Metro Bank: Having its own financial crisis

Metro Bank was the UK's first new high street bank in 100 years when launched in 2010. It is fair to say the past 12 months have been the bank's most challenging, with its share price down more than 85% from over £35 per share to below £5. Its only bond in issue has also suffered a fall in price, and now offers a tantalising yield of over 10% having been issued on a yield of 5.5%.

The signs that all was not well were revealed during Metro's unscheduled announcement in January when it admitted that it had misclassified many of its loans as less risky than they really were. Banks are obliged to set aside capital as a rainy-day buffer for when borrowers default; what this means in practice is that because Metro had misclassified these loans it did not have enough capital set aside.

The shock of the announcement that a bank could fail at something so fundamental was further compounded by Metro's attempts to explain how the miscalculation was identified. Initially commenting that it followed "an internal review", management were subsequently forced to clarify that it was the Prudential Regulation Authority (the bank's regulator) that had pointed out the mistake to the bank.

Metro was a darling of the stock market when it floated in 2016 with its share price quickly rising by around 75% and raising significant capital from the stock market to fund growth, albeit largely from US institutions. However, it was also controversial, making millions of pounds of payments to the wife of the Chairman and founder of the bank for design work. The financial impact of its mistake was that it needed to fund a hole in its balance sheet and quickly, raising £375m in May.

However, one bad apple does not spoil the bunch and we believe the UK banking sector is still fundamentally strong. The Bank of England noted in its most recent Financial Stability Report that capital ratios are now "more than three times higher than before the global financial crisis", while liquidity levels (something Northern Rock, for example, severely lacked) are similarly much improved, with UK banks now holding 65% more liquidity than they did in 2009.

Warning signs are often seen in credit markets before they surface in equity markets. With the deadline for PPI claims closing at the end of August – costing the UK banking sector over £35bn – one of the biggest headwinds for the sector in recent years will fall away. While Metro's bonds have fallen in price, over the past year the prices of bonds issued by other UK banks have rallied, illustrating exactly how solid the sector is seen by financial markets and that Metro's difficulties were all self-inflicted. The Metro model may be broken, but in contrast with the UK banking sector as a whole.

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1 August 2019

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