



# **Virgin Money Q1 2018 Trading Update**

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## **Q1 2018 Trading Update**

Jayne-Anne Gadhia

*Chief Executive Officer, Virgin Money*

Good morning everyone, thanks very much indeed for joining us on today's call. As you will imagine, given what you have seen so far, we are really delighted with our results for the first quarter. We have continued to deliver growth with absolutely no compromise on quality and we have continued strong returns. It has also been a really active quarter strategically for us. We have made progress on our SME business and the build of the digital bank. We have announced our JV with Aberdeen Standard Investments and of course we have launched the very successful partnership with Virgin Atlantic. I would just like to take a couple of minutes to explain our performance in the quarter and then I will return to these strategic developments before we take your questions.

### **Q1 2018 Performance**

#### *Mortgages*

In line with the guidance that we gave at the full-year we are really pleased to report gross mortgage lending in this first quarter at £1.4bn. That translated into net lending of around £200 million and means that year-on-year the growth in our mortgage book was 10.4%, which as you all know, is very materially ahead of market growth for the same period. We continue to believe that writing business at the right volume and the right margin is the right course of action. Let me explain what that means for us this year.

In a market that we think will be broadly flat year-on-year we expect to see low to mid-single-digit growth in balances at a margin consistent with our NIM guidance of no less than 165bps for the full-year. To be clear, we expect Q1 to be our lowest quarter for mortgage growth this year. Our current pipeline is almost 20% higher than it was at the end of the year. There are signs of major competitors increasing pricing and we are well on the way to developing and launching new mortgage products such as lending to portfolio landlords and longer duration fixed rate deals, all within our current portfolio risk appetite.

Our direct mortgage business is growing strongly too and this gives us additional levers to pull if and when we are faced with more competition in the intermediary mortgage market. Despite the fact that there has definitely been and continues to be increased competition in the mortgage market we are pleased with our position in it. Our approach to it feels right and we look forward to another strong and successful year in our mortgage business.

#### *Credit cards*

Our credit card book has grown entirely in line with our plans this quarter and asset quality remains as strong as ever. I know that many of you will want to hear about the continuing strong performance of our 0% balance transfer products. The cohorts of business that we acquired from MBNA continue to perform well in line with expectations. It is data from this mature book that has always informed our new business assumptions. We are now seeing good performance from the first 4,000 customers who have come off promotion since we moved to our own platform. That, as you will know, is a statistically significant number. These customers are now going through the first month of their post-promotional period. To

be really clear, the repayment profile of this group of customers is in line with the expectations that underpin our EIR assumptions.

In the last few weeks we have launched the first Virgin Atlantic credit cards and I am really pleased to say that they are performing even better than we expected. Customers are more affluent, credit quality is therefore higher, and the number of accounts opened is noticeably better than we had initially expected. This underlines the power of our shared brand. Both we and Virgin Atlantic are delighted with this performance and we look forward to it continuing and accelerating through the rest of this year and beyond.

#### *Savings*

Turning now to savings, the retail deposit market has been better for us than we had originally expected. As a result of higher market volumes, particularly in cash ISAs where, as you know, we are especially strong, there has been less price competition than we expected in the secondary savings market. That has meant that we have been able to achieve the funding levels necessary to support our asset growth with ease. In fact, by the end of March we were £200 million ahead of plan for retail deposits and as a result we have been able to reduce front book pricing. We have also been able to reduce back book pricing a little and we repriced £1.5bn worth of liabilities during the first quarter.

One of the real successes of the quarter has been the performance of our stores and lounges. Account openings in store were up 42% compared to the first quarter of 2017. All of this means that I am confident that we are on track to reduce our weighted average cost of funds when compared with 2017, just as we said we would. That confidence was enhanced by our successful MTN issuance last month. As you know, this is our first MREL issuance so it is really important from a strategic point of view as well as from a funding point of view. We were able to generate over £900m worth of demand compared to our plan to raise £350m. Given that level of demand we were of course able to achieve a better price than we had initially expected.

We are ready to launch a covered bond later this year which will further strengthen and diversify our wholesale funding platform. Just to remind you, in February we repaid our remaining FLS balances in full using our final drawing from the TFS scheme.

#### *Fee income*

You will be pleased to know that our other operating income exceeded 10% of total income for this quarter. It is our expectation that it will remain above 10% for the rest of the year. All in all, total income is where we had expected it to be and the quality of our retail franchise remains very strong. As you would expect we have continued to manage costs rigorously and we will continue to do so in order to deliver on the guidance that we gave you at the end of the year for a cost:income ratio of no more than 50% this year.

As I mentioned in relation to the cards book, arrears have remained at very low levels in part of course reflecting a 43-year low in unemployment and wage growth which is now higher than inflation once again. However, it is also to do with us focusing on prime and affluent customers. Although we hear from the big banks that they are beginning to see a slight deterioration in some customer segments I want to confirm that on both mortgages and on cards we are seeing no deterioration whatsoever. That is a result of our diligent focus on underwriting over the years.

### *Earnings and profitability*

From an earnings and profitability point of view we are very well-placed and the balance sheet is in very good shape too. Capital is exactly in line with the guidance we gave at year-end and you should expect us to end the year with a CET1 ratio of around 13%. That could be improved by up to 40bps when we close the Aberdeen Standard deal that we announced back in March. We have now submitted our application to the PRA for a reduction in our mortgage risk weights, as we told you we would back in February. This could be a very material adjustment for us but just to be clear, the timing of any benefit to risk weights is uncertain so our full-year capital guidance excludes the expected benefits.

## **Strategic Developments**

### *Digital bank*

We have also made good progress with our strategic initiatives this quarter. It has been busy. I am really pleased to say that at our Board last week the Digital team was able to show us a first prototype of the digital business. We are on track to be able to deliver a first beta of the digital bank before the end of this year. It is our expectation that we will be able to constantly iterate from there, such that we can acquire a high volume of low-cost current account balances over time. As you know, that will be transformational, both for our customers and for our business.

### *SME deposit account*

We also launched the SME deposit account in January and we continue to expect to deliver £0.5bn worth of balances from this source by the end of the year. As we have previously said, we will bid in the RBS Alternative Remedies package. We are ready to do that now whenever the government are ready for us and we expect to apply for Pot B. We believe that our brand, our capability, our preparedness and customer demand will mean that we are well-placed to be successful, both in the bid for the package and subsequently as a competitor in the poorly-served SME market.

### *Aberdeen Standard Investments joint venture*

As you know, the partnership we have agreed with Aberdeen Standard is expected to transform our investments and pensions business. You should expect us to book 100% of the earnings from that business this year, capital to come in on completion, which will be at the year-end, and then for us to move to a 50/50 joint venture going forwards. This partnership will drive significant growth in funds under management. The enhanced proposition will enable us to transform the scale of this business, transform customer pricing and also the range of products that we can offer to both our investment and pensions customers in the future. To be clear, we see this as a very material strategic development for us.

## **Summary**

In summary we are very pleased with an active and successful Q1, which has come in entirely on plan and, despite competition in the mortgage market, our nimble approach to asset and liability pricing enables us to confirm our outlook for Banking NIM of no less than 165 basis points for the year, entirely as guided. I do want to reiterate that this, combined with costs and impairments performing as expected, means that we expect to achieve solid double-digit returns on tangible equity again for shareholders this year.

In summary we are very pleased to reiterate in full the guidance we gave for 2018. Now, Peter, Hugh and I will be delighted to take your questions. Thank you.

## Q&A

**Robert Noble (RBC):** I wanted to ask about the NIM. Are you guiding to the lower end of your range or above the lower end of your range now? I think you previously said it would be lower at the beginning of the year. Could we get a sense of the path through the year? Did it go below the target and expected to increase or is it already above?

Secondly, a few of your competitors are pointing to higher costs and regulation investment. I appreciate you have reiterated your cost:income guidance but are you happy with 1-2% cost growth expectations this year?

Lastly, the Alternative Remedy strategy, why are you going for pool B and not pool A? Thank you.

**Jayne-Anne Gadhia:** Thank you very much, Rob. We are going for pool B rather than pool A because at the moment our understanding is that the applicants for pool A have to already have an operational and substantive business current account, which is not something that we can offer at this point in time. Pool B currently, based on the criteria that has been given, is the highest pool that we can enter. We feel very confident of our position in there.

I am going to ask Peter to talk about the net interest margin but just to say that you are right that at the year-end we guided to between 165bps to 170bps for NIM. What we are now saying is that it will certainly be no lower than 165bps.

**Peter Bole (Chief Financial Officer, Virgin Money):** Good morning Rob. In terms of banking NIM we would expect to be fairly stable across the year, if anything a little stronger in the first-half and a little lower in the second-half would be how we see it shaping up. In terms of costs we are guiding towards no more than a 50% cost:income ratio and we feel pretty comfortable with that. We do not expect to see much cost growth during the course of this year.

**Jayne-Anne Gadhia:** We are super focused on cost-management in a competitive environment, as you would imagine. We have got in place a productivity programme. Last year, as we updated the market, we implemented a programme across our entire network, stores and head office, which updated everyone's technology. That has enabled us to get some real process gains and some of the investment that we are making in improving technology and processes is definitely coming through in cost efficiency.

**Aman Rakkar (Barclays):** I had one additional question on NIM. I am interested to what extent your NIM guidance may or may not be dependent on UK rate hikes coming through. I appreciate market expectations might have shifted a little bit. I think at full-year you suggested you had one rate hike planned for this year?

Then second, could you tell us, in the November rate hike last year how much of the rate hike did you pass through your customer deposits? Given you sound like you are having quite a positive start to the year on deposit performance, how do you see that rate pass-through evolving as you go forward, particularly in light of replacing TFS?

**Jayne-Anne Gadhia:** Thank you for that Aman and nice to speak with you for the first time. I think that it is very clear to us that we never model rate increases into any of our outlook. We did that many years ago and discovered that that was not the best way to run a bank. In terms of all of the guidance that we give we assume that there is no change in interest rates. That is important I think. In November we managed across the portfolio, the asset and liability side to be continuingly competitive, fair to our customers and to take advantage of the overall market position for our business as best we could. As far as what we will do when the next rate hike comes in, then clearly there are benefits to banks and customers as rates move. However you would not expect me to give away what we do now as that is a competitive choice that we should make at the time. As I say, we have not planned in for a rate rise so there could be some upside depending on when that happens.

**Michael Helsby (Bank of America Merrill Lynch):** I have got two questions. First, I want to explore the margin a little bit more, if that is alright? Then I have got a second question on bad debts. Firstly on margin, Royal Bank told us the gap between their front and back book mortgage for Q1 was 80bps. I was wondering if you could give any commentary on what you see at the moment? Also, on deposits I was wondering if you could tell us what the marginal cost of deposits was in the first quarter? I was wondering if there was any change in origination mix? I think you have flagged that you have clearly got niches that you can push into but I was wondering if there was any change in origination mix, maybe more buy to let in the quarter?

Also, this quarter has been interesting in that there has been quite a big LIBOR base rate gap as the market priced-in rate rises. Back in the day, pre-crisis that was always an issue for the likes of Northern Rock, HBOS and the other mortgage banks. I was wondering is that something that we need to watch at Virgin or can we just ignore it because that was driven by the funding mixes back then? I have got a second one on bad debts but I can come back to that one if you like.

**Jayne-Anne Gadhia:** Between us we will try and answer all of those. Thank you very much Mike. 80bps difference between RBS front and back book, is that right? That sounds more extreme than I imagined. What I can tell you is if that number is right that we are nowhere close to that and part of the reason that you would expect that to be the case of course I presume they have got a much more significant SVR book than we have. We are much less exposed to SVR compression than any of the big banks and that will mean that although of course in this competitive environment front book pricing is lower than back book pricing. Our exposure to that is certainly less than the very big banks. I could not tell you about how ours compares with some of the smaller ones but it is certainly less of an issue for us than the big ones.

**Michael Helsby:** Can you remind us what your SVR is now, Jayne-Anne?

**Jayne-Anne Gadhia:** It is 8% of our book. It is on an average of three months so it tends to be customers that are waiting to decide what to do next rather than long-term SVR which is what some of the big banks like Lloyds have, for example. That is why our exposure is very limited.

**Hugh Chater (Chief Commercial Officer, Virgin Money):** I will start with origination mix on mortgages since we are in mortgages, Mike. Broadly the first quarter has been very

similar to what you would expect us to do. We have matched the market in as much as we have seen a higher percentage of our new business come through on buy to let and first-time buyers from this time last year. Everything else is pretty similar to what you would have seen us originate last year and entirely in line with the risk appetite agreed with the Board. I think tracking the market is probably the best way to summarise that.

**Michael Helsby:** What is the average LTV of your first-time buyer flow? Is that something you can give?

**Hugh Chater:** I do not actually know that off the top of my head so I think we will have to come back on that one. In terms of marginal cost of deposits even with all the competition in the asset side, we have actually seen front book pricing in the secondary savings market being more benign than we had anticipated. Hence the comment in the statement about above expectations on price and volume in savings in the first quarter.

**Peter Bole:** Mike, in terms of the position on LIBOR, obviously you have seen the gap open up there. From our perspective with the hedging we have got in place, we are not unduly exposed to that. If anything it is a very slight benefit to us where it has been but it really is not very material. Going back on the question that you put to Hugh on LTV on the front book in the first quarter, pretty consistent with what we saw last year.

**Michael Helsby:** On bad debt, I appreciate that the performance is extremely good and that is to be expected. We are in a bit of a new world now with IFRS 9, so I was wondering if you could tell us what GDP growth you have assumed in your IFRS 9 assumptions. If you could give us any type of impairment sensitivity to a 1% change in that GDP assumption?

**Peter Bole:** To be honest Mike, I do not have the specific GDP figure to hand but it was pretty close to the consensus for the year. The reality is that the biggest impact for us will come from unemployment on the card book as opposed to GDP. It is not hugely sensitive to GDP but it is not something that we have put out in disclosures at this point. Clearly it will be as the IFRS 9 disclosures get released during the course of the year.

**Jayne-Anne Gadhia:** Although it is not answering your question directly in terms of sensitivities Mike, what we have said previously is that the unemployment assumptions that we take account of as we build our cards book are well in excess of 6%. We have built in some stress in our current pricing and underwriting criteria and it assumes unemployment is significantly higher than it is today.

**Peter Bole:** The GDP number that we have is 1.25%.

**Guy Stebbings (Exane BNP Paribas):** Going back to credit conditions it is interesting you used the words strong credit conditions. Previously you have tended to refer to stable rather than strong. Just to check I am not reading perhaps too much into your wording there, especially given the backdrop that although unemployment is obviously very low but we are seeing a softening in some metrics and a pick-up in IVAs last week, for instance, and personal bankruptcy. Can we infer from your comments you are not seeing any concerns at all in terms of early warning implications at this stage?

**Jayne-Anne Gadhia:** You can. We are seeing no concerns whatsoever at this stage. I hope you would expect that given the focus that we have always put and told you about on affluent

customers, high quality credit and diligent underwriting. At the moment it is absolutely rock solid and we do not see any signs of deterioration in the book at all.

**Guy Stebbings:** On capital I think you said at the full-year you would shortly be signing off the ICAAP with the regulator. I do not know if there is anything you can tell us around that timing or implications for the pillar 2A PRA buffer? I appreciate it could be difficult in terms of timing sensitivities around that but any colour you can shed.

I would also be interested to get your thoughts on how IFRS 9 might impact this in the future. We heard from the regulator that it was looking at offsets where higher stress drawdowns under IFRS 9 versus the IAS 39 basis would imply a higher PRA buffer. This was limited to adjusting systemic buffers so clearly less help for yourselves. I appreciate transitional arrangements means this is less of an issue for the time being but clearly in time could become important.

**Jayne-Anne Gadhia:** I am going to disappoint you by saying the ICAAP's submitted, we have had our discussions with the PRA but we have not had any feedback yet. We are not expecting any surprises but we have not had anything back yet that we can talk about.

**Peter Bole:** Guy, so far the regulator has demonstrated a fairly common-sense approach to IFRS 9 and they are now looking through it with a transitional relief. Clearly they are going to go through a series of ICAAPs probably this year for the first time looking at IFRS 9 impact on stress. However, I am reasonably encouraged by the position they have taken thus far that they will look through it and look for offsets against capital where possible because it is pretty clear that they did not expect the change in accounting basis to result in an increase in capital requirements for the industry.

**Richard Smith [KBW]:** Two from me, if that is all right. The first is on the mortgage risk weight model changes. I wondered if I could draw you a little bit to quantify the potential benefit as you see it at the moment and if there were any further tweaks that you could look to make which might result in more optimisation there?

Then the second was around the deposit base and four months in from the SME deposit launch I wondered if you could give any sense of how the early reception has been?

Then finally if you were seeing any further repricing potential following your comments around the repricing done to-date on the retail side of things? Thanks a lot.

**Jayne-Anne Gadhia:** On the SME deposit base we are exactly where we expected to be in terms of acquiring new business and continued to expect to deliver £0.5bn worth of deposits by the end of the year. As you would expect, you do not launch a new business and go straight in on the right run rate as a multiple of 12, if you see what I mean? We started off in January with a relatively clunky process and a little amount of marketing as we were finding our way into that market. We have moved price around to get to the right place. That has definitely been very successful. We have now got to what we think is a sweet spot. We have started to market much more aggressively which is what we should be doing. As a consequence we have seen a significant upturn, as you would imagine, in volumes. On 10<sup>th</sup> May we put in place new processing which enables customers not to have to print off a form in order to sign it to get their product to us but to do it all online. Obviously, that is

going to make a significant difference too. It has been a really good start, we have learned a lot, we are on track and we have got more to come, I think is my summary of all of that.

As far as mortgage RWA model changes are concerned I will ask Peter to say something about that but, as I have said in my opening remarks, the fact of the matter is that we have been running on models that were largely acquired as part of the Northern Rock acquisition and as a result the risk that was assumed in those models is significantly more than the risk of the mortgage business that we are writing. There are a number of technical points which we think are quite straightforward that demonstrate that now. Our RWAs compared to our peers are significantly higher for the same risk class. We have put in the model changes that we think are appropriate to align with our peers. That, if it were to be approved, would be very material. We are not expecting that level of materiality to necessarily come through in one go because we understand that the regulator might want us to step that approach. We do not know. We have not had that conversation with them but that is our underlying assumption. I think you could see, if and when that comes through, certainly a double-digit potential improvement in our underlying RWA in our pillar 1 position.

**Peter Bole:** I think that is absolutely right. If you look at the benchmarking for institutions with similar portfolios, similar LCD profiles, you can see pretty readily the scale that Jayne-Anne refers to there. In terms of further tweaks the reality with these models is they are constantly being tweaked and there is constant reiteration on them. Probably one of the key things that will follow on this is the move to a hybrid model away from variable scalar, which is something that is happening across the industry. We expect to be a net beneficiary of that change across the sector but I think the change that we spoke about year-end and Jayne-Anne has highlighted this morning is the material one for us at this point.

**Jayne-Anne Gadhia:** Just before you all get carried away, please do not model it as this year as we have submitted this to the PRA but we know that they have got a lot of work to do for the newly ring-fenced banks and we know that we are in the queue. At this point in time we do not have a date from them around when we are likely to get this in and approved. We are assuming that it is not this year and if it is that would be upside.

**Hugh Chater:** Just to reiterate we are pleased with the repricing we have done so far this year and that, as you know, has been the most recent one in a series of back book repricing that we have successfully undertaken. As it stands at the moment we have no short-term or medium-term plans for more repricing on the savings side.

**John Cronin (Goodbody):** Thanks for taking my questions. The first one is a point of clarification in relation to the reference to 4,000 customers coming off the promotional rate on the zero balance cards. For my own understanding, can you confirm that those 4,000 customers have actually migrated to the end-date rate and not an interim promotional rate in some circumstances? When exactly did they come off? That is my first question.

My second question is on the risk rated asset intensity point again. There are two strands to that. We had seen some uplift last year and you had previously referred to new mortgages coming on at 20% and other mortgages rolling off at about 12% broadly. Is there any specific guidance you can give us in terms of how to model that out? Are those still reasonable assumptions in the absence of a model change approval from the PRA?

Then I am trying to understand the extent of how material the model changes that the PRA could approve would be given your average mortgage risk rate is a touch above 17%. I appreciate the large banks are almost half of that, in some cases even less so, but with the advent of BASEL III on the horizon or the final reforms package pertaining to BASEL III, how low can they go?

Then finally, on the SME I am just wondering around the number £500 million you quoted before, could there be some upside to that from an end-year balance perspective? What kind of asset yield broadly do you expect to write that business at? Thank you.

**Jayne-Anne Gadhia:** First of all I am going to answer two questions and then ask Peter and Hugh to help. On RWA intensity we have modelled 19% RWA this year and beyond until we get any improvement from the PRA. I cannot be any more crystal clear than that for you all.

**John Cronin:** Is that on new business?

**Jayne-Anne Gadhia:** No, on the book overall. That is what we are modelling and, as you will obviously understand, if and when we get improvements from the PRA then we would expect them to be significant. The way that we are looking at that is that could take us down to something around mid-teens. We will see where that comes out and I do not mean that to be guidance because you can never guess what a regulator is going to do. However, it could be that sort of order of magnitude we think.

On SME we are not going to talk about upside at this point in time though we will be delighted to get to £0.5 billion worth of deposits. We are modelling the SME deposits in line with retail deposits at this point in time. If that gives us any underlying benefit, then great. However, at the moment as we get into this marketplace to be no better and no worse than our retail yield is a good place for us, as you would imagine.

**Hugh Chater:** As you would understand John, credit card customers at any given point in their life with us can have a variety of different price points on their account for different types of transactions. The vast majority of these customers, the 4,000 who have now matured off their acquisition promotional rate, will have that balance moved to their contract rate. However, it is impossible to say that that is the case for all of them because of course we have customer level pricing which is how we actively manage to deliver the yield that we are forecast to deliver on the book. It is that level of sophistication that gives us the ability to manage a complex book to deliver the kind of returns that we are forecasting, both within the promo period and outside it.

**Jayne-Anne Gadhia:** To be clear John, these 4,000 customers are behaving in the way that the team had expected. They do not all behave in exactly the same way but they are behaving in the modelled way. The reason that we are not surprised at that, and I understand that there has been some questions in the market, is that we did work on this exact product for more than ten years with MBNA. We bought £1bn worth of that book. We have data that goes back for ten years. That data is strong and solid and the assumptions that we have used to underpin the new business are based on last empirical evidence and ongoing customer behaviour. Surprise, surprise, when you use data of that richness, depth and quality for that period of time we can stand behind it with a confidence that we have done for the last 12 months and continue to do so. As the book rolls off that confidence is being repaid very fully. It is entirely in line with plan.

**John Cronin:** Thank you for all of that. One final clarification, when did the 4,000 customers start rolling off?

**Hugh Chater:** They have rolled off and they have been rolling off since the beginning of the year.

**Chris Cant [Autonomous]:** I wanted to come back around on margins. You mentioned that your margin guidance or expectation does not allow anything for rising rates and I do not think you ever disclosed the margins or NII sensitivity to us. However, when I think back to your 2015 results, which I appreciate is a while ago, you cut your NIM guidance at that point by 5bps when you took out a 50bps rate rise assumption, which I think is what you were referring to Jayne-Anne. Is that still roughly the right yardstick in terms of the potential upside you may see if rate rises do come through? Could you give us an update on that please? Relatedly, a number of your competitors have given a sense on the pass-through on deposits for the recent rate rise in terms of the deposit beta. I was just wondering if you could give us yours?

I have got a second on cost of risk please. Your guidance was for less than 20 basis points for the year which I think the market had taken to imply something in the high-teens. Is it fair to assume from the tone of the commentary today that you are running in low double-digits during the first quarter? Thank you.

**Jayne-Anne Gadhia:** On the cost of risk, because by its very nature arrears is something that we want to report on at the end of the year rather than the beginning of the year you would understand that I would be very cautious in saying anything other than we expect a cost of risk of less than 20bps. Given the conversation that we have just had you are right to assume that it is not at that level at this point in time, but we are still guiding to less than 20bps.

As far as the amount of NIM is concerned I think we have previously disclosed that 25bps there either way in terms of sensitivity on our book is worth around about £10-12m. That is the way in which we have talked about it previously and I think I have stood up and told the market previously.

**Peter Bole:** Yes, I think that is broadly right. The challenge is ultimately it is a response compared to the position so we have done quite a lot of repricing on the book. We have changed the T&Cs so in many respects, yes, we will end up monitoring the market when changes go through and judge our relative price position on different parts of the book in light of that. It could be in that range. It could be a little less but fundamentally it is a positive for us, rising rates.

**Jayne-Anne Gadhia:** Last time's increase in bank base rate to be absolutely clear - broadly we used that to manage our competitive position. We did not see a material benefit or loss as a consequence of that. It was very helpful for us to reprice different parts of our portfolio in ways that meant we are competitive going forward. That gives us an opportunity as rate reps come in to look at things on a specific basis. We are not going to guide to that, as I say, because that is a competitive sensitivity for us.

**Chris Cant:** On the final point that you were responding to there, I was interested on your deposit pass-through specifically. I appreciate there are moving parts on both sides of the

equation. I guess some in the market are concerned about the strength of your funding franchise in a world in which TFS is being withdrawn etc. You indicated that pricing has trended better than you were anticipating but some of the larger banks even have talked about 60% pass-through on deposits.

**Jayne-Anne Gadhia:** As we were priced very competitively in the marketplace Chris, we did not need to pass-through a very material amount of that base rate rise to our customers on the deposit side of the book. To pick you up on that point about people being concerned about our funding franchise, I think you said, we have absolutely no concerns about that whatsoever. There is a lot of talk about what TFS would do for the secondary savings market. We found the secondary savings market to be resilient. We found, as I said in my opening remarks that we have been able to price better than we expected for the volume that we need. As I also said, we have also been able to reprice some back book deposits in our favour.

I think one of the things you should all bear in mind is that we have always been priced very competitively. The wiggle room, if you like, that we have between our current pricing and that of our competitors gives us real confidence that we can continue to improve pricing. I want to absolutely reiterate because it is so important to you and us, that from our perspective retail funding is a super-strong franchise and Hugh is focused more on managing it down to the level of plan, and we had that absolutely about £200m over by the end of March, than managing it up. We are pricing down for volume rather than pricing up to acquire it. That is why we had had such a very strong quarter and that is why we are able to reiterate our net interest margin guidance for the year. I hope that is clear. Thank you, Chris.

**David Wong (Credit Suisse):** Three questions from me, if I may? First off is a quick one, on your plan to apply for the RBS Alternative Aid grant what is your plan B if your application is not approved and you do not get the grants? What would you consider as an alternative strategy for the SME part?

The second question is the NIM, at the full-year results you talked about being at the low end of 165-170bps and you slightly tweaked it to no less than 165bps. I am trying to get my head round the incremental messaging around this slight tweaking of the language. Broadly-speaking do you feel more positive now about the NIM than you were at the full-year 2017 results, for example?

My third question would be on the growth outlook. You are guiding to low-to-mid-single digit growth in 2018. As a management team would you be happy to achieve low single-digit growth in 2019? Based on the current trend if you not happy with that kind of expectation, could you perhaps share with us some kind of things you are contemplating to boost growth? For example, would you be happy trying to achieve growth integrated as part of a larger platform? Many thanks.

**Jayne-Anne Gadhia:** On RBS let us be really clear, we think that we are one of the leading brands, if not the leading brand in the challenger space who can truly transform this very badly served SME market. The development of our digital bank means that we can see how we can do this in a way that works for small business owners in an efficient and modern way where we can provide top quality Virgin service and a breadth of products that is something

that the SME community have told us that they want. There is no doubt that our brand and our franchise is something that appeals to small business owners and is a very material opportunity for us. We absolutely confidently believe that that is something that the independent trustees who are looking at the RBS Alternative Remedies Fund – we do not know who they are. I am not speaking at all from any information. I do not even know yet the dates when that is going to be available to be applied for, but we would imagine that given the way in which HMT have portrayed what this fund is for, which is a new brand to challenge, to provide better service to the SME market, then we think that we are very well positioned in order to be successful in an application for pot B.

Beyond that we have not really thought. We are just focused on being successful there with excitement and confidence. The SME deposit business that we currently are building is giving us continuous confidence. So to slightly answer your question, I suspect, we do have an SME strategy that is outside the RBS Alternative Remedies programme and that is something that we would also intend to build on.

As far as NIM is concerned to be honest I guess what we are really doing in this quarter is saying, we thought it would be towards the lower end of the range, 165-170bps and we are, by saying no less than 165bps, in my view just pointing out to you that we are going to be at the low end. I just wanted to make that even more clear; than we had done at the end of the year but that is not because we are seeing any deterioration and not because we are any less confident. I hope that you can tell from our comments and demeanour this morning that we are very confident of producing NIM for the year of no less than 165bps entirely in line with the guidance that we gave at the full-year.

As far as growth is concerned, as you would imagine, we have a lot of conversations, Peter, Hugh and I in particular, certainly weekly if not daily, about the right trade-off between volume and return. We have talked to a number of our shareholders about this and, as you would imagine, most of them believe that the right balance between volume and return is absolutely right for us and for our business, their investment and our franchise. We take all of that into consideration, by which I mean franchise, returns and volume, when the three of us and others have these conversations. On the one hand, we would like to write more mortgage volume and on the other hand we think we have done absolutely the right thing in the first quarter to write the right volume at the right price and to protect that NIM and to protect very strong double-digit RoTE for shareholders going forwards.

All of that said, I have a friend at the BBC and I asked him how competition was going with Netflix. He said, 'It is really difficult,' and I said, 'Tough times then.' He said, 'No, the most interesting times I have ever operated in.' We feel a bit like that. It has given us not a new lease of life but a real burning platform to be able to develop our mortgage business from and we have done that very strongly in Q1. What we realised we were doing is we were mining deep into the very, highly-competitive two-year re-mortgage business and we are broadening that franchise without going outside our portfolio risk appetite, which is important for us. We do see Q1 as being the lowest growth quarter of the year. We do see growth for the annual results as being higher than we have produced for this quarter. However, to be clear, we see that growth as being consistent with producing 165bps or more of NIM for the year and strong double-digit RoTE for shareholders. That is a constant trade-off that we believe is the right thing for us and any management team to do for the best interests of our shareholders.

**Ian Gordon (Investec):** Firstly on other income, your comments on Q1 out-turn were better than I was expecting, as were the full-year expectations. Obviously the new card partnership with Virgin Atlantic is expected to help in the medium-term but I thought that is too early to be impacting the Q1 number. Can you give me a bit more colour around that?

Then secondly on capital, obviously you have raised your guidance for 2018 to include the 0.4 uplift from the JV deal. I am not modelling any model assumption benefits until next year but your hints today are better than mine already I am assuming. Your operational efficiency metrics mean that your capital generation is improving this year. Put simply, one of two things has to happen. Either your existing capital surplus gets so large that you have got to consider distribution or you find significant further growth opportunities which are not yet reflected in consensus expectations or a combination of both. How are you thinking about that?

**Jayne-Anne Gadhia:** As you would expect, I agree with your positive outlook on operational efficiency and the future outlook for the business. We produced a really strong quarter in a difficult competitive market. We expect, as you know from our guidance, that the year will be strong and our strategic programmes are going really well. From our perspective we have not yet got to the place where we are able to discuss what we think we might do with a capital surplus because, as you know, we have got the Aberdeen money to come in, as you have already highlighted and potential RWA improvement. Once we have seen the out-turn of all of that then we will be able to properly tell you what we think is the right thing to do. For now I am agreeing with your optimism, agreeing that that is going to be a nice problem to have but we are not going to be able to give you the answer until we get closer to it.

As far as OOI is concerned there are two product reasons that things are better than you expected maybe. Our Investment & Pensions business even before the Aberdeen partnership has continued to go strongly. Some of that has been FTSE but most of it has actually been new business coming in on both pensions and investment, which is obviously very good news. Secondly, our travel insurance business has turned up again. You notice it turned down a little bit last year because we had repriced it. We have resigned or extended our contract with our suppliers and been able to refresh our products. We have had a very encouraging start with travel insurance at the beginning of this year.

**Hugh Chater:** I think that is exactly right, Jayne-Anne. We are very pleased with the new deal we have with Mapfre and our partner there. They are demonstrating a real desire to rekindle the growth and success that that programme has had in the past. We are very pleased with that and, as Jayne-Anne said, on our Investment & Pensions new business but also retention of existing assets is better than we had anticipated. Net-net the average funds under management for the quarter have been stronger than we had anticipated.

**Andrew Coombs (Citi):** On deposit repricing you cut the rate on your defined access cash ISA from 1% to 0.5% in February for less than three withdrawals. At the same time you have an easy access cash ISA that offers 1% irrespective of withdrawals. Obviously the rational customer would switch in which case there is no benefit to you. However, as we know, there is often inertia in which case you get a 50bps benefit on that repricing. I wanted to know what the amount of deposits that were repriced and also how many have switched versus stayed on the same product?

Second question in terms of rate sensitivity, you obviously swap out both the fixed assets and fixed liabilities but the churn on your liability book is faster than on the asset side. In terms of rising rates does that mean there is initially a net negative impact or you then get the net positive over time?

**Hugh Chater:** Absolutely right in terms of the action that we took on the defined access book that took effect in the first quarter. We notified it last year. The performance of that in terms of the churn was in line with our expectations. We had anticipated that those customers would respond. Obviously what we saw was in line with our expectations and I think that has been part of a performance that we have commented on in the first quarter, which just to reiterate, private deposit book has been really, really strong, all in line with what we had assumed.

**Peter Bole:** Andy, on the base increase there are clearly a number of moving parts when a base rate comes through, and just to be clear as well, we do not look at it in isolation. It is absolutely dependent on where the book is, where our price points are and what repricing activity we have done. That said, we see it as a net positive. It is just a question of how positive the timing of the year will have an impact on that. However, we would not see it going backwards before it gets better. The timing is reasonably clean on both sides of the balance sheet and so we do not have an initial drag, as you might have surmised.

**Andrew Coombs:** Okay, so it is a positive from day one and your 165bps guidance assumed no rate hikes over the remainder of this year?

**Peter Bole:** There is nothing material in there and yes you are right. I am hesitating slightly. Ultimately there could be if we decided depending on our price point to move things in a staggered way. However there is no fair reason why you would get a lag so that is right.

**Robin Down (HSBC):** Obviously there have been a lot of questions about the RWA movement with mortgage book but I still see your business as being leverage constrained rather than RWA constrained. I was wondering if you could give us any colour about whether there are any levers that you can pull to improve that leverage ratio and actually give you some surplus capital to play with? I think certainly coming at RWAs is just going to push up your core tier 1 and presumably will not do anything in terms of surplus capital?

**Jayne-Anne Gadhia:** Yes, you are right. From our perspective, as we have always said, we have a floor to our leverage position of 3.6%. We do not see ourselves getting anywhere close to that based on our current outlook. Obviously the development of our SME business is something that will really help our leverage position going forwards. We are aware of your point and it is something that we manage. You are correct but we do not see it as a particular constraint in any way.

**Guillaume Desqueyroux (Tideway Investment):** Thank you for taking my questions. It was actually a follow-up on the pension part that you described earlier. You sound enthusiastic about the development with Aberdeen but I was just wondering if you can give any timeline and volume that you want to bring on board. You mentioned that you have 10% of your total income coming from the other income. Do you have a mid-term target about pushing up to 20% or something like that?

**Jayne-Anne Gadhia:** 10% is the guidance we have given pretty consistently and we are sticking with that for the time being. As far as this deal with Aberdeen is concerned, as you know, we have signed initial heads of terms. The fully binding heads of terms will be signed by mid-year. The intention is to close the deal at the end of this year and the reason for that is that we therefore will maintain 100% of earnings on our business till the year-end and then the capital will come in at the year-end. Just to be clear for you all, at the moment I do not know if it is 31<sup>st</sup> December or 1<sup>st</sup> January but we will tell you that when the time comes. However, it will come in at the year-end. Then we will develop our new portfolio of products in 2019. At the moment our Investment & Pensions book is about £3.5bn. Over the first five years of this partnership we would expect that to be multiplied by a factor of four or five and over the next five years we would expect to double that. That is a very material potential growth rate in our funds under management. We have got a long way to go until we get there but nevertheless the partnership is compelling from every perspective.

Okay, I think we must be at the end of our conference now everyone, so thank you very much indeed for joining us. Hope you will agree it has been a really strong first quarter. We are looking forward with real excitement to another successful year financially and strategically and look forward to updating you at the half-year. Thanks very much indeed for joining us.

[END OF TRANSCRIPT]