Metro Bank FY 2022 Results

2 March 2023

Daniel Frumkin (CEO) and James Hopkinson (CFO)

PRESENTATION

Daniel Frumkin

Good morning. Welcome to Metro Bank's full year 2022 results. I'm Daniel Frumkin, CEO of Metro Bank, which I hope all of you already knew. I'm joined today by James Hopkinson, who joins us as CFO. He joined us in September. His timing couldn't have been more impeccable. We're really thrilled to have him. It was a global search. We started with quite a long list of candidates, got down to a short list of about half a dozen, and James was always our preferred candidate. We were glad to woo him into the organization in typical Metro Bank style and in a desire to save money, I met him in Wimbledon at a Costa coffee and had a cup of coffee with him, and I was actually late arriving, so he had to pay for the coffee. But we're really thrilled he's here and you'll get to see him later.

I'm going to start with a brief overview. Then James is going to come on and talk about the financials, and then I'll come back and talk about the path forward. So let's kick off.

So we're stating today very clearly that what I stood up and talked about in February 2020. That presentation that went on almost a lifetime, that the turnaround is now complete. We were profitable on an underlying basis for quarter four 2022. That is earlier than we've ever guided. We didn't guide that pre-pandemic. We didn't guide that pre-war. We have always said we would turn profitable in 2023 and we managed to bring that forward and turn profitable in late 2022. And the turnaround was about fixing things and transforming the operation. So at the end of the day, we have a much more stable and resilient organisation. We have increased heads in risk and regulatory functions by 67% since 2019. We fundamentally rebuilt the governance structures, the Boards broadly new and ExCo's been reconstituted. We've also successfully closed legacy issues that at the time I stood up in 2020, people thought were existential threats. Both the RWA investigation and the OFAC investigations have been closed. I'm most pleased about the financial performance transformation. We said that we were going to drive improved financial performance by shifting mix on deposits and shifting mix on lending and becoming much more focused on risk adjusted returns on regulatory capital, while maintaining a strong cost discipline. So you can see the NIM improvement in the chart in the middle top. NIM bottomed out after the mortgage sale at 94 basis points. For the second half of 2022, we generated a 211 basis point NIM and our exit NIM in 2022 was 222 basis points. That was done through a lot of hard work repositioning the balance sheet both on the asset and liability side. I'm most pleased about the operating jaws we generated during 2022, the fact that revenue grew by 31% and cost reduced by 3%, creating operating jaws of 34%. And again, we're not done. We have lots of diversified growth opportunities in front of us, which I'll come back to in the second half of my presentation. But we have a scalable and dynamic asset generating base and everybody needs to remember we win market share every day. We're opening new accounts that are choosing to bank with Metro because of our exceptional service, our value proposition and our deep commitment to the communities. And by staying focused on operational accounts, PCAs (personal current accounts), business current accounts and instant access savings accounts, we've managed to reduce our cost of deposits by 58 basis points from 2019. And that's all about mix. We are now 96% funded with core deposits.

Now this slide is very busy. I'm not going to spend a lot of time on it. But to be clear, I stood up here in 2020 and promised that I would fix things. Well, this is evidence that Metro Bank has been broadly fixed and the key outcomes on the right hand side is just a small fraction of everything we did. To be honest, one of the hardest

parts of pulling together the presentation was choosing the bullets. But we always said it wasn't a cost story, but we've been extremely disciplined about costs and James will come on to that in more detail. We've added 100 basis points in yield. We fundamentally rebuilt technology platforms, re-engineered our risk and enhanced our IT resilience. We'll talk about balance sheet optimization. I bet most of you probably remember the £3.1 billion mortgage sale at a premium that we got away and then took that capital freed up and reinvested it into unsecured personal lending. At the time, it was a bold move that has paid off handsomely. And ultimately the thing that genuinely matters is we preserved our unique culture through communications.

Now. Let's talk about Metro Bank post turnaround. I get asked quite often, so what is Metro Bank now? Metro Bank is still driven by great colleagues who are engaged in the mission of becoming the best community bank in the UK. When we ran our Voice of the Colleagues survey, it’s sponsored by Glint. We use the Glint Global Benchmark. Glint is owned by Microsoft. It has companies in it like Roche and Sky and large global companies and 95% of our scores in our employee opinion survey are better than the Glint Global benchmark. That's made up of retailers, manufacturers, some of the best companies in the world. And 95% of the time our colleagues say they're more engaged with Metro's vision, purpose and future than the others. We're still best in class for service. We're number one on the high street for the 10th time running. Actually, ever since the survey was started, we've always been number one. We have a deep commitment to our communities. We do Days to Amaze for volunteering, Days to Amaze for colleagues are over 70% year on year. We've educated over 250,000 children in our Money Zone programme. And again, we have local business managers in every store. We have local directors. We have area directors, all who are committed to making the communities in which we operate better. We are on numerous local bids to help the High Street get better. We invest in the communities in which we operate. We raise money for the communities we operate. We are completely committed to our localness. We're still growing. Personal current accounts grew on a compound annual growth rate since 2019 of 11%. Business current accounts 9%. We opened 188,000 personal current accounts in 2022 and 42,000 business current accounts in 2022. That is as much or more than some of our much larger competitors. We’ve built strong commercial edge. We are now much more focused on generating appropriate returns. For everything we invest, for every loan we make, we are completely focused on what it does for all stakeholders, and we have a lot of strategic optionality, I'll come back to that later. All of that led to us achieving underlying profitability in quarter four, and it makes us very confident to target mid-single digit return on tangible equity by 2024. So thank you very much. I'm going to turn over James now to walk through the financials.

James Hopkinson

Thank you, Dan. And just before I start, maybe a personal statement to say thank you very much for the introduction. I'm delighted to have joined Metro Bank last year at this important stage in our journey. I was excited to join a truly customer focused organisation where the culture is infectious and the potential for the next phase is amazing. I found an organization that's put a lot of energy and focus into its turnaround plan, has invested in risk, compliance and systems, but has not lost sight of its customers, its community, its risk appetite, its point of difference, and the opportunity of what it could become.

So today I'm going to step through a few slides describing the momentum in the business and hopefully underline why I chose to join this team. First, just stepping through the P&L at the top left hand side of the slide. In a normalised rate environment, our model has really come into its own. Overall our income is up 31% year on year. That's up by over £124 million, with net interest income up 37% and fee income up 16%. Costs, on the other hand, were down 3% year on year, despite emerging inflation. Driving positive jaws of 34% as Dan mentioned earlier. ECL was up to just under £40 million, reflecting the growth in the lending book and the prevailing environment, which I’ll talk about a little later. Exceptional costs of just over £20 million were down, as previously guided, significantly year on year. Taken together, these factors drove more than £129 million reduction in underlying losses and a 71% reduction in statutory losses to £72.7 million for the year. The overall Metro Bank performance is probably best framed by the fact that the income uplift flew entirely into the bottom line. Customer activity is also at the heart of our income performance, as you can see from the top right hand chart, fee income grew 16% year on year, with positive growth across FX with volumes up 11.5%, more demand for our safe deposit boxes and increased customer activity driving other transactional income streams. Moving to the NIM waterfall at the bottom of the chart. You can see that our NIM grew strongly, up 52 basis points to 1.92%, and with an exit NIM of 2.22% in December. The strong NIM expansion reflects a significant reshaping of the balance sheet, coupled with the prevailing interest rate environment. Our lending yield has increased consistently over the past two years as we have built out our product offerings, including integrating the RateSetter platform. We've built a strong mortgage origination engine and we selectively maintained our largely variable rate Commercial book. Lending yield and mix drove a 36 basis point increase in NIM. The loan to deposit ratio also increased from 75% to 82%, adding 5 basis points to NIM. Our cost of deposits, as Dan mentioned

earlier, was down 4 basis points year on year to 20 basis points despite an increasing base rate environment. Treasury assets have also been reinvested into that higher rate environment benefiting NIM. So turning to the next slide, where I go into costs in a little more detail.

Cost discipline has been a key pillar of the turnaround plan, as you can see from the sequential bar chart, which sets out how we've controlled the cost run rate well, despite the recent inflationary pressures and the action we've taken to support our colleagues through salary increases. As a result of the actions stemming from our turnaround plan, our cost:income ratio has continued to improve, reaching 93% for the second half of 2022. We're stepping up our cost productivity as we service more clients. We're processing more transaction volumes and we have more products on a largely stable cost base. This has partly been achieved as we've invested into scalability. We've automated key customer journeys such as the business online overdraft, and we've launched digital end to end products like auto finance on our RateSetter platform towards the end of 2022. Overall, we believe we now have the infrastructure that can enable growth without significant additional cost. Finally, on exceptional items, the 73% reduction year on year reflects the fact that we've now closed out legacy issues and have delivered on most of the restructuring and transformation activity which we set out to deliver in our earlier turnaround plan. The only new exceptional cost area relates to set up costs of a new holding company, which is progressing well towards the June deadline this year. Turning to the balance sheet.

The balance sheet has been successfully reshaped over the last few years as we've increasingly optimised assets for risk adjusted return on regulatory capital whilst building core deposits through a differentiated service offering. Looking at the lending mix charts in the top right of the slide, you can see that we've grown the overall level of loans and advances by 7% year on year to £13.1 billion. Mortgage lending remains the main proportion of our lending at 58% and our unsecured portfolio has increased its share from 7% to 11% of the portfolio. Offsetting these growth areas, we've been actively running off our commercial real estate and professional buy-to-let portfolios. Alongside the maturing and repaying government-backed lending. One point the year on your chart doesn't quite cover is the fact that in Q4, alongside reaching underlying profitability, we actively constrained asset origination to around replacement levels. A move which underpinned our capital ratios but will result in lower assets growth going forward. Moving down to the bottom right hand of the slide to touch on deposits quickly. The deposit story has also been a significant driver of our performance. As you can see, we grew our current accounts strongly, up 8% year on year, and increasing to a 49% overall share of deposits. And together with demand accounts, core deposits represent 96% of our deposit stock. Looking forward, we do expect to selectively re-enter the fixed term deposit market from 2023 onwards as we can redeploy into low or no RWA investments. Now turning to the bottom left, ECL waterfall chart. As you can see, we have prudently built our stock provision from £34 million in 2019 to £187 million last year. 16% or £30.5 million of that remains as an overlay. The main overlays relate to additional conservatism around inflation and property valuations. We believe that we are appropriately provisioned for the shape of our book and to take into account the uncertain macro-economic conditions. Our ECL coverage ratio has also increased to 1.42% from 1.35% last year. This is primarily driven by our maturing unsecured portfolios as well as the prevailing macro outlook. As we stand here today, we're not seeing any early signs of credit stress emerging but we remain watchful of what has been a changeable environment. Our assessment of the macro scenarios is set out in the appendix to the slides, so I won't go through them here but we do feel we have an appropriately balanced view of our macro risks. Turning to the next slide and looking at the quality of our loan growth in a little more detail.

The overarching theme of this slide is that we have grown our lending in a disciplined way. Starting with the three sets of bar charts. New mortgage lending volumes were up 83% year on year to £2.2 billion. Showing the capacity of the bank to originate. Yet new mortgage lending in 2022 was of better quality overall than the prior year, where average origination LTVs were 69% versus 73% in the prior year. Our unsecured lending story is similar. The recent growth in unsecured has been targeted at more prime cohorts, where the average annual salary now sits at around £52,000 per annum, up 30% since the end of 2020. Additionally, using our internal credit score ratings, the new lending is almost 50% in our strongest four categories, double the rate in 2020. On commercial term loans, we are supporting our existing customers, whilst continuing to rebalance the portfolio where we continue to selectively reduce exposures to the commercial real estate and professional buy-to-let sectors, down 23% year on year, to optimise return on risk adjusted regulatory capital. So in conclusion, we believe that we've added quality assets to the book. We believe we are well provided. And while we remain watchful, we are not currently seeing signs of stress in the market. Moving to capital then.

We’ve turned around the business and reached profitability in Q4. During this period, we've also continued to operate within capital buffers. However, importantly, we've remained above all regulatory minima throughout 2022. Reaching profitability and constraining lending growth, which started in Q4 2022, should see us achieve sustainable capital generation from here. It's also worth highlighting that, in line with the industry, the IFRS 9

reliefs step down on the next few new year days, so 1 January each year from here on. The impact of the step downs in reliefs on 1 January this year was to reduce our MREL ratio by around 30 basis points and our CET1 ratio by around 35 basis points. Importantly, though, the additional reduction in our Pillar 2A requirement which is also effective on the 1st of January, largely offsets the reduction in release, meaning that the headroom above our regulatory minima shown on this slide was broadly maintained. Finally, this is a good opportunity to highlight that our regulators have provided several important capital approvals over the course of 2022. Including setting our MREL requirements at two times our Pillar 1 and Pillar 2A and reducing our Pillar 2A requirement from 1.11% to 0.5% and then again to 0.36% from 1 January 2023, as I just mentioned. Confirming that our Tier 2 notes can continue to count towards our MREL ratio after we have established our new holding company this year. And finally, our application for AIRB continues to progress. So bringing this all together then, and as we look forward to 2023, which will be for us a transitional year.

As I mentioned in my previous slides, we feel that there is still opportunity for NIM accretion balancing higher interest rates and our asset maturity profile and the expected increased cost of deposit pressure which we are seeing in the current market. Inflation is likely to be hard to contain within management costs initiatives. We believe current provisioning levels and the cost of risk are reflective of the likely economic outturn and the shape of our book. And we’re constraining asset and RWA growth so that we can start to sustainably strengthen our capital ratios and importantly, grow our headroom to the minimum requirements. Taken together, we are now targeting mid-single digit return on tangible equity by 2024.

I'm moving to my last slide before heading back to Dan who will talk you through the outlook and the future for Metro Bank. Let me briefly remind you of the key financial takeaways. We reported underlying profits for Q4. We have actively reshaped the balance sheet. We've built powerful asset origination engines and our clients are becoming more active. We've controlled costs well, despite inflationary pressures. We are appropriately provisioned but are watchful and we are targeting sustainable, profitable growth within our current capital constraints. And with that, I'll hand back to Dan. Thank you very much.

Daniel Frumkin

Thanks, James. I'm genuinely glad you're here. So, listen, we've said 2023 is a transitional year and I want to talk a little bit about the future for Metro Bank. I think it's really important to draw a line under the transformation and the turnaround and really stop looking back and start looking forward. So as we start to think about the path forward, the path forward has a lot of the components that are at the core of Metro Bank and have been at the core of Metro Bank since its founding. We're a service led model to create FANS. We're a multichannel organisation with stores at the heart of what we do. We have a great culture brought together by amazing and engaged colleagues. The one thing that separates us from almost every other challenger bank in the market is we are a full service bank. We have a corporate lending division. We have a regional commercial lending business. We have asset finance, invoice finance. We do unsecured personal, we do auto lending. We have a great SME franchise. We have all of the products sets that the large incumbents have. We have cash management systems for our corporates. We have cash management systems for our SME customers. We do a lot of FX, we do a lot of transactional business. We are a full service bank. That gives us a lot of strategic optionality as we move forward. We remain community focused. We believe we win one store at a time. We win in every community we operate in, and we win by staying local. And again, we've improved the foundations of the organisation. We've added risk and regulatory colleagues. We've improved our asset generating capabilities both through the acquisition of RateSetter, repositioning our mortgage offering, building an auto platform that's digital and embedded in our suppliers. It is a different organisation. And I did talk about credit cards quite a bit way back in 2020. And even there whilst still a small part of our business, we increased credit card sales over four times in 2022 versus what we did in 2019. We’re in a place where we still get recognised for how special we are. So we've talked about the CMA results, but two of the things on the right that are really important to me is we're one of the top ten most loved workplaces, and we were viewed as a top ten inclusive employer. We want our colleagues to be the best version of themselves they can be. It's all we ask. Be yourself and be the best version of yourself you can be.

So that helps us build a sustainably profitable business. So we talked about briefly in a prior slide that we opened personal current accounts at 11% CAGR and business current accounts at a 9% CAGR, that's between 2019 and 2022. And for those of you with a short memory, a bit like myself, the reality is, don't forget, two of those years included COVID. It's a phenomenal performance. And then we talked about shifting the asset mix and starting to get into business lines that gave us a bit more margin for every pound of risk weighted assets. So we've done two and a half times more mortgage applications at higher yields than what we were doing in 2019. And the bottom chart is accurate. In 2019, throughout the whole year, we did £11 million of unsecured personal lending.

In 2022, even constraining in the fourth quarter asset origination because of the capital constraints, we still did over £1.1 billion of unsecured consumer lending. Up from £11 million just three years before. And the top right is a chart we've created. But I think it gives you an idea of what we said we would achieve. When I stood up here, we said we were going to focus on risk adjusted returns on regulatory capital. That's what that chart shows you. It's a reasonable proxy, loan interest income divided by RWAs, and it's consistent throughout. So we've added 300 basis points from the lows in 2019 and early 2020 to where we sit today by changing the asset mix of the organisation, by refocusing our efforts where we get paid for the quality service we deliver. And then a more traditional measure is just the spread between lending yield and cost of deposits. Every bank shows it. But if you go back and look at the second half of 2019 or even the first half of 2020. That spread was 200, 190 to 200 basis points. That spread today in the second half of 2022 was 360 basis points. All of that was done through the hard work of focusing on core deposits and changing the asset mix of the organisation.

So stores, you will have seen it, and I'm sure for some of you it'll be a topic of conversation, we are going to open more stores. We are going to open 11 stores between 2024 and 2025 in the North of England. We believe that communities like Newcastle and Leeds, and York and Hull, and others, absolutely deserve the benefits of having a Metro Bank embedded in their communities. And we're excited to go there. But let's be clear, we're going to go there in a different way. We're going to go there making sure the stores are much, much less expensive to build. They're going to have much less excess space in them and we have learned the value of break clauses. So while we will have long term leases, they will have frequent and often breaks. But let me tell you what will be the same. They will look like a Metro store. They will have phenomenal Metro colleagues inside of them. They will be open seven days a week and they will be open early to late. That's not changing. And when we talk about stores, everybody needs to remember the physical presence is about brand building as well as it is about service. So 90% of our personal current accounts that are open digitally are within 20 miles of a store. The stores are a beacon. They create a lot of activity because they exist. And the bottom left of this chart is hugely powerful. Our stores, when it comes to personal current accounts, are two and a half times more productive than the big four. And when it comes to business current accounts, they are four times more productive than the big four. And again, our mix of digital versus store based openings is meaningfully different than what you would see in the big four, because we believe in that face to face personal service.

So again, a bit unlike other retail banks, we have a huge difference. So there are a fair number of retail banks in the UK who are of scale. Who are unlikely to grow meaningfully because they are constrained by their existing size. Metro Bank is uniquely positioned to continue to grow significantly from this point forward. We can grow accounts. We win every day, 188,000 PCAs, 42,000 BCAs, we grow every day. We still have a limited product set. I talked about filling the shelves. We're a little bit better off than we were, but to be honest, there's room to grow. And you saw the fee growth, 16% fee growth year on year. As we grow accounts, as we expand products, we get more transactions, we get more customers walking through the door and it generates more fees. There's lots of communities we're not in. So we'll do the next 11 stores up North and we'll continue to invest in those communities. But the reality is there's lots of places outside the North where we're not who deserve to have a Metro Bank. You know, we're not in Norwich, we're not in Ipswich. The East Midlands is an area we're not well covered in. We're not in Exeter. There's lots of places that deserve to have a Metro Bank. And we continue to grow in all our existing stores. None of our existing stores have reached maturity. They're all still growing and our digital offering is quite well-rated and is really pretty good, but we need to continue to invest in it. And we will continue invest as we move forward. The bottom left is broadly new since I arrived. We have a lot of asset generating capability and we can choose how we deploy that asset generating capability depending upon risk adjusted returns on regulatory capital. We can stress in and out of various business markets, which you've seen. So we've constrained commercial lending, in particular commercial real estate lending. We've broadly shrunk our professional buy to let book. As we said we would, to create capacity to do more unsecured personal lending and more mortgage lending because that gave us a better risk adjusted return on regulatory capital. We will remain disciplined about trading amongst the asset side, not to mention we now have a moment, given the base rate rises we've seen, to actually generate really good returns on very low risk weights by buying gilts and/ or structured products. We don't do any balance sheet optimisation today. We don't do any securitisations. We don't have any forward flow agreements. Again, there are lots of ways for us to use this balance sheet in anger that we're not currently doing. And the bottom right is probably our single biggest constraint. We need to optimise the capital stack and as we get an opportunity to optimise the capital stack, everything above the bottom right can be accelerated and taken advantage of.

So the repositioned model works. We're very happy with where we've ended up post the turnaround. It was a bank designed for our customers, colleagues and communities, and it is still a bank designed for our customers, colleagues and communities. We delivered the turn around and protected the organisation. It's still a service led model. It has a wonderfully diversified asset base and allows us to do creative things. It has a scalable cost

base, as James said. We are ready for much more volume to leverage up what is broadly a fixed cost base. We have a much more resilient bank, a much more stable bank than it was. And the chart on the right, you can recreate. It's all from public information. It's pretty simple to get at. But we have fundamentally repositioned Metro Bank from being close to a building society to now be in clear blue water. We have the funding advantages of a high street bank, and we're generating yield like a specialist lender. There is nobody, nobody in the UK who's in that position. We have lots of strategic optionality to continue to take advantage of that clear blue water. And that clear blue water gives us an opportunity to generate outsized returns as we move forward. Thank you very much for your time this morning. We're now happy to take your questions.

Q&A

Operator

Thank you. Please dial * 1, if you'd like to ask a question. We have the first question from Benjamin Toms of RBC. Your line is open.

Benjamin Toms, RBC

Good morning and thank you for the presentation and taking my questions. Three quick ones for me, please, especially your mid-single digit RoTE guidance for 2024. Can you just confirm whether this is on the reported or an underlying basis please? Secondly, on NIM, the guidance is for accretion in 2023. Can I just confirm that the base of this guidance is the December 2022 exit rate of 2.22%. And thirdly on capital, can you tell us your expected day one impact from Basel 3.1, please? Thank you.

Daniel Frumkin

Sure. I'll start and then I'll let James come in. I'll do the capital. I'll talk a bit about NIM accretion, and James can finish that off and I'll let you talk about the mid-single digit RoTE. So we haven't really started to. Well, that's not fair. We've done a lot of work on Basel 3.1. We haven't yet calculated the impacts in particular, how Basel 3.1 will interact with our AIRB application. As you know, Ben, there's now floors and it gets a wee bit more complicated for us. So we're working through all that. It was a short consultation paper. I think it was about 1,200 pages. So, you know, we are working through it and going through. In terms of NIM accretion, will clearly accrete over the 192 basis point average for the year and then we should be able to accrete above the 222 basis point exit. As we see, we closed a fair amount of lending in the second half of the year. You'll notice loans grew 6% half on half. Those loans will mature and they were higher yielding than our lending yield that is in the financials. So that'll help. And we have investments rolling off that will reinvest, but they'll definitely be some pressure on cost of deposits. So net net, yes, it should continue to accrete over the over the exit run rate. And then, James, I don't know if there's anything you want to say about the way we calculated the RoTE.

James Hopkinson

So we're not expecting material exceptional items from here so our underlying and our statutory return on tangible equity should be very aligned, I would suggest. And in terms of Basel 3.1, I mean it's a very detailed consultation that the Bank of England, that the PRA have put out. I think it's got some very interesting contents. It's early days. We're going through the exercise but the early view looks like mortgages are generally looking supportive, slightly beneficial and depending on the definitions and depending on how the consultation goes, it looks like commercial and SME maybe slightly higher risk weighted. But net net, I think it's broadly neutral.

Benjamin Toms, RBC

Thank you very much.

Operator

Thank you. You now have the next question from John Cronin of Goodbody. Your line is open.

John Cronin, Goodbody

Morning James, and welcome to Metro Bank. Thanks for the call. And just a few questions from me if I can. If I can come back firstly I guess to the mid-single digit RoTE 24 guidance. And I suppose just when I run the

numbers accreting NIM and, you know, maintaining cost of risk as a kind of normalised level and taking in some degree of operating cost inflation, and I look at this on an optimised capital base level and you can kind of see the case for a RoTE towards higher than mid-single digits for 2024. And then trying to understand, is there something I'm missing and in relation to maybe the composition of the balance sheet that could change that has kind of prompted you to go with a with mid-single digit guidance? And maybe within that, like is there a fair degree of caution embedded in that guidance to reflect the kind of macro uncertainties, be it the risk of higher impairments or costs, for example? Just trying to get a bit more colour in terms of how you got to that number. Like any data points you could provide maybe around NIM would be helpful. And then secondly, more specifically on cost of deposits, which was clearly a major talking point for the large top UK bank results, is there anything you can elaborate on in terms of what you're seeing around compositional effects, in terms of any kind of shift in terms of business, I know that you're continuing to grow your customer base in absolute terms all the time, but are you seeing on the part of some customers a proclivity to just start moving into higher yielding accounts? And if so, like how? How? To what extent could that factor alone impact on net interest margin development this year? And then thirdly, look, coming back to some of the higher risk weighted portfolios and just thinking about your capital position. And look, you've been open in terms of operating within buffers, but in any case, some kind of injection of capital were needed beyond what's achievable through income generation or the capital generation in the course of 23. I mean, if you have to sell assets just like to think what kind of portfolios would you be looking up there if you had to sell assets? And maybe just more specifically, I know there was a buy-to-let portfolio that in early 2019 was risk weighted as 100% effectively. You know what kind of size is that particular portfolio now, just get my own head around figures in terms of optionality there. Thanks.

Daniel Frumkin

No worries. Listen, John, I think it's great. So I'll handle the mid-single digit and the risk weights of the portfolio and I'll come to you for the CoD, James. So listen. We think the mid-single digit RoTE is appropriate to guide at this juncture. It's the first positive guidance we've given since I stood up in February 2020 and provided guidance. We wouldn't have guided if we didn't think we could hit it. It also aligns with our targets that you're going to see when the ARA gets published around our long term incentive plan for the executives. So we thought it was the appropriate place to guide. I doubt we have very many differences in our model. And again, tomorrow we can spend some more time unpicking it. I do think maybe one place is I think you were probably kind enough to think we could optimise the capital stack maybe quicker than we're going to be able to, and I think that is the one variable we're wrestling with. You know, when will the capital markets be open to us and at what price, really. Because again, the sooner they're open at a better price, the easier it is to drive more RoTE as I said, given the strategic optionality. In terms of the portfolios we'd sell, there is in the disclosures, there's a portfolio referred to as professional buy-to-let. That was the portfolio that went through a bit of risk weight volatility. It's actually now settled down, to be honest, the majority of the stuff that went to 100%, and I am sort of twitching when I say it, given the impact all of that had. But the reality is, is that as we sit here today, all of that risk weight is now appropriate and not much of what we're left with is at 100%. So I don't know that that portfolio would be one we would sell, we would look at our core mortgage portfolio. We'd probably look at our unsecured lending portfolio. And again, I think I've been pretty clear, we will do what's right for all stakeholders. So if a portfolio sale makes sense, we would absolutely consider it. I would say the mini budget made that a little bit harder to do for us in the third and fourth quarter, but I think markets have now stabilised. SONIA's back down to a place where it's getting reasonable. I think a lot of institutions are risk on a bit. So again, we keep it under advisement all the time. We have investment banks in pretty much all the time walking through what scenarios and everything else. And again, we'll consider everything to kind of manage the balance sheet aggressively, as we always have. And I don't know if you want to talk about the compositional effect of CoD and where we are in terms of the deposit flows.

James Hopkinson

Yes, absolutely. So as we mentioned earlier, we've been actively managing down our fixed term deposit base over the course of 2022, we do expect to re-enter that market. So that will have an upward effect on our cost of deposits. I think the market is, as I think I mentioned, quite changeable at the moment. So there's a lot of movements going through, whether it's interest rates or various other macroeconomic changes which are having an effect on behaviour. I would agree that we've seen that. I think we've seen that across the reporting period across the industry as well and we're no different. So we are seeing the same pressures, upward pressures on cost of deposits. And I think you also asked about the composition of the buy-to-let portfolio. So within our mortgage book, so of our £7.7 billion mortgage, 28% of that book was a buy-to-let mortgage. And then on the professional buy-to-let side, as I mentioned earlier as well, we've reduced that portfolio. See, it was £950 million down to £731 million by the end of last year which is down 23%.

John Cronin, Goodbody

Okay thanks for that. Looking forward to a bit more detail tomorrow. Thanks.

Operator

Thank you. We now have Perlie Mong of KBW. Please proceed with your question.

Perlie Mong, KBW

Hi. I'm sorry to have another NIM question. So I hear that you think you're going to accrete on the exit NIM. I just want to get a clearer sense of what do you think the drivers are? Because it doesn't sound like a lot of it's going to be from deposits. I understand that you're obviously still building stores and growing your current account franchise, etc., but obviously, we've just talked about some of the pressure on the deposit side and, you know, more behaviour shift more recently. So is it going to be more like asset mix shift? Like is it going to be more consumer lending? Is that what's going to drive your NIM accretion. And sort of what do you see the shape of NIM in the year, broadly speaking? But also a question and second question is on your RoTE target. So, yeah, it's obviously very encouraging to see you put out a target like this. But I just want to talk about what happens after 2024 because presumably if you're generating double digit, sorry, mid-single digit returns, then at some point the regulator would probably ask you to meet more of the capital requirements, including the buffers. So, you know, does that imply that you have to, you know, keep back an increasing amount of capital for a few years? So just, you know, obviously understand the regulators have been very supportive, but just sort of how you think about the trajectory.

Daniel Frumkin

Two really good questions. So, listen, I think the NIM drivers are pretty straightforward. You're right, cost of deposits is going to have some pressure on it. But remember, the second half of the year cost of deposits was 25 basis points, not 20. So we've already started to see that come through a little bit. And cost of deposits at the end of the year was, exit was a bit higher than 25 basis points. So the 222 basis points already has some cost of deposit movement in it. The second thing I would say is that if you look, the lending book grew 6% half on half. And the loans we booked in the second half of the year were higher yielding than the loans that we had before we booked them. So you're going to have those loans and yields come through into the P&L and for the first half of 2023 you get the benefit of all those loans we closed in the second half of the year. We also run, I think excluding cash, about a duration of about 1.7 years on our investment portfolio. So again, we get a fair amount of our large investment portfolio back intra year that we can then reinvest at higher yields. So it's less of an asset mix shift. It's much more of the fact that the asset growth occurred later in the year. So you get an annualised effect and the roll off of the Treasury book, which gives us a chance to reinvest and the fact that 2022 already had some increased CoD in it. And then in terms of the RoTE targets, what do we do beyond 2024. Listen, we don't like operating in buffers, right? So it is wonderful the regulator has been supporting as they have been. We've worked very hard to keep the regulator onside. And the key to that is delivering on what you say you're going to do. And I think there's little doubt three years into the journey, we have absolutely delivered on everything we said we were going to do, which gives them confidence. We are hopeful that an optimised capital stack will be available to us in the relatively near term if we get to continue to deliver. Once an optimised capital stack is available to us, which is code for debt capital markets being open at reasonable pricing, the reality is, is we will issue sufficient debt and restructure our capital stack to get out of buffers and have room to grow. But until that occurs, we have to constrain asset growth, consider portfolio sales, and continue to be as disciplined as we have been to get back to profitability. But I would hope if we continue to deliver, that debt capital markets would open to us. And thanks for the questions.

Perlie Mong, KBW

Thank you.

Operator

Thank you. We now have Miruna Chirea of Barclays. Please go ahead when you're ready.

Miruna Chirea, Barclays

Morning, Daniel. Morning, James. Thank you for taking my questions. I just have two, if I may. So firstly, I'm sorry to go back to the 2024 mid-single digit RoTE target, but I was wondering how you're thinking about the path to get there and profitability through 2023. Should we think about it as a straight line progression building towards the target throughout the year? Or do you think there will be a period in which you might not be profitable. And related to Perlie's questions a bit earlier. How should we think about the RoTE profile being sustainable beyond 2024, especially given that we would expect rates to get cut? And then secondly, should I go on to the second question?

Daniel Frumkin

Keep going, keep going.

Miruna Chirea, Barclays

No. Secondly, yeah, I was also hoping to get a sense of how we should think about operating jaws in 2023. So obviously in 2022, we've seen very good progression there. And exit NIM was strong, but it seems that loan growth from here might be limited given that you're having the capital constraints. So how do you think about the outlook for revenues and at the same time, what is the thought process on cost? So we tried to focus on cost inflation that you would call out and how everything about transformation and cost savings in the current environment. Thank you.

Daniel Frumkin

That's great. Listen, thanks. I'll start and then on the operating jaws, I'll turn over to James. So listen, we do guide to a mid-single digit ROTE for 2024. Again, you'll see it in the annual report and accounts when it gets published under the premise of the remuneration committee report that's in the ARA. And, you know, we think that those are eminently achievable. It would be unusual for us to have built a balance sheet that generates enough margin and has enough volume in it not to generate enough income to be above cost, which is how we got back to breakeven. And we did it in a very traditional banking way, we have a big enough balance sheet with enough margin to generate enough income to cover costs. That should be sustainable. Clearly there are some headwinds throughout the year. You're not sure what's going to happen in credit. And so we need to be a little bit cautious about what we say about 2023. But it would be unusual to get to a mid-single digit return on tangible equity in 2024 and go meaningfully backwards in in 2023. So I'm not going to comment on a straight line or a wiggly line or whether it's monthly profitability or any of that. But broadly, it would be unusual for us to go back, meaning backwards, meaningfully, and then somehow sprint back to be a mid-single digit return on tangible equity. In terms of beyond 2024, well we're not really providing guidance beyond that, with one exception. And I know the annual report and accounts hasn't been published yet. It'll be published in a couple of weeks under a relatively tight time frame because we need to get the holding company set up. But you will also see in the remuneration committee report. Remuneration committee report for 2025 has a RoTE target of 5% to 8%. So we do believe it's sustainable. And again, back to an optimised capital stack. If we can get access to the capital markets to allow us to optimise the capital stack, we would hope that we be able to stretch our legs beyond those existing RoTE targets. So we have to be pretty conservative about what we've modelled into the plan. But to be absolutely clear, the core plan has no common equity raise in it. It's all about accessing debt capital markets. And if you want to talk about operating jaws for 2024.

James Hopkinson

For 2023 and 2024. Okay, great. So I think the question was around sort of sources of inflation and how we expected to manage costs going forward. And I think it's probably quite a broad inflationary pressure. So certainly we're looking to continue to support our colleagues with cost of living increases and therefore, we would expect there to be a salary increase, our round starts in March, effective April. And so that would be an area of cost inflation as well as suppliers. I mean, I think our suppliers are, broadly speaking across the space, also seeing the same kind of salary pressures that are in the market. So countering that myself and my colleagues around the business are looking at how we can take advantage of the efficiencies and productivity gains that we've invested in over the last couple of years. And we've continued to look for opportunities to reduce our leasehold costs where there's an economic rationale for buying freeholds of our properties. We've been doing that over the last couple of years and we're now up to 39% of our store footprint is now freehold owned. That's beneficial. And we're also going through line by line with our suppliers, making sure that we're getting the best possible value for the money that we're deploying. So I think those are the two main areas that we'll be looking to try and manage

down costs. I think these are the two main areas where we'll probably experience more inflationary pressure.

Daniel Frumkin

And what I would say is the reason we're confident that we'll have pretty positive jaws. If you think about it, we exited the year with a NIM of 222 basis points. I think from memory the first half NIM was 173 basis points. And the reality is that's almost 50 basis points up. So for the first half of 2023 you're going to see meaningful revenue growth of the fact that NIM is 50 basis points higher for the first half of the year. So we expect reasonable revenue growth next year. We also expect growth in fee income. So at the end of the day, we will have positive jaws next year. Whether, I doubt highly they'll be 34%. But the reality is they will be positive jaws next year.

Miruna Chirea, Barclays

Thank you. That's very helpful.

Operator

Thank you. We now have Corinne Cunningham of Autonomous. Your line is open.

Corrine Cunningham, Autonomous

Good morning, everyone. Few questions for me, please. First of all, the Pillar 2A coming down? Has that been replaced via increased Pillar 2B requirement? So would you say that your regulatory requirements are similar, it's just the mix has changed. And secondly, can you say anything about the timeline to meet your MREL requirements or exiting buffers? Like I said, AIRB. And also, can you just clarify what base rate assumptions you're using behind your NIM? Thank you.

Daniel Frumkin

Sure. I'm happy to take it. So we don't, um. So I got to be a little careful here, but. But we don't comment on our private buffers and whether they exist, don't exist, what they are. But I'll make an exception in your case. So the reality is, is that our Pillar 2A reductions have not been seeing a corresponding increase in our Pillar 2B. So they are genuine reductions based on the belief of the regulator and the risk profile of Metro Bank. So that simple and I think it's very supportive and understanding of the regulator. And actually they understand the risk profile of Metro Bank, which is quite muted actually, given our asset profile. And MREL timeline, i.e. when do we need be out of buffers. We don't have a stated timeline with our regulator. We continue to produce long term plans. We do a rolling five year forecast that's just gone through the board. It goes to the board every February. We share that with the regulator. We provide them capital forecast and specific capital forecast depending upon various market scenarios and we continue to deal with them on a very frequent basis. I talk to them about every month and we continue to keep them abreast. They understand the situation we're in. They're very supportive of the path we're on and there is no cliff edge that we're aware of. In terms of AIRB, I can't say and I am not being coy. I can't say because I don't know. We continue to work really hard on AIRB and to be honest, the regulator continues to work very hard on AIRB. Staffing issues, both with the regulator and with us, have always created a bit of snafu at moments and it has delayed us. And that's always a bit of a challenge. But again, their engagement has been positive. Our engagement has been positive. All feedback to date is quite positive, but we need to continue to work through the process and it's quite an arduous process. So there is no timeline I'm willing to comment on. And then in terms of base rate, I think we have at four and a half and we have a first base rate reduction in 2024.

Corrine Cunningham, Autonomous

Thank you very much.

Operator

As we are approaching the end of the webcast, we have time for only one more question. Our final question comes from the line of Daniel Crowe with Goldman Sachs.

Daniel Crowe, Goldman Sachs

Hi there, good morning. Thanks for the call. Most of mine have been answered. But just a quick one on your TFSME. I was just wondering, could I just get a, I know you've stated that the majority of that is invested into gilts. So just wondering what the duration of that portfolio is, because at the moment that looks like a bit more of a drag than a tailwind. And then just in terms of the plans for the pay down. And then on cost of risk and just to get a bit of the level of confidence on your customers staying at 32 bps. And just note in the stage two increase, particularly in the unsecured if you just have any comments around that. And then the final one, you got the waiver on your Tier 2 that counts as MREL. And obviously, your senior has the clauses to potentially allow us to move up to the holdco. But just checking, there's no issue from the trustee on that moving up if the Tier 2 stays at the OpCo.

Daniel Frumkin

Sure. So I'll do the cost of risk. Then I'll let James talk about TFSME and then the portability of the MREL debt and the flipper clause. So in terms of cost of risk, you'll notice that our ECL expense was up 78% year on year. And we have said that we are not going to grow assets as aggressively in 2023 as we did in 2022. So again, a large portion of that ECL increase was because we grew our unsecured lending portfolio as much as we did in the year. So we're pretty confident based on the economic scenarios provided by Moody's, that actually 32 basis points is there or thereabouts. Now it could get a lot worse and who knows where the economy goes. So we need to be a bit careful. But based off the current forecast, we think that's about right. The stage two increase for unsecured personal was all model driven. We're not seeing any deterioration in the underlying customers. It was all driven off of the models based on the macro forecast. So again, if the macro forecasts get a little better, which if JP Morgan's right, they will. The reality is, is that gives us a bit of headroom as well. And so, James, I don't know if you want to talk about TFSME and then and then the Tier 2 bit.

James Hopkinson

Excuse me. Very good. And so just looking at that, we look at the TFSME funding all the time myself and my Treasury colleagues at the moment. It does provide useful liquidity for us and it's a floating rate so the day that the Bank of England rates changes, that translates into an immediate increase in costs. We also have a relatively offsetting floating rate book in our commercial business as well. So we see broadly that that is a wash after the rate rises go through and repayment starts for us, the profile starts at the end of 2024. So it's on the book for a fair period of time. So it's a good, stable source of liquidity. And the Tier 2 question was.

Daniel Frumkin

Whether the MREL can flip to the HoldCo and whether the fact that the Tier 2 staying behind is, in effect, the ability for the MREL to port up to HoldCo.

James Hopkinson

Yeah, absolutely. So, you know, we've been going through quite an extensive and sort of period of work to try and establish the holding company. We have language in our, you know, MREL documentation which permits flipping that instrument up into our TopCo, which is our intention. We're working through that process very closely with our regulators as well as with the trustees. And on the Tier 2 notes, the Tier 2 notes will remain in our operating company will remain eligible for MREL treatment through to the end of the middle of 2025 with an adjustment that the Bank of England provided to us earlier this year, which we, sorry last year, which we announced. And so the MREL eligibility remains from a Tier 2 perspective on a consolidation basis with the new HoldCo. There is a haircut for minority interest, but it's relatively minor as we look through our five year plan and the value of that Tier 2 starts to attenuate past the call date, it remains on the books.

Daniel Frumkin

Yeah, and all I would say because it's a really good observation about the TFSME. So the TFSME to me is definitely NIM dilutive, meaningfully dilutive because it's not insignificant in size. But the reality is, it's pretty good on liquidity and I don't know why we wouldn't keep it in place because it is neutral from a P&L perspective. But, but you're spot on. If we wanted to goose NIM for some reason, you would exit the TFSME because it really is NIM dilutive.

Daniel Crowe, Goldman Sachs

Thank you.

Operator

Thank you. I would like to hand it back to Dan for any closing remarks.

Daniel Frumkin

I just want to thank everybody for taking the time this morning. I know it's a very busy reporting cycle and we're sort of towards the tail end. I appreciate everybody's engagement and I thank everybody for their support and everybody have a great day. Take care.