VIRGIN MONEY UK

27 July 2021

Virgin Money UK PLC: Third Quarter 2021 Trading Update

Virgin Money UK PLC ("VMUK" or the "Group") confirms that trading in the three months to 30 June 2021 was in line with the Board's expectations.

David Duffy, Chief Executive Officer:

"Virgin Money performed well as our strategy continued to translate into improved financial delivery in a strengthening environment. We carried our momentum of relationship deposit growth into the second half, reducing our cost of funds. Our asset quality remained robust, while capital ratios improved further.

"The positive reaction to our switching incentives and product launches reflects our focus on transforming customer experience, backed by the unique advantages of one of the world's most-recognised brands. We have also advanced our ESG agenda with our first greener mortgage product and sustainability-linked business loans.

"We have increased full-year NIM guidance and, while COVID continues to impact the near-term, we have a strong capital position and robust provisions. We see great opportunities from further developing our digital capabilities to deliver an improved customer experience and greater efficiencies. We are well placed to grow profitably next year as we play our role to support the UK economic recovery."

Q3 Summary – Continued financial & strategic momentum; improving asset quality backdrop

Strong relationship deposit balance growth with stable lending balances

- Relationship deposits increased 3.7% to £29.8bn, whilst overall deposits decreased by (0.8)% to £68.0bn as the Group continued to manage the deposit mix and reduce funding costs
- Mortgages increased 0.7% to £58.7bn benefitting from strong activity around SDLT deadlines
- Personal lending grew 2.5% to £5.2bn driven by growth in credit cards as activity picked up
- Business lending was (2.4)% lower at £8.7bn as BAU activity remained subdued and Government-backed loans reduced as anticipated

Continued Net Interest Margin (NIM) momentum

- NIM improved in Q3 to 168bps (Q2: 160bps) benefitting from a lower cost of funds driven by improvements in deposit mix and repricing as well as higher hedge contributions, partially offset by a more competitive lending backdrop
- Expect NIM to be modestly ahead of 160bps for FY21, stabilising into Q4, as wholesale funding costs and increasing competition offset the ongoing deposit repricing benefits

Ongoing strategic progress; continuing to invest in our future potential and digital capability

- Further growth in new PCA customers to c110k this financial year, benefitting from Brighter Money Bundles campaigns; positive response to credit card cashback offers with 175k registrations and with instalment payments launching later in the year
- Relaunched BCA awarded Moneyfacts 5* rating; innovative Wellness Tracker and Working Capital Solutions set to launch later this year, leveraging the capabilities of our fintech partners
- ESG progress: Launched greener mortgage product and first sustainability-linked business loans

Improving economic outlook and robust asset quality

- Robust credit quality maintained across key portfolios with no significant specific provisions in Q3; balance sheet credit provisions of £678m (H1 21: £721m); coverage of 94bps (H1: 100bps)
- Q3 impairment release of £19m driven by lower modelled ECL from updated macro assumptions
- Quarterly cost of risk of (10)bps (H1 charge: 11bps); year-to-date cost of risk now 4bps
- If the current strengthening in the economic backdrop persists, the Group believes there may be an opportunity for a further reduction in credit provision levels alongside FY21 results

Improved CET1 ratio with FY outlook improved

- CET1 ratio increased c.40bps to 14.8% (including c.45bps of software benefit); benefited from continued strong profitability and benign RWA backdrop; fully loaded CET1 ratio now 13.7%
- Expect FY21 CET1 to be broadly stable against Q3 level, including the software benefit; RWA inflation more likely in FY22
- Solvency Stress Test (SST) outcome and impairment outlook remain key inputs into our approach to considering shareholder returns; expect a further update on our capital framework post-SST

Pioneering Growth

(£bn)	30 Sep-20	31 Mar-21	30 Jun-21	Q3 growth	YTD annualised
Mortgages	*58.3*	*58.3*	*58.7*	*0.7%*	*0.8%*
Business	*8.9*	*8.9*	*8.7*	*(2.4)%*	*(4.0)%*
o/w BBLS	*0.8*	*1.0*	*0.9*	*(3.6)%*	*21%*
o/w CBILS/CLBILS	*0.4*	*0.4*	*0.4*	*(2.2)%*	*32%*
Personal	*5.2*	*5.1*	*5.2*	*2.5%*	*(1.1)%*
Customer lending	72.5	72.2	72.5	0.4%	0.1%
Customer deposits	67.5	68.5	68.0	(0.8)%	0.9%
o/w relationship deposits	*25.7*	*28.7*	*29.8*	*3.7%*	*21.5%*

The Group continued to manage down the cost of deposits in a supportive environment with an improvement in mix, as relationship deposits grew 3.7% during the quarter. Overall deposits reduced (0.8)% with more expensive term deposit balances declining in line with expectations as we continued to reprice the portfolio lower.

Mortgage balances increased in Q3 by 0.7% reflecting higher volumes of new lending and buoyant market conditions ahead of the SDLT changes. Spreads tightened during the period as anticipated and the Group continues to be selective, balancing volumes and pricing carefully.

Business lending declined (2.4)% in Q3 with a reduction in BAU and Government-scheme volumes. The BAU book declined (2.2)% given lower market activity which is expected to improve later in the calendar year. Following the expiry of the one-year interest free period for the majority of CBILs and BBLs customers, Government backed balances declined (3.2)% to £1.4bn as some borrowers started to repay.

Personal lending balances increased 2.5% in Q3. Aggregate credit card spending levels have recovered to pre-COVID levels but with more impacted sectors, such as travel, remaining subdued. Overall, the cards book returned to growth driven by a recovery in both transaction-based and balance transfer balances. The Personal Loan and Salary Finance portfolios performed resiliently against continued subdued market demand.

Group NIM improved 8bps in Q3 to 168bps (YTD: 160bps 9 months annualised), as the benefit of the structural hedge contribution and reductions in deposit pricing provided continued momentum, offsetting a more competitive lending environment. The Group now expects NIM to be modestly ahead of 160bps for FY21, stabilising into Q4, as wholesale funding costs and increasing competition offset the ongoing deposit repricing benefit.

Non-interest income performance remained subdued in the period, given the timing of restrictions being eased, but with some early signs of recovery in card spending fees towards the end of the quarter.

The UK economic outlook improved further in Q3. The rollout of the vaccination programme and the easing of restrictions supported further positive revisions to expectations. Stronger GDP growth, lower unemployment, a robust housing market and greater consumer confidence are all positive indicators of the improving outlook for the operating environment. Overall, while risks remain from the increase in COVID case numbers driven by the new variants and the impact of the removal of Government support schemes later in the year, the strengthening backdrop gives scope for greater optimism about the pace of the recovery.

Delighted Customers and Colleagues

We continued to attract new PCA customers in the quarter, with accounts opened this financial year now approaching 110,000 in total (H1: c.80,000) as our Brighter Money Bundles campaign was launched in November. The third Bundle featuring £150 vouchers for Virgin Experience days has recently been launched, continuing to offer a differentiated proposition in the market. Credit card cashback sign-ups have reached 175,000 (H1: 100,000) and we continue to focus on delivering new propositions such as instalment payments on credit cards in Q4 and additional rewards for debit card customers. The Group is focused on delivering a market-leading customer experience, which will be supported by further investment in digitising the whole customer journey, driving up advocacy levels and improving efficiency.

The Virgin Red reward programme continues to gather momentum, with a growing number of users signed up and over 200 ways to earn and spend Virgin points across Virgin Group companies and other retailers. The offer for the Virgin Atlantic Credit Card was recently launched on the app, to sit alongside the exclusive 15,000 points offer for Red users switching to our M Plus PCA. We are currently exploring the potential to launch other attractive offers for Virgin Money products through the Virgin Red programme.

Our new BCA proposition which launched during Q3 has been rated 5* by Moneyfacts. Switching volumes will be supported in the coming quarters by the launch of our business Wellness Tracker and the wider Working Capital Health proposition later this year, as well as our recently launched partnership with Virgin StartUp. After the end of the quarter, the Group also received notification that with nearly 16k firms having switched their BCA to VMUK through the BCR Incentivised Switching Scheme, the Group had been awarded an additional £8.9m to encourage further account switching activity.

The Group is also continuing to work on transforming its operating model, launching the initial phase of our “Life More Virgin” approach to working. As our colleagues have adapted to the changing environment, the Group remains focused on enabling a more flexible approach to work as we disrupt the status quo. The new approach will support both productivity and wellbeing, improving collaboration and innovation, driving a great experience for our colleagues and customers.

In Q3 our ESG agenda continued to gather pace. We launched new propositions including our first greener mortgage product which we will develop further over the coming months. In Business banking, we advanced our first Sustainability-linked loans for commercial businesses, designed to support businesses whose core activities proactively help the economy transition to a more sustainable economic and environmental model. The Group also switched to Biogas in Q3, saving an estimated c.9 tonnes of carbon emissions per day. All the energy where the Bank is responsible for supply is now sourced renewably.

Super Straightforward Efficiency

The Group has made further progress in reducing its cost base in the third quarter as expected, and continues to anticipate underlying operating expenses of less than £890m for FY21, and less than £430m for H2. Exceptional items in Q3 totalled £(34)m including Integration and Transformation costs of £(22)m and acquisition accounting unwind of £(12)m.

As outlined at the interim results in May, the Group continues to see increasing customer appetite for digital self-service and is evaluating the opportunities to accelerate its digital strategy to deliver an improved customer experience and drive additional efficiencies over time. Our work continues to target (i) increased customer digital adoption, (ii) greater flexibility in colleague working arrangements through our “Life More Virgin” programme and (iii) the potential for further automation. We will give more detail of the potential benefits and incremental associated investment required alongside FY21 results.

Discipline & Sustainability

Credit quality remained robust in the period, with the overall portfolio performing well and no significant specific provisions. Macroeconomic inputs used in the Group’s IFRS9 modelling were fully refreshed in the quarter with March data from our 3rd party provider Oxford Economics. The Group continues to use a weighted average of 3 scenarios: (i) Upside 20%, (ii) Base 50%, (iii) Downside 30%; full details of the weighted average scenario are in appendix 1. Positive revisions to the key economic inputs and a more balanced selection for the ‘Base’ scenario contributed to the overall reduction in aggregate credit provisions to £678m (H1: £721m). The decline was primarily driven by a reduction in modelled ECL which reduced to £327m in the period (H1: £462m) across stage 1 and 2 loans, particularly in Personal and Business banking.

The Group continues to supplement the modelled output with expert credit risk judgement applied through post-model adjustments (PMAs) to account for factors the models cannot incorporate or where the sensitivity is not as would be expected under the unprecedented economic stress scenario. Given the uncertain outlook, the Group decided to increase PMAs, mainly in Business Banking, taking overall PMAs held to £320m (H1: £222m). Overall coverage remains robust, having reduced 6bps to 94bps*.

The Q3 impairment release of £19m equates to a net Q3 cost of risk of (10)bps. The Group remains focused on any potential implications for customers as Government support is fully removed. Nonetheless, if the current strengthening in the economic backdrop persists, the Group believes there may be an opportunity for a further reduction in credit provision levels alongside FY21 results.

	Credit provisions at 31 Mar-21 (£m)	**Credit provisions at 30 Jun-21 (£m)**	**Gross lending at 30 Jun-21 (£bn)**	**Coverage ratio (bps)**	**Annualised net cost of risk (bps)**
Mortgages	*132*	*131*	*59.0*	*22*	*0*
Personal	*293*	*261*	*5.6*	*528*	*43*
Business	*296*	*286*	*8.5*	*379**	*6*
Total	**721**	**678**	**73.1**	**94***	**4**
o/w stage 2	*480*	*446*	*9.6*	*462*	
o/w stage 3	*101*	*93*	*0.9*	*954*	

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

VMUK remains strongly capitalised and CET1 improved c.40bps to 14.8% on an IFRS9 transitional basis in the quarter, including c.45bps of benefit from the treatment of software intangible assets. Fully loaded CET1 also remained robust in the period improving to 13.7% (H1: 13.2%). Underlying capital generation in the quarter more than offset the increase in RWAs, which were 0.5% higher at £24.3bn primarily reflecting the prudent application of additional PMAs related to economic uncertainty and PD recalibration, offset by lower RWAs in Business banking. VMUK's Total Capital and UK Leverage ratios remained resilient at 22.8% (H1: 21.2%) and 5.4% (H1: 5.2%) respectively. The Group remains focused on its inaugural Solvency Stress Test participation, ahead of the bank-by-bank results announcement in December.

Given the improved economic outlook, the Group has not seen material RWA inflation as HPI increases have largely offset PD recalibrations. Potential RWA migration continues to be delayed by the levels of support available to customers, however the Group is closely monitoring higher risk customers for any early signs of PD deterioration. The removal of the c.45bps CET1 benefit from software intangible treatment is now expected in H1 FY22. Hybrid mortgage model implementation is currently anticipated in 2022. Combined with the stronger economic outlook, the Group expects FY21 CET1 to be broadly stable at the Q3 level, including software benefit; with RWA inflation more likely to occur in FY22.

The Group expects a tax credit for the year driven by the reassessment of historical losses and reflecting the substantive enactment of the corporation tax rate change from 19% to 25%, effective 1 April 2023, although this is not anticipated to have a material overall capital impact.

Funding and liquidity remain strong, with the LCR stable at 151% as elevated deposit balances including a higher mix of relationship deposits and further wholesale issuance in the period were offset, primarily by TFS repayments. In May the Group successfully issued €500m of MREL senior debt and £300m of Tier 2, achieving significantly tighter pricing than prior issues, with further tightening in the secondary market. After these transactions, the IFRS9 transitional MREL ratio improved to 32.7% (H1: 29.3%). This represents a prudent buffer of c.6% or c£1.5bn over the Group's expected 1-Jan-22 MREL requirement of 26.4% with no further AT1, Tier 2 or Senior Unsecured issuance anticipated over the remainder of the calendar year 2021.

Given the improved outlook for the UK economy, since H1 both S&P and Fitch revised their outlook on the Group's long-term ratings to Stable, from Negative.

Appendix 1: Key macroeconomic assumptions

Scenario	**Economic measure**	**2021**	**2022**	**2023**	**2024**	**2025**
Weighted Scenario	*GDP (yoy %)*	*5.8%*	*5.1%*	*1.9%*	*1.5%*	*1.7%*
	Unemployment (average)	*6.1%*	*5.7%*	*5.3%*	*4.9%*	*4.7%*
	HPI (Q4 (Dec) yoy %)	*(3.0)%*	*(8.6%)*	*(2.3)%*	*2.4%*	*4.6%*

Source: VMUK calculations, Oxford Economics March 2021 IFRS9

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

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