OSB GROUP PLC

2023 Preliminary results presentation transcript

14 March 2024

Andy Golding, Group CEO
Good morning everybody and thank you for attending the OSB Group's 2023 full year results.

Clearly, I appreciate there is some disappointment over our ‘24 NIM guidance this morning. However, OSB remains a growing and strong ROE business with a healthy future ahead of it.

I'll start by covering the key highlights in terms of performance for the year. April will then take you through more detail on the numbers. You'll then hear a little bit more from me on how our lending and savings franchises have performed, followed by the outlook before we open up to Q&A.

As we reported at the half year, the Group's 2023 results were significantly impacted by the adverse effective interest rate adjustment, which reduced our full year underlying profit before tax by £181.6m. However, I'm pleased that since then there has been no material change in borrower behaviour and we continue to observe a trend consistent with our EIR assumptions for Precise customers.

Our lending franchise performed strongly, delivering net loan book growth of 9%, supported by £4.7bn of new organic lending, despite the challenging interest rate environment and macroeconomic situation that significantly slowed the wider mortgage market.

We've continued to focus Precise Mortgages on growth in the residential sector and Kent Reliance on really serving the professional landlords who still are making purchase decisions, of course, as well as having more complex refinancing needs, and that plays well to the Kent Reliance strengths in our proposition. Our InterBay brand has also seen a 46% increase in new lending during the period.

And retention performance across the board has been strong, with now 78% of borrowers in Kent taking a new product with the Group within three months of their deal maturing, and an already very encouraging 66% of Precise Mortgages customers as our Choices programme there continues to gain traction, enabling us to lock in long-term income for the future.

We remain committed to doing the right thing for our customers, and I'm pleased to confirm that we have embedded the new consumer duty rules within the required timescales and have signed up to the Government's Mortgage Charter.

Looking at our strong credit and risk management performance, three-month plus arrears were robust at 1.4%, with a small increase on last year, largely driven by the elevated cost of living and cost of borrowing, and actually inside our modelled assumptions.

ECL provisions have also increased due to changes in the risk profile of borrowers as they transition to remodelled IFRS 9 impairment stages, although the outlook has improved during H2.

Our capital position remains strong, with CET 1 at 16.1%. Following the successful issuance of Tier 2 and MREL qualifying debt securities, we have met our MREL requirement comfortably in advance of the July deadline.

The Board has recommended a final dividend per share of 21.8 pence, which together with the interim dividend results in a total dividend for the year of 32 pence per share, which is in line with our desired policy of delivering a progressive dividend per share.

The Board remains committed to returning excess capital, and I'm pleased that we have announced today a new £50m share buyback programme to be delivered over the next six months.

I will cover more about our outlook and our guidance later, but we remain excited by the opportunities in our core markets. And I hope that my introduction has provided a useful reminder of the strong fundamentals that provide the backdrop for us to continue to deliver attractive and sustainable returns through the cycle.

This slide shows our statutory financial results, but turning to our underlying results, on the underlying slide we've also shown our KPIs excluding the total EIR adjustment, and I think it's important to do this to understand the underlying strong performance of the business. For example, excluding the adjustment, our return on equity would have been 22%.

April will cover each of these for you in her review, but I hope this snapshot underlines the strong fundamentals of the Group under normalised trading.

I'll now hand over to April, who'll take you through the numbers in a bit more depth.

April Talintyre, Group CFO
Thank you, Andy, and good morning everyone. Nice to see you in person.

This slide presents the 2023 performance on an underlying basis before and after the EIR adjustment. Turning to the key drivers of underlying ROE of 16% or 22%, excluding the impact of the EIR adjustment, the Group delivered an underlying pre-tax profit of £426m for the year.

However, it would have increased to £608m without that adjustment, due primarily to higher net interest income off the back of strong net loan book growth and an improved net interest margin. This more than offset the impact of a net fair value loss from the Group's hedging activities during the year compared to a large profit in 2022. I'll cover NIM in a lot more detail later.

Administrative expenses increased by 14% in 2023, reflecting balance sheet growth, the anticipated impact of inflation, and planned investment in people and operations. However, the underlying management expense ratio, the pure efficiency metric, of 81 basis points remained broadly flat to the prior year, demonstrating our continued focus on cost discipline and efficiency.

The underlying cost-to-income ratio increased to 33% from 25% in 2022, largely due to the lower income.

Excluding the EIR adjustment, the underlying cost-to-income ratio increased by one percentage point to 26%, due primarily to that fair value loss from hedging activities versus the large gain in the prior year.

Looking ahead, we expect the underlying cost-to-income ratio to be broadly flat to the 33% reported in 2023, commensurate with our broadly flat NIM guidance, which we'll come on to later.

The management expense ratio may tick up slightly in a year of slower growth, as we continue to sensibly invest in our digital journey. However, we will continue to maintain the cost discipline and efficiency which we're known for.

We recognised an underlying expected credit loss of £48.5m in 2023, equivalent to a full year ratio of 20 basis points. As you can see on the chart, this was concentrated in the first half of the year, as previously outlined in our 2023 interims, but I will provide some more detail again on the key drivers a little bit later.

Turning to the income statement, you can actually see that fair value loss on hedging activities I mentioned earlier of £10.8m versus the gain of £48.5m in the prior year. A quick reminder, the key driver behind this loss or gain, which will reverse over the life of the swaps, continues to be fair value movements on our pipeline mortgage swaps due to movements in the SONIA forward curve before the mortgage is complete.

The only other thing I'll just point out on this slide is the underlying earnings per share of 75 pence for 2023, reduced by 25%, commensurate with a reduction in profit. Underlying EPS would have increased to 106.7 pence per share, excluding the EIR adjustment.

So I'll just turn to the balance sheet next. This summarises our strong, secure balance sheet. Our net loan book increased by 9% during the year to £25.8bn and that's supported by the £4.7bn of gross new lending in the year that Andy referenced earlier, as well as strong retention.

Retail deposits grew by 12% to just over £22bn during the year, as savers continued to choose the Group's consistently fair and attractively priced products. We remained predominantly retail funded with diversification provided by Bank of England funding schemes and securitisations. Andy will provide an update on the progress of our TFSME repayment plan and securitisation activities a little bit later.

I'm pleased with the credit performance of our loan book during a period of stress caused by the rising costs of living and borrowing. The small year-on-year increase in three-month-plus arrears to 1.4% was inside our modelled expectations and reflects the high quality of our secured loan book and lending policy and demonstrates the resilience of our borrowers.

Our loan book is secured at a sensible loan to values. The weighted average book LTV at the Group level increased to 64% at the end of the year from 60% at the prior year end, reflecting negative house price inflation in the year. However, the new lending LTV reduced marginally to 68% from 71%, demonstrating our continued focus on the risk assessment of new lending.

Now on to the net interest margin. This slide shows our NIM waterfall where you can see the high-level drivers behind the movement in net interest margin during the year. And moving from left to right, I'll start with the cost of retail funds which benefited versus the prior year from initial delays in the market passing base rate rises onto savers in full, and the cost of new retail funding also benefited from widening swap spreads.

However, this benefit was offset by the lower new lending and retention margins caused by delays in mortgage pricing fully reflecting the rate rises and the higher swap costs in a period of extreme volatility in the rates outlook. We nevertheless continued to honour our pipeline as we did throughout the pandemic.

The third bar shows the impact of the Tier 2 and MREL issuance in the year and other funding primarily related to the benefit of equity funding in a higher rate environment, which all results in a full year NIM of 314 basis points, excluding the EIR adjustment of 63 basis points or 251 basis points if you include it.

So let me turn to the NIM outlook. I thought it'd be helpful if I stepped you from the full year underlying NIM for 2023 of 314 basis points, excluding the EIR adjustment from the previous slide to the 2023 exit rate and then on to our guidance for 2024.

2023 was a year of two halves for NIM, the second half NIM of 296 basis points, significantly lower than the first half NIM of 333 basis points, excluding the EIR adjustment as previously guided at interims.

Moving from left to right again on this waterfall, starting with the cost of retail funding, this increased due to deposit spreads normalising in the second half, increasing the cost of new deposits but also retention as the fixed deposit back book started to recycle onto the higher prevailing rates.

At the same time, lending margins continued to be impacted in the second half by delays in the market passing the rate rises and higher swap costs on to mortgage pricing in full. Tier 2 and MREL issuance and other funding resulted in an exit rate for NIM based on December 2023 annualised of 273 basis points.

The 2024 underlying NIM is expected to be lower than the December exit rate because the cost of retail funds reflects the impact of the fixed deposit book continuing to recycle onto those higher prevailing rates. However, this is expected to complete this year in 2024.

On the positive note, new lending and retention margins are expected to be accretive to NIM in 2024 based on our current pricing, swap spreads and planned mix of business. And Andy will talk about some further potential opportunities as the macro outlook stabilises a bit later.

You can also see the impact of Tier 2 and MREL eligible debt issuance in the next bar, including the full year impact of 2023 issuance.

The other funding drag reflects the impact of planned securitisations to help support the repayment of TFSME.

In summary, I hope this explains our full year guidance of broadly flat to 2023 underlying net interest margin of 251 basis points.

I'll turn to impairment provisions next, and this slide provides a waterfall of the movement in the statutory impairment provision over the year. As you can see in the chart and moving again from left to right, we updated our forward-looking macroeconomic scenarios in our IFRS 9 models during the year, which accounted for a £6.4m increase in provisions. Enhancements to models and updates to post-model adjustments were a small release of £1m.

Provisions related to accounts with arrears of three months or more increased by £14.1m and there was a further increase of £14.1m related to changes in the credit profile of borrowers as they transitioned through modelled IFRS 9 impairment stages.

This transition was primarily modelled movements from Stage 1 to Stage 2 with only a small percentage of loans in Stage 2 actually being in arrears. Stage 1 provisions in respect of loan book growth totalled £7.8m and individually assessed provision increases in other items totalled £8m.

As I mentioned earlier, the vast majority of the charge was in the first half of the year with the loan book since then performing slightly better than expected and with a slight improvement in the outlook for house prices.

As at 31st of December 2023, the Group's balance sheet provisions were further reduced by write-offs of £33.6m. These did not form part of the impairment charge for the year as they were expensed to the profit and loss in the periods when the provisions were raised.

The amount was elevated in 2023 due to the write-off of the funding line receivable associated with the 2020 fraud case following the successful sale of the remaining security in line with our write-off policy.

You can see that our total coverage ratio remained broadly flat at 56 basis points for the year. However, it remains more than twice the level it was pre-pandemic at the end of 2019.

Our year-end forward-looking macroeconomic scenarios which were a key driver of our modelled expected credit losses are included in the appendices. I think it's the last page.

Since the year-end, the outlook for house price declines has moderated and we will continue to actively review these scenarios as we progress through the year.

I'll turn next to capital. So turning to our capital position, you can see that the Group's CET 1 ratio remained strong at 16.1% at the end of December. Going from left to right again in the waterfall, which explains the movement in the CET 1 ratio in the year, you can see the impact of the adverse EIR adjustment taken in the first half.

The next few bars demonstrate our very strong capital generation capability, which excluding the EIR adjustment was more than sufficient to support strong net loan book growth of 9% and a full-year progressive dividend per share of 32 pence.

This full-year dividend represents a payout ratio of 29% of underlying earnings excluding the after-tax impact of the EIR adjustment and includes a recommended final dividend of 21.8 pence per share.

On the right-hand side of the waterfall, you can see the full impact of the £150m share repurchase programme completed in the year as we continue to return excess capital to shareholders as we optimise the capital stack.

Today, the Board has announced a new £50m share buyback over the next six months. We will consider the potential for further capital returns later in the year, subject to further MREL issuance to support growth and the final Basel 3.1 requirements when known.

Looking forward, we continue to target a CET 1 ratio of 14% but expect to operate above this target as we wait for clarity on the final Basel 3.1 rules, which are expected to be published in Q2 this year.

A quick reminder on the next slide of the components of the Group capital, both the Group's minimum capital requirements, but also our MREL or TLAC requirements, and also our capital resources, both at the 2023 year-end and the prior year-end.

Total capital resources at the end of the year of 22% include the benefit of our successful MREL qualifying Tier 2 and senior debt issuances during the year. We expect to issue further MREL qualifying debt to meet the future requirements of Basel 3.1, which has an expected implementation date of July next year, and to support balance sheet growth, as well as meeting the end-state MREL requirements by July 2026.

I'll now pass back to Andy, who will give an update on our lending and funding franchises, and then further detail on the outlook.

Andy Golding, Group CEO
Thank you. Our lending franchises have continued to deliver through more than 30,000 qualified mortgage intermediaries. The Legal and General Mortgage Club is the UK's largest, so to win their award as the Best Specialist Lender is one that's particularly pleasing to me.

Our focus on professional Buy-to-Let landlords has continued, helping fund into the critical private rented sector, which provides access to more than 4 million homes. Our Landlord Leaders Community continues to grow, with over 400,000 interactions through social media. It was set up as a source of knowledge and best practice, aimed at ensuring a fair sector for landlords and tenants alike.

In 2023, we increased our market share, despite a significantly softer overall Buy-to-Let market, from 5.8% to 6.2% of stock, and from 6.8% to 8.9% of flow.

In our residential segment, we have managed and maintained our focus on underserved borrowers, leaning into self-employed and minor adverse credit customers, as well as our continued focus on the shared ownership market, supporting in particular key workers.

We've grown our InterBay business, both in commercial and asset finance, and doubled our bridging completions to £437m.

We evaluate options to extend our risk appetite in these markets as the macroeconomic outlook improves.

Our funding platform continues to deliver savings to our strategy of attract, retain, and satisfy. We grew our retail deposit book by 12% in the year, and we opened more than 210,000 new savings accounts, despite the increasing competition.

We successfully retained maturing customers into fixed-rate products at a rate of 91% and 85% in OSB and CCFS, respectively. And net promoter scores also remained high, at over plus 62 in Charter Savings Bank and plus 71 in Kent Reliance.

We complement retail deposit funding with our expertise in wholesale markets, and in June we completed a £330m securitisation of owner-occupied mortgages, with a further £509m of Buy-to-Let mortgages securitised at the start of the year. We saw exceptional demand from our growing investor base, and this allowed us to achieve very attractive pricing on this deal.

We'll continue to access the wholesale markets when conditions are favourable, and benefit from the diversification of funding to support a smooth transition as we repay drawings under the TFSME.

At the end of the year, the Group's drawings under the Bank of England facility were £3.3bn, following the repayment of £900m in the year. And we've repaid a further £600m so far in 2024, and we'll continue with our structured repayment programme through to October 2025.

The Group is recognised for its efficiency and excellent customer service, and through '23 we continue to invest in our digitalisation journey, which will enable us to meet the future needs of our customers, brokers and wider stakeholders, whilst delivering further operational efficiencies. This investment will be a key focus going forward, as we deliver digital solutions to enhance our customer propositions.

Investment in '23 has so far delivered an online broker registration process which enables an intermediary to register for business once for Precise, Kent and InterBay, being business ready across the Group in a single step. A new advanced digital front end to Precise Mortgages, which has new API functionality, stripping back what's not necessary to deliver on our promise of creating precisely the right product at precisely the right time.

In the first half of '24, the Group will also launch an app for intermediaries, enabling them to work with us and get updates on the move.

OSB Group has always been a market leader in cost-efficient delivery, and our investment in technology will enable us to maintain this reputation, whilst also removing friction from our customer experience and enabling a deeper, more personal relationship to be built through the focus on their specialist needs.

So, in summary, a strong operational performance and the fundamentals of the business still good. Clearly, I am disappointed that the first half was impacted by the adverse EIR adjustment.

Our specialist market sub-segments continue to perform well, despite the subdued overall mortgage market, and the Group's target professional landlords demonstrate resilience and provide much-needed housing to the private rented sector, and our specialist residential and commercial brands have good levels of demand and customer confidence show signs of improvement.

Our savers remain loyal to the Group, as we offer them good value with improving net promoter score results, and we're confident we'll continue to deliver proposition-enhancing digital solutions as they're developed.

Based on current application volumes, and against a backdrop of a continuing subdued mortgage market, the Group expects to deliver underlying net loan book growth of circa 5% for 2024.

The underlying net interest margin is expected to be broadly flat to 2023, reflecting the impact of higher cost of funds and the full year impact of some lower margin lending in '23 whilst honouring our pipeline during a period of market volatility.

As I mentioned earlier, we'll continue to evaluate opportunities for NIM enhancement, as the macroeconomic environment allows us to broaden risk appetite in our more cyclical business lines.

The underlying cost to income ratio is expected to be broadly flat to 2023, commensurate with the guidance on the interest margin transition that April described earlier, and the Group remains well capitalised with strong liquidity and a high-quality secured loan book.

We've demonstrated the strength of our customer franchise and intermediary relationships and continue to focus on good outcomes for our customers, our stakeholders, and strong returns for our shareholders.

Finally, before turning to Q&A, I would just like to take a moment to thank April for her dedication and hard work over the years. As you know, she'll be retiring at the AGM. April has been an excellent trusted advisor and support to me over the last 11 plus years, helping to build one of the UK's best specialist lenders. Thank you, and I really do wish you all the best in your retirement.

And finally, I'd like to briefly introduce Victoria Hyde, who is here today, and will be taking over as our Interim CFO, pending the completion of our formal competitive process.

Victoria joined 18 months ago as Deputy CFO, specifically as part of our senior leadership succession planning, and has already made a huge impact on the Group.

Q&A

Benjamin Toms, RBC
Good morning. Thank you very much for taking my questions. If we take a step back, you printed an underlying ROE of 16%, and given the share price move this morning and the EIR adjustment last year, which causes some noise, maybe it could be helpful if you could just provide some assurance that through the cycle, this bank should be expected to deliver at least a mid to high teen ROE?

And then secondly, your latest guidance on Basel was less than 200 basis points. I guess the key here is the regulatory announcement that's coming up in May. And the key thing to look for there is probably whether they phase in the impact from standardised. I think 150 to 200 basis points represents something like £200m of capital. Is the right way to think about a softening of that standard in terms of it being phased in kind of 80% of £200m of potential capital that's freed up for later in the year? Thank you.

April Talintyre, Group CFO
Do you want me to do all of them?

Andy Golding, Group CEO
I think they sound like your questions.

April Talintyre, Group CFO
Okay, that's no problem. I mean, on ROE, you know, look we haven't given medium term guidance, but I think hopefully what comes through on the sort of NIM progression slides is that we are facing some short-term headwinds, particularly as our retail savings book, you know, recycles onto more normalised deposit spreads.

But there is some upside coming from our lending mix, as Andy said, once supported by the macroeconomic outlook, in particular house prices, you should expect us to go back into some of our higher yielding businesses in a little bit more anger.

But I guess if you look at our guidance, you know, we are, I guess, implicitly guiding at sort of high teens ROE.

The other thing perhaps to point out would be the sort of what to expect on the ECL line, you know, we don't specifically guide on expected credit losses. But you know, most of our provision is modelled. And if we start to see improvements in the macro, particularly further moderation in the peak to trough of house prices, you know, that would be positive.

So, you know, as we sit here today, let's hope what we see is macro improvements as opposed to any worsening, who knows, which should support a relatively benign loan loss ratio going forward.

You know, the nature of the beast, IFRS 9 is you’re meant to have perfect foresight, you make all your provisions, and then you either utilise them, you reverse them, or you increase them for further worsening in the outlook.

So I hope that helps without kind of giving you medium term guidance, which we haven't published.

And then turning to Basel 3.1, we did when the consultation paper was first published, you're right, we guided to an impact of up to two percentage points on our capital requirements. And since then, that has reduced somewhat, but because we are in a slightly stressful situation, and therefore we've modelled more defaults. And if you have defaults, then there isn't really an increase in the risk weighted assets as a result of Basel 3.1. And therefore, actually, you know, because of the macro situation, that difference is reduced. I hope that that makes sense, slightly counterintuitive, perhaps.

I think a lot of the lobbying has been around commercial, semi, you know, SME lending. So any kind of rollback from the platinum plating versus the actual Basel rules themselves would be helpful, I think, for our business.

Residential risk weights are coming down for us because of our very sensible loan to value for residential lending. The real driver of the increase for us is larger portfolio Buy-to-Let. And you know, that is the key thing to watch for.

But as you referenced as well, you know, Basel have bent over backwards to ensure that IRB firms get a nice smooth transition and transitional relief but had not originally put that in for standardised firms. Clearly, there is going to be significant impact if it's put in close to what they consulted on for standardised firms, and I hope they do the right thing, and they offer transitional relief. And then I guess the thing we have to balance is that glide path of transitional relief versus IRB accreditation.

And you know, unfortunately, I have to say there is no change to our IRB journey. We await resources from the PRA to formally engage with an application. Before someone asked me, I thought I'd just volunteer that.

Perlie Mong, KBW
Hello. Can I just take you back to NIM? I guess the share price reaction today is reflective of the NIM, maybe a surprise that the guidance is so much lower than market expectations. I guess we are, you know, a quarter of the way through the year. So, I guess, what are you seeing at the front end? Are you, is there any surprises at all? Because obviously, I guess, going from, I guess, consensus of 280 to 250-ish, there might be an element of surprise in your thinking. So, just have those played out as you expected, or, you know, would we expect any more revisions to that guidance later in the year? Not that you can tell us now, but just sort of what you're seeing on the front end would be helpful.

And then the second question is on volumes. So, 5% is a little bit lower than your level of growth historically. And, you know, even last year, you did 9%. And I guess in a falling rate environment with house price stabilising, I guess, we would be a little bit surprised not to see a higher level of growth. Just what are you seeing there to give that guidance?

April Talintyre, Group CFO
Shall I do NIM?

Andy Golding, Group CEO
Yeah, I'll talk about growth.

April Talintyre, Group CFO
So, I think, you know, I hope what came across in that sort of outlook slide is that the drags on NIM really happened in the second half of last year, commensurate with the guidance we'd given at interims for the second half.

The continuation of the retail savings book, recycling onto the, you know, high prevailing costs is sort of a continuation of that. And then we said we expect accretive lending margins. And actually, what we've seen so far this year are totally in line with that expectation.

But as Andy mentioned earlier, if we start to see the improvement in the macro, if we continue to see moderation in the HPI peak to trough, then that would suggest the mortgage market would start to recover. That would certainly give more opportunity for further growth in our core businesses, but would also give us the confidence to, you know, relax the risk appetite again, and start going back into the kind of levels of lending we used to do and what we consider to be the more cyclical, but of course, higher margin businesses, asset finance, development finance, more commercial and bridging.

Of course, we're doing all of this, but we're not doing it at quite the same volume as we would have done pre-pandemic and then pre- the cost of living and borrowing rises.

Andy Golding, Group CEO
Thanks. And then, I mean, on volume, I mean, we always try and be realistic about the guidance we give on loan book growth. And I think, you know, you have to come into 2024 being cognisant of the fact that the Buy-to-Let market, for example, was kind of 49% down last year on the previous year in terms of its overall volume.

And even against that backdrop, you know, clearly, we managed to increase our market share of both stock and flow. You know, the issue for us is one about, rather than chasing volume at any cost, keeping a focus on NIM and keeping that focus on looking for opportunities for accretive NIM as we go through the year. So, don't overgrow just for the sake of it.

Making sure that we've got capital to deal with issues like Basel 3.1 and continuing to look after shareholders in terms of evaluating our opportunities for capital return. So, I think we're being realistic about growth based on where the market is at the moment.

I think if the macro does what the perhaps early signs are that the macro might be doing and confidence starts to return and we get a bit of a pickup in purchase activity, and that'll be both residential and Buy-to-Let, then, you know, there is potential for more.

But also, if that macroeconomic environment improves, as I said in the presentation, we have ways in which we can pivot into some of our more cyclical business lines if the macro is supportive of those and we want to reserve some capability to divert capital into those markets because they long-term are NIM accretive.

James Invine, Société Générale
Hi, good morning. I've got two on the margin, please. The first is, I wonder if you could just help us, please, with the shape of the margin as we go through the year. You've kind of talked about an exit margin from last year of around 270, you're signalling 250 for the full year this year. Does that mean that when we get to December '24, your exit margin is going to be, you know, around the 230 level?

And then the second question is on, I'm just wondering, April, actually what we're assuming for the deposit costs. So you previously talked about moving back to SONIA. Is that basically the expectation that you have baked into this, please? Thanks.

April Talintyre, Group CFO
Okay, let me do the second one first, because that's easier. So yes, at the interims, we've said we're assuming around SONIA. At Q3 trading update, we said it's gone up a bit. So we're sort of assuming around about the SONIA plus 10.

So a more normalised rate, I think, for us at times, you know, the end of '22 and the first half of '23, I think I've said before, we were raising, you know, our sort of retail deposits as sort of SONIA minus 40, SONIA minus 45 at times. And that did lead to an increase in net interest margin that we didn't expect to be sustained. You know, the retail savings markets did eventually catch up and price in those rate rises. And so that's what we assumed.

We're continuing to assume about that level, SONIA plus 10. Clearly, we are doing more securitisation. As part of our blend of funding, it gets you more duration. It also really helps replace the TFSME. So we're not relying completely on retail savings market. Our repayment strategy is a mixture of retail and debt issuance. And clearly, securitisation.

I mean, we restarted, I think, the Buy-to-Let securitisation market earlier this year and managed to break through just under the 100, SONIA plus 100. But clearly, that's more expensive than retail savings.

I think at the moment, sort of residential STS type securitisations are probably about 45 basis points cheaper. So that's kind of where we're focusing.

So - and of course, we will have requirements we expect for further debt issuance as well, not just for Basel, but for just planned growth in the balance sheet too.

So that hopefully that answers your second one.

The shape of net interest margin. I mean, we do expect the drag of that back book of retail deposits one and two year with a weighting towards the one year as that was the most popular product over the last 18 months or so. We are expecting that to sort of complete in the second half.

So if you like that drag will be done. We will continue obviously, to have some drag from MREL as you know, the full year impact of what we've already raised, but also potential to raise more later on in the year. But then you've got that offsetting accretion from new lending.

And I think where we land at the end of the year will probably depend somewhat on what we see as the opportunities for growth. And we will continue to look as Andy just said, for further growth opportunities, not just in our core markets as they start to recover, particularly on the purchase side, but also in those more cyclical businesses.

Grace Dargan, Barclays
Hi, maybe - sorry, just again, coming back on the guidance, maybe particularly on the '24 guidance in NIM. Do you think you're being conservative in that? Or maybe put another way, could you see upside and where might that come from? I guess, in particular, thinking about the asset spread widening, and given the improving rates backdrop. And

maybe linked to that within that asset spread widening, how are you thinking about that have kind of mix shift kind of coming to your points around the cyclicality, versus kind of widening of core products?

And then maybe looking further out, I appreciate you haven't done medium term guidance and won't comment on ROE. But maybe just how you're thinking about a normalised NIM to ask in another way in a normalised interest rate backdrop. Thank you.

April Talintyre, Group CFO
Okay. I'm sorry, Andy. It seems to be the April show at the moment.

Andy Golding, Group CEO
I'm actually happy to answer this one. I mean, I think I would say, you know, you started with are we being conservative on NIM? We always guide on NIM on what we're seeing today. So you know, we look at what's coming through the pipeline, and we look at what the funding cost is of the book. And we use that as a, you know, a solid proxy to give us the guidance.

I mean, in terms of mix, which you touched on, clearly, when we think the macroeconomic is, you know, environment is right, we have the ability to pivot the mix. We did a little bit of that towards the second half of last year with some increased completions in bridging and through our InterBay business. But we are quite a conservative Board in terms of risk appetite. And I think, you know, we want to make sure that it isn't a one swallow does not a summer make situation. And actually, the ongoing trends of the macro environment are supportive, because once you've lent it, you're in, you're in it for a while. So you want to make sure it's credible business in, in the right point of the market.

And then in terms of the widening piece, I mean, you know, OSB has always made good money in a low interest rate environment. And I think, you know, banks have a tendency to widen margins when rates move in either direction, static interest rates are never that helpful. And it would certainly be the plan for us, you know, we've never been the cheapest Buy-to-Let lender on the block, it would be the plan for us to obviously treat borrowers fairly and make sure the products are appropriately priced as interest rates change.

But equally, you know, the competitive nature of the funding dynamic means that as rates fall, the current account benefit for the big providers is less beneficial. And therefore, you get some less intensity of competition on the retail funding market.

But we're not, we're not speculative in the way that we put our plans together. So as situations evolve, we will look to jump on opportunities. But you know, we can't sit here and say this will happen, because we've got to see that economic data wash under the bridge. Did I miss anything? Or do you want to add to that?

April Talintyre, Group CFO
No, no, that's fine. You did that very well.

Andy Golding, Group CEO
Thank you.

April Talintyre, Group CFO
Well, I mean, look back in history, I mean, you know, in the more sort of benign, steady, low-rate environment, we were around about the sort of, you know, anywhere from sort of 260, 280, weren't we? I mean, you know, clearly, we have, you know, a bit of a drag from MREL issuance. But you know, those bars weren't too deep, were they? And, you know, we have tools and levers we can put at the right time.

So, and I can assure you, the Board is very focused on at the right time making those decisions on the more cyclical lending, and but not wanting to trade up the risk return too soon, the risk curve, you know, just to flatten NIM, because that wouldn't be the right decision for us to make. But there are opportunities there for sure.

And, yeah, I think I probably agree with Andy, I think there should be some opportunity. But bearing in mind that, you know, the lending margins that the market, you know, ended up at last year, when we had those expectations of, you know, rates going up further than I think we now believe, you know, didn't pass all that on to borrowers. So I think it will be a natural inclination for the banks to try and take a little bit of that back. So I think I echo Andy's views on that.

Gary Greenwood, Shore Capital
Hi, I’ve just got two bigger picture questions, really. So the first one is on M&A activity, obviously, we've seen a couple of potential deals, one gone through, one potential in the sector recently with Tesco Bank and Virgin Money. So just your thoughts generally on consolidation in the sector and your positioning therein?

And then the second one, it's more of a political one, obviously, it looks like we might get a change of government in the next 12 months. I think historically, a Labour government that's been viewed as being a little bit more cautious around landlords and Buy-to-Let, than maybe a Conservative government, although the Conservative government's clamped down quite a bit. So just in terms of your thoughts on how that might change the environment for your business.

Andy Golding, Group CEO
Yeah, sure. I mean, the M&A activity, of course, the Co-Op are in play with another building society as well. So there has been a bit of a flurry of activity. I'm not sure any of us saw the Virgin-Nationwide one coming until the announcement was there.

But even so, I mean, we continue to scour the market for opportunities. We think about defence, clearly, particularly at times when your share price is under pressure. We clearly make sure that we're well versed in how we would respond. And the Board is very clear on what we believe the intrinsic value of the business to be, you know, so that we can fight the corner on behalf of our shareholders if that's appropriate.

I mean, I think I would say on us and M&A right now, the story is the same as it was over half year numbers. Our job of work is to, you know, get total confidence back in the underlying fundamental business that says we write decent volumes, we churn out a decent return on equity, and shareholders benefit from that, you know, along with all the other aspects of running a good quality customer franchise. And we will continue to evaluate opportunities in the market.

Do I think there's going to be a mass flurry of consolidation? I mean, I think maybe the regulator might like that, because it's easier to regulate fewer entities. I don't know. I think there are some challenging deals. I think we've still got the sort of issues of fair value adjustments on mortgage portfolios that exist from a time when the interest rate dynamic was different. And that makes some of the deals difficult to do. I think you've got, you know, some providers that have got heavy, you know, kind of fintech investment, and therefore believe they're valued as a fintech, not as a bank. And that, you know, makes that sort of deal difficult.

But other than that, I can't say too much on that. I don't think there's going to be massive consolidation, but there'll always be deals to be done if the price is right, and the sort of economic flow is there.

The change of government one, I mean, historically, that's always been something that we've worried about, because, you know, we think the private rented sector, for example, is very important, and you need a supportive environment for that.

Actually, myself and a number of other mid-tier CEOs have spent time with the current Economic Secretary to the Treasury, but also time with the Shadow Economic Secretary to the Treasury. And actually, the mood music we're hearing from the Labour government is much more supportive of actually, you know, making the UK an investable platform, making the UK easier to do business in, and actually understanding that the lending industry and the banking industry is an important and intrinsic part of putting growth and economic value, real economic value into the UK economy.

So I think, you know, when we were talking about Jeremy Corbyn, and some of the rhetoric and that sort of thing, I would have been super nervous. Actually, I'm less so now on that, I think the change of government will be looking for stability and growth, and the banking sector can help with that.

Aman Rakkar, Barclays
Hello, I had two questions. One on capital and one on cost income. So like - you must be frustrated with the regulator, I mean, you - there's an uncertainty around risk weights, that's really not helpful. I hope Sam Woods and the PRA are listening to this call. But you know, your shareholders are actually bearing the brunt of the cost of this, right, in terms of the uncertainty on the capital position. But also potentially MREL issuance.

So I just wanted to double check. The MREL, you know, your NIM bridge into '24 next year, there's some incremental issuance that you're baking into that, does that factor in – you know what assumption on risk density are you kind of embedding in that? Are you assuming, you know, that the risk weights go up as per Basel?

April Talintyre, Group CFO
Okay, I can deal with that.

Aman Rakkar, Barclays
And if that is the case, then kind of what happens if and when we, fingers crossed, get some relief down the line? Presumably, we'll retire that funding in the fullness of time.

The second question is around cost income ratio. So is this a new kind of run rate, cost income ratio on a go forward basis for your business? There's a very convoluted way of saying it. But you know, you've done in the 20s, mid 20s, is 33 the new kind of level that we should expect for your business going forward?

And as part of that, I mean, I've understood that India's been a really important support, you know, for the business, an important part of the operations of OSB …

Andy Golding, Group CEO
Still is.

Arman Rakkar, Barclays
… still is exactly. But I do wonder how sustainable that is as a low-cost centre of running a business. I wonder if you've got a view. I mean, everyone tells me that, you know, economic growth is set to accelerate and wealth creation and affluence and wages and what have you. I don't know if you've got a view there in terms of that medium term.

April Talintyre, Group CFO
Shall I start with capital. Yeah, obviously, we're extremely frustrated at the continued uncertainty as Basel 3.1 implementation has been delayed, frustrated at the consultation paper, and the PRA not wanting to use the UK loss data, and instead adopt calibrations, which are international for Buy-to-Let, which just aren't supported by the loss data in the UK, where Buy-to-Let performs very similarly to residential and very frustrated there was no transitional relief.

But I think the regulatory regime is quite fragmented. In the UK, it had the tendency to platinum plate. And that fragmentation manifests itself in a very low threshold for MREL, as well as, you know, continuing to, I think, actually widen the uneven playing field between the larger banks and smaller banks, and mid-tier banks.

So yes, obviously, deeply frustrating and can clearly empathise with the frustration amongst the shareholders as well, who just want clarity, nothing worse than uncertainty is there. But we have assumed the consultation paper, and that there are no drawbacks, no rollbacks from there. I think it's a sensible thing to do. That's all we have to really base our modelling on. So our capital requirements going forward are based on, it just comes in as written.

But also that the, you know, the macro outlook is, you know, as we've published, is going to come to pass. Clearly, we are forecasting some RWA inflation through defaults as well. So those are kind of two of the main sorts of assumptions going forward.

And that includes, obviously, the impact of, you know, higher LTVs as well, you know, from the HPI drops that are - that certainly at the end of the year, we were forecasting.

So I guess, to answer your question of what would we do, if the rules are different? I really think we have to wait and see what the final rules are. We don't have to wait very long, I hope. They have said May. So fingers crossed, it is in May. And let's hope they have listened to industry and Treasury, when it comes to some of the flaws, we think in their previous consultation paper.

And actually, you know, the longer it's delayed, also, is it really fair to give industry only a year to get ready. So let's wait and see what the implementation date is as well. I do know they're trying to align that to Europe and the US.

Interesting, the US have decided not to just adopt the international calibrations. But I think they're also looking to perhaps say it's the - I'm afraid you have to hold the higher standardised or your internal models as well. So let's wait and see what the UK regulator does when it comes to models. Because clearly, it's, it's been difficult for them to find resources to get the larger incumbents to update, but also to help aspirant firms get through.

So yeah, a very fragmented regulation framework, delays, you know, in implementation and clarity. And quite clearly, yes, very frustrated. And we're not shy about telling the regulator that. And we are very active on the lobbying side, both with Treasury and with the PRA. And - also potential future government as well, when it comes to the regulatory regime.

Cost to income, I mean, do you want me to?

Andy Golding, Group CEO
Yeah, you talk about that, I'll talk about India.

April Talintyre, Group CFO

I mean, to be honest, I mean, if you're looking for an efficiency metric, you know, I really would love the industry to start kind of looking more at management expense ratio. You know, I always talk about management expense ratio, which is about efficiency, and that does represent still the sustainable benefit we get from India.

Yes, there is inflation in India. But it's not just about people - you know, is it still cheaper to hire people in India? Significantly. It's a longer working day. And actually, the talent pool there is, you know, astonishing. And the more and more we're finding deep pools of talent there, with just a slightly different mindset, you know, a real mindset of improving digitalisation, robotising. And therefore, we find actually the employee base there, a real sort of asset to our business. It's not just about the cost benefit, but there is still a cost benefit there as well, of course.

And so from a sort of a run rate perspective, that management expense ratio is the one that I personally focus on, and I know Victoria does as well. And we've managed to keep that broadly flat. And although you may see a tick up this year, if we continue to invest very sensibly in our digital journey for the future, you know, that would be what I would want to draw your attention to.

Unfortunately, you know, cost to income is so influenced by the income line, it's very influenced by fair value gains and losses on hedging activities as well. I know some of our competitors exclude that from their underlying results. But it's such a close part of our business, we're hedging our business, we're not comfortable doing so. But I think that's the line to watch.

Andy Golding, Group CEO
I'll just add a couple of lines on the sustainability of India. And then and then conscious of time, we'll open up to people who are dialled in to see if we have questions from the phone.

But I mean, what you get is kind of what you input in things like the India theory. And for us, we have never treated our staff like they're an outsource operation. They're our staff, you know, the warehouse, the office premises could be in Brentwood, it happens to be in Bangalore or Hyderabad.

They're very much part of the Group very much part of the corporate culture. And as a function of that, our level of attrition in India, where the market norm is 30% plus, is much more akin to standard UK attrition.

And if I said to you that the sort of average cost of a graduate or masters qualified member of staff all in in India is still about £9000 a head a year, the significant delta of that cost benefit versus the UK, and we're not churning over a third of our workforce every year through attrition, is actually superb.

April's already managed to message the talent pool and the availability of resources there. But it continues to be a real kind of jewel in the crown of OSB. It really does support the Group in a way which is incredible and has done, you know, since we got it really working properly in about 2013, with the right management structure and the right way in which we organised it.

Actually, despite some inflation in the Indian environment, despite clearly a fair bit of growth in the economy in India, it has continued to serve the Group really, really well, both in customer service terms, but also efficiency and cost terms.

Ibrahim Saeed, JP Morgan
Hello there. Thanks a lot for taking my call. Could you just refresh us on the EIR? Like, how long do you anticipate - from what I understand, effectively, this is on the back book of the segment of mortgages written and will remain in place till that book rolls off. If you could share what the sort of the remaining duration is on that and, you know, what kind of sensitivity we can see as your front book grows?

And then secondly, I notice that there's a decline in your coverage levels – just what's driving that. Thank you.

April Talintyre, Group CFO
Was that the Stage 3 coverage ratios on expected credit losses, your second question?

Ibrahim Saeed, JP Morgan
Yes. Yes, that's right.

April Talintyre, Group CFO
Yeah. It was really the write-offs in the period which I mentioned earlier. So, you know, including that large fraud case where we have successfully sold all the security now. We provided for that in 2020. But the provision and the loans stayed on the balance sheet until we had sold all the underlying security in line with our write-off policy. So, that dropped the coverage ratio on Stage 3. But overall, obviously Stage 3, a small part of the overall balance sheet, the coverage ratio is overall but broadly flat year on year.

On EIR, I'm not sure I fully understood your question. I mean, I think if you're asking about the liability that resulted from the adjustment we made in the first half, when we changed our forward-looking assumptions for how long Precise customers would stay on the reversion rate, that liability will reverse over the life of those loans, but it's a balance sheet movement, not an income statement movement.

And any impact on our new business pricing as a result of - or new business NIM as a result of assuming only five months on reversion is really second or third order to the other drivers of how we price, such as swap spreads, market competition, etc. So, you know, any ongoing impacts of that is very hard for me to really quantify for you, but of course is incorporated into the NIM guidance I outlined earlier, and that overall expectation of an accretive lending margin for the new business we're writing.

I mean, I can't sit here and say one and done, but I mean, I guess what I'm trying to get is we made a behavioural adjustment in the first half, kind of the P&L impact of that behavioural change was done in the first half. Any small impact that had, I think at the time we said, you know, all else being equal, it would reduce front book margin if we assume new business spends five months on reversion as well. It would be about an 11 basis point impact on the net interest margin.

But I also said, of course, we'll take account of that as we price new business going forward. And I think that's perhaps the message I'm trying to reinforce. It's in there. It's in that NIM accretive lending margin.

Ibrahim Saeed, JP Morgan
Understood. So if we just think forward to next year, obviously you're taking that one point impact this year, but let's fast forward to next year. Should I anticipate still seeing a sort of material adjustment next year or every year going forward till that book rolls off or is it just a one-time thing indeed for this year?

April Talintyre, Group CFO
Well, all I can say is that, you know, since we made that adjustment, we have not seen any significant or material behavioural changes from the assumptions we put in place at the half year. So we assumed on average five months across the Precise book. And that's what we've seen since then. And that's what we continue to see.

I think if we do see rates start to fall and if they fall in anger, you might actually expect people to spend a bit longer on that. But, you know, that would be crystal ball gazing. And right now, all I can say is that I think we were pretty spot on and the behavioural data we've collected since then and observed has supported that change we made in the first half.

John Cronin, Goodbody
Okay, thanks. Just one follow up, if I could, on NIM, please. In terms of just disaggregating the '24 guidance, would it be possible for you, April, to isolate the negative drag associated with the change in the cost of retail funds specifically that is embedded in your guidance? And at what point specifically or roughly during FY24 does that stabilise or, dare I say, begin to inflect? Thank you.

April Talintyre, Group CFO
Well, I hope, listen, I mean, all I can say, I think if you want to disaggregate it, sort of look at the sort of relative size of the bars that we haven't put specific numbers on it. But I think we've tried to make the size of the bars kind of broadly reflective of how each of the components contribute.

I can tell you certainly year on year, we expect the impact of the debt issuance to be around 12 basis points. But I'm sure you could probably do that maths as well. And, you know, I think it will - it's not going to be over in the first half. I think it's going to be over - the retail savings recycling - it's going to be over, you know, in the fourth quarter, if that helps. Just looking at the duration of the fixed deposit book.

Andy Golding, Group CEO
Okay, we are we are at 10:31. If there's any one remaining with a burning question in the room, happy to take it as long as it's not too tricky, then I'll hand it to April. Otherwise, thank you very much for your time. And nice to see you all as always.