Nationwide Building Society
Annual Results 2023-24 Webinar

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Transcript *(amended in places to improve accuracy and readability)*

Nationwide Attendees:

Debbie Crosbie, Chief Executive Officer

Chris Rhodes, Chief Financial Officer

Muir Mathieson, Deputy Financial Officer & Treasurer

Sarah Abercrombie, Head of IR, Credit Ratings & Treasury Sustainability

Annual Results 2023-24 Webinar

Debbie Crosbie

Chief Executive, Nationwide Building Society

Good morning, everyone, and thank you for joining us for Nationwide Building Society full year results call. I'm Debbie Crosbie, I'm the chief executive. And I'm joined this morning by Chris Rhodes, our chief financial officer, and Muir Mathieson, our deputy chief financial officer and treasurer.

I'm delighted to say we have made excellent progress against the strategy that I shared with you 12 months ago. Evidenced through sustained growth in our core markets, a strong service performance and enhanced member benefits. Not only do we remain number one for customer satisfaction amongst our peer group for a 12th consecutive year, but we've also increased our lead in the past year from 3.8% to 5.5%.

Our approach to provide better value products means we are in the unique position of having grown both our mortgage and deposit balances, allowing us to maintain market share despite significant competitive pressures. We also continue to grow in current accounts, attracting our record number of switchers. That's one in six in the overall market switchers, underpinned by our leading market leading cash back incentive.

During the year, we chose to pass on a higher percentage of base rate rises to our savers than our competitors with our average deposit rates over the year 38% higher than the market average. Our mortgage pricing also remained highly competitive in a challenging market, supporting high levels of retention. Together, this has contributed to a record level of member financial benefit of £1.85 billion, which increases to £2.2 billion when taking the inaugural fairer share payment into account.

I'm pleased to say that our strong financial performance, underpinned by robust capital ratios and a focus on delivering efficiency, has allowed us to enhance our fairer share package for this year. Members with an active current account with either a qualifying mortgage or savings account, will receive £100 fairer share payment and for a limited time, all our members will have access to an exclusive bond with a highly competitive interest rate, alongside a £200 member only incentive to encourage more members to switch their main current account to us.

Our branch network remains central to our support for customers, and I was particularly pleased to announce that we have extended our branch promise to 2028, which means we have committed to closing no branches until at least 2028.

We continue to see real value in our branch network, evidenced by one in four savings products opening originating in branch and more than half our fairer share bond openings by value.

Whilst committed to our face-to-face services, we're continuing to enhance and improve our digital services at pace to ensure that we really deliver on giving our customers the choice in how they bank with us with a simply brilliant service at all our touch points. Our Digital Service Mortgage Manager platform allows customers to switch to our best rate in a matter of

minutes, supporting very strong levels of retention. And last month we launched our new digital landlord hub, enabling buy-to-let landlords to manage their accounts online for the first time.

We've launched a brand-new mobile banking app with a refreshed look and added features, and we will continue to innovate, rolling out regular updates with features that we know our customers want to see. We're also leveraging automation and artificial intelligence capabilities to help customers when facing financial difficulties more quickly and more efficiently, and we're actively exploring ways to innovate our complaints process.

In a rapidly evolving landscape, we're also maintaining a strong focus on digital resilience. Last year, our fraud defence systems and specialist fraud team helped prevent more than £130 million of attempted fraud on card and online transactions, and our scam checker service continues to help protect customers.

Finally, we underwent our most significant rebrand in over 30 years. This was supported by our high-profile marketing campaign, bringing to life our purpose and the difference that we bring as a modern mutual. We are also first among our peer group when rated by non-customers or which brand they have heard good things about. That’s one of the key indicators of success.

Our ongoing commitment to deliver the services and products that members value will continue to help the society thrive and stand out as a force for good in value and fairness. Now I'm going to hand you to Chris, who's going to run you through the details of the numbers.

Financial Results

Chris Rhodes

Chief Financial Officer, Nationwide Building Society

Thank you, Debbie, and good morning, everyone. Whilst the economic outlook remains uncertain, the impact of our strategy can clearly be seen across a broad range of performance measures. We continue to lead on customer service, and we are seeing growth on both sides of the balance sheet. Costs continue to be well managed and asset quality remains strong, with a stable arrears performance in the second half of the year. We have continued to price competitively throughout the year, which means member financial benefit is a record at £1.85 billion. When taking our inaugural fairer share payment into account, we delivered £2.2 billion of value back to our members. Now, before I cover our financial performance in more detail, note that any guidance I provide is on a Nationwide, standalone basis.

Underlying profits declined slightly to £2 billion, compared to £2.2 billion a year earlier. Statutory profit is £227 million, lower than underlying profit, due to the £344 million fairer share payment, which is partially offset by below the line hedging items. Total income was broadly unchanged, with the net interest margin reducing to 1.56% from 1.57% a year ago. Costs are £99 million higher, reflecting the new Bank of England levy of £36 million, plus a 2.7% increase in other costs. Asset quality remains strong and better than the industry average. The net loan impairment charge of £112 million is in line with last year, and the long run average at circa five basis points. Provisions for liabilities and charges are £127 million,

largely reflecting an historic administrative matter in relation to withholding tax specific to events from 2018 to 2019.

We expect to recover a significant amount of the charge. A stable balance sheet of £272 billion reflects £2.5 billion growth in lending, offset by a planned reduction in liquidity, including £12.4 billion of Bank of England TFSME repayments. Retail deposit growth of £6.3 billion reflects strong inflows into savings accounts, partially offset by outflows from our current accounts as members moved money into higher paying products. Capital ratios remain strong, with the leverage ratio growing to 6.5% and the CET1 ratio increasing to 27.1%.

Net interest margin was broadly unchanged, as lower lending margins and fewer bank base rate movements offset higher retail funding margins. We expect margins to decline in the year ahead, as the mortgage book reprices towards current new business margins, together with the timing impact of base rate reductions and the unwind of deposit margin increases that took place when rates increased.

Mortgage market activity remained weak through much of 2023. The sharp decline in swap rates around the turn of the year led to a modest pick up, but the market has lost some momentum in recent months. However, our central expectation remains that activity will gradually recover as affordability improves through a combination of income growth and reducing interest rates. Mortgage book margins continue to decline from their peak as mortgages written during the pandemic run off. Completions in the second half of the financial year were written at circa 50 basis points on a blended basis, which includes the cost of rebooking switchers with increased optionality under the mortgage charter. The mortgage market remains very competitive, and we expect new business margins, which include switchers, to settle between 60 and 70 basis points. The current pipeline is at circa 70 basis points.

The deposit market continues to grow in line with expectations, with balances moving from lower paying accounts into higher yielding accounts, though this trend is slowing. Approximately 57% of the change in base rate since December 2021 has now been passed through to our retail variable savings base. Our average pay rate for total deposits is now 312 basis points, which is 73 basis points higher than the market average deposit rate compared to 53 basis points higher at the end of the previous financial year. As a consequence, our member financial benefit, which measures the value returned to members through better long term pricing, increased to £1.85 billion in the financial year. Deposit margins will decrease as base rate reduces, with the broad expectation that the margin widening which occurred as rates increased, will be reversed as rates fall. In addition, there will be a margin drag because of the lag between base rate reductions and the feed through to customer rates. We expect the net interest margin to decline to the low to mid 140s this year, with the H1 outturn likely to be lower than H2 due to the current account switching incentive we have just launched.

Costs increased by £99 million, though £36 million of this increase reflects the Bank of England levy that is now payable in advance of the financial year, and which was previously recognised through income. Excluding this impact, total costs increased by 2.7%, significantly below the rate of inflation. We expect costs to increase by circa 4% this year.

This year's cost of risk is five basis points, which is broadly in line with the long run average. Compared to the base case scenario alone, the multiple economic scenarios uplift the expected credit loss provision by £126 million. The provision also includes modelled adjustments of £164 million, which is mainly due to a probability of default uplift for continued economic uncertainty impacting borrower affordability.

The coverage for the owner-occupied portfolio was six basis points, up one basis point on the prior year. Buy-to-let coverage increased by nine basis points to 53 basis points, reflecting an increase in arrears over the year and the retention of provisions linked to higher interest rates. Unsecured coverage was lower by 40 basis points at 10.2 percentage points, which remains elevated compared to pre-COVID levels. Domestically, downside economic risks have diminished somewhat, but we have maintained a 15% weighting to the severe downside scenario to reflect increased geopolitical risks. Secured arrears have increased from 32 basis points to 41 basis points but have been broadly stable in the second half of the year and well below the industry average.

The average LTV of new business increased to 70% from 69%, driven by our support for first time buyers. The average stock LTV is stable at 55%. Forbearance excluding mortgage charter cases fell from £1.2 billion to £1 billion. Mortgage charter balances are £1.4 billion and as they mature, we are seeing only circa 7% of cases needing additional support or in early-stage arrears. If the current trend continues, then we would expect forbearance levels to increase back to where they were 12 months ago. Unsecured arrears have increased from 1.21% to 1.36% and are now slightly above the pre-pandemic levels of 1.32%.

The 12 month LCR was 191%, compared to 180% at the end of the prior year. Our internal assessment of liquidity, which is in excess of regulatory requirements, explicitly considers behavioural and other characteristics of the book, including the level of uninsured balances and the levels of digital engagement. On balance sheet liquidity totals £47 billion, compared to £37 billion of deposit balances in excess of the £85,000 FSCS limit. In addition, we hold an estimated £79 billion of drawdown capacity at the central bank, much of which can be drawn intra-day. Our funding and liquidity position remains strong. We continue to pre-fund our repayment of TSME drawings and when all TFSME has been repaid, we expect our LCR will sit in a range of 135 to 145%. We have already repaid £12.4 billion of TFSME ahead of contractual maturity, leaving £9.3 billion outstanding.

We issued over £8 billion equivalent of wholesale funding during the last financial year and expect issuance in this financial year to be in the range of £7-9 billion. We are already well progressed against our plan, having successfully issued circa £1.5 billion equivalent in tier two and covered bond format since 4 April 2024. It remains our intention to maintain at least one benchmark outstanding in each instrument type across the liability structure. We continue to ensure our issuance plans take account of credit rating agency requirements for loss absorbing capacity.

Our capital resources are in excess of regulatory requirements, with substantial buffers across risk-based leverage and MREL frameworks. The society holds surplus capital of £5.4 billion to the leverage requirement, and £7.6 billion to risk based requirements. The PRA has consulted on Basel 3.1, and our interpretation of the draft rules suggests our CET1 ratio would reduce to the low to mid 20s on a pro forma endpoint basis. The leverage ratio is expected to remain our tier one binding constraint. We have repurchased circa £175 million of CCDS to date,

which is held on our balance sheet. The PRA has granted a renewed 12-month general prior permission to repurchase CCDS up to the equivalent of 2% of existing CET1 resources, though this does not mean any further buyback exercises will necessarily follow. The current permission will expire in January 2025. Thank you. I'll now pass you back to Debbie.

Update on Virgin Money

Debbie Crosbie

Chief Executive, Nationwide Building Society

Thank you, Chris. Now in March, we announced our bid for Virgin Money, and I'm pleased to say that yesterday their shareholders voted in favour of the acquisition. We believe this deal will provide our members with a wide range of benefits, including a broader and more diverse product range. It will also provide a strong business banking platform, which will enable us to bring a mutual approach to this very important sector. The transaction also delivers strong financial benefits to the society.

In the last financial year, Virgin Money generated pre-tax profits of £345 million and announced distributions of over £270 million to shareholders. Following the acquisition, Nationwide Group will be able to retain these profits in the UK for the benefit of our customers and members. Based on market consensus forecasts for Virgin Money's pre-tax profits in 2024, the acquisition would represent a 17% return on the purchase price. Notably the tangible net asset value of Virgin Money of £4.4 billion as at 31 December 2023 is £1.5 billion in excess of the acquisition price of £2.9 billion. Although the final figures will depend on the fair value of net assets acquired at the completion, a significant gain is expected to be recognised as a result of the acquisition. As we are using existing surplus capital to invest in Virgin Money, our capital ratios will continue to be stronger than the major banks, with an expected pro forma CET1 ratio of approximately 20%.

The transaction has been received positively in financial markets, including by the three major credit rating agencies, which have all recently reaffirmed Nationwide’s existing ratings.

Because Virgin Money is a profitable business today, we can take a prudent customer first approach to our post-acquisition management of the business, underpinned by a gradual integration plan that will not commence for a number of years. Virgin Money will continue as a separate legal entity with a separate board, management team, banking licence and therefore FSCS protection. This will be reviewed within approximately 18 months of deal completion to deliver a clear strategy for integration in the future.

Our initial focus will be to invest in Virgin Money, service, and infrastructure to bring it closer to the level of service the society offers. Nationwide and Virgin Money share many of the same strategic IT suppliers, which will enable some benefits to be delivered ahead of integration. This transaction gives us scale and depth to really compete with the shareholder banks, and we look forward to giving you an update on how we progress at our future results call. Of course, the transaction remains subject to receiving the necessary regulatory approvals, which we anticipate will complete in quarter four of 2024. With that, we're now going to move to questions.

Q&A

Sarah Abercrombie: Thank you, Debbie, and good morning, everyone. If you'd like to ask a question, please type it into the Q&A box on your screen. We already have a few questions, and there are three product related ones from Rohith Chandra-Rajan from Bank of America. The first one for Chris. You've grown mortgages when other major lenders have seen some contraction. What is differentiated Nationwide's offering?

Chris Rhodes: We've built some new digital retention processes. We have a tool called Mortgage Manager, which has been used both for mortgage charter cases, mortgage servicing and switches. Importantly, I think what differentiates us is a combination of service, price and just good products. We have maintained a retention rate of 85% of mortgages coming off the deal. When you look at sort of our stack of various market shares, it's that retention rate that is stand out and has driven the market share from 12.2% to 12.3% in terms of outstanding balances.

Sarah Abercrombie: Thank you, Chris. Now one for you on deposits. Your recent deposit mix performance has been similar to the wider market, with little change in the second half. How do you see the dynamics this year in response to potential rate cuts and the competitive environment?

Chris Rhodes: Yeah. Those deposit dynamics have seen fixed rate grow flow out of current accounts and a flow out of low paying variable rate. What we're now seeing is some real stability. Current accounts at the end of the year were £29 billion. They are still £29 billion as of today. We've got stability in current account balances, and we've hit the peak I think of fixed rates. As the year progresses, I would expect broadly stable current account balances, growth in variable and a slight decline in fixed rate balances.

Sarah Abercrombie: Thank you. The third one is for Debbie please on Virgin Money. It may be too early to discuss, but do you see the acquisition of Virgin Money's unsecured and business lending books as a platform for diversification? What's the bigger attraction, diversification, or scale?

Debbie Crosbie: Thank you. It's a great question. I mean, we see both diversification and scale as really important. In fact, it was the reason why we think the Virgin Money acquisition is a great fit for us. We look forward to delivering a wider range of products. We're particularly excited about business banking, and we think that's a great opportunity. Yes, we will look at a broader range of unsecured products as well. So it's really both. Yeah, looking forward to getting stuck in.

Sarah Abercrombie: Thank you. We've had a few questions on MREL post the Virgin Money transaction from Corinne Cunningham, from Lee Street, from Elsa Dargent. So I'm going to pull them all together. You mentioned no change to Virgin Money's legal structure initially. Does this mean that it's MREL and capital instruments both qualify at a group level? Are we expecting a Bank of England waiver? What are the transition arrangements for any grandfathering? Are you expecting to run with a single point of entry resolution strategy?

Muir Mathieson: Yeah. Thanks, Sarah. Thanks everybody for all of those questions. As Debbie's already touched on, we are in the midst of regulatory approval process. You'll appreciate that until those regulatory approval processes are concluded, there will be only so much we can say. What we have said and as you've already touched on there, that we are

not anticipating any immediate changes to the capital structure of Virgin Money. Over time, of course, we would anticipate that we would seek to align and simplify capital structure across the group. Hopefully that gives you a good enough summary of what we anticipate. Once we do get through regulatory approvals and completion of the deal, we'll be able to say more.

Sarah Abercrombie: Thank you, Muir. Probably a little bit of a follow up there from Lee Street. Do we have any plans to do any funding associated with Virgin Money UK?

Muir Mathieson: As Chris has already touched on, our standalone funding plan is similar to previous years at between £7-9 billion equivalent of funding. We are funding the Virgin Money deal from our own resources, as we've already disclosed, and post completion, we'll be able to say how the acquisition and the larger group will impact our funding plans thereafter.

Sarah Abercrombie: Thank you Muir. A question from Olivier Ducarme for Debbie, please. Thank you for the presentation. Do you foresee any issues from Nationwide's members continuing to request a members vote on the deal?

Debbie Crosbie: Look, overwhelmingly, our members have not expressed an interest in this issue. To give you some numbers on that, we've surveyed 30,000 of our members, and there was only 8% of those surveyed expressed any concern whatsoever about the transaction. The rest of the people who were surveyed were either very supportive or neutral on the transaction. We've also written to our 16 million members twice now, and we've had a tiny response to that in relation to the member vote. Frankly, our members are much more interested in things like our branch promise, the financial package that we've announced today, our fair share payment, etc. I'm really happy that overwhelmingly, our members are very happy with the direction of travel.

Sarah Abercrombie: Thank you. Debbie. Back to Muir now, please. From Nicholas Bonnes, following the renewal of the general prior permission to repurchase the CCDS, what conditions do you set to relaunch a CCDS buyback? For example, solvency levels, completion of the acquisition, stress test results.

Muir Mathieson: Thanks, Nicholas. We haven't set out a public framework or anything as hard and fast as the kinds of metrics you're talking about, Nicholas. we've seen it as a useful tool, being able to provide liquidity and buybacks into the market. We're pleased that that general prior permission has been renewed. As we've said in our disclosure today, that doesn't necessarily mean that we will be announcing more buybacks, but we now do have the option to do that. No framework, no metrics as such. But we're pleased to still have the ability to be able to do those buybacks should we choose to.

Sarah Abercrombie: Thank you, Muir. Back to Chris now please. A follow up on margins from Rohith. When you say you expect all of the deposit margin widening to reverse, do you expect it to go back to zero?

Chris Rhodes: Do I expect to go back to zero? Depends on your view of base rates. Our view of base rates would not have them falling to where they were pre the rate hike cycle. On that basis, I would not expect them to go back to zero. No.

Sarah Abercrombie: Thank you. A similar question from both Luis Garrido and Corinne Cunningham for Muir, please. What is your estimated CET1 ratio, including Virgin Money and including the Basel 4 regulatory changes?

Muir Mathieson: That number we'll put in the public domain post completion of the acquisition once we've got the consolidated reporting all together. That's not something we put out today. Clearly, I'm sure you heard it, Corinne, but just for the benefit of everybody else, low to mid 20s for Nationwide on a standalone basis. We're expecting our CET1 ratio post completion to be around about 20% on a combined basis. I believe Virgin Money have put out some disclosures around minimum initial impact from Basel 3.1. Clearly, the other thing just to note, of course, is that we are expecting the PRA to put out the very important conclusion around Basel 3.1 implementation in the UK by the end of June. All of those disclosures are subject to exactly how the PRA decide to implement it, which we'll find out within the next month or so.

Sarah Abercrombie: Thank you, Muir. Whilst you're on a capital role, another question from Lee Street. What are your expectations for the group leverage requirements when including Virgin Money UK?

Muir Mathieson: Yeah. Thanks, Lee. We clearly will have a bigger balance sheet and as I think many callers on this call will know, the OC buffer is graduated depending on the size of the organisation. So we think this transaction tips us into the next grade up. Clearly, as I say, going through regulatory approval process, ultimately, it's for the PRA to dictate capital requirements and the timing thereof. But that would be our expectation. That clearly the OCI buffer on a risk-based basis will flow through to the leverage requirement as well.

Sarah Abercrombie: Thank you, Muir. Now some questions on margin for Chris, please. From Aman Rakkar at Barclays. What is the exit NIM for financial year 23/24 so we can understand the incremental NIM pressure relative to your low 140s guide this year? What do you see as a normalised NIM longer-term, considering there's an ongoing tailwind from hedge repricing?

Chris Rhodes: Wow, okay. Lots of moving parts in there. The H2 NIM this year was 146, which is broadly the exit NIM of the year. We're guiding you to low to mid 140s. That includes the timing lag of base rate changes. Broadly in that guidance I've given you the timing impact. Well, the range covers roughly 75 basis points of base rate cut. Low end range would be slightly more than that, which is a long way around of saying excluding timing differences, we expect our NIM this year to be roughly the same as it was in H2 last year. I don't really want to go beyond the next 12 months because it's really dependent on mortgage competition and the ultimate response on savings pricing to base rate cuts. But we've got a very good line of sight to this year's number. Like I say, excluding timing differences, think about it as broadly flat this year on the exit of last year as structural hedge offsets both deposit and mortgage margin pressure.

Sarah Abercrombie: Thank you, Chris. A question for Debbie from James Hyde, please. Can you rule out a second acquisition during the integration, given that another one of her former banks is now likely to come up for sale?

Debbie Crosbie: Look, I think what I can confidently say is for the next number of years, we'll be very focused on the Virgin Money acquisition. We don't have any plans to look at anything else at the moment.

Sarah Abercrombie: Thank you. As a reminder, if you have any questions, please type them into the Q&A box. We've got quite a technical one on LCR, Muir. The post TSFME guidance, is that based on the same 12 month average as the way that you report the LCR today?

Muir Mathieson: Yes. We've quoted 150% if we were to have fully repaid all of our TFSME as at the reporting date and the only other thing I would say is we've also, as Chris touched on earlier, in a normalised environment, we'd expect to be around about 135-145% mark, as we've previously discussed.

Sarah Abercrombie: Thank you. Muir. Another one has come in from Corinne. Could you reconsider the distribution rates on the CCDS?

Muir Mathieson: I've got no plans to reconsider the distribution rates on CCDS, Corinne.

Sarah Abercrombie: Thank you. A question for Chris. Can you give us an updated outlook on the arrears profile?

Chris Rhodes: Yeah. Look, we are holding expected loss provisions which cover a significant rise in arrears. We are not seeing that rise in arrears. We got stability in the second half of the year. I think we hold provisions more than we are ultimately likely to need. As time progresses, it will be increasingly difficult to hang on to the economic uncertainty post model adjustment. The timing of that will clearly be determined by economic scenarios, but actually there's nothing in the arrears performance that says we're not very close to the peak.

Sarah Abercrombie: Thank you, Chris. We have no further questions. I will hand back to Debbie to close the call, please.

Debbie Crosbie: Okay. I just want to thank you all for joining and thank you all for your questions. I think I started up by saying we feel very happy with our financial results. The strategy is working, we're delivering against it well, and we also remain very confident about the progress that we're making on Virgin Money, and we look forward to providing you further updates at our next half year results call in November. Thank you.

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