# Virgin Money UK PLC 2023 Interim Results - Fixed Income Call Transcript

**Hosted by Justin Fox (Treasurer) and Richard Smith (Head of Investor Relations)**

**Justin Fox, Virgin Money UK PLC**

Good morning, everybody. Thanks for taking the time to join us. I'm Justin, the Group Treasurer and I am joined on the phone this morning by Richard Smith, our Head of Investor Relations; Matthew Harrison, Head of Treasury Debt Capital Markets; and Gareth McCrorie, our Debt Investor Relations and ESG Manager.

Yesterday we presented our 2023 interim results and hopefully a number of you had a chance to watch that online. If you didn't and you want the materials, please go to the "Financial Results" section of the website, where you'll find the webcast from yesterday's presentation and today's slides, which Richard and I will go through.

From my point of view, we have both the small luxury and curse of reporting after our peer group. And therefore, in many ways, yesterday, 'May the 4th ' wasn't with us. I think Debt and Equity took a turn to the dark side, so we're going to try and rectify that this morning and cover in a little bit more detail some of the themes that we discussed yesterday. And as always, we're very grateful for any feedback you have on the content of this morning's session.

We will go through the first half of our financial performance, walk you through the key elements of our capital, funding and liquidity position and then update you on our issuance plans for the remainder of the year. Then we'll offer up some other themes that we think are interesting and worth talking about, and finally we we'll open up for Q&A. I am now going to hand over to Richard to talk you through our interim results.

**Richard Smith, Virgin Money UK PLC**

Thanks Justin, and good morning everyone. Starting with the key performance headlines on Slide 4. In the first half, our strategy and rates backdrop have continued to translate into good financial performance. We saw the benefit of our digital investment in our relationship banking model coming through increasingly, both in terms of income and customer numbers, as well as the strength of our balance sheet. Our previous investments in efficiency and automation of our customer journeys have so far delivered £93m of the £175m cost savings target. In other words, half of the planned savings have been achieved halfway through the plan, and while our costs were temporarily 5% higher in H1, our cost:income ratio has declined from 54% to 51%.

We're pleased with our earnings momentum in H1. Our pre-provision profits of £456m are up 16% year-on-year, and we've seen a strong performance in income growth of 10%, primarily driven by the further expansion of our net interest margin (NIM), which reached 191bps for the half. Given the recent market volatility, we've been very focused on delivering profitable growth, and we've priced mortgages tactically, given the margin compression caused by the 41% reduction in mortgage applications volumes. We've tightened our credit criteria in Unsecured further, while in the business bank, we've targeted growth in sectors that are performing well in the current cycle. Our growth strategy is proving effective in terms of building improved margins overall.

In terms of our balance sheet, our funding and liquidity remain robust, supported by strong deposit inflows, which grew 3% in the half. Our LCR has increased to 153%, with 72% of our total balances insured under FSCS. Our loan-to-deposit (LDR) ratio has declined further, to 108%. Our updated provision coverage already reflects the expectation that arrears will continue to rise from recent low levels. These changes are model-driven and although we expect arrears to continue to increase, we have not seen any material arrears in the portfolio overall to date. Given a historical performance and quality of our portfolio, 72bps of coverage represents a strong provision level which remains above pre-pandemic levels. Our CET1 ratio of 14.7% is strong and includes the absorption of 30bps for our latest view of hybrid mortgage models, and the completion of our previous buyback in H1.

As we look out over the remainder of the year, we expect our cost income ratio to be in the range of 51 to 52%, reflecting some temporary spending to improve customer service and a slower implementation of our mortgage platform. As we reaccelerate our automation activity in H2, and these temporary costs drop away, we remain very confident in delivering our less than 50% cost income ratio in FY24. We're upgrading our NIM guidance for FY23, based on the strong margin performance seen during the first half. We now expect to deliver at the c.190bps level, which is at the top of our previous guidance range.

Finally, given the surplus capital being generated, we will continue to build a track record of returning capital to our shareholders this year, and we are announcing a 3.3p interim dividend for the first half. As previously guided, we'll make further announcements on buybacks later in the year, after the ACS.

Let me now turn to Slide 5, and the macroeconomic environment that we're operating in. Our strategic delivery has been achieved despite a muted economic backdrop -- although there are signs of this already starting to improve in the second half of the year. Inflation in the UK is proving stubborn, particularly in some areas of core spending, like food, although there are offsets coming through in lower energy prices and generally a tight labour market overall. The GDP outlook is modestly lower, but, at the same time, the UK looks set to avoid a significant recession. As markets and the economic outlook start to improve, we've seen the rate curve flattening out, driving a lower outlook compared to Q1 and FY22. But even at these lower levels, the rate outlook offers us opportunities in the refinancing of our structural hedge at meaningfully higher levels. Justin will discuss this in more detail in his section.

Critically, we continue to see Unemployment remaining low by historical standards, which underpins credit quality, and overall, the more balanced outlook is setting the scene for the next phase of our delivery, which moves us on to lending on Slide 6.

In lending, we traded well over the half against a tough backdrop. Overall, lending finished flat, as growth in Business was offset by a reduction in Mortgages, and Unsecured remained stable. Mortgage balances were a little under 1% lower, a decent performance against a challenging market, as activity levels slowed. We're particularly pleased with our growth in Business, despite the slower market, reflecting the strength of our national and sector-specialised franchise. In Unsecured, we saw modest growth in credit cards, offset by a reduction in personal loans. Card balances were up around 2% during the first half, a slower pace of growth compared to last year, reflecting a further tightening of our credit criteria and our disciplined approach to profitability on the portfolio overall.

Looking forward, we expect total lending balances to remain broadly stable in the second half of the year. In Mortgages, we expect activity to remain muted. In Business, we expect a more moderate pace of growth through the remainder of the year, and in Unsecured, we will look to grow balances modestly further.

I will now talk through the key balance sheet items from Slide 7. We're pleased with the strength of our funding franchise, supporting both a robust balance sheet and our margin outlook. It's good to see our continuing growth in relationship deposits over the first half. In line with the market, we are also seeing higher flows into term deposits, reflecting the rate environment. We're actively participating here, enabling us to lock in term funding at pricing below swaps. Altogether, we grew relationship and overall customer deposits at 3%, outperforming the market and our large UK peers, and reducing our loan-deposit ratio to 108%. The strength of our deposit gathering capability, and continued improvement of our funding mix, leaves us well-placed, despite recent turbulence, to support our lending growth and the refinancing of our TFSME over the coming years.

I will now provide an update on credit performance on Slide 8. We're happy with the quality of our lending book, and we remain well-positioned to manage through current risks and uncertainties. On the left, we've set out ECL over time. You can see that, during the first half, the increase in ECL was primarily model-driven. We adopted updated macroeconomic scenarios at our half-year, which now reflect the post mini-budget downgrades to the economy, giving the timing of our reporting cycle. So our macros are now broadly in line with what we've seen from peers who had December Full Year reporting dates. Alongside this, we've also reduced post-model adjustments relating to potential cost of living impacts, and these risks are now better reflected in the modeled outcome.

The net impact of all of this is at a headline level, total provisions have increased from FY22, resulting in £144m impairment charge, equivalent to an annualised cost of risk of 40bps, modestly above our previously guided run rate. Whilst our credit quality is resilient, we do expect to see a continued normalisation of arrears. That expectation is reflected in our provision coverage, which strengthened further to 72bps. As you can see from the chart on the right, this coverage level is prudent and well above the pre-pandemic level. Given the increase in our credit provisions in the first half, we now expect the cost of risk for the year to be in the range of 35 to 40bps in 2023. So, while our credit quality indicators remain relatively benign, we're well positioned for uncertainty that lies ahead, as I'll now explain in more detail on Slide 9.

We've updated this slide from our Full Year results in November and shows the strength of our portfolio and why we're comfortable with our credit quality and underwriting. Overall, our total portfolio is defensively positioned with balances strongly weighted towards mortgages, which remain around 80% of Group lending. Our mortgage book is a low-risk, prime book, weighted towards owner occupied, originated with strict affordability assessments, with only 6% above 80% LTV and largely on fixed rates.

Our business portfolio remains well diversified, with strong collateral levels and skewed to lending to resilient sectors. We have minimal Commercial Real Estate (CRE), just 8% of business lending, or 1% of overall Group lending. This is conservatively positioned with an average LTV of around 50%. In Unsecured, our underwriting criteria are prudent, and we tightened this further over the course of the year to reflect affordability stresses on customers. Our unsecured customers are generally more affluent, their retail spend has remained resilient over the past year and continues to be weighted towards discretionary or luxury items. Their repayment rates remain stable, and all of that indicates continued good credit quality.

Finally, I'll conclude with the guidance on Slide 10. We summarise guidance for FY23 on the left and reiterate the outlook for FY24 on the right. We've mentioned the various details over the course of the Results presentation yesterday. But just to summarise -- we're now upgrading the Full Year NIM to be around 190bps, we anticipate that the cost income ratio for FY23 will be in the range of

51 to 52% and following the increase in credit provisioning levels in the first half, we now expect that the Full Year's cost of risk will be in the range of 35 to 40bps. We expect to resume buybacks after the results of the ACS in July, while maintaining our CET1 above 14% for the year.

In terms of our FY24 guidance, we remain committed to our double-digit ROTE target set out in November 2021, supported by less than 50% cost income ratio. Finally, we expect to operate within our target capital range by FY24. Overall, I'll conclude by saying that our strategy remains the right one in the current environment, we continue to make good progress during the first half and our outlook is positive. With that, I'll hand it back to Justin.

**Justin Fox**

Thanks, Richard. As you can see on Slide 12, the Group remains very strongly capitalised and with a business that has delivered 72bps of underlying capital generation. In the first half, we recognised a management adjustment reflecting the impact of adopting mortgage hybrid models, something we mentioned at full year. This resulted in an additional £400m of risk weighted assets (RWAs) and a modest increase in excess expected loss, together consuming around 30bps of capital -- that's below the 60bps that we had originally anticipated. This allowed us to close the half year with a 14.7% CET1 position, considerably above our target range, which I will come on to.

If we can now move on to Slide 13. As you can see, our capital position remains robust across all measures. Against the 14.5% requirement, our Total Capital of 21.2% remains strong, and our leverage ratio of 5% remains in excess of minimum requirements. Finally, and I'll expand on this a little further on Slide 16, MREL resources of 31%, which when expressed as a percentage of RWAs, provides a prudent headroom of £1.3bn or 5.4% above the loss absorbing capacity requirement of 25.6% when expressed as a percentage of RWAs.

Moving on to Slide 14. Again, you'll recognise this slide from our Full Year, and our target capital range of 13 to 13.5%. As we said in November, we expect to stay above 14% this year reflecting current economic uncertainties. We currently have around £300m of surplus capital before future capital generation gets considered, and that's relative to the 13.5%. As Richard mentioned, we expect to operate within our target capital range by the end of FY24. We remain less susceptible to future headwinds on capital; Basel 3.1 should be largely neutral on day one, and our pension fund still has a strong IAS 19 surplus.

So, now turning to the breakdown of our capital stack on Slide 15. We've mentioned this in prior presentations, but it's worth reiterating; compared to others in the market, we have a very straightforward capital structure. All the Group's regulatory capital and MREL is issued by a holding company, Virgin Money UK PLC. It's fully eligible, so there are no issues around grandfathering. There is also no FX exposure in the capital structure, providing stability during periods of market volatility. We have excess total capital of 6.8% over and above our regulatory minimum, or a buffer of roughly £1.7bn. While we don't have a target level of AT1, or Tier 2 per se, we're always looking to manage our buffers in an efficient manner whilst maintaining headroom above regulatory optimum levels, to support both future growth, and potential RWA headwinds.

Over the medium term, our AT1 and Tier 2 stack will evolve as we manage buffers within the parameters I've just mentioned, primarily through redemptions and refinancing activity and this was evidenced with the way we managed the AT1 bucket over 2022. As a reminder, our call policy remains unchanged. Future capital call decisions will be assessed on a broad economic basis. We will try and balance factors including balance sheet movements, relative funding costs, current and future regulatory capital and MREL, rating agency treatment, wider wholesale funding needs and prevailing circumstances at the relevant time. Of course, calls are all subject to PRA approval, with whom we have an active dialogue.

Finally, whilst our next AT1 call date is not due until next June, it's worth taking moment to address the asset class given recent events. The structure of our AT1's are in line with that of larger UK banks and are convertible into shares on breach of the standard 7% CET1 trigger, or can be converted or written down at the discretion of the Bank of England at the point of non-viability through the exercise of their statutory powers under the Banking Act 2009. The Bank of England has been very clear in stating that they would respect the creditor hierarchy in any resolution or insolvency event which should provide further reassurance to all of you debt investors.

If I can now turn to our MREL position on Slide 16. We've been subject to MREL end state requirements since the 1st of January 2022, which requires the Group to hold capital resources and eligible debt instruments equal to the greater of two times the Total Capital Requirements (TCR), that being two times the sum of Pillar 1 plus Pillar 2a, or two times the UK Leverage Ratio requirement. In addition to MREL, the Group must also maintain any applicable capital buffers, which together with MREL, represent the Group's loss absorbing capacity, or 'LAC' requirement.

Just to note, we have changed our disclosure slightly here to give you both the Leverage-based and the RWA-based LAC requirements, both expressed as a percentage of RWAs. As you can see, there's currently very little difference between the two. In the future, we do expect to revert to the RWA measure being the binding requirement for MREL purposes. With this in mind, as of 31st of March 2023, the Group's Leverage-based LAC requirement of 7.5% of Leverage Exposures (25.6% when expressed as a percentage of RWAs), was greater than the RWA-based LAC requirement of 25.4%, meaning the Leverage measurement is the binding requirement. MREL resources were £7.7bn, equivalent to 9.1% of Leverage Exposures, or 31% when expressed as a percentage of RWAs. This provides prudent headroom of about £1.3bn or 1.6% above the LAC requirement of 7.5% of Leverage Exposures, or 5.4% above the LAC requirement of 25.6% when expressed as a percentage of RWA.

Again, we do aim to maintain a suitable buffer over our end state requirements to help better manage maturity risk. With respect to our HoldCo Senior issuance plans, we announced our intention to call the £500m MREL Senior note on its first call date at the end of this month, having already refinanced this via the €500m MREL Senior transaction issued in early February. As previously guided, given our MREL position, going forward, issuance will be broadly limited to maintaining the current surplus to regulatory requirements. Finally, it's just worth noting that our Total Capital and MREL buffers would remain comfortable, even at our target operating CET1 range and fully optimised AT1 and Tier 2 buffers.

Turning to funding on Slide 17. The quality of our deposit franchise has supported both resilience and margin. In terms of resilience, the Group has a stable funding base with customer deposits representing roughly 80% of total funding. As the top left shows, our customer deposits are weighted towards retail customers, about 76%, with the balance being from business customers predominantly SMEs, with an emphasis on the S. Importantly, of the total customer deposits, 72% is insured by FSCS. Of the portion that is uninsured, a high percentage is fixed term and/or would incur a charge if customers wanted to withdraw their money. The stability of our funding sources is also highlighted in our NSFR ratio of 136%, which is comfortably in excess of the binding minimum requirement of 100%. Top right, you can see that we have continued to attract strong deposit inflows across the first half, demonstrating our deposit gathering capability and the strength of the franchise and new product propositions.

Turning now to income. Richard mentioned earlier that our deposit performance has underpinned our margin performance. Looking back, you can see bottom left that we have significantly matured our deposit mix, growing lower-cost relationship deposits, while reducing reliance on secondary savings. More recently, we've been active in the market for term deposits, given the pricing opportunities available and the state of the market. This demonstrates our ability to trade tactically and make our size work for us when market conditions are favorable. This mix shift, alongside higher rates, has contributed to a material improvement in our deposit book spread, while offering good value to customers, as you can see bottom right. At this point in the cycle, we feel we are less exposed to rising deposit rates and deposit attrition than some of our larger peers given our strong franchise, our deposit mix, and customer friendly proposition, so we expect to continue to grow deposits modestly further in FY23.

Moving to Slide 18, the Group has a stable and diversified wholesale funding base. As noted in prior presentations, we have negligible short term wholesale funding, and that position hasn't really changed. Of our total debt securities issued, only 20% have a less than one year to effective maturity, reflecting term issuance roll-downs - again, both drivers of our NSFR strength. Following the recently announced MREL call, we have no further capital or MREL call dates and maturities ahead of this year's financial year end. We've also repaid £200m of TFSME in the period, so we now have £7bn outstanding, with contractual maturities ranging from the end of Full Year ‘24 to Full Year ‘26. Given our strong deposit performance, and proven wholesale funding market access, we feel well placed to manage this refinancing requirement, and we still expect to repay TFSME about one year ahead of contractual maturity, with flexibility to repay sooner subject to market conditions. Given the strong deposit performance in the first half of 2023 highlighted in the prior slide, our secured issuance requirements are now expected to be at the lower end of the £1.5 to £2.5bn guidance we gave at Full Year ‘22, and as ever, subject to ongoing deposit flows and relative costs.

Moving on to Slide 19. In response to recent market volatility, we opted to hold more liquidity on the balance sheet. This has provided additional headroom to both internal and regulatory requirements with the LCR increasing by 15 percentage points compared to the end of Full Year ’22, to 153%. As you can see from the slide, we have consistently held prudent buffers in excess of regulatory requirements, and we would expect this to continue going forward. Our liquid assets are high quality and consist primarily of cash at the Bank of England and the remainder consisting of UK government securities, AAA rated listed securities, i.e., bonds issued by Supranationals, or covered bonds.

From an LCR perspective, this means the majority of our HQLAs are classified as Level 1, with only circa 2% classified as Level 2a. And just to reassure everybody, our liquid asset portfolio is fully hedged, from interest rate, inflation and FX risk perspective and the portfolio is accounted for at fair value through other comprehensive income (FVOCI), meaning movements and fair value are recognised in our CET1 positions via the FVOCI reserve. On top of that, we also have unencumbered prepositioned collateral at the Bank of England representing roughly £5bn of secondary liquidity drawing capacity via the bank’s Sterling monetary framework and that does not form part of our liquid asset portfolio for LCR or for internal stress outflow purposes. Over time, the stock of unencumbered prepositioned collateral will increase as remaining TFSME drawings are repaid, and then in addition to that, the Group has a further £19bn of unencumbered assets that are eligible and readily available but not currently prepositioned at the Bank of England.

Turning now to the structural hedge and our rate sensitivity on Slide 20.

We set out here how our structural hedge is supporting margin alongside our usual rate sensitivities. The hedge is a strong underpin to our margin outlook. We introduced the structural hedge when the rate environment was significantly lower, and so now continue to benefit from materially higher reinvestment rates. You can see from the chart on the left how we expect the structural hedge to continue to be supportive for net interest margin. Even before considering reinvestment hedges already written, we'll deliver gross income, in FY23, higher than what we saw in FY22. In addition to this, you should consider the reinvestment yield available, with current five-year swap rates at around roughly 4% relative to the average redemption yield in the second half of around 1%. Expect the hedged notional to begin to reduce somewhat over the second half of the year, reflecting the modest shrinking of variable savings back book, however, this will have little effect on net interest income given the current shape of the rate curve, that is with Sonia broadly equivalent to the five-year rate.

On the right, we have set out our usual interest rate sensitivity using our standard pass-through assumptions. You'll note our rate sensitivity remains positive in year one, even in a 25bps down scenario. This reflects prudent assumptions on product pricing from more elevated rates to date. So, overall, the combination of structural hedge and rate sensitivities leaves us well positioned to maintain margin in the current environment.

So, moving finally, to Slide 21. If I look back over the last six months, it's amazing to think just how long-ago September was. In that period, the market has been through quite fundamental shifts in sentiment ranging from optimism, realism, and at certain points in March, something that felt approaching despair. In our position, this has been both a blessing and a curse to be an onlooker as events unfold. As a newly designated Tier 1 bank, you have to step up to demonstrate you have a good handle on events. So, I think we did a reasonable job of navigating markets exemplified by the underlying balance sheet strength that we have talked about in this presentation. Being smaller, but still being Tier 1, means that you can be more agile in your approach, but you're still held to a very high standard at the same time. So, when I look at our spread performance in that time, we continue to underperform relative to peers, both as spreads widened, but also as they retrace. Like I say, it's both a blessing and a curse to be our size.

So, what to do? Fundamentally, I think time is the answer. Time allows proof to emerge that there is a resilient model at work here. During recent debt engagement events across both Europe and the UK we saw evidence of these proof points permeating for investors with the acknowledgement of the bank's Tier 1 regulatory status and consideration of our name in the same conversation as our larger peers. This was further supported by good performance in our inaugural stress test and with the release of the results of a second stress test due in the summer, it provides the opportunity to demonstrate another tangible proof point in the near future.

To land this point further, it can be argued that our balance sheet has been tested regularly since Brexit, through COVID, the mini-budget, cost of living pressures. So, it's pleasing, but not particularly surprising to see that the asset quality remains resilient and our improved provision coverage, which is well above pre-pandemic levels, ensures we are well positioned to manage what remains an uncertain outlook. Now, despite the economic backdrop, we continue to deliver on our digital strategy, focusing on supporting our customers, continuing to grow profitably, reducing our cost income ratio and delivering exciting and compelling digital propositions, all the while maintaining a strong capital, stable funding, and prudent liquidity position. That's pretty good when you think about the fact that these two banks only came together four and a half years ago.

So, to summarise then, we are very focused on managing down the overall difference to larger peers and of course, you'd expect us to say we don't think the current levels are reflective of where the fair value point is relative to those peers. We will continue creating proof points, continue to tell our story and actively seek the benefit of the force in bringing those together in creating a compelling investment proposition and support further spread compression to peers.

That's it everybody, thank you for your attention. We'll now open up for a line of questioning. So, Nadia, please go ahead and see if there are any questions this morning.

**Operator**

Thank you. We have a question from Lee Street of Citigroup. Lee, please go ahead. Your line is open.

**Lee Street, Citigroup**

Hello, good morning all, thank you very much for doing the call. A couple from me. I guess the first one, obviously from my perspective, I don't really see any parallels between what's happening with the US regional banking sector, whether it's in the UK or Europe, but just any thoughts from you? I presume you agree?!

Secondly, I appreciate you being very upfront about where your spreads trade versus your larger peers. I suppose, is the issue not more on the equity price as well if you look at the discount to book value versus the likes of Lloyds and Natwest? Do you not almost need that to be bridged a bit first before we start trying to bridge the spreads given that, relatively speaking, the spreads are a fair bit closer relative to where the equity trades.

And third one, and I know I've asked you this before, obviously, as you say, blessing and a curse to be your size. While I don't think there's any parallels with what's happening for the US banks, they do have a general trend in the market of the number of banks disappearing, and banks generally getting larger. So, do you think, around your size that's sustainable, and you might ultimately be forced to go out and accumulate some more assets as and when things become available in the market and obviously once you've fully integrated your last acquisition? So, that would be my three, thank you.

**Justin Fox**

Perfect, Lee. I'll take the first one and then Richard, if I can ask you to cover off equity and acquisition, if that's okay?

So, good question on US regional banks, it is something over the last month and a half, we've done an awful lot of thinking about. Quite clearly, we get a lot of questions from the PRA, as I say, we have to do the same things the very largest banks are… often on a daily basis with the regulator. We have a lot of inbound from the Board and the LT in terms of questions and we're very conscious that there are a number of regulatory deliverables, like ICAAPs and ILAAPs, but we've also got the second round of the resolution process to do later this year. And we got inbound some customers saying 'look, is there a read across'? I think we were surprised on the Friday it happened to understand that US regional banks are subject to a different regulatory path to the one that we're subject to. So, in some ways, it's not quite the same, but we're closer in terms of regulatory approach here in the UK to say the largest money centre banks in the US - the JPs, the Wells, the Citi, right?! But we have a higher regulatory test and that's why we're clear to call out the diversity of our deposit franchise, look at the spread and look at things like the balance between insured and uninsured and as we put in there, the level of balances below five grand. We don't have that deposit concentration that we understand Silicon Valley to have had. So, we've got a really diverse customer base, both within retail but also through the business deposit structure. We also prudently manage interest rate risk and market risk generally within the bank. Effectively, we weren't exposed to the movements in interest rates that US banks have been exposed to. I also think there's been an element of catch up, or refreshing within the market, around liquidity rules and liquidity treatment generally. On the sort of worry bead side, we've also been doing a lot of work around trying to understand, both the impact of social media, and increasingly through our ILAAPs, we focus on risk posed by digital channels. So, we're working all of that through, because that's happening in real time and I think, when I come to think about positioning us in terms of things like LCR, I think 153%, for now, feels about the right value. Very focused around how we go about repaying TFSME - that's very much in our thinking - but also saying, think measures like LDR, we think we're kind of at the right level there, too. So, I don't think there's a direct read across but then I think on the other two points, I'll let Richard come in now, and see how we're reflecting on those.

**Richard Smith**

Sure, thanks, Lee. I guess a couple of things, just in terms of your second point around the equity valuation, leading into the spread side of things. As we look at it, there are a lot of factors, some of which Justin's just touched on there, that are pretty correlated in terms of the drivers rather than one being necessarily causal of the other in terms of equity versus debt spread. So, some of the areas where the equity markets particularly focused on at the moment, and we do recognise that we trade at a discount relative to some of the other UK banks given some technical factors in some sense, is around liquidity and size. But also, what we tend to get questioned around has been strength of deposit franchise, credit in the current environment and also, the slight concern around competition across both mortgages, but also deposits as well. What we've aimed to do through some of the disclosure that we've given that we talked to in the presentation, particularly on the deposit space, is to demonstrate the strength of the deposit franchise as we see it in terms of ability to gather inflows through the period, but also, in terms of our ability to do that at quite good spreads as well. So, giving more detail around that side of things. On the mortgage side, we see spreads on the front book being marginally below back book i.e. application spreads in the 70 to 80bps territory against the 100bps back book. But in essence, that gap having narrowed compared to where we were historically, so what we're aiming to land yesterday was a bit more detail around the drivers of NIM as we see them and pleasing to be able to upgrade that from a competitive point of view. I think in terms of the credit side of things, we've obviously played catch up in terms of timing of taking through new economics compared to December reporters and having a more negative view compared to the ones that we had at Full Year. But, actually in terms of book performance, we feel reasonably well placed across all of the portfolios.

In terms of what drives the equity forwards from here, we can see a number of tangible catalysts to do that, most notably, you'll have seen some of the information that we gave around strength of capital position, but also our thinking around timings of buybacks and obviously, the language there, we talked to doing that after the ACS. And clearly, that's something that's a particular focus for the equity market side of things. As we look out into '24, we're also reiterating our double-digit RoTE guidance and the less than 50% cost income ratio. Now, as we see it today, there is an element of continuing to demonstrate that delivery and building that track record will drive a rerating in terms of the equity side of things, but also, doing that with a strong set of fundamentals on the balance sheet will also support spreads on the wholesale funding space as well.

Your point three in terms of scale. I mean, I think we feel like we do have sufficient scale to be able to compete well. We have a very strong organic strategy as I've just been laying out there in terms of getting towards double digit returns and that really is the guiding principle in terms of our focus today. We would consider small tactical in-fills in terms of capability. There's nothing that's particularly front of mind for that but if it was something that were immediately accretive, and didn't disrupt through a large-scale integration, that would certainly be something that we would think about, although clearly, I mean, we consider all options. But for now, given the proximity to our FY24 targets that we set out, that remains very much our focus from a delivery perspective.

**Lee Street**

All right. That is fair, thank you very much for the very detailed responses to my three questions. Thank you.

**Operator**

Thank you. And for our next question, we go to Daniel David of Autonomous. Daniel, please go ahead, your line is open.

**Daniel David, Autonomous**

Good morning all, thanks for doing the call, it's been really helpful. I have two questions. The first one is just on issuance and the way you see different currencies. So, just looking at your outstanding stack, I guess you've mainly targeted Sterling and Euros. I'm just interested to hear your thoughts on whether you might look at Dollar markets in a bit more size and potentially what benefits that might bring or if there's a reason why you haven't gone there so far?

And then secondly, just looking at TFSME and I appreciate the disclosure, and realise this isn't a today topic, but just looking at your contractual maturities that you've got coming up, I note on the slide you talk about secured issuance. I'm just interested to hear if there are any other options to replace TFSME? Clearly Covered and Secured issuance is one, but are there any other options? And then potentially, the cost implications - so earnings implications of those other replacement options would be interesting to hear. I guess there are some parallels to TLTRO in Europe and no doubt that the market might start looking towards the impact of TFSME in the UK. So, interested to hear your thoughts on that topic as well. Thanks.

**Justin Fox**

I like that every single DCM banker is listening in on this call – "oh, are these guys going to do Dollars?" You're absolutely right, Daniel, so our approach to date has been to really try and grow our investor coverage and understanding in the next nearest market - in Euros. We have looked at Dollars and, in the past, and I think that the test for me is, one, it would need to be complementary to what Richard does on the equity side, in terms of looking at that market, but it's also our ability to commit to being a regular issuer. When I look at similarly sized issuers, and I talk to the Irish banks, it is that ability to come up with repeat and sustainable issuance, from my point of view. So, it's clearly a market that would be attractive. I think the other challenge we would have right now is, would US investors feel slightly bearish, because, again, we're a midsize bank in the UK and back to Lee's previous question, is there a read across? We don't see one, but that would possibly be a hesitancy on their part. I think, as we grow, it's certainly part of what we would look to do and clearly, we have tapped the Dollar market in the past through our Secured RMBS issuance.

Now, if I look at TFSME, it's a fair question. My overall view and test is that we shouldn't be looking to repay all of TFSME exclusively through wholesale funding. I look at Treasury having a role to play, but bear in mind, TFSME was brought in to support the franchise's customers, so the franchise has a role to play and it'll be a combination of the both. I don't think that pushes us towards considering OpCo issuance, we have it as a capability but it's not something I would choose to do, because we're trying to build into the forward-looking plan a cost-effective way of delivering that refinancing. Similarly, at the same time, we don't expect TFSME to be extended or changed in any way. We work on the basis that alongside all other banks, that scheme will come to an end and this long period of central bank liquidity support that has existed in the UK will unwind. So, from my point of view, we're about to get into our planning cycle, so this all then will be further refined, certainly as we think about FY24, and FY25, and beyond. Does that answer your question?

**Daniel David**

Yeah, I guess some of the other options other banks have been discussing is repo and commercial paper. I guess just asking you about the options, I was kind of maybe pushing towards kind of what sort of capacity there are to kind of replace there. I guess this is the biggest, well one of our largest unknowns at our end.

**Justin Fox**

Historically, and this goes back to a long time ago, Clydesdale as was, was pretty big in the short-term space, and we haven't been particularly active in it for many years. We do have a small amount of capacity, and we're building out our name recognition and one of the things that we're looking to do there is we work very, very closely with our business franchise around, if there is crossover in customers between what you see through the short-term broker market and what they see coming through in terms of relationship deposits, to get alignment and pricing efficiency there. Equally, we do look at the repo market, so, what I've been keen to develop, certainly over the last 18 months, given the market environment, is expanding our toolset of options that we have, both from a Treasury, but also from an overall deposit franchise perspective.

**Daniel David**

Thank you very much, interesting.

**Operator**

We currently have no questions. I'll now hand it back to you, Justin, for any closing comments.

**Justin Fox**

Listen, thanks for all listening in this morning. Hopefully that was helpful. It's always good to have these opportunities for Richard and I to engage with you all. If you do have specific follow-ups or specific questions, please reach out to myself, to Matthew, to Gareth, to Richard, we are here to help and with that, will bring this call to a close.

Hopefully everybody will enjoy, if you're in the UK at least, a good, long weekend of coronation cheer. Thank you everybody and have a great day. Bye.

**[ENDS]**