



**Virgin Money Half Year 2017
Results Presentation
Transcript**

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Half Year 2017

Jayne-Anne Gadhia

Chief Executive Officer, Virgin Money

Introductory remarks

Good morning everyone, and thanks very much, indeed, for joining us here today, on the very day that we have announced our new partnership with Virgin Atlantic. But I will tell you a little bit more about that later.

So I am really pleased to be reporting this morning another excellent set of interim numbers, which have met our plans and expectations in every respect, including capital and including net interest margin.

We are also very mindful of some of your questions around our credit card business over the past quarter, so we are going to take a little longer than normal to address those points this morning. Just so that you can comfort yourselves, you should expect Peter and myself to speak for about an hour.

H1 2017 financial performance overview

Now let us move on to the first-half results. As you have seen, we grew assets by 15% to £40 billion. Underlying profit before tax increased by 26% to £128.6 million, and that drove an increase in RoTE to 13.3%, up from 12.2% in the first half of 2016. That is entirely in line with our commitment to achieve and sustain solid double-digit returns.

So after taking into consideration our strong performance in the first half of the year, our strong capital position and the prospects for the company, I am pleased to announce that our board has declared an increased interim dividend of 1.9p per share, which is up 19% from the first half of 2016, and which is, coincidentally, entirely in line with our EPS growth.

Consistent track record of progress and delivery

Now, everyone at Virgin Money is rightly proud of these results, and to be clear, they are our best ever and that shouldn't be a surprise to you, because we have a business model that is based on prime credit quality, as we will demonstrate, supported by a first-class management team and importantly by brilliant colleagues who have continued to deliver for our valued customers.

Now, our confidence in the business is built on the three pillars of our strategy, which has served us so well since we listed nearly three years ago. As a reminder, these are growth, quality and returns.

Growth

So turning first to growth, each of our major product lines is exceeding our expectations. Our retail deposit balances grew to almost £30 billion, and helped to fund asset growth. Low-risk secured mortgages remain our largest asset class and our mortgage balances increased to £31.8 billion in the first half of the year, and that is up 7% from the end of 2016. This compared to market growth of only around 1%, as reported at the end of May. And our credit card balances increased to £2.8 billion, which is up 13% from the end of 2016.

Quality

This growth has definitely not come at the expense of asset quality. We maintained our cost of risk at 13 basis points this half, demonstrating our continuing focus on strong underwriting standards and high-quality credit. Indeed, the quality of our customer franchise also continues to increase. This is recognised in our overall Net Promoter Score, which increased to +39. That is a real leap forward, we think, from the +29 that we achieved at the end of last year.

Our strong capital ratios are exactly where we expected them to be, and with a CET1 ratio of 13.8% at the end of the half, we are well positioned for our future growth plans. We have always been clear that we expect a 12% CET1 ratio to be efficient for our business, and, once we get there, we expect capitalised profits to sustain our growth. To be clear, we have no plans to raise new equity capital.

Returns

The flexibility of our operation and very tight management of cost continues to support our profitability. Taken together, these results have produced our return on tangible equity and increased it to over 13.3%.

Resilient macro performance

So let us take a minute now just to consider the macro backdrop and the trends that we are seeing in our market. We think the UK economy has remained resilient during the first half of the year, with positive GDP performance, positive house price inflation, extremely low unemployment and continued historically low interest rates. That said, of course uncertainty remains, not least because the economic impact of Brexit has not yet played out and inflation continues to be in excess of weak wage growth.

We believe that the strength of our franchise, our strategy and our commercial agility all give us the flexibility to adapt to potential changes in the operating environment and to deliver resilient performance throughout the economic cycle.

Size and agility support further growth in mortgage market

Market gross and net lending

We continue to see the mortgage market as a really important part of economic and social prosperity in the UK, and our proven expertise in this area gives us a really solid foundation for future growth. The market for 2017 looks like it is going to remain pretty flat on last year, at around £248 billion, according to the CML. That is a consequence of the EU referendum, of course, as well as last year's buy-to-let reforms.

Developing franchises for the future

Although we have commented on a few areas of weakness, which the press has picked up this morning, all I mean by that is slowing house price growth, largely in London, because actually we continue to see a healthy housing market. Indeed, 58% of our new business flows came from house purchases. Re-mortgaging remains very strong, and retention of our existing customers continues to increase.

The government housing agenda is clear with its primary focus on helping more people to own their own homes. We are strong supporters of this agenda and during the course of this half we have increased our share of new build lending, which now represents around 11% of

our own new lending flow. We continue to work closely with our intermediary partners to take share in this area as well as others, of course. But this area does offer attractive spreads in the context of our overall mix.

We are also pleased to have announced two further extensions to our mortgage proposition in recent days. Only yesterday we launched our carefully controlled custom build proposition. This is another growing area providing strong margins. To date, we are the only top-ten lender to operate in this space. Of course we expect other lenders to follow, but we are pleased that our agility has enabled us to develop a proposition at pace.

Secondly, we are pleased to become one of the first banks to operate in the shared ownership scheme, which is supported by the government. We think it is important to help people to get onto the housing ladder. This scheme provides a measured and low-risk way to lend to a particular segment of first-time buyers.

These are examples of the ways in which we are developing our franchise, and the opportunities we have for the future. But let me be clear that we will always only do so in a way that reflects our disciplined underwriting criteria.

Strong continued book profile

Through our portfolio, our average LTV remains very low at 56%. Buy-to-let continues to be an area of activity for us, being 19% of our flow in the half and we will continue to focus on the smaller private landlords who have strong credit profiles, although there may be the opportunity to serve as portfolio landlords at some point in the future.

Intermediaries remain our most important channel for mortgages and we are delighted with the volume and quality of mortgages that these important relationships produce. Nevertheless, of course we are pleased to see our direct mortgage business increase to just over 10% of our mortgage flow for the year.

Mortgage balance build-up

Mortgage competition of course has been strong, as we know, but despite that we completed gross mortgage lending of £4.3 billion by the end of June. According to the CML, this reflected a 3.6% market share. That is broadly consistent with the Bank of England market share disclosed at the end of May that showed us having 3.5% of the market. For us, this volume has been achieved at front-book spreads of 176 basis points, and that compares to the 180 basis points that we experienced for the same period last year. But while we are seeing some additional asset spread compression in recent weeks, we do expect this trend to reverse as the TFS comes to an end.

At our market share we have shown that we can be flexible in different market environments and still have the capacity to generate high quality growth in the book. So overall, the excellent quality of our mortgage portfolio gives us continued confidence in the development of this important franchise for the future.

The quality of our mortgage book we think is proven. In fact, the quality of this has only improved since our acquisition of Northern Rock, despite that book meeting stringent state aid requirements at the time. We have taken all of that experience and quality focus into the way in which we think about and build our credit card book.

Cards underwriting discipline critical at this point in credit cycle

Our strong and improving customer affordability and credit quality distinguishes us from market

As you know our credit card book has grown strongly in the last two years and I do understand that that means that some people have questioned whether that means that we have sacrificed quality. Let me assure you now that we do not, have not and will not sacrifice quality under any circumstances. We tightened our underwriting criteria from already high levels since the EU referendum on both our front and back books. We have raised credit card cut offs and reduced limits for higher risk customers. I would like to clarify, in fact we announced it as I stood here last year, that we have done this to provide an additional level of prudence ahead of any potential softness in the economy following the referendum, not because we are seeing any concerning behaviours at all in our book, because we are not.

The net result of these actions is that the volume of new accounts that we have accepted is 8% lower than it would have been if we had maintained our underwriting criteria as it was before the EU referendum. In other words, we slowed down our lending well before the current focus on the issue and well before our competitors. As you will hear from Peter, our excellent portfolio performance demonstrates the prime nature of our customer base. We lend only to customers who meet our high affordability requirements and cut off levels. We never down sell. I keep on banging that point home and that is because our analysis tells us that it is down selling of credit cards that plays a significant part in reducing credit quality in other credit card books.

To reinforce the point again, we have no concerns over the quality of our credit card book. We can demonstrate the superior quality of our customers on both an affordability and on a credit quality basis. Our average customer indebtedness is 20% and that is some seven percentage points lower than the overall average customer indebtedness in the market. The average indebtedness of our customers is showing a stable and slightly improving trend versus a trend in the broader market of accepting increasingly indebted customers. I think that is very important based on the Bank of England's position at the moment.

Market commentators in fact have recently expressed concern that the unsecured lending industry is lending to higher risk customers, and this is categorically not the case at Virgin Money. Argus data shows that for 2016, 97% of Virgin Money balance transfer cards were originated in the lowest risk segments. For the same product, the industry overall originated only 71% in those same low risk segments. Given our tightened underwriting criteria we expect our comparative position only to have improved when 2017 data becomes available. As a result, whilst I am never complacent, I lose no sleep over the quality of our credit card book. We don't expect to see material increases in impairments in the current environment and we fully expect the book to be resilient throughout the cycle, which is how our underwriting criteria have been designed.

That leads me onto EIR. As you would expect we spend a significant amount of time and effort to assure ourselves that our underlying assumptions are sound, and I can assure you that we are equally confident about our position here. Our credit card book is top quality, well-underwritten, growing soundly with highly loyal customers and the accounting matches the experiential data that we have. Peter will talk you through that in much more detail a little bit later on. I am pleased to say that our credit card balances have grown safely to

£2.8 billion and we continue to remain on track to achieve £3 billion worth of high quality credit card balances by the end of 2017.

Announcing our new Virgin Atlantic partnership

A high-quality distribution opportunity

You won't be surprised to know that we have been keen to work with Virgin Atlantic for some time, on their Flying Club frequent flyer programme. It has only just been announced this morning and therefore we are not putting too much detail into the market. However, it is a new partnership that we are announcing today. From early 2018 Virgin Money will be the retail financial services partner for Virgin Atlantic's frequent flyer programme. As I am sure you will know, Virgin Flying Club customers tend to be affluent, high quality and highly engaged with the Virgin brands. We have already seen the power of this relationship because we have offered Virgin Atlantic customers Virgin Money ISAs for some time and this programme has exceeded all of our planned expectations. We are now delighted to be partnering with Virgin Atlantic across a whole range of retail financial services where customers can earn Flying Club miles. This is an important and brand new distribution channel for Virgin Money and will be supported by sound economics. This new relationship, along with our very successful partnership with Manchester United, demonstrates our ability to work with partner organisations and to continue to develop the reach of the Virgin Money brand.

Excited by the potential of Virgin Money Digital Bank

A new-build digital platform with access to an established and loyal customer base

The last time we got together we updated you about the build of our Digital Bank and I am really pleased to say that this has surpassed my expectations in terms of progress and design. Equally importantly it continues to be on time and on budget. Just to remind you, this is a programme that we are undertaking with Antony Jenkins' new business 10X. It was always planned to deliver over several quarters and we are now nine months into a 21-month programme. Where we think we have the advantage is that we have a famous brand and nearly 3.5 million customers already. We are an experienced bank with a balance sheet of scale but we can also bring a nimble approach to future digital developments. The Digital Bank will be a customer-centric, data-driven platform with cutting edge analytical capabilities. Where the big banks are focused on digitising their legacy businesses and the fin-techs are developing their understanding of banking, we occupy a sweet spot between the two which we fully intend to capitalise on. Furthermore, we have a base of credit card customers providing a rich source of data. We think these customers will be interested in our initial digital proposition so that we can really help them with their finances.

We are now in a place where we are moving from design into the build phase. The customer proposition is designed and we can now see very clearly how we will be able to benefit through this route from all of the upcoming regulatory and market changes, including PSD2, Open Banking and GDPR. Importantly, the Digital Bank offers the opportunity to drive alternative revenue streams efficiently whilst providing scalable and low-cost retail funding. I am looking forward to updating the market in November with more detail and from our perspective this is a major opportunity to transform our business as part of the digital banking revolution.

Focused on the customer

Customer and industry recognition evidences value of proposition and approach

Our results to date have been achieved because we remain focused on providing our customers with great value, straightforward products, supported by outstanding service, a differentiated customer experience and multichannel distribution. Our exceptional brand recognition and investment in the customer proposition have led to both customer and industry recognition including importantly being acknowledged by the Reputation Institute as the most trusted UK bank.

We continue to invest in our customer proposition. In this half we have launched Virgin Red which gives our customers the opportunity to participate in a Virgin Group-wide loyalty scheme, and also Virgin Money Back which offers our customers a chance to earn cashback when they shop online with a Virgin Money credit card. Increasingly, our customers interacted with us digitally but our seven lounges and 74 stores continue to play an important role in allowing customers to access us face-to-face if they wish, and in reinforcing the trusted relationships that we are building with our customers and with the communities in which we operate. The strength of our customer engagement is illustrated in our increasing customer numbers which has continued despite our decision to reduce our exposure to the travel insurance sector.

It is also evident in our strong Net Promoter Scores. We are particularly proud that our lounges have achieved an NPS of +86 and that intermediaries importantly have scored us a +55. We are also pleased to have won a number of awards in the first-half of the year including Best Lender for Partnerships, Best Online Mortgage Provider and Best Credit Card Provider. That customer and industry recognition provides us with a solid platform from which to build both our current business and our new Digital Bank.

Strong customer franchise leading to enduring relationships

Enduring relationships drive customer retention and increased financial returns

One of the really important and demonstrable things that our customer focus has delivered is an increased level of retention. We have been able to retain customers in all product categories at levels that we have not previously seen. That is because we have commercial teams focused on long-term customer relationships. That is important for mortgages. 73% of mortgages that come to the end of their offer period are now staying with us on new front book products. Over 90% of our savings products stay with us at the end of their term and importantly for those of you particularly focused on our credit card book, we can see that there are a growing number of customers staying with us for at least ten years. And don't forget, this is based on empirical data from the book that we started building in 2002. That does not happen by accident, that's because we have an absolute focus on customer retention across all product lines at all times.

Continued delivery, continued confidence

Significant progress proven over five years

In summary, I wanted to highlight that at Virgin Money we are continuing to deliver exactly what we said we would deliver and continue to meet or exceed market expectations. Since we acquired Northern Rock in 2012 we've grown lending from almost £14 billion to almost £35 billion. The business was losing just over £59 million a year then, and this half alone has

made an underlying profit of almost £129 million. While we have doubled the size of the balance sheet colleague numbers have increased by just 12%. Northern Rock's cost:income ratio was 148%, Virgin Money's is now less than 54%. We have made significant progress over the last five years. We make significant progress each year and we expect that to continue. We have a very exciting outlook in all of our products and strategic developments for the future. Before we get there, I am looking forward to Peter now sharing with you how our first-half numbers have been achieved.

Half Year 2017 Financial Results

Peter Bole

Chief Financial Officer, Virgin Money

Good morning everyone. As you have heard, we have delivered an excellent first-half performance and I will now take some time to go through the drivers of that performance. It may take a little longer than usual, as Jayne-Anne has highlighted, as we step through some of the extended disclosures that we are providing this morning.

Balance sheet progress

Let me start with the balance sheet. The H1 results reflect a continuation of previous trends. The front book market share, exceeding stock share, and the benefit of a maturing retention profile across both savings and lending activity. The result is that as we have maintained and in cards tightened, our underwriting standards, we have continued to grow the balance sheet and preserved our high asset quality.

Gross lending of £4.3 billion translated into net lending of £2.1 billion. In turn, mortgage balances grew to £31.8 billion. Credit card balances increased to almost £2.8 billion and we remain entirely confident in our ability to fund this asset growth, with progress in both retail and wholesale funding in the first-half. The strength and depth of our retail deposit franchise was evident in the 5% growth in balances, well ahead of the market which grew at 1%. This reflected a particularly strong performance in the ISA market.

Moving on to wholesale funding, the strength of our net lending enabled us to draw substantially all of the TFS balances which we had originally expected to draw by year-end. The result is that we are sitting on substantial cash resources at the end of June and this is all available to us for second-half lending activity. We continue to expect to draw between £5 billion and £6 billion in total by the time the TFS closes at the end of February 2018. We have also made good progress in the first-half developing our wholesale funding capability. A second investment-grade credit rating was published by Moody's in June and we have just received approval for our regulated covered bond programme. That broadens our funding options beyond our established RMBS and MTN programmes, and we expect to be a regular issuer, coming to market at least once a year.

Lastly, as Jayne-Anne has highlighted, all of our capital ratios are exactly where we expected them to be at this point. They leave us well-positioned for future growth but I will return to capital a little later on.

P&L – Further growth in profitability

Strong income growth, cost control and high asset quality drove improved profitability

Turning to the income statement we were very pleased with the net interest income growth at 14%. This was driven by our asset growth combined with stable net interest margin of 159 basis points. At a headline level, other income grew by 3% reflecting the performance of our investments and pensions business. This included a gain of £6.1 million from the sale of Vocalink. Excluding this gain and a similar amount last year from the sale of Visa Europe other income increased by 1.6%.

Turning to costs, these grew by just 4%. This was entirely a result of additional depreciation charges as we continue to invest in the core platform to drive efficiencies and to ensure it supports our excellent customer service. Set against total income growth of 13% this resulted in a cost:income ratio of 53.9%, an improvement of close to five percentage points as our operational leverage continues to come through.

A continued focus on asset quality was evident in the cost of risk which at 13 basis points was in line with the second-half of last year. In spite of improving loss rates the absolute impairment charge increased to £22.2 million, entirely due to the volume of credit card lending. I will come back to the strength of our asset quality later on.

As a result of the combination of income growth, together with continuing operational leverage and controlled cost of risk, underlying profit grew by 26% to £128.6 million. Underlying earnings per share improved by 3p to 18.5p with return on tangible equity growing by just over one percentage point to 13.3%.

Net interest margin

Lower funding costs support reduction in asset pricing

I will now step through the drivers of this performance in a bit more detail starting with net interest margin which performed exactly as expected. Firstly, funding cost benefited both from the active management of retail pricing and from the impact of TFS. We repriced approximately £10 billion of retail deposits in the first-half with retention of repriced clients exceeding 95%. Additionally, we notified customers in relation to a further £1 billion which we will reprice in the second-half. The result of this activity was a weighted average cost of funds of 98 basis points, down from 138 basis points in H1 last year, which in turn led to an 18 basis point benefit to margin. The benefit that we have seen in cost of funds has in turn flowed into asset pricing in the half with the consequence that lower asset spreads resulted in a 21 basis point reduction in total margin.

While competition for mortgage customers remains strong, we saw a remarkable stability in spreads throughout most of the first-half and as Jayne-Anne said, it is our expectation that the more recent narrowing of spreads should step back up as a rational response to the end of TFS funding early next year. This is something we will monitor closely in the second-half as we determine the appropriate rate of growth going into 2018. Lastly, the relative mix of mortgage and credit card balances increased margin by three basis points. Taken together these movements resulted in total NIM for the half-year of 159 basis points. That is flat on the second-half of 2016 and at the upper end of our previous guidance.

We have also highlighted our new metric on the slide, banking NIM, and we plan to include this going forward. This is calculated by excluding our treasury asset portfolio from the average interest earning assets in the NIM calculation. We think this is a helpful addition to explaining our performance as it allows us to highlight non-trading movements in balance sheet structure that may impact total NIM without impacting our profitability. One example of such an item is our decision to bring forward a material element of our planned TFS drawing to June. The result is that until this funding is actually deployed in our lending activity it does not really affect our profit. We pay the Bank of England 25 basis points for the funding and reinvest at 25 basis points. However, it will influence the NIM calculation by increasing the denominator. By separately providing banking NIM, this non-trading impact will be clear.

As a result of the advanced drawdown of TFS, we expect total NIM for the full year to be at the lower end of our previous guidance of 157-160 basis points, and if we accelerated further TFS in H2, this could further impact that metric. However, we expect banking NIM to remain stable.

Drivers of effective interest rate

EIR modelling reflects empirical customer behaviour

I now want to spend a few minutes on credit card income. Given its importance to our business we have decided to expand further our disclosure on this topic. I will start by taking a moment on the nature of our card book. We offer a wide range of credit cards each with a variety of promotional durations and fee structures. The way in which customers use our cards varies widely and we have tried to illustrate this in the top left chart. Some customers make full use of promotional terms before repaying the balance in full at the end of the promotional period. Others will use it for short-term borrowing to pay for large items like household goods or family holidays before paying it down over a period of a few months or spreading it over a longer period. There are customers who use this card as an everyday part of their financial affairs with high transaction volumes and the balance fluctuating as their financial circumstances change over the course of many years.

When it comes to income recognition, as we have said previously we account for card balances on an amortised cost basis using the effective interest rates or the EIR method. In determining the EIR we consider all of these observed customer behaviours and we model cohorts at an individual vintage and product level using our extensive data. For each cohort we model the mixed uses of the different customers to form a view of the expected cohort balance profile shown in the top right chart. To be clear, the empirical behaviours by customer in the top left-hand chart are combined to create the cohort average in the right-hand chart.

Combining the cohort balance with the product interest rate and any promotional duration we then derive the expected cash yield for each cohort as shown in the bottom left chart. This cash yield for each cohort is converted to the effective interest rate to give a stable accounting yield over the life of the cohort. That is shown in blue in the chart.

While our data points to balances on individual cohorts extending on average to ten years and beyond, for modelling purposes we restrict the calculation of EIR on every cohort to just seven years. We have extensive data going back to 2002 and granular analytics in place to monitor customer behaviours at a customer, cohort and product level. The result of the

effective interest rate approach is that at any point in time the cash yield on a cohort will differ from the accounting yield depending on the cohort's maturity. In the early stages, more income will be recognised than has been billed, and this reverses over time such that by the end of seven years the cash and the accounting yield are the same.

Credit card income

Data and analytics underpin card economics

Having recapped on the requirements of the EIR accounting, let me turn now to our focus on performance and oversight of that accounting. Given the importance of the assumptions underpinning this model, the level of oversight is significant and, as you would expect, includes detailed monthly review by cohort and product, formal quarterly appraisal including recalibration of behavioural assumptions as necessary and continual executive focus including both internal and external challenge and review.

H1

So, what does all of this mean for the half? At 30th of June, we held an income accrual within loans and advances to credit card customers of £124 million, which adjusting for tax is equivalent to 8% of our tangible net asset value.

This accrual had grown from £82 million at the end of December with the movement of £42 million representing accrued income in the H1 income statement. To put that in context, 60% of card income, the majority, represented cash income build in the period. And we would expect the proportion of cash income to increase from 2018 onwards. Let's put it in another way: 13% of our total reported income in the first half has been recognised through the credit card EIR accrual. And as you might imagine the detail and number of moving parts is significant. So I have tried to draw at a couple of the more important charts to give a sense of the type of monitoring that we look at.

Balance profile

So this first chart sets out the average balance profile for a number of different balance transfer products, and this index is the cohort balance over time against the peak level of borrowing. So as you can see, the broad shape of the balance profile is fairly consistent with peak borrowing in the first three or four months, moderate pay down during the initial promotional period, and then a more rapid repayment around the expiry of the promotional period before stabilising at a sustained level of balance.

One of the key features to draw out on this chart is that as promotional periods have lengthened, the long-term engagement with the customer has improved, and consequently the level of longer term balance has increased. This improvement has been driven by customers having their Virgin card front of wallet and by good engagement with the subsequent promotional activity that we have offered.

Modelling time horizon

The second chart is important in validating our judgment about the modelling time horizon we use. We monitor the average level of balance and cards at seven years and beyond, again as a percentage of the peak balance.

This chart demonstrates that over time, the relative proportion of balance that remains after seven and ten years, has gradually increased. At over seven years over 20% of the balance

now remains on a typical cohort. And at ten years, the equivalent figure is over 15% of the peak balance remaining. To limit the inherent uncertainty in assumptions, we took the decision to model no more than seven years, despite evidence of balances remaining for over ten years. And that remains the case today, we model a seven year period after which income is recognised as it is billed.

Sensitivities

So to complete the disclosure around this important income line, we've provided some sensitivities. We think that within the industry, different firms use different modelling periods. While our seven year modelling period is entirely supported by customer behaviour, for illustration we've provided the financial impact where we've accounted for card EIR using a five year modelling period from the outset. As you can see, it would have reduced the EIR rate by 1.1% in half one and would have reduced income by around £11 million. The balance sheet accrual would have been £32 million lower, at £92 million.

It is also worth noting that the sensitivity to modelling period will decline over time. There are three factors driving this: the slowing rate of growth in the book; the seasoning of the book, particularly with only around one-third of balances originating in 2016 and 2017 being on the longer duration balance transfer promotions; and finally, as a function of continued growth in other product lines. So taken together, this means that we expect 2017 to see the peak impact of the cards EIR modelling on the income statement. From 2018 onwards, we expect the differential between cash and accounting income to diminish both in absolute terms and as a percentage of total income.

So we are confident that our assumptions are thoughtfully compiled, closely monitored, recalibrated as circumstances dictate, and match the empirical behaviour of our customers. This data set will continue to be enriched as more and more cohorts mature in the coming months and years.

So to recap, the three key messages are: stick rates have shown an improving trend as balance transfer period have lengthened. Empirical data for stick rates support accounting assumptions for balances outstanding and for our modelling period. And as we look forward, we expect the influence of accrued income to peak in 2017 and decline from 2018 onwards.

Operational leverage

So moving on to operational leverage, the half year saw further improvement in operating efficiency, as well as an increased level of investment in our existing platform and the new Digital Bank infrastructure. Within mortgages and savings, we have seen a 12% cumulative efficiency saving in back office functions. In cards, calls per account to our service centre fell by 20% compared to the first half last year and the overall unit cost per card fell by 25%. Total costs remained well controlled and just £6 million ahead of the equivalent period in 2016, which as mentioned previously was entirely due to an expected increase in the depreciation charge.

And this in turn fed into continued strong JAWS, with income growth of 13% set against cost growth of 4%. This performance gives us real confidence and further improvement to our cost:income ratio, and in particular to an exit run rate of 50% this year. Investments in business as usual across revenue and capital expenditure is consistent with last year at £23.2 million. This continues to underline our commitment to investing in improved business

processes today and in the future. Additionally, we invested £20.4 million in our digital bank. And you should expect a similar quantum in each half year to the end of 2018.

Asset quality

So I will now move from operating leverage to asset quality. And as you can see, the make-up of our portfolio continues to be very stable with secured mortgages representing 92% of balances and prime credit cards making up the remaining 8%. We expect our lending to remain in similar proportions in the future. The split of our mortgage lending between buy-to-let and residential lending has also remained stable at 81% and 19% respectively, with average loan to value ratios broadly unchanged at 56% and 55%. And to recap, we do not offer unsecured personal loans, car loans or commercial real estate loans.

Secured lending

So if I turn first to secured lending, we are a prime lender in UK mortgages, to be clear, with no exposure to self-certified mortgages, or other legacy high risk back books. We have a clear and consistently applied risk appetite. We are very clear about where we want to lend and where we do not. And we only write business of a high quality that would allow us to achieve our returns goals through the cycle. In mortgages, this has meant staying at the upper end of prime, with strong affordability rules and we ensure the downside risk is well understood and manageable.

Virgin Money has been stressing customer affordability above SVR for many years, and at SVR +3% since July 2014 with the result that the portfolio exhibits a high degree of resilience. In addition to the affordability stress, we apply a debt to income limit, and thirdly a loan to income limit. And we use the most prudent outcome from these tests to determine the maximum lending amount.

Lending and residential properties in London and the south east remains a topic we monitor closely. As we have mentioned before, our lending limits protect us in areas of rapid house price growth. And over half of our mortgages in London have a loan to value of less than 50%. Asset quality is therefore strong today and likely to be resilient to any future downturn. The result of our careful approach is that when you look at the arrears levels, we see a steady improving trend both at a vintage level, as you can see in the bottom left chart, and when set against the growth in the total mortgage book in the bottom right chart.

So similar to our mortgage book, the strict application of our risk appetite determines a high asset quality in our credit card book. Our underwriting and affordability criteria create points of differentiation versus the market and our peers. As Jayne-Anne said, Argus data shows that 97% of Virgin Money balance transfer credit cards were originated in the lowest risk segments. For the same product, the industry overall originated only 71% in those same low risk segments.

Jayne-Anne also referred to the fact that we have tightened our affordability criteria. The result of this approach to underwriting is seen in the amount of disposable income our customers have to service their credit card debt. This net free income for new card customers has been on a rising trend since 2015, with the most recent cohorts showing an average net free income of £763 per month. And to be clear, this income is available after customers have serviced all their borrowings including a stress assessment of their payments to us.

And the outcome of our underwriting and focus on affordability can be seen in arrears and charge-off data. Our lower risk asset profile produces an arrears performance which is both low and stable. And similarly, if we look at loss performance lagged by 12 months to compensate for the lack of seasoning in the book, Argus data shows that our annualised asset charge-off rate is clearly lower than the broader industry.

So, the careful management of credit risk is reflected in the total impairment charge, increasing by just £4.8 million to £22.2 million. This charge resulted in a cost of risk of 13 basis points, just one basis point higher than the first half of 2016, and unchanged in the second half. The mortgage cost of risk remained at one basis point. And in cards, the total cost of risk fell by 15 basis points to 158 basis points, reflecting the improving quality of the book as well as the less seasoned newer lending. And when we look at the level of provision coverage of impaired loans in the mortgage book, that was at 11.9%. This reflected the continued low level of impaired loans, which decreased as a percentage of our total mortgage portfolio and the strength of our provisioning approach.

Credit cards

In credit cards, we provide for losses on fully paid up balances based on a statistical assessment of expected arrears. The result is provision coverage in excess of 100% of impaired balances. And this provision coverage also strengthened to 123.3% in the first half of the year.

We are however never complacent and make sure that we understand the potential impact of a downturn. So to give you some very simple points of reference, and these stats take into account both credit cards and mortgages, we estimate that a 1% increase in unemployment for a full year would equate to around a 6 basis point increase in the cost of risk. A 1% increase in bank base rate would lead to an increase in cost of risk of just 0.6 basis points. And a 5% fall in house prices would equate to a one basis point increase in the cost of risk. Now there is of course a caveat that these are unlikely to occur in isolation. The impact would likely be cumulative. But it gives you a feel for the resilience that we built into our book. And we are of course also preparing for the transition to IFRS 9 with our current view of the macro outlook, had we been reporting the 30th June numbers using the latest iteration of an IFRS9 model, we are confident that the increase in provisions would have been less than the £50 million assumed in our capital plans.

So what this demonstrates is that under both IFRS9 and IAS39, our disciplined underwriting and strict affordability is evident in the quality of our lending portfolios. And this asset quality is reflected in our statutory profit. And the key point to make in statutory profit is that increasingly it aligns to the underlying profit. IPO share-based payments are now less than a million pounds in the period. And the most significant item on the reconciliation is £5.5 million relating entirely to the development of our Digital Bank, and this is captured under 'strategic items'.

Following the significant progress on the Digital Bank that Jayne-Anne has outlined, we took the decision to discontinue previous software development on an earlier project, and this accounts for £4.8 million of the charge and it will not recur. The small fair value gain on derivative instruments during the year will unwind over the life of those instruments. And our

tax charge of £33.3 million in the first half gave an effective tax rate of 26.9% with the result that our statutory profit after tax increased by 34% to £90.5 million.

Capital position

I will now turn to our capital position, which is exactly where we expected it to be at this point, and it reflects our strong profit performance.

The £91 million of post-tax earnings is equivalent to a 7.8% increase in our opening equity capital resources. This strong capital generation has been applied to invest in the business to support lending and to pay dividends as well as AT1 coupons. As I previously referred to, the £20 million we invest in the digital bank is recorded as an intangible asset which is deducted from capital resources.

Risk weighted assets grew by 14.5% to £8.8 billion for four main reasons. First, our continued growth in mortgages with a mix impact from front book lending. As we have described before, our advanced models for mortgages are relatively conservative and as a result, our new lending is booked with a risk weight well in excess of 20%. This is despite new business loan to value being broadly consistent with prior years.

So this compares to the risk weight of mortgages redeemed in the half, which was closer to 10%. And as a consequence, while we grow the book, our average risk rate increases with the average having risen to just over 17% at June compared to 16% at the year-end. And this conservative approach positions us well ahead of any potential regulatory developments in the area.

Secondly, at 30th June, a higher proportion of our mortgage pipeline was committed than at year end, and this seasonal impact flows through immediately to risk weighted assets.

Thirdly, the growth in credit card balances, which we recognise with the 75% standardised risk weighting, and finally the balance of growth coming from the standardised calculation of operational risk, which reflects the continued income growth of the business. As well as a short-term increase of 70 million of additional risk weighted assets which is as a result of the accelerated TFS drawings and this will reverse in the second half. So this growth in risk weighted assets together with the increase in investment as well as dividend and coupon distributions, resulted in a CET1 ratio at the end of the first half of 13.8%. This was in line with the expected development of the business, and well in excess of our internal minimum CET1 ratio of 12%.

The total capital ratio was 18.4%, and the leverage ratio at the half year was 3.9%. It is worth noting that the accelerated TFS drawings temporarily decreased the leverage ratio by just over 0.1% at 30th June.

Summary

So, in summary, we are pleased with the capital generation in the half and our capital strength as we look to the second half and beyond. Giving the view of regulatory development which we have made an allowance for in our outlook we're well positioned to continue to deliver on our growth plans.

Conclusion

So to conclude, the results of the first half of 2017 represent another period of significant progress for Virgin Money and we've continued to deliver on our targets. The strategy of

growth, quality and returns resulted in underlying profit before tax increasing to £128.6 million. Return on tangible equity increased by 1.1 percentage points to 13.3%, and the sustainability of those returns is underpinned by high quality lending growth, stronger retention and customer engagement, as well as the continuing operational leverage. Those returns continue to be delivered in part through an increasing dividend. The 19% increase in the interim dividend to 1.9 pence per share reaffirms our confidence in our future plans. Now, given the additional disclosures today, I am sure there will be a number of questions. But before we come to those, I will hand back to Jayne-Anne. Thank you.

Full Year Expectations

Jayne-Anne Gadhia

Chief Executive Officer, Virgin Money

Confidence

Thank you very much Peter. And I hope the extensive disclosures that Peter has just given help to share the confidence that we have got in our strong business model because we do look to the future with confidence. Despite uncertainty relating to Brexit, we continue to experience a strong UK economy. As you know, unemployment is at a 42 year low, which is positive for our business and for our customers. And we expect the UK housing market to remain resilient. We think that a market share between 3%-3.5% remains appropriate for us at this stage.

We do remain vigilant about the potential for certain regions to see house price weakness and we'll continue to manage this through strict application of our existing lending policies and our risk appetite. As we've explained, mortgage spreads are expected to continue to face some pressure, but we do expect this to be alleviated if the market behaves rationally as the TFS is withdrawn.

We are committed to maintaining the prime quality of our credit card book to build resilience throughout the cycle, and we continue to expect to reach £3 billion worth of credit card receivables with no deterioration in asset quality by the end of 2017.

Other operating income

We are pleased with our current progress on other operating income, which we expect to remain at around 10% of total income for the full year. We reduced travel insurance businesses this half as some of the pricing has become uneconomic, but our optimism in the insurance segment remains. Progress with life insurance has been strong, and we expect to enter into further insurance partnerships in the months ahead. As a consequence of our focus on asset quality and on the assumption of a continued stable macroeconomic environment, we expect the full year cost of risk to be only marginally higher than the first half of the year.

Cost

Our continued tight control over costs combined with ongoing efficiency improvement means that we remain on track to exit 2017 with a cost:income ratio of 50%. We are pleased that we have been able to build on our funding franchise. In the wholesale markets, we are planning a further RMBS issuance in the second half of the year. And the recent authorisation of our covered bond programme gives us the opportunity to diversify our funding further. Our

capital ratios remain strong and position us well for continued growth. We continue to move as planned towards a CET1 ratio of 12%, which is both efficient and materially higher than our minimum regulatory requirement.

Retail

Our retail franchise remains extremely strong and we expect to see a continued reduction in our overall cost of funds. It is our intention to draw further from the TFS before the withdrawal of the scheme taking total drawings to within previous guidance of between £5 and £6 billion. And as Peter has explained, our NIM expectations for the full year are that we will be towards the lower end of our previous guidance of 157 to 160 basis points, predominantly driven by our decision to advance our TFS drawings. But to be clear, we expect our banking NIM to remain stable in the region of 172 basis points. As a result of all of that, we remain confident of sustaining a RoTE in solid double digits for the remainder of this year and beyond.

Beyond 2017

And as we look beyond 2017, we have a number of significant and value accretive developments underway that we are very excited about. We remain confident about the organic growth in our existing plans. And whilst we have always said that we will review any M&A opportunities as they arise, the quality of our organic plan continues to set a very high bar against which we assess any potential investment. We continue to develop our product range. Our savings and investment franchise is growing ahead of our expectations and the arrival of a dedicated team led by John Tracy, formerly CEO of TD Direct, gives us confidence in the development of this part of the business.

Strategic partnership

We are delighted to be announcing our strategic partnership with Virgin Atlantic today. The strengths of the Virgin Group more widely has always presented a real opportunity for us and this morning's announcement represents a great step forward in this area. And we remain extremely excited by the development of our digital banking platform. It is our expectation that we will be launching a digital bank on time and on budget towards the end of 2018. This development will increase our customer reach and our access to low cost retail funding at scale.

Overall

Overall, we are delighted that we delivered strongly against our stated objectives for H1, 2017. We will continue to put customers at the heart of everything that we do and we look forward to the future with absolute confidence.

So thank you very much for staying with us for an hour. We would now be delighted to take your questions.

Q&A

Michael Helsby (Bank of America Merrill Lynch): I have got a question on slide 18, if that is alright? It is to do with the stick rates. It is quite interesting that it has been improving. In a way this strikes at what quite a lot of people in the market are worried about and I would like to get your perspective on it. People worry that at the end of the balance transfer period that there is an adverse selection so the quality of the stick rate if you like is deteriorating as people stick on for longer. Given your comments, it does not feel like that is what you believe is true but I was just wondering what extra data points or any comments you can give us to give us some more comfort on that? Thank you.

Jayne-Anne Gadhia: Thanks Mike. A key answer to that question is that of course stick rates do not just happen by accident and we work very hard to make sure that we are managing them both at the right volume and at the right quality, and through responsible lending as well. As you know we have a CRM programme for all of our credit card customers and we can choose which customers we believe are the right customers to perhaps borrow further or to have deeper relationships with us. Where we approach customers who do borrow further or do stay longer Argus data shows that those customers are of higher quality than in general in the earlier portfolio. That is why the stick rates are both longer term because we build on that relationship position if you like and higher quality because we have done that analysis before we approach customers in the first instance. I think these graphs start to show it. There is more Argus data that proves that to us.

Ian Gordon (Investec): Morning, can I have two please Jayne-Anne? Firstly on mortgage volumes. Obviously I can see that gross volumes were at a new record in Q2. Peter referenced in his RWA comments that your commitments at half-year were above your year-end position. Though I would be grateful for a broader comment on pipeline given that I note after £2.1bn of net in H1 consensus seems to be expecting £1.5bn in H2 which looks slightly odd. The second question on EIR, following on from Mike's question really. I guess you will appreciate why your note one in this morning's release perhaps scared the horses a little bit and the presentation we have just had is rather more reassuring. Can I just confirm, I think when you spoke to us in April last year the average life experience at that point was approaching ten years? Just to be clear, that measure has increased as well as the stick rate performance?

Jayne-Anne Gadhia: On mortgages, Ian, just to be clear we have always said that we aim for 3.5% market share. What we have always done, and we have almost felt that it serves us well to be honest, is just when the market is strong at the beginning of the year we tend to go into it, if you see what I mean? That gives us a little bit more flexibility for the rest of the year. We do not expect to write more than 3.5% market share because that is the way in which we are managing our capital position. Given our outlook for the total market you will be able to work out where you think we are going to be for that period.

As far as average life and stick rates are concerned the stick rate has remained very, very stable. The thing that I continue to be surprised by I suppose, though it gives me great confidence, is that we have been in the credit card market since 2002, and we have data right the way back to 2002, obviously including through the crisis, and the behaviour of the card book has remained very, very, very stable all the way through that. Our stick rates are based

on empirical evidence as well as existing customer behaviours. We are, as Peter said, hugely confident about and the prudence actually in our seven-year stick rate given the way we build it. Sometimes I think what people hear quite simply is every customer stays for seven years. That is not what we are saying. We are saying the average cohort taking into account all customer behaviour on balance, stays for this shape over ten years actually, but we draw a line at seven because actually we can see that that cohort is going to be with us for much longer than seven years. That has not changed but our confidence in it has actually increased not decreased.

Ian Gordon (Investec): Thank you. If I could just follow-up on that briefly? Whereas it was all very interesting to read of what the sensitivity is for a five-year average life, in your response to PRA you will be explaining that? That is all very interesting but not very relevant to your experience?

Jayne-Anne Gadhia: Absolutely, yes. And I think you are right. A number of people have picked us up on this. In giving the sensitivity to the five and seven year life all we are trying to show is from my perspective had the appropriate life for us been five years income this half would be down by £11m. It is not the appropriate life for us. Seven years is the appropriate life for us and we have as we always do constantly reviewed that and remain completely confident of it.

Ian Gordon (Investec): Very clear, thanks.

Jayne-Anne Gadhia: Thank you. Good morning

Robert Noble (RBC): I have got a question on RWA growth and capital. RWAs grew a lot faster than assets and loans in the first-half and I appreciate all of the factors that you ran through. What is it going to look like going forward? Are RWAs going to continue to grow faster than loans and presumably eat up more capital down to 12%? Can you maintain a double-digit loan growth with that level of RWA to asset density that you are kind of running towards?

Jayne-Anne Gadhia: It's interesting and I shall ask Peter to answer in more detail but for me let me at least start. For me this gives me really good strong confidence. To be clear, we never said anything other than our outlook for CET1 ratio is 12%. We think that is sufficient and it is very materially ahead of our regulatory requirements. It gives us very significant management buffers. That is important. We are also very, very clear in this time that while I agree with the Bank of England that we need to be very cautious around how we lend, but actually we are very clear that we are lending through the cycle both on cards and on mortgages. As a result, when we put mortgages on the book they start at a high risk weight but over time with the evolution of HPI and the evolution of customer repayment profile and risk profile it comes down. As we put on new customers at a high risk weight and we say those risk weights will improve, if that is the right way of putting it. Such as, as Peter pointed out, they come to us in risk weights in excess of 20%. By the time they leave us their risk weight is about 10%. It is very much that through-the-cycle approach that's maturing now but –

Robert Noble (RBC): You are at 17%, now though.

Jayne-Anne Gadhia: Our overall position at the moment on a blended basis is 17%, up from 16% during the last reporting period because of the weight of the new business volumes. For us we are managing that capital position with risk weights through the cycle with good quality mortgages which we think position us really well both absolutely and against competitors from a capital position and an asset quality position going forward. I don't know whether Marian or Peter, you will have to come up.

Peter Bole: There are only two things I would add to that. I agree with all that. There are two temporary or transitional pieces at the half-year that add to a couple of hundred million of risk weights. One is just the point we have discussed about seasonality in the pipeline. That ebbs and flows throughout the course of the year and that is at £139m I think from the slide. The other piece is a small amount of the surplus TFS that we are holding has been invested in assets that are adding about £70m on to the risk weights. Again they will unwind in the second half of the year as well. That is £200m that unwinds as the second-half goes through.

Robert Noble (RBC): Okay. Just to your point Jayne-Anne, it is 17% risk weight now and you are putting on customers at 20%. Back book is at 10% but that 20% comes down so should the risk weight density then stay at around about 17% or should I expect it to drift towards 20%?

Jayne-Anne Gadhia: You can expect it to get a little higher I think. For sure

Robert Noble (RBC): Below 20%?

Jayne-Anne Gadhia: Yes. We have always said to the market that we expect our RWA to be around 20%. We said that even from listing. To be clear, not because the risk of the assets is deteriorating but because of the prudent approach that we have to modelling the risk weighted position that we have got. We are a growing book and we want to do that through the cycle. We have had questions obviously throughout this period around how we feel we are positioned should the regulator increase the risk weight requirement. We think we are very well-positioned for that, if that was to happen.

Robert Noble (RBC): Thank you.

Jayne-Anne Gadhia: Thanks.

Rohith Chandra-Rajan (Barclays): If I could maybe start by coming back to consumer credit and again thank you for the additional disclosure. You obviously sound pretty comfortable in the way that you have grown the business, and the business that you have been writing and the underwriting standards. I wonder if you could talk a little bit about your response to the Bank of England's concern that particularly on balance transfer product it is quite difficult to track changes in customer credit quality. So if the customer's credit situation status deteriorates you do not necessarily have data because the monthly payments are quite minimal to start with. That would be the first one.

I guess more broadly then on consumer credit, what is your expectation of the range of remedies if you like that the Bank of England might be thinking about and if that would impact the business in any way? Then I have got one on the margin as well please?

Jayne-Anne Gadhia: I will come back on margins then so I do not forget the other two. As far as data is concerned on the balance transfer portfolio we have heaps of data on all of our customers from the very first moment that they deal with us. I think too that sometimes,

forgive me for putting it quite like this, there is a view that a 0% balance transfer card means that people take out the loan and they do not do anything for the next X months. Of course they have to make a monthly repayment so we can see all the time how customers are behaving against that required capital repayment. That is very important. A large number of customers transact on that card and we can see very clearly what they do at all points in time. Those new transactions obviously also require repayment. We can see where customers are involved in what we would deem to be more risky transactions, if that is taking cash out of ATMs or using it in a casino or something. You know that you have got a riskier customer at that point and therefore we can appropriately manage that customer relationship with a lot of detail.

Part of the reason that we remain very confident is that our credit cards business is a hugely data-driven business and it is the reason we are so confident about the digital bank actually. Michele built with Chris the very rich data-driven business that is the cards business and we are doing exactly the same with the digital bank. And I think in these days where data is all we are very, very well-placed as a consequence. Part of the reason for my confidence comes from the fact that we are hands-on managing our credit card book responsibly to enable customers to both manage their own finances well in whatever times are ahead of them and to be confident that our portfolio is well-managed for the future. I have got no concerns about that at all Rohith because we are all over it, to be clear.

Second point around what sort of interventions we might expect from regulators around unsecured consumer lending, I do not have a crystal ball any more than you do. In the paper that came out from the PRA a couple of weeks ago it seemed to us that they were at least as much if not more focused on motor finance and unsecured lending than on credit cards. To be really clear, Virgin Money does not do motor finance and we are not in the unsecured lending market. For us it is the credit card market that we are most focused on. We have given you I hope the reasons why we remain very confident of our position in it. Part of the challenge for us I think is that we have grown strongly but of course the percentage numbers look higher than the absolute market share, if you like, because we started from such a low base with £1bn worth of book from MBNA which we knew well, but the rest has grown over the last couple of years, not even towards our natural market share yet, if you see what I mean? On the one hand it is strong growth within our context but in the market context it is not hugely significant in terms of volumes. If you see what I mean?

As far as any interventions are concerned I wonder whether part of what the consequence may be is if you remember 18-24 months ago we were sat in rooms like this talking about buy-to-let lending and whether that is going to be a problem.

And of course, it was not in the end, because I think all lenders were able to focus on their own portfolios and work out what to do to get to a place that they were happy with, without regulatory intervention. I suspect that there will be some element of that happening in the market today.

I do not expect the PRA to be in a position to change accounting standards. That does not seem, to me, to be their job. To be very, very clear from an accounting point of view the way in which we account for our credit card portfolio is absolutely in accordance with how it should be, of course. Our assumptions are well supported and appropriate given empirical evidence.

In the end, I guess that the regulator needs to decide whether or not they expect additional capital to be held against EIR assets on 0% balance transfer portfolios. To the extent that they do, the gap, if you like, between our minimum 12% CET1 position and our required regulatory minimum is very, very material, and we would easily accommodate any other add-on that might come – and I am not suggesting that I think that is what will come, but we could easily accommodate it within those buffers.

Rohith Chandra-Rajan (Barclays): Thank you. Very comprehensive.

Jayne-Anne Gadhia: Thank you and Margin?

Rohith Chandra-Rajan (Barclays): Yes, so the guidance of the lower end of the 157 to 160 basis points implies 155 for the second half, or something above 155, dependant on additional TFS drawdown. I guess as you release that or you utilise that surplus liquidity that you have built up, that would be a margin tailwind, then, going into next year. I was wondering if you could talk a little bit about the margin dynamics for 2018, appreciating that we are only halfway through this year.

Jayne-Anne Gadhia: Yeah. We are not guiding to 2018 at this point. Although of course we will be doing that soon. As far as my outlook for the future is concerned, we still have – every time I stand up and say this, you will go, 'It must be the last time.' It has not yet been the last time that we have been in position where we know that we need to reprice our liability side of our balance sheet. As Peter said, you can see that in the last 12 months we have reduced our weighted average cost of funds by 40 basis points.

We are currently in a position where our retail deposit pricing is still significantly ahead of our competitors, and so we would expect some repricing to come through to compensate, if you like, for exactly the position that you are talking about where our net interest margin is going. That is why we feel confident this year about being able to sustain a banking NIM of 172 basis points. I hope that that banking NIM position gives you more clarity around our NIM disclosure, because from a product perspective we are holding our product economics very well. It is quite a competitive market, and a flat base rate environment, and we see the remaining flat and pretty strong at 172 basis points for the rest of this year.

The rest of the NIM position as Peter has already described, is very much around some of the more esoteric issues, particularly including TFS. And in my view is that as far as TFS is concerned, whilst that is available to draw, it makes sense to draw it. It should not draw available funding simply because of the optics on a market measure. It would not be right for our business or for our shareholders for us to do so. That is why we introduced the banking NIM position.

Rohith Chandra-Rajan (Barclays): Thank you

Jayne-Anne Gadhia: Nick?

Nick Baker (Goldman Sachs): Thanks a lot. It is Nick Baker from Goldman Sachs. The first one, actually, is just around deposits. Picking up on your comments around potential for deposit repricing going forward, you have about 29.5 billion of deposits now, and in the release you call out that a touch over 300 million is current accounts. I was hoping if you could decompose the remaining 29.2 billion, as to how much of that is in fixed-term deposits, how much is in easy access, to the extent that you can comment around that.

Then the second question is around the EIR rate. So the 6.8%. So as you will presumably disclose this going forward, just so that we are prepared, what has been the degree of historic volatility in that 6.8% number? Has that fluctuated between 6.5% and 7.5%, or has it been in a much narrower band?

Jayne-Anne Gadhia: So I will try to answer that in a sec, and Peter might add, then I'll ask Hugh to talk to talk about retail deposits in a moment. So do not forget, as Peter has demonstrated, we composed the total EIR position, from a number of cohorts and the cohorts are in the range from, I do not know, 5-something to 6/7-something, if you see what I mean. So a sort of weighted average of the cohort performance that comes out at 6.8%, which is an important thing to think about, I think. Did you want to add something to that?

Peter Bole: Yeah, to be honest that is the answer I would have given. In terms of historic volatility, I mentioned in the presentation we do recalibrate as we go along. I think that calibration has been very low certainly in my time in the business in the past year. So it has been virtually immaterial in terms of adjustments through recalibration.

Nick Baker (Goldman Sachs): So in the sort of tens of basis points, then?

Jayne-Anne Gadhia: Yes.

Peter Bole: Yes.

Hugh, would you like to come up and perhaps answer, talk, are you miked up – we should have a microphone, excellent. Let me introduce you to Hugh Chater. I think most of you know who Hugh who is our Commercial Director.

Hugh Chater: Good morning, everyone. So in terms of our retail deposit book and in terms of the stock on that book, we have 55% of that sitting on variable rate product at the moment, and we have actually seen, through the course of this year, a slight growth in our new business, actually, from that percentage. So it is a slightly higher percentage on term, but that still gives us a very substantial part of the book to, as Jayne-Anne has talked about, to look at moving rates on that while retaining a very competitive rate for those customers.

Nick Baker (Goldman Sachs): Sure. And then just a follow-up on that. If I work out from disclosures, it looks like the average cost of deposits is about 106 basis points. So a touch above the cost of funds. What is the most expensive chunk within your deposit base then?

Hugh Chater: What is the what? Sorry.

Nick Baker (Goldman Sachs): The most expensive component within the blend of your deposit base? Which is the bit that is dragging, or is above the 106 basis points, so that one that you would look at to reprice first?

Hugh Chater: Yeah. I mean, obviously term is priced higher than variable, of course. We have a substantial book within the variable base of savings sitting on a defined access product. That is one of the areas that we will be looking at in terms of opportunity going forward.

Nick Baker (Goldman Sachs): Thank you.

Shailesh Raikundia (Panmure Gordon): Hi. Shailesh from Panmure Gordon. I just have a couple of questions. I was interested in the comments you mentioned that sort of total income the card EIR accruals as a percentage of your total income would reduce going

forward. What is the implication? Is it that the implication that you are trying to reduce your total zero % balance transfer as a percentage of your total book? So I was just wondering what the reason behind that is.

Secondly, just a follow-up on the 2018 NIM guidance. Well, you have not given guidance, but just as you launch the digital bank, we assume that there will be a significant increase in your current account, basic current accounts. That should have a positive impact on your NIM going forward. I was just wondering whether you could elaborate a bit more on that.

Jayne-Anne Gadhia: Yes. So we are not giving any numbers out on the digital bank yet, because we want to do all of that on the market day in November, which I hope you will all come to. But directionally Shailesh that is correct. That is how we are thinking about it for sure. Peter, would you like to answer the EIR question?

Jayne-Anne Gadhia: Do you want to stand up so the cameras can see you?

Peter Bole: Yeah, the point about the proportion of income from EIR accrual diminishing is not to do with a mix change or a reduction of balance transfer, but it is simply the seasoning. There was a chart on the bottom right on the first EIR chart that I called out that just showed the profile. There was a sort of period where the effect of interest rate is higher than the cash yield, and a period where it was lower than the cash yield. It gets to the same answer after seven years. Just because of the weight of the portfolio, it is still relatively early. If the effective interest rate is higher than the cash yield which drives up the portion of the accrual. As the book seasons and the rate of growth moderates to a more consistent level of growth, it is just the arithmetic switches, and that results in the effect of the accrual diminishing.

Shailesh Raikundia (Panmure Gordon): Very clear, thanks.

Jayne-Anne Gadhia: Thanks. David

David Moore (Credit Suisse): Good morning it's David Moore from Credit Suisse. I have one question on the credit card, and one question probably on the leverage. Just to start with the credit cards, so I guess the first thing is how are you thinking about growth in 2018? You are going to be at £3 billion in 2017, but how should we think about the growth profile beyond that? Are you still thinking about 10% of your book being in credit cards would that be in 2018?

Secondly, on, I think it was a comment was made probably at the Q1 full-year results that this is going to be the year where you are going to start seeing material cohorts of customers, credit card customers, coming off their balance transfer periods. I think in terms of what you have been observing so far, could you perhaps give us a bit of comment about whether the redemptions are in line with what your expectations were? I am conscious of the fact that probably the credit card market in 2002 was probably not quite the same as it was in 2017, so is their behaviour any different from what your data might have told you historically?

Jayne-Anne Gadhia: Once we get to the £3 billion worth of credit cards, the way in which you should think about it is exactly right. The credit card exposure is about 8% of our total assets. We would expect that to be certainly contained, and it may very well be that mortgages will go faster than the credit card book, but you would not expect it to accelerate beyond that share of balance sheet; I think that is important.

The second thing is that, certainly as yet we have seen no change in behaviour, I get a note from Hugh every Saturday morning actually about the credit card behaviour in our credit card book, in many ways, and it is absolutely rock solid. I think we should make sure that you all understand that point, too, because despite the fact that, I know we all expect different behaviours from different generations or different digital access, we do not actually see any change in behaviour at this point in time at all, and I think that stability is really important. Did I miss part of your question? You had another one David?

David Moore (Credit Suisse): Just a question on your leverage ratio. It is 3.9% now. As you look out at the next one or two years, where do you expect, what is in your plan for it? Do you expect it to remain below 4%, or you would expect it to trend down towards the 3.6% minimum debt?

Jayne-Anne Gadhia: We have given the minimum that we would be happy with, and we will manage it optimally between where it is today and the minimum. It will not necessarily be below 4%, but we will guide for the properly next time around. Perhaps I should just reinforce that by saying, we do not expect it to deteriorate.

David Moore (Credit Suisse): Ok thank you. On a slightly related point, you have talked about laying the ground for more wholesale funding, for example, from RMBS. What would that leave your loan-to-deposit ratios running at for the next two to three years? What is the rationale behind that, if you will?

Jayne-Anne Gadhia: We have said that loan-to-deposit ratio won't breach 120%, and we have not changed that guidance at any point, given the availability of TFS. Once TFS is not available, unless it is replaced – which I do not expect it will be – by any sovereign position, we would expect it to get tighter, less than 120%. Hello Andy.

Andrew Coombs (Citi): Could I just ask one question in three parts. On capital, I will start with the mortgage risk weights. You have gone from 16% to 17% half and half, and you mentioned you expect it to stabilise around 20%. Should we assume a similar trajectory, i.e., you reach 20% by the second half of 2018 and stabilise thereafter?

The second question is on the capex spend. £20.5 million from the digital bank, you are going to launch end 2018. Presumably, that capex spend then drops abruptly thereafter?

And thirdly, given the aforementioned points, does that mean you think your Core Tier 1 ratio is going to trough in the second half of 2018 before gradually recovering thereafter?

Jayne-Anne Gadhia: Marian, do you want to come and talk about risk weights would that be sensible? Would that be sensible? Do come up and have a chat about it, because we have both had a go. We would definitely, to reinforce the point, Andy, I know that you said that you feel that our capital ratios have reduced. They sort of have, in an exactly planned manner, if you see what I mean. They are exactly where we expected them to be, exactly where we guided them to be. I think that we would not be using shareholders' money efficiently if we felt that we were not going to get the 12%, and so you should assume that we are going to get towards 12%. We are a very low-risk bank. I think we have tried to make that point. The big banks are talking about holding a 13% CET1 ratio. For all sorts of reasons that I am delighted with, we are not Barclay's, we are not Lloyds, we are not RBS, we are not

HSBC, and I think for a bank like us to hold 1% less CET1 than they do makes eminent sense. To be clear, it is very, very materially above our minimum regulatory capital requirements.

And all of those should give our shareholders are confident that we are managing efficiently, our shareholders are also confident, our Board is confident, that we have plenty of capital to manage risk. I can assure you that we take that with utmost seriousness. But You should expect it to go down to 12%; we said that in 2014, and we have tried to do everything that we said that we would do since then, so yes, I think, is what I am trying to say.

Marian, why do you not talk a little bit about this? I am sure most of you know Marian Martin, who used to be Marian Watson, our Risk Director.

Marian Martin: Just a little bit on the risk weights; some of this you will know already. Cards are on a standardised approach for us, so that is extremely predictable; at pillar 1, a 75% risk weighting. Our mortgage models are models that we inherited from Northern Rock, so they were built on a big old dataset from the Northern Rock portfolios of old. Over the last several years, we have worked to refine and optimise those models, to make sure they are a better fit for the portfolio that we are writing today: a really high-quality credit portfolio. But the style of our model means that, that they are through the cycle, they are not highly volatile, and they tend to give us a risk weight which looks high compared to our arrears performance, so if I benchmark where our arrears emergence looks compared to the industry, it is very low. If I benchmark where our risk weight is, compared to the rest of the industry, it looks high, and that is why we are really confident that as the shape of the portfolio changes and possibly the macroeconomic environment changes, and to the extent that there is any regulatory pressure in the way that we model mortgage risk weight, we have got capacity within our modelling approaches to accommodate that. I would expect, during 2017, our mortgage risk weights to be stable from where they are today, and I do not think we are forecasting 2018; so I will leave it at that.

Jayne-Anne Gadhia: Then to your specific point, Andy, around the build of the digital bank, you are right; the capex will be invested by the end of 2018. Think we have time for one more question. Guy? Sorry Chris we might fit you in at the end as well.

Guy Stebbings (Exane): Thank you. Hopefully two relatively quick ones. Thanks for the updated guidance on IFRS-9, the less than £50 million as of the 1H 2017 balance sheet. Are you able to give any colour in terms of how we should think about that, maybe a year in advance, a year and a half in advance, the ongoing impact once the book, one gets larger, and two seasons a bit more? And does that shape any of your thinking around the credit card book, which, it sounds like you do not want to grow it proportionally from here, and perhaps because IFRS-9 is the largest contributor to that increase, that might be the reason?

Jayne-Anne Gadhia: It is not the reason. Part of the reason we have given in the guidance that we have today is that there are some people in this room who have a much, much, much bigger number, and we just wanted to make sure that we banded that sensibly. The IFRS-9 outcome, in our hands, as modelled, continues to demonstrate the quality of the book, and it is the quality of the book that drives where we come out on IFRS-9, not IFRS-9 that is driving us to any changes, if you see what I mean. Peter would you like to add to that?

Peter Bole: The only thing I would just say is that, it is a bit of a truism. Ultimately, IFRS-9 does not change the amount of losses which we experience in the portfolio, so any differential

in terms of what we see in the income statement through IFRS-9 compared to IAS 39 is really just a function of growth, and growth rates. And so to some extent, I am hedging my bets here, it depends on the growth rate in the book in any given year going forwards. That will determine the differential that you might see, but at the moment, Jayne-Anne's highlighted, how we are reviewing it, the quality of the portfolio, it is less than the £50 million that we had in our capital plans. We actually feel pretty sanguine about the influence it will have.

Guy Stebbings (Exane): Can I just very quickly ask, on other operating income, once adjusted, it continues to lag NI in terms of growth rate. I know you have talked about the new partnership with Virgin, other insurance partnerships. Can you give any more concrete detail in terms of how you are going to start to grow in line with NI?

Jayne-Anne Gadhia: I think I have said all I can say at this point in time. It continues to be the one area of the business that we have taken time to really develop, and we will keep on focusing on that, bringing in this new experience of the whole team, not just one person from TD Direct is very encouraging from a savings and investment point of view. The life insurance partnership with Budget is very encouraging. It is not huge yet, but it surpassed our budgeted expectations, and the Virgin Atlantic partnership, as you rightly say, could transform that going forward. Chris last question to you then. I'm braced.

Chris Cant (Autonomous): It's just a quick one. Thank you for the disclosure on the credit card accruals. I just wanted to check the accrual in the period, the percentage of card income, was higher than maybe I had anticipated. I just wanted to confirm, was there any decline in the cash yield on cards contributing to the higher accrual component during the period, or is it purely just a mix thing where you are getting to the peak of balance transfer cards in the book?

Peter Bole: Yes, it is the latter.

Chris Cant (Autonomous): Okay, I thought so, yes, but I just wanted to confirm. Thank you.

Jayne-Anne Gadhia: Thank you all so much for coming today. It was great to see you again. Look forward to seeing you next time. Thanks very much.

[END OF TRANSCRIPT]