Metro Bank H1 2023 Results

1 August 2023

Daniel Frumkin (CEO) and James Hopkinson (CFO)

PRESENTATION

Daniel Frumkin, CEO

Good morning and welcome to Metro Bank's H1 2023 interim results. We're glad you can join us this morning. For the running order of the day I'll start with a bit of an overview, relatively brief, then I'll turn it over to James who will walk you through the numbers and then I'll come back on with a few slides to talk about the potential of Metro and the strategy going forward.

So let's kick off. So we start where we always start. Metro Bank remains committed to being the number one community bank in the UK. We've made huge progress to becoming the number one community bank in the UK, and we do that by exemplary customer service, which is seen through being the number one best bank on the high street for the 10th time running, actually since the studies began we've always been number one on the high street.

We do that through our special sauce, which are our colleagues, our colleagues are unbelievable. They make everything at Metro work. And we know our colleagues remain engaged because 95% of our voice of our colleague scores, our employee opinion survey, were above the global benchmark. And you may have seen we are now the lead and first ever sponsor of women and girls cricket. We're really proud to help girls cricket grow throughout the UK. We know full well we could influence the lives of many young women and girls throughout the UK by helping them engage in sports, giving them the confidence that comes from participating in sport and helping them grow, to help lead their communities going forward.

The next couple of boxes are a little interesting. We tried to do something a bit different. So we've seen a 50% increase year on year in accounts opened in the hours that only Metro was open. So after 3pm, before 9am, and on weekends. It's a sign that our seven day a week model, our extended hours open early to late, still works. 50% more accounts were opened than a year ago during the hours that we are the only ones open. It makes a difference. In addition to that we saw 11% more safe deposit visits during that period as well. Another sign that our extended hours seven day a week banking is a real differentiator. The other differentiator amongst many is that we have local business managers in every store. We have actually more than 120 business managers across 76 stores. Their job is to help small businesses and small corporates grow. The only way the communities in which we operate get bigger, thrive, can add more value, is by growing. And we need the small businesses and the small corporates in those communities to grow with us. We only do as well as the communities in which we operate. We're completely committed to the localness of Metro Bank. And a sign of that is the people we dedicate to help those communities.

The bottom left. We have 76 stores today. We are committed to opening 11 more stores before the end of 2025 in the North of England. We're close, I think we might have actually already signed, our first purchase agreement for a piece of property in Chester. And we continue to look for sites across the North of England. We'll continue to be open early to late and open seven days a week. We continue to win awards, be it for our mortgage business, which has done really well over the last few years, to being one of the top ten most loved workplaces in the UK. All of that and the culture, the differentiators of Metro, has allowed us to open over 200,000 new accounts in the first half. We opened 106,000 personal current accounts in the first half and 23,000 business current accounts in the first half. That's 8% more personal current account openings than the second half of 2022 and 20% more business current account openings than the second half of 2022. The business is continuing to win FANS every day. It continues to grow every day. We saw deposit inflows in June. While in the first half we saw a bit of deposit attrition like every other bank in the UK. We were quite pleased to see meaningful inflows in June that continued into July and those flows included increases in current accounts.

We continue to transform the financial performance of the business. The jaws continue to widen while cost of deposits are up meaningfully in the first half of 2023, our lending yield grew more. So we are continuing to grow and continuing to expand the spread between lending and cost of deposits. And it took me a while to get here but the reality is, it's quite a moment for us to have first half profitability on both an underlying and statutory basis. The fact that we could print £16.1 million of underlying profits and £15.4 million of statutory profits in the first half of the year is quite a moment for Metro Bank given the journey we've been on. We're primed for further profitable growth. We managed to hold costs down. Cost decreased at Metro Bank half on half and year on year. I'm not sure another bank could say that this time. We continue to maximise the balance sheet. We continue to look at mix all the time. You will see we’ve slowed growing in unsecured personal lending and continue to invest in our mortgage business. That's all about risk adjusted return on regulatory capital. We continue to invest in the business to make sure we have scalable and dynamic asset engines and are starting to invest meaningful amounts into our deposit gathering engines, which I'll come back to.

I think overall it's a stable business. When James stands up, you're going to see the balance sheet is as it was. We continue to build a balance sheet to create sustainable earnings that allows us to be profitable as we move forward. We're primed to scale up so as we grow the business, we've actually built a scalable platform. And there's more work to be done in that area, but we're making real progress. And there's significant margin accretion potential, which I’ll come back to at the end. And with that, I'll turn it over to James to walk through the financials.

James Hopkinson, CFO

Thank you Dan. So today I'm going to walk through a few slides, setting out the bank's improved performance and return to profitability. So first, looking at the P&L on the left hand side. Overall, income was up 21% year on year, but broadly flat versus the second half, reflecting three broad themes of these results. First, assets maturing into a higher rate environment. Second, we've been constraining our lending and our appetite for raising higher cost deposits. And third, reducing current account balances and increasing deposit costs, which I'll cover later in the presentation. So moving down the P&L, fees were up 14.5% year on year and 1% half on half, reflecting some seasonality and strong underlying customer activity levels. Despite ongoing inflationary pressures, we've managed costs tightly, down 3% both half on half and year on year, driving 24% positive cost:income jaws year on year. Touching quickly on ECL, expected credit loss, this was down 49% half on half, reflecting several repayments in our commercial business, some improvement in macro variables and overlays and the continued lack of clear signs of elevated credit stress. Finally, exceptional items are now significantly lower as we closed out legacy issues and completed the insertion of our holding company. The bottom line, therefore, is a statutory profit of £12.7 million for the first half, marking our third consecutive quarter of underlying profitability, as Dan mentioned.

Moving to the NIM waterfall, you can see that NIM grew by a modest three basis points, half on half, as lending yield was broadly offset by increased costs of deposits, which were up from 25 basis points in the prior period up to 66 basis points this half. The next slide digs into costs in a little more detail.

From the chart on the left hand side, you can see that people related costs have remained broadly flat across each of the last three half year periods, despite pay increases for the majority of our colleagues in each of those periods. The main driver of cost reductions has been the decision to bring the majority of our change capacity and capability in-house, significantly reducing the number of contractors towards the end of 2022. The team has adopted a fixed capacity agile development process which has contributed towards the reduction in professional fees, down 33% from the second half of last year. Each area of the bank has also been very diligent in scrubbing supplier contracts to try and offset inflationary pressures. The result of this has been an improvement in the cost income ratio from 113% in the first half of 2022 down to 90% in the current period. And finally, as previously mentioned, we've closed out the remediation actions and completed the turnaround plan. So the exceptional items have significantly reduced. With the most recent exceptional item being the one-off insertion costs of the holding company.

Moving to the balance sheet. Again, as previously guided, we are constraining our asset originations to at or below replacement levels. Resulting in a 4% reduction in lending during the half and a 2% reduction in risk weighted assets. The top right chart shows that retail mortgages remain the significant majority of our assets, albeit with reducing balances. We also continue to see repayments in government-backed lending. Our commercial real estate exposures are now less than 5% of our total lending and we've continued to constrain our consumer originations. Bringing this together then for credit quality. The £11 million ECL charge reflects the maturation of the consumer book, repayments in our commercial business and the impact of macroeconomic variables. Looking forward, we expect consumer ECL to continue, although commercial is more likely to normalise from the releases seen in the first half. Non-performing loans and past due loans have increased in the period largely driven by seasoning of the consumer lending from earlier years. Our ECL coverage ratio has increased from 1.41% to 1.54% in the period, which includes post-model adjustments and overlays of £24 million or 12% of the ECL stock. While we remain watchful of the impact of the economic environment, we believe we are appropriately provisioned.

So moving to the deposits chart. This shows, as Dan mentioned, that balances are down 3% half on half, in line with the prevailing trends across the industry. Importantly, however, there are green shoots emerging with more stability in the second quarter, which is down only £67 million from the first quarter. That's 0.4% compared to Q1. And we've seen deposit inflows in both June and July.

So moving to our asset mix. Mortgages represent 59% of our lending. This book remains high quality with a loan to value ratio of 58% and no exposures above 100% LTV. New lending loan to value has reduced four percentage points year on year to 67% and buy-to-let new lending reduced to only 14% of first half originations. On commercial, the book is largely floating rate with a high level of collateral, which remains at 55% LTV. And the segment also drives 51% of overall deposits for the bank and a good share of our fee income. Moving to consumer lending. On the bottom left segment, where balances were down 5% in the half. Origination quality also remains high in this portfolio, with the average borrower salary of £49,000 in the period, that was up 6% compared to the first half of last year. And over half of the new lending now is to our top three risk categories.

So turning to deposits. Our proposition, as you heard earlier, continues to attract new customers at pace, with 106,000 personal and 23,000 business current accounts opened in the first half. The bottom left charts shows, in line with the wider industry, deposit outflows in the first quarter of the year as cost-of-living pressures combined with some additional seasonal tax payment factors. Those outflows, however, moderated in the second quarter, as I said earlier, down only 0.4% quarter on quarter. And we have seen strong deposit inflows in both June and July. Our payments data are pointing towards individuals paying more monthly amounts to energy, utility and mortgage providers. Although there is some growing evidence that increased wages may be starting to ease the monthly pressure on people's savings. And we're also seeing recent growth in non-interest-bearing business deposits, which is encouraging. As you'll hear from Dan later, we have been investing in our Cash ISA and savings product set and see real opportunities there to win share. And importantly, we retain very strong liquidity and funding metrics with a loan to deposit ratio of 81%, a liquidity coverage ratio of 214%, and a net stable funding ratio of 132%.

So turning to capital. As you can see from the main chart, we've accreted around 70 basis points to our MREL ratio since the 1st of January as we have constrained lending to live within our means and we have delivered profitability. We continue to operate within our MREL buffers, and also at Tier 1 level following the countercyclical buffer increase to 2% on the 5th of July. Our AIRB application is still in progress and as previously highlighted, we continue to review options across the capital stack to strengthen our capital base. It is also important to note that the regulators have provided several important approvals over the past year, including last week agreeing to a further extension of our MREL eligibility for our Tier 2 notes, now up to maturity in June 2028. They have reduced our Pillar 2A requirement from 0.50% to 0.36% from the 1st of January this year. And they have also supported the establishment of our holding company.

So moving finally to our outlook and guidance. Overall, we continue to target mid-single digit return on tangible equity by 2024. And again, we give directional guidance for the key lines for 2023 compared to 2022. I’m going to spend a little bit more time on this slide to give some context. On NIM. We continue to expect full year NIM to be higher than last year, although the second half outcome is heavily dependent on our deposit shape as well as how we are constraining our asset origination. And therefore it is likely that there will be more NIM pressure in the second half. Breaking NIM down a little and starting with the lending yield. While we are constraining asset origination, there is strong embedded yield uplift in our book. For example, 35% of our mortgage book is due to reprice in the next 18 months with a yield of around 2.5%. In our Treasury book, we have about £1.5 billion maturing in the next 18 months, and that yield average is just over 3%. On cost of deposits. We expect this to continue to increase as we pass on more of the UK base rate increases and also continue to increase the mix of fixed term and higher cost deposits in our deposit base. Moving to costs. We will manage costs tightly, but inflation will continue to weigh against our cost initiatives and it's likely that costs will increase in the second half. On cost of risk. We continue to be watchful of the external environment, but we're not seeing any material signs of emerging stress. And finally, on capital, we'll continue to look to accrete capital through disciplined RWA allocations. In summary then, our steady progress has underpinned the return to first half profitability. We've seen strong customer acquisition plus better recent deposit trends. We continue to be disciplined on cost, risk and asset allocation. And we are investing in a fuller deposit product set to go alongside our scalable asset origination engines. And with that, I'll hand back to Dan to walk you through our strategy and our priorities. Thank you very much.

Daniel Frumkin, CEO

Thanks James. So before I kick off, just a quick reminder on what makes Metro special. So we have colleagues who are truly engaged to deliver a high-quality service unmatched and unparalleled in the UK. That service led proposition allows us to generate core deposits to provide a real advantage for Metro through the cycle. So I'm going to spend a bit of time on the slide working counterclockwise. So you can see strong growth in customer numbers since 2019. Both for business current accounts and personal current accounts. And again, we opened 129,000 new current accounts in the first half of 2023. Our deposit franchise is positioned for continued customer growth. Our high street franchise continues to perform. All our stores are getting bigger. We continue to win FANS every day. We re-entered the fixed term market in a very disciplined manner, but again have started to grow fixed term deposits to further look after our FANS. We clearly have good deposit pricing. I think you'll see that as I come on to a later slide, and we continue to invest in our digital capabilities. If you look at the deposit mix slide, it's one of the things that really shows the strength of Metro. We're in line with the high street banks. We're broadly focussed on core service led deposits. We have a very small percentage of our overall book that is fixed term. That is a meaningful differentiator to other mid-tier banks and specialist banks. It's really hard to grow those blue bars and relatively easy to grow the grey bar. And then in the upper right, all our stores are still growing. We're going to enter new communities, which gives us new opportunities to grow and more importantly, gives those communities a true banking champion. We remain underweight in certain products, which I'll come back to. There are lots of new current account propositions that we will introduce over time. We've just launched enhanced business overdraft to continue to cement our position in the SME marketplace, and there are further capabilities we can deliver.

So if you look at three markets, relatively well-established markets, the cash ISA, retail easy access and business easy access. They are are large markets, cash ISA markets over a £300 billion market, retail easy access is almost a trillion pound market, and business easy access is over a quarter of a trillion. We under punch our weight in those markets. We have a market share that doesn't align with our current account market share for any one of those three markets. And that's intentional. We underinvested in our deposit franchise when rates were low, completely understandable given the rate environment we were in. We have since over the last handful of months, begun to invest pretty significantly across all three of those products. And the thing that's really exciting about Metro, that differentiates us from every other bank that has reported this period, is we have an opportunity to double our deposit base, double our deposit base, generate £15 billion of new deposits by simply taking those three markets and getting to our natural market share. We will be in a place by early next year to have the infrastructure necessary to attack all three of those markets. There's not another bank that has the opportunity to grow organically like Metro Bank. It is extremely well positioned to return to being the growth engine it was. And not only that, not only do we have an opportunity to grow deposits by entering three well-established markets and only getting to our natural market share and grow deposits by £15 billion. We're the only challenger bank that has a full set of asset origination capabilities. We're not a monoline like some of the specialist banks. We have a broader offering than almost any other mid-tier bank and our product offering aligns with the large high street banks. We can do asset finance, invoice finance, corporate, commercial, we can do unsecured personal, auto finance and mortgages. We trade across those businesses depending upon risk adjusted returns on regulatory capital. You will have seen in James' comments, and as you dig into the numbers, that we have slowed the growth of unsecured personal lending. Actually unsecured personal lending actually went backwards in the last six months. That is because the risk adjusted return on regulatory capital in that business is not as strong as it was before the rate rises. So we've pivoted to a bit more commercial and a bit more mortgages. That optionality on the asset side allows Metro to outperform its peers.

So we have a deposit generating engine that has a huge untapped potential and we've asset generating engines that can take that liquidity and put it to work at very attractive returns. So onto the strategic pillars, they are the same as the day I arrived. And they're all delivering. So we continue to grow revenue, I accept it slowed a bit half on half, but year on year very strong. Cost. Cost discipline is one of the things I'm most proud of in the organisation. All of our colleagues work very hard to control cost. It's the only way we've been able to reduce costs half on half and year on year. We've invested heavily in the infrastructure. We now have real asset optionality and are quickly building liability optionality. Our communication structures, both internally and externally, are working. You can see that through the employee opinion surveys and the engagement of our colleagues. Balance sheet optimisation. We remain focussed on what we can do to maximise the balance sheet to potentially pivot to free up capital. The balance sheet optimisation is where we are opportunistic. And if you look at the left, we have a service led model that continues to provide core deposits. We have a diversified asset generating engine. We have a resilient risk and control environment. We've invested heavily in our risk function, in our control environment, to make sure what we're doing is sustainable, predictable and repeatable. Ultimately, the last bullet point is the one that's important. We have positioned the bank to grow quickly. We've positioned the bank to grow appropriately and we positioned the bank to have real leverage to be able to grow and generate significantly outsized returns for our stakeholders. But we do need to optimise the capital structure at some point. Because the engine is primed to go. There is a business that is ready to be unleashed if we can continue to strive to optimise the balance sheet. And then the chart on the right has a few less dots than last time, the half year numbers are a little more opaque from some of our competitors, but the positioning is still true. Metro Bank operates in clear blue water. So the black dot is a high street bank. We have cost of deposits that are in line with the high street bank per the left-hand scale. The scale across the top is lending yield. Our lending yield is more in line with a specialist lender. Both of those are better than any of the mid-tier banks. We are in a unique position to take advantage of the opportunities in front of us and we're excited about what the future holds for Metro. So with that, I'm happy to turn it over to questions, and thank you.

Q&A

Conference Call Operator

If you'd like to ask a question today, please press * followed by 1 on your telephone keypad now. When preparing to ask a question please ensure your headset is fully plugged in and unmuted locally. That’s * followed by 1 to ask a question today. And our first question comes from Guy Stebbings from BNP Paribas. Guy, your line is open. Please go ahead.

Guy Stebbings, BNP Paribas

Hi. Morning everyone. Thanks for taking my questions. So I’ll start on deposits, really actually I’ll stay on deposits I think. So I completely understand your points on the deposit franchise strength and how your mix aligns much more with the larger banks, but I guess it is perceived to be a headwind for the whole industry, how that mix evolves. I just wondered if you could share any more colour on how you think the mix of the book will look for deposits if we were to look forward a couple of years time? I appreciate there's a lot of uncertainties there and you talked about the opportunity to invest and double the deposit base. I'm just trying to wonder how do you avoid churning your current base in terms of some of the more efficient deposits that you might have while, you know, still being transparent to customers around other product segments as you expand your product range, especially given the regulatory focus around this at the moment? And then also on deposits, you talked about inflows in June and July, can you give comments as to where those were or what sort of deposits it was that came through? Thank you.

Daniel Frumkin, CEO

Sure. So listen, inevitably the deposit mix is evolving. We've seen that. We haven't been in this kind of a rate environment for 15 years. So I think it will normalise back to a level, our average balances in our current accounts, be it business current account or personal current accounts, are not significantly large. So therefore we think in terms of deposit mix, we think it morphs a bit over time but then begins to stabilise. What I don't have sight of, you know, where peak rates are going to end. I mean, we can argue about it. You know, we've seen everything from 5%, to 5.5%, to 6%, to 6.25%. I think if peak rates are sort of 5.5%, so sort of 50 basis points from where we are, then I think the deposit mix you see today is probably in line with what you would expect to see over time. It's inevitable that we had a bit of COVID build-up of deposits as well and people weren’t travelling, they weren't eating out as much. I think liquidity builds up in the system, so I think you're getting to a more natural level. Let's do June and July off of the back of that because I think it fits better before we get to the double deposit base. The reality is, in June and July we saw increases in deposits across all of our deposit categories, including non-interest-bearing liabilities. So we did see an increase in particularly business current accounts in both June and July, and we saw more stability in the personal current accounts in June and July. So, you know, two swallows don't make a summer, but we've seen some green shoots and early signs of those trends. In terms of doubling the deposit base. You're right. There's always a risk of a bit of a churn, i.e., movement between the deposit products. We think based on our average balances, we don't think that's actually the case. We believe a lot of our customers have cash ISAs, they just don't have them with us. We believe a lot of our customers actually have instant access savings accounts, both personal and business, they're just not with us. So we think there's an opportunity to deepen our relationship with our existing customer base and attract new customers, because as we all know, the cash ISA market is relatively competitive, a bit of hot money really that moves around that we're not able to take advantage of as we sit here today. So, you know, we're not overly concerned and all of our modelling about growth, took into account what we thought would happen to the existing book. And like I said in my presentation, I don't know that there's another bank that is staring at a deposit opportunity in established markets like we are. It's a genuine differentiator for our ability to grow the franchise going forward.

Guy Stebbings, BNP Paribas

Okay. That’s helpful. Thank you.

Conference Call Operator

The next question comes from Benjamin Toms from RBC. Benjamin, your line is open. Please go ahead.

Benjamin Toms, RBC

Morning both. Thank you for taking my questions. You've reiterated your NIM guidance this morning of an increase in 2023 over 2022 from 192 basis points. I know you expect more NIM pressure in the second half. Can you provide us directionally whether you think this means that NIM will be lower half two vs half one, which will help give some sense of an exit rate? And can you confirm the base rate assumptions that underpin your FY24 guidance of mid-single digit ROTE? And then additionally, can you update us on your interest rate sensitivity to lower rates? You have a large proportion of current accounts vs peers, and although you operate a Treasury portfolio, you don't have a structural hedge like some of the larger UK banks, which suggests that you'll have a higher sensitivity than peers to low rates. Maybe that's not the right way to think about it. Thank you.

Daniel Frumkin, CEO

Great. Well, I'll let James dive in on both the NIM, the ROTE guidance and actually our ALM assumptions on down rates.

James Hopkinson, CFO

Very good. Thank you. So I think when we think about NIM, we're trying to balance a number of variables and we talked about a number of them earlier. I think probably the most sensitive one for us is our deposit mix trajectory in the second half and going forward. If we saw more months like June and July, I think we get to one place. If we saw more months like January and February, albeit there were some seasonal factors there, we get to a different place. So I think that makes it quite a challenging place to be precise. I would point out the embedded yield. So we've given some guidance on the asset side of the book to try and give a little bit more colour. So for completing your models, you'll be able to run that through and actually give some sense of where NIM is looking. I would say though, I think as I said earlier, I think there's likely to be more NIM pressure in the second half, all things being equal, although if we are able to grow our deposit base strongly, I think that would be, you know, a real positive. So I can't really be very precise for you I'm afraid on the first question. Second question was around?

Daniel Frumkin, CEO

ROTE guidance, what terminal rate we are using.

James Hopkinson, CFO

Yeah. So I think on slide 27 we've given some breakdown of the macroeconomic variables that underpin our forecasting but also of our risk environment. So you get to see we slightly reduced our interest rate profile through the next five years. I think the terminal rate from memory, can't quite see it on my page at the minute, I mean it is I think 4.5% [corrected] in our model.

Daniel Frumkin, CEO

And the last one was down rates and assumptions. How sensitive are we to down rates?

James Hopkinson, CFO

Yeah, so as I said, I think we've got quite a lot of our book maturing in the next 18 months or so. So as we start to re-enter the asset side of our business, we are likely to see, even if rates do come off as predicted, we can see real upside opportunity to our asset profile. We are naturally hedged as an organisation, we look at the deposits and that provides a natural hedge for our business going forward. So we're not fully structurally hedged, as other organisations may be.

Daniel Frumkin, CEO

All I would say is Ben, we do spend a lot of time looking at up and down rate scenarios. We go through it at ALCO and we're broadly hedged. We're not making an interest rate bet either way. We haven't swapped a lot of fixed to floating to take advantage of the operating environment and we're not swapping a lot of floating to fixed in anticipation of a down rate environment. We try to stay as hedged as we can. We try not to run a big interest rate position because honestly, that's not our job.

Benjamin Toms, RBC

Thank you.

Conference Call Operator

The next question comes from Miruna Chirea from Barclays. Miruna your line is open. Please go ahead.

Miruna Chirea, Barclays

Morning Dan, morning James. Thanks for taking my question. I just have two quick ones please. One on cost and one on profitability. On costs, I think that at full year results you were talking about a normalised 2% or 3% year on year cost growth, with this year being higher than that. And as you highlighted before, in 1H costs were down 3% year on year and half on half. So I was wondering, is there scope for a downward revision on cost for this year? And in latter years how should we think about the 2% or 3% growth you called out before as a normalised run rate if inflation turns out to be running higher for longer? And then on profitability, how should we think about the path to the 2024 mid-single digit ROTE target? Because obviously it's great to see profitability be drawn, but can we expect this to be sustained from here and to build towards the 2024 ROTE target in a straight-line progression, or is it not that straightforward? Thank you.

Daniel Frumkin, CEO

Good. I'll start and I'll turn over to James a bit to add on. So on cost, you're right, we guided that costs will be up this year and probably above the normalised 2% to 3%. I think we've taken very aggressive cost actions supported by our colleagues to try to be as disciplined about cost as we could be. And I think that was the right decision to make. And I think it's got us to the point where we are. But I think from this point forward, I think it'd be prudent to build in some cost increases as you start to build into the second half. I mean, in this year, I doubt this year we'll get back to a 3% increase overall given the first half decline. But you should definitely build a bit of cost increase from here on out. So, as we have headwinds in terms of profitability for 24, there's a few things, we are now capitally accreting, so we need to decide what to do with that incremental capital as we obtain it, whether we want to lend up a bit more the balance sheet and use some of that capital we've accreted to grow lending to create a bit more margin in the business. And that's something we're considering. And then it depends on deposit flows between now and the end of the year. We've made some assumptions about what happens to deposits over the next six months and in the first six months of 2024, that will influence our ability to hit the ROTE target for next year. So I don't think I would take the first half and just model it straight out. I think there's a little bit of swings and roundabouts as we get stuck into it. I don’t know if you’d like to add anything James?

James Hopkinson, CFO

The only thing I would say, as Dan highlighted, early in next year we think we'll have the tools to really go after some big new deposit markets now. And we would love to have the additional capacity to put that liquidity into risk weighted assets. That's not available for us at the moment, but we believe we can raise liabilities at sub-Bank of England base rates. So there is an opportunity, even whilst we are capital constrained, to earn a reasonable margin on growing that business. So I think as you as you think about 2024, I think you need to have to think about the new areas of business that we're also looking to invest into.

Miruna Chirea, Barclays

Thank you.

Conference Call Operator

The next question comes from John Cronin from Goodbody. John your line is open, go ahead.

John Cronin, Goodbody

Thank you. Good morning both. Thanks for taking my questions. Look, I'm just returning to this point on the prospective deposit growth opportunity. Look, I see what you're saying in terms of the issues in terms of deploying that to risk weighted lending opportunities, and obviously the prospect of earning a nice carry to invest it or putting in place on the balance sheet of the Bank of England or indeed other avenues. How should we think about that in terms of potential quantum over the next 6 to 18 months to try to kind of size what this could be in terms of NIM re-profiling and balance sheet size in the absence of potential AIRB accreditation? And then secondly, look, on the AIRB accreditation application, can you give us an update in terms of where you think the risk weights would go to post-AIRB accreditation, roughly speaking, and what implications that would have for your return targets as well as the kind of levels of surplus capital, crystallisation or creation that could generate? And I think thirdly, maybe just a quick one, I notice recent press around your foray into the professional-by-to-let market as well as anything you can talk about the particular attraction of that market to you. But I assume we should think about that as a kind of a slow burn at this point. Thanks.

Daniel Frumkin, CEO

Yeah so John listen, as always really thoughtful, thank you so much. So in terms of deposit growth from having better kit to attack those three markets, I think it's likely not to affect the second half of this year meaningfully. I do think it will start to affect 2024 pretty meaningfully actually. As everybody knows, the cash ISA market is kind of a first quarter market, we're pretty adamant we will be active at that point. So you'll see some meaningful growth in cash ISAs. I do think you'll start to see some growth next year in instant access as well, both in personal and business. So I think a lot of the deposit growth is a 2024 item. In terms of NIM, you're right, it'll be NIM dilutive because we'll be raising money at a cost, probably below Bank of England base rate, but higher than our existing cost deposits. And if we're just as capitally constrained as we are today, we'll have to place it with the bank or with others, but at rates not too far off of base rate. So the spread on that will be a bit narrow. It's clearly income accretive but NIM dilutive, I can't really give you the numbers yet, John. Maybe we'll talk about it a bit more at the year-send in terms of where we're willing to nail the 2024 guidance a little bit clearer, but I don't think you'll see any of it in 2023, some of it'll go into 2024. The interesting bit for us in that is that you're right, we're RWA constrained. It would be lovely to envision a point in time where the bank wasn't RWA constrained and could take that liquidity and earn a proper spread on it by putting it out in the commercial business or in appropriately priced mortgages. So, I mean, you know, at the end of the day, we've always talked about balance sheet optimisation. We've always I think when we've met with investors, both debt and equity, been very clear that there were three pre-conditions for the board and the executive to look at, you know, debt and equity capital markets. Those three preconditions were; Sustainable profitability. We've now printed three quarters in a row of profitability that feels pretty good. About getting the Tier 2 extended for at least out to 2027. We managed to get it extended out to 2028. So that feels like another check mark. And the third precondition for the board and the executive to consider debt and equity markets was attaining AIRB, and that remains unknown. We continue work aggressively with the regulator. The regulator remains very responsive. We have a great working relationship at the technical level between the two organisations and broadly, we have answered all of the questions that we've been asked and we've submitted lots of paperwork as you would expect, and we just need to let that process play out. And I want to be really clear that once those three boxes are ticked, so once we get AIRB to tick the last box, it does not mean we would go to debt or equity markets. It just means we would feel like we have the option to consider it. And as we've done to date, we will take advantage of market opportunities as they present themselves to us. So if the right opportunity came up to access debt and equity markets, it would unleash the beast, so to speak. As a business, we would no longer be RWA constrained. You can take the excess liquidity and generate really sufficient returns with it. But you're right, under our current constraints, NIM will be somewhat compacted by the growth in deposits because we'll only really be able to put it to work in zero risk weighted or low risk weighted ways. In terms of AIRB, I can't give you a number, John. I think the reality is, we have a rough idea of where it's going to come out because we continue to go back and forth. You know, it's clear that our lack of internal data, which, you know, we just haven't made enough bad loans which funnily enough I think is a good thing, but in this case is a bad thing. So we haven't made enough bad loans, so we don't have enough internal data. It's clear we're going to have to layer in conservatism to make up for a lack of internal data and that's a lot of the discussion we're having with the regulator. There aren't too many banks in the UK and really there's no other bank in the world that's trying to get AIRB accreditation with a limited internal data set. And so, you know, they're working hard, we're working hard, we just need to let that play out, but there'll be some cost from RWA perspective to our limited internal data. And then professional-buy-to-let, we just we really didn't have a mortgage system. So we have now properly put in place a good mortgage system. It allows us to introduce more product flexibility. I don't know that any of them are going to become very big for us, but we've been limited on what we could do from a product perspective on the asset side because of some of our kit. We're now fixing that in the mortgage space, which just gives us more flexibility. But I'm not thinking it's going to become a huge part of the balance sheet very quickly, John.

John Cronin, Goodbody

Okay. Thank you. One follow up on the first one on the deposits. And I mean, presumably, I note your comments in relation to leveraging your existing customers as well to a greater extent. I presume the real kind of win here would be that angle, from an operating leverage perspective and the consequent return on risk weighted asset implications of growing your existing customer deposit base strongly because like I don't really care about NIM, like, I mean this is hugely accretive. Presumably if you can win more from the existing suites without incurring substantially larger costs. Right?

Daniel Frumkin, CEO

I agree. So, John, you're spot on. So we are working hard in particular in cash ISAs, we could participate in the cash ISA market to a greater extent today, but we don't have an automated switching service. So if we were to do that, we need to hire dozens, more than dozens of people and put them in a shed to imitate the automated switching service. So that doesn't feel scalable to me. So we have chosen not to participate since I arrived, in that market in an aggressive way because it doesn't pay for itself because you end up adding so many operating costs. The reason we're waiting to get into that market over the next year is we're building a digitally enabled straight through processing with a switching service embedded in it so that we can scale that up. If you're a customer, great. If you're a non-customer, it's fine. Our incremental cost of acquiring that deposit will be very low. And that's really what we've tried to achieve and tried to build on the asset side. And we're now building on the liability side slightly more aggressively.

John Cronin, Goodbody

Thank you.

Conference Call Operator

The next question comes from Daniel David from Autonomous. Daniel, your line is open. Please go ahead.

Daniel David, Autonomous

Good morning. Congrats on the results and thanks for taking my questions. The first one is just a quick one on capital. Can you just confirm the transitional IFRS9 benefits that are included in capital ratios? And then the second one is on MREL. So noting what's happened with the Tier 2, should we be assuming that the 9.5% senior drops out of your MREL ratio in 2024, or is it potentially a 2025 benefit for MREL? And then could you just maybe talk us through how you're thinking about that kind of cliff edge when the roughly 450 basis points will drop out of your MREL ratio? And I'm just cognisant of the comments you just made with regard to AIRB and debt and equity markets. Just interested in your thoughts. A bit more background on that. Thanks.

Daniel Frumkin, CEO

Sure. So I'll do the MREL and the thoughts on the capital markets. I'll let James talk IFRS9 and he can come back on MREL as well. So the Tier 2 counts to 2028. You are right it goes to its full maturity, which is unusual for the Bank of England Resolution Directorate to agree. As we sit here today we have no indication that the October 2024 call date is not the date where the MREL will stop qualifying as MREL capital because as everybody knows the rules. That's why there's a call date in there, because it's one year prior to maturity. We've not explored with the resolution directorate whether there's flexibility on that or anything else. We don't think we'll need to. We're pretty confident in our ability to refinance that note when the call date comes around, given the financial performance and the opportunities that are present to us. But you're right, it is a cliff edge and we're fully aware of it. Board talks about it. I think it gets mentioned in the financials in the footnotes a bit, we're all very aware of its existence and we continue to talk to bankers and holders about what we do when the call day comes in terms of accessing debt and equity capital markets. I think, you know, we'll be opportunistic. And if there's a moment in time where we think it makes sense, we'll do something once we meet the first three pre-conditions, because to be honest, we hope AIRB is approved. We have no idea whether it will be or won't be. We're just in the application stage, but hopefully gets approved. And when it gets approved, hopefully there will be some RWA reduction, that RWA reduction obviously goes into the top of the capital stack, which improves CET1. And the extent that it improves CET1 obviously will influence the ability to access both debt and equity capital markets. So it's a variable we need to know. But again, we'll be opportunistic. We'll do it when it makes sense, and when the board and the executives think it makes sense and not before that. And then do you want to cover off the IFRS9?

James Hopkinson, CFO

Sure. The transitional relief. So going forward I think there is 60 basis points more transitional relief to flow out, kind of split evenly over the next two years.

Daniel David, Autonomous

Thank you very much.

Conference Call Operator

We have time for one final question, which will come from the line of Carlo Mareels from MUFG Securities. Carlo, your line is open. Please go ahead.

Carlo Mareels, MUFG Securities

Yes, good morning. I think that with Dan's question, my question was answered as well. Thank you very much.

Daniel Frumkin, CEO

No, thank you.

Conference Call Operator

This will conclude today's Q&A. So back to Daniel Frumkin for closing remarks.

Daniel Frumkin, CEO

So I just want to thank you all for taking the time today. It's a moment for Metro Bank to be capitally accretive again. It's been a number of years to be generating profits that are flowing through and into our capital ratios. So thank you so much for the time and I look forward to speaking to you again in about six months. Cheers.