VANQUIS

Neil Chandler
Vanquis Bank Managing Director

1,587
Colleagues

1.7m
Customers

£173.5m
Adjusted profit before tax

£1,461.5m
Year-end receivables

Certain alternative performance measures (APMs) have been used in this report. See page 237 for an explanation of relevance as well as their definition.

Vanquis Bank is a leading specialist in the large and established credit card market. It has a strong capital base and has access to liquid funds through the resilient retail deposits markets.

Executive summary

Who we are

- A well-capitalised, liquid bank with further capital and funding opportunities
- A leading specialist player in a large, established and growing card market

Current position

- We are better at understanding our customers and what they need
- Well progressed through the recalibration of the model:
  - Persistent debt
  - ROP income attrition
  - Customer and culture

Growth ambitions

- Delivering profitable growth while recalibrating our model:
  - Strong new customer origination engine
  - Credit line increase (CLI) balance growth on strong upward recovery track
  - Credit card innovation (white label partnerships/ self-employed card)
  - Digital programme
  - Cost programme
  - Unsecured personal loans opportunity
  - Leveraging core capabilities in credit risk and data and analytics

Financial targets

- Targeting c.£2bn receivables and c.20%–25% ROE in the medium term

1.1m

active users and 87% of new customers register on the Vanquis Bank app

> "The continuing development of digital capability is an essential driver in delivering good customer outcomes and maintaining the returns of Vanquis Bank in the context of a moderating revenue yield.
>
> **Neil Chandler**

Vanquis Bank – financial performance

Vanquis Bank is a leading specialist in the large and established credit card market. It has a strong capital base and has access to liquid funds through the resilient retail deposit markets. During 2019, Vanquis Bank has continued to make good progress in adapting and changing its business model to changes in regulation and a better understanding of customer needs. As a result, the shape of the income statement is changing, with lower revenue yields being mitigated by lower impairment, increased cost efficiency and managing the balance sheet more effectively to reduce interest costs. Management is making good progress in developing and executing plans to return the business to profitable growth in the medium term with a number of strategic initiatives underway.

	Year ended 31 December		
	2019 £m	2018 (restated)[1] £m	Change %
Customer numbers ('000)	**1,720**	1,773	(3.0)
Year-end receivables	**1,461.5**	1,495.1	(2.2)
Average receivables[2]	**1,459.9**	1,507.4	(3.2)
Revenue	**580.9**	644.9	(9.9)
Impairment	**(198.9)**	(241.6)	17.7
Revenue less impairment	**382.0**	403.3	(5.3)
Revenue yield[3]	**39.8%**	42.8%	
Impairment rate[4]	**13.6%**	16.0%	
Risk-adjusted margin[5]	**26.2%**	26.8%	
Costs	**(177.1)**	(176.4)	(0.4)
Interest	**(31.4)**	(36.0)	12.8
Adjusted profit before tax	**173.5**	190.9	(9.1)
Exceptional items[6]	**12.4**	—	n/a
Statutory profit before tax	**185.9**	190.9	(2.6)
Cost income ratio[7]	**30.5%**	27.4%	
Return on assets[8]	**10.4%**	11.1%	
Return on equity[9]	**32.4%**	44.0%	

1 2018 comparatives have been restated for the change in treatment of directly attributable acquisition costs following a refresh of contractual terms with affiliates in 2019 – this has resulted in a £6.6m increase in 2018 profit before tax, a benefit of £10.5m to 2019 profit before tax and is expected to result in a reduction of approximately £6m in 2020 profit before tax compared with previous plans.
2 Average of month-end receivables for the 12 months ended 31 December.
3 Revenue as a percentage of average receivables for the 12 months ended 31 December.
4 Impairment as a percentage of average receivables for the 12 months ended 31 December.
5 Revenue less impairment as a percentage of average receivables for the 12 months ended 31 December.
6 Represents a net exceptional credit of £12.4m (2018: £nil) comprising: (i) an exceptional credit of £14.2m (2018: £nil) in respect of the release of provisions established in 2017 following completion of the refund programme in respect of ROP and a re-evaluation of the forward flow of claims that may arise in respect of ROP complaints more generally; and (ii) exceptional restructuring costs of £1.8m (2018: £nil).
7 Costs, before exceptional items, as a percentage of revenue for the 12 months ended 31 December.
8 Profit before interest after tax as a percentage of average receivables for the 12 months ended 31 December.
9 Adjusted profit after tax as a percentage of average equity for the 12 months ended 31 December. 2018 average equity has been restated as though the £50m of rights issue proceeds injected into Vanquis Bank in April 2018 had occurred on 1 January 2018.

Vanquis Bank – financial performance continued

Vanquis Bank's adjusted profit before tax reduced by 9.1% to £173.5m in 2019 (2018 (restated): £190.9m). The reduction in adjusted profits mainly reflects the continued moderation in ROP income of approximately £20m and 2018 benefiting from the release of £10m of remuneration-related accruals as a result of the business performing below expectations throughout 2017 and 2018. These adverse variances were partly offset by an improved impairment rate, tight control of costs and a reduction in interest costs. Vanquis Bank's statutory profit before tax reduced by 2.6% to £185.9m (2018 (restated): £190.9m), a lower rate of reduction than adjusted profits. This reflects the benefit of an exceptional provision release of £14.2m (2018: £nil) in respect of the ROP refund programme partly offset by exceptional restructuring costs of £1.8m (2018: £nil).

Demand for Vanquis Bank's credit cards continues to be strong. Despite tighter underwriting standards, including the withdrawal of the 69.9% APR product, and the implementation of revised affordability processes which have reduced new booking volumes by approximately 25%, new customer bookings of 369,000 were 3,000 higher than last year and ahead of management's plans. This reflects the benefit from the implementation of the new underwriting engine towards the end of 2018 which has enabled Vanquis Bank to enhance the customer onboarding journey. This includes the full roll-out of soft search pre-application for all channels and the pre-approval and pre-population for all affiliate channels, both of which have resulted in an improvement in application completion rates.

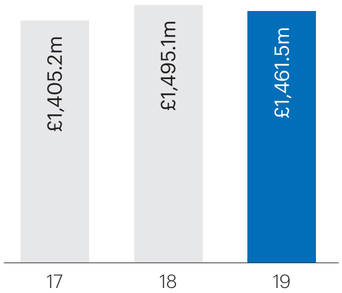
Despite strong booking volumes, customer numbers ended 2019 at 1,720,000, 3.0% lower than last year (2018: 1,773,000). The year-on-year reduction reflects the closure of approximately 65,000 inactive customer accounts in the fourth quarter in order to manage contingent risk if there is any deterioration in the economic environment and the sale of 56,000 customers on payment arrangements during the year.

Receivables ended 2019 at £1,461.5m, a 2.2% reduction on December 2018 (2018 (restated): £1,495.1m), and compares with management's internal plan of delivering broadly flat receivables in 2019. The reduction is consistent with recent Bank of England industry data showing that credit card customers repaid more than they borrowed in November and December 2019 and, in the case of Vanquis Bank, includes the greater than expected impact of changes in regulation in respect of persistent debt remedies and revised affordability processes.

In response to the FCA's definition of persistent debt within the Credit Card Market Study (CCMS), Vanquis Bank has introduced a number of measures including: (i) increasing minimum payments due in the last quarter of 2018 and communicating higher recommended payments in early 2019; (ii) placing restrictions on the credit line increase programme; and (iii) implementing a number of communication strategies during 2019. At September 2018, approximately 11% of active Vanquis Bank customers were up to date but met the definition of being in persistent debt (including customers in arrears and in payment arrangements this increases to 15% of active customers). The business has been actively working with these customers with a view to removing them from this position in advance of March 2020, which is the first 36-month checkpoint after which customers who still meet the definition of being in persistent debt will be offered a way to repay their balance in a reasonable period of no more than four years. Management anticipates that approximately 2% of the September 2018 cohort of customers will still meet the definition of persistent debt at March 2020. Vanquis Bank continues to proactively work with the remaining customers in advance of March 2020 as well as those customers who have met the definition of being in persistent debt after September 2018.

Year-end receivables

£1,461.5m



Vanquis Bank, consistent with the rest of the Group, implemented revised affordability processes in November 2018. Together with the impact of not extending credit to those customers meeting the definition of persistent debt, this has resulted in a reduction in the level of further credit extended to existing customers under the credit line increase programme. Credit line increases in 2019 were approximately 35% lower than in 2018.

Revenue has shown a 9.9% reduction to £580.9m in 2019 (2018 (restated): £644.9m) compared with the 3.2% reduction in average receivables. The revenue yield has moderated from 42.8% (restated) in 2018 to 39.8% in 2019 due to three factors. Firstly, there was a further decline in the penetration of ROP within the customer base following the voluntary suspension of sales from April 2016. This resulted in a year-on-year reduction in ROP income of approximately £20m. Secondly, there has been some further moderation in the interest yield from: (i) a modest increase in the mix of nearer-prime customers; (ii) downwards repricing of higher APR accounts where the customer has improved their credit standing; and (iii) balance reductions applied to accounts as part of the ROP refund programme were typically at higher APRs. Finally, there have been some changes to the basis for charging late and over-limit fees to customer accounts.

The ROP refund programme was completed during March 2019 and the FCA has confirmed that the programme is now closed. There has been no material change in the level of complaints arising in relation to ROP following the announcement of the settlement in February 2018. Accordingly, following completion of the refund programme and a re-evaluation of the forward flow of claims that may arise in respect of ROP more generally, £14.2m of the provision originally established in 2017 has been released as an exceptional credit in 2019. The remaining provision held in the balance sheet of £11.7m (2018: £45.7m) reflects management's revised expectation of future claims which may arise in respect of ROP more generally together with sundry costs of dealing with those claims.

Delinquency trends showed a favourable movement compared with last year due to a shift in mix towards better quality customers. In addition, the second half of 2018 was adversely impacted by the impact of enhanced forbearance and an increase in minimum payments due in response to persistent debt regulation which resulted in a step-up in payment arrangements which has not been repeated in 2019. Accordingly, the impairment rate in 2019 has reduced to 13.6% of average receivables compared with 16.0% in 2018. Underwriting standards have been progressively tightened over the last two years which, together with the historical resilience of the business model, means that Vanquis Bank is well positioned if there is any deterioration in the UK economic environment.

The risk-adjusted margin has moderated from 26.8% (restated) in 2018 to 26.2% in 2019, reflecting the reduction in the revenue yield substantially offset by the improvement in the impairment rate discussed above.

Costs have shown a modest 0.4% increase to £177.1m in 2019 (2018 (restated): £176.4m) with cost efficiency remaining a strong focus for Vanquis Bank. The stable cost base has been delivered despite 2018 benefiting from the release of approximately £10m in respect of share-based payment, incentive and bonus arrangements as a result of the business performing below expectations throughout 2017 and 2018.

Interest costs of £31.4m have reduced by 12.8% during 2019 (2018: £36.0m) due to the reduction in Vanquis Bank's blended funding rate, after taking account of the cost of holding a liquid assets buffer, from 3.5% in 2018 to 3.0% in 2019. This reflects the impact of Vanquis Bank repaying its intercompany loan from Provident Financial and becoming fully funded with retail deposits in November 2018. The intercompany loan represented a higher cost of funding for Vanquis Bank.

Vanquis Bank's return on assets has reduced to 10.4% in 2019 (2018 (restated): 11.1%) due to the moderation in the risk-adjusted margin partly offset by cost efficiency. Return on equity has reduced from 44.0% (restated) in 2018 to 32.4% in 2019. This primarily reflects the rebuilding of the equity base following the implementation of IFRS 9 on 1 January 2018 (which resulted in a £111.4m reduction in equity) and the ROP refund provision reflected at the end of 2017 (which resulted in a £178.0m reduction in equity). Vanquis Bank's return on equity is expected to moderate to the Group's target range of between 20% to 25% over the medium term reflecting: (i) the average equity base stabilising; and (ii) the risk-adjusted margin reducing to between 23% to 25% due to the ongoing reduction in ROP income and the impact of downwards repricing and fee changes implemented in 2019.

Vanquis Bank paid a dividend to Provident Financial of £80m in February 2020.

Vanquis Bank – growth initiatives

Vanquis Bank's medium-term target is to deliver £2bn receivables (currently £1.5bn) and an ROE of between 20% to 25%. In addition to growing and developing the core credit cards proposition, the business is pursuing a number of strategic initiatives to deliver these targets.

Loans

The focus of the Vanquis Bank loans proposition has so far remained on providing unsecured loans to existing credit card customers and the loans receivables book ended 2019 at £28.9m (2018: £26.0m). Volumes have been kept at modest levels during 2019 as Vanquis Bank has been preparing for a relaunch of the loans proposition, leveraging the capabilities of both Vanquis Bank and Satsuma, in order to provide a joined-up range of online unsecured lending products. The unsecured loans market remains attractive for Vanquis Bank to expand into with over £1bn of credit issued each year and approximately 12% of Vanquis Bank customers already having a loan from another provider. To capitalise on this opportunity, a new Director of Loans has been appointed and a new business and financial plan has been developed based on price points up to 59.9%. The medium-term aim is to grow to a receivables book of £150m, based on serving both Vanquis Bank customers and the open market.

White-label credit card partnerships

The way in which customers are researching and applying for credit cards is evolving mainly due to digitisation. Growth in traditional direct marketing channels has slowed as more customers are choosing to source credit cards through affiliates and aggregators. Vanquis Bank is very active in this area and has formed strategic distribution partnerships with key players, widening distribution reach and obtaining attractive acquisition costs. There is the opportunity for Vanquis Bank to develop this further by establishing white-label credit card partnerships with affiliates, leveraging the affiliates brand and digital marketing specialism with Vanquis Bank's balance sheet, credit decisioning and customer servicing capabilities. Vanquis Bank is working toward launching a new white label partnership in the first half of 2020.

Self-employed ecosystem

Developing a tailored proposition for self-employed consumers also represents an attractive opportunity. There are approximately 5 million adults (and growing) in the UK who are self-employed and Vanquis Bank serves approximately 250,000 of those consumers. Providing the self-employed segment with a distinct card, with attractive and tailored features, represents a good fit with Vanquis Bank's core competencies. The business plans to undertake a test in 2020 and then, subject to satisfactory progress, build out the proposition through 2021 with product enhancements, including the potential to establish a broader, multi-product, self-employed ecosystem, leveraging wider group and third-party partners.

Digitisation

The continuing development of digital capability is an essential driver in delivering good customer outcomes and maintaining the returns of Vanquis Bank in the context of a moderating revenue yield. Vanquis Bank has continued to make good progress in its digitisation programme during 2019. There are now over 1.1 million active users and 85% of new customers register on the Vanquis Bank app. Customers are actively using the app to engage with the business with over 200,000 push notifications being sent out per month and almost £100m of payments being processed via the app. In addition, over 300,000 customers have taken up the option to receive statements via the app rather than receiving the traditional paper copy. Vanquis Bank also successfully introduced a chatbot in March 2019. Historically, one of the most effective channels to contact customers who may be about to miss, or have just missed, payments was via SMS. The chatbot provides a much more interactive way to automate these SMS conversations and now instigates approximately 70% of SMS conversations which has led to improved customer response rates. Both the app and the chatbot are examples of scalable, customer-led concepts that can be developed for wider application and deliver benefits for both the customer, through a better experience, and Vanquis Bank, through cost efficiency. Vanquis Bank's medium-term aim is to deliver operational leverage by maintaining a stable cost base whilst growing the business.

Vanquis Bank – management changes

Neil Chandler joined Vanquis Bank as Managing Director in April 2019 having previously been the Chief Executive Officer of Shop Direct Financial Services and prior to that the Chief Executive Officer of Sainsbury's Bank. The Vanquis Bank Executive Team has been significantly refreshed and strengthened under Neil's leadership with the appointments of a new Operations Director, Chief Risk Officer, Customer Director, Product Director and a Digital Transformation Director.

Robert East joined as Chairman of Vanquis Bank and a member of the group board in June 2019. Robert is also Chairman of Skipton Building Society.

Oliver White, Finance Director of Vanquis Bank, will be leaving the business to pursue other career opportunities. The Board would like to thank Oliver for his efforts over the last three years in helping reshape Vanquis Bank, commencing the cost efficiency programme and the completion of the ROP refund programme, and wish him all the best in his new role. A search for his successor is underway.