Metro Bank FY 2020 Results

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Presentation

Daniel Frumkin

Good morning everyone, and thank you for taking the time in what I know is an extremely busy period for everyone, I promise we'll be significantly briefer than last year, if for no other reason than we're on track, we're delivering what we said we would deliver last February. I will say that I'm getting a bit tired of being stuck in my lower ground floor. It is really time for COVID lockdown to end and for normalcy to return. I have no idea when that will be, and I think the new normal will be different than the old normal, but I genuinely look forward to being able to do this in person.

Turning to the agenda, it's relatively straightforward. Again, you'll hear from me for a bit, then David will walk you through the financial results, and then we'll come back to me for a bit of a wrap-up.

So, this slide is a slide we used last year, and I think the core to this slide really is the upper two bullets under 'Our Strengths.' They remain exactly as they were pre-COVID. We're uniquely positioned as an organisation, that while COVID has damaged the financials in the short term and creates some long-term challenges which I'll come on to, it doesn't change the ability for Metro to be successful. Because for Metro to be successful, we need our tremendous colleagues, beit in-store, Amaze Direct, or in Amaze Central, to do what they do well, to do what they do better than anybody else. And that's look after our customers by being completely focused on customer service, on taking customers and creating FANS. If we do that, we then need to just simply provide more products, provide more options to our existing customer base. That's the strategy.

And we now have 2.2 million customers, up 10% on last year, and it puts us in a place where we can deliver on the strategy, even with COVID. So, listen, I'm not making light of the year we've had. At a personal level, it's been extremely difficult for lots of our colleagues and lots of people throughout the UK. It has been a challenging year financially. It has been a more challenging year financially than we expected. And as you look forward, there are some challenges with rates environments based on the Bank of England reducing the base rate to 0.1% that create a further hurdle for the organisation going forward. But even in the face of those challenges, Metro has stood up, been resilient and has a clear path forward back to profitability and generating adequate ROTE.

Now, it doesn't mean the lower-for-longer rates aren't painful. It doesn't mean that lower-for-longer rates actually don't create some pressures on our negative operating jaws. That being said, what we've effectively done this year is accelerated the asset mix part of our strategy. It was always part of our strategy to do more unsecured personal lending, to do more specialist niche mortgages, to deliver more fee products like insurance. It was always part of our strategy. So, we will still look to create new customers, we will look to generate new deposits. But we've also started to meaningfully get traction on accelerating the asset mix of the bank.

We'll come back to some of the points at the bottom. I just want to end this slide with being very clear that the strategic drivers that we discussed last year are still the strategic drivers for Metro. The strategy we laid out about being more Metro and doing more for existing customers still exist even with COVID.

Turning to the next slide, I don't have much to say on this other than you'll see that for us it still is all about customers, colleagues, and communities. We still strive to be the best community bank in the

UK. And we'll simply get there by being more Metro, by being more of what we already are, by doing a better job for customers by meeting more of their needs. It's who we are and who we want to be.

Now, with that, I'll turn it over to David, who will walk you through the financials.

David Arden

Thank you, Dan, and good morning everybody.

First up, KPIs. We said last year that COVID-19 will deepen the J-curve, and our financial performance reflects this. Excluding the impact of COVID though, the financials are broadly in line with our expectations at this stage of our transformation plan. The underlying loss before tax of £272 million, includes an estimated £124 million COVID impact, principally in the form of increased ECL. The statutory loss of £302 million was further impacted by a number of exceptional items, which I'll come on to shortly.

We continued to deliver for customers throughout a very difficult year, and consequently the business has retained momentum in the core franchise, evidenced by strong account growth and deposits ahead of where we were expecting them to be this time last year.

Liquidity remains high, and capital metrics are well in excess of regulatory minima, given the actions we have taken on the balance sheet. And importantly, the core financial performance of the business really gained momentum in the second half with the underlying loss reducing by more than half. I'll unpack this over the coming slides.

Turning to revenue, whilst the full year is unsurprisingly softer, given the rates environment and multiple lockdowns, I'll focus on the evolution we've seen during the second half.

Net interest income increased 15% half-and-half as we took action on deposit pricing and started the move to a high-yielding asset mix, both of which fed through to NIM. We would expect NIM to accrete further in 2021 if cost of deposits continue to fall and lending mix continues to shift to high-yielding segments.

Fee income recovered materially in the first half; up 39%. This was a combination of increased customer activity, particularly through the summer and the autumn, as well as the implementation of new fee initiatives. The outlook for fees during 2021 will be significantly affected by the path towards the exit from the current lockdown. However, I would anticipate as the country returns to some level of normality, fee income will increase from current levels. Also, and Dan will pick up on this later, as we continue to fill the product shelves, this will provide further incremental fee opportunities.

Turning now to costs. On Run the Bank costs, we have shown strong discipline and cost growth. Whilst the headline increase is 9%, adjusting for new items such as RateSetter and new stores, on a like-for-like basis, cost growth has been contained at 1%. I anticipate that Run the Bank costs will grow low- to mid-single digit in 2021, excluding the annualisation of RateSetter costs. On RateSetter itself, post the purchase of the back book, we will accelerate plans to more fully integrate the business which should provide further opportunities for cost efficiency in 2021.

Looking at Change the Bank spend, we are broadly where we thought we would be at this stage and in line with the parameters that we guided to in February last year. Change spend this year has been primarily focused on infrastructure and regulatory programmes, and whilst this will continue in 2021, we do expect a greater proportion of the expenditure to be allocated to revenue and cost initiatives. Our guidance on the broad Change the Bank programme is unchanged. However, I would anticipate a marginal uptick in expenditure in 2021, over 2020, as we seek to maintain the strong momentum we've built up throughout the year.

Moving onto expected credit loss, pleasingly there has been no material change here compared to when we last spoke. In fact, the macro picture has so far been better than we predicted in June. That said, we believe it is too early to form a definitive view given the ongoing uncertainty and continued government measures to support the economy. As such, we've increased our post-model overlays and post-model adjustments to bring this to a broadly flat position relative to half one, and thereby retaining our conservative position overall. We believe this is fundamentally the right thing to do at this time. Now, provided the economy turns out as modelled, then we would expect the ECL charge in 2021 to be relatively benign, although I would caution that there is still a high level of uncertainty as we head into the year.

Overall, asset quality remains robust. Dan will talk in more detail shortly. But on the graph on the left, you should expect to see a greater proportion of consumer unsecured in 2021 as we leverage the RateSetter platform and brand. And within retail mortgages, a greater proportion will be higher-yielding assets.

On the line chart, we've illustrated the progression of active payment deferrals across the year. At the onset of COVID, we saw a large number of customers taking up the option of a payment deferral. That peaked at 21%. As we progressed through the second half, the vast majority of mortgage customers came off payment deferral and returned to normal repayment terms. It's pleasing to see they were down to just 1% from October onwards. However, there has been a small portion of customers who have required further support in the form of forbearance, which is driving up the uptick in NPLs in H2, which you can see on the right there. This increase was anticipated within our ECL assessment, and we are appropriately holding post-model overlays to manage the impacts of this migration. And before I move on from this slide, I'll also note the positive movement in debt-to-value half-and-half, both in retail mortgages, which is due to HPI indexation and the portfolio sale and the commercial loan book as customers have paid down debt.

Turning now to the balance sheet, we continue to maintain a strong liquidity position, further strengthened by the mortgage disposal, which results in a proforma LCR of 331% and an LTD ratio of 75%. It's clear that the value of liquidity in the market today, given elevated savings balances and ongoing support measures, is less than it was 12 months ago. We intend to reduce liquidity over the medium term. A note on this slide, we are and will continue to utilise TFSME funding as this provides low-cost flexible funding options for the bank.

Which brings me onto deposits. All the metrics are heading in the right direction, but of particular note is that the quality of the deposit base continues to improve. 16% growth in retail and SME balances is strong. And we've seen 7% of ISS switchers choose Metro Bank. So, we're punching above our weight in terms of market share.

The mix shift is positive with 39% of the book now in current accounts compared to 29% last year. Given that the 11% deposit growth is ahead of where we were expecting this time last year, alongside the additional funding that the mortgage disposal brings and the likelihood that some of the BBLSs-related deposits will be transient, absolute deposit growth will be less of a focus for us in 2021. Our focus will be managing both the quality and the cost of deposits.

Cost of deposits themselves fell to 65 bps this year, which are both pricing actions taken and the structural mix of the book. The exit rate on COD was 39 basis points. We would anticipate that continuing to fall into 2021.

Turning to capital, post-completion of the mortgage book sale, our position is strong, and the disposal removed any near-term need to raise MREL. Proforma total capital plus MREL stands at 24.4%. and CET1 is 16.3%.

A few points to highlight here. Given the PRA's recent comments, we are not including the EBA software benefit in management decisions regarding capital going forward. The RateSetter back book acquisition that we announced in January and we expect to complete in April will reduce capital on day one. The precise amount will depend on the level of amortisation in the book at that time. Clearly, though, we expect this to be capital-accretive over time.

We note the change to timing on end-state MREL from 1/1/22 to 1/1/23, and we can confirm that we have until 2023 to implement a HoldCo.

And finally, on this slide, we are currently drafting our response to the Bank of England MREL review discussion paper, but we have no view on the outcome.

Turning to the P&L, I've covered most of these items earlier, and in particular the improvement on half-and-half losses being improved by more than 50%. Looking at the full year loss, £124 million – that's nearly half the loss – is attributable to the impacts of COVID-19. And £96 million relates to Change the Bank costs, which nearly doubled largely because of a lower capitalisation rate.

I also want to take a moment to focus on the exceptional items below the line. On impairment and write-off, the bulk of this relates to the write-off of Old Bailey, the central London office we exited in H1. We've continued to see ongoing remediation costs, principally related to the sanctions work. I would anticipate those continuing into 2021, but they should be at a lower level than we've seen in 2020.

And finally, just for clarity, we have booked the gain and sale of the mortgage book below the line. That's 90%, and we booked the remaining 10% in the early part of 2021.

On the balance sheet, I'll not talk in detail, other than to say it remains relatively simple and highly liquid.

Before I pass back to Dan, a couple of summary points from me. We appreciate that these are another challenging set of financials. That said, we have taken appropriate action to manage the impacts of COVID, the bank's capital position, and to also accelerate the mix shift on the asset side of the balance sheet. The P&L regained momentum in the second half with the underlying loss reducing by more than 50%. We have been, and we will remain disciplined on cost, and we are entirely focused on completing the turnaround and returning the business back to medium-term profitability.

Dan, back over to you.

Daniel Frumkin

Thanks David. So, let's just spend a few minutes going through a few of the strategic drivers that we enacted throughout this year and built on from what we said last February.

So again, this slide is a slide you've seen before. It's been slightly modified, and I think the key to this slide is that the core drivers, the foundation we're building on, continues to be available to us to serve as the foundation for the turnaround. And that is just the exemplary customer experience that we deliver. And again, we're the number one High Street Bank under the CMA results for the sixth time in a row. We're Bank of the Year in Money Age. There is every evidence that our customer service proposition delivered by our phenomenal colleagues be it in-store, in Amaze Direct or Amaze Central continues to resonate with our customers and gives us an opportunity to do more for those customers as we go forward.

To be able to do more for those customers, you heard last year that we need to build out our product offerings. I told the story of the credit card debacle that was my experience. I think that is shared if it was unsecured lending or overdrafts, we just need to get better at meeting more customer needs, and we've made real progress this year in building out some of our core infrastructure, not only on product but on channel as well, by launching business current account opening online, which we think compares favourably with anything in the market, and we've just re-opened business account opening online this week, and we're excited by quickly getting into a multi-director space and being a unique offering in the marketplace. So again, for us, it is really about doing more for our existing customer base while continuing to grow our customer base through exemplary customer service.

Now, we need to get better at channel. We need to invest in digital. We need to invest in the telephone, all of which is understandable given the focus on store investment in the first decade of

Metro's existence. We will continue to leverage the existing store estate. We're going to open two more stores in '21 in Bradford and Leicester, which we're very excited about. But beyond that, we're going to pause store openings for a period of time and continue to invest and develop our existing colleagues in-store and our existing customer base while growing customers throughout our existing footprint.

However, as mentioned earlier, clearly the lower rate environment has meant we've needed to accelerate our asset-led strategy. The bit that's good is we're not turning up telling you what we're going to do, we're turning up telling you what we have done. This isn't a story about oh we realised that rates are going to be lower for longer, we should do something. This is a story about taking action as early as late March, early April to reposition the balance sheet to ensure a return to profitability and adequate ROTE for our shareholders.

So, you can see in the upper left, this strategy of being able to take excess liquidity and invest it in Treasury assets at relatively low risk weights, leverage up the balance sheet and generate a good return on tangible equity is no longer really available to us. With AAA RMBS yielding 40 bps, it's really difficult to see how one can take its excess liquidity and make an adequate ROTE going forward. Therefore, you'll see in the upper right, we meaningfully reduced our pricing on fixed-term deposits. That isn't prospective. That is retrospective. We have already done it. You can see in 2019 that we had 103 basis point differential between Metro Bank one-year, fixed-term deposit pricing and the big four. Today, that's eight basis points. You can see on the bottom left, we'd always talked about entering specialist sort of niche mortgages. It was always part of the plan and we were going to gradually move into that space over the next few years. The reality is with COVID rates biting, we decided to make that transition much quicker, and you can see we went from 90% prime mortgages, 10% specialist niche and turned that on its head, on a dime, actually, and have been running greater than 80% specialist niche mortgages and only 20% prime, really, since most of the second quarter in 2020.

And again, we made the acquisition of RateSetter, a business that I don't think was in our plans to acquire. I don't think we thought it would become available. We made that acquisition, announced it in the spring, and closed it in the late summer. And since we started lending under the RateSetter platform in October, we've done greater than £120 million of unsecured personal lending. To be clear, that is more unsecured personal lending than Metro Bank has done organically since its inception.

In addition, RateSetter not only delivered talented colleagues, a good platform, skills in credit-scoring and decisioning in product management, and agile IT that have been very value adding to the bank. It also delivered a brand and a channel, the aggregator sites, that were never in our plan last February. So, being able to leverage up the RateSetter brand, not only for unsecured personal lending, but most likely credit cards in the aggregator channel is incremental to what we envision for unsecured lending volume going forward. And again, the back book purchase of the RateSetter loans is an opportunistic transaction that will be NIM-accretive and ROTE-accretive.

Turning to the next slide, most of this was covered by David, so I won't spend a lot of time. I just really want to say that not only did we accelerate the strategy we laid out last February, but we did so with real discipline around costs. So 1% cost growth like-for-like, I think, is the lowest cost growth in the history of Metro Bank. Again, we were opportunistic. We purchased the freehold on three properties and took advantage of the changing market dynamics to help the optionality and financials of Metro going forward.

Turning to the next page, again, David covered most of this, but I do want to highlight one thing, and it's on Revenue, the first line, BBLS and CBILS. We did about £1.5 billion, maybe a little more than that, of government-backed lending from a standing start. We did roughly 35,000 BBL loans over a few months, or £1.4 billion in lending. Now again, that's more than 70 times the total SME lending done at Metro Bank since its inception. I don't say that to talk about the past. I say it to talk about the future. We've demonstrated our ability to scale. We've demonstrated our ability to take advantage of a market opportunity. We've demonstrated our ability to meet customer needs. We've demonstrated our ability to do more for our existing customer base in a very difficult environment, all while controlling costs and delivering other inorganic activities. I think it makes it pretty clear we have an opportunity going forward.

This slide is really here at the request of investors and analysts. It was used for the half-year, and I think there's a couple of bits that I'd like to show. One is the drop going into this lockdown wasn't as severe as the drop going into the first lockdown, and some of that January will be seasonal, and you can see we've already started to see a meaningful uptick in activity while we're still in lockdown. The majority of our stores remain busy. We have a significant portion of our footprint still open seven days a week, and we still have the longest hours on the High Street. That activity pickup gives us hope that fee income and other activity-based income will rebound as we come out of lockdown.

So lastly, I think the summary speaks for itself. I'm not going to add much other than a couple of bits, and that is we've had a good year. I know the financials aren't what anybody would hope for, myself included. I know the loss has been impacted by COVID. I know we ate up more capital than we would hope to have done in the first year of the turnaround due to COVID. But we delivered organically against the strategy. We started to build out new products. We started to enhance our digital offering. We've continued to make progress in store. Customer numbers have grown by 10%. We were number one in the CMA results again. It was a good year. Not only have we moved forward with our core strategy, not only have we delivered against what we told you last February, but we also took new inorganic activity and were opportunistic off of the back of the pandemic.

We sold £3.1 billion of mortgages to NatWest. That was a transaction that was good for both parties. Those mortgages, given their yields, are better owned by NatWest. We got a fair price, and one we were quite happy with. We acquired RateSetter from a standing start. We acquired that business in about 60 days. We closed it about 60 days after that. We were up and running and lending under the RateSetter platform within 30 days of acquisition. It's now built into every channel at Metro. You can now borrow money digitally through Metro, which you could never have done before, thanks to the RateSetter platform. It's built into all our stores and will launch once the pandemic starts to lift. It's given us functionality and capability we didn't possess.

We've acquired the RateSetter back book. Again, a transaction that was opportunistic and made good sense for the bank going forward, and we also bought out a few properties from landlords who needed the cash and were happy to do transactions that made sense for them and made sense for the bank.

Lastly, I'll just end with a statement. So, last year I said there was a path forward that returned this organisation to profitability and generated reasonable return on tangible equity for our shareholders going forward. That path still exists. COVID hasn't changed the strategic opportunity available to Metro. COVID hasn't blown us off course. What COVID has done is create an opportunity for us to do some inorganic things that has allowed us to accelerate parts of the strategy that put Metro in good stead going forward.

So, it will be difficult going forward. I will ask a lot of my colleagues. I'll ask a lot of everyone in Metro to continue to drive the organisation forward. But I am confident, more confident today than I was last year, based on the delivery and the transactions we did in the path forward for Metro. So, with that, I will just say thank you for your time this morning, and David and I are happy to take any questions.

Q&A

Benjamin Toms

Good morning, both, and thank you for taking my questions. Two from me, please. Firstly, I appreciate that you've not reprinted your longer-term plans in the presentation, but broadly speaking, do you expect to be profitable by the end of 2024 on a reported or an adjusted basis? If you can't give guidance on this, could you give some colour on what the biggest unknown factors are which are driving the uncertainty? Is it rates or loan losses or volumes or something else? And then, my second question, you gave Run the Bank cost guidance for FY21 of low- to mid-single digit percentage growth. Plus, then, you add on the annualisation of RateSetter costs. So, am I right in saying then, an all-in basis for the year-on-year guidance for Run the Bank costs is roughly in the 8% to 10% range? Thank you.

Daniel Frumkin

Ben, thanks for the question, I really appreciate it. The long-term guidance, the medium-term guidance, we're just not in a place to reconfirm where that sits, and I think you hit the reasons in your speech. We don't know where rates are going to go. The bank's still talking periodically about negative rates. We don't really understand what the macro-economy is going to look like post-the withdrawal of government support that needs to occur over the next few months. So, given that uncertainty, I think it would be imprudent for us to guide and provide any medium-term guidance. But I do want to be clear, there is a path forward that returns this bank to profitability, and I think that path is pretty self-evident off of the performance we did this year and the actions we took to begin to reposition the balance sheet to improve NIM, and then in turn, that NIM will flow through profitability. So, we do see a path. We're just not really willing to guide at a medium-term level because of the uncertainty around rates in the macro environment.

In terms of costs, David, I'll let you pick up the specifics around costs.

David Arden

Thanks, Dan. Good morning, Ben. On Run the Bank costs, we've been very clear that, excluding RateSetter you should expect a low- to mid-single digit in '21. With RateSetter, we acquired the business in mid-September. It added £8 million to our cost base in 2020. When you annualise that, we should get to broadly where you pan out, Ben, although I would say that, as we said in the presentation, once the back book transaction is complete, we'll look to more fully integrate the RateSetter business into the Metro Bank business, and therefore, I would anticipate there's opportunities for cost efficiency there.

Benjamin Toms

Thank you.

Freddie Sleiffer

Hi. Thanks for taking my questions. Firstly, you've given us a lot of colour around unsecured and mortgages. But just curious on your thoughts about SME lending, which was obviously strong in 2020, but how are you expect balances to develop over the year once the government-backed scheme ends and what assumptions are you making around estimate lending in your NIM guidance of slightly up this year.

And then, sort of tagging on from that, just on risk-weighted assets, wondering if you can give us some guidance as to the progression you expect over the next year or two years, even. Obviously, the mortgage book is rolling off, but then the unsecured book will be at a higher risk weighting, I'm assuming, but that's only a two-year book. So, if you could give us a sense as to how to think about the headwinds and tailwinds to risk-weighted assets, that would be very helpful.

Daniel Frumkin

Sure, thanks Freddie for the question. I think SME-lending is an important part of the foundations we're building. So, I think the infrastructure we built around BBLS lending is being morphed into what I would call a standard sub £250,000 SME-lending platform that we'll have available through our LBMs, who are present in every store, in our local corporate lending, which we have regionalised throughout the UK. We're hopeful in that space, although I must admit, Freddie, we don't know what lending looks like beyond all the BBLS and CBILS support that customers have gotten.

Our sense is that a fraction of those customers, and maybe not an insignificant fraction of those customers, borrowed money to provide some insulation because they were unsure of what COVID was going to cause in their businesses. So, in terms of demand for lending in that space, we're not sure what we see over the next 12 to 18 months, but we're positioned to take advantage of it.

In terms of the NIM growth, the majority of the NIM growth is driven by the existing SME lending we've done, and then followed up by more unsecured lending and mortgages. We're not really expecting a huge push on the SME side, mainly because we don't think they'll be much demand based off of the government support programmes.

In terms of the RWAs, I think you got it in one. Unsecured personal lending, 75% risk-weighted versus the mortgages that are 35% because we're seeing less bang. So therefore, clearly RWA utilisation goes up as we expand the unsecured lending platform or the SME-lending platform, which would be 75% risk-weighted as well. And we're completely focused on risk-adjusted returns on regulatory capital. So, we will manage the balance sheet and the asset mix of the balance sheet based off of what we believe is the right risk-adjusted return on regulatory capital as we move forward. So, I think you will see the RWA utilisation drift up slightly as the asset mix shifts to unsecured consumer and then a bit of SME.

Freddie Sleiffer

Great, thank you.

Grace Dargan

Hi. Thank you for taking my questions. If I could just ask a couple. So, on deposit repricing, could you give us a steer maybe on the NIM improvement you're expecting from that? And can I confirm whether there is any part of the deposit base yet to reprice, and if so, roughly how much?

And then, secondly, it's good to see the investment in the high-yielding assets. Do you have a time scale for the full reinvestment? And perhaps just tagging on to that, on the specialist mortgages, could you give us a little bit more detail on the market that you're targeting with those specialist niche mortgages and how the spreads compared to your vanilla products? Thank you.

Daniel Frumkin

Sure, Grace. Thanks for the questions. I'll answer in reverse the order if that's OK, and then I'll turn it over to David to talk about deposit repricing and how the base is repricing over time because, obviously, some of the one-year fixed-term money will reprice as we go out through the course of the year.

In terms of the investment in higher-yielding, we hope to continue to build up the unsecured lending portfolio at reasonable pace throughout the course of the year. We're being a bit measured, given the uncertainty in the macro environment at the moment. So, we are top of the Best Buy tables on the aggregator sites with the RateSetter brand, and we think quality is probably more important than volume as we sit here today. But we're pretty pleased with that, and I think if you're modelling it forward you should expect the unsecured lending portfolio to grow throughout the course of the year.

In terms of other activities in the high-yield space, in terms of speciality mortgages, what we're doing, for the last few months, it's really been focused on the 90% loan-to-value product, which as you know, got completely dislocated in the UK during the pandemic, which was an opportunity for us to generate some volume that we're quite comfortable with.

In addition, I think we will be looking at professional buy-to-let, we're looking at things like self-employed, the niches that are pretty well-known and serviced by other really good specialist lenders, an OSB or a Paragon, and they're well-established markets and well established niches that we're going after. So, we're pretty comfortable there's an opportunity for us there, and we have a team in place that really grew up doing specialist lending, so we're quite pleased with the quality of what we've seen today.

And then, David, I don't know if you want to pick up the deposit repricing, in the deposit base, repricing?

David Arden

Morning, Grace. As Dan said in the slides, we're currently just above the average rate for the Big Four. I wouldn't anticipate that we price below the Big Four; I think we will be just slightly above, but we've still got some of the FTDs to roll through in the first half of this year, and probably a bit into the second half, so that gives us quite strong momentum on further reductions in COD alongside the structural mix that we now see nearly 40% of the book is non-interest bearing, and the variable rates - I think all the pricing action we've taken on the variable rate now, so that structural mix should see us continue to reduce as we go into the new year.

Grace Dargan

That's great. Thank you very much.

Christopher Cant

Good morning, both. Thanks for taking my questions. I'll limit myself to two. I have an awful lot. I know we've got a session on Friday. First one: do you still think you can achieve sustainable profitability at anything commensurate with the return target you were hoping to hit by 2024 without raising fresh equity to support the strategy? You've had an unexpected pandemic hit you, you've had 65 bps of rate cut which you weren't expecting, there's been a bite out of your capital from incremental provisions. I just think the capital glide path looked very fraught when you stated a year ago that you would be able to deliver that without raising fresh equity. I really struggle to actually put numbers in a spreadsheet which get you anywhere close to profitability without needing a fresh equity injection in order to upscale the business. So, just your thoughts around that would be very helpful.

And then on the costs, I was trying to roll together your cost guidance. Obviously there's quite a lot of parts to it, but it looks to me like you're pointing to the Run the Bank costs of 420 million to 430 million, and then with the Change the Bank, it sounds like that's going to be a bit higher. So, are we looking at 530-ish of costs in 2021 in terms of the above-the-line costs that you report, not including the remediation stuff you're still taking below the line? Thank you.

Daniel Frumkin

Chris, thanks for taking the time. I know it's a busy stretch, so I really appreciate you making the time for the presentation, and I appreciate the questions. David, I'll come to you in a second around the costs. It feels like Chris got his numbers about right, as usual.

In terms of the achieving profitability without needing fresh equity, we're still pretty confident, Chris. We think there is a path forward based off of an asset mix shift, a repricing of liabilities, and discipline around costs as we get beyond the transformation plan. So, you need to remember while the Change the Bank costs were elevated this year, and you're right, we think it will be a bit higher next year, the Change the Bank costs. That's because we've been successful in driving more change quicker than we anticipated. It hasn't changed what change we've done.

The list of programmes really were set almost last February, and we're just picking through them with some minor amendments. But for the most part, at some point, that starts to subside, we start to get some cost benefit from that investment, a bit more straight-through processing, a bit more self-serve for our customers, which again, helps on the cost side as we get into the outer years of the plan.

We would think we could build up a reasonably-sized unsecured lending portfolio in line with others in those markets, especially now that we have access to the aggregator sites. And we think the specialty mortgage market is one, given the skills that we possess, that we can do well in, and the combination of all that really becomes quite NIM-accretive. And then with the discipline around costs, I think there's a path to profitability, and I think there is a path to getting to a reasonable ROTE.

Now, we don't know what's next, so I thought your summary was really good, and I wish I would have had it before the Board earlier in the week because it was a better summary than I gave, but the pandemic and the rate cuts and the provisions are things that were definitely headwinds that weren't in the original plan. But even with those, we see a path back to profitability and we see a path back to a reasonable ROTE over a reasonable time horizon. I don't know that we can say much more than that because I don't really know what the next six to 12 months holds, depending on how the macro economy evolves, depending on where rates go, but we do see a path, and the plans we put together as we sit here today, we don't anticipate raising further common.

So, I accept that it might be a point where we disagree, and we can spend some time - I think it's Monday, not Friday, now. I think we've had to move the session to Monday from Friday. We can spend some more time when we're together on Monday and dig through it a bit. I'm happy to spend some time, but we do see a path forward. And David, I don't know if you want to cover off costs?

David Arden

Sure, morning, Chris. You’re right. I think we've been very transparent on the costs. I think the split between Run the Bank and Change the Bank is helpful. We've been very clear on how we anticipate Run costs progressing, and on Change the Bank programme, we’re broadly in line with where we said we'd be this time last year. We had £63 million of OpEx in 2020. Given the strong momentum we've seen in the programme throughout 2020, and as we head into the first part of 2021, I would anticipate the that 63 is slightly bigger in the year.

So, that should give you enough to work through what the outturn will be on the cost base for 2021. I think what we are providing is really transparent and helps you to understand exactly where we're heading on the cost base. What I would say on the Change the Bank is we’re now predominantly OpEx in that change spend, so it's not ballooning out in terms of capitalisation spend, and once the Change the Bank programme is done, that should reduce gradually over time.

Christopher Cant

And in terms of the implications, is the 530 in the right sort of ballpark, allowing for some inflation in that Change the Bank in terms of the above the line cost?

David Arden

I've not worked through the exact maths, but it sounds right when you work it through.

Christopher Cant

That's really helpful.

David Arden

We've been very clear on how we see that progressing.

Christopher Cant

If I could ask one more, and just coming back to the strategy and the equity side of things, you talked about focusing on risk-adjusted returns on RWAs and the challenge faced with liquidity in a low-rate environment. You sold this book of mortgages to NatWest with a yield of, I think it was 2.1%.

If I think about that from a risk-adjusted return perspective, particularly if you are to get IRB down the line, I suspect the revenue to RWA on that, after allowing to normalise cost of risk, would have been higher than the RateSetter book that you acquired because I think there was an 8% yield, but on a much higher risk weight, and obviously that will come with a meaningfully higher cost of risk. So, can I infer anything from that with regards to your expectations on IRB? It's something you didn't touch on in the presentation, or perhaps I missed it, but I struggle a little bit with the risk-adjusted returns comment just because the book you sold would appear to have better post-IRB risk-adjusted returns to me.

Daniel Frumkin

Chris, really fair challenge. So, I think there's a couple of bits. We don't really control IRB. It's up to the regulator to make a determination based on the quality of the submission we make to gain AIRB. Clearly, we're continuing to work on it. Clearly, we've brought in some individuals who are quite skilled in that area to help make progress, but again, the timeline for that is an iterative process working with the regulator into all that, so I don't know the timelines.

But the reality is that, in a future state where we get risk weights that are significantly lower than the 35% then the math you've walked through is relatively straightforward. In an environment where we have 75% risk weights on unsecured personal, and 35% risk weights on resi mortgages, an eight versus a two is a pretty good trade. So, in the mortgages that we sold to NatWest were prime, very prime mortgages, and had a duration, I think we disclosed the duration when we did the trade. I think they had a duration of sub-two years, so I'm not sure what the balances would have been left in a couple of years' time, and we can originate and have an engine that can originate replacement mortgages at pace. So, we thought it was a transitory relationship for a period of time, and not actually that long a duration, so a pretty short period of time. Does that make sense?

Christopher Cant

Yeah, I guess the duration on the RateSetter book that you've acquired is also -

Daniel Frumkin

Pretty short. Yeah, it runs off. But the point is, is that your fundamental premise is that if you go out, let's say, six years, let's just go way into the distance and so we don't get in any medium term guidance. You're six to seven years out, and Metro Bank is a fully accredited IRB institution. Then, you can assume that our asset mix will reflect that as we go forward. But you can assume in an interim state, where actually it will take us years beyond when we get accreditation for the mortgage portfolio, to get accreditation for unsecured lending portfolio and other portfolios because it's a multistage process. You get one piece of it done, and then you apply for others as you move forward. I think that time horizon creates an opportunity for us to trade the business one way now, and then we can pivot to trading in a different way when and if we get IRB.

Christopher Cant

Okay. I understand the logic. I guess the slight concern that raises is back to the first question with regards to sustainability of the capital position. It looks like you're going to be unprofitable at a pre-provision level again in 2021. The capital ratios at the end of the year, obviously above your minimum, but it looks like you're going to be pretty challenged again from an MREL ratio perspective during the course of 2021 if you don't get IRB. So, I understand totally the rationale of the position you set out. I guess I'm just a bit nervous that the assumption that I and, I guess, others have been making around the time that IRB is perhaps a bit optimistic.

Daniel Frumkin

Yeah, maybe. Again, I can't be drawn on that, so we'll see how it unfolds. We can pick it up again a bit more on Monday. Chris.

Christopher Cant

Thank you very much.

David Arden

Thanks, Chris.

Martin Shaw

Hi. Just two questions from me. The first one: on the Stage Two commercial lending book, could you just outline what percentage of that is related to loans through the government schemes? It's obviously had a material tick-up.

The second question: again, flowing back to capital. You're obviously proving that you have the customers, you're generating the product mix. How are you trying to assess when the right timing is to approach markets for - you said you don't need equity capital, but either forms of subordinated capital or equity capital that you need to really drive growth in the asset base to then take advantage of the operating leverage that you're building.

Daniel Frumkin

Martin, I'll do the second part of the question first, and then I'll turn it over to David to talk about the Stage Two and the commercial book.

It's a really astute observation, and I think Chris was being kind in his question a bit because part of the reason the mortgage trade made sense - and again, as you know, you know, Morgan Stanley really helped us with it; they were stars. The reality is that some of it was opportunistic, given the premium we managed to gain on the sale, which alleviated the short-term need for raising MREL or any other instruments.

And the reality is that I fully accept that the turnaround is in a stage that we need to prove that we're starting to turn NIM, we need to prove that the asset mix is coming through, and I think this set of results is good green shoots. We're not talking hypothetically. We've actually done stuff, but we need that to play through. And the longer we can wait before accessing capital markets, fundamentally, the better it is, because I think the story becomes clearer for everybody about the path forward. And so, for us, time's our friend, because we are very confident in where this organisation goes and how it trades going forward. But we need to prove that to more people hopefully before we have to access capital markets.

And David, I'll turn it over to you about the Stage Two in commercial.

David Arden

Hey, Martin. How are you doing? When they look at the commercial book, back in last year, 29% of our commercial customers took a payment deferral. We've seen that 75% have now returned to full contractual terms. 24% of that 29% remain on a payment deferral or other support measures. And we think that's the right thing to do. We said at the half year we would be patient creditors as we think it gets a better outcome for customers and for the bank.

But the ECL position at the full year fully accounts for that movement and those additional support measures we've given our customers. And of the items that's currently in Stage Two, 95% of it remains up to date. So, I think it's still early days, given the government support measures in place, but we are working very diligently with our commercial customers and across the book to make sure that we get the right outcome for every individual customer.

Martin Shaw

So, none of the loans there are loans made under the government schemes. Is that correct?

David Arden

Yes. Because they were not due for repayment yet. Although we have taken from ECL for it, but they're not through the stage process yet.

Brad Golding

Hi, gentlemen. First, a little surprised that you pushed back on the timing on the Holdco. Can you discuss that a little bit more?

Daniel Frumkin

So, Brad, it was off the back of the review that the Bank of England published at the start of the year that gave really everybody, new entrants under the regime an extra year, so that's all it is. There's nothing more to it than that, really.

Brad Golding

OK. So, something that I had inquired about repeatedly because of my position as a sub-debt holder and was told things were continuing to move forward and I guess they are just at a dramatically different pace. I don't want that to sound like a criticism.

Daniel Frumkin

We are doing the work, Brad. There's nothing really there other than we just have a bit more time based on the regulatory guidance.

Brad Golding

OK. And you're going to take that time?

Daniel Frumkin

We may, we may not. We haven’t decided. We're still working through it.

Brad Golding

OK. And I don't want that to sound like a criticism of Luke, who's done a terrific job to, pardon the pun, reset our relationship, and I want to point that out fairly openly.

My next question would be about a more transformational transaction, which would allow you to address some of Chris's earlier comments about equity raise, because I think again as debt holders, we're looking at this and understanding that there are a lot of ways to solve the existing problems, including doing a transaction which allows for purchase discount badwill, whatever you want to call it.

Daniel Frumkin

So, Brad, what I would say is that we continue to be open to transactions, both acquisitions and disposals, that are the right transaction for our stakeholders. And I think we demonstrated that over the last 12 months, and I think we will continue to do the work behind whatever opportunities are presented to us, and it really all comes down to the math. If we can make the math work on a transaction, then we would absolutely consider it. And it's just that simple.

I do hope that there is more confidence that the leadership team and the Board will take action and transact the balance sheet in a way that's in the best interests of stakeholders because I think we've demonstrated that, both for acquisitions as well as disposals. So, if the right transaction comes along and the math works, we would absolutely consider it.

Brad Golding

I'm going to press you on that a bit because in looking through your press release, it looks like in your consumer book year over year has actually dropped, not increased, which when I looked at it, came as a bit of a surprise. So, what is the right transaction? Because you're still moving in the wrong direction here ex whole loan sales and whole loan purchases.

Daniel Frumkin

Brad, a couple of bits. One is the consumer book would have been affected by Zopa run-off because there was an agreement here to buy some flow agreements from Zopa, and actually RateSetter started originating loans in October, but the majority of the £120m has been done since the start of this year, so that you wouldn't see it start to bleed through the financials yet. It's one of the reasons why we need a bit of time to actually start to see the NIM turn and start to see the asset mix shift start to bleed through into a higher NIM.

We're still very happy with the RateSetter acquisition. It's giving us what we thought it would give us in addition to a whole other channel, the aggregator channel, that we never expected to have access to. So again, we're quite pleased with it, but it's early days.

Brad Golding

Unfortunately, I think time may be the one, given the cost base, the one thing, and I think we've all tried to make this point, you don't have. That said, what is the right transaction?

Daniel Frumkin

I don't know. We'll have to wait and see what comes across our desk. I'm not going to get drawn on specifics.

Brad Golding

Of course not. OK, thank you.

Daniel Frumkin

I'd just like to end by thanking everybody for making the time. I know it's a very busy stretch of the calendar, and I really appreciate everybody making time for the investor presentation, and everybody just stay safe and have a great day. Thank you.

David Arden

Thanks, all.