Virgin Money UK PLC Full Year Trading Update 04 November 2021 – Call Transcript

Hosted by David Duffy (CEO) and Clifford Abrahams (CFO)

David Duffy, Virgin Money UK PLC

Hello, good morning and good evening to those of you who joined from Australia, thank you for attending this call.

As you are aware, we have made the decision to accelerate our Digital First strategy following our observations of market trends emerging in the post-pandemic environment. We recently issued an RNS indicating that we are executing a material reduction in our branch presence, in recent days we have completed our Digital First strategy analysis and have agreed the financial outcomes with our board. Given the launch of our new strategy with updated guidance, we felt that it was appropriate to communicate these outcomes as soon as possible.

My intention today is to provide an overview on our financial performance in 2021 but I also will address what the acceleration of our Digital First strategy will deliver, both for our customers and also for our shareholders in terms of medium-term guidance on ROTE and costs.

In headline terms, accelerating our Digital First strategy means that over the next three years, we will deliver a Digital First bank, targeting 100% digital origination across the majority of our products; this origination will be supported by memorable customer experiences and a unique Virgin rewards offer. In addition, we will launch a range of new market competitive products and propositions to further underpin our growth ambitions. Over the same period, we will deliver double digit ROTE, a cost income ratio of less than 50% and a sustainable dividend.

I will provide some more details on this strategy in the next few slides but first let me address our financial performance for the full year 2021. As you can see from the slide, the bank is performing well - we have delivered a statutory ROTE of 10.2% and a statutory profit before tax of £417m. Our balance sheet mix continued to evolve with NIM increasing to 1.62% for the full year and with an exit rate of 1.70% in Q4.

Our relationship deposits have grown 19% year-on-year and our cost of deposits has declined 37bps versus FY20. Our costs have also declined 2% year-on-year, and I will come back to this topic shortly, and very importantly our integration and rebranding of the bank is now substantially complete. This is a major achievement given the operating environment of the past two years.

We've delivered strong growth in our established digital propositions and our Virgin branded PCA sales have increased 95% compared to last year and our new cash back proposition supported good growth in unsecured volumes. Our Virgin cards book has performed very well growing 4% against a market which contracted 6%.

Across our portfolio, our asset quality has also remained resilient, and we are maintaining a strong provision coverage of 70bps. Our cost of risk for the full year was therefore a credit of 18bps, and finally our CET1 ratio has improved to 14.9%, demonstrating a strong TNAV progression. I am also pleased to announce that as a result of this strong financial performance, the Board intends to recommend a dividend of 1p per share.

If we turn to slide 5, I will talk a little about the strategic drivers of our performance.

As we previously discussed, we consciously adopted a strategy of delivering growth in margin accretive areas and the combination of this approach and our liability management strategy has delivered a sustained improvement in our overall NIM; this in turn has helped us to deliver a strong improvement in our underlying and statutory ROTE. I am especially pleased to see the growth of our CET1 ratio from 13.4% in 2020 to 14.9% in

2021, which was achieved despite some significant headwinds, including the absorption of a significant close out of PPI, the cost impact of the COVID period, and increased Tier 1 bank regulatory costs.

Our balance sheet is strong, we are a well-capitalised and well-funded bank and our momentum gives me a lot of confidence as we move to a digital growth strategy in a post pandemic world. Let me now turn to the economic backdrop and how we are positioned.

So on this slide, I've set out the latest macroeconomic indicators from our 3rd party provider Oxford Economics. Overall, as you are no doubt aware, the backdrop in the UK has continued to improve over the second half of the year. This improvement in the economy has seen GDP expectations increase further with a recovery to pre-pandemic levels now expected in the final quarter of this year. Unemployment forecasts are also supportive of a growing economy.

The most significant change since we reported our half year numbers has been the recent sharp increase in inflation, which is expected to continue to rise throughout the remainder of this year and into the early part of 2022. Recent data and comments from MPC members have seen expectations increasing that a base rate rise could occur in the not-too-distant future. As a result, we have seen the swap curve steepen through the second half of our financial year, and this has been beneficial for our structural hedge. Clifford will take you through our rate sensitivity and gearing to an improving rate environment in more detail in his section.

Let me talk now about integration, rebranding, and the implications of emerging digital trends for our Digital First strategy. As I said, I am pleased with the progress that we've made on delivering integration and rebranding in the past two years. We delivered the critical FSMA part VII and have restructured the bank, reducing staff by 20%, branches by 44% and recently our head office footprint by 38%.

We have now retired legacy brands and migrated customers to the single Virgin Money brand and rebranded our entire store network. The vast majority of products and services are now sold under the Virgin Money brand, including the recently launched national Virgin Money Business bank, as you saw at the start of the presentation. Initial feedback from customers has been positive. We are now also in a position to offer innovative Virgin Money branded propositions and rewards across our entire product portfolio.

I am very proud of what we have achieved to date. As a result of our previous investment, we already have a Fintech capable platform, which our new investment will build on. I am especially pleased with this progress, given the very difficult operating environment of the past two years, and we are now very well positioned for the next stage of our Digital First strategy.

Let me now turn on slide 8 to some of the COVID digital trends that are informing our strategy. We have talked before about the fact that one of the biggest impacts of COVID was the acceleration of the use of cloud-based technology in banking and in every other aspect of our lives. It is not just the use of this technology that has changed, but also the pace at which it can be deployed.

We have seen the rapid emergence of cloud-based platforms and a significant change in customer behaviours both in our personal lives and in business. These changes are structural and in addition, competitors are accelerating the digital nature of competition. This competition comes from existing global incumbents creating digital only subsidiaries, as well as from payments firms and big tech firms rolling out marketplace models.

We have also seen a dramatic shift in the nature of work. The post pandemic world will require a new contract between employers and employees, and we will be at the forefront of delivering flexible remote working models supported by our technology partners. We believe that this approach, that we will call A Life More Virgin, will deliver a competitive advantage in terms of retention and the recruitment of a diverse resource pool.

In order to deliver effectively on this accelerated ambition, we have formed key strategic partnerships which are central to our strategy. We're working with Microsoft on our operating platforms and cloud capability, and also with Global Payments and TSYS to support the delivery of a digital wallet which integrates our unique Virgin loyalty scheme.

We also have an existing strategic partnership with Capita and this will deploy our straight-through digital mortgage service, and our broader engagement with Fintechs will allow us to deliver memorable experiences across our Virgin Money Business bank and also across the group product profile. We believe we now have the right partnerships to support the digitisation of our products and processes and we will leverage these partnerships to accelerate our Digital First strategy. The implementation of our strategy will require us to accelerate investment in key areas, in slide 9 I will address this issue.

Before I explain our cost profile in the future, I think it is important to understand the context of the past. Over the past three years we have delivered an exit rate cost reduction of £180m, however some of this benefit has been diluted by delayed change programmes due to COVID, greater investment in regulatory requirements as we become a Tier 1 bank and new systems investments to support the roll-out of Government support during the lockdown. As a result, we updated our 2021 cost guidance earlier in the year and our cost outcome is broadly in line with our revised guidance. I had hoped that we would have achieved a higher level of net cost reductions at this point, and I have therefore stepped back with the Leadership Team and asked ourselves 4 questions - how can we catch up on our plans, what does the technology shift offer in terms of additional savings, what would it cost to deliver those and how are we positioned to compete in a digital world.

We have concluded that the competitive imperative of a post pandemic world requires us to shift the bank to a digital growth strategy and to invest much faster in digital processes for our existing and new products and services; however, at the same time, we are confident that as part of this shift in strategy, we can deliver approximately £175 million in additional cost savings. We will be investing approximately 50% of these savings, either directly in the pull forward of digital initiatives, or by absorbing cost inflation in the 3-year period, with £275m of below the line investment. In other words, we will deliver an outcome over the next three years which we expect to deliver a significant reduction to the bank's cost base.

Looking ahead, we believe we can pursue this strategy and at the same time, deliver double digit returns by 2024, with a cost income ratio of less than 50% and a statutory profit and sustainable dividend in each of the three years. Clifford will provide more details in each of these areas in his presentation. We believe that delivering the above outcomes while pivoting the bank to a more aggressive, growth orientated Digital First strategy will enable us to compete effectively in a rapidly changing digital marketplace and will enable sustainable value creation for our shareholders.

Let me now turn to slide 10 where I will outline what this investment will allow us to deliver. This year we have launched a national Virgin Money Business bank with innovative products and propositions, and we will continue to expand the capabilities of the Business bank working with up to 20 different Fintech companies. Early next year we will launch Staircase to Credit, which is an innovative subscription-based unsecured lending model, and we will launch our straight-through digital mortgage capability with an integrated Mortgage Coach app. We are also working closely with our Investment JV partner, abrdn, and we plan to deliver an app-enabled product that will attract a new customer base.

As you can see on the slide, we will offer a wide variety of other PCA and BCA innovations and will align these with the delivery of a digital wallet and an integrated Virgin Red loyalty scheme. These initiatives and more will allow us to achieve above market growth in the areas that we prioritise. The majority of these initiatives will be delivered in 2022.

We will also begin implementing the final parts of our Life More Virgin employee operating model when negotiations with our union conclude later this month. This purpose-led digital colleague proposition includes full harmonisation of terms and conditions for all employees, enhanced technology and has been created to enable fully flexible remote working.

Finally, as I highlighted earlier, we have signed a contract with Microsoft to support the delivery of a more cost-effective operating platform. This platform will be cloud-enabled, and all mobile technology will be refreshed every three years. We are also deploying data analytics tools to create an agile customer-centric delivery model.

Turning to slide 11, let me now briefly highlight how this investment will drive efficiency and support our growth and customer experience ambitions. The investment we are making will allow us to deliver these digital efficiency solutions faster and will fund the cost of optimising our operating model and physical footprint. We intend to rapidly digitise our customer interactions, whether it is in the onboarding process or as part of the service that we provide to our customers. A key element of our strategy will be to convert the majority of non-digital customers to this digital model. We intend to support our customers with a primarily digital interface that resides in the cloud and this will allow us to operate with fewer service centres.

We will offer a similar digital experience to our staff, and this will enable the roll out of our post-pandemic remote working model. This approach will allow us to continue to optimise the branch footprint and to materially reduce our property footprint, including head-office centres. Our strategic partners will help us to deliver these customer and employee services through a cloud-based infrastructure and this model will allow us to also consolidate our data centres down from 6 to 2.

Overall, we have very specific action plans agreed with the leadership team for each of these outcomes and we are therefore confident that we can deliver these cost, customer and colleague benefits going forward. I will now turn to slide 12 which covers how we intend to pull forward investment in the delivery of new propositions that support our growth agenda.

I am confident that the investments that we are making will deliver the returns that we are guiding to in 2024. As you can see on this slide, our initial Virgin branded propositions have demonstrated strong growth and prove that we can attract digital, affluent customers through digital channels, and on a national basis rather than just in our heartlands. Our PCAs and Credit Cards are close to a combined 100% digital sales model; this is the ambition we have set for all of our key growth segments.

If I look to the future, in the next three years, I am expecting us to grow market share in Unsecured and Business, and whilst margins remain compressed, we will be tactically smart in the Mortgage sector, but we will seek to maintain our current market share. We also see significant opportunity in our JV with abrdn, and we are expanding our ambitions here and will provide more substance later in 2022. We have developed specific plans to roll out a large number of new and existing products and propositions going forward and I have outlined these on slide 13.

By the first half of the FY22, we intend to launch our debit card cashback offering and our new unsecured subscription-based lending proposition, which will help Gen-Z customers build their credit score whilst removing the complexity of interest and charges. We will also be going live with our M-track solution for Business customers which we've developed with our key Fintech partners. This proposition uses API technology to provide businesses with a customised dashboard and educational materials, helping them to run their businesses more effectively and to save time.

We have also launched the Virgin Red loyalty proposition to support the roll out of our digital wallet, and I won't cover all of these individually, but I think you can see we have a busy digital agenda going forward. You will also see from the roadmap that we have a number of propositions which will underpin our ESG goals, including further enhancements to our Greener mortgages and sustainability linked business loans.

I have mentioned the roll out of our digital wallet and given this is a significant launch I think it would be worthwhile explaining what our plans are, and so if we turn to slide 14 I have provided some details of our strategy. We have previously announced publicly that we have formed a strategic partnership with Global Payments. They will co-invest with us to build a digital wallet that offers enhanced customer functionally but will also offer an integrated Virgin Red loyalty scheme. We anticipate the first iteration of this wallet will be available in the second half of 2022. This scheme will offer customers the ability to earn points as they spend in the app, it will also allow customers to buy now and pay later and it will have the ability for customers to earn points and cashback on both debit and credit cards; these points can be deployed for value across the Virgin ecosystem and beyond.

Our buy now pay later product will have a credit eligibility model built into the offer. This is an essential ingredient for this customer convenience, to avoid potential conduct issues in a soon to be regulated universe. It is important to note that our wallet will also be available to non-customers as well as existing customers.

This is an exciting initiative for us, and it has the potential to combine innovative relevant product capabilities with the power and capabilities of the Virgin brand and the broader Virgin Group; we will continue to provide updates on our progress in future presentations. It is now time to hand over to Clifford for his presentation, however, before I do that, I would like to make some concluding comments on our performance.

Our Leadership Team have delivered a strong performance this year. Over the past few years we have navigated a series of complex hurdles, including the IPO, Brexit, PPI and other legacy matters, and an acquisition with a complex integration and rebranding agenda; and of course the pandemic. Yet we are announcing today a Virgin Money bank that is integrated, rebranded, with a strong balance sheet, a clear digital growth strategy and an underpinning of a statutory profit and the resumption of a sustainable dividend.

As the CEO, I am confident that our strategy will see us entering a new phase where we can compete effectively in a post pandemic digital world that has changed materially; I will return to this theme after you hear from Clifford. At this point, I would like to hand you over to Clifford to address some of the financial performance in detail and to get his perspective on the bank.

Clifford Abrahams, Virgin Money UK PLC

Thanks David. As you know I joined Virgin Money in March, so I've had a good amount of time to get to grips with the balance sheet and also to work with David and the team on accelerating our Digital First strategy. I'm very pleased with the strength of our balance sheet at the full year; our robust asset quality, strong provision coverage and capital strength, with PPI and much of COVID uncertainties now behind us. We are also benefiting from rising rates through our re-introduced structural hedge and have now restarted the dividend.

As David described, we have done a good job of integration and are showing good trading momentum, particularly with our new Virgin Money branded propositions. We now have the opportunity to digitise further, delivering better cost efficiency and accelerating profitable growth into the economic recovery. So a clear path to double digit returns and sustainable dividends.

Now turning to the highlights of our FY21 financials on slide 16 which show improved pre-provision and underlying profitability. Our performance reflects improved NII, costs down year-on-year, an impairment release of £131m reflecting the improved economic outlook; offset by lower other income, from reduced activity levels.

Taken together, this delivered a substantial improvement in underlying return on tangible equity to 17.8% or 14.9% excluding tax changes. The Board also intends to recommend restarting the dividend at 1p per share, reflecting our strong capital position.

Moving now to statutory profit on slide 17. It's good to see a return to statutory profit in FY21. There's quite a bit going on here, which I will take you through. As David described, we've been working hard to accelerate our digital strategy, resulting in an extra £45m of restructuring charges in '21, taking total restructuring charges to £146m for the year. After £88m of acquisition accounting unwind charges in FY21, there are now only around £50m of charges remaining over the next three years, to be taken mostly in '22.

Within legacy conduct costs, we incurred around £60m as we concluded PPI remediation, with limited further charges in the second half of the year. Within other items, we incurred around £70m relating to changes to intangible assets following a review of capitalisation practices, where we are taking a more prudent approach.

A £57m tax credit reflects a higher valuation of historical losses following corporation tax rate increases announced earlier in the year, more than offsetting the tax charge on current profits. Going forward, we expect the effective tax rate to remain relatively low with further loss recognition, before returning to more normalised levels in the low 20s from FY24. Finally, TNAV per share improved to 290p. I'll now talk you through the results in more detail.

Turning to funding on slide 18, I'm pleased with the work we have done to reduce our overall funding costs. While total customer deposits were stable in the period, we improved mix and repriced, delivering a sharply reduced overall cost of deposits to 53bps. Our successful new current account proposition, together with customers holding higher average balances, resulted in a 19% increase in relationship deposits. At the same time, we reduced more expensive term deposits by 29%.

Looking ahead, we see some further scope to bring down our overall cost of deposits as we continue to improve our deposit mix. In wholesale, we managed overall balances and managed mix, as maturing secured funding has not needed to be replaced. At the scheme closure in October 2021, we had drawn £7.2bn of TFSME, and repaid all our TFS drawings. Secured issuance is expected to normalise through 2022 with the closure of TFSME, and we anticipate £2-3bn of issuance in the year. So overall we reduced the cost of both retail and wholesale funding, benefitting overall net interest margin.

Moving now to lending on slide 19. We managed lending volumes prudently though the year as we navigated the pandemic, with overall balances broadly stable. In Mortgages, we entered the year cautious on HPI and prioritised margin amid strong market conditions. In the second half of the year, increasing competitive pressure saw us compete tactically and balances contracted marginally. Going forward, we will continue to participate tactically, focused on maintaining strong overall returns and growing in targeted higher yielding segments where we have an established specialism.

Business lending balances contracted as expected during the year, with weaker BAU demand due to government lending scheme usage. In the second half of the year, government backed lending balances became eligible to make payments for the first time, resulting in balances contracting slightly to £1.3 billion. And for those businesses choosing to use Pay as You Grow for Bounce Bank loans, we are seeing the majority extend their loan term from 6 to 10 years. We are now targeting a return to growth in Business lending, supported by the rollout of our M-Track proposition.

Finally, I am very pleased with the performance of our Personal lending book where balances increased by 4%, a strong performance given the subdued market backdrop. We are now seeing consumer spending above pre-pandemic levels and are well placed to benefit from the recovery with customer propositions that now include cashback and instalments. Looking ahead, we are targeting above market growth in higher yielding sectors, including Personal and non-government Business lending. In Mortgages, we will continue to participate tactically and look to maintain market share.

Moving now to net interest margin on slide 20. I'm pleased with our net interest margin performance of 162 basis points for the year, 6 basis points up year-on-year. Throughout '21, we showed good momentum with a strong Q4 exit rate of 170 basis points. This uplift in margin was primarily driven by our deposits performance. Our structural hedging programme, restarted towards the end of Q2, and it also contributed to our performance.

These factors were offset somewhat by customer lending, with reductions in headline pricing, particularly in Mortgages during the second half of the year. Looking ahead into FY22, we expect a higher full year net interest margin of around 170 basis points. That expected year-on-year improvement includes the full year effect of the structural hedge, lending growth in higher yielding sectors and a further deposit repricing benefit. Against this, we will absorb the impact of higher mortgage competition on overall margins, where we see new business application spreads below the level of our overall book spread, at least for now.

Moving to our structural hedge on slide 21. We have now fully re-instated our structural hedge. On this slide, I'll take you through the size of our hedged position, expected increased contribution from the hedge and our interest rate sensitivity now that we have returned to a fully hedged position.

You'll recall that we re-introduced the structural hedge towards the end of the first half, having unwound the structural hedging position in 2020. At Q3, the Group had re-invested with balances of £25 billion and during Q4 we increased the size of the position further to around £26 billion. During October, we expanded the structural hedge further after concluding a methodology review and an updated assessment of rate sensitive balances and behavioural life of deposits. This now takes the size of the total hedge to around £32bn.

In terms of the financial impact, the contribution from the previously hedged position that was unwound in FY20 remains the same. That hedge was around £24 billion of notional and has been locked in at c.80 basis points since Q3 20, with 1/60th rolling off each month. The 2021 contribution was around £150mand it will be £120m or so in FY22 and is gradually reducing out to FY25. The new £26bn hedge, which was reinvested through the second half of '21, was executed using swaps with an average duration of 2.5 years at an average yield of around 32bps and contributed around £30m to gross NII in FY21.

Given the shape of the yield curve and the higher hedge size of £32bn, we estimate structural hedging contributions to income will be meaningfully higher in FY22 relative to FY21 on a gross basis, with the £6bn of additional capacity invested at recent higher rates. In terms of what this means for interest rate sensitivity, based on the higher hedge size of £32bn, we estimate our 1-year sensitivity to a parallel shift in rates deliver around plus £20 million or minus £10 million for a 25 basis point increase or decrease respectively. This is down relative to the year-end position, since the additional value we are locking in from upsizing the hedge is in place, with a reducing ongoing exposure to rate changes.

I'll now move onto non-interest income on slide 22. Our non-interest income performance reflected weak market conditions with performance relative to last year declining £31 million overall. In Personal, our performance was impacted by lower credit card transaction fees as spending reduced under lockdown, as well as the removal of some overdraft fees following the High Cost of Credit Review. Business was more resilient and Mortgage income was broadly stable.

We saw positive signs in the second half of the year as other income, excluding one-off gains and fair value, increased by £4m relative to the first half, with the lifting of restrictions. In the near term, we expect non-interest income to improve further relative to FY21, given the full easing of restrictions and the general increase in activity levels. Over time, we are targeting non-interest income to rise as a percentage of total income as we see growth from existing opportunities, such as our wealth joint venture and as we capitalise on new propositions.

Turning now to asset quality on slide 23. I am pleased with the quality of our lending book, and we are well positioned as government support is fully withdrawn. Credit quality was robust through the year with tage 3 loans remaining around 1%. Arrears and default levels remain low across portfolios, and forbearance levels are stable. Charge-offs also remain low, with around £100m of write-offs net of cash recoveries, less than in FY20.

During Q4, we reflected updated economic scenarios from Oxford Economics. Relative to our Q3 assumptions, these include higher GDP growth and lower unemployment in the short term, peaking at 5.4%. We still remain prudent with HPI, though now factor in a less severe contraction in '22 of 6%. All of this led to a reduction in Stage 2 balances, resulting in around £200m of lower modelled and individually assessed ECL provisions, relative to H1.

We are conscious that the outlook remains uncertain, so we've maintained around £200m of post model adjustments. Overall, our final ECL provision of £504m represents a reduction of £231m from FY20, resulting in portfolio coverage of 70 basis points, and still above pre-pandemic levels. This produced an income statement release of £131m, equivalent to a cost of risk credit of 18 basis points. We expect the Group's cost of risk to rise through FY22 towards 'through the cycle' levels.

I'll now turn to costs on slide 24. You heard from David that we are accelerating digital investment, which will drive cost efficiency and also unlock our digital growth potential. On this slide, I'll talk through the gross cost savings we are targeting and the impact on our cost outlook in FY22, before taking you through our medium-term outlook on the next slide.

To support our digital strategy, we will incur around £275m of further digital development and associated restructuring costs by FY24, reflecting our 'Digital First' investment programme and associated severance and property closure costs. Investment will be front loaded with around half taken in FY22. This investment will deliver around £175m of gross cost savings over the next three years, of which we plan to re-invest around half back into the business, inclusive of inflation, to support growth.

In terms of those gross cost savings, we have set out on the left where we see these being derived from. We expect around 45% of savings as we improve end-to-end digitisation, reducing the number of manual processes and as we streamline operations. A further 35% will come from reductions to our store footprint and as we rationalise office space. The remaining savings will come from lower spend on 3rd parties, suppliers and key contracts.

On the right-hand side, we have set out what this means for FY22 costs. We will continue to see gross savings play through from our existing integration and transformation activity and as we see benefits from our new digital development and restructuring programme. Overall in FY22, we expect to see these gross savings offset by inflation, growth and additional digital development costs. Inflation here includes pay inflation and normalisation of bonuses. Growth includes costs associated with higher transaction volumes post-COVID. Digital development costs arise from delivery of digital projects such as Mortgage end-to-end digitisation and Business Banking proposition delivery. We will also see short term higher cost of digital development from adopting a more prudent capitalisation approach, as I referenced earlier. So overall, broadly flat underlying costs year-on-year.

Moving onto our medium-term outlook, on slide 25. I'll talk through here our expectations for costs to decline over time, the drivers of income growth, and why we are confident we will deliver cost income of less than 50% by FY24.

First, costs. We have set out our operating expense profile in terms of 'base' opex and 'digital development costs' since the acquisition, as well as our expectations out to FY24. Looking back, David explained we have seen increased investment, which has had a consequence on the level of net cost reduction in the business. Looking forward, we will front-load digital development costs, which alongside growth and inflation, broadly offsets reductions in base opex in FY22. In terms of general inflation, we are assuming an average level of 2% per annum.

In addition, as we reflect a more prudent capitalisation approach, where we are excluding certain costs from capitalisation and also capitalising less, we will see higher opex related digital development costs in the near term, before seeing a decline in D&A over time. So going forward, we expect digital development to have two impacts. We will see a lower level of base opex as we drive efficiencies from the deployment of digital initiatives, and we will see a lower burden of digital investment spend, as our investment reduces the cost of change.

In time, we expect this combination to drive a lower level of total underlying costs. We will also drive income growth and David has already shared our plans. Our digitally led propositions will enable us to take further share in PCAs and BCAs, target adjacent segments in Unsecured and roll out new features in Business. We expect to build our fee income where we see great potential, and expand our addressable market in Mortgages.

In general, we are taking a prudent view on base rate rises through FY24. So taking all of this together, we are targeting a progressive increase in total income over time, along with reducing costs, which together will enable our less than 50% cost income ratio target by FY24.

I'll now say more on capital on slide 26. I am pleased with our capital position of 14.9% at FY21, and this included the benefit of software intangibles of 53 basis points. We saw strong capital generation in FY21 reflecting primarily over 200 basis points of underlying profits, 19 basis points from lower RWAs, both offset by 23 basis points of AT1 distributions, 107 basis points of exceptional items, and a further 6 basis points of dividend. Our MREL ratio is strong at 31.9%, comfortably in excess of end-state requirements and as such, we are not anticipating any HoldCo Senior issuance in FY22.

Looking into next year, we expect continued capital generation from ongoing statutory profit but with a number of headwinds to net capital generation. In 2022, we expect the reversal of CRR2 software benefits will reduce CET1 by around 50bps next year. We expect RWAs to grow, reflecting volume growth and density increase changes as we target growth in higher risk weighted sectors. We also see a risk of RWA inflation, with pro-cyclicality remaining. Our FY22 RWA expectation does not include benefits from the move to IRB for our credit cards portfolio and the adoption of hybrid mortgage models. Both of these depend on regulatory approval, with hybrid models expected to take effect from FY23 and Cards IRB transition the year after.

We are pleased that the Board intends to recommend paying a dividend and remain committed to establishing a sustainable dividend going forward. Overall then, we expect CET1 to reduce somewhat next year but remain comfortable and we will update further on our capital and dividend framework after the results of the Solvency Stress Test in December, alongside Interim Results in May.

Finally, I want to finish on guidance and outlook on slide 27. We have given guidance on KPIs for FY22 throughout our presentation and set this out on the left-hand side. We are making good progress on driving the key pillars of our strategy as David described earlier, with a clear roadmap to statutory double digit returns in FY24.

Our assumptions are realistic. To recap, we reflect general inflation of around 2% per annum, a prudent view on base rate rises through FY24. We assume front book mortgage spreads which are lower than stock in FY22, before building back from FY23 onwards, and we take a prudent approach to cost of risk and capital requirements.

Our double-digit statutory returns in FY24 will be supported by net interest margin expansion, as we target above market growth in higher yielding segments, a higher contribution to total income from non-interest income, a sub 50% cost income ratio and lower below the line charges, which we think have peaked in ’21.

I will now hand back to David for his concluding remarks.

David Duffy

Thank you, Clifford, so before we take questions, let me summarise the presentation today. As I have said, we have delivered strong financial results for 2021 and I am confident that we will deliver double digit returns with a cost income ratio of less than 50% by 2024 and that this will be underpinned each year by a statutory profit and a sustainable dividend. We have come through a complex period over the past few years, but have emerged from the pandemic with a well-capitalised and well-funded balance sheet, strong asset quality across the book, and a bank that is profitable and can support a sustainable dividend.

We are now an integrated and rebranded bank that has good growth momentum in our established Virgin propositions. Over the next few years we intend to expand our products and propositions and move to a near 100% digital origination and service model for our customers and colleagues. This shift will enable us to become a more efficient and agile bank that can compete effectively in a digital future and deliver on our medium-term guidance.

Thank you all for your attention, and with that I’ll now hand to the operator to host the Q&A session. Thank you.

Operator

Our first question comes from Ed Henning from CLSA. Your line is now open. You may proceed with your question.

Ed Henning, CLSA

Thank you for taking my questions, I've got a couple. Can we just firstly start on NIM? You called out your exit NIM of 170bps. There's a lot of tailwinds that are running into '22. Why, you know, can you just run through why your guidance isn't potentially higher in '22, but yet going forward, you think the guidance on the NIM will improve just on the back of mix? Is that implying you think Business loans are going to go backwards in '22?

Clifford Abrahams

Yeah, thanks for the question. Look, as you say, we've guided to 170bps. We feel good about that guidance. We've exited the year at 170bps. We've got strong tailwinds that you talked about, the structural hedge. I think it's just a bit early in the year to get excessively bullish. You know, we do have a competitive mortgage market right now, so we're naturally prudent in our guidance at the start of the year, but we're feeling good about our NIM momentum right now.

Ed Henning

And just in your medium-term guidance, are you assuming base rate rises?

Clifford Abrahams

We have assumed a base rate rise actually at the tail end of that three-year timeframe. We've based our planning on Oxford Economics, so you can look that up, which is quite prudent. So we feel we've been prudent in our base rate assumptions. Our planning does assume the interest rate curve that we've seen in recent weeks, so we've got the benefit of that. But you'll also see the roll of the hedge going forward and that will support NIM going forward.

Ed Henning

And just one final one on NIM, are you saying with your medium-term NIM guidance, excluding the base rate rise, you believe just mix is going to drive an increase in NIM going forward?

Clifford Abrahams

That's right. I mean, you see, David talked about maintaining market share in Mortgages, which is our lowest spread business, but outpacing the market in Unsecured and Business, which are our high yielding areas. And we're feeling good about both the momentum and our new propositions driving growth. So high single digit growth over that three-year period. We're already seeing good growth come through on the Unsecured side and we expect the SME side to pick up nicely as the recovery picks up and government support measures fade out.

Ed Henning

Okay and just one more on growth, just a follow on from that. I know you've said today you'll be selective on Mortgages, but yet you're going to grow at system. You know, the last little while the book hasn't grown, system's been quite strong. You know, can we actually expect growth coming through in Mortgages? And then on the Business side, with the roll off of potentially some government backed loans, do you anticipate system to go backwards next year in Business loans?

David Duffy

You know, maybe Ed, I'll pick that up. So on the Mortgages side, I think if you -- you know us well enough, you've looked over the past number of years, we're tactically very agile in terms of the Mortgage business in the different segments. And I'm quite comfortable with our positioning on maintaining market share. So I think that will occur. If you look at the rest of the growth profile, we see on the Cards business, for instance, that's a very strong growth contrary to the market, and it's a super prime book. So I think that will continue. Broadly Unsecured is coming back quite strongly, so I think we will see that grow. And on the SME side, there are a lot of sectors in the economy as the government looks to invest in the infrastructure and levelling up that will be SME driven, that will see net growth separate from the firms that have taken the government loans. So I think there will be some muted demand in various sectors who have taken on significant cash flow and the majority of those that did that with us - took government loans - actually put it on deposit with us. We'll be able to monitor that behaviour quite closely and then thereafter, we're looking at the rest of the economy: technology, renewables, et cetera, starting to grow and coming out with a lot of requirements for capital expenditure. So I think there is plenty of room to grow in the SME business, and I'm quite comfortable with the medium-term guidance that we set based on the growth assumptions in that area.

Ed Henning

Okay, thanks.

Operator

Thank you. Our next question comes from Grace Dargan from Barclays. Your line is now open. You may proceed with your question.

Grace Dargan, Barclays

Good morning, thank you very much for the call - a question on costs and then on Mortgages, if I can. So on cost, maybe we could just push you a little bit. Could you give any guidance on the phasing of the gross savings that you see coming through? And associated with that, I guess, is there a risk to your guidance from higher inflation, maybe you could tell us what kind of assumptions you've captured in your guidance?

And then secondly, on Mortgages, just thinking about mortgage margins, could you give any sort of detail around what your back book spread is at the moment and kind of what you're seeing in terms of application and completion margins? And I guess thinking you're talking about tactically around maintaining your mortgage market share, are there any specific areas you're looking to focus on or is that more a general comment on pricing discipline? Thank you.

Clifford Abrahams

Okay, I'll start, I'll tackle the cost questions and the margins and I'm sure David will continue on our focus areas. I think in terms of cost, we expect a good contribution from cost savings in each of the next three years. I think we've got good tailwinds on cost savings coming out of full year '21 and that will play through into '22 and beyond. So I wouldn't call out a particular back end or front end loading there. We have indicated that we expect incremental costs in full year '22 offsetting those savings, hence, broadly stable in the year. But after that, we'd expect costs to come down in nominal terms. I think inflation, you know, clearly there's some uncertainty right now. Our expectation, broadly in line with consensus, is we expect medium-term inflation of around two percent and the current uptick in inflation to be temporary. So that will give you a sense of our inflation assumptions. We're much more confident around our cost income ratio target, which we've articulated the nominal costs, and we see some natural interplay, you know, if inflation persists, we'll see that benefit come through in terms of our interest rate sensitivity.

On margins, we've been reluctant to give specifics for margins on Mortgages. I would say that our recent completions are broadly in line with our book margins, but the applications and the pipeline has been somewhat lower hence our caution on spreads going into full year '22. We've seen very recently some pick up in headline rates from competition and we'll see where interest rates go in the next month or two. So that'll give you a flavour, so we're cautious on mortgage spreads really going into '22, but our medium-term planning is based on normalisation of spreads over time.

David Duffy

Thanks, Clifford. And just to give you a sense of, your question around the commentary - is 'tactical' or a 'general comment'? I think we're looking at two things: the evolution of the marketplace, which Clifford just referred to, seems to be that we're now seeing the withdrawal of the ultra-cheap or ultra-low margin type mortgages, and I expect that trend to increase over a period of time in line with the interest rate curve. So I think there will be some dilution of the pressures that have occurred there. Equally, at the same time, we're being very specific about opportunities we see in some of the sectors like the buy-to-let, some higher LTV, some higher scale large-amount loans and we have developed specialist capability in each of those areas. So, we will look at those as specialist areas, but we will also look at the market - we dynamically price, so you'll have seen in prior years we come in and out of segments with quite a lot of flexibility. So we'll be reactive to market dynamics, and we'll be focused on some niche areas where we see specialism and I think the market will stabilise, begin to improve in terms of margins. So I think that's the best way I can explain that comment on tactical.

Grace Dargan

Perfect, thank you very much.

Operator

Thank you. Our next question comes from Guy Stebbings from Exane. Your line is now open. Please proceed with your question.

Guy Stebbings, Exane BNP

Hi, good morning both, thanks for taking the questions. First, just want to talk on costs and whack one back on mortgage volumes. So, on cost you've given the £175 million estimated run rate savings and suggested half would be reinvested and half towards the bottom line. So simple maths suggests that you end up about £815 million in 2024. Just wanted to check that's sort of fair and then what you're saying on inflation - do we read your comments, that if it's in line with the two percent figure that you gave, that's captured in the investment component? So, sort of delta around that two percent, is whether we should be thinking about a higher figure than 815 million? And also just to check, is the cost income guidance of less than 50 percent a statutory cost income target?

And then on mortgage volumes -- I sort of refer to the previous questions -- it's gone backwards in a market where there's been very healthy volumes. I appreciate there's been some pricing pressures resurfacing. You've always said you're going to pivot more the balance sheet towards Unsecured and Business, but I'm trying to understand why you didn't grow in the second half of this year but plan to grow tactically going forward. It sounds like you think spreads might increase, so I'm just trying to understand if spreads don't increase, does that mean that you won't keep market share? Thanks.

David Duffy

Maybe I'll just pick up that last point, Guy, on the mortgages as we're on that theme and then we'll back into your cost questions. I think if the margins don't improve, that's not the basis for which we've created our growth assumptions. So we would expect there's some benefit if we see that but right now, we expect to be able to operate tactically, as we've done over the many years of price compression. If you look back at the big bank compression a few years ago, pre-COVID, that was a similar scenario. We're still able to compete in that space.

Just to refer back to why we then didn't grow previously in the last couple of quarters. You will recall us, over the last couple of years, we have talked about the fact that we were significantly overweight in the mortgage book versus our other businesses and versus our competitors. So, we had constantly said we would look to hold the market share. So it's not a question of suddenly taking advantage and growing at uncontrolled levels; we're creating a portfolio effect where we said we will be focused on margin accretive areas for growth, with our liability management strategy that drives NIM. So at the end of the day, we've been consistent on the mortgage book in terms of holding market share and then being really tactically smart in achieving that. So that, Guy, that's just a reminder, a little bit of background context on the mortgage book and why we're not particularly growing in historical terms and why we're still confident about how we will grow regardless of the margin behaviour in the going forward outlook. And maybe then on costs, Clifford?

Clifford Abrahams

Yeah, happy to pick that up. I think mathematically, that's right. So we've said £175 million gross savings, we'll reinvest around half. We've been reluctant to call out nominal cost targets, whether that's for full year '22 or '24 for a couple of reasons. One is uncertainties around inflation, so the guidance I've given reflects two percent inflation and clearly that could be, that could be different. We do see some natural hedging, if you like, if inflation is persistently higher, we think that will ultimately flow through in rates and we'll see that in the top line in due course. We also, frankly, we're feeling good about the growth prospects of the business and if growth is there, and we are planning for growth, but if growth outpaces even our current plans, you know, we want the ability to invest into that growth. Some of our products, we have variable costs, but we're really encouraged by some of the recent growth we've seen in unsecured, and we don't want to constrain the business. So we're -- the target we're focused on is the less than 50 percent cost income ratio. But we do expect costs to come down in nominal terms after the full year '22.

Guy Stebbings

Okay, thank you. That's helpful. And so just to confirm, is the cost income target the statutory number?

Clifford Abrahams

No, its underlying. As we quote it, you know, currently, I'd say -- and I think we've given guidance here -- we're expecting those below the line charges to diminish over time. We've given guidance on the acquisition accounting unwind, and that's really going to be quite small at the tail end of that planning period. And on our exceptionals, that £275 million is very much front loaded.

Guy Stebbings

Okay. Thank you.

Operator

Thank you. Our next question comes from Chris Cant from Autonomous. Your line is now open. Please go ahead.

Chris Cant, Autonomous

Good morning, thank you for taking my questions. Sorry to flog a dead horse, but I just wanted to ask again about the loan growth assumptions and particularly around Mortgages. If I take a step back, I think you said you expect high single digit growth in Unsecured and I don't know whether that applied to Business as well? Those were your kind of growth areas. What kind of loan growth should we be thinking about for the book as a whole? I mean, when I hear you say mortgage growth and you expect to maintain market share in Mortgages, I interpret that to be, you know, some growth broadly in line with market, maybe a touch below. But if that's the case, should we be penciling in something north of 2 percent loan growth over the next couple of years if you are getting that strength in unsecured lending? I don't think consensus is there at the moment, but just wanted to check your view on, you know, the overall loan book growth we should be thinking about as part of what you're trying to deliver.

And then on the cost income and then kind of the cost debate. Obviously, you've set a less than 50 percent target assuming no rate hikes to '23 from what you've said. If I think about, you know, consensus is currently around 48 percent cost income ratio, I mean, is the emphasis on the, on the 'less than' here because I think, you know, the simple math we're all going to do is the £815m mentioned in the previous question and then gross that up. And if I look at your slide for income where you've got the sort of the fuzzy bars on slide 25, you know, looking at that, it implies something back around full year '19 levels for income. So that would get you to kind of 50 percent on the dot. Am I missing something? I mean, it feels like your income guidance, particularly on NIM, has been quite conservatively struck given the rates assumptions you're making. And you've said that you think the 170bps for 2022 is sort of cautious or it's early in the year, so you've been prudent. I'm just trying to understand that, yeah, how much below 50 percent should we be thinking here because it feels like it should be meaningfully, but I just want to invite you to comment on that.

Clifford Abrahams

Yeah, I'll comment on sort of top line growth and David will follow up on cost to income ratio. I think there are a couple of things around NII. So we've talked about net interest margin. So we're giving guidance, you know, very early in the year at around 170bps; we're feeling good about that in our momentum, right. We're seeing -- I call it tailwinds into the three-year period on net interest margin. So we're still seeing deposit costs come down. We're growing strongly or we expect to in our high yielding segments, and we've got the full year effect of the structural hedge and the enlarged hedge recycling through that period. So we're feeling good about net interest margin momentum through that period.

In terms of loan growth, I think you mentioned 2 percent. I feel over that three-year period, we should be outpacing 2 percent. So we're looking to grow market share. So that would be high single digits in Unsecured and SME over that period. I think our caution in the short term is that while we're seeing good pickup in Unsecured, we've yet to really see that come through in the SME. So it really depends on the timing of the trends that David talked about and I think around Mortgages, look, we think subdued into '22, but we expect to maintain our market share over time. And I think we'd see at least some growth in Mortgages during that three-year period. So that should give you a feel for our confidence around, I'll call it lowish, but decent single digit balance sheet growth.

David Duffy

Thanks, Clifford, and thanks, Chris. Just to your particular question on cost income ratio 'is the emphasis more on below'. I think it is, but I'm sort of balancing that with the comments that Clifford just made around growth because -- and that's why we've said below 50 percent -- if -- I think we'll be very efficient in achieving cost targets, we've done a lot of work on that. The issue is if we see a really big step up in growth in the economy and we want to follow that growth trend, then that might drive more cost. So we're looking at being able to deliver on the guidance we've given and be able to absorb some step up and growth as well. So we're keeping that balance in mind, which is why we're not trying to drive to a specific cost number and much more focused on a cost income number because at this juncture, we're confident about the growth levels that we can achieve and if there's more growth than that, as I said, we may want to invest in that. So it's going to be a balance, but we'll see it as we journey through the next three years, and we can talk about it in detail on that journey.

Clifford Abrahams

Just building on that, we're committed to the 50 percent or less on the cost income ratio. I think our primary metric is that ROE, that double digit ROE, and we're feeling good about that right now. I talked in the presentation about what we think are prudent assumptions and frankly increasingly prudent assumptions. So we've been prudent on base rates. You see the strength of the structural hedge that we've put on. We're seeing the economic recovery play through. We expect exceptionals to be really materially lower in '24. We're seeing that lowish tax rate. We've been prudent on capital requirements. You see, we've guided -- we've announced the Pillar 2A requirement coming down after the financial year. So we're feeling good about our prudent targets, and we're determined to deliver on that ROE target that we've set out.

Chris Cant

That's really helpful, thank you. If I just try to stitch together a little bit, so if NIM's going to be a little bit above 170bps by the sounds of it, at least by the time we get out to '23, if not this year, if you've got something over 2 percent loan growth over plan period as a whole and if other income is to then grow within the revenue mix, because that bit feels quite important as well?

It feels like you've got decent NII growth. So, for other income to grow within the mix of that must be quite meaningful growth. We must be looking at something for income north of £1.7bn, I guess for 2023. Is that the right sort of triangulation here? I guess I can't get to the other income growth without that.

Clifford Abrahams

No. Look, we're not going to guide beyond full year '22 on specific numbers, but the themes -- the drivers of income, you know, I think -- I feel are quite right. I mean, you've picked up other income. You've seen -- bluntly, lockdown in the U.K. only came through in July, which is at the tail end of our reporting period. So we'll get a full year effect of that coming through. I mean, there are some uncertainties around COVID and the winter, but we're feeling good about the momentum, about our timing, and we think now's the time to invest in the business and we can see that visibility of growth on other income based on our current propositions in the next year or two. And that's before some of the sort of exciting propositions that David talked about that are in the pipeline.

Chris Cant

Okay, thank you.

Operator

Thank you. Our next question comes from Rob Noble from Deutsche Bank. Your line is now open. You may ask your question.

Rob Noble, Deutsche Bank

Morning all, can I ask how much of the growth in Unsecured lending do you see coming from buy now pay later? And what returns do you see on this product going forward in comparison to other types of unsecured lending? And then secondly, on your NIM guidance for 2022, you've not put in a rate rise, but are you expecting -- are you using market pricing for the swap curve but with no base rate increase? And if that's the case, what do you see a physical 25 basis point rate hike actually doing to earnings in one year? Thanks.

David Duffy

Thanks, Rob. And maybe I'll just pick up the first one, which is on buy now pay later. I think we haven't really incorporated any material assumptions from that in our planning. What we've done is plan the product rollout and that we anticipate to be the latter half of '22 and then momentum will gather into '23 and '24 but we've deliberately not based our growth on any assumptions around that product area. Now, if we launch that successfully, which I'm confident we will and we combine it with the Virgin Red Loyalty Scheme, which will be a little different than most of the other buy now pay later schemes, I think that's going to be quite attractive. But we'd like to get the product rolled out and then look at the early stages of performance and then we'll be giving some guidance once we have comfort around that. It's likely that we'll have a Capital Markets Day later in the summer of '22. And what we'll be looking to do is get a little bit more specific around that topic at that time.

Clifford Abrahams

Yeah, look on guidance, as I said, we feel good about the 170bps. We feel that the -- we put on the hedge, the enlarged hedge, after the end of the financial year, so really quite recently and that supports, you know, our comfort around the 170bps. So that guidance does reflect the -- call it the current yield curve, but that's moved up even in the recent week or two. And so it's underpinned by that structural hedge, so we're feeling good about that. I think the -- we give our sensitivities -- interest rate sensitivity in respect of a parallel move in the yield curve, effectively the swap curve and you're quite right, we're less sensitive to base rates per se. There is some sensitivity to base rates. If base rates go up, we'll get some income benefit of that, but that will also be expected to drive some pickup in the yield curve at the front end. I think big picture, we've enlarged our structural hedge up to £32 billion now, and that's effectively crystallised the benefit of recent higher rates that we've seen over the last few periods and underpinned our comfort in our guidance.

Rob Noble

All right, great, thanks very much.

Operator

Thank you. Our next question comes from Joseph Dickerson from Jefferies. Your line is now open. You may proceed with your question.

Joseph Dickerson, Jefferies

Hi, good morning. A lot of questions I have, have been addressed, but I guess just a high-level question on costs and, you know, in light of the higher restructuring charges announced, et cetera, and the guidance for FY22. Do you feel that you are underinvested on the cost side in the past vis-a-vis where you wanted to take the bank digitally because you've been headed at digital, for lack of a better word, a digital direction for a while now? So how much of this is catch up and how much of this is proactive for the future? Thanks.

David Duffy

Thanks, Joseph. Let me just take that one. I think with regard to the past, I don't think we're underinvested. I think we've done actually quite well. We're positioned very well because of historical investment in building our platform, which is a single platform for all our products and services, which is Fintech enabled with a microservices layer. So that's good from a historical investment perspective. But at the same time, you'll see a lot of the cost is both on growth with new digital products. So rolling out the Digital Wallet, the subscription based Unsecured lending. So taking advantage of what we see as real market opportunity and our brand to play in new spaces with new products, I think that's the growth side of the investment. But then there is the cost of exiting our architecture in terms of the structure. Six data centres down to two, fewer contact centres, staff, you know, the two-thirds reduction, more or less, in the footprint of the total gross space we have with head offices and branches. So I think it's the exit cost as well of that restructuring to move us much further down the curve on an accelerated basis into the digital kind of operating model. So I think it's a -- it's not about the past, actually, I'm quietly happy that we invested smartly, and it allowed us the potential to make the decision to accelerate into the new products and accelerate the exit of the non-digital type of architecture that we have. So I feel good about that, and I think it's going to be once, you know, we take these steps and become much more digital in our operating capability. The future investment will really be about being smart in terms of product capability and competitiveness in the marketplace, rather than restructuring as we're dealing with today.

Joseph Dickerson

Great, thanks.

Operator

Thank you. Our next question comes from Jason Napier from UBS. Your line is now open. You may ask your question.

Jason Napier, UBS

Good morning. So the first group of questions, I guess, are around various moving parts and net interest margins. And then I had a question on cost, if I could? So as far as NIM goes, I appreciate you don't want to talk about the specifics on mortgage spreads, but given its 80 percent of the book, it's naturally a really important area to understand clearly. Are you saying that in 2023 and beyond, you're expecting wider credit spreads than are in the market at the moment? And of what magnitude is that assumed recovery? And then secondly, if you could give us more specifics around deposit costs, please, the exit rate at the end of full year '21 and what it is you're expecting going forward. To my mind, the fact that deposit costs are already rising in the system is surprisingly early in the tightening cycle and certainly, for banks that have greater reliance on the term market, I think it's really important to understand where it is you think that that is going. You may not have base rates in your asset side planning, but I guess we would hope that you would have them on your deposit cost strategy planning. So the first one on mortgages, second on deposits.

And then as far as costs go, I guess quite surprising to see intangible write-offs around software that weren't introduced in the pre-announcement and I just wondered to what extent that might produce a saving in 2022 in terms of P&L? And then any of the building blocks that you could give us around later cost saves. You've mentioned that you're going to be capitalising less and presumably you won't be telling us that you'll be investing less, but where can we get confidence around the decline in costs later in the plan, please?

Clifford Abrahams

Yes, I'll pick -- I'll pick up -- there's quite a few questions there. I think in terms of Mortgages, I would confirm what you said. So we're seeing mortgage spreads in applications, you know, somewhat below our book right now. And we expect that to continue, or we're anticipating or planning for that to continue through this year and that's reflected in our around 170 guidance and we do expect that to normalise over time and the guidance we've given around double-digit ROE in FY24 reflects a normalised mortgage environment. So you can play your sensitivities around on that.

In terms of cost of deposits, we quoted 53 basis points for the full year and clearly, we've seen a declining trend. So I would say it exited the year maybe 10 basis points less than that. We're still seeing some tailwind from reducing cost of deposits. So, we have over 10 billion of term deposits that are rolling off and when we -- when we are repricing those, we don't keep all of those because we're well-placed for deposits right now, but when we do, those term rates are actually less than the maturing rates. So that's my comments on deposits.

As far as intangibles are concerned, yes, I mentioned that we've written off about £70 million of intangibles. Some of that reflects historical projects, but much of it reflects a more prudent approach to capitalisation. You know, you can imagine, this is my first full year, I've had a very careful look at that and I think the right way to manage that, manage that portfolio is to be; call it, a more prudent practice around capitalisation and what that means - you see in full year '22, the first year where we're doing more IT investment, more development costs, but we're also taking a more prudent approach to capitalisation, so you see those costs as a headwind this year and that's one reason why costs are broadly stable as a whole. But over time, and once we get through that bow wave of investment, you've got a mechanical reduction in our depreciation and amortisation over time, because bluntly we will have capitalised less. So that should give you some comfort that we have almost a mechanical benefit of reduced D&A -- depreciation and amortisation going forward.

And much of our change activity -- and David referred to this is about moving to the cloud, fully developing our agile change methodology, our DevOps methodology, which we've seen in our business and in other banks, including my last employer, will have a material impact in improved productivity of change, reduced cost of change and time to market, so that gives us confidence in change costs coming down over time. And alongside that, you know, you've got the £175 million of cost savings that David described, how we expect to deliver on those, so that gives us confidence that costs will come down in nominal terms after full year '22.

Jason Napier

Can I just follow up on the normalisation of credit spreads question, please? One of your larger competitors has disclosed that they think that current spreads are 60 basis points on the front book, below the back book. So they are 100 versus 160 on their numbers. How -- I think it's really important that we understand how big a recovery we're talking about here?

Clifford Abrahams

A couple of comments -- we have seen very recently both swaps picking up, but also a number of competitors raising their headline rates. I think the way to think about it and model it, is that at the outer years of the call it, the planning period that we've set out, we expect to maintain market share, so not grow market share in Mortgages, but also maintain our overall book margins. So we don't expect new business to be accretive to margins, but we don't expect it to be dilutive and we think we can do that by further penetrating the segments where we have specialties and trading through it, as David described earlier.

Jason Napier

Thank you.

Operator

Thank you. Our next question comes from Victor German from Macquarie. Your line is now open. You may proceed with your question.

Victor German, Macquarie

Thank you. I've got two more questions. With -- maybe starting with costs, one of the things that we've observed over the years is banks looking to reduce their costs over the medium-term, but consistently being surprised with inflation around the digital investment actually, and I look at your guidance, you were planning to spend £275 million below the line and that will be spent in the next three years and then you increase your digital development as well. As you're looking forward, what do you think your sort of exit digital development cost looks like, and why do you think it's not going to increase over that time period? I'm looking at slide 9 and it looks like it's pretty stable, but…

Clifford Abrahams

Yeah, I'll pick that up, I think -- you know, I joined Virgin Money in March, so I have experience elsewhere. I think the industry as a whole has struggled to digitise existing operations and develop new propositions, I mean, I think all in an environment of flattish income. I think as -- I think from our perspective we've done a really good job on integration, and we still have more digital development opportunity. We've set out at the back of -- the back of our presentation, our kind of, our target call it end state, page 34, and that really will put us, you know, best in class in terms of simple IT infrastructure, cloud-enabled, fully agile and a much simpler, you know, operating environment.

I think at the same time -- I think that in itself is inherently cheaper and we will be putting, you know, we'll be putting more change through because we expect a greater agility and higher productivity. And at the same time, you see, we've been unequivocal about our ambition to digitise. So we've seen -- we've taken branch numbers down to around half since acquisition. David's talked about end-to-end digitisation, data centres, service centres and so on. So we expect to be a much more digital bank and that will enable us to take cost down, but crucially, put more volume through and I think one of the exciting things about what we're talking about, it's not just a cost out story, it's a growth story. So we determined to open the jaws and that's the opportunity, we think for Virgin Money.

David Duffy

I think, just to add to that Victor, the key here is that you're taking the institution with that heavy real estate and heavy branch architecture and moving it to a much more digital model. Now, when we get to that point, the underlying theme of your question is, you will have less to invest in total cost because you're investing in digital new product capability as opposed to transforming the organisation. So we see this as we've invested, we've built the platform, we've got customers, products, services, we've got a microservices layer, we've got Fintech integration. All of that's good. We now need to take the rest of the steps on our architecture, physical as well and then improve the services we offer by automating them, improve the employee operating model by making it cloud-based and then consolidating efficiencies around data centres and service centres. So I think that's the journey we're on, but once you get to the end of that journey, you're in a different universe in terms of the spend that you need to make.

Victor German

No, that makes sense. And so, if I look at then, sort of taking what you've said and look at the slide where you look at your income progression versus cost, is the income progression based on the assumption that you will achieve what you are trying to achieve and you'll become far more digital, but your competitors don't necessarily get to the same point as quickly? Or is the assumption -- and that's basically enabled broadly flat or stable margin? Or are you incorporating the potential that the industry becomes more efficient as well? And margins in the industry start to come down as a result?

David Duffy

Yeah, maybe just one comment from me, Victor. I think we're not making assumptions that the industry will remain inefficient. We're taking the view that as we invest and become more efficient in our growth and acquisition of customers and our servicing cost, that will be margin accretive. If you look at why we're comfortable with that, if you look at the Card business that we have today, that's grown at a super prime business at 4 percent growth versus the industry, which is minus 6 percent. The same with relationship deposits, the same with 95 percent increase in PCAs. So for us, it's a combination of a few things. We believe we'll become more efficient in terms of the cost of delivery, more efficient in terms of the acquisition and that's underpinned by the brand, which has demonstrated its power over the past year in terms of those PCA sales. So a combination for me of the brand is unique, the loyalty scheme we will have is unique. We've proven that over the past year in terms of value and the digital benefits will come, and that's why we're confident as opposed to assuming anybody else is inefficient, Victor.

Victor German

Okay, so, it sounds like it's the margin mix benefit that really underpins that income growth and improving margins over time?

Clifford Abrahams

That's right. I think if, you know, if you model it out, I mean we -- in terms of market share, I mean, depending on products we're anything from 3 to 7 percent, right. So in contrast to some of the very big, you know, banks out there, it's really tough for them to meaningfully grow market share. For us, we think we can grow market share in Unsecured and SME. Why do we think that? Well, in Unsecured bluntly, we've done it and we have a pipeline of new propositions coming through. On the SME side, many of you are seeing and hearing the adverts regarding the launch of our national Business bank. So we have the propositions there ready to go and we think we can take market share and a couple of percentage points of market share really moves the needle in terms of our overall top line. So you play that through, together with the rising rate environment, the fact we've locked that in already with our structural hedge gives us confidence in the continuing momentum on the top line, which, combined with the investment and opportunities on cost, gives us confidence that we can deliver that less than 50 percent of cost income ratio and 10 percent ROE.

Victor German

Thank you very much.

Operator

Thank you. Our next question comes from Sheel Shah from J.P. Morgan asking, "What drove the P2A reduction of 50bps with the MDA now 8.7 percent? Can I ask what capital target is being assumed for this plan?"

Clifford Abrahams

Yeah. Look, you'll understand I'm not going to comment on the specifics of that P2A movement, but we felt it was right to announce it today. We think we've been cautious in terms of our capital requirements. For that 10 percent, we've assumed 14 percent capital requirements. We're currently a bit above that. We've participated in the industry stress test for the first time this year. Results are out in December, and we, you know, we're committed to updating the market on capital framework, including capital requirements and dividends going forward by our interim results next year, which is May.

Operator

Thank you. Our next question comes from Rohith Chandra-Rajan from Bank of America. Your line is now open. Please proceed with your question.

Rohith Chandra-Rajan, Bank of America

Hi, good morning. Thank you very much. I have a couple, please. The first one, I'm sorry, just coming back to Mortgages. So in terms of that strategy, what -- to focus on the specialist segments which you talked about before. But just could you clarify what proportion of the book those specialist segments are currently? And then I have a second one on the hedge please.

Clifford Abrahams

So on specialist segments, I mean, we've highlighted a couple, which is the higher LTV segments, new build and Buy-to-let. So Buy-to-let has seen tax changes recently and there are different structures that we need to develop in order to fully address that marketplace. And our current buy-to-let is a little less than 30 percent of the book. I think your second question, I didn't quite catch that?

Rohith Chandra-Rajan

Yeah, sorry. So the second question was just on the hedge. So with the expansion in October -- and I appreciate there's an equity element to the hedge as well as the products hedge, but the overall £32 billion is now bigger than your relationship deposits. So I'm just interested in the thinking behind the hedge expansion and if you see scope, if you grow those relationship deposits further as you anticipate, if there's scope for expansion in the hedge? And then I think you also talked about when you reposition the hedge about it rolling off one sixtieth per month, is that also the case for the 6 billion that was added in October, does that match that maturity profile?

Clifford Abrahams

Yeah, I think that's broadly right. I think you're quite right, the hedge reflects the equity component. I think the runoff, I think assume one sixtieth, so weighted average life of around two and a half years. We've got the complexity of these different tranches that we've explained. Essentially, what that means is, you know, we skipped rolling the hedge through the very low interest rate period of about a year ago and so by putting on that extra 6 billion really very recently, I think we have the benefit of a quite nicely yielding hedge in place, as well as an enlarged rolling opportunity. The extension of the hedge reflects the stickier deposits that we have, you know, which have seemed to remain sticky. We feel fully hedged right now. So our approach that we adopted halfway through last year shortly after I arrived was essentially to hedge interest rates. So we're not actively managing that capacity. We're looking at, you know, we want to be fully hedged. We think that's effectively fully hedged, that 32 billion, and we will calibrate that as our relationship deposits and current accounts grow or potentially shrink over time.

Rohith Chandra-Rajan

Thank you. Sorry, can I just be clear that the 6 billion that you've just put on, is that also a two-and-a-half-year average maturity?

Clifford Abrahams

Yes, it is.

Rohith Chandra-Rajan

Thank you. Thanks very much.

Operator

Thank you, our next question comes from Benjamin Toms from RBC. Your line is now open. Please go ahead.

Benjamin Toms, RBC

Morning, thank you for taking my questions. Firstly, on cost of risk, could you just remind us what you think your through the cycle cost of risk is, given changing mix, and over what timeframe do you expect the 200 million PMAs to be unwound over – is the majority of that happening in full year '22, either through use or release? And then secondly, in terms of reducing number of branches, you're currently have 131 inclusive of your recently announced closures. Given the ambitions of 100 percent digital origination of the majority of products, is the plan to reduce the branch footprint to a basic skeleton over time? Or do you still think they have a strategic place? Thank you.

David Duffy

Thanks, Benjamin. Maybe I'll just pick up on the branches and Clifford can pick up on the cost of risk and the PMA. The philosophy on the branches is that, yes, the purpose of branches has completely changed in the universe. But what we're doing is looking at the model of digitisation that we're doing, and the market pace of digitisation are going to dictate what we do. So we're not prejudging it in any way. You have to address a transition also with vulnerable customers U.K. regulation. So our view of the world is we will deliver a service to customers in those communities so long as they want it, and we will adapt that as we see behaviours adapt. And what you see from COVID is much more of a self-serve model, a big decline in use of cash and much greater functionality being offered through the digital channels to limit the need for people to go to branches. So I think the simple way to think about it is the market evolution in terms of customers behaviour will dictate what we do next.

Clifford Abrahams

Yes. Through the cycle cost of risk, we've said in the past towards 30 basis points. I think that's reasonable in the short period. I would say over the next few years as we grow in Unsecured and Business, you may well see that ticking up as the mix of the book changes.

I think in terms of PMAs, it's hard to predict precisely because it's all about overlays to models, if we feel the models accurately reflect what's going on, obviously we would release the PMAs. I think the way to think about this, I expect '24 to be, call it a more normalised year, whether that's cost of risk or release of PMAs. You know, I'm hopeful that it's sort of out the system, which is why we've quoted ROEs for '24. And we, you know, we were careful in our kind of phrasing around cost of risk for full year '22. We said towards through the cycle cost of risk, I don't expect '22 to be a sort of normal year in that sense, so -- so you'd expect to see cost of risk somewhat lower than that through the cycle number I quoted.

Benjamin Toms

Thank you.

Operator

Thank you. Our next question comes from Edward Firth from KBW. Your line is now open. Please go ahead.

Edward Firth, KBW

Thanks very much. I'm sorry, it's rather late to be asking another question, but I just want to ask about inorganic moves. If I look back, I mean, I think, post Virgin Money you were targeting costs of less than 800 for next year, we're now going to be more than 900. So I guess sort of cost saving potential of synergies doesn't seem to be perhaps what we might have hoped. Does that inform your thinking when you look at other opportunities that may be around in the market at the moment? Thanks very much.

David Duffy

Thanks, Ed. I think we still believe that we'll deliver real value in the cost equation. And that's why we've given the three-year guidance. So you know, you're moving to a digital growth model rather than a low growth cost out model and so I think, you know, if you look at the additional savings we're planning, it's very, very significant when combined with what we've already achieved. But if you look at the correlation of that and broader M&A -- I can make a generic comment -- I don't see value in scale acquisitions, which take you into massive complexity on systems, technology and regulation and take you out of the competitive universe for a few years. The acquisition we did was low complexity on integration and high value in terms of brand synergy and competitive capability as a result of that. So I think what we've done is sufficient and now it's about digital growth rather than acquisition complexity.

Edward Firth

Great, thanks so much.

Operator

Thank you. Our next question comes from James Invine from SG. Your line is now open. Please go ahead.

James Invine, Société Générale

Hi, good morning. I've just got a couple of short ones on the margin, please. The first question is, could you please give us the cost of your term deposits, I think that was 134 basis points in the first half. Just wondering what it was for the full year, or the second half. And then the second question is, could you just remind us, please, what portion of your mortgage book is on standard variable rates? Thank you.

Clifford Abrahams

Yeah, I don't want to get into too much detail around term deposits. I mean, it's come down sharply, so I think you'll see the annual report that we'll issue as scheduled on the 24th, that's likely to give you more detail. I think we -- what I would say is we're still seeing a tailwind from the, call it, the churn of term deposits. And, you know, we expect that to persist really, I would say, through towards the second half of full year '22, and we'll pick up the SVR comment after the call.

James Invine

Okay, lovely. Thank you very much.

Operator

Thank you.

David Duffy

I think -- I'll just check here -- it seems like from IR that we're coming to the end, and I also know we're coming to the end of our time allotted. So I just want to say thank you to everybody for attending the call at short notice. I hope you understand from us our optimism and positivity about the future. But obviously, we are available to have a lot more conversations, and we will -- our IR team will make sure that happens. So if you feel there's anything else you want to get into in some more depth, please contact us and we'll make ourselves available. And I'll close the call there. Thank you all very much.

[ENDS]