Virgin Money UK PLC Interim Financial Results 2020 – Presentation transcript

Hosted by: David Bennett (Chairman), David Duffy (CEO) and Ian Smith (CFO)

David Bennett, Virgin Money UK PLC

Good morning to those joining in the UK and good evening to those joining us from Australia and welcome to Virgin Money UK PLC's 2020 Interim Financial Results presentation. Before David and Ian take you through the presentation, I just wanted to briefly introduce myself to those who don't know me, following my appointment as the Group's new Chairman this week.

I have to confess to a certain sense of déjà vu here as I became CEO of Alliance & Leicester in July 2007, at the start of the last major crisis, having been CFO there for six years and I remember all too well being questioned by some of you who are on this call today, back then. I have worked in financial services for over 35 years and as I mentioned, have the scars and learnings of managing through the Global Financial Crisis some 13 years ago or so.

I joined the Board of CYBG now Virgin Money UK as Deputy Chairman in 2015 and have been SID for much of that time. In addition to Virgin Money, I currently chair Ashmore PLC, the emerging markets asset manager and I am a NED of PayPal Europe.

For Virgin Money, since the crisis began less than two months ago, the leadership team led by David have done an astonishing job of reinventing the way we work as we prioritised the health of our colleagues, the health of our customers, and the health of the bank. The Board have been heavily involved in the bank's response to this pandemic, with deep dives into our portfolios, regular appraisals of customer behaviour and the support we are providing, as well as good debates about how we best support our colleagues at this time. The Board and I believe we are well-positioned for the challenges ahead.

I hope to meet many of you in person in my new capacity as Chairman when we emerge from lockdown but for now, I will hand over to David and Ian to talk in detail about our response to the pandemic and our first half performance.

David Duffy, Virgin Money UK PLC

David, thank you and I'm delighted to have you confirmed in the role of Chairman and I think your experience and the continuity you provide will be invaluable and I look forward to continuing our existing excellent working relationship.

Welcome to the presentation everybody and thank you for taking the time to join. I hope you're all keeping safe and well in these difficult times. Given the COVID-19 implications, we're going to take a slightly different approach to our presentation today. I will share a brief overview of the business and Ian will provide a detailed review of our balance sheet strength and portfolios, and the first half results. I will finish with some closing thoughts on the implications of COVID-19 for 2020 and beyond and that should take us about 40, 45 minutes, and we will then pause and go to Q&A then hopefully be closing it around 10 a.m.

Before I begin, I also just wanted to update you all on the search for our new CFO and I'm pleased to confirm that we have undertaken a thorough process and have recommended a candidate to the regulators this week and we expect we'll receive feedback from the regulator in due course.

Turning to slide 5, the COVID outbreak has clearly transformed the whole world, our industry and our business. However, we are confident that the strategic approach we outlined at our Capital Markets Day in 2019 remains appropriate. But let me talk you through our current COVID-19 priorities before returning to the next steps in our strategy.

Our immediate priorities, no surprise, are focused on the health, safety, and economic well-being of our customers, colleagues, and the communities in which we operate, but equally it's critical that we protect the bank's capital. Given that priority of focusing on our capital, I am confident that we start from a position of strength. We have a conservative balance sheet mix, a resilient capital base, and a prudent funding and liquidity position and this means that we're well-placed to be able to provide the necessary support to all our stakeholders while managing the bank through this crisis.

My Leadership team and I are working closely with both the UK Government and UK Finance to help design and deliver funding or forbearance programs to support the various individuals and businesses in the UK that need our support and we're now offering a wide range of support packages to all of our customers who need those. For our Mortgage customers, we have granted around 60,000 mortgage payment holidays which is about 15 percent of our customers and we have implemented a digital request service to speed up access to this support for our customers.

In our Personal division, we are proactively supporting our lending customers with to date 32,000 credit card payment holidays, which is around 2 percent of customers and 8,000 personal loan payments holidays, that's about 6 percent of our customers and helpfully 90 percent of these payment holidays are delivered online. For any deposit customers in difficulty, we also offer access to their funds penalty-free where needed, although to date we have not seen many of those requests.

In our Business division, our focus is on supporting our existing customers and extending facilities to ensure wherever possible, viable businesses are supported through a period of what is really cash-flow challenges. This can take the form of lending facilities, obviously capital repayment holidays and overdrafts, as well as the different Government initiatives that are in place. Our experienced relationship managers have moved quite fast to engage with customers and we've had about 10,000 conversations with our business customers in the past few weeks. And to date we have supported businesses with around 4,500 lending support facilities including £135 million of lending approved via the Government's Coronavirus Business Interruption Loan Scheme. We're also committed to supporting the bounce back and CLBILS schemes too.

From an operational resilience perspective, we have been able to keep 95 percent of our branches and all of our call centres open and across the business these call centres are operating at near pre-COVID service levels. I'm enormously proud of how our colleagues have risen to the current challenges and I'd like to thank them all for continuing to offer excellent support for our customers and I have personally held CEO calls or videos with almost 4,000 colleagues over the past four weeks to thank them, to provide reassurance and to listen to their concerns.

Today more than 70 percent of our colleagues are working remotely. Our prior investment in our colleague IT platform has meant that we've been able to implement this model within two weeks. We are helping our colleagues to adapt to working from home and it's interesting that many are telling me that they're more efficient and can offer better service to customers in this new model, which shows great potential for the future. We also recognise that at this time our communities need extra support and our Virgin Money Foundation has made over £850,000 of funding available to local charities responding to the COVID-19 pandemic. Our Virgin Money Giving Team has also delivered record donations to charities despite being in lockdown and this includes having helped raise £13 million in donations to the NHS and over £20 million last month to all charities.

Turning to slide 6, I will now turn to the overall financial performance and our balance sheet strength going into this environment. Our first half financial performance was resilient, and we delivered on our key strategic objectives and that includes balanced growth, capital optimisation, funding efficiency, cost reduction and margin stabilisation. Our balance sheet is strong with a resilient capital base including a sizeable £800 million CET1 management buffer and a prudent funding and liquidity position. Our lending portfolio is also defensively positioned, and we are not exposed to the most impacted sectors such as travel, high-street retail, energy or commercial real estate. Ian will explain the details of our portfolios later in the presentation.

In terms of a balance sheet mix, we achieved good growth in our target areas of Business and Personal, both up around 6 percent whilst in Mortgages we maintained our pricing discipline in the first half. On deposits, we saw continued growth of around 4 percent in our relationship deposits which was also very pleasing. And as a result, we were able to deliver on our NIM guidance, with stability in the NIM at Q1 and a slight expansion in Q2, leading to a first half NIM of 1.62 percent. Our efficiency drive continued in H1 with costs down 3 percent year-on-year and a cost: income ratio of 57 percent, and our Transformation programme delivered a further £23 million of net run-rate cost savings in the period with a total of £76 million delivered to date. Asset quality remained robust pre-COVID with a 23 basis points cost of risk.

However, due to the economic implications of COVID, the outlook for credit impairments has changed and we have determined that an additional £164 million of COVID-related impairment provisions are required at this time. And this will leave us with nearly £550 million of on balance sheet provision reserves and Ian will talk you through the detail of this shortly.

Finally, exceptional costs were in line with expectations and we took no further PPI conduct provisions in the period. Given that the PPI complaint uphold rate is tracking lower than expected, we anticipate that the current run rate could lead to a provision surplus.

The combined outcome is that we've delivered an underlying profit of £120 million, with a 4.6 percent underlying return on tangible equity, a statutory profit after tax of £22 million and retained a resilient capital ratio of 13 percent. I will now hand over to Ian to take us through our balance sheet strength and the financial results in detail, and will return to discuss our thoughts on the full year and beyond.

Ian Smith, Virgin Money UK PLC

Thanks David, and good morning to those of you in Europe and good evening to those dialing in from Australia. I hope you're all keeping safe and well in these difficult times. I'm going spend a bit of time now, as David said, talking in detail about the numbers. There's a lot of ground to cover but I'll try and keep it brisk.

So, pre-COVID we delivered a robust set of results and it was encouraging to see the business perform well, particularly on net interest margin and cost delivery. Of course, that's an important backdrop to the current environment, and it underpins the confidence we have in our strategy and our ability to execute.

Before I cover the results, I want to talk about our balance sheet, so our loan book, funding, and capital. The headlines will be familiar from our investor call on 31 March, but I do want to give a little more detail now and make it clear that the bank is well prepared for whatever may lie ahead.

On 31 March I made the point that not all portfolios are created equal. So today I'm going to dig into our loan portfolios, walk through how we thought about the risks that lie ahead, and how that's helped us construct our ECL provision at 31 March. I'll talk about our capital position and how RWAs could evolve over the next 18 months. And finally, a few words about funding and liquidity.

Now while the macro environment is clearly uncertain, we believe the way we've built our portfolios and their natural defensive nature provides a degree of resilience to the aftermath of this economic and social shock. Our lending comprises prime, resi and buy-to-let mortgages; a carefully constructed relationship-driven business portfolio, with a clear sector focus and that helps us avoid unhelpful concentrations; and a high-quality personal lending book predominantly focused on the more affluent customer credit card portfolio. Consequently, quite frankly, the margins throughout our portfolio reflect the lower risk inherent in our lending.

Pre-COVID, the portfolios performed robustly and in line with expectations. The business as usual total cost of risk was 23 basis points with a low incidence of specific provisions in the Business portfolio.

Since the onset of the U.K. lockdown, and in line with our peers, we have seen payment holiday requests in Mortgages and Personal and requests for capital repayment holidays in Business. Now while I sort of hesitate to borrow the phrase du jour, I think we're "past the peak" because the number of requests has slowed markedly in the last couple of weeks. We are comprehensively engaged in supporting our business customers, where appropriate, via the range of Government guaranteed loan schemes.

And as David said, we have booked a COVID-related impairment provision on top of the normal ECL of £164 million, based on scenarios modelled with conservative economic assumptions and supplemented by expert judgement and this took our on-balance sheet ECL provisions to almost £550 million as at the end of March.

It's a mixture of judgement and rigorous analysis, art and science if you like, but we believe that this provision is prudent. It reflects the significance of the economic shock but also the potential shape of the economic cycle. The modelled demand and cash flow shocks for businesses and the risk of elevated unemployment means that additional provisions are predominantly related to the business and personal portfolios with limited impact on our mortgage book. There's limited CET1 impact from this additional provision as around £90 million has been set off against our Excess Expected Losses capital deduction and the remainder benefits from IFRS9 transitional relief at 85 percent, leaving us with a resilient CET1 ratio of 13 percent and an £800 million buffer to the regulatory minimum.

So, turning to slide 8, I'll talk through the portfolios in more detail. But let me say up front that our key credit metrics currently remain robust across the board. Unlike some of the peer group, we saw hardly any specific provisions triggered by COVID-19 as at 31 March. Our mortgage book is primarily owner-occupied with low average LTV and LTIs and it's been built over the last few years under the MMR regime adhering to prudent underwriting standards and there's nothing niche or legacy in that book. The business portfolio is predominantly lending to larger and mid-market SMEs, typically in lower impacted sectors. We have very limited exposure to sectors in the front line of economic damage, and two-thirds of the portfolio is fully or partially secured. And 80 percent of our personal portfolio is the prime, affluent credit card book that was built on the lessons learned in the GFC downturn.

So, on slide 9, Mortgages. 76 percent of the book is owner-occupied. We've got no sub-prime, no self-cert or other specialist categories and portfolio arrears stand at 0.4 percent, which is nearly half the industry average. Owner occupied has got strong credit metrics, low LTV with 21 percent of the book being greater than 75 percent LTV and 3 percent greater than 90 percent LTV, good affordability with average loan-to-income of three times and critically, the portion of the book in the danger zone of high LTV and high loan-to-income is negligible. Our Buy-to-Let business is focused on amateur landlords with small portfolios and high levels of income to ensure resilience under stress.

This is a strong portfolio. The key dynamic is the length of the lockdown and the effectiveness of the Government support measure and we expect the latter to be very helpful in supporting incomes for customers, but it's still too early to determine exactly how much of an offset that provides. Around about 15 percent of our customers have been granted payment holidays which is in line with the peer group.

So, slide 10, our Business portfolio. There's no question that this is a tough time for businesses. We believe that our portfolio is well-constructed, but this stress, of course, is like no other. And we think it's helpful to look at our portfolio through two lenses, sector exposures and the size of business customer.

On a sector view we think of the book in four main buckets, and almost 80 percent of our lending is in sectors that we expect to be less impacted than others and less than 10 percent of the book is in the highest impacted category. More than ever, cashflow is critical, along with access to alternative sources of funding. And so, it is helpful that our book comprises stronger cashflow mid-market SME business, typically with turnover of £2 to £100 million accounting for 96 percent of lending by value. These larger SMEs are usually more established with higher numbers of employees, cash reserves and access to advisers. In addition, unprecedented levels of Government support are on offer with rate relief, wage support, and cash grants all helping alleviate the pressure. We expect almost all of our Business customer base will be eligible to benefit from one of the Government schemes.

And finally, our entire business portfolio is relationship-managed by dedicated RMs of long-standing. This is critical, it means we've got around 300 expert RMs on the ground proactively contacting customers, keeping right up to date with the customer, providing support and helping to manage emerging risks.

On slide 11, I thought it'd be helpful just to show you how we think about the book in those four buckets I mentioned. 55 percent of the book is in sectors that we think are least exposed to damage from the COVID-19 situation. Agriculture is our largest concentration. We are very well diversified and collateralised across different subsets of agri and early indicators show limited impact of the crisis on farming revenues. One tail risk is the availability of migrant labor over the summer, but overall our book remains well positioned.

In health and social housing, our principle exposure is care homes and specialist care. Revenues are resilient as beds are very much needed in this crisis. And social housing hasn't seen much impact so far; revenues are holding up, supporting book quality. 22 percent of the book is in lower impacted sectors, this includes specialist hotels, primarily city-centre, around two-thirds in central London and while these are currently impacted, the strength of the location and the brands mean we are positive about their future relevance and ability to trade profitably and exposures are underpinned by good levels of collateral.

As you know, we've had limited exposure post-GFC to commercial real estate and what's on our books is low LTV and very conservative covenants supported by strong cashflows and coverage. We have zero speculative development CRE. Manufacturing is well diversified and most of our customers can flex costs by furloughing staff, reducing variable costs materially, effectively hibernating the business. Around 14 percent of our business lending is to sectors that are more immediately exposed in this stress. Now, the degree of impact depends on the type of business supported, so supermarket service providers are less impacted, while entertainment firms more so. But we have private equity backing in this space and often, that provides an additional layer of support and there is also invoice and asset finance available.

We think of the last bucket as higher impacted sectors and while we're not in high street retail, we do have some exposure to small retail businesses where flexibility and security can be more limited. In the entertainment sector, our exposure is typically to larger businesses where the loan is syndicated across multiple lenders. Crucially, we don’t have meaningful exposure to the most impacted sectors, such as airlines, oil and gas, travel, high street retail, or speculative development CRE.

So, turning to slide 12, we disclose £3.6 billion of undrawn exposures in our business portfolio, but it's worth noting that more than half of that balance is unlikely to be drawn. Revolving credit facilities and overdrafts are the real areas where we might expect to see drawings. We haven't seen much sustained drawdowns to date, and certainly not to the extent that I've read about in other banks. The important thing to understand though, in terms of RWA impacts is that we already hold c.70 percent of the potential drawn RWAs against these lines and so not a huge capital impact should the customer decide to draw down.

Finally, looking at what's been happening with the customer base since the middle of March, as David said we've helped around 4,500 Business customers manage their cashflow via lending facilities, overdraft extensions and increases, capital repayment holidays, and through the Government-backed loan schemes.

Moving now to slide 13 and Personal. In our Personal portfolios, you know, experience shows that unemployment is the highest driver of impairment and that certainly is what drives our impairment models. Our unsecured segments comprise prime, affluent customers, so, we start from a good place.

Our cards portfolio has been deliberately built more conservatively than the market average. The £4.2 billion book is 90 percent the heritage Virgin Money portfolio, largely built up since 2015 and the heritage CYB portion primarily comprises PCA customers who are known to the bank. We've targeted lower-risk demographics with lower levels of indebtedness and robust underwriting standards. Average age, average income, and the proportion of homeowners is high, with low exposure to self-employed customers and with debt-to-income and persistent debt much better than the industry average.

Personal loans are a mixture of long-standing banking customers and more recent digital customer acquisition in good quality, keenly-priced business, again, with lower debt-to-income, higher affluence, and lower self-employed.

Moving on to slide 14, I just want to say a few words just about the cards portfolio. The cards management team has got deep experience. They managed scale credit card portfolios through the GFC and on this slide, I wanted to explain just how that experience has been applied in building and managing our book.

Now stressed losses can be material in unsecured lending; however, we know that on top of the standard risk metrics, customer affluence makes a big difference in mitigating losses. The team have used that experience to construct a portfolio skewed toward higher affluence, building affluence predictors into our underwriting, with higher score cut-offs, no acceptance for customers with higher indebtedness, and a strict policy of no down-selling. And third-party benchmarking shows that VMUK has achieved higher quality originations every year relative to industry averages.

We've also focused the book on a lower risk product set. Market-wide balance transfer arrears have been better in stress and through the cycle and so our portfolio was built BT-heavy, with lower debt service costs for the customer. And only a small proportion of customers move post-promo in the next six months, limiting near-term risk.

On to slide 15, as a result of that careful portfolio construction, our vintages perform much better than the industry and typically, our cards delinquency has been one-third of industry levels. As I mentioned, unemployment is the key driver of stressed losses and while we won't be immune, our affluent customer profile typically has larger resources to fall back on in stress.

Now Government support on income is, again, helpful. VMUK is focused on delivering the right support for customers, over and above what's required of us. So far, in our Personal business, we've had a low level of requests for payment holidays: less than 2 percent in cards and less than 6 percent in PLs and again, we've seen the rate of applications slow markedly over the last couple of weeks.

So, that's our loan portfolios. And I'll just spend a bit of time now talking about how we've tackled impairment provisions. On slide 16, I'm going to focus on how we've developed the COVID-19 impairment provision. Firstly, we've seen next to no COVID-related specific provisions in our business book, to date. So, the impairment provision we have taken is forward-looking and it's been developed using a combination of economic scenarios and expert judgment - the art and science, I talked about earlier. And I should also just be clear for listeners that we sourced the economic forecasts from Oxford Economics; we don't develop our own economic forecasting.

Now, much has been said in relation to the shape of the shock and the subsequent recovery. Our core belief is that no matter the scale of the short-term disruption, the UK faces a long period of low growth, declining asset values, and structurally higher unemployment. Consequently, we weighted the economic scenarios in our IFRS9 models 100 percent to our pre-COVID-19 downside scenario and we show the most important of the economic variables in this scenario with the purple lines on the graph on this slide and it's this economic modeling that delivered the base provision for the COVID ECL.

Next, we also reviewed each of our portfolios, looking at specific vulnerabilities, and we increased the base provision for those items. We assumed a proportion of the customer base on payment holidays will move into genuine forbearance and arrears. We looked at elements of the business portfolio that might suffer under stress and we allowed for adverse ratings migration on the more exposed segments of the book.

Finally, the third layer is really that conscious that more recent economic forecasts have assumed a deeper economic shock than was anticipated a few weeks ago, we also modeled the impact of a pandemic scenario developed by Oxford Economics on our business and cards books. And the key attributes of this scenario are a deep 2020 GDP reversal and unemployment spike into Q1 2021, followed by recovery in 2021 and beyond, and those are the red lines on our graph, and this last piece leads to a further top up of the provision.

We believe that the combination of these three elements leads to an appropriately conservative assessment of ECL due to COVID. The key drivers of credit losses are the duration of lockdown, the pace of economic recovery, the resulting unemployment rate, and the effectiveness of the Government support schemes.

So, taking all of that together and turning on to slide 17, our aggregate COVID-19 provisions are £164 million. That's made up of £146 million charged to the income statement and £18 million of existing economic uncertainty overlay. The COVID-19 provision has increased our ECLs by nearly 50 percent and we think that is some way more than our peer group. We now have £542 million of ECL provision reserves, providing good coverage of our portfolios and most of the increase in and the stock of provisions is against our business and personal books.

Our CET1 ratio was largely undisturbed by the additional impairment charges. £90 million was absorbed by our EEL deduction, or in Aussie parlance, regulatory expected loss in excess of eligible provisions, and the remainder attracted IFRS9 transitional relief at 85 percent.

Now, we're not giving guidance on full-year cost of risk. However, given that our start point is prudent, and based on the current economic outlook for 2020 and 2021, we wouldn't ordinarily expect further provisions of this magnitude. However, the forward-looking picture is highly uncertain and there's obviously a risk of further deterioration.

I wanted to say a few words about RWA migration, and so we deal with that on slide 18. I really wanted to explain why we're less exposed to RWA migration risk in the short-term, particularly during the second half of this financial year. I also want to highlight some work we have under way that subject to regulatory approval, deliver material RWA benefits.

We have no capital markets-exposed business. Our counterparty credit and CVA risk weighted assets are very low, so we have negligible exposure to RWAs that typically move most quickly and materially in volatile markets. Currently, our personal portfolios are assessed for capital requirements under the standardised approach and RWA densities are fixed at 75 percent, with low risk of inflation due to environmental factors.

Our business banking portfolio is primarily on Foundation IRB, which is less sensitive to changes in external conditions. The models use a fixed regulatory LGD and so RWA migration is only driven by PD fluctuations.

Our mortgage books are on advanced IRB and we will see RWA inflation if arrears drive higher PDs and, of course, house price index reductions can affect LGDs. But our RWA density is already higher than peers, reflecting model conservatism and we upgraded our LGD models in the half just ended and importantly, in our models, HPI reductions don't start to bite until we exceed 20 percent.

We're also progressing several RWA initiatives that we estimate will in aggregate, reduce RWAs by 5 to 10 percent. Firstly, as you know, we're transitioning our cards portfolio to IRB. The application is in with the PRA and on the current timetable, we should receive accreditation by the end of FY20. In addition, we have several initiatives in our business RWA model suite. For example, we've just applied to move from a contractual maturity approach to one based on effective or behavioural maturities and that change in tenor reduces the RWAs. And these initiatives will also yield savings over the next few quarters. Taken together, the scale of the cards and business initiatives in the second half of FY20 is similar to the model-related RWA increases we saw in the first half.

Finally, we are pursuing a material improvement in mortgage risk weights by moving our heritage models to the hybrid approach. This is a key industry initiative that, by and large, was expected to lead to net RWA increases for many of our peers; whereas, we had always anticipated it would reduce RWAs for Virgin Money UK. That one’s a longer project - we're working on the basis that we'll secure approval for the new models in the first half of calendar 2021.

Now all of these developments are, of course, subject to PRA approval and the impact is dependent on the portfolio at the time, and any conservativism the PRA would like us to add. However, we have a good track record of making our case. Remember, in 2018, we were the first bank to secure IRB accreditation since, I think, 2007.

Turning to slide 19, our CET1 ratio is resilient at 13 percent, equivalent to a management buffer of around £800 million against regulatory requirements of 9.9 percent after the reduction in the Counter-Cyclical Buffer to zero. In addition to the substantial RWA improvement opportunities we talked about just now, we're managing our capital carefully in the current environment. So, just a few things for you to note. We will moderate our growth in higher RWA density lending, such as unsecured in the short-term. In Business, we're focused on supporting existing customers and we don't expect to see much new customer acquisition in the next couple of quarters. And PPI is well under control and I'll talk about that a little bit later.

In addition, we're delaying all non-mandatory spending. Our integration and transformation programs have been paused. The Virgin Money brand relaunch and heritage rebranding are also paused; we wouldn't get the right return on investment in the current environment, but we expect these to be re-phased into FY21. That all leads to lower integration and transformation costs in FY20, but we will expect to incur these costs in the future, as we gear back up.

So, finally, turning to slide 20, funding and liquidity are in good shape. Only around 12 percent of our funding is wholesale and the deposit franchise is ticking along very well. We started the year with very strong liquidity, as a precaution heading into the FMSA Part VII and the LCR, at 139 percent, remained very healthy as of 31 March. On the non-deposit funding side, £7.1 billion of TFS will be refinanced into TFSME. The bulk of our wholesale funding is more than one year in maturity and our funding plan always allows for nine to 12 months of market shut-out without Government support.

Since 31 March, we've seen substantial deposit increases because customers have moved to conserve cash. We had £1.2 billion of deposit growth in the month of April, with lending flat to slightly down. Now, some of this deposit increases we expect to be temporary and I guess the only impact in the short-term is likely to be some mild NIM dilution.

So, really, that's the sort of roundup of the balance sheet. I'm turning to slide 21. I hope you found that detail helpful. I'm going to move on to discuss the key points in the first half results and then, I'll hand back to David to close.

So, turning to slide 22, our underlying performance in the half was resilient against a tough backdrop. The income environment remained difficult, we’re down 3 percent, year-on-year, due to NIM compression although we improved 3 percent half-on-half, with the margin expanding to 1.63% in the second quarter and higher other income from sale of gilts.

Costs fell 3 percent year-on-year, offsetting the income pressure, leaving our cost:income ratio stable at 57 percent. And pre-COVID, our credit performance was strong with a cost of risk of 23 basis points; including COVID, our cost of risk was 63 basis points with the COVID impact annualised in that calculation.

Underlying PBT at £120 million was lower year-on-year and half-on-half, driven by the COVID-19 impairment charge. Our underlying return on tangible equity was similarly impacted, down c.6 percentage points to 4.6 percent, although prior to COVID impairment charge, we delivered a double-digit return.

So, turning to slide 23, we returned a statutory profit after tax, of £22 million. Exceptional charges of £127 million in the first half had two main drivers: integration and transformation costs at £61 million and £57 million for acquisition accounting unwind. There were no legacy conduct charges in the half. We had a tax credit of £29 million, due to the re-valuation of deferred tax assets following the announcement by the Government that it would maintain the corporation tax at 19 percent. TNAV improved 3.3 pence, half-on-half, helped by an increase in the defined benefit pension asset.

Turning to slide 24, we continue to do well in deposits, improving the mix by focusing on our relationship deposits in accordance with our strategy. Deposit volumes eased in Q2 as we took our foot off the gas on savings and TDs, following a strong first quarter. Relationship deposits grew strongly, though: up 4.3 percent. We continued to capture a leading share of RBS switching deposits with £177 million in the half.

We saw a modest improvement in the cost of deposits. We did some back-book repricing in March and those reductions will feed through in due course and, of course, we'll expect to see further price reductions as a result of the base changes that we saw during the month of March, as well. And then, finally, wholesale funding costs increased by 9 basis points as a result of a richer mix.

On slide 25, a few words on lending growth. Our growth and mix was in line with our strategy. Mortgages were down 1 percent on September 2019, but broadly flat compared to the first quarter, as we continue to optimise for margin management. Business lending grew 5.7 percent, with business as usual boosted by a contribution of £127 million from RBS switching. Lending growth in Personal was driven by cards, where balances were 6 percent higher half-on-half.

Now, it's hard to call what the second half of FY20 might look like for loan growth. Our best guess is that it'll be more muted than the first half and really, the components play out like this. The curtailment of the mortgage market following lockdown means we'll see negligible new business, although it will be partially offset by higher retentions. We'll see facility drawdowns and Government support scheme lending replace BAU origination in Business, but we're unlikely to see the growth rates we had in H1 and we will be throttling back Personal lending to some extent.

On page 26, thinking about margins, book yields were encouraging in this half. Yield compression abated a little in Mortgages, as we flagged in our results last year and Business yields were trimmed, really due to lower LIBOR rates. Personal saw a good increase as a result of better pricing, better mix, and also continued seasoning of the cards book with a stronger EIR out-turn relative to our prudent assumptions.

The improvement in the group's net interest margin in the half followed the shape we set out at Capital Markets Day last year: a richer mix of lending, better deposit costs through our focus on relationship customers, and a wholesale funding headwind from refinancing TFS and building MREL. We also benefited from starting to run-off some of the excess liquidity we were holding for FSMA Part VII and that, together with back-book deposit repricing, is one of the key contributors to the improvement between Q1 and Q2.

Now, the 65-point base rate cut in March hits our rate-sensitive assets almost immediately, with a bit of a lag in repricing deposits because of the customer notice requirements. So, what that means is we'll see an immediate stepdown in our Q3 NIM, as the yields on our SVR mortgage portfolio, liquid assets, and elements of the business book reduce, with some offsets from deposit repricing and TFS. We get a good chunk of that reduction back in Q4, as we see deposit repricing catch up the lag to assets, and so our exit rate into FY21 is a bit stronger. On that basis, we now expect FY20 to finish squarely in the 155 to 160 basis points range. Now the outlook for net interest income will obviously depend on volumes which, as I mentioned are expected to be a little more subdued in the second half.

Turning to slide 27, the shape of OOI is as we described at the November results last year, after stripping out the benefit of a one-off sale of gilts. Dealing with that upfront, it's not a regular practice for us. In March, we sold a small chunk of our holdings to take advantage of attractive market pricing and to lock in a gain of £16 million and we're re-investing the proceeds into other high-quality liquid assets.

Core divisional non-interest income is broadly flat on H2 2019 and down slightly on H1 2019. Mortgage and Business fees were both solid. Fee income in Personal was down, largely due to the implementation of the new rules on overdraft and returned item fees that we flagged last year. Credit card income was also down slightly in March, with some COVID impact on card spend. And finally, as we flagged before, investments income was negligible in H1, as the ASI joint venture is getting up and running and we don't expect material JV profits in the near-term.

On slide 28, a few words on costs. Our costs were down £15 million, 3 percent year-on-year, and broadly flat half-on-half. Now last November you'll recall we guided to a net reduction of costs, after deducting £11 million for the transfer into the ASI joint venture, of more than £30 million, and that this would take the cost base down below £900 million and was predicated on the delivery of a further £50 million of run rate synergies from integration and transformation. I explained these initiatives were largely branch closures and people exits, and the crystallisation of benefits would be back-ended into FY20.

On 26th February this year, we announced significant restructuring proposals that would lead to the closure of around 52 branches and around 500 colleague exits. However, following escalation of the COVID situation in March, the Board decided it would be in the best interests of customers and colleagues to temporarily suspend the restructure until further notice. That means deferring the benefits from those initiatives, with a consequential impact on the cost out-turn for the year. We now estimate that underlying operating expenses for FY20 will be £20 million higher than originally guided.

Now a number of initiatives were delivered as planned in the first half, increasing cumulative run rate net cost savings to £76 million and key cost-saving initiatives included 400 role reductions and consolidation of office space. Restructuring and rebranding costs in the period were £61 million, lower than planned and commensurate with the deferral of initiatives.

Our overall integration and transformation plans remain intact, including the target for £200 million of net cost savings and the total cost-to-do that we committed to. So, still heading to £780 million. However, COVID has introduced a delay and so the delivery profile of those benefits and costs will be re-phased once we know how the UK will return to work after lockdown.

On slide 29, briefly, on impairment, I mean clearly the focus for impairments is on the COVID ECL requirement, which I've talked about in detail. In business as usual, the portfolio continued to perform very well, with a pre-COVID impairment charge of £86 million or 23 basis points, in line with expectations and the small increase on last year is mainly about the richer mix of the book. And, really, the only item to call out here is the improvement in gross cost of risk in Personal, which fell 61 basis points, half-on-half and this was driven by a one-off model recalibration in H2 last year and, also, some dilution effect of growth in good quality assets, all provisioned in Stage one. Our principal asset quality metrics are solid, March '20 versus September last year and that continued into April and it reflects our focus on responsible credit decisions and our controlled risk appetite.

On page 30, a few words on PPI. We've made really good progress on PPI, processing IRs and complaints. £161 million of the provision was used in H1 '20 and the remaining provision covers the assessment, the finalising remediation on the complaints from the IR population, plus some other elements of tidy-up, such as the Official Receiver discussions.

At the end of September, we had 50,000 complaints and around 325,000 IRs. We have closed all of those complaints and have processed all but 8,000 of the IRs. Now, the IR-to-complaint conversion rate was slightly higher than expected. We ended up with around 100,000 complaints from the IRs and we've processed 25,000 of those, with 75,000 still to do.

More importantly, the uphold rate on the complaints have been much lower at around 25 percent over the past six months versus 40 percent provided for. If that uphold rate continues and nothing else comes out of the woodwork, it implies a potential provision surplus. However, we won't count our chickens just yet. Processing is paused for COVID-19; we're about to restart and it's possible the hiatus may mean that closing out PPI takes a little longer than we anticipated - but we will be done and dusted later this year.

So, turning to slide 31, we had, in the first half, net underlying capital generation of 24 basis points and after absorption by exceptional and non-operating items the CET1 ratio was around 30 basis points lower at the end of the period.

A couple of things to call out here. As explained earlier, the CET1 ratio has not been affected by the increased ECL provisions for COVID-19. RWAs absorbed almost 60 basis points of CET1 in the period. Half of that related to a scheduled upgrade of LGDs in our heritage VM mortgage models. As I flagged earlier, we anticipate a broadly equal and opposite impact from RWA model initiatives in the second half.

The 22 basis points of ‘Other’ primarily reflects the Group's pensions scheme contributions paid in fiscal Q1 and we've agreed with the trustee to suspend pensions deficit contributions in calendar 2020, as our triennial valuation is under way and ‘Other’ also includes some negative reserve movements.

Now, we’ve flagged consistently that FY20 was the tightest year for capital generation, and that we expected to see a stronger print in FY21 and FY22, as cost savings kick in and restructuring and acquisition unwinds abate. Despite the COVID-19 pause, that remains our overall view.

Total capital at 19.5 percent and U.K. leverage ratio at 4.9 percent remained robust. At 25.6 percent, we remain comfortably ahead of our interim MREL requirement of 18 percent. The final MREL compliance deadline of 1 January 2022 is one of the few regulatory initiatives that has not been relaxed. We had our next MREL trade oven-ready in mid-February, just as markets went south and we'll look to resume MREL build later this year, we've got about £1.5 billion to go.

So, finally, turning to slide 32, and our look forward. It's highly uncertain how the UK economy will emerge from lockdown and it'll take some time to see the effects of policymaker actions and ultimate impact on the real economy and our customers. But we believe we've got a good line of sight to the likely out-turn on NIM and costs for FY20 and so we're happy to guide on those.

We expect NIM will come in between 155 and 160 basis points for the full year, and we will aim to manage underlying operating costs lower than £920 million, including the bank levy. Over time, the Board aims to return to paying dividends and build those sustainably, and we'll take stock closer to the year end on dividends for FY20, but consensus expectations of low to nil for FY20 make sense for now.

Medium term, we still plan to improve our returns through the three key financial drivers we set out at Capital Markets Day last year - a richer mix of lending, lower deposit costs, and £200 million of cost out. Nothing has changed in that regard; although the UK lockdown means we'll need to revisit and rephase our delivery times, and David will give a glimpse of how we're thinking about that, though, realistically it'll be later this year before we can firm up on those.

So thank you for listening. I realise it's been a long session, but I hope you found it helpful and I'll now hand back to David.

David Duffy

Thanks, Ian. And I will now close out the presentation by touching briefly on our strategy and the opportunities that may arise based on what we're learning in this environment. If you turn to slide 34, while it feels like a long time ago now, the purpose, ambition, and strategic priorities that we outlined at our Capital Markets Day back in June, remain valid for the future environment. The targets we set for 2022 also feel appropriate for us to aspire to in the medium term and as Ian has referenced, the timeline for delivery is now more uncertain until the impact of COVID-19 becomes more visible.

In the short term though, we need to focus on supporting our customers in difficulty and protecting our capital. We have therefore taken the decision to defer a number of the transformation and re-branding programmes that were scheduled for the second half of 2020, but we see this as a temporary delay and plan to continue with these in due course.

We have learned a huge amount over the past few weeks about our capacity to design, build, and deploy projects and propositions at scale in a fraction of the time we ever thought possible. As we continue to learn, I expect that we will be able to develop more efficient delivery models for the post COVID-19 world.

And if I give you a couple of practical insights, we were able to stand up the three new Government support schemes within two weeks with a digital application process. We've also enabled the entire bank to work with a cloud-based Microsoft suite of products, and that was done in three weeks. Usually, it would have taken a lot longer in a pre-COVID world. And the rapid adoption of digital solutions as a consequence of COVID-19 presents Virgin Money with new opportunities in the future. We are a smaller, more agile bank than some of our competitors, and our strong digital capabilities should allow us to leverage the industry-shaping forces that COVID has unleashed. We expect to be able to accelerate our existing plan to fully digitise our bank as soon as the environment stabilises.

The Board and my leadership team are looking closely at the changing business models, customer behaviors, and employee expectations, and are developing an understanding of the opportunities that could emerge from this rapidly evolving environment. We fundamentally believe that an agile, purpose-led, full service digital bank can innovate at speed, and will be able to create significant new opportunities in the market.

[interference on the line]

Ian Smith

David, let me pick up. David, and the Board, and the leadership team are looking at changing the business models, responding to different customer behaviors, and employee expectations. We think that being agile and full-service digital will allow us to innovate at speed and should create more opportunities for us. We're going to support customers as they update their business models and ways of working through just flexibility and digital-enabled mobile workforce and we're seeing material shifts in customer behaviors with digital enrollment up 40 percent in April and I think that plays well to our digital ambition.

And so the combination of those factors should allow us to deliver a better customer experience, but also more efficiently, with greater convenience for customers, and greater flexibility to colleagues, so we think we're going to learn some important lessons and take some opportunities from the things we've done in this crisis.

So, in summary, we're confident that strategic priorities are right for the medium-term, but in the short-term we're going to focus on supporting customers and protecting capital and, you know, I guess that's the key priority for us, certainly during this difficult period.

Finally, just turning to slide 35, reminding everybody that the defensive balance sheet has nearly £550 million of on-balance sheet provisions to absorb future losses, a disciplined approach to risk management, as demonstrated by the regulators willingness to accredit us as an IRB bank; our capital base is resilient with a CET1 ratio of 13 percent, incorporating a management buffer around £800 million, and we have several opportunities to further improve capital resilience, as I talked about earlier.

Allied to all of this is the unprecedented level of policy-maker support across both the Government and regulators and while these are clearly not a panacea, the scale of support on offer should help mitigate some of the worst impacts from the pandemic. And finally, we've learned that, you know, you build a franchise in difficult times based on how you treat your customers. I'm confident that the support we're providing customers, colleagues, and communities will ensure that we come out of this with our reputation enhanced and a business that's built to thrive in the new operating environment.

So that's the end of prepared remarks. We'll now turn to Q&A and so back to you, Maxine, to see if we have any questions on the conference call line, please.

END OF PRESENTATION

Q&A

Operator

We have a question from Alvaro Serrano, from Morgan Stanley. Your line is now open.

Alvaro Serrano, Morgan Stanley

Good morning. I had a question on provisions and then another one on margins. Can I just confirm the provision taken is equivalent to the 100 percent pandemic scenario because I know you've taken three different looks at it, but I just wanted to confirm that if going to 100 percent pandemic scenario, would there be any additional top ups?

And in payment holidays, you also mentioned that you've taken an assumption of some of these going into non-performing. Can you give us details on how many of your customers have asked for payment holidays and how many of these are you assuming will go into non-performing?

And the last one, just on margin, your cost of deposits at 98 basis points. What have you assumed in your margin guidance that that comes down to by the end of the year? Thank you.

Ian Smith

Okay thanks, Alvaro, I'll take those numbers related ones. So, the pandemic scenario, the pandemic shock, was applied to our business and cards portfolios, so not across the whole book. So it's important to understand, the way we've built this up is, you know, significantly lower for longer economics applies across the whole portfolio, that's the base. It was really an additional stress to take account of a, sort of, major short-term spike in the pandemic and that was applied to business and cards. It actually resulted in a relatively small top up to the overall piece. You know, our core economic assumptions I think, are suitably prudent.

And your second one, on cost of deposits. We're not precisely specifying how far that will go but, you know, there's a reasonable opportunity both in terms of just what happens on those that automatically reprice, but also in our savings book where we have admin rates that we can move according to market and we've seen those come down from highs of, you know, sort of 160 towards, on our savings portfolio, down towards a hundred basis points.

Alvaro Serrano

And on payment holidays, I don't know if you can get into that?

Ian Smith

I beg your pardon, yes, you did ask about that. So, the absolute statistics on payment holidays is in mortgages, 60,000, and that's 15 percent of the customer base, you know, in line with the industry really. We've seen 32,000 holidays in credit cards, that's less than 2 percent of the customer base, and 8,000 holidays in personal loans, and that's 6 percent of the customer base.

Now what we did with those, you know -- it's impossible to tell for any banks at the moment, how much of that will translate into genuine forbearance. When we looked at the overlay requirement, we did some sample testing in order to determine how many of the customers were simply being conservative versus those that might be experiencing genuine distress and we allowed for those in the development of the provision. It's pretty small in mortgages, very small in mortgages, and roundabout sort of -- we allowed for something of the order of, sort of 25 percent in the personal portfolio.

Alvaro Serrano

Thank you.

Operator

We have a question from Robin Down from HSBC. Your line is now open.

Robin Down, HSBC

Hi. This one is aimed perhaps a little bit more at David Bennett, as he said, many of us remember sitting through a number of these presentations back in 2007 and 2008, and every bank at that point stood up and said, "our book is better than the average" and yet, we had a lot of sort of negative surprises come through. I'm slightly surprised when I look at the provisional levels that you've got here that you're applying a pandemic scenario where you're assuming that one in ten people lose their jobs and yet, the provisioning that we've got on things like the credit card book, to me feels very, very light.

I think across Stage one and Stage two on the personal loan book, you've got provisions coverage of about 3.5 percent, which just feels low. So I just wonder, you know, whether you're actually comfortable with these levels of provisions, or whether or not we should just really be expecting another big sort of top up to come in Q2, as we actually see the unemployment coming through?

Ian Smith

Hi, Robin, it's Ian, I'll take that one. Look, I think, keep coming back to understanding the shape of this. Broadly speaking, a sort of deep GDP shock that then immediately bounces back doesn't actually feed through to a particular significant increase in impairments in our book beyond what we've allowed for already. The important thing on that sort of peak unemployment of 9.7 percent is that it recovers quickly, very quickly and so I think a combination of, you know, we've provisioned on the basis of a more sustained structural increase in unemployment, close to 6 percent average across our core scenario, and the spike simply adds a little bit more to that. I take you back to the mix and quality of our book and the greater affluence, and therefore the less propensity to incur losses there. So that's the base of it. We are -- of course we're comfortable with provisions. We've done a pretty thorough and comprehensive job on those and we think that the quality of our book is, you know, the best defense in these circumstances.

Robin Down

That’s fine, it just feels like in pure, absolute terms, you just have not set aside enough for the crisis coming through, but I guess we'll have to agree to disagree on that and we’ll see.

Ian Smith

I think it will take some time to sort of settle these down and make some comparisons. I think we've been pretty conservative. Our uplift overall on ECL is, you know, we think we've gone further than the other banks, across the board. So, going back to your point about comfort, we're comfortable we've done a prudent job on this.

Robin Down

Okay. Thank you.

Operator

We have a question from Chris Cant from Autonomous. Your line is now open.

Chris Cant, Autonomous

Good morning, thank you for taking my question. Just to come back on the same point really and something you said on your investor call at the end of March. Obviously we've never seen Virgin go through the Bank of England stress test, but at the end of March you talked about, when you run those scenarios internally, you see similar CET1 drawdowns to peer banks and you don't consider yourself to be an outlier.

I guess the tone and everything you've said this morning would suggest you do think that you're a bit of an outlier, in a good way, in terms of both asset quality on the book and the ECL side, and also capacity to avoid RWA inflation. So, how should I reconcile those two sets of comments? One saying you don't think you're an outlier and then what you've been saying today in terms of how a stress develops, is it just that the stress scenario you're talking about today is so different from the stress scenarios in the Bank of England stress tests? Thank you.

Ian Smith

Hi, Chris, and thanks for that. So, you know, I think it's always difficult to compare like with like in terms of portfolios and other things. So a lot of our read across was to ensure that we didn't, you know, or to test whether we looked like a negative outlier, and we don't. I think that the stress is, so we sort of compare, you know, comparable portfolios with comparable portfolios. The stress is a bit different, we see this as overall a sort of much more of a sort of a lower for longer type stress in terms of recovery. So that is a wee bit different from what was in the ACS last year. And I think you know, our sort of CET1 drawdown overall is impacted in those circumstances by, you know, ability to rebuild capital generation through cost reductions and other things, we're already taking quite a lot of cost out, et cetera, et cetera.

So, the comment back on 31 March was more about saying, look, don't assume that somehow we're going to be worse than the other banks and to your point, you know, I think the mix particularly in the mortgage and cards book suggests that, you know -- we do have a stronger, more defensive portfolio.

Chris Cant

Okay, thank you.

Operator

We have another question from Ed Henning from CLSA. Your line is now open.

Ed Henning, CLSA

Thank you, thanks for taking my questions. Can you just touch a little bit on risk weight migration if the scenario plays out as your forecast, you know, what are you thinking there for risk weight migration to start with?

Ian Smith

So hi, Ed. You know, on the scenario that we've outlined, we might expect to see some risk weight migration in mortgages in FY21 simply because of what we'll see there in potential higher PDs and anything that may happen in HPI. And the other piece of risk weight migration is one of, sort of, adverse ratings migration in the business book.

That's more sort of split evenly in FY20 and the first half of FY21. Offsetting that of course, is you know, the benefits of lower exposures and lower undrawns, so that really helps to offset. So, net RWA migration isn't expected to be material because of the shape of our portfolio. So -- I hesitate to give numbers on that, we're not really giving more detailed guidance on it, but the shape of it is we'll probably see a little bit of net migration in FY21, but we're not expecting to see that material on the current base case.

Ed Henning

So, maybe another way to ask it, if it's not going to be that material, your benefit from the risk weighted assets rolling off will more than offset your potential risk weight migration on your scenario at this stage?

Ian Smith

It certainly offsets a good chunk of it.

Ed Henning

Okay. A second question, just on your NIM, looking forward. As you pull back on cards and also business growth you know, a lot of your -- the book [interference on the line]

Ian Smith

Ed, you broke up a little bit for me there - your question, was it around the sort of impact of lower growth in Business and Personal -- on the net interest margin? The mix effect?

Ed Henning

Yes, the mix effect that you previously called out, obviously, that now gets pushed out - is that fair?

Ian Smith

I don't think that's going to be hugely different Ed. As I said earlier, when you combine that with the fact that the mortgage book is, you know, probably going to see a bit of net shrinkage, certainly in the next six months, just given what's happening in the market, I think we'll be able to maintain the mix progression, albeit on a slightly smaller aggregate loan number.

You know, our own sort of base case -- for the end of this year is probably -- you know, a wee bit better than consensus, so, and I think the mix will be preserved.

Ed Henning

Okay. Thank you.

Operator

We have a question from Guy Stebbings from Exane BNP Paribas. Your line is now open.

Guy Stebbings, Exane

Thanks for taking my questions. The first was just to come back to margin. The stepdown that you're talking to in the second half this year is much lower than some of your peers -- presumably the lower starting NIM, lower structural hedge contributions -- that helps, but I would have thought the drop in the card balances and measures to support the consumer such as interest-free overdrafts and things like that would have had a similar impact, or been a similar headwind into the second half? So, I don't know if you could talk to level of conviction on the NIM guidance, given the uncertainty that's out there, and also the phasing, because it sounds like you're talking about Q4 NIM being up on Q3, given the deposit repricing. Is that right? What should we think about into 2021?

And sorry -- just to take a quick tag on onto the NIM, is it right to assume that the better yield on the card book has been helping to offset some of those other headwinds? It certainly looks like that happening in Q2.

And then the second question was just on PPI and the provision surplus -- you might take a judgment there, and if you could help us at all in thinking around the sizing of that £218 million, which is currently left -- I mean, on the face of it, it certainty looks like more than a single-digit million release, if that run-rate holds. So, any colour would be very useful. Thanks.

Ian Smith

Okay. Thanks, Guy, morning. So, on NIM, I -- the level of conviction is very high. We have a really good handle on our book and if you do the arithmetic on the basis of how we've guided in the past -- you know, we used to talk about 10 million for a 25 basis-point cut. If we assume that 65, is as good as 75, you do the arithmetic on that, you factor in a quarter of lag in deposit pricing, you actually get to a pretty good estimate of what we think the income effect will be in the second half.

And to some extent, I had to be restrained by my colleagues from giving you quarterly NIM guidance going forward, mainly on the basis that -- well -- you know, we do feel pretty confident about it.

So, why are we different from the others? So first, I think it's shape of the book. And in looking at this, clearly the two banks last week, that disclosed, you know, significant step-downs were Lloyds and Barclays -- we're much more mortgage-heavy than those banks, in terms of proportion of the book and we're also much more fixed-rate mortgage-heavy compared to that so our SVR balances are just a shade over 6 percent. So, first of all, we don't see the same extent of challenge there. The higher business books in the other banks makes for more sensitivity and then, certainly, in cards, a good chunk of our portfolio is fixed-balance transfer on EIR, so again, less sensitive to fluctuations in volumes there.

So, if you add into that a bigger opportunity on deposit repricing, as we talked about when I was answering Alvaro's question around the opportunity in savings for example -- that the other banks don't have – and then the overall start position already having taken quite a lot of the pain, particularly on the mortgage book. I think it's all of those factors that really combine to say we don't suffer as badly as some of our peers as a result of the rate environment.

So, for example, overdrafts is a good one. Our overdraft penetration is much lower than our peers and to some extent, that reflects, you know, a sort of previous, quote, unquote 'weakness' in the book in that we didn't have compelling products and product penetration in overdrafts. The impact of offering a £500 interest-free element overdraft for the crisis means that it's easily absorbed within our guidance. And the other thing to understand is that our overdraft position in this new world was always much more competitive and customer friendly than other banks. Other banks are charging rates at sort of 39.9 percent and have had to reduce those in response to the crisis. We went in right from the get-go with a much more competitive 19.9 percent rate for mainstream overdrafts that we haven't had to touch.

So, I think it is about different positioning, Guy, and also just recognising that we've taken our lumps on NIM compression in the last couple of years, much more than the other banks have.

Structural hedge is the last piece. You know, our contribution from structural hedge has always been a good deal lower than other banks, we don't benefit from it as much in income terms, and so we don't suffer as much on the downside now. So, different positioning.

As you can imagine, we've done a lot of soul-searching as to why we might be different from what the other banks are talking about at the moment and so, that's why we're so high conviction.

Your shape is right. You know -- exactly as we guided, the stepdown in Q3 and then, when deposit pricing catches up, we regain a good chunk of that stepdown and you know, all other things being equal, then we're sort of flat into FY21.

The benefit from, sort of cards EIR -- really, in 2019, we were sort of pretty prudent in terms of our assumptions. We've, you know, benefited from that coming into this. That benefit certainly has helped the margin, but there's a bunch of other things there too: deposit repricing, running off a bit of excess liquidity, et cetera. Sorry, I've gone on a lot in that answer, but it's really important to convey to you how confident we are in our margin guidance.

On PPI -- look, the main thing to convey here is, you know, it's going pretty well, against our assumptions and we're certainly very confident that what we're holding is enough. The extent to which we can get a small release out of that, let's wait and see what happens. There's still a bit of water to flow under the bridge, but certainly, at current run rates, you know, it would indicate we've got more than we need.

Guy Stebbings

Okay. Very clear, thank you.

Operator

We have a question from Benjamin Toms from RBC Capital Markets. Your line is now open.

Benjamin Toms, RBC

Hi both, and thank you for taking my questions. You just noted in the presentation that MREL requirements are one of the only regulatory matters or measures not to be relaxed as a result of COVID-19 and is that comment one of surprise or a potential flag that there's some expectation the regulator could do something with the requirements here in terms of relaxing them?

And then just in relation to your expected excess loss deduction in CET1, have you used all that deduction up now, and just as we go through the next couple of quarters, and as the macro overlay gets allocated to real cash losses, do you have to build that buffer back up again or does it stay where it is now? Thank you.

Ian Smith

Thanks, Benjamin. Yeah, it looks -- I think the regulators should have given everyone an extra year on MREL build and we certainly ask for it every week, but it isn't something they've been minded to grant up until now so, yes, it would have been nice to do.

And then in terms of the excess expected losses, yes, we've essentially eliminated that deduction from capital; the extent to which it increases going forward, it is about the rate of conversion to actual losses. Well, sorry, let me stop -- it's different from transitional relief. So, transitional relief, you know, is all about Stage one and two, and to the extent that our losses are incurred in Stage three, it doesn't attract transitional relief. Excess expected losses are purely about your regulatory expectation. So, if that exceeds your provision amount, irrespective of what stage they're in, then you have a deduction.

At the moment, you know, the things that are going to drive increased regulatory expected losses – it's probably most sensitive to PDs in the mortgage book. So, you might see that pick up a little bit in 2021, but it's different from transitional relief. I hope that makes sense.

Benjamin Toms

Thank you.

Operator

We have a question from Joseph Dickerson from Jefferies. Your line is now open.

Joseph Dickerson, Jefferies

Hi, I've got a couple of questions. Firstly, on the unsecured from credit card growth in particular. So, the Bank of England data is showing net repayments, which is driving down balances year-over-year in the systems. Are you seeing a similar phenomenon and so, effectively the implied growth rate if there was a higher propensity to revolve is actually higher than what it looks like optically, and is this current phenomenon something you expect to continue into the second half of the year, that's question number one.

And then secondly on slide 30 in your comments that there might be a potential PPI provision surplus, if you could give us some thoughts around the timing at which you might know that, in other words, is the calendar year end et cetera, and basically thinking through the math of it all -- I mean, if I look ex. the operating and processing costs associated with this, there's about £269 million of provision -- is the right way to think of this to apply an uphold rate of 25 versus 40 percent, so you're looking in the order of magnitude of £100 million kind of surplus, firstly or would you include the processing costs in the calculation? I guess -- how to try to dimension that somewhat based on the numbers that you've put out today. Thanks.

Ian Smith

Sure. Hi, Joe. Thanks for that. So, on unsecured credit growth, a couple of things, and you know, sort of, propensity to continue that. I think the first thing is, our unsecured growth has also included some growth in personal loans and that has really been about us, I suppose growing to more of a natural market share given we've stayed out of that market due to a sort of lack of capability for a while. That's been part of our growth and, you know, who knows what will transpire in the next six to 12 months on that.

On credit cards, again we've got to sort of look at the shape of our book, and the shape of our book is, you know, still around sort of 60 to 65 percent balance transfers, those are not sensitive to general credit card market trends. It tends to be -- it's low-cost borrowing for affluent customers, and it's largely fixed. So, I don't think we are as exposed to short-term reductions in overall credit card balances that the rest of the market would be. So, yes, we might expect to see some lower growth in the second half, but the shape of our book means that we're less sensitive.

Can I -- let me just pause on PPI just for a second here. First of all, you know, there's nothing in our capital guidance or anything like that on PPI. We don't want to be drawn on the sort of size of potential provision surplus or anything of that nature. It is not of the scale you sort of conjectured there, Joe, and I think the key thing to take away from that is, you know, the risk of further provisions is very, very low, and think of it that way. So, no threat to capital from PPI legacy conduct is much more important than thinking about there being a sizable release.

So, and just in terms of your sort of high-level calculation, there's remediation and cost to do that apply to all complaints. So, it's the extent to which, as we process these claims, they turn into claims that are valid for compensation and that is running at a much lower rate, although that rate of compensation, the amounts of remediation we payout, is slightly lower, but more or less in line, and our processing costs are more or less in line, so it's not an extrapolation. So as I say, on PPI, I think what we should all take away from here is that the threat to capital from legacy conduct, we think is off the table.

Joseph Dickerson

Thank you.

Operator

We have a question from Fahed Kunwar from Redburn, your line is now open.

Fahed Kunwar, Redburn

Good morning Ian, a couple of questions, one on capital and one on loan loss provisions. Just on capital, thinking about the kind of risk weight guidance you have given. Do you think kind of CET1 troughs around here? A few of the banks have said it should trough in Q2 not too far kind of, from current levels? Do you see the kind of 13% or around the 13% kind of trough level of CET1 based on the guidance you've given?

Just on your MDA as well, any update on the Pillar 2A reduction that you're hoping for as you go through all the kind of COVID related stuff, it still seems quite high and I know a lot of it was for the kind of the operational stuff with the CYBG / Virgin merger.

And the second question I had was just on the provisions, kind of following up on the earlier questions. Can we get a couple of things? On your hundred percent pandemic scenario, if you apply it to mortgages, how significant would the loan losses be and it feels like the shape of the curve really is why the credit card losses seem to be a lot less than I think we would have thought if you assume a 10 percent unemployment rise or an increase to 10 percent. If you assume a kind of shallower recovery or a less steep gradient on the second leg of your recovery, how sensitive are the loan losses, are they kind of increased exponentially, as we assume that GDP on the second leg of this is lower, any help on that would be very much appreciated. Thank you.

Ian Smith

Sure. Okay. So, on capital, yeah, I think certainly in the short term we'd expect to see a sort of capital low point comes with our third quarter, so second quarter for the December reporters and then the other thing that is you know, is helpful for us is the extent to which we see some of those RWA benefits come through towards the end of the year, that, you know, help with the build back up. So, yes, a sort of trough in the third quarter if you like.

On pillar 2A, so we've got an ICAAP in with the PRA right now where we think that, you know, we've put forward a case for a lower pillar 2A requirement. We have to wait to see where the PRA comes out on that and it's probably quite an interesting time for them to be thinking about ICAAPs and things at the moment. So that's, you know, we should hear, I guess, sometime early summer on where we come out from that, so we might have an update for you in the Q3.

So, in terms of loan loss provisioning, we didn't apply the sort of pandemic scenario to the mortgage book principally because of two things. One is the mortgage portfolio is much more -- it's sensitive to longer-term unemployment, so not a short-term spike, per se, and also house price reduction, and what we've already baked into our base case scenarios -- the purple lines on the graph if you like on the slide there -- is a sort of higher peak to trough movement in HPI and sustained unemployment over the next five years at close to 6 percent. So, we didn't think the pandemic scenario was going to move the needle particularly on mortgages.

Fahed Kunwar

One follow up, just on the kind of shape of the curve on the second leg, how sensitive are the credit card and business losses if you assumed a kind of shallower or weaker recovery coming out of this -- is it exponential or is it quite linear?

Ian Smith

Sorry, Fahed, can you repeat -- I didn't get the first part of that question.

Fahed Kunwar

It feels like the credit card losses are low considering the depth of the recession. Just thinking about how sensitive your scenario modelling is to the second leg, and you've got quite a sharp rebound in both unemployment and GDPs. How should we think about if that recovery isn't as strong as perhaps you think? How sensitive, what are the sensitivities around that credit card and business banking book, would the losses kind of exponentially increase if your recovery, if the recovery is slower?

Ian Smith

Yes. Okay. So, it's a good question Fahed, and it is about a sensitivity. So, it's hard to sort of frame this. I suppose one way of framing it is, you know, consensus out there for aggregate two year losses, so, FY20 and 21 is a good deal higher than, you know, our own view of the world, and I guess what you have to see is unemployment and HPI to weaken significantly and be sustained across that to get anywhere near that consensus outcome. So, I guess that's where -- that's how we think about it.

Fahed Kunwar

Thank you very much.

Operator

We have a question from Martin Leitgeb from Goldman Sachs, your line is now open.

Martin Leitgeb, Goldman Sachs

Yes, good morning. I was just wondering if you could comment what impact you would expect from the newly launched Bank of England Term Funding Scheme on your business both in terms from an asset and liability perspective if you like. I was just wondering if that changes anything and how you think about the mix in terms of Mortgages, Personal, Business, as outlined on the Capital Markets Day, or whatever that's essential, principally, largely unchanged.

And secondly, I was just wondering if you could give us an update on how you're progressing on the Virgin Money current account. Thank you.

Ian Smith

Okay, thanks, Martin. So on TFS, I guess the way we're thinking about this is to be reasonably circumspect at the moment, and what I mean by that is, we had an aggressive TFS pay down schedule through the course of this year. Obviously, we sort of paused that, our £7.1 billion of TFS is not too far away from our initial allowance on TFS so based on your stock of lending. So, what that tells us is, we'll benefit from the terming out of lower cost funding in a way that we weren't in the previous case. So, it helps, you know, net-net from a margin perspective.

In terms of then how that might drive what you do in terms of business shape of things going forward, I think it's too soon to tell and it's too soon to tell from two perspectives really. Our ability to draw and indeed our appetite to draw more TFS, will depend on the extent to which then we see net lending growth through this year because that's the conditions to exceed your initial allowance of 10 percent and, you know, we're not banking on that at the moment, just from a prudence perspective. I mean we did see, you know, net lending against our 1 January position anyway, so in theory, there is some stuff there to be deployed, but we're still just sort of working through that. And then I think we also need to just think about how the sort of competitive landscape plays out. We weren't a fan in original TFS of pursuing growth that, you know, sort of particular growth funded by TFS, because you have to pay it back, and you know, that refinancing means that it's a sort of a temporary benefit, I guess unless you can refinance it on favorable terms. So, I think, jury is out on how much that impacts our plans for growth.

I think your question was one about, how are we thinking about how we're progressing the Virgin Money current account launch, is that correct?

Martin Leitgeb

Yes. I guess its more broadly a kind of update, obviously, it's one of the key elements of the strategy going forward having current accounts, I was just wondering what, or how have you guys progressed it?

Ian Smith

Okay. So, the sort of, you know, conversion of B to Virgin Money current accounts, the sort of soft launch of the digital project I guess, early days -- you know, a decent customer response, we're actually, you know, selling new current accounts even today, which surprises me, because I wouldn't have thought that customers would be focused on opening new current accounts at the moment. Digital sales are actually holding up reasonably well.

It was always a thing for next year with the big launch of proposition and everything that goes with that. Obviously, as we said in our remarks, there's a bit of a delay as a result of COVID-19 and you certainly want to launch this with a kind of maximum impact, so that'll be an early FY21 thing. And, you know, our sort of personal deposits, current account deposits have done reasonably well in this first half.

I think the other important thing to note is, you know, Virgin Money current accounts were about both personal and business and the business stuff has also been paused, but we've seen, you know, good core business current account openings and balance generation. So still feel good about it, we still like the sort of early signs from the conversion of B, it's just that things have moved to the right slightly in terms of launch of the big proposition.

Martin Leitgeb

Perfect. Thank you. Thank you very much.

Operator

We have a question from Aman Rakkar from Barclays, your line is now open.

Aman Rakkar, Barclays

Hi Ian, just one quick one from me. I'm struggling just a little bit with your cards book, some of the disclosure on your credit cards book. You've laid out some really helpful stuff about the quality of that book in your slides today and the prime nature of that book, but you also do provide in your 2019 annual reports a distribution of balances by probability of default on your personal book. So I know that would include some non-cards bits and pieces in there, but if I look at that it says that, you know, only 28 percent of your credit cards book has a probability of default below 50 basis points, which is typically the threshold for something being considered investment grade or sub-investment grade. So you've got 72 percent of your credit card book which you yourself consider to be sub-investment grade. I mean, there's just something about that disclosure, which -- I'm struggling to reconcile those two views of your cards book. Is there something about that annual report IFRS9 disclosure, which I'm kind of misinterpreting? Thank you.

Ian Smith

I'm going to have to go do some digging on that, but, I guess, a couple of things. It would be a sort of mix, you know, it would be a mixed picture with PLs and overdrafts, not just cards that are in there, so, you know, we would just need to sort through that for you, we can certainly come back to you on that. And it's a question of whether these are sort of actual PDs versus regulatory PDs for books that are on standardised and again I don't know if that's playing into it. So, we'll come back to you on that one.

Aman Rakkar

Okay. Appreciate that's a fiddly question. Thank you.

Operator

We have a question from Rohith Chandra-Rajan from Bank of America. Your line is now open.

Rohith Chandra-Rajan, BAML

Hi, good morning and thank you for a very comprehensive presentation and obviously lots of Q&A. I was just wondering if I could come back on provisions and capital, please. The coverage that you show on Slide 17, business is obviously a lot stronger than peers, I guess, reflected in the SME bias of the book, but mortgages at nine basis points is just 20 to 30 percent of what the coverage levels that peers have, and the 440 on the personal book is maybe 40, 45 to 50 percent of the coverage.

On the mortgage book certainly relative to major banks rather than the specialist lenders I can't see that there's a particular difference in the mix that you have that would suggest its materially better credit quality. And then on the personal book, appreciate the arrears levels that you've shown and actually David Bennett's comments at the beginning reminded me that Alliance & Leicester used to show arrears levels by vintage and I wondered whether you have that comparison for your own book on the basis that actually a lot of your book, it tends to be a bit younger and less well-seasoned than some of the peers out there. So that would be helpful in terms of trying to compare the coverage levels.

And then CET1 just to come back on that, you indicated a reduction in Q3 and then a recovery in your Q4. I noticed on Slide 32 you didn't reiterate the 13 percent guidance for the full year so I was just wondering if you could help us think about the moving parts for that in terms of transitional relief you'd expect on further IFRS9 provisions, the model approvals looks like they are potentially about another 30 basis points in the second half and a little bit of RWA inflation and so any additional colour on top of what you've already given on that would be really helpful. Thank you.

Ian Smith

Thanks, Rohith and I hope we've convinced you on margin now. So, look, three really good questions there. I beg to differ on the sort of mix and quality question on mortgages and, maybe, just to take you back to, you know, what did the sort of shape of our mortgage book versus peers look like pre-COVID. And so, what you saw there was we against a range of the bigger bank peers have much lower proportion in Stage three and that backs up our, you know, half industry arrears rate, all those sorts of things. So, a much stronger performing book.

What could lie behind that? I suspect it -- if you look at, say, ours versus HSBC's we have kind of followed a similar path in terms of just, you know, both the period in which we've built our books and others and, you know, sort of general shape of it. We don't have any of the sort of niche specialist stuff that must be driving the sort of different shape of staging in some of the more established peers. Remember the Virgin Money Book back in 2012 was seeded with £15 billion of the very best quality mortgages that Northern Rock had to offer.

So, you know, if we take us back pre-COVID when nobody was worrying particularly about our mortgage book versus others, you know, I think there are some clear distinctions there and then look at what we've done since then. Since then, we have increased our provisions in the mortgage book, proportionately more than any of the other banks. So, I think we've done a good job and we've got a really good mortgage book with none of the sort of specialist self-cert -- you know, the stuff that used to get done 10 years ago that is still hanging around. It's a book that turns over pretty quickly. It's been written under MMR -- very, very comfortable with the mortgage book there.

On personal -- I mean I think, again I just wonder if you're being slightly unfair. We talk about the performance of vintages and so the arrears performance that we give on the slide that shows that we are, you know, about a third of the rest. It's comparing like with like in terms of vintages. So, I don't think that youth of the book plays into the difference there, it's simply a stronger performance on like-for-like vintages.

And then on CET1, yeah, I agree we have the sort of reiterated guidance at, you know, sort of 13 percent guidance for year end. I mean I guess you can probably interpret that with, you know, all things being equal, we'd want to be there or thereabouts just on the moving parts I've spoken about and I suppose 13 percent to some extent we've sort of parked, I think, until we see what lockdown looks like, and what I mean by parked is that we sort of go look -- we've got a big stock of capital. A big sort of buffer to MDA, and I know Barclays are talking about it in terms of threshold to MDA last week, in those terms.

So, I think we're going to just manage that stock of capital as best we can. On our base case I wouldn't expect us to be too far off of the 13 percent by end of the year, but we will have to see what transpires, there are a lot of uncertainties in things that we are -- we can't control. I mean, we've got much more control over NIM and costs, which is why we're content to guide on those and we'll do our best in other respects.

Rohith Chandra-Rajan

Okay, I appreciate there is a lot of uncertainty, so, thank you very much for that.

Ian Smith

A pleasure.

Operator

We have a question from John Cronin from Goodbody. Your line is now open.

John Cronin, Goodbody

Hi, Ian. Thanks for the call. Just a few from me. One is on the -- given the experience -- given the balance transfer card market that's seeing shrinkage in terms of product availability, how does that now play into your thoughts around retention of balances and could there be scope for an adjustment in the EIR on those balances which could therefore boost capital in the short-term?

The second question is -- it's on pensions – clearly you've agreed a roadmap with the trustees of the pension scheme in terms of contributions for another number of years, but what are the risks on the horizon in that respect in terms of an updated actuarial valuation and what that might mean?

And currently, just to follow up on the previous question on deposits -- current account deposit capture – look, any guidance you can give us in terms of evolution of the composition of the deposit book would be helpful. But noting you're -- wondering whether it could accelerate a little bit faster from here, observing your move last week to bump up the rate for current account customers albeit just with respect to small balances, but just keen to understand how we might think about that given rate attrition in the market more broadly? Thank you.

Ian Smith

Hi, John. Thanks. I was really hoping you would have one for David there, but I'm -- I'm back on my feet again. So look, I'm sure David will complement it if I don't do a good job.

Balance transfers, yeah, it's interesting -- I mean, again -- it's so hard to make predictions at the moment, as to what might happen. And so, I'm kind of just responding to your question and trying to be helpful. Typically, in our sort of stress modeling, its normal customer behavior and this is what we've observed previously, is that in a crisis when there are demands on customer's funds elsewhere and less availability of credit, you do see people stick around post-promo. You know, essentially because they are no better offers out there and that is helpful from a sort of income and capital perspective and its certainly some of the behaviour that we model into our ICAAP stresses and other things like that. So, I think that it is an assumption but it isn't something that we are sort of baking into either margin guidance or volumes or anything else at the moment. I think we're going to have to just see how this plays out. But, yes, it is sort of a basic tenet that when there are a fewer offers around, you tend to see -- and this is what we've seen in our historical modeling -- you tend to see people stick around for a bit longer and that is helpful from an income perspective when people are post-promo.

On pensions, the triennial's going on at the moment – it’s actually quite a difficult environment in which to do a triennial evaluation given the sort of disruption that's been experienced. You know, I guess broadly speaking, the funding position has improved every year and I think we're in good shape from a trustee funding perspective. The conversations with the trustees are really around, so, you know, what's the journey time look like and what's -- because we're much closer to the end game on this than other schemes given the age and stage of most of our pensioners and those conversations are still ongoing. The key things or sort of risks or additional funding requirements that would drive the short-term sort of trustee deficit, they’re pretty small actually. You know, we're talking about equalisation, those sort of things, but nothing that we think is going to move the needle adversely in terms of capital requirements coming out of triennial discussions. I hope that helps.

And then on deposit capture. Again, you know, it is hard to tell. We've seen, you know, a big uptick in balances on current accounts and other things at the moment. That should iron out. You would imagine that as customers face into one or two challenges that they might spend some of the cash that they've hoarded over the last couple of months. I think for us, you know, we are -- the tweak we did last week on the current account proposition was just really about enhancing our overall offer and it was good to see some of the personal finance editors pick up on what I think, is a more customer friendly proposition all round in terms of both what we'll offer on small positive balances and I think a superior overdraft proposition for most customers. So that might help us. But we're not going to be in the market, heavy marketing and things at the moment, simply because we're not sure we'll get best bang for buck.

I think the real focus then is how do we accelerate current account acquisitions once we get into later in the year both on the Business and Personal side, and that really is about dusting off the original plans and propositions and really getting on and executing them. I think maybe the one change is, we’ve probably learned a lot more over the last eight weeks on how to sell products digitally than we knew before, and I think that's a good thing.

Andrew Downey, Virgin Money UK PLC

Okay, I think we've exhausted all the questions, so we'll close it there. The Investor Relations team are around if anyone's got follow ups, so feel free to get in touch, but operator, I think we're done.

[ENDS]