Metro Bank H1 2021 Results

28 July 2021

Daniel Frumkin (CEO) and David Arden (CFO)

PRESENTATION

Daniel Frumkin

Thank you. And good morning, everyone, and thanks for taking the time this morning. I know it's a busy reporting cycle, so I really appreciate you making effort to join us. I must say it feels odd to be back into the office. It's been a long 18 or so months, and it's very nice to be back, and I hope when we report year-end numbers, you'll be able to join us in person. I long for the days to be able to perform in front of an audience.

I think today you're going to see a presentation that's pretty familiar to you. I'll speak for a while and a brief overview. Then, David will walk through the numbers, and I'll come back on to give you a bit of an update on the strategy as it sits today. I think the presentation will be meaningfully shorter than it's been historically, and I'll come onto that in a second.

But before we start the presentation, I really just want to make one observation that's really important. Up until this point - this is my fourth results presentation in Metro - in the prior three, we have spent the majority of time talking about what we were going to do, to walk you through the strategy and the strands of the strategy and how we were going to deliver sustainable profitability and return the organisation to providing adequate returns to our shareholders. Today is meaningfully different. It is a moment we're pivoting away from telling the story to talk about actually what's occurred in the business. We will talk about actual loan volumes, actual growth in unsecured consumer lending, actual improvement in lending yield, actual improvements in underlying net profit.

We're really pleased to be at a point where we can start talking about the results of all the effort we've put in. Now, I'm not making light of it. It is a genuinely difficult journey ahead. We're in the period of a turnaround plan that is always the most challenging. The phrase I like to use is we're sort of in the cold tundra of delivery, where when you open your front door, you don't want to go outside, the winds blowing, snow drifts, there is no alternative. We are now in the phase where we need to deliver.

The good thing is, on results in the first half of the year, you can see positive momentum in the business that I think shows that the team is doing a great job on delivery. And lastly, before I get into my slides, you will not see guidance – medium-term guidance going forward. I think David and I would really like to be in a position to give you medium-term guidance, but we don't think it's prudent at this stage. The macro economy still remains too uncertain. We have no idea what the economy is going to look like as the government withdraws support. We're still in the middle of a pingdemic. We're not quite sure where it's all headed. It wouldn't be prudent to give medium-term guidance. But we long for the day when we can. So, into my slides.

In terms of momentum, you see the underlying drivers that help drive the P&L have improved meaningfully in the first half. Again, lending margins improving as we accelerated the higher-yielding better risk adjusted return assets. The cost of deposits has reduced meaningfully, and our cost focus remains. There's always work to do on cost, but costs are broadly flat half on half when adjusting for the RateSetter acquisition.

And if you adjust underlying revenue for the sale of the mortgage portfolio late in the second half, revenues are up 14% half on half. The underlying loss before tax decreased by roughly 6% half on half. There is real momentum in the business that is starting to come through both the balance sheet and the P&L.

And all of that is premised on meeting more customer needs, so the middle blue box. We need to continue to stay focused on our customers, colleagues, and communities. It's what makes Metro Bank special. It's what differentiates us other from High Street and fintech institutions. The people-people banking driven by great colleagues who are completely focused on the customer.

And then, again, we need to be able to demonstrate that we can manage our capital position, and I think it's the bottom of the box. We have clearly demonstrated our ability to optimise the balance sheet, and we're very much on that journey, and we will continue to do what we need to do to optimise the balance sheet on a go-forward basis.

You can see lending yields increased. You can see customer deposits have continued to grow. You can see cost of deposits has dropped on the right-hand side. And most importantly, consumer lending is now over £700 million. It's up about £0.5 billion in six months.

With that, I'll turn it over to David, and he can walk you through the financials. Thank you.

David Arden

Thank you, Dan. Good morning, everybody. Before we get into the detail, just to highlight in the following slides we've taken you through three sequential reporting periods. We've done that just to strip out some of the longer-term trends, and half on half messages are difficult to bring out, given the 3 billion mortgage sale that we did at the end of last year, and the ongoing situation with COVID, which makes fee progression harder to draw out. So, let's get into the detail.

Turning first to KPIs. Our brand and unique service proposition continue to resonate well with customers, and we've seen strong account growth. Total deposit growth has exceeded our expectations and momentum remains positive. The performance in deposits and the proceeds from the mortgage sale means that our liquidity position is elevated. LCR is over 300%. Capital ratios remain above regulatory minima and NIM has held steady despite the impact of the mortgage sale, and we're seeing a positive exit trajectory on NIM.

The underlying loss in the period reflects both the mortgage sale, which has reduced income by around 30 million in the half, and the ongoing challenges with fee income. Adjusting for the mortgage sale though, underlying loss improved 6% half on half and 49% year on year. The half on half movement in Stat loss not only reflects the lost income for the mortgage sale, but also the exceptional gain that we saw at the back end of last year. Adjusting for those items, Stat loss improved 10% half on half.

Now, let's drill down into revenue. We've made good progress on NIM to keep it flat over the period. Cost of deposits has continued to fall, and lending mix and yield have both improved, contributing 18 bps to NIM in the half. Although net interest income was flat half on half, this is despite the mortgage sale, which impacted income as we know, by 30 million. Adjusting for the sale, net interest income increased 27% half on half and 57% year on year.

The proceeds from the sale led to a substantially higher liquidity and a lower loan to deposit ratio, and note that while the excess liquidity is NIM-dilutive, given the rate environment, it's P&L neutral. So, given the mortgage sale, a flat half on half NIM is a really strong result. It's demonstrating positive trajectory with an exit NIM over 135 basis points. We would expect NIM to continue to progress in the second half as cost of deposits continue to fall and lending mix and yield continue to progress.

On fees, it's been a challenging half, given the ongoing COVID situation. Further lockdowns has understandably led to lower customer activity, and fees have remained subdued. We would hope that customer levels return to normal in H2, although at the half year, I would caveat that heavily given ongoing case volumes in the UK and the uncertainty that remains.

And just before moving on from this slide, I just want to highlight that, adjusting for the mortgage sale, total revenue improved 14% half on half and 47% year on year.

On costs, it's a similar theme to the full year. Run the Bank costs on a BAU basis have been well controlled, and excluding RateSetter half on half has been limited to less than 2% growth. These costs are expected to remain contained with low single-digit progression in H2. That's broadly in line with guidance we gave at the full year. And I just want to emphasise that cost management is an intense area of management attention, and rest assured, we continue to focus heavily on costs and how we control them over the medium term.

On Change the Bank, we can continue to deliver what we said we would do. In fact, we're probably slightly ahead of where we expected at this stage in the change programme. And as we've passed the peak of the Change the Bank expenditure, we will stop breaking out Run the Bank and Change the Bank and move to a simpler total bank cost guidance in 2022.

On deposits and lending, we continue to see strong momentum on deposits, and it really underlies the strength of the franchise. At the end of the half, fixed-term deposits made up just 15% of the total base. We've proactively repriced deposits, and rates are now comparable with the big High Street banks. This, coupled with the structural mix of the book, has led the strong downward pressure on costs of deposits. We expect it to continue to fall in H2, albeit at a lower rate. It's difficult to guide on total deposit volumes. We're focused on quality, not quantity of deposits.

On the right-hand side of the chart, you can see a new graph that demonstrates how we're shifting the emphasis on the balance sheet. We've refocused Commercial to more relationship building with trading businesses and away from transactional commercial real estate.

And you can see the impact of the mortgage sale in H1 last year and the ongoing mix shift on consumer this year from the back book on RateSetter and the ongoing organic originations, which are really strong in the first half.

This slide shows the balance sheet strategy we laid out is starting to come through, and we would expect these key metrics to continue to progress in H2, although we remain clearly cognisant of our capital constraints.

Turning now to ECL. When we presented 12 months ago, we explained the step-up in ECL in response to the pandemic. We retain that cautious approach today. Given the ongoing level of uncertainty and the macro environment and the continued government support measures, we continue to be prudent. Post-model overlays have been retained so that our total ECL charge and the provision is similar to H1.

Mortgage customers have largely returned to contractual payment terms. Only 0.1% of our mortgage customers are now on a payment deferral, and that's down from 22% at the peak last year. Underlying credit quality is in line with our expectations, and our actual losses so far have remained low. Absent any adverse changes in the macro environment in H2, we would expect another benign ECL charge.

Turning now to capital. CET1 is 13.9% and MREL [21.7]% at the half year, and you can see the movement from full year to half year. The ratios include software relief. That's equivalent to 100 basis points, and that will end at the beginning of 2022 in line with the guidance from the PRA. As a reminder, our MREL requirement is 20.5%, and currently, our end-state MREL requirement is 20.7%, excluding any confidential buffer.

We note the new MREL consultation paper and welcome the Bank of England's acknowledgement that MREL is a challenge for the mid-tier sector. We will, of course, be discussing the application of the CP to Metro Bank with the Bank of England in due course. In the meantime, we do not anticipate accessing capital markets in H2 and we would expect to operate in our MREL buffers for a period of time.

On the P&L, we've covered most of the items on the page, but just to draw out the exceptional items: there was an 8.4 million residual gain from the mortgage disposal; we impaired 7.5 million of peer-to-peer intangible assets, given that we don't do peer-to-peer lending any more; and remediation costs of 25 million are primarily related to sanctions. We would expect remediation costs to fall in H2, though that remains uncertain, given the level and the extent of the work that we're undertaking in this area.

And just to re-emphasise the point on the P&L, if you adjust for the mortgage sale, net interest income increased 27%, or 57% annually, total revenue increased 14%, or 47% annually, and underlying loss improved 6%, and 49% annually.

Turning to the final slide from me. The balance sheet remains very simple and highly liquid. Our LCR of 309% remains elevated and we are holding excess liquidity. But just again, just to re-emphasise, whilst excess liquidity is NIM-dilutive, it is P&L-neutral. For instance, we could reduce liquidity by repaying TFSME, but that's a zero-sum trade, and we would rather retain the optionality and the flexibility, given the macro environment.

So, in summary from me, these results reflect the challenges the bank is facing, and they also reflect where we are in our turnaround plan. We said last February that this is a revenue story, and we're seeing real underlying momentum in revenue. This has been improving as we progress through the half. We remain absolutely focused on returning the bank to medium-term profitability, and we thank the ongoing support of all our stakeholders.

And with that, I'll pass back to Dan. Dan?

Daniel Frumkin

Thanks, David. We're still working on our transitions. This whole thing of having to get up and down and move around is all very new to us. I'm so used to just sitting in my lower ground floor - or basement, if you're American - and staring at a screen. So, this is all a bit new.

I'm just going to spend a couple of minutes going through three slides on a quick actual outcomes for the first half of the year. I'm going to start with the upper left, which I think is really important. We talked about this focus on risk-adjusted returns on regulatory capital and what we would do, but you're starting to see that really come through. The acquisition of RateSetter is starting to make an actual difference to the balance sheet. It's started to help drive increasing lending yield.

I think, on the mortgages side, you're starting to see that yield come through, and again, the 3 billion mortgage sale – we're still really happy with that transaction, and we think it was a good transaction and made a lot of sense for the organisation at the time. We've also, as have many other financial institutions in the UK, done a fair amount of government lending, which is very capitally-efficient and provides adequate returns, but more importantly supports the communities in which we operate, which I think is really important.

On the bottom left, I think you can see those jaws, those jaws are really impressive and they are actually the momentum that you're starting to see, and it will be that widening of those jaws that continues to allow us to make the journey back to profitability. So, the fact that lending yield has gone up to 3.14% in the second [quarter] of 2021 - it's meaningful progress to where we were a year ago, and again, cost of deposits are down meaningfully.

I think the upper right is just a mix story. We don't think we're special in that regard. We think most financial institutions will see a change in the deposit mix, as customers don't really get paid for taking duration, so fixed-term deposits are down, and we're really pleased with the deposit mix overall because, again, it helps us reduce the overall cost of deposits.

And the bottom right is just to show the liquidity increase. And then, a bit of a unique balance sheet, right? We have over £9 billion of liquidity on a £23 billion balance sheet. Over 40% of our balance sheet is sitting in liquid assets, which is different to most of our peers. It clearly depresses NIM, but is NII-neutral to slightly NII-accretive. So again, we think holding the liquidity makes sense. We think it's prudent, and we think it's the right thing to do, but it clearly has downward pressure on NIM.

I think, if you move on to the two big drivers of the mix shift and the reason why the lending yield has started to move, on the left-hand side, you see the mortgage offerings we've added into the bank over the last six months, and you also see on the bottom, where we have meaningfully moved the blended mortgage yields on the completions from sort of 2.3% in first-half 2020 to 3% in first half 2021. We are really pleased with the progress we're making in shifting the mortgage book at pace.

In addition, on the right-hand side, you start to see the benefit of the RateSetter acquisition. I know that the balance sheet purchase of the back book will get a bit of attention, but I think you need to understand that on a month-in, month-out basis, we're seeing real origination volumes from the RateSetter platform that are truly helpful to reposition the balance sheet.

You can see that really, historically, Metro's generated almost no organic volume for unsecured personal lending, and you can see from the date of acquisition how we've ramped up monthly originations under the RateSetter platform. We were cautious initially to bed in both operationally and from a credit perspective. We are now very comfortable with the quality of the volume we're seeing, and we're excited about what that platform gives us.

To put it into perspective, in the last few months, we've done roughly 20% to 40% more unsecured consumer lending than RateSetter did in the highest single month in its history. It is performing extremely well, and we're really pleased with the ongoing volume.

I think, on the bottom right, it's just to highlight again Metro Consumer Finance. We created that business unit to focus on what I call process credit, be it overdrafts, credit cards, SME lending, SME overdrafts, and I think, over time, we will start to see it make a positive difference for the organisation just like it has on unsecured consumer credit.

And then, lastly, I just want to end on what I think are the green shoots of the business. We understand we still have a long way to go. We understand we have a lot of execution and a lot of delivery to make happen, but these are tangible green shoots that you're seeing in the business, and these are the green shoots that we will continue to build upon. Lending yield is up 92 basis points since the end of 2019. Loan interest income divided by lending RWA, a rough estimate for return on regulatory capital, is up 187 basis points. The cost of deposits is down 59 basis points.

Again, those are real momentum, actual results, that are making an actual difference to the P&L, and will continue to make a difference as we move forward. And at the top, you can see that we've taken consumer lending from 2% of the balance sheet lending mix to 6%, in a relatively short period of time.

So, I just want to end by saying, I know it's difficult to see through the numbers because of the mortgage disposal in late second half 2020, but if you make the adjustment for that mortgage disposal and look at the underlying drivers of the business, you can see real momentum. And while we still have lots to do, we're really pleased with where we are at this point of the turnaround.

With that, David and I are happy to take your questions. Thank you very much for the time.

Q&A

Ben Toms

Good morning, both, and thank you for taking my questions. First is on RateSetter and the strong volumes that you've had there. I think you mentioned in the slides, 300 million organic loans in the half. Can we model similar levels of volumes going forward, or potentially even to improve this run rate because Q2 looked a bit stronger than Q1. That's the first question.

And secondly, on the slides, you also mentioned some infrastructure costs of 16 million. Can you just give some colour on that number? And you mentioned a systems upgrade. Is there a material cost associated with that? And when do you expect that to be completed? Thank you.

Daniel Frumkin

Sure. So Ben, thanks for the question. In terms of the second half of 2021, we would expect the unsecured personal volumes under the RateSetter brand to be slightly in excess of that 300 million number you've mentioned. Again, volumes strengthened through the first half of the year as we got more comfortable with the platform and the credit scorecard. So, I think that's probably a little light, the 300 million.

In terms of infrastructure spend, it is everything from some cyber spend to improve our cyber security, it's everything from patching systems and making sure our servers are secure, it's some investment in overall IT resilience as well as other infrastructure spends around financial crime, some fraud systems, and all of that. So, it's a hodge-podge, but again it creates a more stable platform on which we can create sustainable profitability over time.

In terms of the third piece. I'm not sure. Ben, what was the third piece again?

Ben Toms

Just around you mentioned a systems upgrade in the slides. Is there a particular cost associated with that and how long will that take?

Daniel Frumkin

Yeah, and I'm looking at David. We're not really in the middle of any systems upgrades that I'm aware of that are significant. Our Temenos core banking platform is strong. We're doing a bit of an upgrade on the mortgage platform, but that's single millions, so there's nothing that should create untoward risk or any volatility for us going forward.

David Arden

And it's all captured, Ben, within the change the bank budget. So, we've got a good handle on everything we're doing.

Ben Toms

Great, thank you.

Grace Dargan

Good morning, both. Thank you for taking my questions. Firstly, I just wanted to ask about the MREL review. Note that you flag it in the release. I guess, would you be looking to apply for the extension that they're talking about in that? And do you think you would be eligible? I know in the review they talk about the criteria for not having reached your end state MREL, but I think technically you touched on that when you did the mortgage disposal, so just your thoughts on that would be good.

And then, secondly, great to hear about RateSetter and the colour around that. Looking at your other high-yielding lending, particularly for the different mortgages that you call out, maybe you could give a little bit of colour on the benefits you're seeing from that in terms of the originations in the first half? And I guess associated with that, do you think, going forward, there could be higher impairment charges associated to those mortgages? Thank you.

Daniel Frumkin

Yeah, so Grace, really good questions. In terms of the MREL review, to be honest, we weren't surprised by the outcome of the MREL review. I think, one needs to remember everybody has a role to play and everybody needs to remember their ultimate objective. I think, from a bank perspective, I think everybody is aware that I was pretty vocal on the need for change in the MREL rules, and from a macro perspective, you can make a coherent argument for why aligning MREL rules with global standards makes sense.

But I think actually from the Bank of England's perspective, I fully appreciate the cost to the tax-payer, the cost to each and every one of us, of the 2008 financial crisis, and I think that's still live in everybody's memory, and I think having prudent conservative capital rules minimises the risk to the taxpayers having to fund a bail-out. So, I'm not surprised that they basically held the line.

I thought Chris Cant's note was very good in terms of our positioning on the MREL guidance, and I do think there is this uncertainty around whether we would qualify for the two-year extension or not. We haven't yet explored it with the Bank to know whether we would qualify, but I want to be really clear, it's really not all that interesting to us in terms of a two-year extension because if you look at our interim MREL state and our end-state MREL requirements, it is [20] basis points of difference, which in the scheme of things, actually really isn't a meaningful issue for us, so we're taking it away, we're going to think about it, but again, we've always planned - every forecast we've provided since I joined in September 2019 has always included MREL as it's currently constructed, and we never assumed that there would be a change and we've never run the bank, assuming there would be a change. So, I think the Bank of England wrote a document that I am completely aligned with in terms of understanding their position. So, I think we're OK.

In terms of mortgages, we had a really strong first half of the year - and I think Barclays said the same thing this morning - I think the reality is that mortgage volumes were elevated thanks to the stamp duty waiver, and I think that's made a real difference. June, for example, is - I think - our third highest completion month in the history of Metro Bank. We're really happy with volumes, but us, I think every other High Street Bank and every other mortgage provider has seen a dip in volume since about the middle of June. We've started to see this week actually a bit more of an uptick and we think as we get into the autumn, it will go back.

We have modelled the credit losses on the new mortgage portfolio. Before we make a change in our credit risk appetite we actually look at risk-adjusted returns on regulatory capital, we run it through our risk committee, we take it up to the Board risk committee if it's significant. So, we're really comfortable that the incremental changes we made to our underwriting criteria provide really good risk-adjusted returns to the bank. So, we're pretty comfortable. And again, our provision methodology is really robust, and we pick up those changes as it gets built into the models as we go forward. So, we're really pleased.

Grace Dargan

Thank you.

John Cronin

Good morning, both, and thanks for taking my questions. First of all, I'll just return to that perennial question on IRB. And just listening back to the language in the audit committee report - I know you didn't speak a whole lot about it at the full year results stage - going back to the language in the audit committee report from your annual reports around seeking IRB accreditation in 2021, look I don't want to ask you about expectations on timing in overall terms, but I would like to get a sense of, if it's possible, where you are in the process and to what extent it is inter-related with the ongoing regulatory investigations.

My second question, then, is just coming back to MREL. Dan, I'm a little bit surprised maybe. I appreciate that, at one level, you completely acknowledge the Bank of England's position on this, which I wholeheartedly agree with in terms of you know the global financial crisis and the consequences that arose, but on the other hand, I think, getting back to that economic argument, it sounds like you've given up the fight, as it were, even though the paper's just a consultation paper in terms of actually seeing thresholds rise. Is that a fair assessment? And I also have a question, just to point out that on the Bank of England's website, they have the final requirement of 21.5%, and you mentioned 20.7% earlier, David. Is that just a lag in terms of the Bank of England's website being a little bit out of date?

And finally, I have a question on excess liquidity. And going back to your comment, David, on flexibility and optionality rather than repaying TFSME, to what extent, you're presumably looking on an ongoing basis with capital constraints in mind, of course, as possible acquisitions to bolster your higher-yielding lending activities. Are interesting opportunities coming up in that respect? How likely is it that we could see some more inorganic activity through the course of the rest of 2021 or beyond? And I'll stop there.

Daniel Frumkin

OK, John, that's a robust list, so let me try to tick them off in some respects, and I'll turn it over to David as we work through them.

On IRB, again, it's not within our gift to talk about timing, it really is within the regulator's gift. We continue to work through the process. We've brought in since I've joined a new Chief Credit Officer, a new Head of Portfolio Risk. We brought in modellers underneath the new Chief Credit Officer. We have made tangible improvements in our ability to model and understand the balance sheet, which I think is recognised by the Bank of England. So, again, progress is being made. We continue to put a fair amount of energy and money into it, but timing and the eventual outcome is out of our hands, and we're completely working with the bank.

The one thing I'd say before I turn over to David to add is that it's completely unrelated to investigations. Again, we find the PRA's team to be very understanding of the situation that Metro Bank is in. They clearly have a deep knowledge of the bank. They have a deep knowledge of where the bank is headed. And they really do not get caught up in some of the past activities. This is about forward looking, and they've been great. So, again we continue to work closely with them, and we look forward to working with him closely going forward.

And I don’t know if there's anything you want to add on IRB.

David Arden

No, I think you’ve covered it perfectly, thank you.

Daniel Frumkin

Good. In terms of MREL, I'll turn over to David for the Bank of England website because honestly, you've got into level of detail - that's why he gets paid. In terms of giving up the fight, maybe John. The reality is that I think a CP, whilst it is a consultation paper. It is mostly fully baked. I don't think you're going to see substantial changes off the back of a CP ever issued by any regulator really anywhere in the world. We went through a very robust process under the discussion paper. I think the Bank of England was really open and listened during that consultation process of the discussion paper.

We met with everybody from the Governor down, we met with senior people in the Treasury. They all understood our position. They all understood the impact on the macroeconomy. They all understood that it means we can lend less money to SMEs, that we can open fewer stores, that there would be lower employment at Metro because of the capital rules. But ultimately, I think they came to a decision that isn’t really surprising, that really what they get paid to do is to insulate the tax-payer from volatility in the banking sector and the way you do that is force banks to hold more capital.

And I think, ultimately, they played the role that they were supposed to play, and I think I played the role that I was supposed to play. But for the CP, it's pretty fully-baked, so maybe we’ve given up the fight.

I don’t know, David, on the website and the requirements.

David Arden

Yeah, John, I'll double check, but if memory serves me, it'll be a timing lag. I think the Bank of England update once a year, but I'll double-check and get back to you if that changes.

Daniel Frumkin

And then last, on liquidity John, I think listen, given the macro uncertainty, given the fact the government hasn't withdrawn all its support yet from the economy, given that deposits are clearly elevated from some BBLS money being deposited, from people not spending any money because they've been locked inside for 18 months. We don't know where deposits end up. We don't know where liquidity ends up. It’s just prudent to carry excess liquidity if it's not costing you anything.

And while we would love to be able to report a better NIM because it makes it easier to convince all of you that we’re making progress, and I do know you need to look through the numbers to get to the conclusion. It’s just prudent to carry the excess liquidity. Whether we use it for inorganic or organic, I don't know, John. We will see as we go through the next 6 to 12 months, but it just doesn't seem right to shrink liquidity at a time where there's still a fair amount of economic uncertainty, and the fact of the matter is it doesn't cost anything, right? I mean at the end of the day it’s either net zero from an NII perspective, or slightly accretive from an NII perspective. So yeah, do I wish we could report NIM a bit higher? I do. But do I value liquidity and the flexibility that provides? I do. Probably more than I value reporting slightly higher NIM. David, anything you’d add?

David Arden

No, perfect.

John Cronin

Thanks for that. Do you mind if I come back on just a couple of points? First of all, I completely take your point on the consultation on MREL and I'm just eager to understand as to whether there was any scope for further change. But on a couple of the other things, just on IRB. I appreciate that you don't want to say anything else, but we do get updates from other banks in terms of what modules they're working on currently. So, if there's anything you can say on that, it would be helpful just to understand where you are in the process, not timing.

And then, just finally, back to your points Dan on prudence around excess liquidity, totally get it. A bit curious around growth and what RateSetter could do. You have guided to more than 300 million of originations in H2. But could it really scale? I'm thinking about that in the context of whether you might be tempted to acquire in the future or actually drive much more significant growth through the RateSetter channel. Curious to know how you're thinking about that. I'm sorry for all the questions.

Daniel Frumkin

No, John, any time, honestly. So listen, I don't think we want to get drawn into where we are with modules and all that kind of good stuff, but honestly it puts pressure indirectly on the PRA and we don't want to do that. But we are making progress, we are taking it seriously, and we continue to work through that process, but I think at this point we want to be a bit careful on what we do, given the prior history of the organisation. I think we need to be extra sensitive.

And then, on liquidity, it's an interesting point, John. So, again an analogy I used at Exco. I can now see the whole chess board about how we get the bank back to profitability and return it to providing adequate returns to our shareholders. There's no pieces missing on the chess board. I think before we did the RateSetter acquisition, I think we were missing a few pieces. We weren't really ready to become a consumer lending institution, and as a community bank we need to do consumer lending, so it was definitely a missing piece.

At this point, there's nothing that I feel like we're missing. We have a really good mortgage operation. The mortgage operation is pivoted really well to being a specialist mortgage provider. We have infrastructure in that space in terms of systems and people that I think are as good as anybody else in the marketplace, I think Metro Consumer Finance is positioned really well to be able to help on broader product sets like SME lending and overdrafts and credit cards. So, again, I feel that we're well positioned there on the asset side.

Our commercial lending teams, I do hear other banks and other fintechs talk about becoming more people oriented. We are people-oriented. We have regional lending teams scattered across the country, we have local business managers in every store who can help SME's. We are already well-invested and have a structure in place to take advantage of commercial and small business lending opportunities. So, I think on the assets side, we're pretty good.

You know, our distribution network is superb. I think our stores are better than any other bank and I think we're as good as most retailers. So, again, from a liability perspective, we‘re pretty comfortable.

And the bit that gets missed is that we've invested a lot of money in digital, I mean a lot of money in digital, and so our business account opening for small businesses we can do multi-director which we think we're the only one in the country that can do, online straight through processing and we believe our small business BAO opening platform is equal to any fintech in terms of number of clicks and amount of time it takes to get through.

So, we are continuing to invest across channels. And I don't think we're missing anything to get the bank back to profitability and generate adequate returns. We just now need to execute. We need to grind it out, day in, day out, deliver incremental improvement every day, and if we do that we get to where we want to be.

Sorry, I got a big long-winded, but I couldn't help myself. Cheers.

John Cronin

Thank you.

Christopher Cant

Good morning, both. Thank you for taking my question. I just wanted to ask about capital, please. I know we've discussed MREL this morning, but looking forward it seems like Tier 1 capital is actually the key pressure point for you. You've got a 9.3% requirement currently with a 0% countercyclical. So, that could rise to 11.3% over time, assuming that the Bank of England takes the UK countercyclical back up to 2%.

You've got 80 bps of software; I think it was. I don't know whether that's increased a little bit in the half, but 80 bps, I think, was the full year number. So, if I strip that out of your 39 capital, you're at 31. And if I look at slide ten, the middle bars of that slide, the actual reported P&L impact is half, with very benign provisioning, as you say. You had two percentage points of CET1 consumption, I think, in that chart. So, when I look at that, it doesn't feel like you've got much of a glide path from here. At that rate of decline, I think you would be close to breaching the ex-countercyclical buffer number pretty swiftly, maybe in a year or 18 months.

I understand that you're seeing improving profitability, but I really struggle to see how you don't need fresh equity to deal with this Tier 1 issue rather than an MREL issue, *per se*. So, I know you haven't given medium-term guidance, and you said you don't expect to access capital markets in the second half of this year, but do you really still think you can proceed with the multiyear plan out to 2024 without accessing fresh equity? I'm struggling to see how you reconcile that pace of decline in regulatory resources particularly at the Tier 1 level. Thank you.

Daniel Frumkin

Yeah, thanks Chris. I saw your note. So listen I'll make one quick point, well two quick points, then I'm going to turn over to David to get into detail. The first point I'd say is we have no indication that the countercyclical buffer is imminent or in the near term, so I do think just adding in the 2% is probably a wee bit conservative.

And then, the second point I'd make is we're still committed to a plan, and we have a plan that, at this juncture, assumes that we will not issue common, and we think we can get there. But David, I don't know what you'd like to add.

David Arden

No I think you've covered it. Chris, on the countercyclical buffer, as you know, any change would take 12 months to come in, and there's no indication right now that the bank will increase the countercyclical buffer. As Dan said, our plan does not assume any common equity raise through the life of the plan. There are a number of moving parts to our capital consumption and our resources over time, and rest assured, when the time comes, we will take the best action for the best outcome for our shareholders, and we are fully committed to executing the plan without raising common equity at any point in the plan, and the plan is being executed day in, day out.

Christopher Cant

OK, I think I need to sit down with the spreadsheet to try to understand how you can achieve significant consumer unsecured growth whilst making losses. And I think you're still loss-making at a pre-provision level on an underlying basis. Even with the NII improvement you're seeing, you're still some way away from being break-even at a pre-provision level. And just the pace of CET1 decline seems particularly rapid. I appreciate the CCyB would only phase in over time, but as you say, even ex-CCyB, you need to be above 9.3%, as I guess a fairly hard stop, so it does feel very tight. If I ask the question slightly differently then, and I'm trying to understand what I'm missing in your plan here, when do you expect the bank to be profitable?

Daniel Frumkin

Chris, we have a date in mind, and we just discussed it at the Board in July, and we went through rolling forecasts that we do on a regular basis in great detail. But I can't tell you. The reality is we're not providing medium-term guidance, but we hope the macro-environment stabilises enough that when we stand up at year end, we can create much more clarity about when that point is. But we can see the point. We can see models that show us when we get to break-even, but at the moment, we're completely focused on executing the plan, improving the organisation on a day-to-day basis, and we're not really going to provide medium-term guidance. But we look forward to being able to do it, hopefully, at year end.

Christopher Cant

OK, thank you.

Perlie Mong

Hello, thanks for taking my questions. So just quickly, I know you just said that you invest a lot in digital. I'm just wondering, in your Change the Bank part, roughly how much is on tech spend? And I know RateSetter also has an instant quote app. Is there any chance you could use that technology on your other products? And I've also noticed that you've expanded your specialist mortgage offerings. What are the risk characteristics there? Thank you.

Daniel Frumkin

Really good questions, Perlie. Thank you so much for taking the time this morning. I don't really have the split on the spend tech versus non-tech, but actually, between the C&I programme, which again, was the money from the RBS divestiture that we were awarded, and our own core spending on the platform, a significant portion of the C&I spending and a significant portion of our own internal spending was to build better platforms in the digital space. I don't have a split for it. We can probably get some kind of a split afterwards, if it's important, but the spending is pretty significant.

In terms of the tech, it's a really good observation you just made. I think the quote API technology that hasn't been mentioned before is a really powerful tool that RateSetter had spent a fair amount of time building before we launched it into most aggregator channels – we're not quite in all aggregators yet with that tech. And it's a really powerful tool that we do anticipate using across a broader range of channels and products over the next 6 to 12 months. So we're excited about the power that that gives us. And again, creating Metro Consumer Finance and taking the tech team that was embedded in RateSetter, run by Andreas who is really good, to run that whole tech theme for us across Metro Consumer Finance, I think will really allow us to use some of that tech to power a broader offering to both customers and into aggregator channels.

And then, specialist mortgages. Again, we're not really providing guidance going forward, but we don't expect it to move our provision significantly, and actually the majority of what we've done doesn't have a risk profile that we're uncomfortable with or leads to meaningfully higher losses. So, again, as we provide, hopefully, medium-term guidance at year end, we can provide you with a bit more clarity, but we actually think what we've done in that space, it is still really conservative. We're a specialist lender with a small 's' versus some of the others in the market who aren't full-service banks.

Perlie Mong

That's great, thank you.

Daniel Crowe

Hi, there. Good morning, and thanks for having the call. I just wanted to follow up kind of on the MREL and capital constraints and the pace at which you're eating through your capital. I know you say you don't expect to access capital markets, but it seems pretty clear that you're kind of on the verge of hitting capital constraints in terms of MREL, and that's before the software intangibles.

Do you actually think you can continue to grow if you are hitting those constraints? And you certainly will hit them once the 1% software intangible comes through. I'm trying to figure out how - you're saying you're not going to either issue MREL or issue equity, and tying your growth projections through because the two don't tie up.

Daniel Frumkin

So I'll let David take it but I do want to be clear we've always said we would issue MREL over time, we're just not planning to issue MREL between now and year end.

David Arden

Yeah I think that's spot on. We don't envisage accessing capital markets this year – so in second half of 2021 - and therefore, we will operate in our MREL buffers for a period. But we do anticipate accessing capital markets at some point in the future. Whether that's 2022, we can't confirm, because there are other actions and levers we can pull, as we've demonstrated in the past. But rest assured, when the time comes, we will do the best thing for the interests of all our stakeholders. But we will raise MREL. We do need to raise MREL at some point.

Daniel Crowe

Do you think you'll be allowed to run within your buffers given how the PRA has acted, not just with yourselves, but with some of your peers, effectively forcing MREL issuance. But that may not have been particularly useful.

Daniel Frumkin

So listen Daniel, we're probably the testament to MREL issuances that isn't very helpful, I think we may be the poster child. So the reality is that as people will know we operated within our buffers last year pre the mortgage sale. The PRA is fully aware of our forecasts, we walk them through them in great detail, and continue to keep them updated on a regular basis.

So, everything we're saying today hasn't been a surprise to anybody at the PRA and we continue to have an open and transparent relationship with the PRA. So, we also do need to remember that 40% of our balance sheet is sitting in cash and cash instruments. It's a very different balance sheet than your average bank, and I do think that provides maybe a wee bit of flexibility. So, we can only work with our regulator and they are fully aware of our situation.

Daniel Crowe

OK, fair enough. Thank you.

John Cronin

Hi, guys. Thanks for letting me do a quick follow-up. Just on the Buy to Let portfolio, or the commercial loans rather, that were risk weighted at an inappropriately low level and were re-risk weighted at 100%. David, is it possible to give the figure in terms of what the net loans outstanding in that book are now that are risk weighted now at 100%?

David Arden

I haven't got that detail off the top of my head, John, but it's clearly attriting all the time. And it's something we're going to let roll off. We're not in that segment of the market any more. So, it's something that is front of our mind in terms of proactively progressing that segment of our business going forward.

Daniel Frumkin

And John, we're happy to give you a bit of detail after the fact. The reality is that there's a part of that market that other financial institutions do well and get lower risk ratings on because they underwrite it as consumer, and if you underwrite it as consumer you potentially get a different risk weight. So, let us get you some detail because it's probably not as simple as what's 100%. Yeah.

John Cronin

Yeah, because the reason for my question is, you could sell it, right? And that would potentially create capital.

Daniel Frumkin

I would say, John, you are spot on that either under the standardised approach or if we were to garner IRB for retail mortgages, there are some portfolios that are hugely capitally-inefficient from a risk adjusted return on regulatory capital. And there's a few pots of them kicking around the bank, and obviously, I think there are opportunities to create a more efficient balance sheet from a risk-adjusted return on reg cap than maybe what exists today.

John Cronin

Thanks for that.

Daniel Frumkin

Some of the growth that we do will be substitutional growth, not incremental growth over and above the existing balance sheet.

John Cronin

OK, thank you.

Daniel Frumkin

I just want to quickly thank everybody for taking the time. I know it's a really busy day. I genuinely appreciate your interest in the Metro story. I do know it's been a difficult journey, but there are green shoots, and we’re really excited about the path we’re on and convinced that we're on a strategy that will deliver for shareholders over time.

So, again, thank you for the time and have a great day.

David Arden

Thank you, all.