers for that particular line item.

And lastly, on cost, appreciate, obviously, there's a lot of a lot of uncertainty in this environment. And it's difficult for you to commit to your previous guidance. But it sounds, David, like you still are committing to that £780 million cost guidance, perhaps not in 2022, but in later years. Would just be interested in just making sure that that number is still the right number to think about and why you're not sort of just kind of shifting it one year, why are you sort of walking away? Is it just a matter of, you know, your concern around uncertainty for next year? Or is it something more fundamental to be found within the business that doesn't give you as much confidence about the cost trajectory you've had in the past? Thank you.

David Duffy

Okay, thanks, Victor, for those. It's David. I'll just pick up on that cost point and then Enda can come back on the other two points on NII & structural hedge. But specifically, are we confident about where we're going on costs in the long-term trajectory on that? Absolutely we are. So this isn't something we've seen that gives us cause for concern. I think our issue is one of -- we see that there is a trajectory to deliver on our cost ambitions, but there is also a completely different operating model that we can deploy. And as I mentioned that earlier. But to give you some sense of it, what large scale buildings do you need? The model would suggest perhaps considerably less than you might have had before, what branch architecture will ultimately be required? Perhaps there is more to consider there. And then in our internal operating model and all the processes and procedures, we see huge digital opportunity as we've been aggressively pursuing that path. So what we'd like to do is come back with a considered view, which gives a clear trajectory to an end state that incorporates the -- all the elements of COVID that we're exploring right now.

So I would just take away from the call that we are very confident of delivering our cost ambitions and we are just trying to get a handle on the quantum of additional benefit that we might be able to deliver following, you know, settling of the COVID model. So that's where I would take the cost discussion…

Victor German

Just make to make sure we're clear, I mean, it sounds to me like you kind of with everything you just said, that you feel like potential cost opportunity is actually bigger than you originally guided for and the reason you don't want to commit to a number because you think that the cost opportunities might bigger? Is that the way I should read it?

David Duffy

Yes. Ultimately, we see additional opportunity. That's where I put it. I want to look at the cost to deliver it, as well as the cost saving and get a proper understanding of the totality of what we have today and what we foresee we might be able to do and give a clear picture of that. But I would see some additional benefit potentially being available to us.

Enda Johnson

Sure. Thanks, David. So Victor, just OOI and back to the hedge. So on OOI I kind of outlined earlier in the call that I thought that the second half performance was a reasonable proxy in the context of the forward view, notwithstanding what I would say there is obviously that was in a pretty subdued customer behavior environment. So on a go forward basis, potentially not in the very short term, but on a go forward basis, obviously, we would expect that to improve as economic conditions stabilize. We might take some of the hedge questions offline, just given that we don't actually have one anymore. But just to go through a little bit more, our last disclosed notion of volume at H1 was £24 billion and that was yielding circa 90 bps and it cost us about 10 bps to execute the unwind. And now we have a net yield of circa 80 bps and notional coming down 1/60th each month over the next five years. So in terms of a basis point impact moving into 2021, the drag is kind of low single digit basis points from Q4 into 2021.

Victor German

Okay, thank you. And it's generally a straight line.

Enda Johnson

Sorry?

Victor German

And generally, there's no humps or anything? You're suggesting it's sort of straight-line amortizing over five years?

Enda Johnson

Absolutely. 1/60th per month.

Victor German

Thank you.

Operator

We now have a last question from Robin Down from HSBC. Robin, please ask your questions.

Robin Down, HSBC

Hi, good morning. Just a couple of quickies for me and an observation. The first one on the mortgage side, I don't know if you could give us some indication of what your retention rates are, you know, how the sort of kind of internal transfer business has been doing. The second set of questions, or observations really, around the, sort of, interest rate side. My observation is just that your credit department and your treasury don't appear to be talking to each other because the credit department seems to have the most amazingly conservative economic outlook that would presumably produce negative rates. And yet the treasury department is saying we're not worried about that. So any thoughts on that?

But really, the question that comes with that, I noticed you're saying that one of the reasons why you think negative rates might be unlikely is because of the operational challenges of implementing them. I assume you're referring there to Virgin Money systems not being able to cope with negative rates just yet. Just wondered if you could give us a timeline of when you thought the systems might be able to cope with negative rates, because that's a key factor in the Bank of England's thinking as well. Thank you.

David Duffy

I was going to make a comment on the negative rates, and it's not so much an issue of our systems. It's a matter of the entire industry in exactly the same place. And so what the Bank of England is doing is saying to us that it's something that they could consider, but they have not asked us, specifically, not asked to go and build up these systems. So the general conversation around a U.K. finance body representing all the industry would be -- could take the industry a year to get systems ready to operate across the industry with stability. Secondly, it's not clear that that is the implementation model that the central bank would go for. They have a number of other ways to approach this, which might not involve that system kind of change. And the regulators are asking the industry questions about, you know, the science of all of this to understand and work with the Bank of England on any pathway to negative rates and what they might do as a model of implementation. And it's not a certainty that, A, the rates will happen or B, that they would ask us to implement the very significant systems change across the whole industry to make it work. So sorry, Enda, back to you.

Enda Johnson

Yep, sure. Thanks, David. I think your points on implementation are well made, and we've participated in the most recent discussions with the Bank of England around that and we'll leave those discussions with -- privately with them.

In terms of mortgage retention, we've typically operated kind of in a let's call it 70, 75 percent range and we don't necessarily see that changing materially over the coming periods. And then I guess finally, in terms of our internal dialog, look, maybe I'll just say we are very joined up internally in consideration of how we think about all the economics across of our balance sheet and management of the same, but that's how we run our business.

Robin Down

Great. Thank you.

David Duffy

Okay, thanks, everyone. I think we are very conscious of people's time, and we did have a very long introductory session and I thought that it was good in this particular year for us to provide as much disclosure of that, but it also generates questions at a more timely forum. So happy to have Andrew coordinate the IR team, getting back on any range of follow up questions or further details, and we will make sure that we get that to you promptly.

So for now, I would just say thank you very much for your time and focus and questions. And we look forward to talking to you more as we develop the points raised today.

Thank you all very much and we will end there.

[ENDS]