Metro Bank FY 2021 Results

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Daniel Frumkin (CEO)

PRESENTATION

Daniel Frumkin

Good morning, everyone, and thank you so much for joining us. I need to start by apologising to our US stakeholders. I know this timing's inconvenient, but again, it's a difficult choice for us, but we need to look after our UK stakeholders as well. So, onto the presentation. You'll see the first slide actually talks about on the left hand side, there's a clear indication that we're sticking to what has made Metro successful for a long period of time, which is the customer service proposition. So, we're very clear that we continue to stay focused on providing exceptional customer service and creating FANS. Again, the CMA results, we were number one for in-store service on the high street. Once again, we've been recognised by various industry awards, which is always nice, and we continue to grow customer numbers.

I think the middle part of this graph is really important. And we have since 2019 fundamentally changed the shape of the balance sheet. So, you see small business lending, it continues to be a part of what we do, but you'll see consumer lending has grown up to 7% of the overall balance sheet and actually government backed lending has grown to 13% of the overall lending portfolio. Again, not something that even existed when we were in 2019. That has led to meaningful increases in lending yield. And then on deposits, we've reduced fixed term deposits down to about 9% of the overall deposit book by 2021, a significant reduction.

So, what that leads to is you end up with a 61 basis point increase in lending yield over the period and almost a 60 basis point decrease in cost of deposits. So, a meaningful uptick in overall margin. That widening of the jaws in a mere 18 months is really the thing that's driving the transformation. On the right hand side, we sort of do a small tick list. It's not everything, but it gives you an idea of everything we've managed to accomplish. In terms of balance sheet actions taken, I mean the £3.1 billion mortgage sale, the RateSetter acquisition all have had transformative effects on the P&L and the shape of the balance sheet.

Again, we'll talk about AIRB a couple times throughout the presentation, but we're really not going to say much more than the application’s progressing and we continue to work with the PRA in an iterative process.

The legacy issues, we're quite pleased. We put in place in provision today for the FCA investigation. We put a provision in place of £5.3 million. We've made enough progress in that investigation that we're comfortable to put in place a provision. There's still some ongoing work to be done. It will still take a few months before it's finally resolved. We continue to work closely and collaboratively with the FCA and are comfortable the PRA investigation and the RWA issue has been closed. And it's a nice moment to put those behind us. It's a nice moment to put those legacy issues behind us and move on with driving the business forward. Again, we continue to enhance IT and resilience, and again, cost growth for us, it's not, I think it might be the first time ever in Metro's history, underlying operational cost decreased in the second half of the year versus the first half of the year, and actually cost went down. Yeah?

So, in terms of near term focus on the path to profitability, you'll see in the upper left a couple of big drivers. Spot head count’s actually down year on year. Averages are still up a bit, but spot head count’s down. The one I'm actually sort of proud of, it doesn't make that big a difference, but it is, it's actually something we strove to do. All of you know we have excess space in the stores. Moving 310 desks into the stores for colleagues to work in store has started to eat up some of that excess space. It makes a small dent, but it is a step in the right direction. Below, the upper left, you will see that we are optimising our property footprint and we announced today we're closing three stores. So, at the end of the day, those three stores had unique challenges to them and we thought it appropriate to close them and move on. I've always said that we would treat the store estate with a cold calculating eye and we will continue to treat the store estate with a cold calculating eye. And if it makes sense to exit stores, we'll exit stores.

However, we're really comfortable with the store estate where it is now post these three closures. We remain committed to stores. We think the service proposition in stores makes sense. We think it's a differentiator for Metro. And as you saw on the previous slide, we're the clear number one for service on the high street in stores. So, I wouldn't take this as an indication we're walking away from stores as the basis for Metro going forward. But if there are stores that need to be exited, we'll do what we need to do for all stakeholders. We've also, as we've said before, exited Old Bailey, and we now have hybrid working environment in our Holborn offices. We have about one desk for every three colleagues. We are improving efficiency overall, as I said, headcount’s down a little bit and we continue to drive forward. We do expect 2022 exceptional costs to be down meaningfully on 2021. So again, we'll get to guidance in a bit, but we really have gotten through the various investigations as well as the remediation efforts and we're comfortable with the exceptionals.

The middle column just shows some activity levels. We are seeing some pickup post COVID. Obviously January was a bit of a tough month given the sort of quasi lockdown, but we've seen real activities bounce back in terms of spending and store activity. On the right hand side, this is all about what we're going to do, which is really just continue to execute on the plan as we've done to date. We are going to introduce some digital products for SMEs in the lending space, which we think will be quite attractive. And we are going to enter the auto lending space under the RateSetter brand. We continue to build up our consumer lending operation as well as our specialist mortgage operation.

We do continue to shrink the commercial real estate book, the transactional commercial real estate book, which we think is appropriate given our strive to improve risk adjusted returns on regulatory capital. So, this slide you've seen before these are the key performance indicators. I think the takeaway from this slide is all the arrows are going in the right direction, except for capital, which I'll come onto next. And the bottom that we put in a box to make it even easier for you, the bottom bullet point is really meaningful. So, if you adjust for the £3.1 billion mortgage sale that we did at the end of 2020, revenue increased 42% year on year, NII increased 56% year on year. I've been doing this a long time, and I've looked at a lot of bank, peer groups, both in the US, the UK and across Europe, I don't remember another bank growing revenue 42% in a year. And we did it the old fashioned way. We changed the shape of the balance sheet. We lent money and we brought down the cost of deposits.

Now onto capital. So, listen capital, we are currently operating within buffers. So, we're now into 2022. We know the EBA software adjustment rolls off, and we knew we lost a quarter of the IFRS 9 adjustment which means we're now operating within buffers. We are very comfortable operating within buffers. We see no problem operating in buffers. As we sit here today, the regulators fully aware of our capital position. They've seen our 2022 budget. They've seen our five year forecast and we continue to work closely with the regulator, but we are very comfortable operating within buffers. And let me be really clear that I understand regulatory capital requirements, but if you look at whether we have sufficient capital to operate the business and you go to any kind of an economic capital model, and for my sins, I started doing economic capital modelling in the nineties. The reality is for a bank that has 9 billion sitting in its treasury portfolio and half its loan book in resi mortgages, we need a lot less capital than we currently hold to run the business.

Now we understand the importance of the regulatory, we're very clear we're not going to go below regulatory minimum, but we're also very comfortable operating within buffers. You'll see the bottom right bullet point. The HoldCo implementation is now pushed back to June of 2023. It aligns with the first call date of the Tier 2 instrument. Five pillars. We've talked about this since February of 2020. This is the strategy in a nutshell. And I think across all five pillars we've made progress. We continue to work hard to optimise the balance sheet and drive risk adjusted returns on regulatory capital. I think from an infrastructure perspective, this bank is a safer and sounder bank than it was when I arrived. We've made real progress, be it on cyber, fin crime and other activities.

We continue to drive cost down while protecting our service proposition. And we continue to do things as creatively as we can in terms of buying leasehold and creating freehold to change the P&L profile of some of our properties and give us a bit more financial flexibility. So again, striving for scalable growth and improving the margin and NII growth. And ultimately our goal is to become the UK's best community bank.

So, this slide I want to spend a minute on. So, this is just a typical P&L slide and we're going to spend a couple of minutes on the P&L. You'll see the NIM bridge on the left. So, if you take the end of year second half NIM from 2020, which is 128 basis points. Now again, this has to be from memory because I cannot see that slide. So, you're going to have to trust me, if I get at a basis point or two wrong, bear with me, but that 128 basis point NIM needs to be adjusted down for the drop in loan to deposit ratio. Yep. Mainly caused by the mortgage sale. So that 31 basis point drop in loan deposit ratio means we started the year with a NIM that was 97 basis points. Okay?

We ended the year with an exit NIM in the fourth quarter of 156 basis points. If my math is right, that's a 59 basis point improvement in NIM from the start of the year to the quarter four NIM run rate. Again, I'm not sure how many banks have ever driven NIM that hard that quickly, and you'll see fee income growth on the right hand side. The reality is we’ve seen an increase in fee income. We're a pretty simple bank. We need people to do stuff. If people do stuff, our fee income grows. So as the economy opens up, we'll drive more traction and we expect to see further fee income growth.

Operating cost discipline. I think in the upper left, you'll see that overall operating costs. And to be clear, we're going to start talking about overall operating costs. Again, we're going to move away from run the bank and change the bank. This is the last time you will see the run the bank and change the bank split. But in the upper left cost increased by not an insignificant sum but you need to remember RateSetter annualised costs are in there and you'll see on the bottom right that it's the largest single year that we've ever had for change the bank spend. And so, we don't anticipate that reoccurring in 2022 and beyond, we think 2021 will be the single largest year for change the bank spend in the history of Metro.

So, you've seen a drop already from the first half to the second half, which means on the upper left, we actually reduced overall operating expenses 1% in the second half of the year. And again, I'm not sure Metro's ever been able to say that. And we are guiding that overall operating expenses will decline a little bit in 2022.

So expected credit losses, I'm not going to - expected credit losses really aren't the story. The credit portfolio continues to hold up well with a couple of exceptions, and I'll point that out really quickly. But overall, I want to be really clear, we have credit loss expense this year. Not many of our peers actually have an expense. Most of them did net releases. We still have an expense. We're still carrying PMOs and PMAs, which are about 26% of our overall provision number.

So, at the end of the day, we have taken the decision, because of the uncertainty of the macro environment, to be conservative about our overall provision levels. And actually coverage, provision coverage went up from 130 to 135 basis points during the year. And again, most of our peers, you will have seen the coverage went down during 2021. So again, we think there's a level of prudence. The only number that probably is worth highlighting, which we put a little bar around is commercial non-performers have increased. The majority of that is driven by BBLS. And we can talk about BBLS in Q&A if people have questions.

So then let's talk a little bit about the balance sheet and what that means for the income statement. So again, we've talked about cost of deposits. We ended 2020 with 21% of our deposit book in fixed term deposits. We end 2021 with 9% of our deposit book in fixed term deposits. And I think the bottom left needs to be called out, because I can hear the headlines now, deposits only grew 2%, malarkey. The reality is we grew demand current accounts by 18%. We grew demand savings accounts by 20%. We actually shrunk fixed terms deposits by 58%. So, you're right, overall, we grew deposits by 2%, but the reality is we had a ton of activity and a ton of growth that we offset by shrinking fixed term deposits. That gives us a much better deposit mix to improve our asset sensitivity on the right. We are an asset sensitive bank; as rates go up, we make more money.

Now the chart it on the right, every bank does it, right? It's a parallel shift assuming a beta. Our beta's 60%. The reality is that the curve shift won't be parallel and our beta won't be 60%, but it gives you an indication of the earning potential from a rising rate environment at Metro. So, these slides, I think the next couple of slides are new, and they're new because we really want to try to tell the story in a different way. So, if you look at unsecured lending volumes in the upper left, we were averaging less than a million a month organically pre the acquisition of RateSetter. And you can see the growth in there and you can try to draw the lines across. We have cheated here. It's the only place we provide it. We do provide a January 2022 number. We did £102 million of unsecure personal lending during the month of January, the largest single month in the history of RateSetter, more than Metro Bank did since its inception prior to the acquisition of RateSetter and 100 times what we've ever done in a single month organically at Metro prior to the acquisition of RateSetter.

You'll also see that specialist mortgages, which we defined by yield, it's not a great definition. We have a bit of work to do there, but the trend is right. And that is, we are doing a much greater proportion of our overall mortgage lending in the specialist space. In the bottom left, you see loan interest income divided by lending RWAs. We have been much more efficient about bringing out every pound of earnings from every pound of RWA than we were historically to increase that from the second quarter of 2020. So, in 18 months to add 200 basis points and did loan interest come divided by lending RWAs is yeomen's effort. And you'll see the blended mortgage yield. We put that on there for a couple of reasons. One, we didn't chase mortgage yields down in the second half of 2021. We did not feel the need for volume. We were very disciplined about our pricing. And so overall, we're really pleased with how both businesses are performing.

Now this next slide, I will tell you that it hurts your head a little bit. So, let me walk you through left to right what it is. So, on the left, it's a bit like lending yield divided by RWAs, but now it has a capital lens on it where we take that times 20.5 to give you capital. So, I said, when I arrived, we would focus on risk adjusted returns on regulatory capital. I said that would become nomenclature inside the organisation. It would drive our conversations about how we prioritise what assets we focused on, and we would drive the organisation forward accordingly, that has absolutely occurred. And the graph on the left gives you that indication. Now I accept the numerator isn't risk adjusted, fine, but it is still indicatively true that it is the return divided by regulatory capital.

And you can see that in the second quarter of 2020, we were at sort of 19%. For almost all of 2019, we were low twenties to high teens. We're now running 35%, and for almost all of 2021, we were in the thirties. So, if you want to know how we grew NIM or how we grew NII or how we grew revenue, that's how we did it. And that you would say, well, you would think you'd be closer to breakeven if you're driving, generating those kind of returns, you're right. The middle column shows you the headwinds. So, our treasury book, which again is bigger than it has been because of the mortgage sale. We have almost 9 billion in treasury between cash and investments, has really struggled to provide the returns it was providing pre the pandemic.

As you would expect, the rate reductions affect our returns on the treasury book. You will see towards the tail end of 2021, the yield curve started to steepen and we started to generate a bit more return, which has turned out to be great. The other headwind is loan to deposit ratio. We are a capitally constrained bank. We know that, we're mature enough to deal with it, and we're generating as much return as we can out of the lending assets we have. As we begin to free up capital, be it through ARB accreditation, organic capital generation or access to capital markets, this bank has a huge growth potential because we can continue to stretch loan to deposit ratio to align better with our peers and drive significant ROTE for our shareholders.

Now, for those of you who find the math hard, I can suggest a couple things. If you go to footnote two in the interim financials, you will see the lending income. You will also see the treasury income in note two, you will see lending income year on year is down about £15 million. That lending income is down year on year by about £15 million after the £60 million drop caused by the mortgage sale. So, we have recovered £45 million of the £60 million of loan income in a year. And then if you go to page 50 of the interim results and you go to the bottom of page 50, you are going to see the RWA table. And if you look at RWAs related to credit, they've dropped by £550 million in the year. So, we have grown lending income by £45 million in the year, almost closing the full gap from the mortgage sale. And we've reduced credit RWAs by £550 million in the year. If you need the example of what we're talking about risk adjusted return on regulatory capital, it's in those two numbers.

And then if you also look at note two, you'll see the earnings from the treasury, either cash or the investment portfolio. You'll notice they're down about £5 million year on year. That £5 million drop is after putting £3 billion more into the treasury portfolio. So as rates come off the bottom and we can unleash the treasury portfolio to generate more earnings because we're asset sensitive, that headwind turns into a tailwind, which is truly helpful in terms of getting to breakeven.

So, year on year profitability. So, this slide's in here to humour me a bit, if I'm honest. I was very worried that analysts would write, well, you lost £272 million in 2020, you lost £171 million in 2021, you reduced ECL by £104 million. Oh, it's just ECL. And the whole momentum story would be lost. No, actually that's not the way it worked because you need to take the 272 adjust for the mortgage sale, which is £57 million. You need to then get the cost and reduce the £65 million of cost increase, really RateSetter as well as some change the bank spend, then you realise we grew NII £106 million in the year. We're a tiny little bank. To grow NII £106 million a year is really hard yards. And then fees grew by £15 million in the year. So that's £121 million of elbow grease we put in to transforming the P&L during the year.

Then I think we get into this opportunities for growth slide. So, the reality is we start at the 171. If you use the exit rate, the fourth quarter NIM, which is 156 basis points, and you project it out, we begin to close that gap a little bit. And then the things on the right, we didn't want to be overly specific, but rate rises are going to happen. We know we'll continue to shift the asset mix. We've already had £102 million of unsecured lending in the month of January alone. We will see continued fee growth, because we think activity will bounce back. We've told you that costs are going to go down year on year and we told you exceptionals are going to drop meaningfully. So, at the end of the day, I think you can start to see a path. And again, the last bullet point I want to spend a minute on because I think it's gotten lost in the story. This isn't about getting to breakeven. This is about getting the growth engine that was Metro Bank firing on all cylinders again. And what we’ve successfully started to do, and I think by the middle of this year, we'll have, for all intents and purposes accomplished when we launched the SME products and the auto lending products, we will have hooked a very good asset generating engine, be it specialist mortgages, unsecured lending, auto, credit cards, small business lending, onto a really good liability generating engine.

We will have created a balanced institution that will continue to grow significantly beyond breakeven and be able to get to really good returns for our shareholders. In addition, we're not in a lot of markets. We're not in Newcastle. We're not in York. We're not in Leeds. We're in Bradford, but not Leeds. There's a lot of places we're not, we don't have good coverage in the Midlands. We're not Norfolk any meaningful way. There is a lot for us to do to continue to drive the Metro story into communities that deserve the service quality that we deliver. So, this is a growth story that's kind of gotten lost for the last couple of years. And I think you can now see that the growth is both on the asset side and the liability side, which is transformational for the organisation.

So, I think the next slide, I think all of that, all of this to get to this point has been accomplished by our colleagues. We shouldn't kid ourselves. This has been a hard two years; between the pandemic, the amount of change we've asked Metro to go through, to transforming the balance sheet. All of that has asked a lot of our colleagues and they're a great group. They're wonderfully diverse. They look like the communities where we operate in. They are phenomenal at looking after customers and creating FANS. Those in Amaze Central do everything they can to support the frontline staff in the stores and AD to try to make sure we're doing everything we can to grow FANS.

If you think about Metro, we stayed open seven days a week in almost all our stores throughout the whole pandemic. We were up more hours than any other bank during the pandemic. We have educated almost a quarter of a million children since inception in our money zones. The thing that makes Metro special is our localness. We are connected to the communities in which we operate. One of the ways we do that, we have 120 local business managers scattered across our store estate to help the local community be successful. They're there to help small businesses grow and prosper so the communities in which we operate in can do better. And then we've put some quotes in from FANS because we thought it was appropriate and gives you an indication of the advocacy we create.

Good. So, then we get into outlook. We are not providing medium term outlook. We think it's premature given the uncertainty in the macro environment. You've got inflationary pressures. Are they transitory? Not transitory. But let's take a little bit of a look at of where we are in terms of the momentum building in the business. So, if you look at the second half versus the first half, NIM is up 23 basis points, we've seen a 17% increase in fees in the second half of the year vs the first half of the year. We reduced costs in the second half of the year and we've seen a 44% improvement in the underlying loss before tax half two over half one. That's pretty good going, in a half. And then if you take a look at the quarter four averages or momentum going to 2022, there is. So, our cost of deposits for the year were 24 basis points, we're down to 15 basis points, lending yields up to 319 basis points and NIM’s up to 156 basis points.

So, we think 2022, we think you'll see higher loan growth in 2022 than you saw in 2021. Although again, we're going to be very disciplined about risk adjusted returns on regulatory capital. That'll always influence how much long growth you see. I think you've seen the strong exit NIM. I would say there, there, there are some momentum in that number, but it'll be a bit offset by cost of deposits potentially, but there is some momentum in that number. Fees will be influenced by the pace of recovery, but it looks like the pace of the recovery will be reasonably strong, which should mean there will be a bit of fee growth. Cost, we've been pretty clear that we're guiding to a reduction in operating costs year on year, and exceptionals we think will be less than 20% of what they've been running. And capital, we're comfortable operating within buffers and we'll do what we need to do if we think we need to do it.

So, I'm going to close here, but I want to be really clear about the momentum in the business. So, 2021 was meaningfully better than 2020. The second half of 2021 was meaningfully better than the first half of 2021. The fourth quarter of 2021 was meaningfully better than the prior three quarters of 2021. We have real momentum in the business that is now coming through in the NIM in the P&L and is embedded in the balance sheet. So, thank you. I'm happy to take your questions now.

Q&A

Ben Toms

Good morning, Dan. Thank you for taking my questions.

Daniel Frumkin

Morning, Ben.

Ben Toms

Morning. First one is on capital really. The MREL ratio capital fell half and half. Although you note that both you and the regulator are comfortable operating in your buffers, although clearly it's not what you want. Can we extend the assertion to mean that everybody is comfortable with your MREL ratio ultimately going as low as the lower regulatory bound of 18%?

And the second question, you've continued to grow your unsecured lending book really well. Slide 10, I think shows the positive momentum here, particularly at the beginning of this year, as you noted, was there a particular driver of the stronger originations in January and we should we expect this trajectory to continue upwards in 2022, or do you think it'll now start to tail off a bit?

And then lastly, just around your guidance and the balance sheet, you say that you expect growth higher in 2022 vs 2021. When we just think about the base growth of 2021 as a reference point, should we be stripping out the RateSetter transaction or do you expect growth in 2022 will be higher than 2021 even when reference growth rate includes RateSetter? Thank you.

Daniel Frumkin

Yeah, no worries Ben, three really good questions. I'm going to do them in reverse order if that's okay. So, I think balance sheet growth, we mean even with the RateSetter acquired portfolio in there, we think, listen, we made a conscious decision to continue to exit some mortgages during 2021 that came up and rolled off and we didn't work very hard to retain them because they didn't provide the risk adjusted return on reg cap that was as attractive as some other asset classes we had. We also had to continue to shrink our transactional commercial real estate book. Those things will continue a bit in 2022, but we think they'll be offset by further growth in our specialist mortgage business and further stretching of our legs in unsecured lending as well as a bit of auto and a bit of SME lending. So, I think you can expect some balance sheet growth.

In terms of unsecured lending, the £102 million in January, we have worked really hard to get to a point where we could do real-time quotes, and I think it's been transformational. So, instead of getting indicative pricing, you now get real-time quotes from RateSetter, which is one of a handful of institutions that does that and they work really hard with their scorecards and all their vendors to try to make that work. So operationally, we are slicker about doing unsecured personal lending. We're also doing a bit more through the stores, a bit more through the direct channels, RateSetter, through its website soon a fair amount more.

We actually think the unsecured lending market is bouncing back a bit, and we expect that to continue through 2022. We think we're one of the top couple of three players on the aggregator sites for unsecured personal lending, and we anticipate that continuing through 2022. So, we think there's reasonable growth. Do I think it's £100 million a month? I don't actually, I think January was an exceptional month, but you can take a look at where the balance of unsecured personal lending is it tends to be an 18 to 20 month product. You can pick a number of unsecured personal lending originations for a month and realise that the balances of our unsecured personal lending will be meaningfully at higher at the end of 2022 than they were the start.

And then lastly MREL, all we're guiding is that we are happy to operate within buffers and we won't breach regulatory minima. So, our MREL regulatory minima from memory, I think is 18.2% (end state). And that's the regulatory minima that we will not breach. Above that, everything else is buffers.

Ben Toms

Thank you very clear.

Grace Dargan

Hi, morning. Thank you for taking my question. Maybe if I could ask one on capital as well and then one on costs. So, on capital, I guess, near term noting you've got the roughly 100 basis points of headwinds kind of this year. What are the avenues to support your capital throughout 2022, given you may still be loss making this year, albeit noting the momentum in the business? And then secondly, on costs on your guidance, what kind of inflation assumptions are you including in that wage growth assumptions? Any colour around that would be helpful. Thank you.

Daniel Frumkin

Sure. Happy to. Yeah, listen, Grace, great questions again. So, listen, in terms of supporting capital, I think we've been pretty clear that we have multiple different actions available to us and if we choose to take them, we can. So, but at this point, we're not planning to take any actions. I think the key to this organisation is getting it to breakeven. I think you've seen the momentum in the business and that momentum I think creates a clear path that can be modeled to breakeven. And that's the single most important thing for Metro Bank to achieve.

In terms of cost, I provided this to a reporter this morning. So, I feel like I should just provide it. I think I'm going to get in a bit trouble for it, but the reality is we had initially budgeted for 2022 salary increases for colleagues about 2%, 2.5%. We ended up approving and have rolled out and will be announcing over the next week or so to our colleagues, a pay round that's closer to 5% overall. That creates a bit of budget headwinds, probably about £8 million to £10 million for the organisation. Even with that headwind, we are still guiding that operating expenses will be down year on year marginally.

Grace Dargan

Perfect. Thank you.

Sheel Shah

Morning. Could you give a sense of the moving parts for NIM over 2022? I've noticed that you've used the 60% pass through assumption for deposits. Could that be higher given around 50% of deposit base is to SMEs and corporates? And what are you assuming on mortgage margins through the year?

Daniel Frumkin

Okay. Let me, give me two seconds and then I'll come back to you. So, if you go to the NIM slide, which is slide six, and apologies, I have to put on glasses, I am old enough to need reading glasses. If you take a look at the NIM slide on left hand side of slide six. Yeah? So, a lot of the NIM accretion getting us from 97 basis points to even the 151 basis points, a chunk of that was cost of deposits, right? So, we had 24 basis point increase related to cost of deposits. It's likely while there'll be some annualised effect on cost of deposits, because again, fixed term deposits exited throughout the year. I think you shouldn't model in as much benefit from cost to deposits because it can't really get much lower than it is. So, I think the lending mix and the lending yield, I think will continue to create benefit as we roll into 2022 as will the investment yield. So, I think those are the moving parts for NIM.

In terms of the asset sensitivity, and if you go to slide, sorry, let me flip through, if you go to slide nine, in terms of the asset sensitivity, the 60% beta for the first 40 basis points of rate rise that we've already seen, we've had a beta significantly below 60%, but you are right over time. I'm not sure, what the beta will be. We haven't really come off of zero before in the country. So, if for a long time, so coming off of zero rates, we continue to stay plugged into the market. We continue to review what competitors are doing and we continue to reassess, but at least for the first 40 basis points, we've been below the 60% pass through rate, or beta if you're from America. And the reality is our deposit mix being mainly non-interest bearing liabilities gives us a bit more flexibility than somebody who's funding their balance sheet with fixed term deposits. So, we're pretty confident that there is earnings in rising rates.

Sheel Shah

Thanks.

Chris Cant

Good morning. Thank you for taking my questions. I had a few on mortgages. Obviously you've focused on specialist mortgages, and I think a lot, not all, but I think a lot of what you were doing in 2021 was higher LTV business within that kind of specialist envelope. And I guess some buy to let in there too, if I think about what's been happening with pricing in the market, higher LTV and buy to let pricing for the market overall has been really, really compressed quite dramatically in recent months. And I think that the spread pickup you're getting for the industry overall for high LTV business right now is the lowest it's been since before the financial crisis. So, what spreads do you think you are actually going to be able to develop going forwards on specialist lending? I know earlier in the year you were talking about getting a hundred bps spread pickup versus peers or sort of vanilla business, I suppose, what spread are you actually seeing on applications at the moment on a blended basis? Cause I can't imagine you're seeing that higher level. And if you are, you think you're competitive in that space?

Daniel Frumkin

Yeah. So, can I ask a question, Chris, what would you think would be - so can I turn it on its head a little bit? What would you expect us to be seeing given the competitive pressure for acquisition yields?

Chris Cant

What some of your larger peers are saying, NatWest recently said at the end of the fourth quarter that blended application spreads were down to 70 basis points. And I would guess that the 100 bps spread pickup that you would've been talking about earlier this year would've come down a bit, given what we've seen in terms of higher LTV and buy to let pricing relative to vanilla resi business. So, I guess less than a 100 bps above that, but I honestly don't know because your pricing is quite standoffish at the moment when I look at the rates on your website, as you say, you've been willing to kind of not grow mortgages. I'm just curious as to what you actually see as an application spread relative to that 70 basis points that some of your larger peers are talking about. Where are Metro application spreads at the moment, what do you think that's going to be?

Daniel Frumkin

Yeah, sure. So why don't we do that first and then we can go through the rest of your questions. Okay, because I think it's a good one. So, I think if you go to slide 10, you'll see last year where first half and second half and we did the majority of our volume, specialist mortgage in the first half of the year, not the second half of the year. So, 2.7%, 2.9%, the blend is, I don't know, upper 2.8% probably for the year. Yeah? Maybe in the low 2.9%.

Chris Cant

That’s the spread to base rate, right?

Daniel Frumkin

No, that's the overall yield. That's just the overall yield. That's the gross yield, Chris. Yeah? So, we can argue about what you want to use to take off of that. I'm just going to give you overall yield. Yeah? Because is it the swap rate? Do you know what I mean? I don't want to get into – yeah, because we could argue about what we're actually doing spread over. So, I'm going to give you gross yield. Okay. I think so far, and again, I'm providing some 2022 numbers, but I'm going to do it because I think it's indicative, we have seen a meaningful uptick in application volume in the last three or four weeks. We're almost running at application volumes that look like the first half of 2021. Yeah? So pretty strong for those who remember, because at that point you had all the stamp duty stuff and everything else. So pretty strong application volumes and we are within 30 or 40 basis points of the 2.8% kind of a number you see there. So upper 2.4% to mid 2.5% in terms of gross yield, which I think provides a pretty good risk adjusted return on reg cap. *[editorial note: the chart on slide 10 is presented net of base rate]*

Daniel Frumkin

So, if I think about that versus where swap rates are today, and I don't know where you write the majority of your business, your larger peers talk about writing kind of 50/50 split of two and five year fixes. But if I think about where the five year rate is right now you're talking about spread over five year business there of maybe 140 basis points vs the sort of 70 basis points that NatWest would be talking about. Is that the sort we should be thinking about?

Daniel Frumkin

Yeah, although I would say for our five year business, we're charging more, so that's a blended application yield. Yeah? So, I would think on our five year business, it would be closer to a 2.9% or a 3%. Yeah? So, I think we're thereabouts, Chris. I mean, I don't have a sense that we're - I think we did a lot of specialist volume last year. We would be in line with some of the asset only generators that are currently in market. The reality is we run a really good specialist business with a great team who are very well connected in the market. And we still think we're generating really good returns out of that business. And we continue to be nimble about introducing new products and being creative in that space and listen, so this is getting long-winded and I apologise, because I know we need we have Barclays behind us, but the reality is that we manually underwrite every mortgage decision. Now we were doing that when we were doing prime resi, why we were doing that, I don't know, but the reality is we have a group of people who allow us to do creative things in a pretty risk adverse kind of a way. So, we're really happy with that business. Yeah?

Chris Cant

Okay. If I could ask about capital and conscious that, as you said, there's another call coming up. So, I'll limit myself to two. When you talk about operating within buffers, I appreciate you're now operating within your MDA buffers. Are you happy to go below your Tier 1 MDA? Because and I asked this question at the first half, I guess things have moved on a bit now as, so we now know that the counter cyclical buffer in the UK is going up to 1% this year and likely going to 2% by mid-2023. So, your MDA is going to be 11.3% for Tier 1 and as of 1 Jan, you are at 11.5% and that's pre growth, pre further losses in 2022. So, are you happy to run below your Tier 1 MDA as a bank?

Daniel Frumkin

So, again, when we have conversations with the regulators, we acknowledge that we are going to be in buffers across the capital spectrum. Yeah?

Chris Cant

Okay. And the regulators, I mean, generally dipping into the capital buffers. I appreciate MREL might be a little bit of sort of a softer debate given that it's an emergent requirement of the last couple of years. But when we think about going into capital buffers at say a CET1 or Tier 1 level, generally we'd expect the regulator to then start having some degree of intervention in certain aspects of the running of the business. So, do you expect dipping into your regulatory capital buffers as opposed to MREL buffers you know going below that MDA on Tier 1, do you expect there to be any constraints of your ability to grow or to pay people or anything like that?

Daniel Frumkin

No, we've not had a single conversation that leads me to believe that there'll be constraints on the plan we put place for the business.

Chris Cant

Okay. Right. Thank you.

John Cronin

Thanks for the presentation, Dan.

Daniel Frumkin

Morning, John.

John Cronin

Hi there. My questions have mostly been asked at this stage on capital. So, I guess look, in terms of alternative capital actions remaining available to you, as a follow-on, I guess from Chris's question, are you progressing any plans to sell loan portfolios at the current time? And would that be your preference rather than an outright capital raise, if you needed to build up your capital base a bit more strongly as you continue to print losses?

Daniel Frumkin

Yeah. So, John, a great question and the question, right? So, you would expect as a CEO of a bank that's operating within buffers, that we have lots of contingency plans and have lots of things that we could do if we need to. Yeah, and I would say that those contingency plans exist as you'd expect them to exist. It would be remiss me not to do that. Yeah? But the reality is the single most important thing is to get this place to breakeven. I think we've shown a really clear path to breakeven today. I think it is now really beyond doubt that this place will get to breakeven. It's really hard to see how zero is still on the table, but our debt capital markets friends and our fixed income investor friends need to figure out how to do math because at the end of the day, the yield to maturities on our MREL and Tier 2 stuff are deeply offending. So, I think we always have contingency plans as needed and I really don't understand how our debt's priced. So, it's pretty frustrating to me, John, as you can tell, but of course we would always have contingency plans.

John Cronin

Okay. And I guess just one final one, looking from press reports recently linking you to a potential acquisition or that linked you to a potential acquisition of Sainsbury’s bank in the past, any prospects of anything else in the pipeline in the near term?

Daniel Frumkin

So, John, I can't make any comment on that. If we have something to say, we'll come back and tell you. Yeah? But we've always been clear that we're always looking at organic and inorganic, but the reality is that we're really focused on getting the organic business back to breakeven. And I think the results here demonstrated, I know there was noise about PE and there was noise about everything else. We stay completely focused on delivering results for our stakeholders, as you can see from these numbers.

John Cronin

Sure. And look, just a quick final one, if I can on AIRB accreditation. So, look, is there any more colour you can give us? I mean, the application has been with the regulator for a number of years. I understand there's been a lot of dialogue between Metro Bank and the PRA on this. Is there anything more you can say around what other requirements need to be met before you would be in a position to potentially achieve accreditation and anything on timing that is associated with the further work that has to be done?

Daniel Frumkin

Yeah. Listen, I know my predecessor got drawn on timing, so I'm really adverse to providing any kind of insight on timing because I think that was a moment that really hasn't borne out to be true. But what I can say is we continue to work closely with the PRA. We find them to be helpful in regards to working on the AIRB application as we find them to be helpful overall, we find them to be bright, intelligent, and knowledgeable, and we continue to have those debates. We have rebuilt the credit team from the ground up since my arrival, and we have a new Chief Credit Officer. We have a team that is really capable in the modelling space. We have very different conversations internally that would clear any use test kind of requirements. So again, the work's ongoing. We just need to let it play out and I'm not going to be drawn on timing because I just think that’s a mug's game.

John Cronin

Right. Thanks.

Sajan Shah

Thank you. Maybe a bit more on behalf of those fixed income investors you talked about, but you have a story to sell now on the platform. Do you think that a £100 million to £200 million capital raise is available for you, if you wanted to go there and get that self-fulfilling boost towards organic capital generation? Obviously that will change material things on the fixed income side. Any colour on that, especially from your key shareholders and their backing. That's my first question.

Daniel Frumkin

Yeah. So, it's a fair question. We continue to have strong support from our key shareholders. I think they've demonstrated that support by being patient through this turnaround. I think we're now on the cusp of providing positive earnings, which I think will be well received by our shareholder base. And I believe we continue to garner their support. Are we anticipating doing an equity raise? We're not really at this juncture, doesn't mean we wouldn't consider it. And I believe we have shareholder support if something interesting came along, but I think as we sit here today, we're not, I do not understand when I look at the peer group yield to maturities and the growth that this organisation is demonstrating and the clear path to profitability, why the fixed income guys are lagging behind, but it's fine. We'll get it fixed over time. I don't need them right now. They're welcome to do the math over time.

Sajan Shah

Thank you. And then just obviously this platform seems like a perfect model for the private equity world, any colour on why those negotiations didn't materialise? And then the third question, can you just give us some colour on the duration of the treasury portfolio?

Daniel Frumkin

Yeah, so listen, a couple of bits, listen, I've known the Carlisle team for a long time, right? I mean, they were at Butterfield. I was hired and interviewed by the Carlisle team in Butterfield in 2010. That was the last bank investment that they did through the fig fund. The fig fund at Carlisle actually hasn't raised money separately. They now invest as part of the overall European fund or the US buyout fund. It just didn't really work, and we couldn't get to a price that we thought was fair and reasonable for all parties included and you know it's going to happen. Right? Do I wish it wouldn't have leaked? I wish it wouldn't have leaked because it leaked very early, and I would've preferred not to talk about it and just have it happen behind the scenes, but listen, they're allowed to come in. And I think at the moment for the Board given the financial performance of the organisation and the path forward from here, the Board is left in a difficult spot for what actual value of this organisation is. And so, it just didn't work. I don't have much more to say about the PE stuff.

Sajan Shah

That's fine. And then just on the treasury portfolio duration.

Daniel Frumkin

Treasury portfolio duration. I don't have at hand, I think my guess is we sit on a bunch of cash. So, if you exclude the cash, I think the overall treasury portfolio duration for actually what's invested, which is a small piece of our liquidity, I think hovers around three years, somewhere between 2.8 and 3.1 years.

Sajan Shah

Thank you.

Daniel Frumkin

But that's from memory. So again, we'll get the IR team to come back to you and give you a better number, but it's directionally correct.

Perlie Mong

Hi. I'll try to be quick because obviously we are running out of time, so just a few quick ones, the first one is on interest sensitivity. So just I've noticed, so thank you for the disclosure on that. I've noticed that a lot of it is sort of sort of tilted towards year two, but I think a lot of peers tend to see more of the impact coming through in first year. So just wondering why is it that the impact is a bit more delayed for you? So that's one, and number two is on cost. Just definitely hearing your guidance on managing down the underlying cost, but I've noticed that running the bank cost is up 3% in the previous year. And obviously you've talked about some inflation expectation in the numbers as well. So, I'm just wondering how you're thinking about investment spend, is that what is being cut down essentially to manage the cost targets? And number three is just very quickly on management change. So obviously David has announced his departure about a week ago. So, sort of just any colour on how do you think that might impact on the delivery of your strategy?

Daniel Frumkin

Yeah, so, okay. Let's go to that. So, sensitivity, relatively straightforward. I haven't looked at the other bank's disclosures, but the other banks I've worked at, it tends to have a bit of a spike in year two. For us, there's just some asset repricing that takes us a bit of a lag, which is actually, I think the question from Morgan Stanley before about the duration of our treasury book, we need a bit of that to roll off to be able to generate the earnings in the outer years. Nothing interesting or overly complicated. We just have some repricing that kicks in. And again, we are doing, which was Chris's question originally, and the market is doing a lot of fixed rate mortgage lending. So again, the mortgage lending needs to roll through. We need to do new originations for some of that to take a bite.

In terms of cost, I think if you go to the cost slide on slide seven, you'll see in half two, we came down to £51 million from £60 million. I think you will see 2022 that we will spend less than twice that £51 million. You'll see a continued reduction and that's driven by a couple things. One, we've done a tonne of heavy lifting and we're pretty much through the majority of, which I think I said when I stood up in February 2020, the first two years would be the majority of the change spend, and we've done exactly that. But you'll see it ramped down, and there's also only so much change the organisation could absorb. At some point you need the organisation to breathe a little bit to bed in a lot of the change we've enacted. So, you are right, overall opex will be reducing, a chunk of that will come from the change spend.

And lastly, regards to David, I really rate David. So, I think David's good at his job and was a good friend and remains a good friend. I think the board was supportive of David. David's departure had nothing to do with change in strategy. David's departure had nothing to do with the falling out over the financials or some big disagreement. It was unrelated to sort of the strategy as it sits today. I will miss David's guidance, but at the end of the day, the strategy was put in place and will remain the strategy going forward.

Perlie Mong

That makes sense. I thank you very much.

Daniel Crowe

Hi there. Good morning, and thanks for taking the question. Good morning. I just want to come back around on capital and MREL again. So, I know you say you're happy just operating within your buffers. Does that mean you have no intention to issue or attempt to issue MREL this year because you're already £70 million short as of first of Jan? And then back to Chris's question, just on the Tier 1, I know you're saying you want to grow, but your capital constrained at the moment. And by end of year the buffer just on current numbers will be very slim to your Tier 1. And you mentioned that you want to work within the buffers. So just, can you give more guidance about what is your kind of capital planning to allow you to grow into the stuff that will provide you the additional earnings that you need?

Daniel Frumkin

So again, I think, Daniel, a couple of bits. So again, we look at all different optionality around capital and I think John Cronin’s right to raise, are you thinking about small asset sales? What do you do? What does that look like? And again, one of the contingencies we have is whether we wanted to issue some MREL and how we would do that and what that looks like, all of that's in play. Do I think it's a 2022 issue? I don't know that it is. Maybe tail end, maybe sometime in 2023. We are very comfortable with the capital plans that we have in the budget for 2022 that has growth in it, and the regulator's seen those and understands how we operate within buffers during that period. So again, I don't have much more to say than that.

It seems to be causing consternation and I don't quite understand it because from an overall sufficiency perspective, we have more capital than we could ever need, and we continue to make sure the regulator is aware of everything we're doing. Now, what I would say is we do need to execute. So, we earn the respect and the right of time from a regulator by continuing to move the organisation forward. And we will continue to move the organisation forward throughout 2022 and continue on the path to profitability. And I think that path isn't all that long. So, at the end of the day, the bleed of capital starts to ameliorate at which point the whole conversation shifts.

Daniel Crowe

Yeah. I guess just the last time there was a breach of MREL, you effectively, you issued a 9.5% coupon MREL, which was terrible.

Daniel Frumkin

Actually, so let's be clear. We weren't in breach of MREL then. That was an emerging requirement that we needed to be in compliance with by a certain time. We didn't approach the regulator at the time to ask for an extension or do anything else. We literally just chose to issue at 9.5%. So, slightly different situation. Yeah, and it transferred a lot of the economics from the business from our equity holders to the bond holders on that 9.5% piece of paper. Yeah? And so, I don't know, Daniel. I mean, again, we can do math here. We get it, and we'll consider our options accordingly.

Daniel Crowe

Okay. Thanks very much.

Daniel Frumkin

I just want to thank everybody for their time today. I know the presentation bumped up against Barclays. And again, I think there's real momentum in the business and that momentum creates a clear path back to profitability. And I appreciate all your support and I look forward to talking to you all individually over the coming months. Thank you so much.