Nationwide Building Society Interim Results 2022/23 Presentation

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

Nationwide Attendees:

Debbie Crosbie, Chief Executive

Chris Rhodes, Chief Financial Officer

Muir Mathieson, Group Treasurer

Robert Gardner, Chief Economist

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Introduction

Debbie Crosbie

Chief Executive, Nationwide Building Society

Welcome

Good morning, everyone, and thank you for joining us for Nationwide Building Society's Interim Results Call. I'm Debbie Crosbie, Chief Executive. And with me on the call today are Chris Rhodes, our Chief Financial Officer; Muir Mathieson, our Treasurer; Robert Gardner, Nationwide's Chief Economist.

Agenda

So I'm going to run through the highlights of the period and provide a brief strategy update before handing to Chris, who'll take you through the numbers for the six months to 30th September. I'm going to keep it brief so that we'll get plenty of time to respond to any questions that you have.

2022/23 interim period highlights

So Nationwide has again delivered a strong financial performance, and our mutual model means that we can continue to support our 16 million members through the current economic uncertainty. We've reported profits of £980 million due to growth in income, driven mainly by rising interest rates. This has meant that we can further strengthen our capital and leverage positions.

We continue to deliver competitive products, high quality services and great customer experiences. We've remained number one for satisfaction amongst our peer group. We successfully grew our mortgage and deposit balances, and we continue to attract new current account members, demonstrating the impact of leading on value and service.

Chris will take us through the financial highlights in more detail shortly. But first of all, I thought I would touch very briefly on our cost-of-living support and our Strategy Refresh.

We've responded proactively to the cost-of-living crisis by extending our branch promise until 2024 to provide practical in-person support for our members, and we've also launched our new dedicated cost of living telephone help line, which does the same. We've also been very careful to make sure that we deliver real value and reward to our members, and we're doing this with tailored and competitive products, particularly for savings, mortgages and current accounts. We've maintained our mortgage lending through the recent disruption and recently moved our switcher rates to below 5% for our current members.

We remain committed to our mutual model

We were able to pay this level of support because our mutual model provides us with opportunities that aren't available to many other financial services providers in the UK. Mutuality will remain core to our Refresh Strategy. It's central to delivering a distinctive experience for our members today and in the future. This also means we can secure change for the good of society with our social investment activity, our community charity boards and the partnership that we have with Shelter.

Our strategic framework will set us up for further success in the future

Our mutual purpose is at the heart of our strategy. We want Nationwide to be considered the number one choice for personal financial services, and we will build member value, service excellence and operational excellence around it. We also want to build upon our reputation for great customer service.

Branches will continue to be part of our approach. We're also going to develop our digital capability so that members benefit from round the clock convenience as well as access to personal support when they need it most.

Over the strategy period, we will grow sustainably by attracting more members and deepening the relationships that we have with existing members. Service excellence will go hand-in-hand with our operational excellence, delivering simple, streamlined and flexible member experiences grounded in resilient controls that protect our members and their money.

So I'm now going to hand over to Chris, who's going to take you through the numbers.

Financial Review

Chris Rhodes

Chief Financial Officer, Nationwide Building Society

Financials

Thank you, Debbie. Good morning, everyone. Over the last six months, we have been focused on supporting our members with great value products and investment in services that ensure they can get the advice and support they need through these challenging times.

During the first half of this year, we have seen profits increase as a consequence of Bank of England base rate rises. Provisions for expected credit losses are elevated due to the uncertain economic environment with coverage levels just below those seen at the height of the COVID pandemic.

We have continued to strengthen our balance sheet and now have a leverage ratio of 5.8% and a 12-month average LCR of 179%.

Net interest income growth has led to an increase in profit

So turning to our financial performance. Underlying profits are £980 million compared with £850 million a year ago. Statutory profit is £11 million lower than underlying profit due to below-the-line hedging items.

Total income was 16% higher, largely reflecting improved savings margins following base rate rises. Other income reduced by £53 million due to the non-repeat of investment gains seen in the first half of last year.

Operational costs are £58 million higher as a consequence of higher inflation and investment in services to support our members. We expect total cost growth in the second half of the year to moderate.

Asset quality remains strong with stable arrears and forbearance levels during the period. The impairment charge of £108 million reflects the deterioration in the economic outlook as well as an increase in model adjustments to recognise the impact on borrower affordability of rising inflation and interest rates.

The charge for other provisions was £19 million compared to £53 million in the prior year, reflecting ongoing remediation of legacy member process. Member financial benefit improved to £320 million for the half year and is now tracking above our £400 million annual target.

We maintain a low risk, strongly capitalised balance sheet

The balance sheet is 3% larger than the year-end, reflecting an increase of £5.5 billion in mortgage balances and a £3.3 billion increase in liquidity, partially offset by a reduction in other assets. Deposit growth of £3.2 billion reflects ongoing current account inflows on a good performance in our traditional deposit franchise. Our stock market share of deposits was 9.3%.

Our cost of retail funding, including current accounts improved during the period as a consequence of the base rate rises. Our average member deposit pay rate is 91 basis points. This is 45 basis points higher than the market average deposit rate compared to 10 basis points 12 months ago, reflecting our higher pass-through of base rate changes.

Capital ratios remained strong. The CET1 ratio increased to 25.5% and the leverage ratio increased to 5.8%.

Net interest margin driven by improved retail funding margins

Income increased compared to the same period last year as a result of higher retail savings margins and the timing benefit of base rate changes. Approximately, 50% of the change in base rate has been passed through to our retail deposit base, including current accounts, and approximately 60% when looking at retail variable savings. This compares to a market average for total deposits of approximately 20%. The mortgage market continues to be highly competitive, placing downward pressure on net interest income.

Mortgage market competition persists, though rate rises support deposit margins

During the period, the margin on the mortgage book reduced to 151 basis points, reflecting ongoing competition for both prime and buy-to-let mortgages. Mortgage margins are now below pre-pandemic levels. Completions in the first six months of the year recorded a margin of 101 basis points, whereas the current new business margins are 114 basis points. And the pipeline of new business expected to complete over the coming months has a margin of 68 basis points.

In the second half of the year, mortgage book margins are expected to decline at a similar pace to H1. Deposit margins improved by 48 basis points during the period as a consequence of base rate rises. We expect this margin moderation to continue into '23, '24 with ongoing mortgage competition.

Costs increase due to the inflationary environment and targeted investment spend

Costs, excluding restructuring, increased by £58 million, of which £29 million reflects inflationary impacts, including a £15 million cost of living payment for colleagues alongside incremental investment in member-facing services.

Restructuring costs increased by £23 million, reflecting decisions we have made to reduce our property estate, which will reduce future running costs. These have been offset by a reduction in historic fraud losses.

Greater economic uncertainty has increased provisions in the period

The cost of risk in the half year has increased to 5 basis points, an annualised equivalent of 10 basis points, reflecting the increasing economic uncertainty and the affordability challenges presented by higher inflation and interest rates. This compares to an annualised cost of risk before the pandemic of 6 basis points.

We have included model adjustments in our expected credit loss assessment to reflect risks that we do not believe are captured adequately in our core models.

Firstly, arrears levels remained low, and some of this is judged to be temporary as a consequence of support provided during the pandemic. We retain a £51 million provision to this risk. The increase in inflation to levels not seen for 30 years creates a risk that may not be adequately captured in our IFRS 9 models.

As a consequence, we continue to hold a model adjustment to reflect the impact of rising inflation on those borrowers most exposed to the cost-of-living challenge. This has been refreshed to include higher inflation and higher wage growth but we have also looked at payment shock and included an expected credit loss of £16 million for those accounts rolling off fixed rates in the next two years. This total provision is now £124 million.

We also continue to hold a provision of £26 million for cladding risk.

Strong asset quality sustained over the period

Arrears and forbearance levels remained stable and below pre-pandemic levels. Mortgage three months plus arrears fell slightly to 32 basis points compared to the industry average of 72 basis points. Three months arrears on the unsecured portfolio rose slightly to 128 basis points but remained below the 132 basis points recorded in December 2019.

Based on the economic outlook and continued cost of living pressure on borrowers, we expect arrears to rise in the coming months. The average stock LTV reduced to 51% over the period, reflecting the strong housing market.

Mortgage refinancing profile

As part of our assessment of expected credit losses, we have looked at upcoming fixed rate mortgage maturities and use the model adjustment to reflect the risks associated with possible payment shocks. We thought you might like these charts.

They show that over the next 12 and 24 months at 22% and 43%, respectively, of the total book will roll off from a fixed rate. The average pay rate for maturities over the next two years on the prime book is around 2%. Whilst these mortgages were originally stressed to a pay rate of circa 6%, we do assume there will be an increase in the 12-month probability of default as they mature.

Assuming they move on to a new fixed rate of 6%, the probability of default increases somewhere around 27 basis points to 88 basis points. As described earlier, this results in an additional expected credit loss of £16 million, reflective of the low LTV of these accounts. Only

5% of these prime accounts have an LTV greater than 80% with only 0.4% above 90% LTV. We only offer buy-to-let mortgages up to 80% loan to value.

The economic environment has deteriorated, with the outlook uncertain

The economic outlook continues to be uncertain and has deteriorated since the year-end. This is reflected in our economic scenarios, which continue to cover a wide range of potential outcomes. Our base case scenario is 45% weighted and assumes a small rise in unemployment and broadly stable house prices.

We attach an aggregate 45% probability to our two downside scenarios, which include material falls in house prices as well as growth in unemployment. The upside scenario, which is 10% weighted, is aligned to a rising rate environment with a gradually improving labour market and rising house prices. The weighted average house price assumption across all four scenarios is a decline of 8% by the end of 2024.

We estimate that a further fall of 5% in house prices compared to our weighted average would increase the expected credit losses by around £20 million. We remain cautious about the outlook given the uncertainties that lie ahead.

IFRS 9 staging and provisioning

Total provisions for expected credit losses have increased by £68 million to £814 million since the year-end. Coverage ratio since the year-end have increased by 4 basis points for mortgages and have remained stable at 11.4% for unsecured.

Coverage levels remain elevated and just below the levels seen at the height of the pandemic. The increase in Stage 2 residential mortgage balances is largely due to rising interest rates in the economic scenarios with the buy-to-let portfolio stage allocation being particularly sensitive to interest rate changes.

Rising interest rates also resulted in an increased probability of default for buy-to-let loans in Stage 1, which led to higher model-driven provisions, and hence, higher coverage. We are comfortable with the asset quality of our buy-to-let portfolio, given the LTV profile and the high interest coverage ratios.

We meet current and expected regulatory capital requirements

We remain strongly capitalised. The UK leverage ratio increased to 5.8% and the CET1 ratio increased to 25.5%, driven by retained profits in the period. Our capital resources are in excess of regulatory requirements with substantial buffers across risk-based, leverage and MREL frameworks.

The society holds surplus capital of £5.4 billion to the leverage requirement and £7.7 billion to risk-based requirements. The leverage ratio is expected to remain our tier one binding constraint.

Based on our current understanding of Basel 3.1, our CET1 ratio would be 20% on a fully loaded pro forma basis. I have previously talked about our desire to manage our surplus CET1 capital more flexibly through the ability to repurchase CCDS periodically at our discretion. I am pleased to confirm that we are actively exploring implementing a facility that would enable us to do so.

And we have made an application to the PRA for general prior permission, which is one of the prerequisites. Subject to this permission and completion of internal governance, we are targeting having such a facility available to us from early 2023.

Our liquidity and wholesale funding position supports our financial strength

Our liquidity and funding ratios support our financial strength with a 12-month average liquidity coverage ratio of 179% at the half year. We aim to remain active in wholesale funding markets in both secured and unsecured formats across a range of currencies with an expected total issuance of £8 billion to £10 billion equivalent per annum.

Our plans assume we retain our prudent approach to wholesale funding by targeting maturities beyond the TFSME redemption window. As TFSME drawings mature, we expect to optimise our LCR in the range of 135% to 145%. We continue to ensure our issuance plans reflect credit rating agency requirements for loss absorbing capacity.

Thank you. We'll be now happy to take your questions.

Q&A

Sarah Abercrombie: Thank you, Chris, and good morning, everyone. We've already had some questions. But as a reminder, please send any questions you may have via the Q&A function on your screens. So our first question is from Lee Street and there are two parts to it. So firstly, really helpful to hear plans for CCDS, but given the very high capital ratios, for Chris, interested in whether you have a maximum leverage ratio target. And for Debbie, could you please share your thoughts on M&A, including consolidating smaller building societies?

Chris Rhodes: So Lee, in terms of a maximum leverage ratio, no, we don't. But let me explain how we look about our capital position. We aim via stress testing to the Bank of England stress test as well as our own stress test to keep a CET1 or total capital level above MDA threshold at the absolute peak of the stress, and that becomes our binding capital management strategy. The leverage ratio is the number that flows from that, albeit, we are clearly sitting on excess at the moment. You can see the strength of our performance in both SS or the solvency stress test at '21 and the ACS of '19.

Debbie Crosbie: Okay. So I'd just reiterate that our immediate focus is on the strategic pillars that I've outlined, which is essentially making sure that we deliver member value and absolutely focused on doing the best job we can with the society that we have today.

However, in the future, there's no question that new capabilities can bring value. My thoughts are that M&A and financial services doesn't often deliver the value that was expected, so we would set a very high bar before we would do anything and it must be something that would deliver a capability that was really about driving longer-term value.

But right now, I just want to reiterate, we're very focused on the society that we have today and making sure that we do the best job we can for our members.

Sarah Abercrombie: Thank you. We've got a question from Alvaro probably for Chris, around the volume dynamics in the mortgage market during October and November, please.

Chris Rhodes: Okay. So right I was going to unpack this. Buy-to-let has seen the biggest impact. Buy-to-let volumes are probably down 75%. Clearly, purchase business in prime is down, but switcher business, i.e., folks booking future deals as they expect to roll off their fixed rates is up. That's what we've seen during the most recent period increase in switches falloff in purchases, but actually the prime market is still relatively good. 75% fall in buy-to-let. The expectation is that will continue for the rest of the year as well.

Sarah Abercrombie: And then we've got some questions from Alistair about the margins in the mortgage market. So I think that the outlook you described, Chris, he's interested to understand what it would mean for the net interest margin outlook.

Chris Rhodes: So, in terms of net interest margin outlook for this year, there's clearly downward pressure from mortgages, but ongoing or potentially ongoing benefit from base rate rises. You will see that our core scenario is for a 4% base rate in early 2023. If that were to transpire using our assumptions on pass-through, the margin in the next 12 months would be broadly stable as the decline in mortgage book margins is offset by the ongoing benefit of base rate changes.

Sarah Abercrombie: Thank you, Chris. We've had a few questions coming in on what you said about CCDS. So Muir, I'm wondering if you could provide any clarification regarding the size of a potential purchase.

Muir Mathieson: Yeah. Thanks, Sarah. So, as Chris mentioned, we, as a mutual, are able to apply for a general prior permission, and we have applied for that with the PRA. The size of that general prior permission is for 2% of our CET1 resources, which as at 30th September equated to £259 million.

Now I will, of course, emphasise that we would not necessarily use the whole of that prior permission but then we could go up to £259 million. And that prior permission is in place for a 12-month period.

Sarah Abercrombie: Thank you. And there's a follow-up question on CCDS, Muir. Can you provide some guidance on when you expect this facility to be available? And will it be an ongoing facility, or will it be time bound?

Muir Mathieson: So, as Chris mentioned earlier, our hope would be that we can conclude internal governance, and we hope that we would get regulatory approval by the end of this calendar year and hence be in a position, should we choose to do anything with this permission to launch in early 2023.

In terms of would it be continuous operation; no is the short answer to that. As some of the people on this call would be aware, we have to operate under Section 9A of the Building Society Act, we cannot be a market maker, so we cannot be a market maker in CCDS. So if we do choose to use this facility and exercise it for CCDS buybacks, then in practice, what we would expect to do would implement a small number of discrete and time limited exercises.

Sarah Abercrombie: Thank you, Muir. A question for Robert, please. Your base case MES looks relatively benign compared to those published by peers. Why are you so confident in the outlook for the housing market?

Robert Gardner: So I'd say the outlook is very uncertain, and that's reflected in the probabilities that Chris described earlier, where we do have significant weight attached to the downside scenarios as well.

In terms of the central scenario, that does still envisage a significant slowdown in activity and house price growth going towards zero. But I think there is a significant chance of a relatively soft landing, given that the labour market is in a very robust position. And the labour market has been resilient to wave of shocks in recent years.

Household balance sheets are also in very strong positions. If you look at net wealth relative to assets and relative disposal income is still very high. Households retain a significant buffer of liquid good assets. And also, they do still have significant protection from interest rate changes in the short term with over 85% of prime mortgage balances on fixed rates.

And obviously, the impact of affordability tests has helped to ensure the households that are refinancing are in a better position to deal with any increases in the outgoing relative to previous periods. And also fundamentally, there's still a constraint in the housing supply in the UK, which would also help to provide support for prices as well.

So as I said, I think there is still a good chance that we do manage to achieve a relatively soft landing but the risks are also clearly skewed to the downside, and that's also reflected across our scenarios.

Chris Rhodes: I guess I'd also point you towards the coverage levels. So if you were to benchmark the unsecured coverage levels, you would see we sit at the top end. If you look at the coverage level of 13 basis points across the portfolio, mortgage portfolio, we're bang in the middle of the pack. And clearly, we've got an arrears position that sits below half the industry average. So I think we remain, with all the mixture of scenarios that we process, really comfortable with the overall level of coverage.

Sarah Abercrombie: Thank you. A similar question. Can you provide a sensitivity of RWA inflation in the context of sort of significant fall in house prices?

Chris Rhodes: Okay. So probably not in a sense that you will have noticed from previous stress tests a significant volatility in risk-weighted assets, driven by the point-in-time models. The step down in our CET1 ratio earlier on – well, at the end of last financial year was driven by the move to our hybrid models. We're still waiting approval from the PRA on the hybrid models, but they will dramatically dampen the volatility of risk-weighted asset growth during a stress.

We've yet to run those models or the – effectively, the hybrid adjustment through the current stress test. So all I can guide you to is a lot less volatility than you've seen before, and all indications would be at the height of the stress, the risk-weighted asset inflation would be lower with the hybrid models than it was with the point-in-time model.

Sarah Abercrombie: Thank you, Chris. I think another one for you, I'm afraid, Chris. Can you give a bit more comfort on the risk profile of buy-to-let in the context of rising rates?

Chris Rhodes: Yeah. So we've given you the chart. Interestingly, you might note, there is no expected credit loss addition from that piece of analysis, largely because of the LTV profile of the book. If you look at that chart, you'll see current pay rates are 2.5%. And whilst it's fair to say, a five-year fixed rate at the moment is 5.5%, we see those – that fixed rate going below 5% in the not-too-distant future.

The reason why I tell you all that is I'm now going to tell you that if I look at the interest coverage ratio – and strike it at 200%, consistent with it being able to afford the mortgage at that kind of higher rate, only 3% of the buy-to-let book that has an ICR below 200% and an LTV above 60%. So a tiny proportion of the book is potentially exposed to rate shock. And that's why the ECL adjustment is zero, but you've got all the data in that slide.

Sarah Abercrombie: Moving on to the deposit side of the balance sheet. Has the 60% deposit pass-through been consistent across the rate increases, or has it risen as rates have moved higher? And how do you expect deposit pass-through to evolve? And following on from that, is there an upper level beyond which you will not let the net interest margin rise above, i.e., where you give a 100% pass-through of higher rates to depositors?

Chris Rhodes: So let's start at the beginning of that. Yes, as we have progressed through base rate rises, the overall deposit pass-through rate has increased. But on average, it's now 60% as we caught that up. Our assumption going forward is it's broadly 60% of base rate rises will get pass-through to retail variable savers.

I think the important context though is actually that's an assumption. The way we manage the book is the other way around, is to look at total market flows, competitive position, we aim for the product set to be delivering value to the members. And therefore, the margin is effectively a solve to on the basis of retaining a very competitive deposit book that meets the needs of funding the balance sheet.

Sarah Abercrombie: Thank you, Chris. When assuming the severe downside scenario plays out with large house price declines, what percentage of the current book is at risk of moving into negative equity?

Chris Rhodes: We'd have to get the calculators out for that. I mean at the moment, the negative equity in the book is £8 million. We will revert on the detailed calculation. It's not compared to previous scenarios, a very significant number, but I will have to get the calculator out I'm afraid.

Sarah Abercrombie: I've got a question on funding plans. £8 billion to £10 billion per annum. Is Nationwide planning to start pre-funding the TFSME maturities? And that's a question for Muir, please.

Muir Mathieson: Yeah. Thanks, Sarah. And the short answer is we already have. So with a guidance of £8-£10 billion of pre-funding per annum, as you can see on the maturity slide, we've got less than that maturing year-on-year. And so we have already begun in that. As we've already said, we already issued since the start of our financial year £5 billion. So we are well on the way to pre-funding TFSME.

The other point just to really emphasise here is that we have not lent all of the TFSME that we borrowed. So we do not need to replace all of the TFSME. So as Chris mentioned earlier, our LCR, which currently sits at 179%, will move back to a more normalised range of 135% to 145% post-TFSME repayments.

Sarah Abercrombie: Thank you, Muir. Chris, can you describe to us the key drivers of Stage 2 loans, especially what causes borrowers to become an up-to-date Stage 2 loan? And how can we think about the propensity to move into a Stage 3 from this point?

Chris Rhodes: Okay. So the reason why you go into Stage 2 is because of a significant increase in the credit risk versus the credit risk at origination. And as you see, as you look at the Stage 3 – Stage 2 table, the vast majority in there is not in arrears. Therefore, it's subject to a significant credit risk.

There’s a number of qualitative factors that drive that, but the two most significant are a doubling of the origination PD or an absolute PD greater than 75 basis points, which will move our performing loan into Stage 2. The move through to Stage 3 is a mixture of default, i.e., 90 days plus or more in arrears. So you hit the 90 days point, you go into Stage 3.

Forbearance, longer-term forbearance would drive you into Stage 3. And then other indicators, for example, if you've got a borrower who is paying, but there is a bankruptcy marker via the credit bureau, that would put them into Stage 3 as well as the default.

Sarah Abercrombie: Thank you, Chris. There's a question about the deposit market. So can you give your view of the trends on this markets and whether you expect competition to intensify?

Chris Rhodes: Yeah. So, as you will note, if you picked the numbers in detail; the market share fell very slightly from 9.4% to 9.3% or perhaps more accurately 9.38% to 9.33%, largely driven by the impact of JP Morgan Chase in the early part of our half year. And the second part of the half year, we've done really well. Flow share, for example, in August was 9.6%. We think competition has levelled out. The current pricing we've got with our 60% pass-through is really competitive, and we are now seeing excellent inflows.

Clearly, that's in the context a slightly slowing growth in the deposit market, but at the moment, we remain very positive about our relative position, both in terms of flow and value back to members.

Sarah Abercrombie: Thank you, Chris. We don't seem to have any more questions at the moment. So as a reminder, if you have any questions, please put them into the chat function on your screens. I've got a question about the buy-to-let market. Can you talk about the future of this market in the context of rising rates and legislative changes, please?

Chris Rhodes: Yeah. So look, I think in terms of new investors, if you like, your profit and loss account looks very diminished compared to what it would have looked like prior to the rate rises, which is why, broadly, I think we've seen the 75% fall in volume. So I think there's a set of challenges around future growth at this interest rate level and whether people will enter the buy-to-let market.

From an affordability and credit point of view, I think I've gone through the numbers that says we are comfortable ultimately with the buy-to-let credit quality, but I think new business flows will remain depressed. And I think that – there's a slightly bigger social issue there in the sense of private rented sector be roughly one in five of all properties in the UK.

A falloff or an exit of buy-to-let mortgage – buy-to-let investors with mortgages, which is where the pressure flows, will potentially put even more pressure on to rent rises. So I think we're in an interesting dilemma at the moment where buy-to-let investment for new investors doesn't work.

Sarah Abercrombie: We’ve got a question from Alastair Ryan asking about in the context of the mortgage margin guidance given, why would we be writing business at such a low margin?

Chris Rhodes: So, as you will see, Alastair, the current pipeline is between 60 basis points and 70 basis points. On a marginal return on capital basis, that remains good. And when you take into account the overall shape of the margin and the cost of funds of retail, that enhances the overall society return as well. So I think as we have said previously, 50- 60 basis points, you still make a good marginal return on capital.

Sarah Abercrombie: Thank you. I've got a question about the distribution of our outstanding mortgage and consumer credit book across household income profile. I don't know whether that's one for Robert or Chris.

Chris Rhodes: I'll start and then maybe Robert or Muir can add. Look, the natural credit policies that the society adopts and the natural profile of homeowners, which is not just the society as the market as a whole, will drive our overall demographic profile of those who have credit to be towards the higher end because that's how you get through the affordability. In lots of ways, focus on average or below average earnings will not be able to afford mortgages and/or unsecured credit.

Sarah Abercrombie: Thank you, Chris. A question on the pension fund for Muir. Given market volatility, how is the society's pension scheme positioned? And are there any matters you draw to our attention at this point?

Muir Mathieson: Yes. So as we've disclosed in our interim results, Nationwide did provision £400 million of a short-term loan at arm's length to our pension fund. And the Nationwide pension fund, our DB scheme, which is now closed to new members, is a very solvent fund. It's very well-funded, and they have plenty of liquidity and did not need that liquidity from the society, but the trustees of the pension fund want to run a very prudent fund and wanted to build in significant additional headroom above the peak in gilt yields that we saw in October.

And so, in order to have that significant surplus for much, much higher gilt yields and real yields than we saw at the peak of the market turmoil, we provision them with actual term loan. Since the half year end, the fund has already returned over £100 million of that loan back to the society as they are converting longer-term assets into liquidity.

Sarah Abercrombie: Thank you, Muir. Another one for you. Has the recent change in interest rates impacted the society's structural hedging strategy?

Muir Mathieson: No. Our structural hedging strategy is very programmatic, so we tend to hedge – we do hedge one 60th every single month. So we have a five-year rolling caterpillar hedge against our current accounts and reserves and CCDS. So an average duration of two-and-a-half years. And just to remind everybody, the purpose of a structural hedge is to smooth income through the interest rate cycle. So as interest rates fall, our profitability will decline more slowly. As interest rates rise, our profitability will rise more slowly.

And so we have smoother earnings through the cycle. And so the disclosures we've got in the appendix to the investor presentation today, you'll see that we're achieving slightly lower income than compared to prevailing SONIA rates as of today half year on half year. So the hedge is doing exactly what it is designed to do that is smoothing through the cycle. We do not take directional views on interest rates in Nationwide. We are here to use – we're here to provision products and services to our members, not to take views on interest rates. Hence, we follow a very programmatic approach.

Sarah Abercrombie: Thank you, Muir. Back to the mortgage book. Can you give a split of the mortgage book between variable and fixed rate and the proportion of two year and five years being written on our book at the moment?

Chris Rhodes: Book is broadly 85% fixed. The majority of that is five-year fixed, but I don't have the percentage off the top of my head.

Sarah Abercrombie: Thank you. There’s a question on interest-only mortgages. And whether if interest rates remain at this high level, we would consider bringing them back? I don't know whether Debbie or Chris, you want to comment on that one?

Debbie Crosbie: So look, I mean we think about interest-only at the moment as a forbearance option, and it can be very useful in the right circumstances, but we want to go through affordability discussions with our members and make sure that, that solution was right for them. In the future, it's not something that's on the pad right now, but we would, as you'd expect, keep a very open mind as to see how things develop.

Chris Rhodes: I mean there's a very small interest-only book. Already, we do small amounts of it but fundamentally for the average borrower needs to be on a repayment basis and interest-only is a good forbearance option, but ultimately isn't the way of buying a home.

Sarah Abercrombie: Thank you, both. A question about savings that were built up during COVID. Have we seen this? And what do we expect to happen to those savings pools going forward? For Robert or Chris for you?

Robert Gardner: Sure. So, if you look at the trajectory of household deposit growth at a market level through the pandemic, we've got about an additional £200 billion or so accrued over and above what we would have expected the market to increase by – since the pandemic began. So that's – it equates to more than £6,500 per household. Obviously, it wasn't evenly distributed across households. It’s disproportionately accrued by older wealthier, higher-income households, but it is a significant additional buffer that has sort of accrued over that period, albeit, as I say, not evenly accrued.

Chris Rhodes: I guess it's fair to say, Robert, as we look at the deposit market, we expect growth to slow, but we don't expect the deposit market to go negative.

Robert Gardner: No. As you say, deposit growth has remained actually surprisingly resilient today, given the pressures on household budgets from high inflation. But as you say, looking forward, with those headwinds expected to remain and the labour market likely to soften. So households’ ability to save is likely to diminish.

And also, if the mortgage market slows in line with the housing market, as is likely, that's also likely to act as a dampen effect on deposit growth as credit creation slows as well.

Sarah Abercrombie: Thank you, Robert. There are no further questions that have come in. So I'd like to hand back to Debbie, please.

Debbie Crosbie: Okay. So well, I would just like to thank you all for joining the call, and thank you for your questions. And look forward to talking again soon. Good day.

[END OF TRANSCRIPT]