Virgin Money UK PLC Interim Financial Results 2022 – Call Transcript

Hosted by David Duffy (CEO) and Clifford Abrahams (CFO)

David Duffy, Virgin Money UK PLC

Hello and good morning, or good evening, depending on where you are joining from and thank you for attending our H1 results presentation.

Today I will give you an update on the progress we've made with our Digital First strategy, both deliverables to date and plans for the second half of the year. I will then hand you over to Clifford to walk through the financials.

Over the first half of the year, we've made good initial progress delivering against the accelerated digital strategy which we announced in November 2021. I am pleased also to report a continued improvement in our financial performance, and this has been supported by the strategic momentum in the business, combined with an improved operating environment. Our statutory profit before tax of £315m was significantly higher than H1 2021, with stronger underlying profit of £388m. We have also delivered a strong CET1 with a 9.1% statutory ROTE.

Total income improved 16% vs H1 2021 with a stronger contribution from both net interest income and other income, driven by a positive rate environment and a continued improvement in customer activity levels. I am particularly pleased with our net interest margin performance which strengthened significantly to 183 basis points for the half year and we now expect a stronger outlook for FY22 NIM of between 180 and 185 basis points. Other income of £83m also increased reflecting higher customer and business activity.

Underlying costs of £456m were broadly stable year-on-year, and despite the higher inflationary backdrop than anticipated, we continue to be well placed to achieve our broadly stable guidance for FY22 and our objective of £175m of gross cost savings by FY24.

Asset quality remains robust, with a low impairment charge of £21m or 6 basis points cost of risk. Notwithstanding the post-Covid recovery, we remain cautious going forward given the combination of the Ukraine conflict, rising interest rates, inflation and the cost-of-living increase.

Having returned to paying a dividend alongside our FY21 results and following the Group's successful participation in its inaugural stress test last year, we are pleased to update the market on our capital framework and returns policy. The Group will operate in a CET1 target range of 13 to 13.5% in the long-term, although we will operate above this level for a period due to the macro economic considerations I have mentioned above. The Group will also target a 30% full year dividend pay-out ratio and the interim dividend is expected to represent around 1/3rd of the prior year's total dividend, beginning H1 2023. Dividends may also be supplemented by buybacks, subject however to ongoing assessment of surplus capital, market conditions and regulatory approval. Given our strong capital position and robust H1 performance, the Board has announced an interim dividend of 2.5p.

Let me now turn to our view of the economy. I've set out here the economic outlook from 3rd party provider Oxford Economics, which has informed our IFRS9 modelling. The biggest change in the backdrop since we updated our FY results, is the increase in inflationary pressures. This has led to further large increases in energy and other commodity prices including food, with the BoE increasing rates and a significant steepening of the yield curve in response. The latest outlook for GDP currently remains resilient, despite slowing growth in Q1 and the base case suggests that the economy has broadly recovered back to pre-pandemic levels.

Consumer activity levels remain strong across our credit card book, with spending now above pre-pandemic levels across all categories, including travel. There is some potential that we could see slower growth in certain segments, such as the mortgage market, as rates rise further, but to date that's been limited.

Expectations for peak unemployment levels continue also to reduce in the most recent outlook, with levels predicted to remain below 4% in the base case. Our early warning indicators also continue to be benign, and whilst the outlook is more uncertain, we are tracking these inflationary pressures carefully for any impacts this is having on the costs of living for individuals and our business customers. However, overall, our book is performing well and will be closely monitored.

Let me now turn to slide 6 on growth. We have continued to focus on leveraging our brand to drive digital growth in key target segments, and we have made a good start to the year, with relationship deposits and unsecured balances continuing to benefit from strong demand. The launch of new propositions and extended loyalty schemes has also been successful. Our national launch of the Business bank will ensure that we are well placed for growth over the remainder of the year as the sector volumes recover.

Relationship deposits grew 4.2% in H1, benefitting from higher new sales of our Virgin Money Personal and Business Current Accounts. PCA sales continue to be supported by attractive switching offers and we added the option for debit card cash-back to PCAs in January. To date, c.120k customers have signed up and are earning, on average, 7.5% cash-back on qualifying purchases. PCA sales in Q2 were double those of Q1, and since the launch of the re-branded Virgin Money PCA in late 2020, we have opened c.180k new PCAs. We will continue to drive this growth by introducing new packages supported by Virgin Red.

Unsecured lending grew 7% over the half, supported by record new credit card account opening levels. Q2 saw c.175k opened, beating the previous record, set in Q1. Our overall proposition remains strong with prudent underwriting and c.350k customers have now signed up to our cash-back offering. The strength of our entire credit card portfolio has seen us deliver above market growth, and we now have c.8% share of the UK cards market. We have implemented Instalment Credit capabilities, allowing our customers access to 'Buy Now Pay Later' functionality in the credit card mobile app, importantly this option is offered within a customer's existing credit limit. Our version of BNPL is supported by deep experience in risk management, anti-money laundering and of course qualifying credit criteria.

Our digital BCA was launched in November. This new fee-free M-account offers businesses debit card cash-back and access to new propositions including M-Track and our soon to be launched Marketplace. The strength of the existing proposition has doubled BCA sales in Q2 vs Q1.

BAU business lending saw a 20% increase in drawdowns QoQ as the lending pipeline builds well into H2. This generated net growth of 1% in the second quarter, although the overall book reduced 2.5% in the half, which is a reflection of a 13% reduction in the government scheme lending book. The government lending book is performing as expected and claims for defaults have been paid in full by Her Majesty's Treasury, and incidences of fraud are extremely low.

I will now touch on the digital momentum of the bank. I am delighted with the momentum that we have achieved in all three of our key strategic digital themes outlined in November. We announced, if you recall, our intention to move to a fully digital capability with close to 100% digital origination, full digital processing and a strong pipeline of new propositions, supported by a digitally led employment model which we call ‘A Life More Virgin’.

Digital Sales of personal banking products (ex. mortgages) are now 97% of total sales, and PCA digital adoption has picked up from 62% to 64%, driving towards our 80% target by FY24. We have made good progress in digitising key customer journeys, with 42% now fully digitised, up from 27% at FY21.

An example of processing efficiency is our voice-based interactions which have reduced 10 percentage points as digital solutions such as chatbots are introduced. Chatbots were first deployed in January and have now dealt with c.650k customer queries, 55% of which were without colleague intervention. This percentage is likely to continue to increase over the rest of the year and will materially improve efficiency and customer service.

We are also continuing to make strong progress in the Colleagues and Property workstream. We launched ‘A Life More Virgin’ earlier this year and delivered gender-neutral, harmonised working terms, enhanced colleague benefits and a trust-based approach which enables flexible and remote working. This has allowed us to tap into new, more diverse talent pools and applications for positions at Virgin Money have risen dramatically as a consequence. As a result, engagement scores for the period have increased to 73% from 68% at FY21.

As we continue to evolve our senior leadership team for our digital future, we have also made progress on the diversity of our senior leadership, and I am pleased to welcome Syreeta Brown, who joined the Group in November 2021 as Group Chief People and Communications Officer and Susan Poot who joined the group in January 2022 as Group Chief Risk Officer.

As we forecast, greater remote working capability is also enabling the Group to reduce its property footprint by more than 20% since FY21, and branch numbers have been reduced as announced in September 2021. The changes in customer demand for more digital-led services will probably continue to evolve and we will monitor customer behavioural changes closely.

We are mobilising the first phase of our Cloud migration in partnership with Microsoft which will begin in FY23 and will drive greater cost efficiencies. We are also making good progress on the digitisation of the bank and are in the process of de-commissioning legacy applications, while building the new applications required to support the new Cloud infrastructure.

Let me now turn to slide 8 which looks ahead to the next 6 months. In H2, we will continue to focus on growing in our target segments and delivering exciting new digital propositions for customers, while at the same time continuing to improve our efficiency and customer service.

We are making really good progress building our digital wallet with our partner Global Payments. As signalled in November, the wallet will offer enhanced product and payment functionality, as well as an integrated Virgin Red loyalty scheme and we remain on track to share the first iteration of the wallet later this year.

Following the successful launch of our debit card cash back programme across Business and Personal, we will soon launch our Gen-Z ‘Multiply’ proposition which is a subscription-based instalment credit offering, and this is designed to help Gen-Z customers build their credit scores whilst accessing credit responsibly.

In the second half of the year we will also build on our M-Track proposition for Business customers. M-Track makes it much simpler for small businesses to manage their money, saving them time and giving them control by providing customers with a snapshot view of their business performance. This snapshot draws together data from their current account, accountancy software, e-commerce platform, social media and other business tools. We will also launch an integrated business marketplace, which helps customers realise business opportunities and to access and integrate specialist solutions such as expense management, tax management, business insurance, invoice discounting and many other services which are important to small businesses. We've developed this customer solution in partnership with Fintechs and the combination of the M-Track and Marketplace apps will I think, allow us to deliver a unique offering in the marketplace.

In the second half of the calendar year, we will also deliver our automated direct mortgage capability. Utilising a modern cloud-based platform, it will drive improved service across both direct and intermediary channels with better turnaround times for our customers and higher conversion. Finally, following the recent launch of our new digital travel insurance proposition, we will broaden our offering and unlock further business opportunities, starting with the launch of a refreshed home insurance proposition.

This combination of new propositions will I think, position Virgin Money as a leader in digital, innovative solutions for all of our customers and will drive our growth potential.

Let me now pass you over to Clifford to take you through the key financials.

Clifford Abrahams, Virgin Money UK PLC

Thanks, David.

I'm pleased to report very strong financial performance in the first half, with good momentum reflecting our digital strategy in execution. You will recognise slide 10 from the full year where we reported strong progress across our key metrics. You can see we have developed further this track record during H1.

As David explained, we've been working hard to improve propositions and so have continued to grow relationship deposits and unsecured balances, shown top left on Slide 10. Top right, you can see that commercial performance has supported a very strong net interest margin improvement to 183 basis points in the first half. With costs and CoR well controlled, we continue to improve RoTE, reporting 11.7% in the first half on an underlying basis; with the gap to statutory further narrowing. Consequently, capital continues to be strong, supporting an interim dividend payment per share of 2.5p, and we were pleased with our performance in our inaugural stress test enabling us to announce today our updated capital framework, as promised.

Now turning to the details for H1 performance from slide 11. I'll comment on profitability first. David has given you the highlights and I'm pleased to report a strong performance with 58% growth in underlying profit year-on-year. That performance reflects improved NII, with NIM increasing by 27 basis points relative to the first half of last year; other income at £83m, reflecting improving activity levels; costs broadly stable, as promised, and impairments, remaining low.

Moving now to statutory profit on slide 12. It's good to see strong underlying performance also driving improved statutory profit in the first half. In line with our Digital First strategy, there was a £46m charge in the first half, and we expect to spend more in H2 as our Digital First strategy builds momentum. TNAV per share improved to 313p, largely driven by statutory profit.

I will now talk you through the balance sheet, starting with funding on slide 13. We delivered further growth in customer relationship balances which were up 4% in the first half, supported by a strong performance in new current accounts. We improved our funding mix, reducing more expensive term funding during the period, which drove the overall reduction in cost of deposits, despite higher base rates. It is good to see relationship deposits now comprising 50% of total customer deposits – a pleasing milestone. We increased our wholesale funding, given the reduction in term deposits.

Moving now to lending on slide 14. You'll see here that we have managed overall volumes broadly flat across the period, with strong growth in Unsecured offset by modest reductions across Mortgages and total Business.

In Mortgages, we have been selective on new business volumes given the competitive backdrop. At the full year, I mentioned that we were seeing spreads below the back book and that trend has continued through the first half. So, we are comfortable with our defensive performance and will look to regrow the mortgage book, with the market, when pricing is more attractive.

Business lending has reduced 2.5%, reflecting reductions in government-guaranteed lending schemes as expected. In the BAU Business book, we saw growth in balances in second quarter. As David mentioned, we are building a strong pipeline here into the second half of the year and we expect to see these balances continue to grow.

I'm delighted with our performance in Unsecured where we have grown balances by 7%, led by cards, where we continue to grow market share. In March, we saw the highest ever amount of monthly retail spend and we expect strong levels of growth for the remainder of the year, supported by the strength of our digital propositions.

Moving onto our net interest margin on slide 15. Our net interest margin of 183 basis points for the half year was strong. We've shown good momentum through the year, allowing us to upgrade our full year guidance to between 180 and 185 basis points. The uplift in margin through the half year was driven by our deposits performance, as we continue to improve our mix; limited deposit pass through, across the sector, with rising rates; structural hedge reinvestment, benefitting from the steeper yield curve, and good growth in higher-yielding, unsecured lending.

These positive factors were partly offset by mortgages, with new mortgage volumes written at spreads meaningfully below those of the back book, as I mentioned earlier. Looking ahead to the remainder of the year, we now expect full year net interest margin in the range of 180 to 185 basis points, reflecting further growth in higher yielding lending and higher interest rates, a lower contribution from deposits as the savings market normalises, offset by headwinds from low mortgage spreads.

Moving now to our structural hedge on slide 16. I'll update you on our structural hedge first and then move onto our rate sensitivity. On the left, you can see at H1, the Group had £32 billion of balances in the structural hedge, having increased the size of the hedge in October last year. You'll note that the average yield has increased from around 45 basis points in Q1 to 52 basis points in Q2, reflecting the higher rate earned on re-invested balances. You'll recall we also have a legacy hedge position that was previously unwound in FY20. The FY21 contribution was around £150m and the FY22 contribution is expected to be around £120m from the legacy hedge. So overall a strong and increasing contribution from our structural hedge going forward. On the right-hand side, we have set out what this means for interest rate sensitivity. You can see our interest rate sensitivity is pretty low in year 1 given the scale of our structural hedge and using our standard pass-through assumptions. However, in practice, we have benefitted significantly from rate rises recently as deposit pass-through has been low. We've also disclosed now our interest rate sensitivity in years 2 and 3, with the benefit in these years relating to the rollover of the structural hedge which builds up meaningfully over time in the rising rate environment.

I'll now move onto non-interest income on slide 17. I'm pleased with our non-interest income performance which was up £11m year on year and up £7m relative to H2 21, excluding fair value and one-off gains. In Personal, other income improved £7m year-on-year, largely driven by higher interchange income from increased retail spend as a result of the easing of lockdown restrictions as well as higher credit card fees. Business fee income also improved year on year, driven by higher account fees and interchange income, and Mortgage income was broadly stable. In the near term, we expect non-interest income to remain robust given the full easing of restrictions and the general increase in activity levels. Over time, we are targeting non-interest income to rise as a percentage of total income as we see contributions from the various initiatives we have set out on this slide.

Turning now to costs on slide 18. You'll recall we set out our plans to accelerate our digital strategy alongside our FY21 results and guided to broadly stable costs in FY22 - we are very much on track. On this slide, I'll first update on our investment programme and then on our cost performance.

We have made good initial progress in taking costs out of the business, delivering £28m of annualised gross savings during the first half. This has cost £46m reflecting our Digital First investment programme. We remain on track to deliver around £175m of gross cost savings by FY24, with around £275m of digital development and restructuring costs across the same period.

In terms of our overall performance in the first half, costs were broadly stable year-on-year at £456m. Gross cost savings earned in the period were offset by inflation and growth, including wage inflation, and higher digital development spend, as planned. Our guidance for FY22 remains unchanged, and we expect underlying costs to be broadly stable relative to FY21

Moving onto our asset quality on slide 19. I am pleased with the quality of our lending book, and we are well placed to manage through current risks and uncertainties. We are of course keeping a close eye on the war in Ukraine, though would note we have no meaningful direct exposures to either Russia or Ukraine, as a UK focused lender. Overall, our final ECL provision of £479m represents a reduction of £25m from FY21 - set out on the left. That performance reflects our solid credit quality, which has remained resilient throughout the year with low arrears and default levels and refreshed economic scenarios. We reduced total PMAs by around £30m including an additional PMA of around £25m, to take into account possible impacts of affordability stresses on existing customers. Despite the reduction in provision, we have maintained a strong overall coverage ratio of 66 basis points, which remains above pre-pandemic levels. This has resulted in a modest income statement impairment charge of £21m, equivalent to a cost of risk of 6 basis points.

Looking ahead, we expect the Group's cost of risk to rise through FY22 towards 'through the cycle' levels. As David said, we are conscious that the outlook remains uncertain, especially with high rates of inflation increasing the overall cost of living. We have yet to identify any material concerns across our lending portfolios but are monitoring the situation very closely and have also taken additional underwriting measures to reflect affordability stresses on new customers.

I'll now turn to capital on slide 20. I am pleased with our current capital position of 14.7% CET1 ratio, which represents a 35 basis point increase from the full year, looking through the benefit of software intangibles, now removed. We saw strong capital generation in H122 reflecting 103 basis points of underlying profits, offset by modestly higher RWAs, AT1 distributions, 27 basis points of adjusting items, and a further 25 basis points for the dividend accrual at 30%.

Looking to the remainder of the year, we expect CET1 to remain broadly stable reflecting continued capital generation from ongoing statutory profit, offset partly by RWA growth as the we target growth in higher risk weighted unsecured and business lending, and further dividend accrual for the final.

Our FY22 RWA expectation does not include any benefits from the move to IRB for our credit cards portfolio and the adoption of hybrid mortgage models. Both of these are dependent on regulatory approval, with hybrid models expected to take effect from FY23 and Cards IRB transition after that. We are pleased to be paying an interim dividend as part of our updated capital framework, which I'll talk through on the next slide.

We are delighted to announce our updated capital framework alongside our half year results, as promised. This now includes a long-term CET1 target of 13-13.5%. As David mentioned, given the heightened current macroeconomic uncertainty, we expect to operate above this range for the time being. On the left-hand side of the slide, we have set out how that target range compares against our expected regulatory minimum. We are also pleased to return to paying dividends sustainably and are committing to a full year dividend payout of 30%. This payout supports our expected growth plans and allows for at least some net capital generation. This first year, we are paying a 2.5p dividend at the interim, and going forward, we expect to pay around 1/3rd of the prior years' total dividend alongside our Interim Results, with the remainder as a final.

As David mentioned, we will supplement the ongoing dividend with buy-backs subject to ongoing assessment of surplus capital, market conditions and regulatory approval. In terms of timing, we expect that any buybacks would be aligned to our May interim results from FY23, not alongside our November full year results. This timing reflects the conclusion of the BoE stress testing process, and subsequent buffer determination, which is generally at the end of the calendar year. We have not ruled out buybacks for the current financial year, however, we would need to take into full consideration the current uncertain environment and any buyback would remain subject to regulatory approval.

Finally, I want to conclude with our full year guidance and medium-term outlook on slide 22. We have given guidance on KPIs for FY22 throughout our presentation and set this out on the left-hand side. We are on track for the guidance we gave at FY21 and in addition, we have upgraded FY22 NIM guidance again and have also updated our capital framework and dividends, as promised. We are maintaining our medium-term outlook repeated here on the right, in particular our double-digit statutory RoTE and now including our updated capital framework

I will now hand back to David for his concluding remarks.

David Duffy:

Thanks Clifford.

In summary I believe that Virgin Money is well positioned for the future. Whilst there is an uncertain environment in the UK and the rest of the world, our results are strong, our books are performing well, we are delivering capital accretive growth, managing our margins well, and achieving growth in our targeted areas.

We are also making good progress on process automation, cost reduction and the delivery of digital propositions and I am confident in our future performance given our prudent management of the balance sheet.

Thank you all for your attention, and with that I'll now hand to the operator to host the Q&A session. Thank you.

Operator:

Ladies and gentlemen, if you would like to ask a question, please press star, followed by 1, on the telephone keypad now. If you change your mind, please press star, followed by 2 to withdraw the questions. Our first question comes from Benjamin Toms from RBC.

Benjamin Toms, RBC:

Good morning both, and thank you for taking my questions. Firstly, can you tell us what the betas have been through this rate cycle, and for the last rate rise? And if I can't push you on a number, can you give colour on whether it's been consistently low and whether you've seen an uptick since the last rate rise? Do you think that they will stay low for the next 25 basis points?

And then secondly, on PMAs, they are about 37% of provisions, which screens as quite conservative relative to peers. What's your current thinking on how these will unwind? And how should any unwind be thought about in the context of a 30% dividend payout ratio - would you expect any release to flow through into dividends? Thank you.

David Duffy:

Thanks, Benjamin. Maybe Clifford, do you want to start on those?

Clifford Abrahams:

Thanks, Ben. I think, on deposit beta -- I'm not going to give specific numbers -- it's clear, the last rate rises have been low deposit beta across the sector, including us. We've passed on moderate rate rises. We've been selective in terms of our propositions, and I do expect the deposit market to normalise and I think we're seeing some of that already in the last few weeks after our period-end. Particularly as growth in the asset base picks up, you're seeing banks starting to price up and pass on base rate rises.

In terms of PMAs, yes I think we do have a decent quantity of PMAs. We see that as a strength in the current environment. We remain cautious so our provisioning is above pre-pandemic levels and we expect those PMAs in relation to COVID, to unwind over time, so not in the short-term, but in particular, PMAs relating to business sectors, we would expect to take a little while to unwind over time. We have stood up a new PMA in relation to the affordability crisis and I would expect, over time, we would take, call it a more normalised approach to IFRS 9, with lower PMAs in general, and any changes in the environment reflected over time in our underlying models.

In terms of payout, we think the right approach to dividend is a payout ratio. So we're not calling out any specifics around exceptionals, either positive or negative. So you should expect us to pay out 30% of net earnings after, after, after. I wouldn't rule out true, true exceptionals, but the principle is that we'll pay out 30% of net statutory profit. We reflect, as you've seen, in this period, we have a decent amount of exceptionals, and we've paid out an amount after that. Ben, I think that answers your questions.

Benjamin Toms:

Thank you.

Operator:

Thank you. We have our next question. It comes from Ed Henning from CLSA.

Ed Henning, CLSA:

Thank you. Morning, and thanks for taking my questions. Two questions from me. Firstly, just following on from the last one, on the deposits and the NIM outlook in the second half, you've got a second quarter NIM of 189, and you're calling for a full year of 180 to 185, with a first half of 183. So, it's a significant fall from the second quarter. And you've talked about a lot of positives, and one negative thing, the mortgage competition. Is it also in there, the normalisation of the deposits that have been more positive now, that will flow through in the next quarter, so that it's artificially high, a little bit, in the second quarter? As the first question.

Clifford Abrahams:

I think you're right, Ed. In all our guidance, looking back, we've been prudent, and we intend to give out prudent guidance. So, I'd factor that in. The two themes you've highlighted -- one is mortgage spreads, and we're currently writing mortgages at spreads below our current book so we expect that to be a headwind on NIM if that continues. I mean, we are pleased to see some pickup in customer rates in the last few weeks, but that trend would need to continue to mitigate that dilution.

I think, on deposits, we're calling a normalisation of the deposit market. I think our first half and the last few months have been quite striking about how limited the pass-through of base rates to deposit rates has been and so, in our guidance, we've reflected normalisation of that. And so, you're quite right, we would expect NIM to sort of track down, based on those assumptions and that reflects your observation. Clearly, you'll have your own views on the market, whether it's base rates, or mortgage spreads, or interest rates, more generally but I think we've been clear on the assumptions which our guidance has been made.

Ed Henning:

Okay, no that's very helpful on the deposits. And then, looking forward, obviously, if the deposit environment is normalised, and you do get continued benefits of base rate rises coming through beyond '22 - while mortgage competition is elevated, do you anticipate still, net benefits going forward from the end rate in 2022?

Clifford Abrahams:

Just reflecting on your question, Ed, I think it's clear looking back, that the deposit pass-through has been limited and you see that benefit come through our NIM. In our guidance, we've definitely moderated that. You know, that might turn out to be more prudent. I think, in terms of spreads, I'm sort of speculating, in terms of how the market is thinking about things, it's possible that the market takes the view that, well, margins on deposits are strong, and they will compete hard on mortgages. Alternatively, which I think is my view, rates are generally sticky, whether it's deposit rates or mortgage rates. So, if base rates normalise or sort of start to flatten off, I think you'll see normalisation on both the deposit and the mortgage side. If they continue to go up over time, which I don't think is consensus, then you might get the behaviour that we've seen in the last quarter or so continuing for some time.

Ed Henning:

Okay. That's helpful. Thank you. I'll end there.

Operator:

Thank you, Ed, for your questions. Our next question comes from Grace Dargan from Barclays.

Grace Dargan, Barclays:

Hi, good morning. Thank you for taking my questions.

If I can ask one on capital and then just come back on mortgages. Good to see the capital policy today. Note the commentary around staying above that target range, due to the macro uncertainty. It would be good to hear what you think you need to see to trend down towards that CET1 target, and how quickly we should be thinking about that?

And then, secondly, on mortgages, and kind of touching on what you were just mentioning. This seems a strong NIM print today but maybe could you give us a little bit of a steer on how much 'meaningfully below the back book' is and just to clarify, whether you're talking completion or application spreads there? And I guess, following on from that, do you see a dynamic where that compression kind of fully offsets the benefits you're seeing or is that going too far? Thank you.

David Duffy:

Good morning, Grace. Maybe I'll just make one comment on the capital and on your question about 'what do we need to see?'. I think the position for us is that we are just looking at the uncertainty that exists in the market. We're really feeling positive about the performance, about capital generation but we're just looking at the market and saying, "What further uncertainty or more volatility could occur?" and for a reasonably short period of time, we would like to assess that before taking a view. It's less about what we'd really need to see and more about just making sure that the situation doesn't deteriorate on a macro level before we make any decisions. And frankly, the same would be true in terms of buybacks. We are very open-minded and actually positive about buybacks, but at the moment, we're just saying, "Let's just exercise an additional piece of caution, and evaluate the volatility in the short term, and then determine how to progress." I think it's more of that approach, Grace. But let me hand you over to Clifford on the other elements of your questions.

Clifford Abrahams:

Yes, on mortgages, we don't quote spreads on an application or completion basis, but I note what some of the bigger banks disclosed last week and I recognise the ranges that they talked about. I think we're operating in the same market. So, no great insight but I can confirm that. I think it's striking, how customer rates have been fairly flattish over the last few months, so whilst the Bank of England has passed on 65 basis points, it's pretty much been absorbed by spreads. But we're seeing in recent weeks, I think, a tick-up in customer rates from a number of competitors and my view is that you see rates are sticky. We feel that the mortgage asset class is a perfectly good asset class, but in periods of volatility, I think it's natural you get some inertia in the marketplace. So that will give you a little bit of a guide on our views going forward and I hope that addresses the second part of your question, Grace.

Grace Dargan:

Yes, that's clear. Thanks very much both.

Operator:

Thank you, Grace, for your questions. Our next question comes from Joseph Dickerson from Jefferies.

Joseph Dickerson, Jefferies:

Good morning gentlemen, congrats on a good set of H1 results.

Just on the guides and the use of the word "uncertainty," which, if I had a word count, I'm sure would come up in the transcript multiple times. You've cited the macro uncertainty on capital but yet, if you look at the unemployment rate, which is quite key for, certainly your losses on unsecured, that's actually shifted downward. So I guess, how do we square the comments around capital with the fact that you've grown your unsecured book 7%, period-on-period? If you could opine upon that, that would be helpful.

And then, just coming back to the NIM. On the NIM guidance, could I just clarify the deposit pass-through that you're assuming relative to the on-the-ground reality? So, is this a theoretical deposit pass-through in the 180 to 185 guide versus a lower on-the-ground reality today, can you just clarify that for me? That'd be helpful, thanks.

David Duffy:

Good morning, Joseph. Just one quick comment on your word count on "uncertainty," Joseph -- I think it's the combination of geopolitical and macroeconomic. So, when you look at the books growing, we're confident in the growth of the business, the quality of the assets that we are putting on our books. I have comfort around our ability to grow the business, particularly in the unsecured space, with the quality that we have. But what we're looking at is just the combination of geopolitical and macroeconomic is an unusual combination and a very rare circumstance. So it's just exercising a little caution around that combination, but that's not affecting our disposition on the growth of the books.

Clifford Abrahams:

The second question, I think you put your finger on it, Joseph. So, looking back at the half-year, we've passed on, really, quite a modest amount, in terms of those base rate rises, as is typical across the sector and you've seen that supporting our quite sharp NIM improvement during the period. I think, looking out in our guidance, we've assumed a -- call it a normalisation -- of the deposit market. I mean I won't get into the specifics of products and so on, but if you look at it on quite a granular basis, that's how we framed the guidance. Clearly, if behaviour in the market is different, our print will be different, but we've tried to take a more consistent approach and consistent with, for example, our interest rate sensitivities and we've talked about the assumptions underpinning that.

Joseph Dickerson:

Great, thank you. David, can I just come back on the geopolitical point that you made, the interaction between the macro and the geopolitical? What precisely on the geopolitical side is it that you're concerned about? Further commodity price disruption, or military escalation? The tail risk? I guess, what particular aspect is it there because I think it would be helpful just to have a sense about how you're thinking about this interaction on -- certainly on the capital position. I hear you on the underwriting point, and I think it’s pretty clear, your underwriting acumen has been pretty good. So, what in particular, on the geopolitical side, is it that you're looking at?

David Duffy:

Thanks, Joseph. I'd be clear in my own mind that I don't overplay it, so, it's a kind of short-term monitoring of the volatility of the moving parts, so, you don't want to over-exaggerate the effect, but what I'm looking at is, if you see a deterioration on the European front, around war, what does that do to economic macro growth levels, interest rates, inflation? Just the combination -- the cocktail. If the position is as it is and starts to improve, then, obviously, that would guide us in a certain direction much more quickly. And it really is because the position has been so uncertain and inaccurately predicted for a reasonable period of time, we'd like to have a little bit of a longer period of time to understand the evolution of those things that could affect the macroeconomic and of course, as you say, things like energy prices continuing, oil embargoes from the whole of Europe could have an impact. So, it's just letting it play out a little bit more, but being confident in our capital base, the strength and quality of our customers, and the quality of our origination and we are tailoring our -- as you described it -- acumen around origination at the same time, and making sure that we have tightened affordability, and all the things you would expect. So, it's looking at it from macroeconomic to execution of origination, and just keeping a balance. I don't know if that makes it any clearer, Joseph?

Joseph Dickerson:

Understood. Many thanks.

Operator:

Thank you, Joseph, for your questions. Our next question comes from Guy Stebbings from BNP Paribas.

Guy Stebbings, Exane BNP Paribas:

Hi, morning, thanks for taking the questions. I had one back on margin, and then one on capital. So, I want to come back on the NIM guidance, because I suspect that implied drop in the second half is what's impacting the share price today so maybe, if we could just try and unpick your assumptions a little bit more, noting your comments on striking guidance prudently in the past. You've talked about using your long-run rate sensitivity assumptions for deposit pass-through, sounds like a bit of spread widening on new mortgages, but still very thin, and clearly a big headwind in terms of the churn there. Limited benefits or no benefit on deposit re-pricing. Then -- are you using swap rates as of today? And also, it sounds like a bit of a benefit from lending mix but not a lot.

Am I missing anything there? I struggle when I work through each of those individual components, how NIM would decline, you know, meaningfully in the second half of the year so if you could help me at all, that would be great.

And then the second one was just -- particularly on capital. If you could update us on how much of a benefit you expect to see from the hybrid mortgage model changes and the card IRB change, if that comes through? Thanks.

Clifford Abrahams:

Yeah. I'll pick up, Guy. I think you've got those trends spot-on. I think the only other comment that I would make is that we've materially upgraded our NIM guidance so we've gone from ‘around 175’ to ‘180-185’, which is a decent range, but quite an upgrade. So we stand by that guidance but would note our prudent track record. And I think it would be a bold person to call the turn in mortgage market. We're guiding based on the trends that we see.

In terms of hybrid and cards, I don't want to put a specific number on it. I mean, we do think, in general, those should be benefits, because our historical approach has been relatively prudent in respect to both asset classes. And you can figure that out for yourselves, where our RWA intensity for mortgages, for example, is meaningfully ahead of some of the bigger banks who have raised them recently. So, we think there should be upside in both those areas. It is a little way out as I commented earlier in my prepared remarks and as we've seen with hybrid, it's taking a little bit longer than we all expected for that process to fully run. And from experience, some of the benefits often get, sort of, eroded through the ongoing process with the regulator. Our approach, as it is right now, is to be prudent, that's how we've run our capital management strategies. We're not calling out a specific benefit or lever but rest assured, we're working hard to deliver those.

Guy Stebbings:

Okay. Thank you.

Operator:

Thank you, Guy, for your questions. We have our next question. This comes from Rohith Chandra-Rajan from Bank of America.

Rohith Chandra-Rajan, Bank of America:

Hi, good morning. Thank you very much. I had a couple of areas I wanted to explore with you, please. The first one was just, how are you thinking about balancing volumes, margins and credit quality? I guess on the mortgage book, you talked about starting to re-grow with the markets once spreads improved; I was just wondering how you think about that and what sort of level of spread you're thinking about that's attractive? And if, in the meantime, given that spreads are under a lot of pressure at the moment, you're willing to cede some market share?

And then on the cards business, you talked about some tightening in the underwriting standards reflecting inflation, cost of living, et cetera. I just wondered, you delivered some strong growth in that book to date, how you saw the prospects for that? And then overall, Q2 volume trends were good. Should we expect growth in the overall loan book in the second half of the year? That was the first question, or first set of questions.

And then the second was just around the deposit mix and this replacement of term deposits with wholesale funding, I was just wondering if that's something you expect to continue? Thank you.

David Duffy:

Okay. Maybe I'll just comment a little bit on the growth levels, and then we can dig into some of the dynamics around that. If you look at the overall growth of the mortgage market that we would anticipate, I think it's more about keeping the book stable. I don't think we'd cede material market share in any circumstance. I think, as you will recall, we talked a couple of years ago that we were in 80% weighting in our mortgage book versus our peers, from a balance sheet perspective, who tended to be in the 45 to 60 type. So we were keeping our market share stable as the market grew and I think that still stands. The pricing to date has not been attractive, and we sort of anticipated that last year when we looked at the market, but we should see that turning and if it does, we would look to grow and Clifford could talk about returns.

If you look at the unsecured space, we've stressed a lot of that at around 9% inflation, at 33% APR on cards, so we really do put strong thresholds for affordability into the mix. We've had good affordability stresses in for a continuum and still growing very well. And I think the balance here is, I would expect to see net growth in SME and in unsecured, based on the products and propositions that we're putting out there in the marketplace, notwithstanding tightened affordability. Clifford, do you want to make a comment?

Clifford Abrahams:

Yes. I agree. I won't comment on our benchmark for spreads but we're committed to delivering double-digit returns at FY24 and that means we expect broadly all propositions to do that over time. In current environment of very tight spreads, we do want to remain open for business, so you can see we've kept the book sort of flattish, but as we see the prospect of double-digit returns returning, you'll see that book return to growth and towards our market share and potentially beyond. We're working hard on developing our more niche strategies in mortgages, where we see the prospect actually for better risk-adjusted returns over time and we're also working hard to finalise our new digital system on the mortgage side, which will not only give us cost efficiencies but enable us to be even more nimble in the marketplace. So that's how we're competing in what is today a competitive market, but we see, long-term, good prospects for us as a business, whilst recognising it's the other areas of the business that we want to pursue growth - outpacing markets more generally in cards and SME, as David indicated.

In terms of deposit mix, we want to maintain a diverse funding profile, and we've continued there. I think over time, in the last I would say year or so, you've seen term deposits come down sharply because we've seen, frankly, lower cost of funding in growing our relationship deposits, where we have good propositions and also tapping the wholesale markets. I think going forward I do expect term deposits to start to sort of flatten off and potentially pick up and, actually, in the current environment we're seeing opportunity to lock in term deposit funding in the retail market at attractive spreads compared to other sources of financing. So you might see the trends that we've seen in the last year or so start to unwind. What I'm particularly pleased about is the milestone I referred to in the presentation, which is the 50% relationship deposits and we've built that up in an environment of, maybe, surplus deposits across the market, but what gives us confidence regarding that going forward is the strength of our propositions on PCAs and BCAs and the good initial progress that David described earlier.

Rohith Chandra-Rajan:

Thank you, that's really helpful. Could I just come back on one thing, which is just the expectation that all propositions make double-digit returns over time? When you think about the proposition, and I'm thinking of mortgages in particular, is that just looking at the mortgage spread less costs and credit costs? Or do you think about both sides of the balance sheet together when you think about propositions making double-digit returns?

Clifford Abrahams:

I think that I don't want to get into our pricing dynamics, but I think my comments around all propositions delivering double-digit returns -- that's both sides of the balance sheet, by the way -- is, frankly, good practice in financial institutions, I hope it's not remarkably different. I think it's bad practice to cross-subsidise for any sustained period of time, bluntly. You know, I've heard all the excuses from colleagues in many different institutions about why it's okay to deliver low returns, but I think all propositions should deliver double-digit returns over time. At any point in time, clearly there's commercial judgments at play in terms of serving our customers, doing the right things for customers, delivering scale, entering a market, and so on, but in principle, that guidance on returns is what guides the business.

Rohith Chandra-Rajan:

That's really helpful. Thanks very much.

Operator:

Thank you, Rohith, for your questions. Our next question comes from Jason Napier from UBS.

Jason Napier, UBS:

Good morning, thank you for taking my questions. Three questions, two of which are quite brief. Firstly, Clifford, for you, can you confirm, please, if the NIM guidance for the balance of the year assumes a continuation of first-half mortgage spreads? Secondly, the commitment to double-digit ROTE, can I just confirm, please, that as of today you're still guiding to the absolute reduction in costs that was guided to at FY21 results? So, you know, sort of £830m there.

And then lastly, a question for David. In days gone by, I think we probably as a market, paid more attention than we do now to plans around the Business side of your product expansion and offerings. If you think about the money you're spending now in the strategic plans that are currently in train, I wonder what you'd encourage us to use from the outside to measure the success of all of that? It would be fantastic if you could give us a sense of what sort of revenues you think might attend to the business investment that's going on, but just some sort of sense that we can use over the next year or two to tell how well that side of the business is going? It certainly was a key part of the strategic plan of your predecessor. I certainly feel like the market's not giving much credit for any evolution of the offering there so perhaps you could tell us a little bit about, what sort of a transformation you think that produces for the group as a whole? Thank you.

David Duffy:

Okay. Thank you. Maybe, Clifford, we'll start with you first in that order.

Clifford Abrahams:

Thank you. So, we're not assuming a material improvement in mortgage spreads going forward. I won't go through the details, but we're effectively assuming current market conditions persist in the mortgage space.

In terms of costs, we're pleased to re-confirm our ‘broadly stable’ for this year. I mean, as you know Jason, we targeted cost savings of £175m that we announced in November last year and we said we'd reinvest around half, reflecting investment in growth and inflation, so those principles remain. I think it's clear that inflation has picked up in terms of expectations, of actual inflation this year and possibly going forward, beyond what we all thought in November last year. But we are looking for cost reductions in nominal terms after full year '22 and we'll update on the details, you know, as we get closer to next year.

David Duffy:

Jason, does that cover that point for you?

Jason Napier:

I guess it does, I suspect there will be some listening who would want more clarity about that, I think the guidance for '23 and ’24 was very clear. That sounds like you know, the implication being that we're not going to be able to hit the sort of consensus numbers, but if there’s nothing more to add?

Clifford Abrahams:

Well, no, I'm not commenting on, I’m not re-framing, I don't want to guide on consensus into next year, I'm making the point that we've seen inflation globally. I think we're been very careful to frame our cost outlook, so we're committed to the cost savings, we're committed to lowering overall costs, but we just need to recognise the realities of inflation picking up. Our target of 50% cost income ratio and below remains, because that underpins our ROE target and that's really our primary target. We have not given targets on cost in nominal terms beyond this year because we felt, frankly, that inflation was uncertain.

Jason Napier:

Got it. Thankyou.

David Duffy:

Okay, and then, Jason, if I understood you on the business side of the bank, I'll make a couple of comments. The first is that we have predicted that we would see growth in the second half and we've started to see that. In the second, in the last quarter, we saw a 1% growth in net lending, and obviously there's a tail effect of the BBLs, et cetera, but we're seeing the underlying growth occurring. We've seen the BCAs double in the quarter, so you can see some underlying momentum in the business. Importantly, we've been net acquiring for a period of time now, which is different than our history in the SME space and that's a lot to do with the investment that we're putting in that you're talking about. The M-Track account and the dashboard that comes with that to facilitate the efficiency and time management of businesses around managing their cash flows and the broader balance sheet and then the Marketplace which we're bringing in later this year - they're the remaining pieces of innovation which we want to bring to bear.

And effectively you're giving a business -- just to be very simple about it -- a platform to connect most of the services that they use in their lives to a single dashboard to help them manage their businesses. That's been extremely well received, and that's what's driving the net growth in customers. So, when you talk about a 1 to 2 year horizon, Jason, on how to measure it, I don't want to give revenue forecasts; that gets into a difficult area, but I think net growth in customers in the business bank is going to be a key focus for us. So showing that we, on a national basis, with a rebranded national Virgin business bank and the technology, that we can generate significant growth in customers and attendant market share. So that's what we'll be focused on and I think within the context of that, over the next year or two, we will begin to talk about the income generation associated with those and what type of income we're generating, but it's just a little early to say what that is yet. So I'd focus on customer numbers as an indicator of the effectiveness of our strategy and the returns we'll get on it.

Jason Napier:

Thank you. And just a very brief follow-up. In terms of customer acquisition on the SME side, is the selling basically digital and broad-based marketing and word of mouth effort? Or is there something more direct that can be done to put the product in front of people and convince them to switch? Success and getting people to switch in business banking has been tricky in the past.

David Duffy:

Yes, it has been tricky, Jason, I think you're right. But what I think what I've seen is a shift in that dynamic where it's a function of many of the things you're talking about, but it's also a function of digital marketing and above the line marketing, which we've done some of to start the process off. It's a powerful word of mouth association as well. We'll look to maximise all of those, but I think it is really coming down to the technology and the integrated nature of the offering, which I believe with the Marketplace rolling out, will be unique in the broader SME marketplace and business banking area.

As we get to the completion of that technology, we'll be heavily marketing it through digital channels and through our network and through our sector experts to make sure that customers understand the offering and how best to benefit from it. So that's why I think your horizon of 1-2 years is good - throughout the rest of this year, we're creating momentum, we're creating a story around it. I was speaking to somebody this morning in the media who talked about their business account, how much they were enjoying using it. It is an early-stage delivery of the technology, building momentum, showing net growth and I think that will compound over the next period of 1-2 years, but we will be able to probably effectively market it best when we complete the rollout of the Marketplace, which is in the next few months.

Jason Napier:

Thank you.

Operator:

Thank you, Jason, for your questions. We have our next question, comes from Jonathan Pierce from Numis.

Jonathan Pierce, Numis:

Hello, good morning both. Two questions, please. The first one is on costs. There was a defined benefit pension credit of about £12 million in the first half, it sounds like there maybe a bit more in the second half as well. I'm guessing that is within the underlying expenses number. So how should we think about that on a full year basis - are we looking at 20 million quid benefit to cost there this year, that will disappear next year? So it would be helpful just to get a bit of guidance on that particular element of costs.

The second question is on the savings accounts. When I look at the average balance sheet, you've paid 33 basis points on average in the first half, which I think is pretty much exactly the same as the rate you paid on those savings accounts in the second half of last year, which is slightly difficult to track what's going on with your savings in particular, because of the linked accounts and various movements we've seen there. But I was surprised that you've managed to hold the overall cost of those savings accounts dead flat H1 on H2 of last year. So, looking for a bit of help around what's been happening more recently - has that 33 basis points on those savings accounts been picking up appreciably of late or are you still managing in the mix to keep it at around that sort of level? Thanks very much.

Clifford Abrahams:

Yeah, I think on cost of deposits, if you look at page 13, you can see that's continued to track down. I think that reflects some products we've had over time, some longstanding products that we've had, as well as the growth of relationship deposits and also where the competition has been. So you've seen we've been able to retain good levels of deposits, despite, if you like, lowish customer rates on deposits. What we've seen more recently, at the tail end of the period, is we're offering really good value, particularly for customers who bring their current account with us, and so our linked saver proposition pays 1% and actually we pay 1% up to £25,000. And what we're trying to do there if you like is offer the general customer, the man or woman in the street, a really good rate for up to £25,000 if they open a current account with us and so we can give them the full benefit of the Virgin relationship, cashback and so on, rather than, if you like, pricing up for people to bring lots of funds with them.

So that's our general approach. We do expect, we use this word "normalisation," but I think you're seeing the pickup in rates on deposits across the market as base rates have moved 65 basis points. We'll see what happens today in respect of another possible increase. So, I don't expect the cost of funds to take another lurch downward from here, but we are earning we think good spreads on those deposits given swap rates have moved up.

I think around pensions, I think there are a couple of things. You've highlighted the specific credit in the first half. I mean we do have a really well funded pension scheme, our surplus is around a billion. We have factored all of that into our guidance and taken a normalised approach to investment returns and management going forward. You know, I've worked elsewhere in other institutions where pensions has been a challenge. I'm really pleased; I joined the bank a year ago and inherited it - I'm really pleased that we're able to have a well-funded scheme to support our staff and our pensioners and that lends resilience, frankly, both to earnings and capital as we've maintained that and we can pick up further details in due course.

Jonathan Pierce:

Okay, thank you for that. Can I just come back and follow up on the first points around deposits? There obviously is quite a big gap now between the rates that are being paid on the everyday saver and the linked accounts. To what extent are you starting to see any cannibalisation of the everyday saver towards those linked accounts?

Clifford Abrahams:

Yeah, I mean I'm not going to get into details of pricing or behaviour, for obvious reasons. I think we are pleased to maintain our diverse funding mix. I think we're also pleased to offer, frankly, good value to our customers, which allows us to grow the franchise, as David said and we will manage our customer rates accordingly to balance that sort of, call it our P&L, but also offering good value to customers to grow the franchise. I do think the last six months or so have been unusual, I use the word 'sticky' if you like, but that's stickiness across the sector, not just us, I think is reflected in the deposits that have been built up by everybody during COVID and also the fairly modest growth in overall assets. So, you know, banks have not needed to source additional funding to grow their asset side. I think I think those factors could unwind, are likely to unwind or normalise, which is what we factored into our guidance.

Jonathan Pierce:

Okay. Thank you very much.

Operator:

Thank you, Jonathan, for your questions. We have our next question from Andrew Coombs from Citi.

Andrew Coombs, Citi:

Hi, good morning. I was tempted to ask another question on interest margins, but I think you've been pretty explicit there in your outlook, so perhaps I could revisit capital and buybacks and then a question on unsecured as well. On capital and buybacks -- I know Grace touched upon this earlier in her question, but if you look at the comments that you provided, you seem to state you plan to be above the 13% to 13.5% target in the near term given uncertainties. At the same time, you talk about supplementing the 30% payout ratio with buybacks. Just so we can try and drill down into this, both in terms of timing and magnitude of buybacks, would you like to provide any framework for what the 'above' near term means in terms of quantity? Is it 14%? Is a 14.5%? Anything you can say that would be useful.

And then second question just on unsecured. Thank you for slide 36 in the presentation, which contains a lot of useful detail. I'm taking that detail in hand, but also the adjustment you put through on the PMA for cost of living crisis. I note that you talk about 19% of balances maturing from the promo period in the next six months, you also emphasise the point your customer profile is a higher quality than the industry average. I'm interested to know more and your thoughts on what you expect to see once those promo periods end, whether you do think you'll see a slightly different experience from what you'd see in the past, given the economic backdrop. Thank you.

David Duffy:

Thanks, Andrew. And I'll leave it to Clifford to give you some colour on the first point. But just again, really reiterate the comment. From my own perspective, again, we look at this in all of the moving parts being part of the consideration and the buybacks, best way to describe it is, the team as well as I, are very open minded and look at the buybacks as something which we would be willing to consider, of course and so, I don't want to create any negativity around that. It's really quite a positive dimension that we've moved our capital dividend ratios and the announcements of that into the clear domain of the 30% and consider it as potentially supplemented by buybacks. And I think it is just a judgment, as I said, about the broader environment. It's a strange environment to find yourself in where we had a day off from COVID and then there was a Ukrainian war, and then there's the cost of living crisis and all the attendant rising interest rates into a slower growth environment. So we just want to have a look for a period of time and that'll affect the timing judgment, but I think you should be clear that we have a positive view on buybacks. It is really a question of balance and making sure that we understand some of that uncertainty I referred to earlier and its trend. But I don't know if there's anything else you wanted to add on that?

Clifford Abrahams:

Yeah, it's just timing. I mean, we've not ruled out any specific time or window, it's really linked to that current uncertainty. We guided to the interims as the general period because we wanted to make the point that ACS, all the stress tests are really quite important. But around that, we've not ruled out any timing and we keep things actively monitoring. I don’t know about you but I'm still glued to events in Ukraine from a personal point of view, but it clearly ripples across the global economy and we need to be, frankly sensible about that. So we’ll keep all of that under active review.

I think in terms of magnitude, I’m just trying to reflect on, I think if we said, if it was 14.5%, then that's only a touch below where we are today, right, at 14.7%. I'm not going to put a figure on it, but if you like, the question behind the question is - any possible buyback, don't assume it's a sort of a oner that takes us down to 13.5% in the short term, right. We’ve managed expectations carefully around timing in particularly in the very near term given the current uncertainty and around magnitude. So, we would expect to operate above the target range and that would still leave room for a buyback, when the Board felt it was wise to do so. I think that was capital and buybacks.

I think in terms of the 19% and unsecured, I think when we look at our trends, that figure is not meaningfully different, so that, call it around 20%. I think we've been one of the leaders in that balance transfer product, that's worked out really well for us. I think part of that reflects competition and where others are and we've been able to grow the book through that means really quite strongly over the last 6 to 12 months. Those promos extend beyond the short term, so that 19% you referred to relates to business we've written somewhat in the past. The book is very stable. We take a prudent assessment of our customers, but also their behaviour at the end of the promo period and we've been operating well within those assumptions. So, I think we're feeling good about the growth of that business. That business has been able to trade quite nimbly through COVID and we're really pleased about the prospects of some of our newer propositions that will come to market that will sustain that growth. So you'll see that growth continue, but perhaps be more broadly based away from that BT proposition that's delivered so well for us in the last few quarters.

Andrew Coombs:

Thank you.

Operator:

Thank you, Andrew, for the questions. We have our next question, comes from Robin Down from HSBC.

Robin Down, HSBC:

Good morning. I think it was mentioned earlier, the stock has gone down 5% on the back of this results presentation and I think there's two or three messages and I just want to confirm with you that these are the messages that you wanted people to take away from today. One is that the buyback could easily not take place until mid-way through next year because, frankly, is the uncertainty going to kind of suddenly disappear in the next couple of months before your Q3, you know, probably not.

The second one is on costs. It feels like you're intimating that there may be some upwards inflation there for future years that we need to factor in. And the final message seems to be on this margin side. You've got the range of 180 to 185, you're telling us that in effect, we could be as low as 180 for the year, which I think implies about 177 for the second half, which starting from 189 in Q2 suggests the exit rate for this year could be as low as around 170 or the high 160s. Am I correct - are those the three messages that you think we should be taking away from this set of results?

Clifford Abrahams:

I think that, maybe taking a step back perhaps, we feel good about our results that we've delivered - so the current set of results. And we've delivered on, at the risk of sounding defensive from, let’s call it the bear points, you know we’ve delivered on our strategy, we've delivered on our cost guidance that we gave at the full year and we're pleased to upgrade our NIM guidance materially, restart the dividend in a sustainable way, and announce the prospects of a buyback when conditions are right. So, I'm not going to speculate on what was going through the minds of investors that have traded in the last 20 minutes or so, but I think from a buyback perspective, I think David has commented fully on the appetite for buybacks when conditions persist, we have not ruled anything out ahead of the midyear next year and so watch this space.

I think around costs, I find it -- again don't want to be too defensive, but it would seem odd if pointing to higher inflation came as news, given what our political leaders had been talking about over the last few months. So, I think inflation is a fact of life, notwithstanding that, we're pleased to confirm broadly stable for the full year. We see inflation as something to manage but we can't defy gravity in that sense. I would point out, one flipside of inflation is interest rates going up and we’ve spent quite a bit of time on this call looking at the benefits of that which would flow through to subsequent years and consequently underpin our confidence regarding the cost income ratio, which will deliver the returns that we're all looking to see.

I think on margins, we've given a range. I think it's sensible to give a range on NIM given the assumptions regarding that we're one player in the mortgage market and one player in the deposit market. We're pleased with the performance and the tactical judgments we've taken in the last quarter or two and we'll look to trade sensibly through the rest of the year, whilst safeguarding the franchise and doing the right things for our customers.

Robin Down:

If I could just come back, I think you're exactly right, Clifford. I think it is sensible to give a range, but the range doesn't feel sensible, in the sense that, it's just simple maths that if you're telling us you seriously could be down kind of 180, 181, it is implying an exit rate for this year that could be down as low as 170, so an almost 20 basis point decline from Q2 against a rising rate backdrop. I suspect you would be horrified if we actually came out with that outturn.

Clifford Abrahams:

Look, I think draw your own conclusions from the assumptions I've guided to. I mean, what management do is give guidance. Guidance is based on judgments at the time, if interest rates move in a particular direction, for example, we benefit from the structural hedge. If interest rates were lower than current markets indicate, that will drive the NIM going down and then we'll have the conversation in six months' time, 'Why did you miss your guidance'? So we're happy to provide guidance, we're clear on the assumptions. We have been somewhat prudent in the past and have been pleased to upgrade on NIM, which we're doing again today, and I'm hoping you're right, but, you know, hope is not a strategy. We've got conviction in the guidance that we've set out and looking forward to having this conversation in six months' time.

Robin Down:

Great. Thank you.

Operator:

Thank you, Robin, for your questions. We have our next questions comes from Chris Cant from Autonomous.

Chris Cant, Autonomous:

Good morning, thanks for taking my questions. One on NIM and NII and one on capital, please. So on the margin, I guess just to follow on somewhat from Robin's question and additional clarification. Within your NIM guidance for the year, are you assuming that the deposit beta, the pass through of rates for the rate hikes that have already happened, is in line with the, I think, 50% or so baked into your sensitivity guidance? So we've obviously had very limited pass through at an industry level in the first half, are you assuming that in the second half, the rate hikes that have already passed, you will see the beta for those hikes increase to something akin to your sensitivity? That would be the first question because I think that's quite a different assumption from essentially every other UK bank. And then related to Robin's point, you have given this NIM range, you say you have conviction on your guidance. Do you have conviction that you won't be above the upper end of that range? That would be a subsequent question.

And then on capital, I'm sort of struggling a little bit with the commentary here. So your MDA is 8.7%. I appreciate the world is uncertain, but you just passed a very severe stress test, the end result of that process is you've cut your capital target range. Your capital target range is way above your MDA, your MDA is lower than most of your domestic peers, and you have a similar target and you currently have more capital than a couple of your large domestic peers who are systemic institutions. Why is it that you have such a high level of conservatism and do you think that that conservatism over time has been good for shareholders? I'm less speaking about an immediate buyback decision there and more about the fact that during 2020 and 2021, you opted not to grow mortgages during probably the richest pricing of the last 10, 15 years as a consequence of your capital conservatism. Do you think that your conservatism is actually beneficial to shareholders over time? Thank you.

David Duffy:

Thanks Chris. Maybe I'll make one comment on the general conservatism and capital and shareholders. I think the position we have had has been one of coming out into an IPO in volatile markets, being met with Brexit shortly thereafter, doing an acquisition, integration, rebranding of three institutions, and then coming out of that straight into COVID and COVID version two and at the same time having to move into the universe of Tier 1 status and do capital stress tests, et cetera, all of which were highly variable and unknown outcomes until we had executed on our path through all of those items. So I think our conservatism has been natural and I think advised in terms of a positive strategy to successfully achieve the outcomes we have done with regulators and others, and then to be able to move back into a dividend plus buybacks curve in this first year, which is what we had intended, so I think we would look at it slightly differently, Chris.

And then to the specific underlying point of a mortgage conservatism. As I said at the beginning, we had an overweight book, we were open in the last number of results sessions talking about the size of that book and that was at 80% of our total asset profile and that we wanted to re-weight that gradually over time. And so optimising the balance sheet with targeting growth in the higher margin areas for the future, we felt was a positive long-term strategy and not to be funny about it, but I think we're coming into a world where that margin strategy will be beneficial.

So, of course, everyone can have a view on this. From where I sit as a CEO going through that environment, I think those were necessary steps we had to pursue and to Clifford's point, I think we've arrived at a dividend profile with an option on buybacks and a strong performance in the business with great investment going into our digital strategy, which I believe will lead to really good growth potential in the future. So if I look at the profile of where we're going, I think investors going forward will be well-served by the strategy we have adopted. But let me just hand over to Clifford just because there are some more detailed comments in there, you might want to make comment on as well.

Clifford Abrahams:

Yeah. So I'm probably going to repeat what I said earlier. Our general approach, or our assumptions on interest rate sensitivities, the deposit pass through of around half, which is I think, in line with other banks, we've clearly outperformed that as a sector from a shareholder point of view in the last six months or so. So I'm not suggesting that unwinds but as we look forward, I think there are a couple of things, one is we are assuming the normalisation of the deposit market; I don't want to comment on products and specific products, and specific deposit rates, but I think markets will normalise. And the principle of some of the benefits from rising rates comes through, some of it is hedged, the other 50%, and some of it relates to the lag, so in a rising environment, there's a lag, we've seen that lag, and I think it's sensible to assume that that lag eventually expires. So we've taken a general judgment over our guidance, we've heard the prudence from some of the commentators on this call. We strive to outperform - both targets and guidance, but we think the best way of dealing with the interest that we get is to be clear on our guidance and clear on the assumptions underpinning that guidance.

Chris Cant:

So just to be clear, you said you're not assuming that the betas on the rate hikes that have come through change, but you're assuming a normalisation, and within that there are some rate changes, but you won't comment, so that sounds like you're assuming the pass through for the rate hikes that have happened prospectively changes, i.e. even assuming no further rate hikes, you will be passing on higher rates for the rate hikes that have already happened as part of that normalisation.

Clifford Abrahams:

Bluntly I've not got into the details that you're, with respect, requesting. What we've done is assume that normalisation in the market. This notion -- I don't want to sound critical -- of automatic pass through, I mean, we've seen rate rises sequentially over months, including some really quite recent, in the real world, all these things happen with a lag that reflect banks funding positions and the competitive market. So there isn't a sort of mechanical approach, notwithstanding perhaps what some peers talk about on analyst calls. So we operate in the real world, we want to maintain a stable funding base, grow the franchise, support our customers. Going forward, I think the right assumption is, we'll call it, a more normalised one. We do that bottom up, we take a view and then we present guidance which we explicitly say has some prudence in it and we'll strive to outperform it.

Chris Cant:

And in terms of the conviction on the NIM range, what's your conviction that you don't end up beyond the top end of that range?

Clifford Abrahams:

I hope we won't be below, I'm not ruling out that we're above. I see where swap rates, for example are, but I don't, you know, I'm just one observer and it's possible they're higher, for example.

Chris Cant:

Okay, all right. Thank you.

Operator:

Thank you, Chris for your questions. I will now hand it over to David for final comment.

David Duffy:

Okay, thank you and thanks everyone for joining the call and obviously, there's a lot to get through and a lot of questions. We're very happy to follow on through the IR world with Richard and the team to get into any more depth you have, and I'll just leave you with a -- maybe it's the CEO's view, but I look at the business we have, the team we have, the strategy we have, and I'm actually confident. I'm optimistic about the future and we’ll battle through volatility, but that's what we do. But I see us with real momentum, we've left that history of all that complexity I described behind, we have a simpler, more straightforward business to manage. We have a good underlying momentum of performance. We have a very clear digital strategy, and we will have a better cost income ratio with good growth in the future and I think in the digital space it's already evident that across every single product it’s starting to bear fruit and that will only accelerate.

So I recognise this is a half year call and it's reflecting the market circumstance at the moment, but if I take a medium-term view, I have a different view of perhaps the tone of some of the questions today, and we will be happy to get into all the details and work through until everyone has a clear understanding, but I would leave you with that thought, and thank you all for your time today, and we'll speak soon.

[ENDS]