VIRGIN MONEY UK

2 February 2021

Virgin Money UK PLC: First Quarter 2021 Trading Update

Virgin Money UK PLC ("VMUK" or the "Group") confirms that trading in the three months to 31 December 2020 was in line with the Board's expectations.

David Duffy, Chief Executive Officer:

"Virgin Money had a profitable and positive first quarter and continued to prioritise our customers and colleagues through this uncertain external environment including through payment holidays and Government lending schemes. We have made a good start to the year with the launch of new customer propositions, further roll-out of our rebrand programme and a return to statutory profit, while maintaining a disciplined approach. The Group remains strongly capitalised and we have good momentum as we look out into the remainder of the year.

Given the current UK-wide restrictions and ongoing uncertainty, we maintain the cautious economic outlook we outlined in November and our full year guidance remains broadly unchanged. Looking ahead, the vaccine roll-out and EU trade deal are encouraging for the UK's economic recovery and we remain focused on disrupting the market through a variety of innovative new products and propositions with a customer and brand experience that is the best in the market."

Q1 Summary – Resilient pre-provision earnings, low cost of risk; FY21 guidance re-affirmed

Stable balances reflect pricing discipline and COVID-19 restrictions on customer behaviour

- Customer deposits increased in Q1 by 0.9% to £68.1bn as further COVID-19 restrictions drove lower Personal customer spending and Businesses continued to maintain high levels of liquidity
- Q1 Mortgages reduced (0.2)% to £58.2bn as the Group focused on margin management and prudent underwriting standards given the uncertain macroeconomic outlook
- Q1 Business lending was +0.1% higher at £8.9bn with lower BAU balances offset by growth in Government-backed loans; BBLS: +14% to £923m, CBILS/CLBILS: +19% to £422m
- Q1 Personal lending reduced (2.0)% to £5.1bn as the impact of COVID-related restrictions resulted in lower retail card spending and reduced demand for personal loans

Stable Net Interest Margin (NIM) as expected; Favourable deposit pricing opportunities

- NIM was stable in Q1 at 152bps (Q4: 152bps), as expected, with higher liquidity and lower hedge contributions offset by an improving mix and cost of deposits, and supportive mortgage spreads
- The Group continues to expect a broadly stable FY21 NIM (vs FY20 level 156bps), based on the current economic outlook and interest rate expectations with the balance of risks and opportunities currently weighted to the upside
- Deposit pricing dynamics are supportive looking forward through the remainder of 2021

Low impairment charge reflects stable asset quality; Continued cautious economic outlook

- Maintained cautious IFRS 9 economic scenarios and weightings from FY20, with updated overlays reflecting recent experience and expert credit judgment
- The Group has not seen material changes in asset quality or specific provisions to date – the extension of Government support sees only a very modest increase in arrears relative to FY20
- Balance sheet credit provisions of £726m (FY20: £735m); coverage of 99bps (FY20: 102bps)
- Cost of risk 10bps (FY20: 68bps) reflects no change in economics or material specific provisions

CET1 ratio benefitted from lower RWAs driven by planned initiatives & HPI increases

- CET1 ratio increased c.50bps to 13.9%, including c.40bps from software intangible changes, c.10bps from the delivery of Business RWA opportunities, partly offset by a £49m charge for PPI in the period equivalent to 19bps
- The Group notes the PRA's anticipated consultation on eligibility of software intangible assets, and now expects a c.13% CET1 ratio in September 2021, excluding the intangible asset benefit, subject to the evolution of the economic environment
- P2A CET1 requirement reduced from 2.5% to 2.2%; Reduced CRD IV CET1 minimum to 9.2%
- Significant c.£1.0bn buffer above CRD IV minimum requirement (excluding software intangible benefits); £726m of provisions, leaves the Group cautiously positioned for an uncertain outlook

Supporting our customers

(£bn)	30 Sep-20	31 Dec-20	Q1 growth	YTD annualised
Mortgages	*58.3*	*58.2*	*(0.2)%*	*(0.9)%*
Business	*8.9*	*8.9*	*0.1%*	*0.5%*
o/w BBLS	*0.8*	*0.9*	*14%*	*n/a*
o/w CBILS/CLBILS	*0.4*	*0.4*	*19%*	*n/a*
Personal	*5.2*	*5.1*	*(2.0)%*	*(8.1)%*
Customer lending	72.5	72.2	(0.3)%	(1.2)%
Customer deposits	67.5	68.1	0.9%	3.5%
o/w relationship deposits	*25.7*	*27.0*	*5.0%*	*19.8%*

Strong levels of customer deposit inflows continued in Q1 with growth of 0.9% in the period. This reflected lower consumer spending given tighter COVID-related restrictions, and increased levels of business liquidity driving growth in relationship deposits of 5.0%, across Personal and Business customers.

There were early signs of some recovery in customer spending before tighter COVID-restrictions were imposed, however the combination of the most recent restrictions and customers' caution in the context of the economic outlook resulted in continued inflows. The increase in deposits saw the loan-to-deposit ratio fall to 106% (FY20: 107%). The Group continues to expect some reduction in deposit balances as we continue our strategy of optimising our deposit mix.

The total loan book declined by (0.3)% to £72.2bn as the Group continued to focus on margin management, prudent underwriting and supporting customers in a continued uncertain environment. A small reduction in mortgages and unsecured balances was partially offset by growth in Business lending.

Mortgage balances contracted modestly in Q1 by (0.2)%, as the Group focused on writing selective new business within a supportive pricing backdrop. The Group maintained prudent underwriting and valuation criteria in the quarter against an uncertain economic environment. Over the remainder of the year, the removal of temporary stimulus measures, such as the Stamp Duty holiday, may see market volumes slow. The Group will continue to be selective, focusing on balancing volumes and pricing carefully.

Business lending grew 0.1% in Q1, where a decline in BAU lending was more than offset by additional demand from customers through the Government-guarantee lending schemes. BBLS volumes increased 14% to £923m in the quarter, whilst CBILS/CLBILS increased 19% to £422m. The BAU book declined 2% to £7.6bn with more limited activity levels seen, particularly in overdraft facilities.

Personal lending balances reduced (2.0)% as the impacts of further COVID-related restrictions saw lower levels of new business and customers prudently reduce debt levels. Our resilient balance transfer book remained stable in the period and now represents 68% of the cards portfolio. The Personal Loan and Salary Finance portfolio performed resiliently against lower market demand and the Group has continued to focus on delivering strong margins on new business.

VMUK has also continued to support Mortgage and Personal customers through the Pandemic with payment holidays ("PHs") where appropriate. The stock of active payment holidays continued to decline across all portfolios. The proportion of customers requiring further support upon exiting their payment holiday has increased modestly, as anticipated, and remains within the level assumed in our provision. As noted at FY20, these cohorts of customers continue to have significantly higher provision coverage relative to the overall portfolio.

- c.£12.1bn Mortgage PHs granted at Dec-31 (FY20: £11.9bn) or c.21% of balances; currently £0.6bn or 1% active. Of matured payment holidays 98% have returned to payment (FY20: 98%)
- c.£265m Credit Card PHs granted at Dec-31 (FY20: £219m) or c.6% of balances; currently £35m or 1% active. Of matured payment holidays 88% have returned to payment (FY20: 92%)
- c.£119m Personal Loans PHs granted at Dec-31 (FY20: £103m) or c.14% of balances; currently £8m or 1% active. Of matured payment holidays 92% have returned to payment (FY20: 95%)

Stable NIM with momentum in deposit repricing; Subdued Non-interest income reflects dynamics of COVID

Group NIM was stable in the quarter at 152bps compared to Q4: 152bps. In Q1, higher levels of liquidity and the impact of a reduced contribution from the Group's structural hedge position, given the flat and low rate environment, were offset by deposit pricing improvements and supportive mortgage spreads.

As previously guided, NIM is expected to improve during Q2 and the Group continues to expect FY21 NIM to be broadly flat on FY20 levels, based on the current economic outlook and no change in base rates. However the balance of risks and opportunities are currently weighted to the upside given deposit repricing opportunities. Higher growth in lower-cost relationship deposits and a reduction in term deposits during Q1 provides additional opportunities to optimise the overall cost of deposits, subject to market conditions through the remainder of the year. Additionally, continued elevated deposit balances offer funding flexibility through reduced wholesale funding requirements, supporting the outlook for NIM.

Non-interest income performance remained subdued in the quarter, as increased COVID restrictions resulted in more muted economic activity.

Maintaining coverage levels given economic uncertainty

The Group has not yet seen any material changes in overall portfolio asset quality, nor been required to make any significant COVID-related specific provisions. Arrears have increased modestly in the quarter, from the subdued levels seen at FY20 but remain below historic average levels as customers benefit from the support available.

VMUK has maintained its cautious economic scenarios and weightings used at FY20. The Group's macroeconomic inputs are based on a probability-weighted combination of three economic scenarios from our 3rd party economics provider Oxford Economics (i) Upside (5% weighting), (ii) Base (50%), and (iii) Downside (45%). The weighted economic scenario includes a c.15% GDP trough, peak unemployment of c.10% and a peak-to-trough house price decline of >20%.

To supplement the modeled output, the Group continues to apply expert credit risk judgement through post-model adjustments (PMAs). These are designed to account for factors that the models cannot incorporate or where the sensitivity is not as would be expected under what is an unprecedented economic stress scenario. Overall modelled and individual ECL of £549m was unchanged (FY20: £549m) whilst PMAs of £177m (FY20: £186m) have been updated to reflect recent experience and the behaviour of customers on payment holidays.

In aggregate the £726m of credit provisions leaves the Group cautiously positioned for the forward economic environment. The Q1 impairment charge of £18m equates to a net cost of risk of 10bps which reflects cautious and unchanged economic assumptions, and the lack of any material specific charges or deterioration in asset quality in the period.

	Credit provisions at 30 Sep-20 (£m)	Credit provisions at 31 Dec-20 (£m)	Gross Lending at 31 Dec-20 (£bn)	Coverage ratio (bps)	Annualised net cost of risk (bps)
Mortgages	*131*	*122*	*58.4*	*20*	*(7)*
Personal	*301*	*301*	*5.3*	*603*	*124*
Business	*303*	*303*	*8.8*	*394**	*51*
Total	**735**	**726**	**72.5**	**99***	**10**
o/w stage 2	*465*	*470*	*12.6*	*367*	
o/w stage 3	*134*	*126*	*0.9*	*1340*	

* Government guaranteed lending balances excluded for purpose of coverage ratio calculation

Total credit provision coverage ratio declined 3bps to 99bps*, with Personal increasing by 12bps to 603bps, Mortgages reduced by 3bps to 20bps. Business coverage increased 3bps to 394bps* in the period.

The outlook for cost of risk for 2021 remains subject to the evolution of the forward-looking economic environment as well as the scale of underlying asset quality deterioration once government support measures are eventually removed. Given the extension of government support measures into the Spring, this deterioration is likely to be delayed further into FY 21.

Continuing to improve efficiency

The Group entered the year with good momentum in its cost reduction programme and has made further progress over the course of the quarter in line with expectations. Planned efficiency improvements are expected to deliver greater benefits in the second half and the Group continues to expect to deliver underlying operating costs of <£875m (inclusive of £10-15m of COVID19 related costs) in FY21. Exceptional items in Q1 totalled £101m including Integration and Transformation costs of £29m, acquisition accounting unwind of £20m, Legacy conduct costs of £49m and other items of £3m.

Strategic progress

At 31 December 2020, the Group had made good progress in rebranding the network with 74 stores representing nearly 50% of the network completed to date and we continue to expect to conclude the programme during H1. In line with our expectations laid out at FY20, we have delivered multiple innovative propositions in Q1; with Exclusive ISA savings offers, Brighter Money Bundles, and the second phase of our Home Buying Coach app all launched into the market. Alongside these new product launches, VMUK continues to focus on enhancing its digital capability. The delivery of new functionality in our digital offering, the launch of APIs for mortgage intermediaries and the ongoing digitisation of the customer journey, continue to underpin the long-term foundations for VMUK to Disrupt the Status Quo.

Well positioned for an uncertain environment

The Group's capital position remains resilient with the IFRS9 transitional CET1 ratio of 13.9% increasing c.50bps in the quarter (IFRS9 fully-loaded CET1 ratio: 12.9%). This increase was primarily driven by the updated treatment of software intangible assets adding c.40bps and the benefit of Business RWA model updates which added c.10bps, partly offset by 19bps for PPI. Q1 RWAs reduced by 1% to £24.2bn primarily reflecting the £0.2bn reduction from Business model updates and with mortgage RWAs benefiting from stronger HPI performance in the quarter. VMUK's Total Capital and UK Leverage ratios remained resilient in the quarter at 20.8% and 5.0% respectively.

The Group notes the PRA's recent announcement on the prudential treatment of software assets, and its intention to consult in due course, in respect of fully deducting all software assets.

To date, the Group has not seen material RWA inflation, given stable asset quality, with recent house price movements benefitting RWAs and the CET1 ratio in the period. The expected 2021 RWA and capital position remain subject to economic developments and delivery of RWA initiatives, subject to relevant PRA approval. Based on current expectations, the Group anticipates delivering a c.13% year-end FY21 CET1 ratio excluding the current software intangible benefit.

Funding and liquidity also remained robust, supported by the elevated deposit balances from consumers and businesses, the Group's LCR position has increased to 151%. In January, the Bank of England confirmed that it expects the Group to meet an end-state MREL requirement (plus buffers) of 27.3% of RWAs from 2022. The Group's IFRS9 transitional MREL ratio of 29.0% (FY20: 28.4%) exceeds this end-state requirement, and now anticipates a modest £0.5bn of MREL senior debt issuance in 2021 as the Group continues to build a prudent management buffer to regulatory requirements.

In line with PRA policy statements, the Group received an updated P2A requirement in Q1 with the CET1 element reducing from 2.5% to 2.2%. While this has been offset by other regulatory requirements, the Group's CRD IV minimum CET1 capital requirement (or MDA threshold) has reduced to 9.2%. The current transitional CET1 ratio equates to c.£1.0bn buffer to this regulatory minimum, excluding the benefit from the change in software intangible treatment in the period.

Legacy Conduct

The Group completed the final processing of all legacy PPI complaints on Monday 25th January. Since the beginning of the programme a total of c.740k complaints have been processed at a cost of £3.1bn. As a result of the completion of that activity, the Group has assessed a further charge of £49m is required. A higher conversion of IRs into complaints, driven by the final validation of IRs to complaints as the programme concluded, saw a small increase in the final number of complaints and drove some additional expense. The Group also saw a higher level of average redress and higher uphold rates on the final cohort of complaints relative to expectations and long-term trends. Further, the Group has set aside some of the provision to cover final review and validation work as the programme finally completes, in line with regulatory requirements and expectations. Notwithstanding the charge, the Group remained profitable in the period. Legacy PPI operations are expected to conclude in the short-term.

Outlook

The economic outlook remains highly uncertain and given the extension of Government support measures it will be further into FY 21 before greater clarity emerges. The recent UK-EU trade agreement and accelerating delivery of the UK's COVID-19 vaccination programme are both supportive to the longer-term economic recovery. However, recent further restrictions across the UK as a result of record infection levels are likely to delay the pace of normalised economic and transaction activity. As a consequence, VMUK continues to adopt a cautious view on economic assumptions and this is reflected in coverage levels, underwriting standards and liquidity levels.

The BoE 2020 ACS was cancelled as a result of COVID-19, to free up operational capacity and to help lenders continue to meet the needs of UK households and businesses. The Group will take part in its first concurrent stress test in 2021.

As previously guided, NIM is expected to improve during Q2 and the Group continues to expect FY21 NIM to be broadly flat on FY20 levels, based on the current economic outlook and no change in base rates. However the balance of risks and opportunities are currently weighted to th e upside given deposit repricing opportunities.

The Group returned to statutory profit in Q1 2021, continues to perform resiliently, is robustly capitalised, and reaffirms the FY21 guidance and targets set out at FY20 results.

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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

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