Provident Financial Group FY20 Results

Presentation

Malcolm Le May
Chief Executive Officer

Thank you, Rosie, and good morning everyone and thank you for joining us for the presentation of our 2020 results. I will now take you through some of the highlights from the year, including some of the important strategic news which we've announced this morning, and also how we've performed year to date in 2021.

I'll hand over to Neeraj, our CFO, and he'll take you through the detailed financial review of last year. I then plan to return to give an update on our strategy and outlook, including how we see the Group evolving in the future and to focus around the three core products that we have: credit cards, vehicle finance, and unsecured personal loans. After that, we'll take your questions.

Turning to slide 4, stating the obvious, 2020 was a tremendously difficult year for many people, including our customers. The impacts of the COVID-19 pandemic are still being felt obviously today. So, even though lockdown restrictions are easing, we still need to be very cognisant of the associated risks from any consequential macroeconomic shocks which may become more apparent later in the year. That having been said, I believe the Group adapted well to the challenges of COVID-19 and as a result, our customers continue to receive the vital support that they needed.

The Group overall reported an adjusted loss before tax of £47 million in 2020, which was better than market expectations, and within that Vanquis and Moneybarn remained profitable for the year as a whole despite the challenging circumstances that they faced. We made the conscious decision at the start of the pandemic to focus on our capital and liquidity, which with the benefit of hindsight was I think absolutely the right thing to do.

In fact, it's really emphasised one of the key competitive advantages against our peers, that of having a banking licence within the Group. This enabled us to lend to our customers throughout the pandemic when some others were holding back. It also means that as lockdown eases, we can keep on lending to our customers as the demand for credit re-emerges. So far this year, we've seen credit card expenditure recover quite quickly as restrictions have eased and we expect the demand for vehicle finance to continue as well.

Now, as you know, we informed the market in March of our intention to launch a scheme of arrangement for CCD. In April, the Court approved seeking a customer vote on the scheme, and we're working hard towards delivering this successfully.

Alongside that, the operational review of CCD that we announced last November has concluded and it is with deep regret that we are today announcing that we have taken the very, very difficult decision to withdraw from the high-cost credit market entirely, which now obviously includes our home collector credit business and our Satsuma businesses.

Initially, we're going to place the home credit business into a managed runoff. That will be likely to run until the end of 2021, and obviously during that time we'll be open to selling the business if a suitable acquirer comes forward.

As of today, sadly, we'll also be entering a collective consultation with CCD's 2100 employees. Some 1500 of these are located across the country and obviously, 600 of them are included in our centre in Bradford, which obviously also includes operations from Group and Vanquis.

As a result, the Group will now focus instead on the largest segments of the mid-cost market, those being sub and near-prime credit cards, vehicle finance, and unsecured personal loans, and I'll come back to this in greater detail a little later on.

I think going forward with the inclusion of an unsecured personal loans mid-cost offering, we'll be presenting a much more product-based view of the Group which serves the needs of our customers with a range of products, and moving away from separate divisions and over time, focusing everything around the bank and its balance sheet£, and through this, accessing its access to its retail deposit base where appropriate, which I think, as I said, is a key strategic advantage.

Slide 5 highlights this more product-based view of the Group and gives I think a useful snapshot of our markets, where we sit within them, and the opportunities they present.

To my mind, the key takeaway here is the scale of the opportunity that we as a Group have to pursue. Our credit card and vehicle businesses have already got market-leading positions in large growing segments and our ambition of growing our presence in the unsecured loan space will benefit from our significant existing expertise across underwriting collections and financing in the near and subprime segments.

Turning to slide 6. The next few slides will focus on how we responded to the operational financial challenges of COVID-19 and the lockdown restrictions that were associated with it.

Our credit card business Vanquis reported an adjusted profit before tax of £38 million for the year, I think a good result given the challenges of COVID-19, and it maintained resilience and appropriate capital and liquidity positions throughout the year. The VREQ, which is the PRA's voluntary requirements around capital preservation was also removed by the PRA during the year, and that allows dividend payments to the Group to resume.

Customer receivables fell to around £1.1 billion as tighter underwriting standards impacted new customer acquisition volumes, and also as customer expenditure was impacted by the various periods during 2020 of lockdown.

In terms of the trends that we've seen in the first quarter of 2021, credit card delinquency trends have remained favourable, as Neeraj will show in his section, and customer spending patterns have improved as the lockdown restrictions have eased, although obviously it's early days. In fact, in early April credit card spending was back to the levels we last saw in April 2019, i.e., before the pandemic, and credit card receivables at the end of the first quarter stood at approximately £1 billion.

Slide 7 shows our unsecured personal loans business. Our intention is to build on our existing expertise within the personal loans segment and expand our offering over time significantly. This will cater to a wider range of customer credit scores over time. Our starting point as a business is just under £20 million of receivables operating in a market which we estimate to have an aggregate size in excess of 1.6 billion or did as of at the end of 2020. You can clearly see that we have a significant opportunity with this product segment, and I'll come back to you in a little more detail later on.

Slide 8 shows our vehicle finance business which reported an adjusted profit before tax of £10.9 million during 2020. It was able to continue lending to customers throughout the year, taking market share and growing its receivables books and customer numbers by approximately 16% and 19% respectively. Indeed, over the last three years our vehicle finance business has grown its customer number by around 80% and its receivables by approximately 60%, which I think is an excellent achievement.

Given the size of this market and our nearly 10% share, I continue to see this as an attractive multiyear opportunity for the Group. Clearly, the demand for privately owned vehicles increased during the pandemic, as people avoided public transport but still needed to get to work and to take children to school, et cetera. Also, I think it's interesting to note that of the new business we wrote during 2020, approximately 38% of the loans went to key workers.

In early 2021, we expanded our vehicle finance customer proposition by moving more into the near-prime segment where with loans there priced at around 15% APR. This launch has gone well, and customer demand is currently in line with our expectations.

In terms of the trends that we're seeing during the first quarter, arrears trends have improved, as we've been able to repossess vehicles once again, which was constrained during the period up until the lockdown ended, and also the underlying demand for preowned vehicles has remained healthy and we can see no reason for this trend not to continue.

As at the end of March, our first quarter receivables in Moneybarn stood at approximately £585 million, which is an increase of around a further 4% since the end of 2020.

Now, turning to slide 9, the consumer credit division, which includes our home collector credit business and also Satsuma. As you know, CCD was on track to break even during 2020 but I'm afraid the impact of COVID-19 and rising volumes of customer complaints on the division meant it reported an adjusted loss before tax of some £75 million for the year.

Again, as you can see from this slide, the home credit market has been in decline for some time. In fact, it's not the only high-cost, short-term market to have had significant challenges in recent years as payday loan, rent-to-own and other segments have virtually disappeared as well.

Rising volumes of customer complaints driven by claims management companies has become a real issue for the high-cost, short-term credit sector over the last 12 months, and I think CCD obviously was not immune to that trend. To this end, we notified the market in March of the challenges it was presenting and therefore our intention to launch a scheme of arrangement for CCD to cauterise the risk of complaints arising from historic matters.

The scheme is an important part of the plans we've announced today, and we firmly believe that it is the fairest compromise we can offer to those customers, past and present, with legitimate redress claims.

As I've said before, if the scheme is not sanctioned in July then it is very likely that we will be forced to place this business into administration or liquidation, and in that scenario customers I'm afraid would receive no redress payments.

So far, in April the Court approved the scheme proceeding to a customer vote. The next significant date for us in this process is 17 May when we will recontact creditors and inform them how to vote, with voting staying open until July when the creditor meeting is due to take place and after that we will ask the Court to formally sanction the scheme.

Moving on to the outcome of the operational review of CCD and taking account of the decline of the home credit market, the rise of complaints driven by CMCs, the financial impact I referred to of COVID, and the evolving regulatory environment, and also our natural footprint. It's clear to me that it's unlikely that CCD will be viable in the future and we will not achieve the scale that we have in our car finance business going forward.

Therefore, as I've said, it's with deep regret that we've announced today that we have decided to take the difficult decision to place the division into a managed runoff for the remainder of 2021, obviously with the option to sell all or part of the division if the opportunity arises.

As I said, this really was a very difficult decision for us to make, particularly given the significant contribution this business has made to the Group's history, but I do believe, sad as it is, this is the right decision for our stakeholders.

Going forward, our focus will shift to building on our strong position in credit cards and car finance and to expanding our offering to customers in the mid-cost unsecured personal loan area, building on the Vanquis loans' work to date and during in the course of 2021. I think this will fit seamlessly with our existing credit card and vehicle finance offerings.

As mentioned already, the regulation of our markets continued to evolve during 2020, and it's vital to me that we maintain a collaborative approach across the Group, as shown here on slide 10. In 2020, a payment holiday and [consistent best] guidance came into effect, and more recently, at the beginning of May, we've adapted to the new breathing space guidelines which have been introduced.

Undoubtedly I think though during 2020 where significant announcements were was the Woolard Review, which was published in 2021, and the review has outlined the FCA's direction of travel in its approach to unsecured credit, which will impact I think all providers, whether prime or subprime and it clearly flagged to my mind more regulatory activity in the high-cost space, but also emphasised the lack of mid-cost credit options for many consumers.

Now, we've obviously studied the report. We were peripherally involved in it - and we studied it with the aim to making sure that we are at the forefront of regulatory developments and good practice. As I mentioned earlier, we are repositioning the Group in the near-prime and mid-cost space and that's very much in keeping with the findings of the review.

Finally, we also informed the market in February that CCD is the subject of an enforcement investigation by the FCA on some of its affordability and sustainability lending practices. There's no further update at this stage, nor do we actually expect the investigation to be concluded until 2022.

Moving to slide 11, in summary. The Group finished ahead of market expectations for the year. I believe the Group has a very resilient capital-led liquidity position, and that served the Group very well during the pandemic. I think it provides optionality as lockdown eases and consumer spending increases, putting us in a good position.

Looking to the future, we've announced our view away from providing any high-cost credit products, which is a key part of making I think the Group more sustainable, and we'll now focus on the larger credit card, vehicle finance, and personal loan markets. These markets are likely to grow as a result of COVID-19 and I think we strong scalable platforms in two of them already and we're building on our existing platforms in the third.

As outlined in our Capital Markets Day of November 2019, the future of this Group could be based around its bank's balance sheet and it will be more of a near-prime and mid-cost credit provider.

With that, I'm going to hand over to Neeraj. He will run you through the numbers and I'll wrap up on strategy and outlook before hosting Q&A at the end of the session. Neeraj, over to you.

Neeraj Kapur

Chief Finance Officer

Thank you, Malcolm. I'll take you all to slide 13. As you can see here, the Group adjusted loss before tax for 2020 was £47.1 million compared with a profit in 2019 of £153 million. The Group adjusted profit before tax and impairment for 2020 was £313 million and that compares with £497 million in 2019.

Important to point out that Moneybarn and Vanquis have remained profitable throughout 2020, and 2020 clearly has been a year of great challenges for everyone, especially our customers, and this is clearly borne out in our results. However, despite this, we have continued to help our customers on their path to better everyday life.

Our receivables have been negatively impacted, unsurprisingly, at the same time increasing our impairment provisions pro-cyclically under IFRS 9, driven mainly by the worsening unemployment forecasts in 2020. These forecasts are improving in 2021, but a lot rests on the pandemic not resurging as we have seen in other parts of the world, and the impact post-furlough ending in September. I'll go through details in some more detail shortly, but we remain cautiously optimistic.

Financially and strategically, the Group has positioned itself during 2020 to deliver the ambitions it set out at the Capital Markets Day in November 2019, albeit COVID has delayed progress. Appropriate capital and liquidity resources have been maintained during 2020 and will be central to the delivery of the Group strategy for the benefit of all stakeholders after taking into account the financial impact of the CCD scheme of arrangement and its controlled rundown.

We have seen evolving supply and demand dynamics in our chosen markets, driven by strong moves towards electronic delivery channels as well as significant regulatory change.

On slide 14, you will have seen that towards the end of 2020 we had added an intermediate holding company into the Group structure, called Provident Financial Holdings Limited. This structure is more typical of a listed group and establishes a buffer to protect the Group listed entity's balance sheet and thereby reduce any volatility risk in the reserves, which is to the benefit of the Vanquis and Moneybarn customers as well as the debt and equity holders. This structure also anticipates the future direction of the Group as set out in our Capital Markets Day in 2019.

We are planning on the basis that the controlled runoff and closure or sale of CCD will cost up to £100 million, which is split roughly 40% redundancy and lease termination costs and the remaining being the operating costs to the end of that runoff period. The consensus in the market for this is actually higher currently than this level.

I'll turn to slide 15. The Group results are set out here by division. Exceptional costs include the provision for the CCD scheme of arrangement and its related costs. The most significant impacts to the Group's products have been from reduced receivables in credit card balances and the IFRS 9 impact on all of our product lines.

Moneybarn has done well to grow its receivables during 2020 while remaining open to new business during the lockdowns and thereby predominantly helping the key worker community.

The key focus of the Group during 2021 will be overhead reduction. Slide 16 shows us the product snapshot and is useful in showing the impact of the pandemic on our 2020 results. You will see in the credit card business that our average receivables were down 15%, our interest margin was down 19%; however, our impairment charges increased by 21% and that led to risk-adjusted net interest margin down 41%. The adjusted PBT was down 25% and that led to an adjusted PBT reduction of 78% leading to a 38% profit for Vanquis.

The vehicle finance division actually did well on receivables and was up 12% and its net interest margin was also up 20%. The impairment, however, was significantly higher at 47%, again driven by two things, mainly the macroeconomic impact on that business's higher [inaudible] charge as well as the fact that during lockdown we were unable to collect cars or bring cars that were repossessed out for sale in the market, so that had quite an impact in 2020, which is now being dissipated. The risk-adjusted net interest margin was down 13% and that's led to an 18% reduction in adjusted PBT for the year; however, has left Moneybarn in quite a strong position in terms of its increasing balances.

The home credit and short-term loans business that Malcolm alluded to earlier reduced significantly in the year in terms of its balances by 33% and against a £200 million cost base this left CCD in a difficult position when it comes to profitability, as you can see on the slide.

The key performance indicators show significant cost of risk increase in 2020, up 18.6%, driven by the poor macroeconomic outlook in 2020. Cost of funding was higher, purely due to the decision to hold significant levels of liquidity in the Group during 2020. The cost-to-income ratio was negatively impact by the 19% drop in Group income due to the pandemic and there was a small decrease in total Group cost during the year. The revenue yield reduction during 2020 also indicates the impact of the tightening of credit risk across the Group as well as the falling CCD balances.

Slide 18 shows credit card spend during 2020, and it has been indexed to February 2020. This shows a dramatic impact of the lockdowns in the year but also shows that our customers have behaved on the whole as the wider market has. The latest view on spend week on week shows differentials between 2020 and now are negligible.

Slide 19 looks at the payment holiday position. Soon after lockdown, which saw the introduction of payment holidays by the FCA, we saw a large take-up of these in the initial phase, especially in the motor loan segment. As we can see from the graph, this demand for payment holidays has dissipated to immaterial levels by the end of 2020 and remains such currently.

Slide 20 looks at the increase in impairment driven by the COVID-19 pandemic. What you will see here is the increase in impairment was driven predominantly by the macroeconomic overlay which increased the amount of impairment charge we held by just over £70 million. The underlying credit quality and core delinquency trends remained favourable during the period. You will see that CCD levels are higher than the other products, but this based on a significantly lower level of receivables.

Slide 21 demonstrates the robust coverage ratios that we have in the Group. Coverage ratio remained strong during 2020, and this slide shows that the coverage ratios have been strengthened throughout the year despite a prudent starting point to 2020. Increases in H1 '20 versus H2 '19 reflect significant deteriorations in the macroeconomic forecasts. Again, the CCD percentage apply to the significantly lower balances than the other products.

Slide 22 is particularly interesting. This slide provides some reason for optimism for 2021, but we remain cautious of both furlough coming to an end and the potential for more powerful strains of COVID. What this does show is the resilience of our customers, which we have pointed out in the past. The Group's significant history and knowledge in this part of the market allows us to both understand and manage our customers through these difficult times, and what you will see with these graphs is that reducing delinquency rate.

Slide 23 looks at our expected credit losses. The expected credit losses have been increased by £73 million, as you see in the graph, due to the negative impact of the macro-outlook. The basis of that macro-outlook is set out in the table to the right and shows a peak severe downside of 12.7% for unemployment. These current consensuses, which include Lloyds, Barclays, Bank of England, et cetera, are coming down quite significant currently, but we remain prudent on the basis that our customers are yet to come out of furlough and may be, in proportional terms, more affected by unemployment than other parts of the market.

The Group's coverage ratio at 35% at the end of the year is very strong, at PCL level but that is enhanced by UCLs, which would take that coverage ratio to beyond 50% if they were to take it into account.

Slide 24 shows that the receivables fell reasonably dramatically during the COVID impact period of 2020. As stated previously, the Group's net receivables were down 18%. Credit card business is seeing some green shoots of improvement now. Most of this is driven by spend in the beauty and hairdressing areas as well as pubs and restaurants, unsurprisingly. There's also a continuing trend towards online purchasing.

The motor finance business continues to grow steadily and into the near-prime adjacent market. This is substantially larger than the addressable market that Moneybarn has been in historically.

Turning to regulatory capital on slide 25. We see that the regulatory capital remains well managed, meeting the requirements of the Group over the next three years after taking into account the costs of running down CCD. The capital reduction of £35 million during 2020 is driven mostly by the post-tax statutory loss in 2020.

Slide 26 looks at our capital stack and some opportunities that arise from it. It shows that the make-up of our Group capital base is 100% CET1, and there is an opportunity to use other common forms of debt capital to support the Group's growth into the future. The first step in our view would be to consider the feasibility of a tier 2 issuance, and that would be based upon both the demand for that issuance as well as the market pricing that that would give us.

Turning to slide 27 and looking at the diversified funding mix that we have, we continually look to diversify our funding sources, and we've been able to add the Moneybarn securitisation to that diversification. We have also repaid our bonds on time and have remained covenant compliant. We also bought back £75 million of bonds during 2020 at a discount. We have improved our undrawn capacity during 2020, allowing the non-bank group to end the year with £144 million of available liquidity.

We continue to optimise both the cost and diversity of funding within the Group. We are creating a contingent funding line through the Bank of England's TFSME offering. In future, the Group will also look to include a greater use of customer] deposits in our balance sheet.

In conclusion, 2020 has been a very difficult year financially for most, but we have navigated these difficult times with a strong focus on capital and liquidity. We continue to target the objectives set out at Capital Markets Day in 2019, and specifically, a return on equity of between 20% and 25%, cost-to-income ratio of less than 40%, with receivables growing in appropriately sized addressable markets. We will focus on costs as well as funding and capital efficiencies to support our strategic goals.

Malcolm will now provide you with more insight into how we will evolve and evidence to support our financial ambitions. Over to you, Malcolm.

Malcolm Le May

Chief Executive Officer

Thanks, Neeraj, and I hope those who are listening found that excellent summary of the financials for 2020 and the first quarter outlook.

Slide 29 shows one of the key changes that we've made since I became CEO a little over three years ago, which was really to renew our focus on our purpose and culture across the Group, namely helping put people on a path to a better everyday life. This is actually central to what we want to achieve here at PFG, how we want to operate, and indeed why we exist. It's helped to unify colleagues, it's increased customer-centricity, and it's certainly making, I believe, us a more sustainable business. In fact, in our most recent survey approximately 90% of the colleagues understood our purpose and that's obviously central what we are trying to achieve over the next few years.

Turning to slide 30, I think this is an important slide as it illustrates how we see our product offering going forward. It clearly sets out why we think credit cards, vehicle finance, and unsecured personal loans are the right products to offer, and also why we are moving away from the high-cost, short-term credit offerings we used to offer.

On the left-hand side, the pie chart sets out the significant difference in size between the markets that we're going to be focusing on going forward, and versus those which we are exiting. In aggregate, the sub and near-prime credit card market, vehicle finance, and personal loan markets, are worth approximately £15 billion, and that compares to some £600 million being the aggregate size as we see it in the home credit and high-cost, short-term loans market.

The right-hand side of this slide shows an illustration of where the various markets sit across the APR spectrum. Our personal loans product will bridge the gap from where we used to operate to where we have existing platforms. Perhaps by way of example, our personal loan product will be focused on lower-risk customers with approximately 70% of them sitting in the near-prime or better segments, and typically with credit scores ranging from the low 500s to 600 or above. By comparison, over 70% of historic home collector credit customers sit in the subprime segment where their credit score is typically less than 500, so it's a significant shift as to the cohort that we're addressing.

I think, as I've said earlier, the mid-cost segment is the regulator's preferred path to market, and where we see the regulatory direction of travel going. We already have large and scalable platforms in this segment with our credit card and vehicle finance businesses and will seek to scale up our personal loan offering using our existing expertise.

Our vision for the future, as set out on slide 31, was actually first articulate to you all in the Capital Markets Day in 2019. Our aim has always been to have three core products centred around the bank with the Group driving capital funding and cost efficiencies, and by this yearend will have made a significant step towards achieving that with our credit card, vehicle finance, and unsecured loans businesses all operating in large markets in the near-prime and mid-cost space.

Our credit card platform has market-leading capabilities across underwriting, collections, and distribution. It maintains a deep understanding of its customers and their behaviour, which has been very important, in fact more important than ever in the last 12 months.

We will continue to diversify our core credit card business and we'll include new offerings for customers with potential to introduce a self-employed credit card in due course, and by continuing to explore partnerships and white-label opportunities such as those we have already with [Tidball] and LOQBOX and they were announced obviously in 2020.

Similarly, turning to vehicle finance, we have excellent primacy rates with our brokers and a market-leading credit and underwriting capability built on our long history of operating within this market. The expansion of the product offering will continue, and we'll obviously seek to work closer ever still with our network of introducing agents and brokers.

We see our personal loan product complementing our existing offerings extremely well and we're building on an already established presence we have in that market to take the business forward. This Group is uniquely positioned in this regard and will benefit from our deep understanding and detailed insights into how our customers behave, which has been established over many years of lending to the customer segment that we serve. This is why we're confident that this development will be successful and why our offering will be differentiated against those of our peers.

We plan to hold a further Capital Market Day later this year, at which point we'll update the market further on our progress.

Finally, turning to slide 32, we see reasons for us to be optimistic, but equally, I am aware and Neeraj is aware of the possible macroeconomic shocks that may yet arise as government support is withdrawn later this year. As I said earlier, we're seeing customer spend increase materially as lockdown restrictions have eased and demand has picked up, and we are starting to see early signs of recovery already, and obviously we're excited by the opportunity in each of our markets, as I illustrated earlier on. I think we're well positioned to exploit this given our balance sheet strength.

Turning to dividends, I plan to update the market on our thinking with our interim results when hopefully I think we'll have a greater line of sight on the economic environment, and the progress we're making on the strategic initiatives I outlined earlier, including obviously the scheme of arrangement and the managed runoff for CCD.

Going forward, I'm convinced that we have the right strategy in place with the capital and diversity of funding to support both our products and their distribution and enable us to grow PFG and create a broader bank for the underserved customer, delivering attractive, long-term, sustainable returns for our shareholders over the medium term.

That covers the slides. Thank you for listening today. We'll obviously now taken any questions that you have, which will be coordinated by our moderator Rosie. So, Rosie, back over to you.

Q&A Session

James Hamilton - (Numis)

Good morning and thank you for the presentation. Clearly, the Group has a very substantial amount of surplus capital sloshing around in this, and my understanding is that you have a relatively cautious outlook ahead of the end of furlough. How much of that capital do you think could be deployed should the macroeconomic environment continue to improve, and do you hope to be able to utilise the vast majority of that capital over the next three or four years?

Malcolm Le May

Thanks, James. I'll start off then I'll hand over to Neeraj. Yes, I think it's a very fair observation. We have maintained a very prudent approach to capital preservation throughout the pandemic and obviously, if you look at some of the more established prime banks in their recent announcements, they have been perhaps rowing back a bit from that standpoint. The reason that I think we've been prudent at the yearend is that clearly, relative to their customer base and their overall profile, where obviously their lending is heavily influenced by asset-backed lending in the real estate markets and mortgages and the likes of that.

Our customer cohorts are slightly different, and yes, whilst the macroeconomic assumptions haven't been as difficult as I think people were assuming in September last year, we've yet to see the impact fully on the economy of them unwinding later this year, and I fear that our particular customer base is more exposed to any blip there. So, we have been prudent. I think we'll need to look at it again very seriously at the half year. I'll hand over to Neeraj to talk about the detail of the utilisation as we see it going forward.

Neeraj Kapur

Thanks, Malcolm. Thanks, James, good question. The way that we are looking at the capital plan over the next three years is that with the cost of the scheme and the rundown costs of CCD, it leaves us in a position which allows us to grow our balance sheet not overly significantly but to a level which I think consensus would be accepting of, but also taking into account that the IFRS 9 charging building up our balance sheet to where it has dropped to will not be insignificant, and that has to be taken into account when you're looking at that capital base.

The capital is adequate and appropriate for the rate of growth that we're considering, which is at a level which we believe balances both profitability during that period with levels of operational resilience to allow us to put that growth [on] safely.

Malcolm Le May

Is that okay, James?

James Hamilton - Numis

Very good, thank you.

Gary Greenwood - Shore Capital

Morning. I've got three questions, if I can. The first one is on the profitability and return on equity outlook. I think in Neeraj's comments you reiterated this was the 20% to 25%

ROE medium term that you had set out at the Capital Markets Day in 2019. So, I'm just wondering how we should think about the ongoing businesses building back towards that sort of return and how important the new unsecured lending product will be in achieving that. That's the first one.

Second one is on CCD and around the up to £100 million of potential closure costs. I'm just wondering if you could talk around the sensitivities to that and why it might be lower in terms of collecting out the portfolio maybe, and also whether it includes the potential costs of the FCA investigation.

Then the last question is on credit cards. I hear what you're saying about the big pick-up in spending. I'm hearing from some of the lenders such as Barclays that they're concerned that it might take a little bit longer for that to feed through to balance growth because customers have built up quite a lot of deposits. I'm guessing that your customer base is probably different to that and doesn't have a lot of deposits, so do you think that increasing spending will translate into growth in interest earning balances faster for you guys? Thank you.

Malcolm Le May

Thank you. Three very good questions. I think we haven't given any formal guidance on return on capital employed and the like, so I think that's something we will return to with our Capital Markets Day. But the sort of range that I anticipate that we will be in is probably north of 20%, 25% as you've said. I think that's a reasonable assumption.

I'll let Neeraj get into the details of your second question in terms of the breakup - make-up I should say, rather than breakup, of the £100 million closure costs and the sensitivities around it but we haven't factored in any number for the FCA investigation because as I've said, it's very, very early days. We don't even know whether it's going to conclude whether there was anything wrong in what they're looking at. There's really nothing further to say at this juncture on that. As I said, I don't think that we'll frankly see any material progress on the outcome of that until 2022.

Neeraj, did you want to get into a bit more detail about the sensitivities there may be around the £100 million? I think perhaps it would be helpful to talk about the extent to which the collect out book is covered, and this is really to help us more on operations stuff.

Neeraj Kapur

Yes. Thanks, Gary, for your questions.

On the £100 million closure costs, the main costs really cover the staff redundancy amounts, the termination of leases, et cetera, for various offices around the country, and therefore the - and then the rest of it is the running costs of getting it to the point where it's no longer running. Those are the kind of costs. The actual book itself is very well provisioned from an ECL perspective, which you will see in the pack, but also the fact that the UCLs in that area pretty much cover the whole lot of that book.

That book has reduced. We did say in March in our announcement that it was down at around £100 million. Since then, it's got below £80 million, certainly circa £70 million, in size and therefore it hasn't really got that kind of size or length of duration left for there to be much coming from the book in terms of the additional provisioning. So, it is really about that, and the quicker that we are able to collect out the rest of the book and close the operations, that £100 million figure that we've set out could be lower based on that. That's kind of where that it.

Malcolm Le May

Thanks. I hope that answered your - your third question, comparing balance growth of our book relative to a prime book. It's interesting; obviously, you've got two aspects of receivables growth. One is new customers that you bring on and the extent to which they spend immediately and build up balances and also then, all importantly I think for us, the growth of our existing customer base.

We have seen that we've got - we've been quite prudent in terms of bringing on new customers during the pandemic and we've been quite prudent in that we've actually also tightened the poorer credit end of the spectrum for our card offers in categories 7 through 9. Having said that, there is quite a considerable amount of capability for existing customers to grow and that's where we've seen the growth as the lockdown has eased.

As Neeraj referred to in his section, we've seen the dynamic of expenditure has been higher, obviously as you would probably expect, in food and beverage. The week of 12 April was particularly high as people went out for the first time when they could go out and it slowed down a bit the week of the 19th because the weather was so cold. I don't think many people wanted to sit outside, but that's been picking up again.

We saw it in the beautician, hair space, that sort of expenditure, which our sort of customers naturally turn to, where we haven't seen the pick-up which we would perhaps normally see at this time of year is on things like your holiday bookings and certainly any sort of international flight travel, but that is something I think we'll anticipate. I think we will see - if this trend continues at the moment, the pick-up in expenditure from our existing cardholders who have been very suppressed, and that might just slightly be a different dynamic to that which you're seeing in the prime book.

Gary Greenwood - Shore Capital

That's great. Thank you very much.

Ian White - Autonomous Research

Hi, morning. Thanks for the presentation and thanks for taking my questions. I had three as well, please.

First of all, just a clarification on the CCD costs. Can I just confirm that the cost of running down the business are pre-tax, and can you tell us how would those costs differ, if at all, in the event that the business was placed into liquidation, please? That's the first question.

Secondly, when do you think you might be in a position to resume the full new customer onboarding and the credit limit increases within Vanquis? I think the release said I think you're about 50% on both of those at the moment. Or what are you looking for, what will you need to see in order for that to return to pre-pandemic levels, and what would be the incremental costs that would associated with that, please, particularly on the new customer booking side? That's question 2.

Just finally, could you just clarify, has there been a further cut to the Pillar 2A capital requirement during the second half of the year? Unless I'm getting myself into a muddle, I think the 2A requirement was given as 19.33% at 1H '20 and now it looks to me to be 100 bps lower. Can you just help us understand what has changed there, if anything, please? Thank you.

Malcolm Le May

Okay. We'll try and answer those. The first question was are the costs associated with the rundown of CCD pre-tax?

Ian White - Autonomous Research

Yes, please, and how they would differ under a liquidation scenario, if at all.

Malcolm Le May

We have done quite a lot of work obviously looking at a liquidation scenario versus what we're doing with the scheme and orderly runoff, and actually, there's very little difference between the two. Clearly, we are already managing the book down, as we described, quite considerably.

If you put that situation into an administration, I think you've got to work on the premise that you (a) find there would be very limited recovery of that book, and also you would lose a number of other benefits that the Group will have, for example, tax losses that it's accumulated over the last three years, which could be utilised elsewhere if you put the thing into administration. So, our analysis suggests economically that there is little difference between an orderly runoff with the scheme versus putting it into administration.

Then to your second question in terms of our attitude towards new customers and onboarding them and the incremental costs of that. We are starting to allow new customers to come onboard. We are starting in a limited way to do credit line increases. We are still being reasonably prudent; there's an advertising campaign kicking off in the second half which will facilitate that. That's all within our budgets for this year in a planned way.

Then I'll let Neeraj answer the question on the Pillar 2 point.

Neeraj Kapur

Thank you. There hasn't been any real - there has been no change to the Pillar 2A during the year, just to confirm that, and we can pick it up later maybe in the calculation that you have that shows a difference, so we can reconcile it more carefully. Yes, there's been no change there, and it remains as was throughout 2020.

Ian White - Autonomous Research

Okay, thanks.

Ed Firth - KBW

Morning, everybody. I had three questions, sorry. The first one was just in terms of the core tier 1. Should we - do you think it would be reasonable to expect that that minimum may come down once you've closed CCD? I imagine some of the operational risk requirements in the sector must be quite high for that business. I guess that would be my first question.

The second was in terms of economic scenarios, and I apologise if you've already put this in the announcement, but it looks to me like your upper, your most optimistic outlook is pretty much now where consensus is. Can you give us some sort of sensitivity? If we were to see - if you were to use just your most optimistic scenario, what sort of writebacks would be reasonable to expect, or what's the sensitivity around that, if that's possible to give us some numbers there.

Then the final question was just at the time of the scheme arrangement the FCA sent you what I think was - I would describe as a pretty strongly worded letter. I don't know how it compares with others, but it seemed to me to be pretty strongly worded. I'm just wondering, what happens to that now? Is that just it and we just forget about it, or is there further action being taken there, or are you in further discussions with them about that? Thanks so much.

Malcolm Le May

Okay. I'll cover the first part of question 1 and number 3. I'll let Neeraj get into the details of the economic scenarios in particular.

In terms of the question about - a general question, should we be anticipating a cut in our core tier 1 requirement. Clearly yes, with the closure of CCD, the operational risk profile of the Group will change. You'll remember, those of you who can remember back to when we did the last issue in 2018 that we had quite a material operational add-on onto us as part of our then ICAAP.

The question of the degree and timeline of any release being forthcoming is really a matter that's out of our hands. We'll obviously submit our views on the ICAAP during the course of later this year, but I can't predict how the PRA will react to that. That part of question 1 I'll let Neeraj embellish that, and then if you take the second question on the economics, Neeraj, I'll then come back on the scheme at the end.

Neeraj Kapur

Yes. Thanks, Malcolm. Hi, Ed. Thanks for your questions. The CET1, as Malcolm said, is in the hands of the PRA. You're quite right to point out the significant risk changes that come from the decisions we've made, and clearly, we will put our case forward as strongly as we can, but it's not within our gift to come up with any difference.

Ed Firth - KBW

Did you have any sort of scale as to what the CCD operational risk add-on is or anything like that that you could help us with? I'm not trying to draw you but just so we can do some numbers on it.

Neeraj Kapur

No. Well, I respect that it's very difficult, it is very difficult, because I wouldn't really want you to take a view on something as significant as that in terms of a reduction and then that reduction doesn't come through, because that's just the issue. The issue isn't to do with the numerics, it's to do with where the PRA would like to see that CET1 ratio going forward. I think it would be better for us; if we did have some indication of that, then we would definitely provide some guidance at that point. As Malcolm says, that's probably if not later this year, early next year.

On the macroeconomic scenarios, you're quite right. One of the things you'll see on slide 23 is the impact of the macroeconomic downgrading during 2020 was £73 million. Ultimately, there's a view that says will that reverse out if we start seeing the kind of positives that we're seeing, and when we look at the current consensus and where that consensus is seemingly going on unemployment specifically, then you could say that it's moving back towards the 2019 level, which would then remove that £73 million. That would give you some kind of boundaries on that.

Malcolm Le May

Then to your third question, obviously there's a limited amount I can say about that. Yes, the FCA wrote as they told us they were going to write to us, setting out their concerns which were in that letter. It's something that they have expressed. It's something that was considered in the Court meeting that took place a couple of weeks ago and notwithstanding that, the judge has obviously allowed the convening meeting, as it's called, to go forward to shareholders.

Inevitably, I think the FCA are not going to approved schemes, they've made that clear. Unless one pays a pound in the pound to complaints, they will always have areas of concern, but they certainly, I think, broadly are happy with the methodology we're putting into the scheme. We will continue to have a dialogue with them but where we are now on the scheme is it's proceeding.

It will go - we're writing to all the creditors, as I said, on 17 March [sic - May] and it will be then for them to vote at a meeting which is taking play on 19 July I think it is. Assuming they vote in favour of the scheme, which is our working assumption, then it will be sanctioned I hope by the judge at the end of July. I don't think you should read too much into that letter really from the FCA. It's important, we're considering it, we're in dialogue with them but it's the nature of these things, frankly.

Ed Firth - KBW

But things like the suggestion that they think you can pay more than £50 million, they're reviewing whether you meet threshold conditions, stuff like that. As an external observer, that all sounds pretty serious stuff, but my sense from you is that you feel pretty relaxed about it. Is that fair or am I - I don't want to put words into your mouth.

Malcolm Le May

No, no. Well, you won't. It's important for us to think carefully about that but we put [inaudible] this in the amount that we think that we can afford to pay when we look at the capital requirements that we have and the plans that we've got for the next few years, and we're not changing anything. It's also equally important that we maintain a good dialogue with the FCA because they regulate our other businesses, so we will continue to be in touch with them. But we believe the scheme will proceed and in its customers' interest for it to do so.

Ed Firth - KBW

Great, okay. Thanks so much.

John Cronin - Goodbody

Morning, all. Thanks for taking my questions. The first one is on the topic that you've previously raised around the potential of bringing Moneybarn into the banking group, and I'm just wondering is there any update in relation to the dialogue with the regulator on that or anything you can say in relation to potential expected timing, noting that you first flagged this in some level of detail at the 2019 CMD.

The second question I have is just on this opportunity in mid-cost credit. You've called out £1.6 billion of addressable market opportunity, a bank that has been writing personal loans for years, very small receivables book. What makes you confident that you can make it work and where are you going to win the customers? As well as that, can you give us any context in terms of what kind of scale to be thinking about, more from a capital consumption perspective at the outset than anything else, just to get a sense as to whether or not that would impinge on your ability to distribute any surplus capital in time.

Then thirdly, just coming back to the closure costs of up to £100 million. I think you've called about 2100 CCD employees working with an average of say £15,000 or £20,000 of a redundancy cheque, that's £30 million to £40 million of costs approximately. It seems significant that it could be up to £50 million or £60 million of extra costs, and any observations on my attempt at high-level calculation on the redundancy point, and could you give a bit more detail in terms of the breakdown of other costs associated with the closure? Because that £100 million does seem a high figure. Thank you.

Malcolm Le May

Thanks, John. Taking the first question first, you're absolutely right, we have flagged our intention to use the bank's balance sheet to fund Moneybarn. It's something - we also in the time since the Capital Markets Day in November 2019 started to diversify its funding anyway by utilising [a securitisation] program which obviously you're aware of, which we're doing with NatWest.

But absolutely, it is our intention to utilise the bank's balance sheet in terms of funding Moneybarn's growth in the future. It's a delicate subject which will require further conversations with the PRA. We obviously are as strict as any bank is under our large limits exposure and that would require conversations with the Bank of England to lift that, but it's something we're planning on doing.

The extent to which we haven't put our foot on the gas pedal to do it during 2020 is really more around all of the high jinks that were going on more generally with the pandemic and I just didn't think we'd really have the attention of the PRA. It's certainly something that's more coming into focus now.

In terms of the mid-cost credit market, it basically - in terms of scale, I think this is something that's going to evolve over time, and I think again it's something we'll come back to at our Capital Markets Day to give you more parameters on that very early stage at the moment. But I think we've also said that we'll come back to you on our review on future dividend strategy at that point. I think they're not mutually exclusive topics, let's put it like that.

Then I'll basically let Neeraj talk a little bit more about the detail of the closure costs.

Neeraj Kapur

Yes. Thanks for your questions, John. On the closure costs, you're right in your broad views of how those costs split out. If we then consider the fact that the normal running costs of CCD were approximately £200 million a year, you can take from that that if it takes six months to get to a point where if there's closure of that division, then that six months could cost in itself £100 million.

Now, clearly what we're talking about here is a much-reduced level compared to that because obviously, we are looking to reduce costs as we go through the process as well and therefore this determines - if we're talking about the end of that process towards the end of this year, then actually that cost level would seem quite reasonable, if not demanding, of our management to deliver. I think the up to £100 million is definitely something we would like to beat but it will be a tough ask.

John Cronin - Goodbody

Thank you. Can I throw in one final quick one, just in terms of the language on Moneybarn loan demand? I don't want to read into it too much, but it sounds like the trends are a bit more positive in Vanquis and Moneybarn at the moment. Is that fair to say?

Malcolm Le May

No, I don't think you should assume that, and I apologise if I created that impression. I think both businesses I think are doing very well, but as I said, because of the natural customer base that we have, we are a little bit more conservative about the future than perhaps some of the prime banks have been. I think in the circumstances, they're both doing very well.

John Cronin - Goodbody

Okay, great. Thank you.

Malcolm Le May

I appreciate that was the last question. I want to just say thank you, first of all, for dialling in and listening. I also want to apologise, there was probably a loud bang in the middle of that presentation, and I should perhaps explain that, because I poured Neeraj a glass water and then proceeded to knock it over and break the glass all over him. So, I'm sorry for that.

I'm looking forward to giving you the update to our half-year results. As you know, they'll probably be in August, and then we are planning, as I say, a Capital Markets Day for later in the year when we'll be able to get into a little bit more granularity about some of the questions you've been asking. Let's hope that we can do that by then face-to-face; it would be good to see you all.

So, thank you with that. If there are any further questions, please contact Owen and we'll make sure that they are addressed. So, thanks again for listening.

[End]