



Virgin Money Full-Year Results 2017

Tuesday, 27th February 2018

2017 Highlights

Jayne-Anne Gadhia

CEO, Virgin Money UK

Welcome

Morning everyone, really good to see you all here today. I was just saying that the gender equality in the room is not yet up to scratch but I hope you will agree that everything else is around our results, so thanks very much for coming to The Stock Exchange today again to hear our annual results presentation.

FY17 Financial Performance

You have had time this morning to read our results and I hope you would agree, we have had another very successful year at Virgin Money and we are looking forward to continued very strong performance. One of the things that we are really proud of is that we have delivered a return on tangible equity of 14%. A number of years ago when I stood at a lectern like this and we had just listed the business we talked about mid-teens ROEs by the end of 2017. A number of you managed to persuade us to say what we meant by that. We meant 14% and we are delighted to have been spot on in delivering that.

That has flowed through to our statutory earnings per share. That is up 29% year on year to 37.8p and our statutory profit after tax of £192.1m is up too, 37% on last year. We are also pleased with a very strong CET1 position at 13.8% as of the year-end. The strength of the capital position and the progress of our business and our outlook for the future mean that the Board are very pleased to recommend an ongoing progressive dividend. That means a final dividend per share of 4.1p and that takes the total dividend for the year up to 6p per share, which is 18% up on where we were last year. We continue in our outlook to expect a continuing progressive dividend.

One of the things that Peter and I thought that we should really bring out during the course of this year is the position of our TNAV. The growth of that has been particularly strong, certainly since we listed and since we bought Northern Rock. We ended the year with a TNAV per share of £2.97 which is 9% up on last year.

Macroeconomic and Regulatory Environment

UK Economy remains resilient

We are delighted with the results, really strong year 2017 and we are pleased to have achieved the results in a UK economy which continues in our experience to remain very resilient. GDP continues its upward trend, as we all know, and interest rates remain low with rates expected to rise only slowly. For us, we are confident that that will repay the strong focus that we have always had on responsible lending and customer affordability. We have always said that unemployment is a key factor in the development of our book and our business. Of course, during the course of the year it reached a 40-year low and the outlook for employment continues to be positive. That supports the strong economy and the resilient consumer. All indices, even the reporting from UK finances as recently as yesterday, show a positive outlook for how consumers are thinking about their finances in the 12 months ahead and that is really encouraging for us.

House prices continue to grow steadily. I am someone who lives in Edinburgh and I see today that Edinburgh house prices in particular are set for a rise. As a national lender we are not over-exposed to any specific region of the country. We maintain really good quality lending in London and that is the region that generates our lowest LTV new business. Just to remind you, we offer loans over £1m only by exception and with full manual underwriting; a very strong position in the housing market. Meanwhile re-mortgage transactions grew by 11% across the market because of course consumers are looking to lock themselves into low interest rates.

The UK continues to experience more demand than supply in housing although I see the Persimmon results this morning show that more supply is coming into the market. That is good for mortgages too I think. In our view that supports a very stable mortgage market although one which is of course experiencing more competition, and we will talk about that a little later, as more lenders, including the UK ring-fence banks, compete for a share of a largely flat market.

Beyond ring-fencing we think that the new developments of open banking, in particular PSD2 and GDPR will lead to a fundamental shift in the way that customers manage their money. We will talk a bit about our digital bank later but with our brand and the digital bank development we think we are very well placed to benefit from changes in customer behaviours and confidently expect to be a net beneficiary of open banking that is giving increasing customer choice and mobility.

Mortgages

Innovation and flexibility enables us to manage for value in a competitive market

Looking at some of the results in a bit more detail, much of our success in 2017 was delivered through our mortgage business which grew by 13% during the year. Our ongoing success in the residential mortgage sector meant that we took 3.3% share of gross lending for the year and an 8.9% share of net lending. Across the mortgage portfolio growth came in all of our major product segments. We were really pleased to have made significant progress both with first-time buyers and new build. In new build we actually increased volumes by 50% during the year.

Our buy-to-let business remained particularly strong and it was 18% of our mortgage business written during the year. A number of people have asked whether or not the structural changes in the buy-to-let market would affect us. They have actually made little difference at all to us achieving our targets in the private landlord sector, which is where we focus for all of our buy-to-let development. However, there remains a significant opportunity for us to broaden out our buy-to-let offering to portfolio landlords. To be clear we are planning to do that during the course of the year ahead.

We are also pleased to have broadened our distribution capability this year. We still are a predominantly intermediary-driven business but we had thought a couple of years ago that it would be important to strengthen our direct channels in anticipation of competition in the intermediary channel. Although 91% of our business in 2017 did indeed come from intermediaries we were pleased to see applications of over £1bn of new business coming to us online and through our call centres. Of course that is important because it positions us very

well to be able to manage pricing and volume outside the intermediary channel and still compete for margin, volume and success.

We were also really successful in developing longer-lasting relationships with customers. Retention is a very key factor that we focus on in Virgin Money and 72% of people whose mortgage came up for renewal in the year decided to stay with us. That is up 4pp since 2016.

What about margins then? I will give you a bit of an overview now and we will talk specifically about our view for VM margins when we come to the outlook section at the end. Of course you will all be aware that competition in the mortgage market hotted up during the course of the year, especially in the last quarter. As a result our mortgage completion spreads were 168bps for the year. That is down 19bps on 2016 but we were able to offset that reduction through a matching improvement in our cost of funds. That of course is very important for us.

Our nimble approach to product and pricing is the real key to making sure that we can participate in the most profitable segments of the mortgage market. That is the dexterity that is going to help us to manage the current competitive environment. In other words, the quality of our mortgage franchise remains very strong. Affordability is high and I find this an extraordinary and very delightful statistic; we have had only 12 repossessions in 2017 compared to 36 in 2016. I guess that is because we continue as always to focus on low-risk and low-LTV business. Just to reinforce some of our statistics which remain very stable, the average LTV of our mortgage book is 56% and our cost of risk is only 1bp. That is definitely a consequence of the strength of our underwriting, not just the benign economic environment. We focus on that very hard.

Credit Cards

Prudent growth, with continued commitment to quality and exciting future opportunities

We focus on credit quality and underwriting too in the credit cards business. Credit quality has remained exceptionally strong there. That is a result of our continued focus on affordability and credit risk management. I think Chris Taylor is here in the room today and happy to talk with any of you around the performance and behaviours of our book. 92% of our cards book classes as medium or low credit risk and that is compared to 81% for the industry as a whole. Our arrears emergence is entirely in line with our forecasts.

The book grew to £3bn of outstandings, exactly as we had planned, as at the end of the year. However, we believe that the rate of growth in the unsecured lending market has probably now reached its peak. Last year the market was very competitive but in recent weeks, as I am sure you will have seen, interest-free periods on balance transfer cards have reduced materially. It is our expectation that profitability in the credit card market will be increasingly driven by retail spend from existing customers. It is in this context that we were delighted to see an increase in our retail spend last year, which was up 8% per card year on year.

We will talk a little bit more later about the growth in 2018 of our Virgin Atlantic partnership. That will of course develop the retail spend on our credit card book because by the very nature of a frequent flyer card this will drive increasing retail spend. That programme with Virgin Atlantic is on track to begin product delivery later this half year.

Savings

A strong franchise, ready to diversify into new customer segments

The growth in our retail savings portfolio was a particular success during the year. We grew the book by 10%, well-ahead of the market, to almost £31bn despite managing a reduction in our total cost of funds, which fell from 80bps to 59bps during the course of the year. We are especially successful in the cash ISA business where 27% growth showed the real appeal of our product range. A further consequence of our success in ISAs where people tend to bring higher balances to us was an increase in average customer balances across the savings portfolio and that average balance rose to £24,000 this year from £22,000 the year before. It also meant that we increased average savings product holdings per customer up to 1.3 savings products per savings customer. Again, retention is a theme for us in our results this year and savings retention was also very strong. 89% of fixed rate savings customers stayed with us after their initial term ended.

However, over and above retail deposits it remains our intention to diversify further our funding sources in both the wholesale and retail markets. In January we started with the planned launch of our SME deposit business which is, six weeks in, starting to gather pace. We still expect to acquire around £0.5bn worth of SME deposits by the end of the year and £5bn in five years' time. We continue to expect our digital bank to provide a high volume of low-cost retail deposits in future years.

We also drew additional funding from the TFS during the course of the year and Peter will talk more about that. However, the high-level message is that we used most of it to repay FLS in order to manage our refinancing profiles. The withdrawal of TFS is of course priced into our future outlook and our refinancing plans over the next four years are conservative.

Finally, during 2017 we were pleased to get regulatory approval to issue our first covered bonds. You will see that in the market soon. This, along with our first planned MREL issuance in the months ahead, will extend our wholesale footprint albeit of course we will remain within our planned loan-to-deposit ratio of 120%.

Financial Services

An increasing contributor to returns

A further contributor to our returns, both now and increasingly in the future, is the growth of our non-interest income businesses. During the year we were particularly pleased with our travel insurance business. We wrote less volume than in 2017 but we still sold 250,000 travel insurance policies. By managing the volume/value trade-off we were able to increase our average travel premium by 11% year on year. We can expect to do more of that in the year ahead. Our new life insurance product has also got off the ground well and new business volumes are exceeding expectations.

However, it is our investment and pensions business that has performed really well during the course of the year with total funds under management now reaching £3.7bn. That is not just to do with the FTSE. The combination of our new specialised leadership team and the enduring appeal of what are very straightforward products with our leading consumer brand, has produced the best year for new funds invested since the year 2000. That is up 27% year on year.

The business also generated its highest ever level of transfers into our stocks and shares ISA. That was up 160% on 2016 and new equity ISA sales increased 40% year on year. I am sure you will agree that such strong results, it is really the first year that we have seen such material positive movement on this business line. These results demonstrate the very significant opportunity that we have to develop our investment and pensions business further. To be clear, we are focused on doing this during the course of this year.

Exciting Strategic Options for the Future

A clear, value-creative plan, funded from our own resources

Meanwhile, and as I said earlier, our key strategic programmes remain on track. I updated the market in November on where we are going with those strategic programmes so I am not going to give you too much more detail today but here goes. In SME, as I said, we launched our initial deposit product in January. It is very early days but it is working well and we continue to plan and expect to offer a business current account to SMEs by the end of the year. Our SME team is also preparing the business case that we need to apply for monies from the RBS Alternative Remedies package and that will enable us to build a material SME business which will disrupt the market and compete strongly.

I see that Sky News was reporting this morning that Lord Cromwell has been appointed as Chair to take that particular programme forward. We would expect to see further engagement coming through quite quickly assuming that that appointment is confirmed. We have got the brand, the relationships and the capability to transform the SME market we think, particularly given some of the bad press that banks have had on this under-served market recently. We really look forward to participating strongly in the RBS process to come.

I mentioned earlier our partnership with Virgin Atlantic is also developing very strongly. Initial products will be launched in the first half of this year and then further additions will come on stream on a regular basis. I am sure that you know that the success of the Virgin Atlantic Flying Club programme is very well-established. It has been going for many years and it has very sticky, loyal customers. During 2017 we also had very significant success in providing savings and investment products to Virgin Atlantic customers. Frequent flyers are the perfect target group for our customers and of course the brand affinity between Virgin Atlantic and Virgin Money makes this customer group especially attractive for us.

In the meantime, progress on the digital bank is continuing apace. Development and testing is ongoing and we continue to expect to launch an initial beta before the end of the year, with full roll-out planned in 2019. I dropped Antony Jenkins a note this morning to tell him that I was speaking today. He had seen our results and he dropped me a note to confirm that 10x are also right on track. The development is constructed as three layers in our digital bank. The first is the unique Virgin-branded customer experience which we fully specified in-house. Second layer is the all-important data layer which enables us to gain a deep understanding of our customers and to offer them the products they want and need at the right time for them.

Now we believe it is this data segment which will provide us with real competitive advantage over the major banks because they need to transform their legacy systems to match this very agile approach. Whereas we of course are building from scratch a brand new data science capability. Michele is here and able to talk to you about data and data science as much as you like. We are very excited about that.

The final level is the banking technology layer which enables us not only to process banking transactions but will also enable us to produce regulatory reporting and similar requirements, which as you will know can be a big overhead for a bank, all at the touch of a button. This approach will drive efficient customer and business processes well beyond anything that we have been able to achieve today. I think that will both improve the customer experience and achieve importantly a materially lower cost:income ratio when compared with today.

In the end of course the final piece of our digital bank will be the ultimate transfer of our existing business onto the new low-cost digital systems. A number of people have said it is the first time that we have explicitly said that. It has always been our intention to migrate from our old systems to new digital systems. The question is, when? At this point we are saying that is the medium-to-long term because of course we have still got a lot of build to do. Nevertheless please do not forget that that migration will completely transform our operational cost base in the years to come.

This is a big deal for us then and many people ask me of course how confident I am in the delivery of such a transformational vision. What I would say today is notwithstanding the innovation that we are seeking to deliver and the complexity of the programme that Michele is leading I am really pleased with where we are at. Code has been put into the live environment on time and is as planned. It is currently being tested. So far so good.

Strengthening Customer Franchise

Progress on both qualitative and quantitative customer metrics

In summary, from me at the moment, 2017 has been another strong year for Virgin Money with all of our quantifiable targets either meeting or exceeding plan. Qualitatively too we have had a really strong year. Our constant focus on customer service and satisfaction has really come through and we have seen our overall net promoter score increase from +29 in 2016 to +40 and that is very close to market-leading and is a real measure of customer advocacy for our brand. Large customers and credit card holders rated us especially strongly and intermediary results were way up there too, continuing on an upward trend.

Of course it is the NPS performance that feeds directly into our retention successes and those go obviously straight to the bottom line. However, as well as increasing retention in 2017 we are also pleased to have grown the proportion of new products that we have sold to existing customers. That has increased from 10.7% in 2016 to 12.2% this year.

We also increased our total number of customers overall. We now have 3,340,000 core Virgin Money customers and an additional 1.4m registered users on the Virgin Money Giving platform. These are people that continue to be fans of the Virgin Money brand and I think provide the heart of both a successful customer franchise today and a sizeable and powerful base from which to grow for the future, both as we are now and once we are digitally-enabled through the launch of the digital bank.

I am going to come back and talk more about the future in a moment. Now it is time for Peter to come and talk to you about the detail of the financial results for the year that we are very proud of.

2017 Financial Results

Peter Bole

CFO, Virgin Money

P&L – Further Growth in Profitability

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

Good morning everyone. As you have heard, the business produced strong financial performance in 2017. I will now step through that performance in a little more detail. Starting with the income statement, net interest income grew by 15%. This was driven by the lending growth Jayne-Anne has mentioned, in effect the strength and reach of the franchise. Banking net interest margin was stable in the second-half versus the first-half at 172bps. This compared to 175bps in 2016. Other income grew by 5% reflecting the performance of the investment and pensions business.

Set against total income growth of 13% cost growth was limited to just 4%. This resulted in a cost:income ratio of 52.3%, an improvement of close to 5pp. Our focus on asset quality was evident in the cost of risk which remained at 13bps, a level at which it has been stable each half since the second half of 2016. This stability has been achieved despite the growth in our credit card book and reflects the improving arrears performance. As a result of the combination of income growth together with continuing operational leverage and controlled cost of risk, underlying profit grew by 28% to £273.3m. Underlying earnings per share improved by 7.1p to 39.8p with return on tangible equity growing by just over 1.5pp to 14%.

Banking Net Interest Margin

Lower funding costs offset reduction in asset pricing

I will now step through the drivers of this performance in a bit more detail, starting with banking NIM. You might recall we introduced this metric at the half year. We think it is more helpful at explaining what is happening in core profitability. As I have said, we have seen stability in banking NIM in 2017 with the second half in line with the first half of 172bps. During the course of the second half we saw a repeat of the same pattern we had seen in the first half. A continued improvement in retail funding costs which drove an 8bps improvement in banking NIM. Wholesale funding cost drove a further 4bps improvement. The lower funding cost offset a 12bps reduction in NIM from reduced asset spreads. The net result was stable banking NIM across 2017 at 172bps. For completeness total NIM for the year was 157bps in line with guidance.

In cards we have spoken at length about the influence of EIR accounting on our income profile. We have continued to closely monitor the cards portfolio in the second half and to ensure customer behaviour is fully reflected in the EIR calculation. You may also recall at the half year that we indicated the influence of the cards EIR accrual on our income would peak in 2017. As the bottom chart highlights the peak actually happened in the first half at £42m, with the contribution in the second half reducing to £36m.

Continued Improvement in Operating Leverage

Efficiency improvement reinvested in core business and digital future

Moving on to operational leverage, investment in the business drove continued operational efficiency and we enjoyed further benefits of scale on fixed overheads. This operational

efficiency benefitted from the sustained level of investment in our existing platform. For example, we have seen a 21% increase in the number of retained mortgages processed per FTE. Coincidentally new savings accounts opened per FTE also increased by 21%.

Total costs remain tightly-controlled and just £12.5m ahead of 2016 at £348.5m. The increase from 2016 was predominantly due to growth in the depreciation charge reflecting the ongoing investments in the business. That tight cost control in turn fed into continued strong JAWS with income growth of 13% set against the cost growth of 4%. In the final quarter of 2017 we reached our long-held target of exiting the year with a cost:income ratio of 50% or less and a Quarter 4 ratio of 49.4%.

An investment in business-as-usual across revenue and capital expenditure is consistent with last year at £52.8m. This continues to underline our commitment to investing in improved business processes in the core bank today and in the future. Additionally we invested £40m in our digital bank of which £38.3m was capitalised as an intangible asset. As we said at our Strategy Day in November, you should expect a similar quantum of investment in 2018.

Strong Asset Quality

Straightforward, high quality lending portfolio

I will now move on from operating leverage to asset quality. In summary there was no shift in the risk profile. Arrears continue to show no sign of deterioration and as a result we maintained a low cost of risk. We have used this slide before to set out the shape of our book and as you can see we continue to operate a straightforward, high-quality lending portfolio. With secured mortgages representing 92% of balances and prime credit cards making up the remaining 8%. We expect our lending to remain in broadly 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. The average loan-to-value ratio is broadly unchanged at 56% and 54%. The LTV of new mortgage lending was also consistent with prior years at 68.1% compared to 68% spot in 2016.

Strong and Improving Credit Metrics for Mortgages and Cards

Low risk and improving arrears

To reiterate, we are a prime lender in UK mortgages. We have a clear and consistently-applied risk appetite and we only write business of a high quality that would allow us to achieve our return goals through the cycle. The result is that when you look at the arrears levels we see a steady and improving trend both at a vintage level. You can see in the top-left chart with each vintage that comes onto the book they improve with each cohort that comes on. Also when set against the growth in total mortgage book in the top-right chart.

It is a very similar story in credit cards where the strict application of our risk appetite drives high asset quality. Argus data confirms that 98% of Virgin Money balance transfer cards were originated in the lowest risk segments. For the same product the industry overall originated only 74% in the same low-risk segments. This is reflected in our low arrears profile. If we look at loss performance lagged by 12 months to allow for the lack of seasoning in the book the Argus data shows that our annualised asset charge-off rate is clearly lower than the broader industry. This reflects the point we have been making for some time now, that we

have exercised underwriting discipline at a time when the market continued to loosen standards.

Credit Performance Reflects High-Quality Assets

Low impairments and low cost of risk with strong provision coverage ratios

The result of this arrears performance was stability in the cost of risk. The mortgage cost of risk was flat at 1bp and in cards the total cost of risk fell by 19bps to 151bps, reflecting the quality of the book as well as the influence of the less-seasoned newer lending. Performance of new cohorts of cards remains strong with all cohorts showing a cost of risk lower than or in line with previous vintages. The quality of asset portfolios and low arrears is reflected in the total impairment charge.

In mortgages the impairment charge fell marginally to just £2.2m while in cards it increased by 21%, marginally less than the 24% growth in balances. In total the impairment charge of £44.2m resulted in a Group cost of risk of 13bps. Lastly, provisions as a percentage of balances in arrears increased to 32.9% from 29.4% in 2016 as we retained appropriate coverage of balances at risk of loss.

Statutory Profit Before Tax

Underlying profit increasingly flows through to strong statutory profit growth

This strong underlying performance is reflected in our statutory profit before tax for the year. Strategic items of £6.5m relate to our digital bank development with the vast majority of that charge following in the first half of the year. IPO share based payments are now less than £1m and fair value adjustments in relation to hedging items were just £3.3m in the year. Allowing for the bank tax surcharge our effective tax rate was 26.8% reflecting a charge for the year of £17.5m. Our statutory profit after tax increased by 37% to £192.1m. Allowing for coupon payments to the holders of AT1 securities the profit attributable to shareholders increased by 29% to £167.3m.

Balance Sheet Progress

Further diversification of funding options

We talked about the drivers of performance. Let me now turn to the balance sheet. The strong lending activity in the year has resulted in 14% growth in loans and advances to customers to £36.7bn. Our on balance sheet liquid asset portfolio grew by 123% to £3.3bn from £1.5bn a year earlier. This was partly a reflection of the repayment of £650m of FLS that had provided off balance sheet liquidity.

Moving to the other side of the balance sheet asset growth was supported by the strength of the retail deposit franchise which saw savings balances increasing by 10% to £30.8bn. Wholesale funding increased to £8.1bn. The largest element of that increase came from the term funding scheme where we had drawings at December 2017 of £4.2bn compared to £1.3bn a year earlier. We also made good progress on our wholesale funding programme with a well-subscribed £750m RMBS issue from our established Gosforth programme. This offering further diversified our investor base with strong demand from the US.

The result of this balance sheet progression was an increase in our loan-to-deposit ratio to 119.1%. Since the year end, we have extended our TFS drawings to reach a total of £6.4bn. In addition to the £5.5-6bn we had previously guided to we have taken advantage of our TFS

borrowing capacity to accelerate the final repayments of FLS and replace them entirely with TFS. This has the added benefit of extending the maturity of our overall drawings. As Jayne-Anne has highlighted we will repay this funding in an orderly fashion well in advance of the contractual maturity dates. With that in mind we have made significant progress in our funding options in 2017 and continue to do so in the first couple of months of 2018.

On the retail side we have spoken about the strength of the existing franchise. Our developments in SME and the digital bank are targeted at improving that franchise further. We also received the regulatory approval for our covered bond programme and a second investment-grade credit rating from Moody's for Virgin Money Plc during the year. We are currently in the process of updating our existing MTN programme to support planned issuance of MREL compliant debt starting in 2018. As a consequence of this activity when we look forward we expect to see the loan-to-deposit ratio reducing gradually so that it comes back down below 115% over the next three-to-four years.

Capital Position Supports Continued Business Development

Retained earnings create capacity for growth, investment and distributions

If I move on from the balance sheet structure our capital position in 2017 benefitted from the strong profitability. Retained earnings of £167m, equivalent to a 14% increase in our opening equity capital resources, demonstrated strong organic capital generation. This has been deployed to invest in the business, to pay dividends and to support lending. The £38m we invested in the digital bank was deducted from capital resources as were our dividends of £27m.

Lending growth resulted in risk-weighted assets growing by 19.3% to £9.2bn. If I break that down cards risk weights, which were on a standardised basis, grew by £436m in line with balance growth. Within mortgages there were two main moving parts. Firstly, the net increase in mortgage lending accounted for an increase in risk weights of £1,180m. Consistent with previous periods this increase reflected a degree of risk weight inflation with new lending having above-average loan-to-value. It came onto the balance sheet with an average risk weight of over 20% whereas balances repaid in the year typically carried a lower LTV and as a result had an average risk weight below 15%. The consequence was a slight uptick in portfolio risk weight density across the year.

Secondly, the improving asset quality within the portfolio came through and that, along with model changes, resulted in a reduction in risk weights of £154m. The movement in other risk weights reflected a formulaic increase for operational risk in line with the standardised approach. This is partially offset by small movements elsewhere in the balance sheet. Taking all of this together the growth in retained earnings combined with the movement in risk weights resulted in a CET1 ratio at year end flat to the first half of 13.8%. The leverage ratio was 3.9% and this growth in equity resources represents around 9% increase in the tangible net asset value per share to £2.97.

Now I mentioned in passing the programme of model improvement work. This is an area of significant focus within the business. When we benchmark the output from our advance mortgage models we consistently demonstrate the conservatism of our risk quantification. This in part reflects the through-the-cycle nature of our modelling but it is also a function of the way in which our models are calibrated and in particular the legacy of the Northern Rock

data sets. As we continue to enhance and improve our models and those related data sets we see the potential to reduce the risk weight density across the portfolio. This is not baked into our guidance at this point and clearly a material improvement would require regulatory approval. However, it does reinforce the strength of the capital position.

CET1 Capital Headroom

Well placed for the transition to IFRS 9 accounting requirements

When we look at that position at the end of December the 13.8% CET1 ratio provided significant headroom to our 8.95% CET1 regulatory requirement. At 31st December 2017 this requirement was Pillar 1 of 4.5%, 3.2% for the CET1 element of our Pillar 2A add-on and a capital conservation buffer of 1.25%. Given the nature of the balance sheet at 31st December the Basel I floor was our biting constraint for Pillar 2A and drove an increase in our required CET1 when compared to our individual guidance.

As we look forward there are various moving parts. With the Basel I floor falling away from 1st January the CET1 requirement for the Pillar 2A add-on falls to 2.2%. CRD4 buffers will gradually increase with the capital conservation buffer rising to 2.5%. The Bank of England has advised that the counter-cyclical buffer will rise to 1% by the end of this year. Our end-state requirements assuming stable Pillar 2A guidance look more like 10.2%.

We are well-placed for the transition to the new accounting requirements of IFRS 9. We estimate the transition will reduce the Group's CET1 ratio by approximately 1bp from 1st January, taking transitional relief into account. Excluding the transitional relief the reduction in the CET1 ratio would be approximately 36bps. These impacts remain within expectation and are reflected in the Group's capital plans. As a consequence, our expected out-turn for CET1 at the end of 2018 of around 13% ensures we maintain significant headroom against regulatory requirements and provides capacity should those requirements change. Our current plans also suggest 2018 will be the low point for our capital before retained earnings more than outstrip the effect of investment and growth.

Doing what we said we would do

To conclude, 2017 represented a further year of significant financial progress for Virgin Money. The high-quality lending growth, combined with further operational leverage, has driven improved returns on tangible equity, at 14%, earnings per share are 29% higher at 37.8p and tangible net asset value, up 9% at £2.97. This has been achieved with no degradation of asset quality, further diversification of the funding base and with continued focus on the strength of the capital base and capital ratios.

Looking Ahead

Jayne-Anne Gadhia
CEO, Virgin Money

Delivering on Financial Targets

I hope you agree that our 2017 results were gorgeous. I think they represent really strong foundations for continued success for Virgin Money.

Over the course of the last few years, we have delivered on our financial targets despite unexpected changes in the external environment such as the bank tax surcharge, which Peter referred to earlier, and the exceptionally slow rise in interest rates. The reason we have been able to do that is because we have always had a number of levers and opportunities available to us and things are no different in that respect today.

Tactically, our nimble approach to the mortgage market will enable us to optimise volumes and margins in the face of growing competition. That is because we are going to build on successful product diversification, particularly in the buy-to-let, first-time buyer and new-build segments. Also, as I mentioned earlier, we will continue to expand our direct distribution capabilities as well and we will also maintain our strong intermediary franchise through excellent customer and broker service.

We think that each of these initiatives will help us to optimise volume and margin in a more competitive market.

Opportunity to Cut Cost of Funds

We also have real and material opportunities to reduce our cost of funds again in the year ahead. We are going to be benefiting from a full year of back book deposit repricing and there is still some repricing to go. SME deposits are accelerating and at a price that is significantly cheaper than retail deposit pricing. On top of that, we have a full year's benefit to come from our TFS drawings as well as the opportunity to reduce our wholesale funding costs through the programmes that Peter has mentioned, such as the new covered bond issue, which we expect to provide funding at a favourable cost.

We will of course continue to manage costs as we have done over previous years and we are confident that we have the levers available to us to manage to a 50% cost:income ratio in a range of volume scenarios.

Reduced Risk Weight

Peter has mentioned that we also have a real and material opportunity to reduce our risk weights. Just to remind you, our models are based on the experiences of Northern Rock because we inherited those models when we bought the Bank, but now, six years on, we have sufficient standalone data to improve those models based on our own empirical experience and of course the risk in the Virgin Money mortgage book is significantly lower than the risk that the Northern Rock book represented.

We will engage the PRA on this opportunity in short order and we are hopeful of receiving their response in the course of this year.

New Growth Opportunities

In addition to these tactical levers, we continue to drive forward new growth opportunities. A successful application for funding from the RBS Alternative Remedies Package will of course accelerate our SME capabilities and we expect probably cover our costs.

Our new partnership with Virgin Atlantic is unique and it will provide us with access to new and profitable customer segments. To be clear, it was a contract that we were delighted to win.

Our experienced Investments and Pensions team have proven their ability and will continue to expand our capital-light business model in the year ahead.

Add to that the structural transformation we expect with our digital bank, which will bring, to remind you, low-cost funding, new customer groups and materially lower operating costs, and you will understand why we are excited about the opportunities ahead to grow material shareholder value over the long term, especially from the point we are starting at.

Competitive Mortgage Market

What does all of that mean for the 2018 outlook? Housing and mortgage markets are both proving resilient and house prices are certainly stable. We expect the mortgage market in 2018 to be around £260bn. A number of people who have been presenting in the last ten days or so have talked about mortgage pricing and I think that there is some consensus that there is reason to believe that mortgage pricing could have reached the bottom. The withdrawal of TFS should drive an increase in rates, especially from smaller players, and larger banks could be affected by leverage requirements on their growing mortgage portfolios. The question of course is whether this upward pressure on pricing will be offset by continuing competition in the mortgage market, especially from the ring-fenced banks with surplus liquidity to deploy.

You will have heard from all of the banks that have reported so far that the last three months have seen sustained mortgage market competition and a reduction in customer pricing and, not being isolated in that respect, from November we therefore decided to start to write lower volumes of business to protect returns and to adjust our cost base in respect of that; to adjust our cost base accordingly.

That means that when we looked at Q1 2018 we would be pleased to achieve modest growth in our mortgage volumes, albeit supported by very strong economic fundamentals. It is very clear to us from the sustained success over the last six years that our natural mortgage market share is in the range of 3-3.5% of the gross mortgage market and although Q1 is likely to be a bit lower than that, we do expect to trend back towards this level over the course of 2018.

To be really clear, even if competition continues unabated, we expect to post low single-digit percentage growth in our mortgage portfolio. We also expect our credit card book to achieve single-digit growth and that will be driven of course by our relationship with Virgin Atlantic. As we said in November, we expect a banking NIM towards the bottom of the range; 165-170bps for the year, and we are not changing that guidance, despite market competition because of some of the other levers at our disposal. This will be supported by a continuing improvement for example in our cost of funds as repricing initiatives crystallise a full year's

benefit and new products such as SME take effect and last year's investment in our new account opening platform drives higher and more efficient volumes, especially in our stores.

Meanwhile, we are seeing no deterioration at all in customer behaviour on our book and, as you know, we have consistently tightened our credit underwriting criteria on both the mortgage and cards portfolios. Our expectation therefore is that our impairment experience will amount to a cost of risk including the impact of IFRS 9 of something less than 20bps in 2018.

As I have said, the Virgin Money executive team, all sat here today, will continue as always to manage costs hard. We are planning on a cost:income ratio of no more than 50% for 2018, even if we take lower mortgage volumes into account.

Solid Returns on Equity

As a result of all of that, very importantly, I can say with confidence that we continue to see solid double-digit returns on equity for 2018. As we said in November, investment spend in the year is likely to total around £100m and that is because we are funding our strategic programmes as well as supporting normal BAU requirements.

However, despite this level of investment, our CET1 ratio will be around 13% and could be even better, especially if the RWA model improvements for our low-risk book come through in the way that Peter and I have discussed. As you have seen, that CET1 position is well ahead of our current and anticipated regulatory requirements. That enables us to anticipate a continued progressive dividend for the year ahead.

Progress since Northern Rock Deal

Before taking your questions, I just wanted to finish our update of a great year and a strong outlook by reminding you of some of the financial progress we have made since we acquired Northern Rock in 2012.

I like these charts. We have turned a loss-making bank into one delivering underlying profits of over £273m and that is a 58% CAGR since 2013. Returns progress has been equally strong, especially given the proven and sustained low-risk nature of our bank. Somebody did say to me recently there would be lots of businesses that would die for a RoTe of 14% and we are very proud of it. Growth in TNAV has also been very strong, with a CAGR of 12.7% since 2012.

As we have said, capital is strong and well ahead of regulatory requirements. Our strategic programmes are designed to enable us to extend and sustain this progress for many years to come. We have the people, we have the performance and we have the plans to compete and win in a challenging and changing market. As a result, we look forward to delivering strong performance once again in the year ahead.

Q&A

David Lock (Deutsche Bank): I have two please. First one on the model changes around the risk weights. I just want to understand this, because of course you have a rather unique model at the moment, which is where when house prices go up the risk weight goes up. So, I want to understand, is this about re-basing it lower or is this about moving to a more conventional risk weight model? I have a second one.

Jayne-Anne Gadhia: I will come back to you for your second question in a moment. I will try and say a little bit more about the risk weight position overall and then I will ask Marian to answer that question specifically. In thinking about our risk weights going forward, as I say, we have a mismatch between the Northern Rock position that we acquired if you like, which we have amended along the way, and the position of our very low risk book today. You will see if you look at a comparison of us and our major competitors and peers that actually we hold more capital against our lower-risk mortgage book in some cases, and so you would expect us to be working on the improvement of RWAs. Some people have said to us, 'Why would you do it at this time, particularly with the new Basel rules coming in? Does that make sense?' We do not expect them to be until 2022, so there is a lot of room to go, if you see what I mean, and a lot of benefit for us to get. Also, by reshaping the capital position, that frees up capital for us to invest in our SME business, which seems to us to be a very efficient thing to do. I know I am not directly answering your specific question, but I am going to ask Marian to ask the technical bit. This is Marian Martin, our Risk Director.

Marian Martin: Good morning, everyone. We have a style of model called the Variable Scalar and the PRA have issued guidance in the last year or so to say that they would like all banks to move onto a hybrid-style model. That is a little bit technical. It will change the style of modelling we do. I think the more important point though is that we have a number of components of our resisting models, which will survive into the new style of model, where our more recent performance in the mortgage portfolio will allow us to better calibrate the modelled answer to a very low-risk asset pool and that is really the benefit that we should expect to see in the short-to-medium term. What I am talking about there is behavioural scoring and some improvements to our LGD models. Ask if you need any more clarification at a high level.

David Lock: I guess just very, very high level, if house prices go down, does that mean the risk weight goes up or does it go down on the new model? Very high level.

Marian Martin: The way the Variable Scalar works is, as house prices pass their historic peak, the model component which adjusts for forecast falls in house prices to project a capital requirement, there is less headroom because it is through the previous peak. So, it is about the relationship between current house prices per region and the previous peak for each region and we should probably take more detailed questions offline because it gets a little bit more complicated.

David Lock: Thank you. I have a second one which is hopefully simpler, which is just on the deposit costs. I would be interested to hear you talk about some flow through for lower deposit costs coming through this year. When you look at the Bank of England data, it is clearly showing that new deposit costs are higher than old. I just wondered if you could give a

sense of what kind of spread or gap there is between the savings that are rolling off and those that are coming on this year.

Jayne-Anne Gadhia: Let me introduce Hugh Chater, who is our managing director of our overall business.

Hugh Chater: Good morning, everybody. I think there are two things at play here. Jayne-Anne was talking about benefits crystallising for the full year of some of the re-pricing that we did last year. In terms of what we are seeing in the new business markets, pricing in the secondary markets has actually been pretty stable through the first six-to-eight weeks of this year and actually we have seen some of our competitors start to reduce price, helpfully as swaps have gone up, so there is a compounding benefit there, if you will. I think it is probably too soon to say how the rest of the year obviously will play out, but we have been pleased with what we have seen so far on those.

Ian Gordon (Investec): Morning. Peter referenced the constant improvement in arrears performance of cards by vintage. You referenced the point we have observed in the market that terms for 0% deals have been getting shorter and shorter. In simple language, other things being equal, that seems to lead forward to stronger profitability of new origination of card product. Is it fair? Please discuss.

Secondly, two points on guidance. I just wanted to nit-pick, because notwithstanding your very strong capital position and strong liquidity, it seems like you are giving yourself quite a lot of room for outperformance in pieces of your guidance. On mortgages, you have guided to single-digit growth. I think your £260bn of gross mortgage lending seems perfectly reasonable. Your Q1 guidance given out in November, again, understood. If you get anywhere close to 3% gross share, if you retain your strong retentions performance, quite easily to outperform certainly in the mid-point of that guidance.

Thirdly, just in terms of impairments. I know, sitting here today, when post-Brexit madness was at its peak, the sell-side consensus for 2017 was 40bps. You have just done 13bps. At the November day, I was surprised to see you give the less than 20bps guidance based on an unemployment rate of 5.2%. 5.2% for 2018 does not feel very likely to me, so has your confidence around that guidance increased?

Jayne-Anne Gadhia: In terms of credit card profitability, I think the way to think about that is on a net present value basis. It is interesting, Peter, Marian and I were discussing this only last week, that we do see NPVs on credit cards certainly remaining very stable and very positive, if that helps.

On our performance, I think that the truth of the matter, Ian, on mortgages, is that at this particular point in the competitive cycle as it were, it is difficult to say. So, what we hope we have done is to lead you to a place which says, we are not going to be stupid if the market goes really mad. We are definitely going to be managing for strong returns in the way that we always have. If we can do that and achieve the volume position that you outline, then we will all be delighted, but it is difficult to call that at this particular point in time I guess, so we try to cut a sort of middle way.

As far as impairments are concerned, you are right to point out that they continue to be very strong and for us there are no surprises there, because we know that we have aimed to write

such good quality business right the way through the cycle on mortgages and on credit cards. Marian, obviously from a credit risk point of view, is on top of this all the time. Is there anything that you wanted to stand up and say about that?

Marian Martin: I think what you are referencing around unemployment rate is the way that we have calibrated cut-offs effectively within our credit underwriting. We try to be very conservative in the way in which we think about credit policy and calibrate our credit and other risk decision-making, and you are right, that does give us confidence around cost of risk. We feel that we manage it well and we will continue to do so.

John Cronin [Goodbody]: Thank you. If I can just come back to the risk-weighted assets point for a moment, you have given some good colour in terms of how you expect that could evolve but is contingent on regulatory approval nonetheless. I am just trying to understand better around the potential benefits associated with the model changes and what kind of time frames. You have alluded to FY18 as a potential year for benefit. That is my first question.

Jayne-Anne Gadhia: To answer that very straightforwardly, I hope, the PRA are very aware that we have this plan in mind and they are geared up to do the work that they need to do to respond to it, if you see what I mean. We are at the beginning of that regulatory process or at the end of our internal calculation process, so actually, when we say it could be this year, it could be next, it is about waiting for the regulator to get through it, as opposed to waiting for us to have to do any more work, if you like. We are not guiding to the impact that it may have on our capital ratios at this point and just to be very clear – I saw you sensibly wrote about it this morning, is it in our guidance or not? As Peter said, it is absolutely not in our guidance. We have not assumed any benefit from this in any of the guidance that we are giving.

John: On the second question, maybe two parts. One is on the portfolio buy-to-let lending that you are going to go after, is there anything you can say about volume growth aspirations and time frames in that context? I suppose part B of that question is in relation to SME. You have called out a £500m target for this year, £5bn within five years from a deposit-gathering perspective. Anything on the lending side you want to say at this point?

Jayne-Anne Gadhia: On buy-to-let, because we are seeing that in the competitive market, as you say, we are going to be focusing on different segments including buy-to-let, we would expect to see some increase in the volume of buy-to-let that we take in 2018 as a proportion of our total business, but not materially different. We said 19% I think on the slide that Peter showed; 19% buy-to-let in the portfolio. We might write flow of a few percentage points higher than that but not materially higher than that.

As far as SME is concerned, the reason that we are not giving any guidance at the moment beyond deposits and current accounts is that the RBS process requires us not to have planned to do the thing that we apply for. And that is not just us; I am sure you will have heard that from everybody else in the market. Therefore, it is difficult for us to put any numbers or any sort of construct to that until we can talk to you about the proposal that we have made for the RBS monies and talk about our success in that. So, at this point, our plans only assume the two numbers that you repeat: the £500m by the end of this year; and the £5bn in the five years' time. As we develop our SME plans as part of the RBS package, that will expand.

John: My final question is on the credit cards. On the EIR for 2017, I did not see a number referenced within the accounts this morning. I am just wondering if you can say anything about how it has developed. I noticed some language around your willingness to continue to observe customer behaviour patterns, in the context of your EIR assumption, but maybe in furtherance of that point, you do still hold your seven-year expected life assumption. Not wanting to compare apples and oranges, but I noted RBS last week in its IFRS 9 transition document stipulated that they use a three-year life. Is there anything that concerns you at this point around that seven-year life assumption?

Jayne-Anne Gadhia: No. And I will ask Peter perhaps to say something a bit more detailed in a moment. I did see in your paper this morning that you said something like the words that were used implied that we might be weaker in our confidence around those models. That was accidental. We are in no way weakened in our confidence of the performance of our book and the way in which we expect the EIR asset to perform against our assumptions. As you can imagine, we and others have done an enormous amount of work around that, so I can say that with confidence and probity, if you see what I mean.

As far as the RBS position is concerned, you are absolutely right to say that it is comparing apples and oranges. As you know, they do not sell 0% balance transfer cards. And as I understand it, it is very helpful for them from an IFRS 9 point of view to use a three-year life. So, I think we dismissed that as completely irrelevant to our own position. Our own position is predicated only on the empirical experience that we have of our own customers and we continue to be very confident about that.

Peter Bole: I am not sure there is an awful lot I would add to that, Jayne-Anne. People make their own choices based on their own priorities, John, so it is hard to draw a direct comparison. Our data continues to show a very similar pattern to that that we shared extensively at the half year.

Fahed Kunwar (Redburn): On the margin guidance, obviously you talk a lot about funding cost advantages coming through in 2018, but there is quite a swift decline in your margins going to the low end of 165 from the current 172. How much mortgage-rate decline do you have baked in there from the current levels, considering you also talk about the potential that mortgage rates may have bottomed out as well?

My second question was on your core tier 1. I think your management buffer is materially higher than all your UK peers; maybe three- or four-fold higher. Then you have the RWA reduction potentially coming on top of that, but your pay-out ratio is 11% or 12%. Do you see something ahead that we are not seeing? Why is your buffer so much higher? Your RoTe is 14%; it is easily more than enough to fund mid-single-digit loan growth as well.

The third question was how much of your interest-free balance transfer credit card book has now actually matured in 2018? How much comfort should we get from the 40% stick rate and the impairments on that particular portion? Has there been a big maturity this year, or is that going to be later on in the year?

Jayne-Anne Gadhia: I will start with that one. You are right to say that this is the time that the 0% book starts to come off its interest-free period, so we do not have very material volumes of data yet. Chris is here somewhere; I see Chris Taylor. The really interesting thing is of course that we can see the behaviours running into that period and they are actually

slightly better than where we had planned for them to be. So, the initial indications I think you would agree, Chris, are very strong. You are right though. When we stand up here again, then we will have more detail to report.

On the CET1 ratio, I will ask Peter to come up here and say a little bit more about it in a moment, but I would say that, to be honest, we are a growth stock, we are a growth company, and we expect to invest capital in highly returning profitable growth for many years to come. So, that is part of the answer to the question. Then on margins, the mortgage market is becoming extremely competitive, as you will have seen. Two days ago, I asked Hugh what the best customer front book rate was on a two-year fixed mortgage and it was HSBC at 140bps; cost to the customer. Yesterday, it was 128 from Santander. So, it is all over the place. On the other hand, despite seeing Santander coming down, we have seen some of the other big names pricing back up. So, I guess that the best thing I can say is that we reported a mortgage spread of 168bps for the whole year last year. We exited the year at 10-15bps lower than that. Hopefully that will be helpful.

Peter Bole: There is not an awful lot to add. I think the point about headroom on the CET1 ratio is well made. That is why we have drawn it out, because there is good headroom there. However, the key thing is the sense of growth and opportunity and ongoing investment in the business at this point. So, I think that is why we think that is a good level to be at and an appropriate level.

Michael Helsby (Bank of America Merrill Lynch): Firstly, can I just draw you a little bit more on your buy-to-let comments? Are you going to bring in some expertise? Because in the more complex arena, clearly that is not something that you have done before. Also, whether that will extend into limited company buy-to-let as well as individuals.

Secondly, on your guidance. Thanks very much for I think some very clear guidance, at least in the near term. You have anchored that with a 50% cost:income ratio, which is good. I was just wondering on the cost side if you could explain a little bit of how you are going to manage that when you are clearly investing a lot for the future, but you have a little bit of near-term uncertainty, what opportunity have you got on the cost line to compensate? Thank you.

Jayne-Anne Gadhia: I will ask Hugh to speak about buy-to-let. On the cost line, I hope we have proven year-on-year that as a team we have been able to manage costs effectively. We have done that by flexing our marketing spend, we have done that by flexing our bricks and mortar spend. For example, we have built a lounge or more than one every year since I have stood up here and we are not planning to do that this year although we are in fact opening a lounge that we paid for last year, in Cardiff in the next week or two. We have overall reshaping of our IT strategy that is both – it is what we call EBO. We have finished renegotiating a particular contract for our mainframe systems at the moment, which are both going to take us into a more effective technology position and at a cheaper rate, because we are benefiting from the new digitisation, etc. It took us two-and-a-half years, but we put in completely new technology for our customer service colleagues. We called it Kitkat, if ever you hear that; I cannot remember why we called it Kitkat. It has transformed the way in which they are able to manage their workload, serve customers and, as a consequence, reduces costs too. All of these benefits come through for the full year in 2018, along with tactical reductions that everybody is focused on.

Hugh Chater: Thank you, Jayne-Anne. On buy-to-let you mentioned portfolio and you mentioned limited companies. I will deal with portfolio first. As Jayne-Anne mentioned in her opening remarks, we are well on track for the build of that. We think the majority of that can be done with our existing underwriting capability, because the system will essentially guide us through the revised required underwriting requirements for up to, I think 11 properties. In terms of limited company, that is definitely an opportunity and I think the market will be heading that way as the changes start to restrict maybe some of the amateur landlords' appetites. We are not firm in our decision to go there yet but we are definitely looking at it. If we were to do that, then I think we would inevitably need some additional expertise, but I think that is available and we have a very strong track record in buy-to-let, as you know, so I think we will remain an attractive lender for the intermediaries to look to, to land that business with.

Michael Helsby: Can I have another one actually, for Michele? It occurred to me that obviously we have had in the last week a couple of big banks talking about the digital expectations and the like. I was just wondering if you have seen anything that worries you in terms of how you are going to compete in the future.

Michele Greene: The short answer is no. There is clearly a lot of change happening, but I think everything that we are seeing continues to further confirm and consolidate the strategy that we are on. So actually, the more movement we are seeing, the more positive and optimistic we are about not just where we are at, but where we are intending to go. That includes all facets, be it open banking, PSD2, any new concepts. This is worldwide as well, because as you would expect, we are keeping an eye on everything that is going on and interacting a lot in the fintech space with a lot of new solutions, new concepts, all parts of the eco-system we are building, and it continues to be really exciting and clearly the right thing for us to be doing.

Jayne-Anne Gadhia: Just to add to that, Mike, I continue to think that we are absolutely in the sweet spot for that. There are some really good smaller fintechs but they do not have the brand and there are some really significant investments going into the big banks, but they do not have the consumer franchise, if you know what I mean, from a trust point of view that we think open banking really requires. Therefore, we absolutely see it as a real strategic advantage for us; a competitive advantage for us.

Christopher Cant (Autonomous Research): I just wanted to ask about your deposit franchise. You gave a number on a previous question as to the exit spread for the mortgage book. I was wondering if you could give us the equivalent figure for the saving spread that you showed in the slides; the 59bps for the year?

Then a broader question. One of your smaller peers has far fewer deposits, far fewer customers and trades on a very high market cap to deposit ratio. You have £30bn of deposits in your deposit book, of which £17bn is shorter than three-month' duration, so it is not all fixes. How much of that £17bn should we think of as being rate insensitive in a rising rate environment and how much of a benefit do rates provide to your NIM as we head into 2018?

Jayne-Anne Gadhia: We have not given, and are not, going to give the exit rate for deposit costs on the way out, simply because at this particular point in time we have not disclosed it and I cannot bring it to mind.

Peter Bole: The only thing I would add is that, I mean, Jayne-Anne highlighted a fair amount of volume of repricing activity on the deposit book that happened during the course of 2017. Clearly that has not flown in, in aggregate to the average for the year, so we continue seeing that benefit coming through as we look into 2018 average cost of funding. Just to clarify, that 59bps is the overall weighted average cost of funds, so it includes the wholesale.

Christopher Cant: On the second question, on the portion of your £17bn of non-fixed deposits, which are rate-insensitive, or which you think will be rate-insensitive in a rising rate environment?

Hugh Chater: Obviously, we are very pleased with the retention rate that we get across our fixed book. I should also say that one of the things that we have focused on, particularly in the last 18 months, is the proportion of the book that is ISA as opposed to non-ISA deposits. On that, we see much stickier balances, both in term and in variable. So again, whilst in theory of course that money is more likely to be price sensitive, what we find with ISAs is that the combination of our brand and our capability to process it, together with the type of customer it attracts, gives us confidence that actually a good proportion of that variable rate book will remain with us, because that is the evidence that we have on the behavioural tenor of the ISA business.

Jayne-Anne Gadhia: When you look at the overall experience of repricing our portfolio, our attrition rate is normally – and we have brought pricing down as you know very substantially – between 5% and 7%; I would say that that is our sort of overall risk position, from empirical experience.

Peter Bole: The only thing I was going to add is, just to give you some sense of how we are thinking about it, Chris. We have assumed one further base-rate increase during the course of this year and that is reflected within our guidance, so the influence that has on the deposit book is already reflected in the lower end of the 165-170 NIM guidance that Jayne-Anne said.

Nick Baker (Goldman Sachs): Given your discussion around the potential for RWA relief and the fact that you flagged that you would see it most likely being deployed in SME going forward, given current conditions in mortgages, could you remind us what is your current updated risk appetite on the leverage ratio as well?

Jayne-Anne Gadhia: Yes. The last position that we agreed with our board as risk appetite was 360.

Nick Baker: And that is a minimum level?

Jayne-Anne Gadhia: That is the minimum, yes.

Peter Bole: That is our risk appetite floor.

Jayne-Anne Gadhia: But we do not see it getting to there.

Guy Stebbings (Exane BNP Paribas): I want to circle back on a couple of points. Firstly, on the EIR asset and how that has moved. Thanks for disclosure, which I think it went from 42m increase in the first half to 36m in the second half. Presumably with the slower growth in that but going forward and the mix changing slightly with the Virgin Atlantic partnership, we should expect that to drop off even more starkly.

Jayne-Anne Gadhia: Yes.

Guy Stebbings: If I could really push you just for a bit of colour around how we should see that going and perhaps even when it might turn negative. If you were able to give any commitment around that, that would be very helpful.

Peter Bole: Yes, we do see it continuing to come down. It is not a sharp fall-off as you would suggest there. We expect to see it coming down a little bit further in 2018 and then down again into 2019. I think from memory, it is three years out before we get a neutral position on the P&L.

Guy Stebbings: Circling back on capital and the 13% that you are guiding towards pre- any benefit on the model versus the 10.2% regulatory minimum before any management buffer or PRA buffer, are you able to give us any reassurance that we are not going to see any uplift in PRA buffers or anything like that, and it really is just about having a big gap to invest more in the business?

Jayne-Anne Gadhia: We have an ICAAP process going on with the PRA at this particular point in time, so we will await their response to that. At this particular point in time though we feel very comfortable with the 10.2% position that Peter has put forward.

Peter Bole: One thing I would say – this is not me front-running because we have not been through the conversation with the PRA at this point, but clearly there are components of the current Pillar 2A add-on that are really calibrated off the pound notes assessment. If the risk weights come down as a percentage, that shifts, so there is a little bit of that dynamic you have to play through as well. That is why we are guiding without those risk rate improvements at this point and once we have been through the PRA we will be able to give more light on that.

David Wong (Credit Suisse): Just two questions. The first one is, could you kindly update us as well on the size of the EIR balance sheet asset. I think it was 8% of TNAV at 1H 2017. I just wanted to know what the position was at year-end 2017.

The second question is on the deposit repricing which you intend to take. Can you just remind us of the sort of scale and quantum of which you plan this repricing and size was? In the past you used to be able to do about £5bn each time. I think it is more recently running around £3bn per exercise if I was not wrong. So perhaps how much are you intending for these exercises you are taking in 2018?

Jayne-Anne Gadhia: Less than that. Probably between £1bn and £2bn.

Peter Bole: The EIR asset at the end of the year, from memory, is £157m on the balance sheet.

Andrew Coombs (Citi): I have two questions, one on mortgage volumes and the interplay with margins, and the second I want to just come back to the deposit pricing. In terms of mortgage volumes, you made the decision to slow growth in November, so October presumably was based on the old run-rate pricing to some extent. I think you had 2% quarter-on-quarter growth in Q4 and you are now saying modest growth in 1Q 2018. Just to clarify, I think you said for the full year, based on where completion spreads are today, you would still see low single-digit volume growth. It is a case of you would need industry completion spreads to improve again in order to get back to that 3-3.5 range. Is that fair?

Jayne-Anne Gadhia: Yes. That is exactly right. Just to be clear, that is because we are prioritising returns over volume at this very competitive part of the market.

Andrew Coombs: Understood. A second question on the deposit pricing: we can back into the average retail deposit pricing using the interest expense notes in the back of the account, but on your SME pricing, given you are going to have this substitution effect, you have launched that product now, what is your average pricing on that new launch?

Jayne-Anne Gadhia: 60bps.

Andrew Coombs: It is well below the retail?

Jayne-Anne Gadhia: Well below, yes. Thank you all very much indeed for coming along and for your attention. Look forward to seeing you next time. Thank you.

[END OF TRANSCRIPT]