

28 July 2020

Virgin Money UK PLC: Third Quarter 2020 Trading Update

Virgin Money UK PLC (“VMUK” or the “Group”) confirms that trading in the nine months to 30 June 2020 was in line with the Board’s expectations.

David Duffy, Chief Executive Officer:

“I am pleased with the way the Group has performed during the pandemic. In a severely disrupted environment we are delivering on what we set out in May; to safeguard the health and wellbeing of our colleagues, customers and communities while protecting the bank. Our Q3 financial results reflect lower demand from consumers due to the pandemic, but strong demand from businesses for Government-supported schemes, with the Group further increasing its provisions to reflect the uncertain economic outlook while maintaining a focus on margin, cost and capital management.”

“Our priority remains on offering the right support for our customers in need. We have now granted c.67k mortgage and c.53k personal payment holidays, and we’ve supported c.25k business customers with lending arrangements. We know that things may yet get more difficult for many of our customers, but we are determined to continue to support their needs where we can and to fulfil our role in the economic recovery. I’m proud of the way our colleagues have responded to the significant challenges of recent months, and encouraged by the agility with which we have adapted our operations.”

“We have now recommenced our transformation and rebrand activity, taking what we have learned through the pandemic to deliver on our mission to disrupt the status quo as a full-service digital bank.”

Q3 Performance Summary

Q3 balances reflect economic activity and customer behaviour during UK lockdown

- Customer deposits increased in Q3 by 4.8% to £67.7bn primarily due to lower Personal customer spending during lockdown and Business customers maintaining higher levels of liquidity
- Q3 Mortgage portfolio reduction of (1.0)% to £58.9bn reflected the effective closure of the new purchase market under lockdown, partially offset by improved retention rates
- Q3 Business lending growth of 5.7% to £8.8bn driven by significant demand for the Government backed lending schemes with £619m of BBLS and £248m of CBILS lending provided at end June
- Q3 Personal lending reduction of (2.7)% to £5.2bn primarily due to lower credit card balances

Net Interest Margin (NIM) declined in line with expectations

- NIM declined to 157bps (9 months annualised) with a Q3 NIM of 147bps (Q2: 163bps) due to the immediate asset repricing following the base rate reduction and cost of holding excess customer deposits; liability repricing actions will drive an improvement in NIM in Q4 and beyond
- The Group continues to expect a FY20 NIM of 155-160bps

Asset quality in line with H1; reflects ongoing support mechanisms

- The Group has not yet seen any significant specific provisions or credit losses in relation to the pandemic given a backdrop of Government support and VMUK forbearance measures
- The Group has updated its IFRS9 impairment models incorporating more cautious economic scenarios (see Appendix 1) and refined its overlays to reflect payment holiday assumptions, resulting in a prudent net increase in its provisions of £42m primarily in Mortgages and Personal
- Total balance sheet credit provisions of £584m (H1: £542m); coverage ratio of 79bps (H1: 75bps)
- Net cost of risk (9 months annualised) of 55bps (H1: 63bps); Q3 net cost of risk of 40bps

The Group’s capital position remains resilient with a CET1 ratio of 13.3%

- CET1 ratio increased c.30bps to 13.3% due to c.£0.5bn of net reductions in RWAs primarily due to a regulatory benefit from extending the “SME Supporting Factor” RWA relief to larger exposures
- The PRA confirmed in July that VMUK’s Pillar 2A CET1 requirement reduced from 2.9% to 2.4% equating to an MDA threshold of 9.4%; c.£950m of CET1 management buffer in addition to £584m of balance sheet credit provisions, providing significant resilience for an uncertain environment

Supporting our customers

(£bn)	30 Sep-19	31 Mar-20	30 Jun-20	Q3 growth	YTD annualised
<i>Mortgages</i>	60.1	59.5	58.9	(1.0)%	(2.6)%
<i>Business</i>	7.9	8.3	8.8	5.7%	15.6%
<i>o/w BBLs/CBILs</i>	<i>n/a</i>	<i>0.0</i>	<i>0.9</i>	<i>n/a</i>	<i>n/a</i>
<i>Personal</i>	5.0	5.3	5.2	(2.7)%	4.4%
Customer lending	73.0	73.2	72.9	(0.4)%	(0.1)%
Customer deposits	63.8	64.7	67.7	4.8%	8.3%
<i>o/w relationship deposits</i>	21.4	22.3	24.7	10.8%	20.8%

There was a significant increase in deposits of 4.8% in Q3 reflecting lower consumer spending under lockdown with growth in relationship deposits of 10.8%, primarily in Personal and Business current accounts. We have seen customer spending increase as lockdown has eased and expect this to continue which should unwind some of the Group's excess deposit position, but further actions will be considered to manage the margin impact should it persist. These significant deposit inflows have contributed to a reduction in the Group's loan-to-deposit ratio to 108% (H1: 113%).

As expected, Mortgage balances reduced in the third quarter by 1.0%. Q3 saw little activity in the new purchase market given the impacts of lockdown with limited physical surveys possible and new-to-bank re-mortgage activity was also lower given social distancing restrictions and subdued consumer confidence. These impacts were partially mitigated by higher retentions. VMUK continues to expect a muted Q4 given a lower pipeline entering the quarter, but is seeing demand build into FY21.

Business lending growth of 5.7% in Q3 was driven by support for customers through the Government-guarantee lending schemes including £619m of BBLs on the balance sheet at end June and £248m of CBILs. We also continue to support customers through our own initiatives including capital repayment holidays, overdraft extensions and ongoing expert relationship manager advice, with c.25k customers now supported in total. Business lending (excluding the Government schemes) reduced c.£0.4bn in the period due to a reduction in working capital facilities.

Personal lending balances reduced by 2.7% in the period primarily due to lower credit card balances. The impact of lockdown has led to much lower spending on revolving credit facilities and lower personal loan demand, although as expected balance transfer lending balances have remained more stable (c.65% of cards balances). Similarly, lower consumer spending resulted in a significant reduction in non-interest income from debit and credit card transactions, with spending down 25% and 55% respectively in April/May on expected volumes, but returning to more normal levels in July.

VMUK continues to actively support its Mortgage and Personal customers through this difficult time with payment holidays ("PHs") where appropriate, although the level of new requests has reduced significantly since the peak in April. VMUK and the wider industry has also agreed to extend PHs for a further 3 months to those customers who evidence a requirement for them. However, the initial cohort of PHs expiring suggests at this stage only a small proportion of customers require an extension.

- c.67k Mortgage PHs granted to date at 17-Jul (30-Apr: c.60k) or c.20% of balances; c.70% of customers have matured from their 1st PH with c.31k PHs in total still in force at 17-Jul
- c.42k Credit Card PHs granted to date at 17-Jul (30-Apr: c.32k) or c.5% of balances; c.30% of customers have matured from their 1st PH with c.32k PHs in total still in force at 17-Jul
- c.11k Personal Loans PHs granted to date at 17-Jul (30-Apr: c.8k) or c.9% of balances; c.75% of customers have matured from their 1st PH with c.4k PHs in total still in force at 17-Jul

NIM trajectory in line with expectations

The Group's NIM declined to 157bps (9 months annualised) down from H1 of 162bps. As expected, Q3 NIM declined to 147bps (vs Q2 of 163bps) reflecting the impact of the recent base rate cut and the associated timing mis-match between asset and deposit repricing, as well as a temporary NIM drag from the cost of holding excess deposits. As previously guided, the Group expects a NIM improvement in Q4 as liability repricing actions take effect and excess deposit balances start to unwind, and continues to expect a FY20 NIM of 155-160bps.

Following the reduction in Bank Base Rate to 0.1%, and noting future market rate expectations, the Group concluded that its 5-year structural hedge had generated maximum value. In Q3 the Group's term structural hedges were fully unwound, locking in expected NII contributions from the hedges over the next 5 years. In the future, the Group anticipates a more dynamic approach to hedging these balances. Based on the current rate outlook, the Group expects no significant adverse impact on NII in FY21 and beyond compared to the 5-year rolling approach, but it provides the Group with optionality should the rate environment improve.

Further credit provisions increase

The Group has not yet seen any significant credit losses nor been required to make any significant specific provisions in relation to the pandemic impact. It has updated its IFRS9 models for all of its portfolios with a more cautious set of updated economic assumptions from Oxford Economics (Appendix 1) and refined its management overlays to reflect expectations in respect of the behaviour of customers on payment holidays.

VMUK uses a probability-weighted combination of three economic scenarios (i) Recovery Scenario (30% weighting), (ii) Pandemic Shock (30%), and (iii) Pandemic Sustained Downside (40%). The Recovery Scenario reflects a c.8% GDP shock in calendar 2020 and recovery in 2021 and beyond. The Pandemic Shock scenario incorporates a more severe c.13% GDP shock with peak unemployment of c.10% in 2021 and HPI peak-to-trough of c.25%, but an economic recovery from 2021. The Pandemic Sustained Downside scenario incorporates a similar economic shock, but with a much slower recovery including elevated unemployment and a more subdued house price recovery.

The IFRS9 probability-weighted model outputs supplemented by the payment holiday assumption overlays required a net additional impairment provision of £42m, leaving the Group with £584m of total balance sheet credit provisions. This ensures the Group remains prudently provisioned for the economic environment. The Group's Q3 P&L impairment charge of £74m is gross of write-offs and recoveries in the period, and equates to a Q3 net cost of risk of 40bps.

	Credit provisions at 31-Mar-20 (£m)	Credit provisions at 30-Jun-20 (£m)	Lending at 30 Jun-20 (£bn)	Coverage ratio (bps)	Annualised net cost of risk (bps)
<i>Mortgages</i>	50	81	58.9	14	10
<i>Business</i>	261	254	8.8	321*	187
<i>Personal</i>	231	249	5.2	490	364
Total lending	542	584	72.9	79*	55
<i>o/w stage 2</i>	267	295	7.2	407	
<i>o/w stage 3</i>	148	144	0.9	1670	

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

The Group's total credit provision coverage ratio increased by 4bps to 79bps, with Personal increasing by 50bps to 490bps and Mortgages by 5bps to 14bps, reflecting more cautious assumptions in relation to the outlook for unemployment and HPI. Business coverage of 321bps* remains broadly unchanged reflecting the significant provision taken in H1 that was reaffirmed as appropriate in the updated modelling.

Integration and Transformation

While the Group remains committed to our Integration and Transformation programmes a majority of these activities remained on hold during Q3 as we prioritised support for customers and colleagues during the pandemic. As a result, exceptional items in Q3 totalled £51m including lower restructuring and integration costs of £19m, acquisition accounting charges of £28m and other items of £4m.

On 1st July VMUK announced the recommencement of its previously planned headcount reduction and branch closure programme. This will deliver cost synergies in FY21, with restructuring costs of c.£60m expected in Q4. The Group continues to expect FY20 underlying operating costs of <£920m.

Supporting our Colleagues

The health and wellbeing of colleagues continues to be a priority for the Group. We expect the current working model the pandemic has brought about, whereby the majority of colleagues are working from home, to remain in place for at least the remainder of 2020. Building on the successful implementation of this working model, management has been engaging all colleagues across the Bank in shaping our future working model to reflect the changing attitudes and requirements of both customers and colleagues.

Supporting our Communities

The importance of Sustainability and Environmental, Social and Governance (ESG) performance has increased further through the pandemic and the Group remains focused on supporting its communities. Virgin Money Giving, the Group's not-for-profit fundraising website, processed donations 11% higher in Q3 than the same period last year, while the Virgin Money Foundation has pledged £1.25m to local community organisations in the North East of England, Norfolk and Glasgow since March. The Group is also refreshing and accelerating its Sustainability and ESG strategy and will provide an update on the strategy and targets at its full year results in November.

Well positioned for an uncertain outlook

The Group's capital position remains resilient with an IFRS9 transitional CET1 ratio of 13.3% at 30 June 2020 (12.7% IFRS9 fully-loaded), which increased c.30bps due to a net c.£0.5bn reduction in RWAs to £24.7bn. This was driven by c.£0.7bn of RWA reductions from EU-approved regulatory changes to the exposures eligible for "SME Supporting Factor" relief as well as lower volumes, partly offset by increased Mortgage RWAs due to model updates. Strong Business lending growth in the period had a limited RWA impact due to the Government guaranteed element attracting a sovereign risk RWA of zero. The Group also retained strong Total Capital and UK Leverage ratios of 19.1% and 4.9% respectively, and a prudent liquidity position with LCR of 148%.

In June, VMUK successfully issued a €500m Euro-denominated MREL senior instrument, improving the MREL ratio to 28.1%, which is in line with the Group's expected Jan-22 Final MREL Requirement and means future MREL issuance is focused on building a prudent buffer.

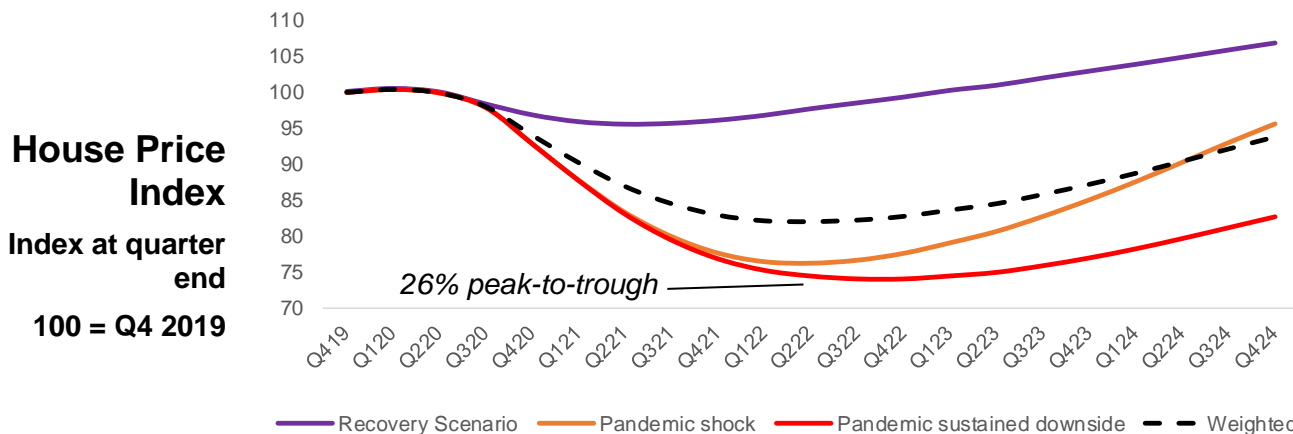
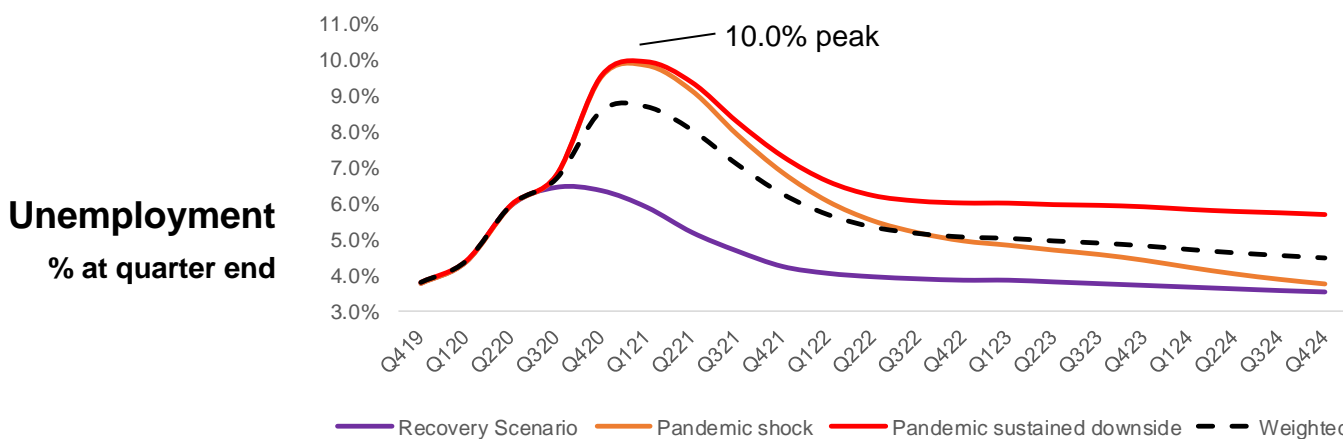
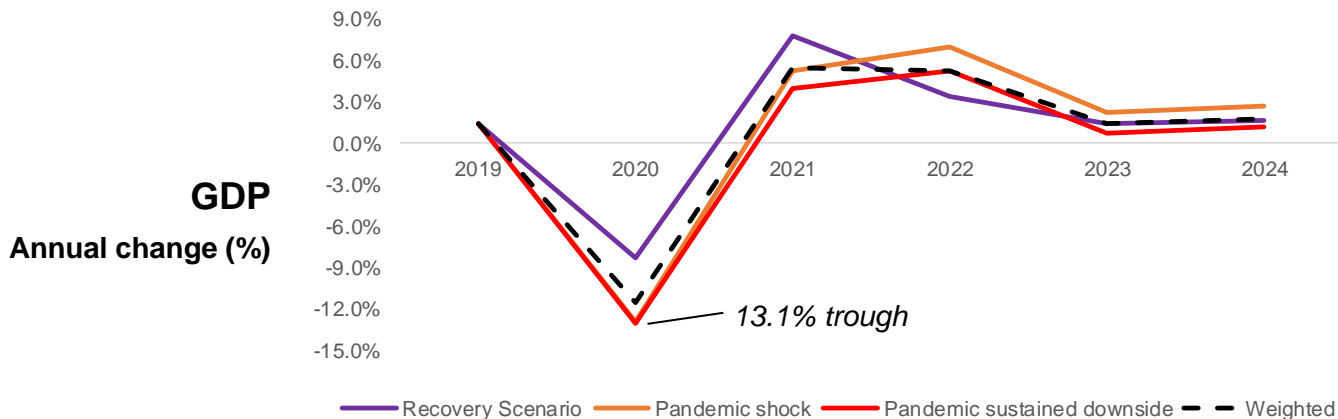
In July, the Group received its updated P2A requirement with the CET1 element reducing from 2.9% to 2.4% leaving the Group with a CRD IV minimum CET1 capital requirement of 9.4% and a significant management buffer of c.£950m in excess of its regulatory minimum based on June capital levels. The Group also concluded the triennial valuation of its defined benefit pension scheme. As at 30 September 2019 the valuation had improved from an actuarial deficit of £290m to a surplus of c.£145m. As a consequence, the Group is now committed to pay the £50m FY20 contribution that was deferred to FY21, but thereafter is no longer required to make further capital contributions to the scheme.

Looking ahead, the current EBA consultation on the treatment of software intangibles, if implemented in its proposed form in the UK, is expected to result in an increase in the Group's CET1 capital. This is currently anticipated to become effective during the Group's financial Q4 and is estimated to be equivalent to a c.30bps CET1 ratio improvement based on the Group's RWAs at the end of June.

After initially pausing the majority of PPI processing activity to focus on COVID-related customer support, the Group has re-started the operation and is currently building capacity back towards pre-COVID levels. All Information Requests (IRs) have now been processed and based on latest projections it is expected the programme will complete by December 2020. The Group has 68k complaints left to assess and expects to complete the programme within its current provision levels.

The UK economy is emerging from lockdown and we have seen increased consumer spending and economic activity in recent weeks. However the economic outlook remains highly uncertain and it may be some months before the full extent of the impact of the lockdown on the Group's customers is visible, once Government and other support measures are withdrawn. The Group has set provisions based on cautious economic assumptions, is preparing assiduously to manage higher levels of customers in financial difficulty and continues to closely monitor the performance of its portfolios. In addition, as previously indicated, the Group continues to work through the impact of the pandemic on our strategy and will update the market in more detail alongside its full year results in November.

Appendix 1: Key Economic Scenarios (Source: Oxford Economics provided on 21/05/2020)



Scenario	VMUK Weighting	Economic measure	2020	2021	2022	2023	2024
Recovery Scenario	30%	GDP (yoy %)	(8.3%)	7.8%	3.4%	1.5%	1.7%
		Unemployment (average)	5.8%	5.0%	4.0%	3.8%	3.6%
		House price index (yoy %)	(3.3%)	(0.8%)	3.4%	3.6%	3.8%
Pandemic Shock	30%	GDP (yoy %)	(13.0%)	5.2%	7.0%	2.3%	2.7%
		Unemployment (average)	6.7%	8.5%	5.5%	4.7%	4.0%
		House price index (yoy %)	(7.2%)	(16.3%)	(0.0%)	9.6%	12.4%
Pandemic Sustained Downside	40%	GDP (yoy %)	(13.1%)	4.0%	5.2%	0.7%	1.2%
		Unemployment (average)	6.7%	8.7%	6.2%	6.0%	5.8%
		House price index (yoy %)	(7.2%)	(17.3%)	(3.7%)	4.0%	7.5%
Weighted Scenarios		GDP (yoy %)	(11.6%)	5.5%	5.2%	1.4%	1.8%
		Unemployment (average)	6.4%	7.5%	5.3%	4.9%	4.6%
		House price index (yoy %)	(6.0%)	(12.1%)	(0.5)%	5.6%	7.9%

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