Pillar 3 2019

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PILLAR 3

1. EXECUTIVE SUMMARY

This Pillar 3 disclosure complements and expands on information disclosed in Metro Bank's 2019 Annual Report and Accounts. It provides information on Metro Bank's regulatory capital resources and requirements, including a reconciliation of financial capital to regulatory capital, credit risk, market risk and operational requirements, and key ratios as required by EU Capital Requirements Regulations (CRR).

During 2019 we continued to maintain a robust capital structure, supported by a £375m equity raise. We also raised £350m of MREL-eligible debt in order to meet the interim minimum requirements for own funds and eligible liabilities ('MREL') requirements that came into force on 1st January 2020.

Further to the commitment made to the market in February 2019 to externally assure our risk weighted assets ('RWAs'), we are pleased to confirm that this undertaking is now complete and the Board has received a reasonable assurance opinion from PwC on the 2019 CET1 and Total Capital ratios.

The work we have undertaken, including significant investment of time and resources, supplemented with specialist advice and external assurance, allows Metro Bank to demonstrate to the market that last year's RWA misreporting was taken seriously. On the basis of a materiality threshold of 35bps, meaning that a misstatement of the Capital Ratios of that level or greater would be considered material, Metro Bank confirms that its capital ratios are materially correct.

Alongside the assurance work, we have also reviewed our processes and control environment, and we continue to work on further enhancements to our systems and controls.

Common Equity Tier 1 ('CET1') ratio

15.6%

(2018: 13.1%)

See page 25

Tier 1 capital ratio

15.6%

(2018: 13.1%)

See page 25

Total capital ratio

18.3%

(2018: 15.9%)

See page 25

CRR Leverage ratio

6.6%

(2018: 5.4%)

See page 28

Liquidity Coverage Ratio ('LCR')

197%

(2018: 139%)

See page 46

Risk Weighted Assets ('RWAs') (£'million)

9,147

(2018: 8,936)

See page 25

Total assets as per published financial statements (£'million)

21,400

(2018: 21,647)

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PILLAR 3
continued

Summary of risk profile

The management of risk lies at the heart of everything we do. Our overall risk strategy is maintained by the CRO and approved by the Board. We have a set of risk management principles that must be followed across the Bank, and robust controls in place to ensure risk is managed effectively. Our risk strategy and Risk Management Framework are under continuous review.

In summarising the movement in risk metrics for 2019:

Table 1: RWA Summary

	2019 £'million	2018 £'million
Credit Risk	8,591	8,560
Counterparty Credit Risk	5	2
Market Risk	5	4
Operational Risk	546	370
Total RWA	9,147	8,936

Table 2: Key Ratios

	31 December 2019 £'million	31 December 2018 £'million
Common Equity Tier 1 ('CET1') ratio	15.6%	13.1%
Tier 1 capital ratio	15.6%	13.1%
Total capital ratio	18.3%	15.9%
Total capital plus MREL ratio	22.1%	n/a
CRR Leverage ratio	6.6%	5.4%
Liquidity Coverage Ratio ('LCR')	197%	139%
Risk Weighted Assets ('RWAs')	9,147	8,936
Total assets as per published financial statements	21,400	21,647

We have maintained a robust capital position throughout 2019, supported by the £375 million equity capital raise in May 2019 and a slowdown in the pace of RWA growth, up 2% to £9.2 billion. Although the January 2019 adoption of IFRS 16 and RWA adjustment resulted in one-off capital impacts, our CET1 ratio remained above both our 12.0% minimum target and our 10.6% minimum regulatory requirement at 31 December 2019. Our 15.6% CET1 ratio and 18.3% total capital ratio demonstrate the strength of our capital position and provide headroom for controlled growth and the delivery of our strategy.

The senior non-preferred debt issuance in October 2019 ensured compliance with our interim MREL requirement of 18% of RWAs plus 3.5% regulatory buffers, with the Bank closing 2019 with a total capital plus MREL ratio of 22.1%.

- The movement in RWAs are predominantly driven by movements in credit and operational risk. Credit risk RWA has increased from £8,560 million to £8,591 million, primarily driven by the RWA adjustment we announced in January 2019.
- Counterparty risk is calculated on derivative and repurchase agreements. The RWA has increased from £2 million to £5 million as the number and size of trades has increased year on year.
- Market risk. The foreign currency open position RWA has increased from £4 million to £5 million.
- Operational risk is calculated using the Basic Indicator Approach. This is based on a 3 year average of revenues which have increased and therefore increased RWAs accordingly.
- The CRR leverage ratio increased from 5.4% to 6.6% driven by changes in capital and balance sheet changes as described in this document.
- Liquidity coverage increased from 139% to 197%. The Bank is holding more cash due to capital and debt raises and selling a £521m loan book during the year.

We ended the year with CET1 Capital at 31 December 2019 of £1,427 million (31 December 2018: £1,171 million), which is 15.6% of RWAs (31 December 2018: 13.1%). This exceeds our Tier 1 regulatory minimum of 10.6% (31 December 2018: 10.6%) based on our current capital requirements (excluding any confidential PRA buffers, if applicable).

In March 2020, the Bank of England announced a package of measures in response to the economic shock posed by COVID-19. First, cutting the base rate to 0.1% to support business and consumer confidence. Secondly, introducing a new Term Funding Scheme with incentives to support lending to small and medium-sized enterprises ('SMEs'). Finally, reducing the countercyclical capital buffer ('CCyB') to 0% from 1%, that had been due to reach 2% by December 2020. The adjustment to CCyB reduces our minimum CET1 requirement to 9.6% and our interim total capital plus MREL requirement (including regulatory buffers) to 20.5%.

In January 2019 we announced that we had adjusted the risk weighting of certain commercial loans secured on commercial property and certain specialist buy-to-let loans that had the combined effect of increasing our risk-weighted assets by £900 million ('RWA Adjustment'). The Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA') are independently investigating the circumstances and events that led to the RWA adjustment. The FCA is also investigating disclosure relating to our application for AIRB accreditation. We are satisfied that the risk weightings have now been assigned properly. We are continuing to work on further enhancements to our systems and controls. We continue to fully co-operate with our regulators in all respects.

Basis and frequency of disclosures

Metro Bank PLC is a UK based bank that provides services to retail and commercial clients. It is authorised by the Prudential Regulatory Authority ('PRA') and regulated by the PRA and Financial Conduct Authority ('FCA') and is required to comply with regulatory rules implemented by the PRA and European Banking Authority ('EBA'). These rules are enforced in the UK by the PRA and introduce consistent capital adequacy standards governing how much capital banks must hold to protect their depositors and shareholders.

This Pillar 3 report is prepared in accordance with the Capital Requirements Regulation and Capital Requirements Directive (CRR and CRDI IV). The report is also prepared in accordance with the relevant European Banking Authority guidelines, most notably the 'Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013' as amended by Regulation (EU) 2019/876 in effect at the reporting date.

Further to the commitment made to the market in February 2019 to externally assure our RWAs, we are pleased to confirm that this undertaking is now complete and the Board has received a reasonable assurance opinion from PwC on the 2019 CET1 and Total Capital ratios. The relevant capital ratios are disclosed in Table 3, and Note 3 explains how they are calculated.

The work we have undertaken, including significant investment of time and resources, supplemented with specialist advice and external assurance, allows Metro Bank to demonstrate to the market that last year's RWA misreporting was taken seriously. On the basis of a materiality threshold of 35bps, meaning that a misstatement of the Capital Ratios of that level or greater would be considered material, Metro Bank confirms that its capital ratios are materially correct.

In meeting the regulatory requirements, this document provides information on Metro Bank's capital and liquidity position, risk management processes, regulatory methodologies and disclosure.

Application of the Basel Framework

Pillar 3 rules apply to banks, building societies and investment banks. These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. CRD IV also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

The framework consists of three pillars:

- Pillar 1: Defines the minimum capital requirements that banks are required to hold for credit, market and operational risks.
- Pillar 2: This builds on Pillar 1 and incorporates the Bank's own assessment of additional capital resources needed in order to cover specific risks faced by the institution that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process ('SREP') and is used to determine the overall capital resources required by the Bank.
- Pillar 3: Aims to improve market discipline by requiring banks to publish information on their principal risks, capital structure and risk management.

Scope

Metro Bank has two subsidiaries: SME Invoice Finance Limited and SME Asset Finance Limited. Both firms are regulated by the FCA only and are not CRD IV regulated entities. Metro has applied for, and been granted, permission to use the individual consolidation method when producing prudential returns.

There are no current or foreseen material practical or legal impediments to the prompt transfer of own funds or repayment of liabilities among our parent undertaking and our subsidiaries.

We do not have any joint ventures.

Purpose and frequency

This document sets out our 2019 Pillar 3 Disclosure, in accordance with the rules laid out in the CRR (Part 8) and our Pillar 3 Policy Document. Our Pillar 3 Disclosures are published annually in conjunction with the date of publication of our financial statements. The purpose of these disclosures is to give information on the basis of calculating Basel III capital requirements and on the management of risks we face.

Basis of disclosure

We are required to report on the basis of our consolidated financial situation. Unless otherwise stated, all figures are as at 31 December 2019, our financial year end, with comparative figures for 31 December 2018 where relevant.

The disclosures may differ from similar information in our Annual Report and Accounts prepared in accordance with International Financial Reporting Standards ('IFRS'); therefore, the information in these disclosures may not be directly comparable with that information. For the year ending 31 December 2019 we used the Standardised Approach to credit risk and market risk and the Basic Indicator Approach ('BIA') to operational risk.

Regulatory considerations

In December 2016 the EBA published the final guidelines on the Pillar 3 disclosures (EBA GL 2016/11) which came into effect on 31 December 2017 for Globally Systemically Important Institutions ('G-SII'), Other Systemically Important Institutions ('O-SII') and any other institutions that have been advised by competent authorities to comply with some or all guidance in these guidelines.

We do not currently fall into any of the above categories, however, some tables and templates in the guidelines have been adopted and disclosed where applicable and appropriate.

In January 2018 the EBA published guidelines on transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds. The required disclosure can be found in Section 3. Additionally, CRR II came into force on 27 June 2019. As an amending regulation, the existing provisions of CRR have been applied unless amended by CRR II. The changes that have taken effect immediately relate primarily to MREL and include changes to qualifying criteria for CET1, AT1, and Tier 2 instruments, the inclusion of additional holdings eligible for deduction, an amendment to the treatment of deferred tax and the introduction of requirements for MREL.

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Exemption from disclosure

1 Materiality

In accordance with CRR Article 432 and the EBA guidelines on materiality, confidentiality and proprietary and on disclosure frequency (EBA GL 2014/14), firms may omit one or more disclosures if the information provided by such disclosures is not, in the light of the criterion, regarded as material.

We consider that information is material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

We have omitted the following disclosures specified in CRR as they are not material:

- Geographical split of impairments. Almost all (99.9%) of past due but not impaired loans and advances to customers and impaired loans and advances to customers are categorised as being in the UK. Almost all (99.9%) of closing impairment provisions are categorised as being in the UK. The past due exposures and impaired exposures relating to other geographical areas are considered immaterial, in line with the requirement of CRR Article 432.
- Pre credit risk mitigation balances. As mentioned in section 5, all balances are post-CRM. Metro does not apply CRM except in the very few cases where we invest in assets that carry explicit guarantees. These assets are CQS1 both pre and post-CRM.

2 Proprietary or confidential information

In accordance with CRR Article 432 and the EBA guidelines on materiality, confidentiality and proprietary and on disclosure frequency (EBA GL 2014/14), firms may omit one or more disclosures if the information provided by such disclosures is regarded as proprietary or confidential.

We consider information to be proprietary if sharing that information with the public would undermine our competitive position. Proprietary information may include information on products or systems which, if shared with competitors, would render our investments therein less valuable. We consider information to be confidential if there are obligations to customers or other counterparty relationships which bind us to confidentiality.

No disclosures have been omitted because they are proprietary or confidential.

3 Non-applicable disclosures

We have omitted the following disclosures specified in CRR as they are not applicable:

- CRR Article 438 (d): We use the standardised approach to calculating risk weights, not the Internal Ratings Based ('IRB') approach.
- CRR Article 441: We are not a G-SII.
- CRR Article 452: We use the standardised approach to credit risk, not the IRB approach.
- CRR Article 454: We use the BIA to operational risk, not the Advanced Measurement Approach ('AMA').
- CRR Article 455: We do not use Internal Market Risk Models

Changes to disclosure

We continue to develop the quality and transparency of our disclosures to ensure that they are as clear and informative as possible.

There have been several enhancements since our 2018 report. The key changes include:

- Additional data on average exposures have been added in table EU CRB-B in section 5
- Additional commentary on securitisation and simple, transparent and standardised ('STS') methodology in section 10
- New information on MREL in section 3

Review by Board

Metro Bank is committed to a robust internal controls framework in order to ensure that external reports and disclosures are subject to adequate verification and comply with the relevant standards and regulations. As an external publication, the Pillar 3 disclosures have been subject to internal verification and are reviewed by the Risk Oversight Committee ('ROC') on behalf of the Board. The governance in place allows for sufficient challenge and oversight prior to publication.

The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of our Annual Report and Accounts.

"We attest to the best of our knowledge that the Metro Bank Pillar 3 disclosures comply with the regulatory requirements around Pillar 3 and have been prepared in compliance with our internal controls framework."

David Arden
Chief Financial Officer

Andrew Shiels
Chief Risk Officer
16 April 2020

2. RISK MANAGEMENT

The management of risk lies at the heart of everything we do. Our overall risk strategy is maintained by the CRO and approved by the Board. We have a set of risk management principles that must be followed across the Bank, and robust controls in place to ensure risk is managed effectively. Our risk strategy and Risk Management Framework are under continuous review.

We will continue to embed improved risk management, processes and procedures and will make further improvements over the course of 2020.

We set out to align our people, processes, and systems to the way we manage the risks inherent in our business activities. This supports management of the business in a safe and compliant way.

Our approach to risk management consists of:

- A robust compliance and control environment
- Fair and consistent customer treatment and outcomes
- Maintaining a strong risk culture, with the right expertise

OVERVIEW

We know that a culture that truly focuses on delivering our purpose of creating FANS will reduce the risk of customer harm as well as deliver consistently fair outcomes.

All colleagues are responsible for managing risk as part of their day-to-day role. Customer-facing colleagues are at the forefront of risk management, along with their line managers. Oversight is provided by the Risk team.

Our risk and control framework is designed to ensure that:

- all principal and emerging risks are identified, assessed, mitigated, monitored and reported;
- our risk appetite is clearly articulated and internal policies are aligned to it; appropriate processes, systems and controls are in place to support all colleagues in performance of their roles within our risk appetite; and
- ongoing analysis of the environment in which we operate takes place to identify emerging risks and regulatory requirements.

Everything at Metro Bank starts with our culture, which supports risk awareness by encouraging every colleague to think about the relationship between their role and our purpose of creating FANS whilst growing safely and sustainably; and to be comfortable asking questions to ensure their actions do not result in financial loss, reputational damage or customer harm.

DEVELOPMENTS IN 2019

The announcement in January 2019 ('the RWA announcement') that we had adjusted the risk weighting of certain commercial loans secured on commercial property and certain specialist buy-to-let loans, with the combined effect of increasing RWAs by £900 million, has had a substantial impact on how we manage our RWAs. In response, the Board established a Working Group, supported by a major professional services firm, to review and assess the issues and factors that led to the errors. The objective of the Working Group was to identify and assess root causes; and determine what short-term tactical solutions, as well as long-term strategic solutions, would be required to ensure accurate reporting of risk weightings going forwards.

Over the course of 2019 we made a considerable investment in remediation activity to enhance regulatory reporting processes, systems and controls as well as enhancing the risk management framework more broadly (details of which are set out later in this report).

2019 also saw us complete an equity capital raise in the second quarter of the year. The intense speculation that preceded it resulted in a concentrated period of net reductions in deposits, reflected in total customer deposits closing the year at £14.5 billion. The reductions were concentrated in May 2019 and we demonstrated a return to net growth in the second half of the year. The adverse sentiment that the speculation created mostly impacted a limited number of larger commercial customers, with retail and small business customer deposits remaining resilient throughout the year.

In response to the reductions in deposits, we took actions to manage capital and liquidity positions with loan and treasury asset disposals, management of lending volumes and initiatives to regain momentum in deposit growth. Though not without its own challenges, the senior non-preferred debt issuance in October 2019 also further strengthened the total loss-absorbing capital position, whilst ensuring compliance with interim MREL requirements ahead of the 1 January 2020 deadline.

These challenges demonstrated the robustness of our risk management and mitigation approach as we were able to successfully manage these events. We have however learnt valuable lessons from these events and have put in place a programme of investment in risk infrastructure going forward to assist with this. This investment in our risk infrastructure is a key component of our refreshed strategy.

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BOARD ROLE

The Board is responsible for setting strategy, corporate objectives and risk appetite. The strategy and risk appetite consider the interests of our customers, shareholders and other stakeholders. Each principal area of risk to which we are exposed has a Risk Appetite statement detailing the metrics by which we measure the level of risk we are prepared to accept. Depending on the risk measure, the maximum acceptable risk may be zero. On the advice of the Risk Oversight Committee ('ROC'), the Board approves the risk appetite for each principal risk category, whilst providing oversight to ensure there is an adequate framework in place for reporting and managing those risks. The Board has delegated responsibility for reviewing the effectiveness of this framework to the ROC.

The Board is also responsible for maintaining an appropriate control environment to manage risk effectively, and for ensuring that capital, liquidity and other resources are adequate to achieve our objectives within our risk appetite.

INTERNAL CONTROLS FRAMEWORK

The Board has delegated responsibility for reviewing the effectiveness of the internal control framework to the Audit Committee. This committee monitors and considers the internal control environment, internal and external audits and risk assurance, and is assisted in its oversight role by our Internal Audit function. Internal Audit carries out both regular and ad-hoc reviews of risk management controls and procedures; and reports the results to the Audit Committee.

The Director of Internal Audit's reporting line is to the Chair of the Audit Committee, with a dotted line to the CEO, and therefore supports the function's independence.

As part of their work in 2019, Internal Audit and the Audit Committee reviewed the commercial RWA controls enhancement programme.

CHIEF RISK OFFICER AND THE RISK FUNCTION

Our Chief Risk Officer ('CRO') leads the Risk function, which is independent from operational and commercial functions. The CRO is responsible for ensuring that appropriate risk management processes, policies and controls are in place, that they are sufficiently robust, that key risks are identified, assessed, monitored and mitigated, and that the Bank is operating within its risk appetite.

The Risk team provides specialist knowledge and support to colleagues, acting as a reference point for advisory queries, whilst also overseeing colleagues and the risk management and controls in place. It operates themed, targeted and ad-hoc reviews to provide assurance to the leadership team, and ultimately to the Board, that risks are properly managed, controls are effective, and that we are not exceeding our risk appetite.

We have invested and will continue to invest in risk management to ensure that the risk function can continue to provide independent assurance to the ROC, Board and other stakeholders that risks in the Bank are being appropriately controlled and managed. During 2019 and early 2020 we have strengthened our risk senior leadership team with the addition of two new senior roles reporting to the CRO: a Director of Prudential Risk and a Risk Chief Operating Officer. We have also made a series of experienced hires across all lines of defence to boost the strength in depth of risk management capability, and enable the transfer of best practice knowledge across the Bank. As part of our Strategy and Long Term Plan we have allocated additional investment to support delivery of key initiatives to enhance risk management capability, systems and infrastructure.

RISK MANAGEMENT POLICIES

We have established risk management policies to identify and analyse key risks, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The Risk team regularly reviews these policies and controls to verify compliance and to reflect changes in market conditions and business activities. Policies have annual or biennial review, depending on materiality, with a schedule maintained and presented at every ROC meeting to ensure reviews are tracked. We use training and management standards and procedures to develop a robust and effective control environment – one where all colleagues understand their roles and obligations.

RISK APPETITE

Our approach to risk appetite is to set relevant quantitative and qualitative measures against which risk management performance can be reviewed for each principal risk. Risk appetite is set by the Board, based on the recommendation of the ROC, and implemented by the Executive Risk Committee and its subcommittees. The risk appetite has been developed in line with business plan, strategy and vision, and is underpinned by a culture in which all colleagues embed risk considerations in decision-making.

RISK OVERSIGHT COMMITTEE

The ROC assists the Board in providing leadership, direction and oversight with regard to risk governance and management, and also assists the Board in fostering a culture that emphasises and demonstrates the benefits of a risk-based approach to risk management and internal controls. It works closely with the Audit Committee. It is chaired by a Non-Executive Director and meets at least quarterly. Its responsibilities include:

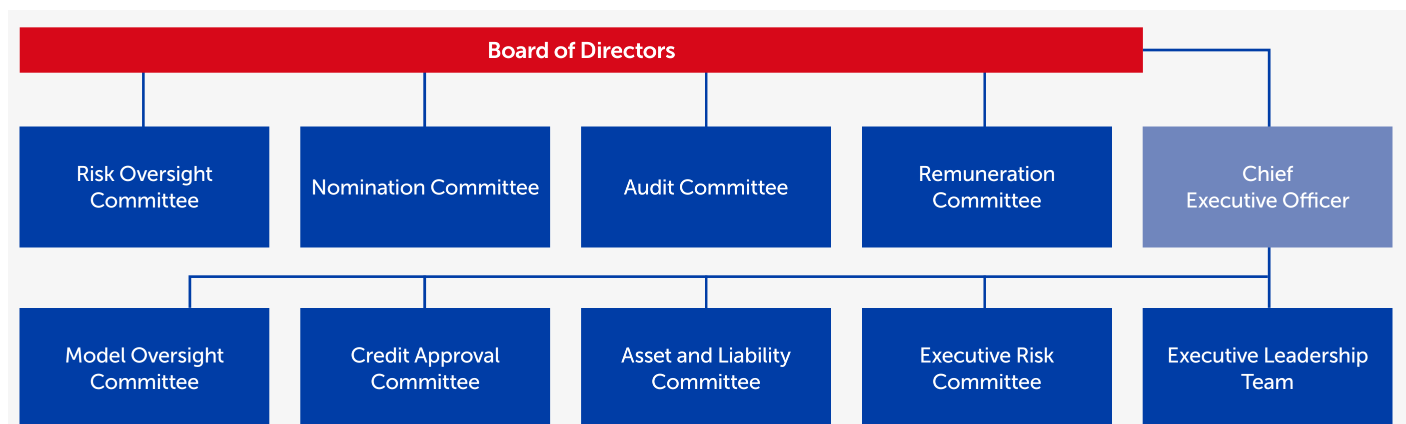
- recommending risk appetite statements and measures to the Board;
- regularly reviewing risk exposures in relation to the risk appetite;
- reviewing risk policies, and approving or recommending to the Board for approval; and
- monitoring the effectiveness of risk management processes and procedures put in place by management.

For detailed reports from the Risk Oversight Committee, the Audit Committee, the Remuneration Committee and the Nominations Committee, and details on their structure, roles and responsibilities, please refer to the 2019 Annual Report and Accounts.

EXECUTIVE LEADERSHIP COMMITTEES

The CEO, supported by the Executive Leadership Team, is responsible for executing the strategy, managing risk exposures and making decisions and recommendations to the Board, as appropriate, via the following executive risk committees:

Committee	Role
Executive Risk Committee	The Committee is chaired by the CRO and meets monthly. It and its subcommittees are responsible for: oversight of risk policies; reviewing credit, prudential, operational, regulatory and compliance risk management issues with regard to risk appetite; oversight of the Enterprise and Credit Risk management frameworks and performance of the Key Risk Indicators ('KRIs'); reviewing Assurance reports and findings; making recommendations for adjustment of policies to the Board; monitoring portfolio performance against risk appetite; along with the CFO, approving the impairment levels; and approving all material aspects of IRB rating systems, including all material models.
Credit Approval Committee	The Committee is chaired by the CRO or Director of Commercial Credit and is responsible for: sanctioning higher value lending requests, and any exceptions to policy; monitoring overdue accounts; and granting and reviewing delegated lending authorities.
Model Oversight Committee ('MOC')	The Committee is chaired by the CRO, meets monthly and is responsible for: oversight of model governance and model risk monitoring, approval of all material models including combining and retirement of models.
Asset and Liability Committee ('ALCO')	The Committee is chaired by the CFO, meets monthly and is responsible for: ensuring that an appropriate balance is maintained between funding and lending activities; ensuring that we meet internal liquidity targets as set out in the Liquidity Policy; analysis of Capital Market trends, considered along with actual and projected business performance to assess the adequacy of funding to meet the projected targets; agreement of pricing decisions to ensure visibility of trading and capital impact; and monitoring interest rate risk.



This graphic illustrates the key committees of the Bank with risk responsibility – to keep it simple, not all are shown.

For further details on the Board of Directors and their experience, please refer to the Corporate Governance section of the 2019 Annual Report and Accounts.

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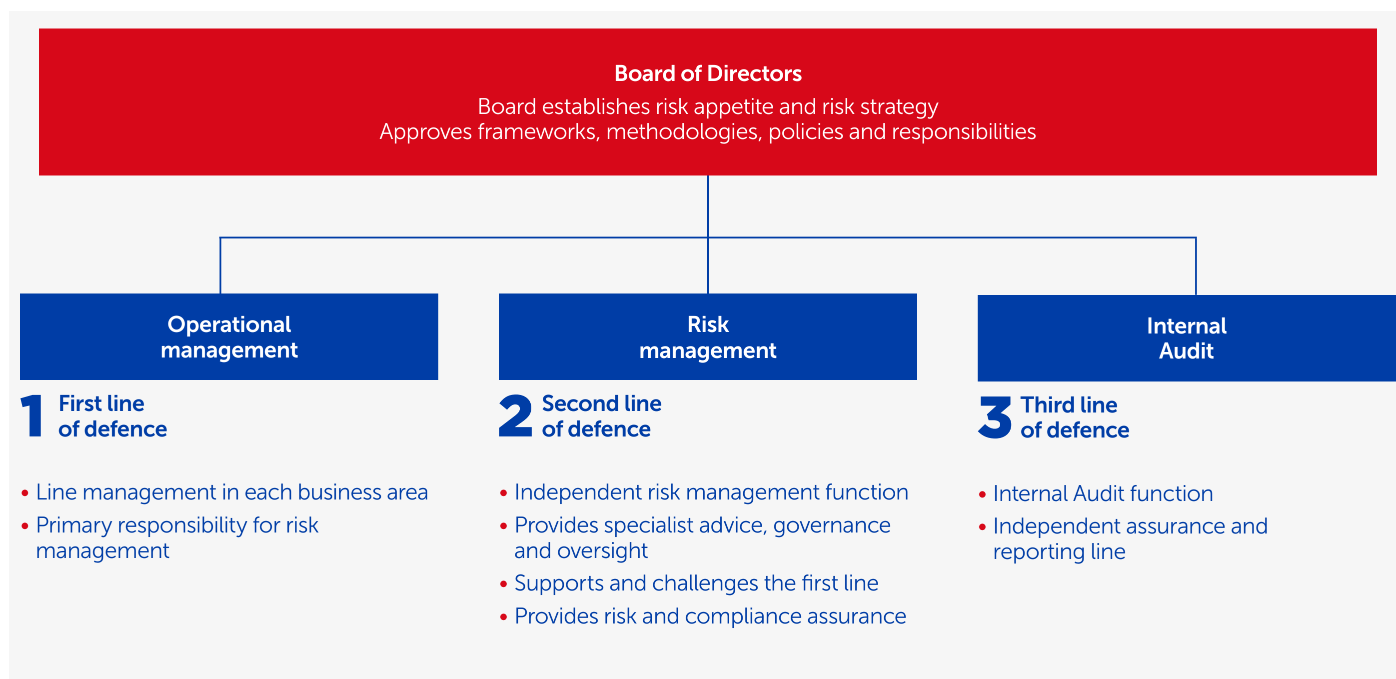
THREE LINES OF DEFENCE MODEL

We operate a 'three lines of defence' model for risk management. The first line of defence is operational management, who manage risk by maintaining appropriate systems and controls that are operated and effective on a daily basis. The second line of defence comprises the risk management function, providing independent advice and oversight through specialist support teams and the risk committees. The third line of defence is Internal Audit, providing independent assurance through internal reviews and reporting the results to the Audit Committee.



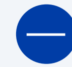
PRINCIPAL RISKS

Our principal risks represent defined groupings that we use to help consistently identify, assess, manage, monitor and report risks. Using consistent risk categories enables risks to be aggregated to determine their overall impact on the Bank. The principal risks are designed to be both comprehensive and mutually exclusive.

The principal risks are detailed below. In addition to the eight risks listed there is also a ninth principal risk in the form of strategic risk. Strategic risk is a manifestation of material instances, or a combination of, the other eight principal risks. As such, strategic risk is assessed in line with those principal risks.

1. Credit risk

Definition
Credit risk is the risk of financial loss due to a borrower's failure to meet the terms of any debt contract or where a borrower otherwise fails to perform as agreed due to financial difficulties.



Change since 2018:
No change

APPETITE

Our credit risk appetite is set to ensure that the risk we take is commensurate to the returns we receive. Our credit risk appetite is defined through our Credit Risk Policy which is owned and approved by the Board annually. Portfolio-level policies and credit risk appetite are recommended by the Executive to the Board via the Executive Risk Committee ('ERC') and the ROC. The credit risk appetite is specified as a set of key performance indicators ('KPIs'), concentration measures, capital and impairment components. Policy and appetite are based on sound credit risk principles.

CHANGE IN YEAR

There have been no changes to the risk level during 2019.

MITIGATION

Lending and collateral

Our foremost exposure to credit risk is through the loans, limits and advances we make available to our customers. We primarily mitigate credit risk through holding collateral against our residential mortgage and commercial term loan portfolios. Collateral is usually held in the form of real estate, guarantees, debentures and other liens that we can call upon in the event of the borrower defaulting. All real estate assets taken as security are supported by an external valuation with a first fixed charge registered at the land registry. At 31 December 2019, 95% (31 December 2018: 94%) of our loans consisted of retail mortgages and commercial term loans secured on collateral with average debt-to-value of 59% (2018: 61%) and 60% (2018: 59%) respectively.

Our exposure to loans of greater than 100% remains low at less than 1% of retail mortgage lending (31 December 2018: less than 1%) and 11% of commercial term lending (31 December 2018: 11%). In the retail mortgage lending portfolio, these loans have principally been part of portfolios we have acquired. For commercial term lending, additional forms of collateral (such as debentures or unsupported guarantees giving recourse to our customers) are excluded from these debt-to-value ('DTV') figures, so the true credit risk exposure on these loans is lower and is underwritten on the strength of all types of collateral.

The approval for consumer lending and retail mortgages is automated and underpinned by scorecard and policy rules. The end-to-end process is overseen by our colleagues in the first line and approved in accordance with agreed delegated lending authorities.

The approval for commercial lending is a manual approval undertaken by a specialist team of commercial underwriters in accordance with agreed delegated lending authorities. It is underpinned by a commercial lending policy supported by sector specific standards/guidelines.

Undrawn commitments

We have additional limited credit exposure to committed and undrawn amounts, such as unused overdraft limits and facilities. At 31 December 2019 we had £296 million (31 December 2018: £242 million) of undrawn credit card and overdraft facilities. We mitigate credit risk in respect of these undrawn balances by regular customer monitoring to allow undrawn limits to be removed if we observe credit quality deterioration.

Interest-only lending

We have exposure to refinance risk. This is the risk from loans to customers who are subject to a bullet or balloon payment at contractual maturity but who find themselves unable to refinance or otherwise make this payment. This risk arises principally in the mortgage book where the exposure to interest-only loans stands at £4.4 billion (31 December 2018: £4.4 billion). There is further exposure to refinance risk in the Commercial Book of £1.5 billion (31 December 2018: £1.6 billion) from interest-only loans and a portion of non-fully amortising term loans.

We manage this risk by ensuring the borrower has an appropriate repayment plan in place or would be able to refinance the lending at the end of the term. Also, by ensuring these loans are appropriately collateralised (see lending and collateral section above), we would have first charge in the event of default by the borrower.

Sector exposure

We manage the level of credit risk concentration based on individual borrowing entities, deal type and sector. We have specialist sector lending teams including in healthcare, hospitality, property and not for profit.

PILLAR 3
continued

Geographic exposure
We also manage our lending exposure by region. Our current residential mortgage and commercial term lending is concentrated within London and the South East, which is broadly representative of our current customer base and store footprint. As we expand our footprint over time we envisage our geographical exposure of lending will change. All of our current loans exposures are secured on UK based collateral.

Investment securities
As well as our loans and advances, the other main area where we are exposed to credit risk is within our Treasury portfolio. At 31 December 2019 we held £2.6 billion (31 December 2018: £4.1 billion) of investment securities which are used for balance sheet and liquidity management purposes, of which £2.4 billion (31 December 2018: £3.4 billion) is eligible as collateral at the Bank of England.

We hold investment securities at amortised cost or fair value through other comprehensive income ('FVOCI') depending on our intentions regarding each asset. We do not hold securities at fair value through profit and loss.

We have a robust securities trading and investment policy which requires us to invest in high-quality liquid debt instruments. At 31 December 2019, 82% of our investment securities were rated as AAA (31 December 2018: 81%) with a further 16% (31 December 2018: 15%) rated AA- or higher with some use of derivatives for hedging purposes.

Additionally, we hold £3.0 billion (31 December 2018: £2.5 billion) in cash balances, which is either held by ourselves or at the Bank of England, where there is minimal credit exposure.

MEASUREMENT
We measure credit quality for impairment purposes using a suite of IFRS 9 models. We have a strong suite of credit risk models and have invested heavily in credit risk model development in support of enhancing our IFRS 9 calculation, stress testing capability and AIRB programme. Our stress testing capability was enhanced significantly during 2018 and continued to be so over the last 12 months.

Our IFRS 9 models incorporate the impact of a range of possible future economic scenarios. We have placed a higher probability on our downside scenario (a worsening economic outcome), largely to reflect a greater likelihood of a worse outcome for the UK economy due to exiting the European Union. The models used are subject to the internal model governance, are validated by an independent team, regularly monitored and annually reviewed.

KPIs are defined, reported against and escalated through to the ROC. KPIs on portfolio concentrations are included in the monitoring reviewed by the Executive and Board Committees as part of our risk appetite. They are reviewed annually, with limit setting a collaborative exercise between first and second line teams. Limits are dependent on business objectives for the coming year. There are three classes of metrics: Tier 1 owned by the Board, Tier 2 owned by the Executive Leadership Team, and tracking metrics owned by management.

We monitor lending policy exceptions and their subsequent performance.

Credit risk quality assurance reviews are performed regularly and cover our sub-portfolios and sector exposure. The reviews cover top exposures, portfolio trends, concentration, key risk areas and recommendations.

As of 31 December 2019, all exposures are measured under the standardised approach for credit risk for regulatory capital; we are parallel running the AIRB rating system for residential mortgages. We continue to progress our AIRB application and continue to engage with the PRA on this iterative and detailed project.

MONITORING
Credit risk is overseen by the CRO, ERC and the ROC.

Three functions support the management of credit risk and report to the CRO:
- Our Commercial Credit Underwriting team supports the creation of commercial credit policies, ensures the business has suitable credit assessment tools and procedures and provides an independent review of individual commercial credit proposals and renewals.
- Our Credit Risk and Analytics team develops credit risk policies in accordance with the risk appetite, develops appropriate frameworks to comply with regulatory and statutory requirements and works with other areas of the Bank to ensure credit risk control practices are effectively implemented throughout the Bank. It monitors aggregate exposures and reviews portfolio performance and concentrations, providing comprehensive reports including KPIs to senior management, ERC and the ROC. It also develops and monitors models used for automatic credit decisioning, portfolio management and impairment, and develops stress test methodologies.
- Our Treasury Risk team supports the development and implementation of applicable policies and procedures and monitors the credit risk aspects of the Treasury portfolio.

Non-performing loans
Non-performing loans are loans which have more than three instalments unpaid (90+ days past due). All non-performing loans are included within Stage 3.

2. Operational risk

Definition
Operational risk is the risk of direct or indirect loss from failed or inadequate processes, people or systems, or exposure to external events.

Change since 2018: Increase

APPETITE
We aim to minimise the amount of operational risk and as such seek to maintain robust operational systems and controls.

CHANGE IN YEAR
Operational risk has increased during the year. The change in delivery pipeline in 2019 contained remediation, regulatory and mandatory change, and exciting developments for the SME marketplace using the C&I funds. This volume of change has heightened both the change delivery risk, and the ability of business areas to absorb large amounts of change into their processes. These risks are being activity managed through our change risk frameworks and reported through governance. As operational resilience, fraud and cyber security threats continue to evolve and affect the banking industry, we continue to monitor and manage these to appetite.

MITIGATION
Policies
We have detailed policies, procedures and controls in place which are designed to evaluate, monitor and report these risks as well as, where appropriate, develop mitigation plans to minimise the impact of losses suffered in the normal course of business (expected losses) and to avoid or reduce the likelihood of suffering a large extreme (or unexpected) loss.

Investment in our systems and technology
We continue to invest in the ongoing maintenance and development of our key controls, which combine system and process measures to mitigate risk or to minimise any impact on us or our customers.

The pace of our growth and levels of change experienced inside and outside the Bank have increased the execution risks associated with delivery of the transformation programme described earlier in this report while also continuing to deliver consistently great service to our customers. Therefore, in 2019, we continued to invest heavily in our systems. One of the largest changes was the delivery of the upgrade of the T24 core banking system which went live in July 2019. We will continue to invest in fully or semi-automated controls to support us in managing within risk appetite, while freeing up colleagues to focus on our customers.

We have been expanding our SME product offerings as part of the BCR Capability and Innovation programme, working with new third-party providers, extending our physical store presence and enhancing our technology for growth. To mitigate the risks introduced through this change we are investing even more in our digital platforms to build resilient and secure technologies. The current era of evolving technology requires us to maintain a secure digital infrastructure which is crucial to protect data and provide secure reliable services.

We continue to evolve our ability to deliver superior service to our customers through our integrated technology stack. Given the rapid pace of change, continuous improvement of our technology infrastructure is essential to effective management of the risks associated with bank's delivery agenda and the expansion of our digital footprint.

Delivery of the new strategy is dependent on additional investment in technology infrastructure. Ongoing investment is also required to protect the Bank and our customers from the evolving threat of cyber risk.

Culture and training
As we evolve, we aim to do so safely through continued investment in training our colleagues. This enables them to deliver the right outcomes to our customers, whilst maintaining a safe, reliable and resilient banking operation.

Operational resilience
Operational resilience has been a central part of our risk management activity throughout 2019. This includes an ongoing maturity assessment of our cross organisational resilience capability, a review of our mobile channels; enhancement of our crisis management plan and operational disruption event response planning as part of the T24 upgrade, and enhanced operational risk scenario analysis, particularly as part of our Internal Capital Adequacy Assessment Process ('ICAAP').

PILLAR 3
continued

MEASUREMENT
We measure operational risk using a number of quantitative metrics. These KRIs and KPIs are defined, reported against and escalated to the ROC.

MONITORING
We continuously develop and embed our approach to the management of operational risks with the aim of maintaining robust operational processes, systems and controls. In 2019 we continued to enhance our risk and control framework with the refresh of our risk appetite statement and operational risk policy, and development of operational (including IT) resilience capability; change risk management tools, and further alignment of risk governance to support consistent monitoring and escalation across the business areas.

Operational risk is overseen by the CRO, ERC and ROC.

Monthly Business Risk Committees are the business governance forums used to escalate risks and issues that are outside of appetite to the ERC and the ROC. Monitoring and oversight, along with compliance to policy, is provided on an ongoing basis by the Operational Risk Oversight team.

Targeted deep dive, thematic and desktop operational risk reviews are completed as part of an annual assurance plan completed by the Risk and Compliance Assurance team.

3. Liquidity and funding risk

Definition

Liquidity risk is the risk that future financial obligations are not met or future asset growth cannot occur because of an inability to obtain funds at a reasonable price within a reasonable time.

We consider liquidity and funding risk to have increased year on year due to observed adverse movements in deposits and liquidity throughout the year, and the enhanced rates required to raise debt and deposits during 2019.

Change since 2018:
Increase

APPETITE
Our liquidity risk appetite is based on the principle that we will ensure we maintain liquidity resources which are sufficient, both as to amount and quality, to ensure that liabilities can be met as they fall due; and to ensure that we maintain a prudent funding profile, appropriately diversified within the context of a deposit-led bank. Our approach is to ensure that we can both meet payments as they fall due and support asset growth in line with plan, in both normal conditions and in the event of a liquidity stress, and that we can survive a severe liquidity stress event and continue as a going concern.

CHANGE IN YEAR
Liquidity and funding risk has increased during the year owing to deposit outflows experienced prior to our equity capital raise, increased competition in the deposit market, and higher volatility of large commercial deposits. Additionally, in 2020 we expect the impact of COVID-19 to have a negative effect, however given the inherent uncertainty over the length and scale of the pandemic it is too early to fully evaluate the impact of the situation.

MITIGATION
Deposit-funded approach
Our mid-term guidance as set out in our 2019 Annual Report and Accounts underlines our approach of having a long-term loan-to-deposit ratio of less than 100%. Our retail deposit-led approach means we do not currently have reliance on wholesale funding to enable our ongoing lending.

We aim to attract deposits that are diverse and are low cost, which are less sensitive to competition within the deposit market. At 31 December 2019 40% of our deposits came from commercial customers (31 December 2018: 53%) with the remaining 60% (31 December 2018: 47%) coming from retail customers. Additionally 29% of deposits at year end (31 December 2018: 30%) were in the form of current accounts, with the remainder split between a combination of instant access and fixed-term savings products. In 2019 our cost of deposits was 0.78% (2018: 0.61%).

Despite large adverse movements in deposits during short periods of the year, our deposit base at year end is stable and resilient, and retail deposits form a higher portion of our balance sheet than commercial deposits.

Liquidity management

We aim to hold a prudent level of liquidity to cover unexpected outflows, ensuring that we are able to meet financial commitments for an extended period. We recognise the potential difficulties in monetising certain assets, so set higher-quality targets for liquid assets for the earlier part of a stress period. We have assessed the level of liquidity necessary to cover both systemic and idiosyncratic risks and maintain an appropriate liquidity buffer at all times. Our Liquidity Coverage Ratio ('LCR') ensures that we comply with our own risk appetite as well as regulatory requirements.

Our liquidity portfolio consists of cash and balances at the Bank of England as well as high-quality liquid assets ('HQLAs') that are available to monetise in the event of stress.

We set out the maturity structure of our financial assets and liabilities by their earliest possible contractual maturity date; this differs from the behavioural maturity characteristics in both normal and stressed conditions. The behavioural maturity of customer deposits is much longer than their contractual maturity. On a contractual basis these are repayable on demand or at short notice, however in reality are static in nature and provide long-term stable funding for our operations and liquidity. Equally, our loans and advances to customers, specifically mortgages, are lent on longer contractual terms however are often redeemed or remortgaged earlier.

The total balances depicted in the analysis do not reconcile with the carrying amounts as disclosed in the consolidated balance sheet. This is because the maturity analysis incorporates all the expected future cash flows (including interest), on an undiscounted basis.

Term Funding Scheme repayments

TFS closed to further drawdowns in February 2018. Our drawdowns of £3,801 million will mature in 2020, 2021 and 2022 in the amounts of £543 million, £2,778 million and £480 million respectively. We will repay TFS through a combination of deposit growth and via a reduction in excess liquidity. This is currently under review in light of measures announced by the Bank of England in March 2020, which included a new funding scheme, the TFSME.

Capital management

We hold capital to protect our depositors, cover our inherent risks, provide a cushion for stress events and to support our business strategy. In assessing the adequacy of our capital resources, we consider our business plan, risk appetite, the material risks to which we are exposed and the appropriate strategies required to manage those risks. We prepare an annual Internal Capital Adequacy Assessment Process document that sets out how we identify and manage the key risks to which we are exposed and details our capital requirements, capital resources and capital adequacy over the planning period, including under stress scenarios. This process is used to ensure that we apply appropriate management buffers to regulatory capital requirements in line with risk appetite.

In order to appropriately monitor and manage the Bank's capital resources, we produce regular reports on the current and forecasted level of capital for the Board and the Executive Leadership Team (chaired by the Chief Executive Officer). The key assumptions and risk drivers used to create the stress tests are regularly monitored and reported, and are used in determining how we will evolve our capital resources and ensure they are appropriate for growth.

We manage capital in accordance with prudential rules issued by the PRA and FCA, in line with the EU Capital Requirements Directive. In June 2013 the European Parliament approved new capital reforms (referred to as 'CRD IV'), which implements Basel III in Europe. CRD IV legislation has been effective from 1 January 2014. We are committed to maintaining a strong capital base under both existing and future regulatory requirements. We are working to ensure we are compliant with the incoming CRD V/CRR 2 requirements which were published in June 2019, mostly taking effect from mid-2021. These include requirements on the leverage ratio, market risk, and counterparty credit risk.

The Minimum Requirement on Own Funds and Eligible Liabilities (MREL) took effect on 1 January 2020 on an interim basis, and comes fully into effect in 2022. Holding MREL debt is a requirement placed on larger firms to ensure that in the event of their failing and requiring resolution by the Bank of England, their customers continue to have access to their funds, and the operation of their accounts will not be affected.

Recovery planning

The Recovery Plan ('RP') details a series of indicators which would tend to suggest a stress event may be in train. It assigns responsibilities and actions to key individuals, specifies timeframes, and establishes the Recovery Committee ('RC') chaired by the CFO which sits as required in the event of a liquidity stress. The RC was convened in 2019 during the periods of heightened media speculation described elsewhere in this report.

PILLAR 3
continued

MEASUREMENT
Our asset and liability management ('ALM') system is used to capture all positions across the Bank and evaluate their liquidity. We calculate our LCR and perform stress testing of our liquidity daily. Forward-looking short-range forecasts are produced at least monthly.

Early warning indicators ('EWIs') are set out in the RP. Colleagues monitor these on a regular basis and bump up any triggers. A cost of funds model is used help colleagues account for liquidity, capital and interest rate risk in pricing.

We perform an ILAAP every year for the identification, measurement, management and monitoring of liquidity, having due regard for the PRA Rulebook section 'Internal Liquidity Adequacy Assessment'. The Treasury team seeks ILAAP input from a range of teams including Finance, Risk, and Products, before taking the ILAAP through a robust governance process.

The conclusions of the ILAAP are reviewed and approved by the Board, assisting in: identification of our material liquidity risks; deciding the management of material liquidity risks; and determining the Board's risk appetite.

For liquidity risk, we assess against internal and external requirements. The chief external requirement is the LCR, and a series of internal requirements are set and maintained through our ILAAP.

MONITORING
The Treasury function has responsibility for our compliance with liquidity policy and strategy. The Regulatory Reporting team monitors compliance with LCR. The ALCO is responsible for liquidity and funding risk. Liquidity and funding cannot be considered in isolation, and we have regard to liquidity risk, profitability and capital optimisation when considering funding sources. We issued MREL debt for the first time in October 2019. Our LCR has remained strong throughout the year, ending 2019 at 197% (2018: 139%).

4. Market risk

Definition
Market risk is the risk that earnings or the economic value of equity will underperform due to changes in interest rates, foreign exchange rates, or other financial market asset prices. Our ability to manage market risks contributes to our overall capital management.

APPETITE
As maturity transformation is one of the primary roles of a bank, we are exposed to interest rate risk by many of our activities. Our Market Risk Policy is set with a view to ensuring that our funding resources are invested in assets that satisfy our earnings risk and economic value risk appetites.

CHANGE IN YEAR
There have been no changes to the risk level during 2019. Market volatility has increased during the start of 2020, driven by global economic uncertainty resulting from the COVID-19 pandemic.

MITIGATION
Interest rate risk
We benefit from natural offsetting between certain assets and liabilities, which may be based on both contractual and behavioural characteristics of these positions. Where natural hedging is insufficient we hedge net interest rate risk exposures appropriately, including, where necessary, with the use of interest rate derivatives. We enter into derivatives only for hedging purposes and not as part of customer transactions or for speculative purposes.

Our Treasury and Treasury Risk teams work closely together and ensure that risks are managed appropriately – and that we're well positioned to avoid losses outside our appetite, in the event of unexpected market moves.

Foreign exchange exposure
We have very limited exposure to foreign exchange risk. Foreign exchange assets and liabilities are matched off closely in each of the currencies we operate and less than 5% of our assets and liabilities are in currencies other than pounds sterling. We do not have any operations outside the United Kingdom. We offer currency accounts and foreign exchange facilities to facilitate customer requirements but do not perform speculative trading activities. We calculate foreign currency open position risk as part of our quarterly regulatory reporting requirements to the PRA.

We have hedge accounting solutions in place to reduce the volatility in the income statement arising from these hedging activities.

Treasury management
We are mindful of upcoming regulatory changes, as we shape the investment portfolio in 2020 and beyond – and are working to reduce the proportion of our assets that are ineligible for a ring-fenced entity. Natural roll-off of ineligible assets is expected to continue, and we will cease to acquire assets which a ring-fenced entity may not hold.

MEASUREMENT

We measure interest rate risk exposure using methods including:

- economic value sensitivity: calculating repricing mismatches across our assets and liabilities and then evaluating the change in value arising from a change in the yield curve. Our risk appetite scenario is based on a parallel rate movement of 2% to all interest rates, but we evaluate based on a series of other parallel and non-parallel rate changes. The scenarios are designed to replicate severe but plausible economic events and to have regard to risks which would not be evident through the use of parallel shocks alone.
- interest income sensitivity: the impact on 12-month future income arising from various interest rate shifts. Our risk appetite scenarios are based on parallel rate movements of 2% and of divergences of up to 1.15% between Bank of England base rate and LIBOR against a constant balance sheet. We also evaluate a series of other parallel, non-parallel and non-instantaneous rate changes.
- interest rate gaps: calculating the net difference between total assets and total liabilities across a range of time buckets.

The frequency of calculating and reporting each measure varies from daily to quarterly appropriate to each risk type.

We use an integrated ALM system which consolidates all our positions and enables the measurement and management of interest rate repricing profiles for the entire Bank. The model takes into account behavioural assumptions as specified in our Market Risk Policy. Material assumptions can be updated more frequently at the request of business areas, in response to changing market conditions or customer behaviours. The model also takes into account future contracted or expected growth in lending and deposits.

We measure and monitor our exposures to foreign exchange risk daily and do not maintain net exposures overnight in any currency other than pounds sterling, with above 5% of our total assets and liabilities.

MONITORING

Interest rate risk

Interest rate risk measures have limits set against them through the Market Risk Policy, and these are monitored on a regular basis by the Treasury Risk team. Measures close to the limits are escalated to Treasury in order to enable prompt action, and limit excesses are escalated to the ALCO. A digest of interest rate risk measures and details of any excesses are presented monthly at the ALCO. The ongoing management of interest rate risk in the banking book is also governed by ALCO.

Limits are set for the economic value of equity ('EVE') and net interest income ('NII'). EVE shall not drop more than £25 million based on the worse of a +200bps or -200bps instantaneous symmetrical parallel shock to interest rates, and one-year NII shall not drop more than £15 million based on the same shock. The EVE and NII limits are monitored daily by risk. Performance against limits are reported monthly to the ALCO (with exceptions communicated by email) and more regularly to senior management, as well as being noted by the ROC and the Board.

Furthermore, a £15 million limit is set for a set of asymmetrical movements between LIBOR and the Bank of England base rate. Our Treasury Risk function runs a series of other interest rate risk simulations on a monthly basis to ensure that the ALCO is kept updated of any other risks not captured by the policy measures.

We enter into hedging arrangements when the natural hedging in our book is insufficient to enable the Bank to remain within our limits. All derivatives are entered into macro or micro fair value hedge accounting arrangements in order to minimise volatility in the profit & loss account.

A positive interest rate sensitivity gap exists when more assets than liabilities reprice during a given period. A positive gap position tends to benefit net interest income in an environment where interest rates are rising; however, the actual effect will depend on a number of factors, including actual repayment dates and interest rate sensitivities within the banding periods. The converse is true for a negative interest rate sensitivity gap.

The table below shows the sensitivity arising from the standard scenario of a +200bps and -200bps parallel interest rate shock for a one-year forecasting period upon projected net interest income.

Sensitivity of projected net interest income to parallel interest rate shock for a one-year forecasting period	200bps increase £'million	200bps decrease (not floored at zero) £'million
At 31 December 2019	**8.1**	**(8.2)**
At 31 December 2018	(3.4)	2.8

PILLAR 3
continued

5. Financial crime risk

Definition
Financial crime risk is the risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to comply with prevailing legal and regulatory requirements relating to financial crime (which we define to include internal or external fraud, anti-money laundering/counter terrorist financing, bribery and corruption and sanctions compliance).

Change since 2018: Increase

APPETITE
We have no risk appetite in relation to financial crime risk.

CHANGE IN YEAR
Financial crime risk has increased during the year due to changes to global sanctions and obligations with which we must comply.

MITIGATION
Investment in our systems and controls
We continue to conduct horizon scanning activity to identify emerging trends and typologies as well as to identify and prepare for new legislation and regulation. This includes participating in key industry forums (or associations) such as those hosted by UK Finance. As required, we will update our control framework to ensure emerging risks are identified and mitigated. We updated all our Financial Crime policies in 2019 to ensure alignment with regulatory obligations.

In 2019 we also mobilised a Financial Crime Improvement Programme to invest in and deliver enhancements to our business-wide financial crime systems and controls.

Resourcing and training
Resourcing continues to be a significant focus for us to ensure the Financial Crime Framework is implemented effectively. Headcount has increased across all lines of defence and we have recruited additional specialist resource in 2019 to support operational teams in the first line of defence and to bolster second line Financial Crime Policy, Advisory and Assurance functions. We continue to invest in our colleagues' development to improve their capabilities through industry recognised financial crime qualifications. All colleagues receive financial crime training which is updated to reflect new requirements, ensuring our colleagues are able to meet their personal regulatory obligations and assist us in achieving our risk appetite and financial crime obligations.

Sanctions
We have no appetite for non-compliance with legal and regulatory obligations in respect of sanctions.

In November 2017, on the advice of external legal counsel, we notified OFAC that we had discovered that a UK-based entity with which we had a banking relationship was subject to US sanctions relating to Cuba. We ended our relationship with the relevant entity.

In addition, in 2019 we discovered that a payment made to one of our customer's accounts, which had been received from a UK-based financial institution, had been routed to the UK-based financial institution from Iran. A further notification was made to OFAC.

A review of the foregoing matters, together with a review of our sanctions compliance policies, has been initiated by ourselves with the support of external advisers, which is still ongoing.

We continue to fully co-operate with our regulators in all respects.

Anti-Money Laundering and Combating Terrorist Financing
We have no risk appetite for financial crime and seek to comply with all relevant UK Anti-Money Laundering and Combating Terrorist Financing legislation. We continue to invest in capabilities to identify and detect potentially suspicious activity with work to enhance automated monitoring capabilities continuing through 2019 into 2020. This will improve our ability to identify suspicious activity to support external reporting obligations under the Proceeds of Crime Act 2002 and the Terrorism Act 2000.

Anti-bribery and corruption and anti-tax evasion
We comply with the UK Bribery Act 2010 and have zero tolerance for undertaking and/or facilitating bribery and/or corruption and will always avoid giving or receiving improper financial or other benefits in our business operations. We also comply with the Criminal Finances Act 2017 and have a zero tolerance approach to facilitation of tax evasion. We are committed to acting professionally, fairly and with integrity in all our business dealings and relationships. Policies and standards were revised in 2019.

Fraud
We have maintained our investment in fraud prevention and detection systems which has resulted in some significant losses being prevented, thus protecting our customers from becoming victims of fraud.

In 2019 we successfully updated our core banking platform with no increase in fraudulent activity impacting our customers. We also worked in collaboration with the Telecommunications Industry to enhance our controls preventing the social engineering of customers by fraudsters imitating Metro Bank.

Following the launch of our 'Be Your Own Hero' campaign in 2018, we continued to update our customers on new fraud trends as well as providing hints and tips to enable them to protect themselves from becoming victims of fraud.

We anticipate that in 2020 we will see fraudsters targeting customers through social engineering attacks and utilising our digital channels to make fraudulent payments. We have measures in place to help combat these, including technology to enable us to proactively avoid, respond, recover and learn from fraud events. We work in close partnership with our cyber security team and external cyber alliance agency in this area.

MEASUREMENT
The Financial Crime Risk team own our control framework with accountability for execution owned by our colleagues across the first line. The Risk team define our risk appetite and recommend this to the Board for approval. In order to monitor the effectiveness of our control framework and the alignment with our risk appetite, KPIs are defined, reported against and escalated through to the ROC. We report monthly on our Bank-wide account opening pass rates, fraud volumes and associated operational losses through this process.

MONITORING
Our policy framework also sets out key requirements which must be complied with consistently to manage our risk.

We have risk-based audit and assurance plans to monitor the effectiveness of our controls. Dedicated and skilled resources are in place to complete these reviews with findings and recommendations tracked through our financial crime governance structure.

We maintain policies and compliance standards, aligned to our legal and regulatory obligations, which also articulate our risk appetite.

Each year we complete a financial crime risk assessment to ensure that our financial crime control framework is commensurate and robust to manage our inherent business risks across each financial crime area.

We participate in external industry forums, including being an active member of the Cyber Defence Alliance and liaise with government bodies such as UK Finance, the Home Office, HMRC, Financial Conduct Authority ('FCA') and law enforcement to support our identification of new and evolving risks.

6. Regulatory risk

Definition
Regulatory risk is the risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to adhere to applicable laws, regulations and supervisory guidance.

Change since 2018:
Increase

APPETITE
We have no appetite for regulatory non-compliance. We aim to comply with all relevant rules, regulations and sourcebooks. We have policies and procedures in place to ensure compliance with our regulatory obligations, and robust oversight and monitoring to evidence compliance. Alongside this, we regularly engage with the PRA, the FCA, and other industry bodies to proactively manage this risk.

CHANGE IN YEAR
The range and complexity of regulations with which we are required to comply has increased, and this continues into 2020. During 2019, several key initiatives to implement regulatory changes were significantly progressed or completed. Notably, these included PSD2, High Cost of Credit and Annual Statement of Fees, alongside the implementation of new measures required by the Competition and Markets Authority ('CMA').

Our culture, built on transparency, fairness and customer focus, sits at the heart of how we deliver our vision and strategy, and this is implicit in our approach to delivering regulatory change. It is the essence of who we are, and it helps us to meet our legal and regulatory commitments.

PILLAR 3
continued

MITIGATION
Avoidance
Our mitigation strategy favours risk avoidance through ensuring compliance with our relevant rules and requirements. We seek to achieve this through the allocation of appropriate resources for regulatory compliance advisory and oversight activities. In instances that challenge our ability to comply or remain compliant with a particular rule, we seek to collaborate and engage early with our regulatory supervisors to reduce the risk to an acceptable level.

Our Board, ROC and Executive Leadership Team (via the Executive Risk Committee) continue to monitor and oversee our focus on maintaining regulatory compliance. This includes periodic reporting on regulatory themes, regulatory changes on the horizon and the regulatory environment, alongside supporting key risk measures and Board-approved policies and standards.

MEASUREMENT
We have policies, procedures and standards in place to ensure compliance with our regulatory obligations. This is supported through our Enterprise Risk Management Framework by oversight and monitoring activity to evidence compliance.

In 2018, Metro Bank, supported by a 'big four' accounting firm, undertook a review of the classification and risk-weighting of certain commercial loans secured on commercial property and certain specialist buy-to-let loans that had the combined effect of increasing our risk weighted assets by £900 million ('RWA Adjustment'), as announced in January 2019.

The Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA') are independently investigating the circumstances and events that led to the RWA Adjustment. The FCA are also investigating disclosure relating to our application for AIRB accreditation.

We are satisfied that the risk weightings have now been assigned properly. We are continuing to work on further enhancements to our systems and controls.

MONITORING
As an industry, our regulatory obligations are increasing, including the introduction of minimum requirements for own funds and eligible liabilities ('MREL'), and the second Payment Services Directive ('PSD II'), The Board and senior management are focused on responding in a timely and effective way to these changes, including ensuring we are appropriately resourced and have sufficient capability in these areas to not only implement the changes but also ensure we have clear visibility of the impact of changes on our business model.

7. Conduct risk

Definition
Conduct risk is the risk of treating customers unfairly, and delivering inappropriate outcomes that lead to customer detriment.

Change since 2018:
Increase

APPETITE
We have no appetite for conduct risk. We aim to provide customers with simple, fairly priced products delivered with consistently great service and convenience. We are committed to avoiding customer harm.

CHANGE IN YEAR
Conduct risk has increased in 2019, driven by changes to complaints handling processes relating to fraud and social engineering, and an increase in compensation for fraud instances.

MITIGATION
Simple and transparent products
Our simple, transparent product range continues to help ensure that customer outcomes are fair. Our colleagues are fully trained in all relevant products and services and these are delivered to our customers through all channels, with openness and transparency. We believe in looking after our existing customers and will never offer teaser rates or better rates for new customers that aren't also available to our existing customers. Our products are reviewed regularly to ensure they continue to meet customer needs and operate as expected. We are committed to ensuring that our communications to our customers are clear, fair and not misleading. Sales incentives in stores neither exist nor are perceived by colleagues to exist.

Make every wrong right
Our service-led business model gives us an inherent advantage. We are committed to doing the right thing for our customers and to making every wrong right. When we identify issues that have caused customers detriment as a result of our own actions we will seek to put these right. We made a provision of £12m for customer remediation, which will be actioned during the course of 2020.

MEASUREMENT
We measure and monitor conduct risk through product governance activity, compliance monitoring, analysis of expressions of dissatisfaction, root cause analysis and reporting through customer treatment forums. We also use our 'Voice of the Customer' surveys to inform continuous improvement activity. KPIs are also defined, reported against and escalated to the ROC.

MONITORING
As well as monitoring the trends in the metrics outlined above, we constantly analyse the root cause of complaints and any underlying trends, to identify opportunities to improve service provision while delivering consistently fair outcomes for customers.

8. Model risk

Definition
Model risk is the potential for negative outcomes from random or systematic errors in model development, input, calculation or use of outputs. Models are always approximations and never perfect and there are therefore risks associated with using them. These risks range from their theoretical basis, the data and methods used in their construction, the economic conditions under which they are developed, and their use.

Change since 2018:
No change

APPETITE
There is a low appetite for model risk. This is defined as part of our overall risk appetite and is regularly monitored by the Model Oversight Committee ('MOC') and ROC. All models are evaluated on the basis of our model governance framework and detailed procedures and target operating models are in place to manage model risk.

CHANGE IN YEAR
There have been no changes to the risk level during 2019.

MITIGATION
Governance
MOC is the designated committee for the management of model risk. The Model Governance Committee ('MGC') is the technical committee overseeing the model risk lifecycle. Any material model is presented to the MOC for approval ahead of implementation or model changes.

The MOC defines and approves standards relevant to model risk and recommends policies and model risk appetite to ROC for approval on an annual basis. The MGC owns the minimum standards and target operating models to mitigate model risk and also defines roles and responsibilities, with clear ownership and accountability.

The model governance function maintains a model inventory which records key features of models including ownership and review schedules. The model governance function also tracks model risk and actions from both MGC and MOC.

Independent review
An independent model validation function is part of the Enterprise Risk Function. This team is independent from the Model Development team and is responsible for reviewing the model development submissions and maintains a model validation action log to track model risk mitigation plans. Models are also subject to internal and external audit.

MEASUREMENT
A set of KPIs are regularly reported and discussed at the MGC, MOC, ROC and Board. On a monthly basis the MGC reviews any material validation actions and tracks their completion.

MONITORING
A dedicated Model Monitoring team is responsible for assessing the ongoing performance of credit risk models against pre-specified tolerances approved by the MGC as part of the model monitoring standards. Model monitoring is regularly performed and results are discussed at the MGC and MOC where actions are agreed and tracked to completion. Non-credit risk models are also subject to monitoring according to metrics and a schedule agreed at MGC but this monitoring is carried out by the user areas concerned rather than by the Model Monitoring team.

In addition to our principal risks, we monitor other potentially significant or emerging risks.

PILLAR 3
continued

Emerging risks

CREDIT CYCLE/CYCLICAL RISK

The credit cycle is the expansion and contraction of access to credit over time. Credit cycle risk is the risk of our customers not being able to access credit in adequate quantities when required, causing pressure on their cash flow and ability to meet credit obligations when due.

Cycle risk is systemic, affecting a number of providers of finance, but also idiosyncratic, affecting specific individuals, businesses and sectors. It typically does not have a tangible measure.

Credit cycles tend to drive the economic cycle which, over a period of time, has four distinct stages.

- Economic growth when credit is readily available
- Cycle peak when credit availability exceeds the underlying market demand causing over-gearing
- Economic contraction when credit availability is restricted
- Cycle trough when credit is severely restricted, preventing economic growth

It is widely accepted in the absence of a more direct measure that the impact of credit cycle risk is instead reflected in the value of real estate assets.

Management and mitigation are achieved through our robust lending policies ensuring appropriate customer gearing levels are maintained throughout the credit cycle. Additionally, the performance of individual exposures and the quality of supporting real estate assets and other tangible assets are monitored regularly.

Portfolio monitoring and analysis are governed by a set of credit risk appetite metrics measuring key areas such as performance and sector concentrations. Portfolio monitoring reports are provided monthly for review and challenge at senior management and Board level.

COVID-19 PANDEMIC

Given the inherent uncertainty over the length and scale of the pandemic it is too early to fully evaluate the impact of the situation. The short term economic disruption, and potential for longer term economic slowdown, will result in a deterioration in credit risk profile and higher than expected credit risk impairments. Additionally the situation has the potential to increase both the likelihood and impact of our other key risks including operational, market and funding and liquidity risks although there has been no immediate significant increase in our risk exposure in these areas. Our mitigation approach to all our key risks is outlined through pages 11 to 21 and these mitigants will support the Bank in managing the effects of the pandemic.

We continue to focus on supporting our colleagues and customers through this period and the initiatives we have introduced, including providing temporary forbearance as well as participation in other Government support measures, should also assist in reducing the potential impacts.

CYBER RISK

Cyber risk management continues to be an area of key focus. We aim to maintain robust cyber security systems and control measures, and seek a low level of risk in both of these areas.

To mitigate the risk we combine traditional information security controls with a cyber intelligence capability, and a proactive partnership with law enforcement.

We continue to develop and embed our approach to managing cyber risk across the Bank, learning from intelligence sources and industry peers to identify new and emerging cyber risks. We use a combination of automated tooling metrics with intelligence-led insight to manage our cyber risk profile, enabling us to stay ahead of the continuously evolving threat of cyber threats in order to protect our customers and the Bank.

OPERATIONAL RESILIENCE

Recent disruptive events across the financial services industry, and beyond, evidence the importance of safe, resilient operations. Increasing external complexities compound the risk exposure across the industry. In response we are committed to investing in the continued enhancement of resilience controls and capabilities, so that we can continue to deliver consistently excellent service to our customers.

Operational resilience will remain high on the regulatory agenda, with regulatory supervision activity expected in early 2020. The Bank of England ('BoE'), FCA and PRA have, on 5 December 2019, released a shared policy summary and co-ordinated consultation papers on requirements to strengthen operational resilience in the financial services sector, further indicating that this is a key priority for 2020 and beyond.

CULTURE AND PEOPLE

We know that our unique culture is what sets us apart. Our focus on exceeding customers' and colleagues' expectations by delivering consistently great service creates an emotional attachment to our brand. Achieving this culture is dependent on attracting and retaining the right people.

Given the challenges in 2019, there is a risk that we may not retain or attract colleagues in key roles that will support execution of the Bank's revised strategy. To address this, we are continuing to invest in our people and culture to ensure Metro Bank remains a great place to work.

ECONOMIC CONDITIONS: BREXIT

The UK economy continues to face uncertainty resulting from the UK's decision to leave the EU ('Brexit'), which took effect on 31 January 2020. Brexit poses a risk to the UK economy in the short, medium and long term. It includes the risks of withdrawal from the EU, negotiating new trade agreements and foreign investment. The impacts will not be immediately visible, but will affect the economy over the months and years to come.

Underlying economic performance across the UK has, since the referendum, been better than initially projected. In 2019 employment levels have improved and wage growth has outpaced inflation. There have been some property price decreases in London and the South East and we expect house prices to remain subdued with low turnover. The overall picture supports a view that conditions for lending in the consumer markets are stable, albeit with headwinds for reduced growth.

Business investment continues to wane and there are continuing structural changes to the retail sector and some healthcare sectors. We continue to monitor external projections. Our impairment provision outlook includes an additional scenario and higher weighting that reflects a worsening outlook for the economy. Using these and more severe outlooks we have stressed the lending portfolios to provide a view on how the business may perform and thus ensure sufficient levels of capital and liquidity.

Direct operational impacts on us from the EU exit are limited but we are aware of indirect effects on our colleagues and customers. We believe the UK's continued provision of innovation and high-value services, the weaker pound and the relatively flexible labour market should enable the UK to prosper longer term.

PILLAR 3
continued

CLIMATE CHANGE
During 2019, as part of its Future of Finance project, the PRA indicated its initial expectations of firms on the subject of managing the financial risks arising from climate change. It expects firms to take a strategic approach which will consider how actions taken today affect future financial risks. Firms are asked to embed climate change considerations in their risk management and day-to-day operations.

Examples of how this may affect Metro Bank include:

- Change in risk on lending portfolios secured on property, arising from heightened energy efficiency standards in domestic and commercial buildings
- Technology changes such as development of electric vehicles or renewable energy technology which may affect the value of financial assets in these sectors (albeit Metro Bank does not hold any assets of any such companies as at 31 December 2019)
- Businesses to which Metro Bank has lent money may fail to adapt, disclose or mitigate the risks arising from climate change which can result in climate-related litigation and may affect their ability to repay loans when they fall due

We have also observed activist investors/shareholders attempting to influence other banks to withdraw or not offer services to clients considered to be contributing to the climate crisis.

The time horizons of the crystallisation of these risks are uncertain, but the scope and magnitude of risks from climate-related factors are likely to depend on future scenarios — however, these will, at least in part, be determined by actions taken today. Where action taken is insufficient or too late to achieve climate goals, there is potential for severe financial impacts to Metro Bank. Whilst these risks may be mitigated by an orderly transition to a low-carbon world, there can be no certainty that all relevant parties will act in sufficient time.

We do not currently lend to carbon-intensive industries, nor do we lend to project finance initiatives and we have no plans to do so. As a community-focused bank we know that climate change risk is becoming of increased importance to many of our stakeholder groups and as such are developing our approach towards it. This includes working towards ensuring that climate change forms part of our stress-testing scenarios.

3. CAPITAL RESOURCES
Throughout 2019, Metro Bank remained complaint with the capital requirements that were in force as set out in European and national legislation:

TIER 1 CAPITAL
As at 31 December 2019, our capital base was made up of £1,427 million (31 December 2018: £1,171 million) of Tier 1 capital. Tier 1 capital consists of fully issued ordinary shares, satisfying all the criteria for a Tier 1 instrument as outlined in the PRA Handbook and CRR, and audited reserves, which increased due to a £375 million equity raise in May 2019.

TIER 2 CAPITAL
Tier 2 capital is £249 million (31 December 2018: £249 million). Tier 2 capital consists of Fixed Rate Reset Callable Subordinated Notes due 2028.

The details of the main features of these capital instruments can be found below. Further details of the capital raise can be found in the Financial Review section of our 2019 Annual Report and Accounts.

CAPITAL COMPOSITION
Table 3 summarises the composition of regulatory capital. Our capital adequacy was in excess of the minimum required by the regulators at all times.

REQUIRED LEVELS OF OWN FUNDS
CRR Article 92 describes the calculation of capital ratios and the use of different tiers of capital resource. Metro Bank has at all times complied with these requirements.

Table 3: Capital Composition

		31 December 2019 £'million	31 December 2018 £'million
	Capital Resources		
1	Capital instruments and the related share premium accounts	1,964	1,605
	Of which: ordinary shares	–	–
2	Retained earnings	(392)	(209)
3	Accumulated other comprehensive income (and other reserves)	11	7
6	**Statutory Total Equity per Financial Statements**	1,583	1,403
	Regulatory Capital adjustments		
7	Additional value adjustments (negative amount)		
8	Intangible assets (net of related deferred tax liability)	(164)	(197)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	–	(47)
	Other regulatory adjustments (IFRS 9)	8	12
28	**Total regulatory adjustments to CET1**	(156)	(232)
29	**Total Regulatory CET1 capital**	1,427	1,171
45	**Tier 1 capital**	1,427	1,171
	Tier 2 capital: Instruments and provisions		
46	Capital instruments and the related share premium accounts	249	249
51	**Tier 2 capital before regulatory adjustments**	249	249
58	**Tier 2 capital**	249	249
59	**Total capital**	1,676	1,420
60	**Total risk weighted assets**	9,147	8,936
	Capital ratios and buffers		
61	CET1	15.6%	13.1%
62	Tier 1	15.6%	13.1%
63	Total capital	18.3%	15.9%
64	Institution specific buffer requirement	7.99%	7.36%
65	*Of which: capital conservation buffer requirement*	2.50%	1.88%
66	*Of which: countercyclical buffer requirement*	0.99%	0.98%
67	*Of which: systemic risk buffer requirement*	0%	0%
67a	*Of which: GSII or OSII buffer*	0%	0%

PILLAR 3
continued

Table 4: Capital instruments main features

	Capital Instruments main features		
1	Issuer	Metro Bank PLC	Metro Bank PLC
2	Unique identifier	GB00BZ6STL67	XS1844097987
3	Governing law(s) of the instrument	English	English
	Regulatory treatment		
4	Transitional CRR rules	Common Equity Tier 1	Tier 2
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2
6	Eligible at solo/(sub-)consolidated/solo and (sub-)consolidated	Consolidated	Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Fixed Rate Reset Callable Subordinated Notes
8	Amount recognised in regulatory capital (£)	97.42	248,812,045
9	Nominal amount of instrument (£)	97.42	250,000,000
9a	Issue price	0.0001p	Par value
9b	Redemption price	n/a	100%
10	Accounting classification	Equity	Liability – amortised cost
11	Original date of issuance	Various	26/06/2018
12	Perpetual or dated	Perpetual	10 years
13	Original maturity date	n/a	26/06/2028
14	Issuer call subject to prior supervisory approval	n/a	Yes
15	Optional call date, contingent call dates and redemption amount	n/a	26/06/2023
16	Subsequent call dates, if applicable	n/a	None
	Coupons/dividends		
17	Fixed or floating dividend/coupon	n/a	Initial fixed coupon
18	Coupon rate and any related index	n/a	5.50%
19	Existence of a dividend stopper	n/a	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Mandatory
21	Existence of step up or other incentive to redeem	n/a	No
22	Non-cumulative or cumulative	Non–cumulative	n/a
23	Convertible or non-convertible	n/a	Non–convertible
24	If convertible, conversion trigger(s)	n/a	n/a
25	If convertible, fully or partially	n/a	n/a
26	If convertible, conversion rate	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a
28	If convertible, specify instrument type convertible into	n/a	n/a

	Capital Instruments main features		
29	If convertible, specify issuer of instrument in converts into	n/a	n/a
30	Write-down features	n/a	None contractual, statutory via bail-in
31	If write-down, write-down trigger(s)	n/a	n/a
32	If write-down, full or partial	n/a	n/a
33	If write-down, permanent or temporary	n/a	n/a
34	If temporary write-down, description of write-up mechanism	n/a	n/a
35	Position in subordination hierarchy in liquidation	n/a	Tier 2
36	Non-compliant transitioned features	n/a	n/a
37	If yes, specify non-compliant features	n/a	n/a

Full terms and conditions of our shares are available on the Investor relations section of our website https://www.metrobankonline.co.uk/investor-relations/

MINIMUM REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL)

In November 2016, the BoE provided additional information on how MREL will be applied to firms that are subject to the use of resolution tools that the BoE would employ in the event of a firm entering resolution. From 1 January 2022, those firms, which include Metro Bank, will be required to hold both their going concern requirements together with additional MREL of an amount equal to those going concern requirements. The timetable for meeting MREL has been extended to 2022 and the BoE will review calibration and transition by the end of 2020, before setting end-state MREL. Interim MREL has been established for the transitional period.

The BoE has set Metro Bank an interim MREL requirement of 18% of RWAs plus buffer requirements which must be met from 1 January 2020 until 31 December 2021. To help meet these requirements, Metro Bank issued £350 million of MREL eligible debt in October 2019. As at 31 December 2019 Metro Bank's interim MREL ratio was 22.1%.

LEVERAGE RATIO

CRD IV requires firms to calculate a non-risk based Leverage Ratio, to supplement risk-based capital requirements. The leverage ratio measures the relationship between our capital resources and total assets, as well as certain off balance sheet exposures. The purpose of monitoring and managing this metric is to enable regulators to limit the build-up of excessive leverage in the banking systems and at individual institutions.

The Leverage Ratio is calculated as Tier 1 capital/total exposures, defined as:

- Tier 1 capital: defined according to CRD IV on an end point basis (assuming the full impact of CRD IV requirements on Tier 1 capital were in force with no transitional provisions).
- Total exposures: total on and off balance sheet exposures (subject to credit conversion factors) as defined in the Delegated Act amending CRR article 429 (Calculation of the Leverage Ratio), which includes deductions applied to Tier 1 capital.

We actively monitor and manage excessive leverage:

- We have set an internal minimum target for the leverage ratio of 4%, compared to a regulatory minimum of 3% proposed by Basel;
- We take into account the leverage exposure when forming business plans;
- We actively assess the overall level of leverage when determining the long-term plans for our growth and capital resources;
- Leverage is regularly reported to the Board, and included within all business plans.

Our leverage ratio at 31 December 2019 was 6.6% (31 December 2018: 5.4%) and was above the regulatory minimum of 3% at all times during 2019. Tables 5 and 6 provide more details on the components of the exposure measure used to calculate our leverage ratio, disclosed in accordance with the templates prescribed by the EBA.

The movement in the leverage ratio in the year was caused by an increase in Tier 1 capital as we raised an additional £375 million capital during the year.

See 2019 Annual Report and Accounts.

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continued

Table 5: LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

		31 December 2019 £'million	31 December 2018 £'million
1	**Total assets as per published financial statements**	**21,400**	21,647
4	Adjustments for derivative financial instruments	**15**	–
5	Adjustments for securities financing transactions ('SFTs'[1])	**7**	–
6	Adjustments for off-balance sheet items	**255**	267
7	Other adjustments	**(171)**	(210)
8	**Total leverage ratio exposure**	**21,506**	21,704

1. SFTs are any transaction where securities are used to borrow cash, or vice versa. Practically, this mostly includes repurchase agreements (repos), securities lending activities, and sell/buy-back transactions.

Table 6: LRCom: Leverage ratio common disclosure

		31 December 2019 £'million	31 December 2018 £'million
	On-balance sheet exposures (excluding derivative and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**21,393**	21,686
2	(Asset amounts deducted in determining Tier 1 capital)	**(164)**	(249)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**21,229**	21,437
	Other off-balance sheet exposures		
	Derivative Exposures	**15**	–
	Securities Financing Transaction	**7**	–
17	Off-balance sheet exposures at gross notional amount	**710**	1,125
18	(Adjustments for conversion to credit equivalent amounts)	**(455)**	(858)
19	Other off-balance sheet exposures	**–**	–
	Capital and total exposures		
20	Tier 1 capital	**1,427**	1,171
21	Total leverage ratio exposures	**21,506**	21,704
	Leverage ratio		
22	Leverage ratio	**6.6%**	5.4%

APPLICATION OF TRANSITIONAL ARRANGEMENTS FOR IFRS 9

On 1 January 2018, IFRS 9 transitional capital arrangements were implemented by Regulation (EU) 2017/2395. We elected to apply the transitional arrangements. The table below provides a comparison of our own funds, CET1 capital, Tier 1 capital, RWAs, CET1 capital ratio, Tier 1 capital ratio, total capital ratio and leverage ratio, using the template IFRS 9-FL from the EBA guideline (EBA/GL/2018/01).

Table 7: Comparison of institutions' own funds and capital and leverage ratios with and without the application of transitional arrangements for IFRS 9 or analogous ECLs

		31 December 2019 £'million	31 December 2018 £'million
	Available capital (amounts)		
1	CET1 capital	1,427	1,171
2	CET1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	1,418	1,159
3	Tier 1 capital	1,427	1,171
4	Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	1,418	1,159
5	Total capital	1,676	1,420
6	Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	1,668	1,408
	Risk-weighted assets (amounts)		
7	Total risk-weighted assets	9,147	8,936
8	Total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	9,156	8,924
	Capital ratios		
9	CET1 (as a percentage of risk exposure amount)	15.6%	13.1%
10	CET1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	15.5%	13.0%
11	Tier 1 (as a percentage of risk exposure amount)	15.6%	13.1%
12	Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	15.5%	13.0%
13	Total capital (as a percentage of risk exposure amount)	18.3%	15.9%
14	Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	18.2%	15.8%
	Leverage ratio		
15	Leverage ratio total exposure measure	21,506	21,704
16	Leverage ratio	6.6%	5.4%
17	Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	6.6%	5.3%

4. CAPITAL REQUIREMENTS

4.1 MINIMUM CAPITAL REQUIREMENTS

We target a minimum CET1 ratio of 12% and a leverage ratio greater than 4%, both of which maintain adequate headroom above our regulatory minimum requirements as defined by our ICAAP process. Our CET1 ratio for 31 December 2019 was 15.6% (31 December 2018: 13.1%), total capital ratio was 18.3% (31 December 2018: 15.9%), and regulatory leverage ratio was 6.6% (31 December 2018: 5.4%).

Table 8 sets out our RWAs and Pillar 1 capital requirements. We have applied the Standardised Approach to measure credit risk RWAs and the BIA to measure operational risk RWAs. Under the approach we calculate our Pillar 1 capital requirement based on 8% of total RWAs. This covers credit risk, operational risk, market risk and counterparty credit risk. Our capital adequacy exceeded the minimum required by the regulators at all times.

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Table 8: EU OV1 – Overview of risk weighted assets

		RWAs		Minimum capital requirements	
		31 December 2019 £'million	31 December 2018 £'million	31 December 2019 £'million	31 December 2018 £'million
1	Credit risk (excluding counterparty credit risk (CCR))	8,591	8,560	687	685
2	*Of which the standardised approach*	8,591	8,560	687	685
6	CCR	5	2	–	–
7	*Of which mark to market*	4	2	–	–
12	*Of which CVA*	1	–	–	–
19	*Market Risk*	5	4	1	–
20	*Of which the standardised approach*	5	4	1	–
23	Operational risk	546	370	44	30
24	*Of which basic indicator approach*	546	370	44	30
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	–	–	–	–
29	Total	9,147	8,936	732	715

Table 9: Capital requirements

	31 December 2019		31 December 2018	
Minimum requirements	CET1	Total Capital	CET 1	Total capital
Pillar 1	4.50%	8.00%	4.50%	8.00%
Pillar 2A	0.85%	1.52%	0.85%	1.52%
Total capital requirement (TCR)	5.35%	9.52%	5.35%	9.52%
Capital conservation buffer	2.50%	2.50%	1.88%	1.88%
UK countercyclical capital buffer*	0.99%	0.99%	0.98%	0.98%
Total (excluding PRA buffer)	8.84%	13.01%	8.21%	12.38%

* On 11th March 2020, the Bank of England issued a statement on measures to respond to the economic shock from Covid-19. This listed several actions that the Bank of England would implement, including reducing the UK countercyclical buffer to 0% with immediate effect.

4.2 PILLAR 1
We use the Standardised Approach for credit risk and the BIA for operational risk. Under Basel III, we must set aside capital equal to 8% of our total risk weighted assets to cover our Pillar 1 capital requirements.

4.3 PILLAR 2A
4.3.1 Capital requirements
We must also set aside additional Pillar 2 capital to provide for additional risks. Within Pillar 2, Pillar 2A considers, in addition to the minimum capital requirements under Pillar 1 risks, any supplementary requirements for those risks and any requirements for risk categories not captured by Pillar 1.

We are required to maintain a certain level of capital to meet several requirements:

- to meet minimum regulatory capital requirements and to ensure we operate within our risk appetite;
- to ensure we can meet our objectives, including growth objectives;
- to ensure we can withstand future uncertainty, such as a severe economic downturn; and
- to provide a level of comfort and protection to depositors, customers, shareholders and other third parties.

We produce regular reports on the current and forecasted level of capital, as well as the results of stress scenarios, to the Board and to the ROC (chaired by a Non-Executive Director) and the ERC (chaired by the CRO).

4.3.2 ICAAP

The Board has established an Overall Capital Adequacy Framework in order to ensure that the Bank adheres to the regulatory Overall Financial Adequacy Rule. The Bank's Overall Capital Adequacy Framework ensures that the Bank adheres to the Overall Financial Adequacy Rule by linking the Bank's Capital Objectives – which requires a Board appetite for capital – to the Bank's ICAAP, creating a feedback loop. The Board considers that the Bank adheres to the PRA's Overall Financial Adequacy Rule, and Overall Pillar 2 rule.

The purpose of the Metro Bank ICAAP is to:

- Ensure the Bank has adequate capital now and over the horizon of its forecast;
- Determine the Board's capital risk appetite;
- Identify the Bank's material risks that impact capital;
- Articulate the management of those material risks.

The bank assesses capital adequacy over the horizon of its forecast by utilising stress testing.

The objectives of Metro Bank's stress testing process are to:

- Determine the quantum of capital the Bank requires for severe stress events;
- Support Bank wide capital planning and management;
- Explore capital sensitivities in the long term plan; and
- Assess how the Bank's capital needs might change over time.

The primary objective is to determine the quantum of capital that the Bank should hold to withstand an extreme but plausible stress scenario.

4.3.3 Capital buffers

In addition to the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be utilised to absorb losses in stressed conditions.

Capital conservation buffer ('CCB')

The CCB is designed to ensure that institutions build up capital buffers outside of times of stress that can be drawn upon if required. As at 31 December 2019, the capital conservation buffer was 2.5%. This is the highest level required under the current rules.

Countercyclical capital buffer ('CCyB')

The CCyB requires financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss absorbing capacity and acting as an incentive to limit further credit growth.

The Financial Policy Committee is responsible for setting the UK CCyB rate for credit exposures located in the UK. As at 31 December 2019 the UK CCyB was set to 1%. The 0.99% shown in Table 11 is the weighted average of CCyB's issued by various national bodies and exposures in those countries.

On 11th March 2020, the Bank of England issued a statement on measures to respond to the economic shock from Covid-19. This listed several actions that the Bank of England would implement, including reducing the UK countercyclical buffer to 0% with immediate effect.

The geographical distribution of our credit exposures relevant for the calculation of its countercyclical capital buffer is disclosed in the table overleaf.

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continued

Table 10: Countercyclical Capital Buffer

	31 December 2019						
	General credit exposures	Securitisation exposure	Own funds requirements				
	Exposure value for SA £'million	Exposure value for SA £'million	Of which: General credit exposures £'million	Of which: Securitisation exposures £'million	Total £'million	Own funds requirement weights	Counter-cyclical capital buffer rate %
	010	050	070	090	100	110	120
UK	16,465	1,580	659	25	684	0.998	1%
North America	–	–	–	–	–	0.000	0%
Other European Countries	5	–	1	–	1	0.001	0–1.25%
Rest of the World	7	–	1	–	1	0.001	0–2%
Total	16,477	1,580	661	25	686	1.000	

	31 December 2018						
	General credit exposures	Securitisation exposure	Own funds requirements				
	Exposure value for SA £'million	Exposure value for SA £'million	Of which: General credit exposures £'million	Of which: Securitisation exposures £'million	Total £'million	Own funds requirement weights	Counter-cyclical capital buffer rate %
	010	050	070	090	100	110	120
UK	15,642	2,876	1,251	230	1,481	0.982	1%
North America	43	161	3	13	16	0.011	0%
Other European Countries	25	24	2	2	4	0.003	0–1.25%
Rest of the World	93	–	7	–	7	0.005	0–2%
Total	15,803	3,061	1,263	245	1,508	1.000	

Table 11: Amount of institution-specific countercyclical capital buffer

		31 December 2019 £'million	31 December 2018 £'million
010	Total risk exposure amount	9,147	8,936
020	Institution specific countercyclical buffer rate	0.99%	0.98%
030	**Institution specific countercyclical buffer requirement**	90	88

G-SII buffer

Financial institutions that are considered to represent a higher risk to the global financial system, based on a number of key factors, are defined as G-SIIs. G-SIIs are categorised into buckets based on size, interconnectedness, substitutability, complexity and global activity. As a result of its bucket allocation, each G-SII's capital requirement is determined from within the range of 1% to 2.5% of RWAs.

This buffer is not applicable as we do not meet the definition of a G-SII.

5. CREDIT RISK
5.1 CREDIT RISK EXPOSURES
5.1.1 Credit risk exposures by exposure class

Our Pillar 1 capital requirement for credit risk is set out below. The Pillar 1 requirement in respect of credit risk is based on 8% of the RWAs for each of the following standardised exposure classes.

Total credit risk exposures as at 31 December 2019 had decreased by £235 million, primarily due to the sale of £1.5 billion treasury assets but this is partially offset by the increases on lending secured on immovable property (£574 million) in line with our overall lending growth and increases in cash held with the Bank of England (£548 million).

Table 12: EU CRB-B Total and average net amount of exposures

	31 December 2019			
Exposures subject to the Standardised Approach	Exposure Value at end of period £'million	Average net exposure over the period £'million	RWA £'million	Capital required £'million
Central governments or central banks	3,200	2,803	–	–
Institutions	212	206	42	3
Corporates	764	737	683	55
Of which: SME	583	563	546	44
Retail	569	688	381	30
Of which: SME	250	303	146	12
Secured by mortgages on immovable property	13,565	13,853	6,039	483
Covered bonds	469	451	47	4
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–
Securitisation Position	1,580	1,734	316	25
Exposure at default	92	71	95	8
Items associated with particularly high risk	18	60	27	2
Other Exposures	1,000	989	961	77
Total	**21,469**	**21,592**	**8,591**	**687**

	31 December 2018			
Exposures subject to the Standardised Approach	Exposure Value at end of period £'million	Average net exposure over the period £'million	RWA £'million	Capital required £'million
Central governments or central banks	2,652	2,514	–	–
Institutions	188	141	38	3
Corporates	633	523	574	46
Of which: SME	469	387	439	35
Retail	859	826	565	45
Of which: SME	455	437	263	21
Secured by mortgages on immovable property	12,938	11,403	5,938	476
Covered bonds	507	403	51	4
Claims on institutions and corporates with a short-term credit assessment	134	186	66	5
Securitisation Position	3,061	3,201	595	48
Exposure at default	59	61	65	5
Items associated with particularly high risk	51	54	77	6
Other Exposures	622	523	591	47
Total	21,704	19,835	8,560	685

PILLAR 3
continued

5.1.2 Geographic distribution of credit risk exposures
Our credit risk exposures as at 31 December 2019 and 31 December 2018 by geography are detailed in the table below.

Table 13: EU CRB-C Geographical breakdown of exposures

	31 December 2019				
Standardised Credit Risk	UK £'million	North America £'million	Other European countries £'million	Rest of the world £'million	Total £'million
Central governments or central banks	3,066	134	–	–	3,200
Institutions	212	–	–	–	212
Corporates	764	–	–	–	764
Retail	569	–	–	–	569
Secured by mortgages on immovable property	13,554	–	5	6	13,565
Covered bonds	469	–	–	–	469
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–
Securitisation position	1,580	–	–	–	1,580
Exposure at default	92	–	–	–	92
Items associated with particularly high risk	18	–	–	–	18
Other exposures	1,000	–	–	–	1,000
Total	21,324	134	5	6	21,469

	31 December 2018				
Standardised Credit Risk	UK £'million	North America £'million	Other European countries £'million	Rest of the world £'million	Total £'million
Central governments or central banks	2,592	60	–	–	2,652
Institutions	188	–	–	–	188
Corporates	612	–	21	–	633
Retail	859	–	–	–	859
Secured by mortgages on immovable property	12,927	–	6	5	12,938
Covered bonds	507	–	–	–	507
Claims on institutions and corporates with a short-term credit assessment	54	43	6	31	134
Securitisation position	2,918	143	–	–	3,061
Exposure at default	59	–	–	–	59
Items associated with particularly high risk	51	–	–	–	51
Other exposures	622	–	–	–	622
Total	21,389	246	33	36	21,704

All exposures to individuals outside of the UK are secured on UK property. All other exposures outside the UK are to foreign currency denominated securities that are held for liquidity and interest rate risk purposes.

5.1.3 Residual Contractual maturity of credit risk exposures

Our exposures as at 31 December 2019 and 31 December 2018 analysed by remaining contractual maturity are detailed in the table below.

Table 14: EU CRB-E Residual Maturity of Exposures

	31 December 2019					
Standardised Credit Risk	On demand £'million	Up to 12 months £'million	1–5 years £'million	5–10 years £'million	More than 10 years £'million	Total £'million
Central governments or central banks	2,751	51	293	–	105	3,200
Institutions	212	–	–	–	–	212
Corporates	224	165	117	124	134	764
Retail	60	181	133	25	170	569
Secured by mortgages on immovable property	5	146	1,260	2,031	10,123	13,565
Covered bonds	–	101	341	27	–	469
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–
Securitisation position	–	–	–	–	1,580	1,580
Exposure at default	19	5	15	10	43	92
Items associated with particularly high risk	–	14	4	–	–	18
Other exposures	47	953	–	–	–	1,000
Total	3,318	1,616	2,163	2,217	12,155	21,469

	31 December 2018					
Standardised Credit Risk	On demand £'million	Up to 12 months £'million	1–5 years £'million	5–10 years £'million	More than 10 years £'million	Total £'million
Central governments or central banks	2,286	66	300	–	–	2,652
Institutions	188	–	–	–	–	188
Corporates	150	264	71	97	51	633
Retail	222	16	222	118	281	859
Secured by mortgages on immovable property	–	92	1,302	1,944	9,600	12,938
Covered bonds	–	57	450	–	–	507
Claims on institutions and corporates with a short-term credit assessment	–	18	116	–	–	134
Securitisation position	–	928	2,068	–	65	3,061
Exposure at default	13	1	7	8	30	59
Items associated with particularly high risk	–	26	8	17	–	51
Other exposures	–	622	–	–	–	622
Total	2,859	2,090	4,544	2,184	10,027	21,704

PILLAR 3
continued

5.1.4 Industry distribution of credit risk exposures
Our exposures at 31 December 2019 and 31 December 2018 analysed by industry are detailed below.

Table 15: EU CRB-D Concentration of exposures by industry

	31 December 2019						
Standardised Credit Risk	Construction £'million	Education £'million	Health & Social Work £'million	Hospitality £'million	Investment & Unit Trusts £'million	Legal, Accountancy & Consultancy £'million	Real estate (Management of) £'million
Central governments or central banks	2,751	–	–	–	–	–	–
Institutions	–	–	–	–	–	–	–
Corporates	6	1	61	19	25	103	–
Retail	–	–	16	–	–	11	1
Secured by mortgages on immovable property	65	30	197	306	9	49	11
Covered bonds	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–
Securitisation position	–	–	–	–	–	–	–
Exposure at default	6	–	5	6	–	–	–
Items associated with particularly high risk	14	–	–	–	–	–	–
Other exposures	–	–	–	–	–	–	–
Total	2,842	31	279	331	34	163	12

	31 December 2019							
Standardised Credit Risk	Real estate (rent, buy and sell) £'million	Recreation, cultural & sport £'million	Retail £'million	Personal £'million	Financial & insurance £'million	Public admin & finance £'million	Other £'million	Total £'million
Central governments or central banks	–	–	–	–	134	315	–	3,200
Institutions	–	–	–	–	212	–	–	212
Corporates	128	6	30	49	202	–	134	764
Retail	19	1	–	334	1	–	186	569
Secured by mortgages on immovable property	2,352	47	82	10,279	27	–	111	13,565
Covered bonds	–	–	–	–	469	–	–	469
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–
Securitisation position	–	–	–	–	1,580	–	–	1,580
Exposure at default	6	1	6	62	–	–	–	92
Items associated with particularly high risk	4	–	–	–	–	–	–	18
Other exposures	–	–	–	–	47	–	953	1,000
Total	2,509	55	118	10,724	2,672	315	1,384	21,469

Standardised Credit Risk	31 December 2018 Construction £'million	Education £'million	Health & Social Work £'million	Hospitality £'million	Investment & Unit Trusts £'million	Legal, Accountancy & Consultancy £'million	Real estate (Management of) £'million
Central governments or central banks	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	188	–
Corporates	33	1	46	37	25	36	4
Retail	6	1	36	8	–	96	2
Secured by mortgages on immovable property	99	14	156	203	–	60	124
Covered bonds	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	6	–	–	5	–
Securitisation position	–	–	–	–	–	–	–
Exposure at default	–	–	1	1	–	–	–
Items associated with particularly high risk	10	–	6	4	–	–	5
Other exposures	–	–	–	–	–	–	–
Total	148	16	251	253	25	385	135

Standardised Credit Risk	31 December 2018 Real estate (rent, buy and sell) £'million	Recreation, cultural & sport £'million	Retail £'million	Personal £'million	Financial & insurance £'million	Public admin & finance £'million	Other £'million	Total £'million
Central governments or central banks	–	–	–	–	60	2,592	–	2,652
Institutions	–	–	–	–	–	–	–	188
Corporates	78	8	28	–	97	1	239	633
Retail	193	3	8	488	8	–	10	859
Secured by mortgages on immovable property	2,544	13	89	9,446	60	45	85	12,938
Covered bonds	–	–	–	–	507	–	–	507
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	79	–	44	134
Securitisation position	–	–	–	–	3,061	–	–	3,061
Exposure at default	3	1	3	50	–	–	–	59
Items associated with particularly high risk	26	–	–	–	–	–	–	51
Other exposures	–	–	–	–	–	–	622	622
Total	2,844	25	128	9,984	3,872	2,638	1,000	21,704

Metro Bank invests in certain Residential Mortgage Backed Securities (RMBS). These are shown under the heading of Financial & Insurance. In the 2018 Pillar 3 disclosure we showed these under Investment & Unit Trusts.

5.2 CREDIT RISK – LENDING

Credit risk is managed in accordance with our lending policies, risk appetite and risk management framework. Lending policies and performance against risk appetites are reviewed regularly. This section provides further detail on the specific areas where we are exposed to credit risk.

PILLAR 3
continued

5.2.1 Residential Mortgages

All applications are scored and managed via an origination system that connects the store or broker with the underwriting team. All applications above cut off and in line with the credit policy are reviewed by an experienced team of mortgage underwriters who further verify the application. Applications are underwritten in accordance with the residential mortgage lending policy and each loan has to undergo an affordability assessment, which takes into account the specific circumstances of each borrower. Information is obtained on all loan applications from credit reference agencies, which provide a detailed insight into the applicant's score, credit history and indebtedness, and which is carefully reviewed by the underwriters.

We have a conservative approach to lending: we will typically only lend up to up to 90% debt-to-value ('DTV'). The average DTV of the residential mortgage loan book is 59% (31 December 2018: 61%). We perform an indexed revaluation of mortgage collateral at least on an annual basis.

We offer advice to mortgage borrowers but do not sell payment protection insurance policies, nor any other type of insurance.

5.2.2 Commercial Mortgages

We have a conservative approach to underwriting commercial property loans and this has resulted in a portfolio of low DTV loans to good quality borrowers. A team of experienced underwriters carefully review all applications.

Properties are individually valued and a detailed report produced to ensure the property is acceptable security and will present minimal problems in the event of default, where the asset has to be recovered and sold. Valuations are performed by highly experienced and qualified external firms. The valuers provide commentary on the tenancy/letting of properties where the commercial mortgages are connected to an investment property transaction.

Affordability assessments are performed on all loans and other forms of security are often obtained, such as a personal guarantee.

Loans to commercial mortgage customers are secured on properties solely located in the UK, principally in the South of England. Concentration risks are closely monitored and credit exposures are well diversified by sector and geography. Regular reviews are performed on loans in the portfolio, with particular attention paid to larger exposures.

5.2.3 Non-performing Loans and Provisioning

Definitions

Past Due: An account can go into arrears by either missing their due amount by one penny or by one day. If the account continues to miss their due amount they will start rolling through the cycles until they manage to clear some or all of their debt at which point they will cure. Details of past due accounts can be found in the our Arrears Management Policy.

Impaired: A loan will be considered to be 'non-performing' or 'credit impaired' when it meets our definition of default – that is to say, the loan is 90 days past due, or the borrower is considered unlikely to pay without realization of collateral. Unlikeliness to pay is assessed through the presence of triggers including the loan being in repossession, the customer having been declared bankrupt, or evidence of financial distress.

A loan may also be considered to be non-performing when it is subject to forbearance measures, consisting of concessions in relation to:

- A modification of the previous terms and conditions of the loan which the borrower is not considered able to comply with; or
- A total or partial refinancing of a troubled debt contract that would not have been granted had the borrower not been in financial difficulties.

It may not be possible to identify a single discrete event which defines an asset as 'non-performing' or 'credit impaired'. Instead, the combined effect of several events may cause financial assets to become credit impaired.

Management
The performance of loan assets is monitored monthly. Late payments and arrears cases are reported in detail and reviewed on a regular basis, and detailed credit reports are submitted for review to the monthly Executive Risk Committee ('ERC') and to the ROC on at least a quarterly basis.

We maintain a provisioning policy which applies to all our lending activities, setting out policies relating to impairment.

We assess on a forward-looking basis the Expected Credit Losses ('ECL') associated with the assets carried at amortised cost and fair value through other comprehensive income ('FVOCI') and recognise a loss allowance for such losses at each reporting date.

Impairment provisions are driven by changes in credit risk of loans and securities, with a provision for lifetime expected credit losses recognised where the risk of default of an instrument has increased significantly. Risk of default and expected credit losses must incorporate forward looking and macroeconomic information.

IFRS 9 requires a higher level of expected credit loss to be recognised for underperforming loans. This is considered based on a staging approach presented in Table 16.

Table 16: Staging approach under IFRS 9

Stage	Description	ECL recognised
Stage 1	Financial assets that have had no significant increase in credit risk since initial recognition or that have low credit risk at the reporting date.	**12-month expected credit losses** Total losses expected on defaults which may occur within the next 12 months. Losses are adjusted for probability-weighted macro-economic scenarios.
Stage 2	Financial assets that have had a significant increase in credit risk since initial recognition but that do not have objective evidence of impairment.	**Lifetime expected credit losses** Losses expected on defaults which may occur at any point in a loan's lifetime. Losses are adjusted for probability-weighted macro-economic scenarios.
Stage 3	Financial assets that are credit impaired at the reporting date. A financial asset is credit impaired when it has met the definition of default. We define default to have occurred when a loan is greater than 90 days past due (non-performing loan) or where the borrower is considered unlikely to pay.	**Lifetime expected credit losses** Losses expected on defaults which may occur at any point in a loan's lifetime. Losses are adjusted for probability-weighted macro-economic scenarios. Interest income is calculated on the carrying amount of the loan net of credit allowance.
Purchased or originated credit-impaired ('POCI') asset	Financial assets that have been purchased and had objective evidence of being 'non-performing' or 'credit impaired' at the point of purchase.	**Lifetime expected credit losses** At initial recognition, POCI assets do not carry an impairment allowance. Lifetime expected credit losses are incorporated into the calculation of the asset's effective interest rate. Subsequent changes to the estimate of lifetime expected credit losses are recognized as a loss allowance.

For details on IFRS 9 Expected Credit Losses, please refer to Note 30 of our 2019 Annual Report and Accounts.

At the end of 2019 we held an ECL provision of £34 million (31 December 2018: £34 million).

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continued

Table 17: EU CR1 A: Credit Quality of exposures by exposure class

Standardised Credit Risk	2019			
	Defaulted Exposure (Gross carrying values) £'million	Non-Defaulted Exposure (Gross carrying value) £'million	Specific Credit Risk Adjustment £'million	Net Values (a+b-c) £'million
Central governments or central banks	–	3,200	–	3,200
Institutions	–	212	–	212
Corporates	–	774	10	764
Retail	–	580	11	569
Secured by mortgages on immovable property	–	13,570	5	13,565
Covered bonds	–	469	–	469
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–
Securitisation position	–	1,580	–	1,580
Exposure at default	92	–	–	92
Items associated with particularly high risk	–	18	–	18
Other exposures	–	1,000	–	1,000
Total	92	21,403	26	21,469

Standardised Credit Risk	2018			
	Defaulted Exposure (Gross carrying values) £'million	Non-Defaulted Exposure (Gross carrying value) £'million	Specific Credit Risk Adjustment £'million	Net Values (a+b-c) £'million
Central governments or central banks	–	2,652	–	2,652
Institutions	–	188	–	188
Corporates	–	636	3	633
Retail	–	866	7	859
Secured by mortgages on immovable property	–	12,949	11	12,938
Covered bonds	–	507	–	507
Claims on institutions and corporates with a short-term credit assessment	–	134	–	134
Securitisation position	–	3,061	–	3,061
Exposure at default	59	–	–	59
Items associated with particularly high risk	–	51	–	51
Other exposures	–	622	–	622
Total	59	21,666	21	21,704

Table 18: Loss allowance under IFRS 9

	2019				
Loss allowance	Stage 1 £'million	Stage 2 £'million	Stage 3 £'million	POCI £'million	Total £'million
1 January	**(9)**	**(11)**	**(12)**	**(2)**	**(34)**
Transfer to/(from) stage 1	**(2)**	**2**	**–**	**–**	**–**
Transfer to/(from) stage 2	**–**	**–**	**–**	**–**	**–**
Transfer to/(from) stage 3	**–**	**3**	**(3)**	**–**	**–**
Net re-measurement due to transfers	**2**	**(2)**	**(8)**	**–**	**(8)**
New lending	**(1)**	**–**	**(2)**	**–**	**(3)**
Derecognitions	**–**	**2**	**5**	**2**	**9**
Changes to model assumptions	**1**	**1**	**–**	**–**	**2**
31 December	**(9)**	**(5)**	**(20)**	**0**	**(34)**

	2018				
Loss allowance	Stage 1 £'million	Stage 2 £'million	Stage 3 £'million	POCI £'million	Total £'million
1 January	(7)	(15)	(13)	(1)	(36)
Transfer to/(from) stage 1	(1)	1	–	–	–
Transfer to/(from) stage 2	1	(1)	–	–	–
Transfer to/(from) stage 3	–	1	(1)	–	–
Net re-measurement due to transfers	1	(5)	(4)	–	(8)
New lending	(6)	(2)	–	–	(8)
Derecognitions	1	10	5	–	16
Changes to model assumptions	2	–	1	(1)	2
31 December	(9)	(11)	(12)	(2)	(34)

Table 19: EU CR2-B – Changes in the stock of defaulted and impaired loans and debt securities

		Gross carrying amount value defaulted exposures	
		A	A
		2019 £'million	2018 £'million
1	As at 1 January	**58**	55
2	Loans and debt securities that have defaulted or impaired since the last reporting period	**70**	35
3	Returned to non-defaulted status	**(8)**	(9)
4	Amounts written off	**(22)**	(1)
5	Other changes	**17**	(22)
9	**As at 31 December**	**115**	58

Year on year there has been an increase in non-performing loans primarily due to a number of commercial loans being classified within stage 3. This reflects the aging of the book and increased incidences of forebearance.

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continued

Table 20: Impaired exposures and past due exposures by industry

	31 December 2019		31 December 2018	
	Past due but not impaired £'million	Impaired £'million	Past due but not impaired £'million	Impaired £'million
Personal	66	67	67	44
Hospitality	2	9	39	1
Develop, Buy, Sell and Rent Real Estate	74	6	38	5
Health and Social Work	17	5	11	1
Construction	1	18	4	–
Legal, Accounting, Consultancy	3	–	3	–
Other	2	10	11	7
Total	165	115	173	58

Analysis by geography
Almost all (99.9%) of past due but not impaired loans and advances to customers and impaired loans and advances to customers are categorised as being in the UK. Almost all (99.9%) of closing impairment provisions are categorised as being in the UK.

The past due exposures and impaired exposures relating to other geographical areas are considered immaterial, in line with the requirement of CRR Article 432.

5.2.4 Credit Risk Mitigation (CRM)
Credit Risk Mitigation techniques are used to reduce credit risk on an exposure. This involves the exposure being supported by eligible collateral as defined by CRR. Eligible collateral includes cash and certain securities and commodities.

Whilst these types of collateral are used in the lending decision process, they are not used when calculating regulatory exposure values, except for securities held as part of our treasury function that carry explicit guarantees. These securities have investment grade CQS1 both pre and post guarantee.

5.3 CREDIT RISK – LIQUIDITY PORTFOLIO AND INVESTMENT
Credit risk of bank and treasury counterparties is controlled through our Treasury Instruments and Dealing Policy which limits the maximum exposure by entity where we can deposit or invest. All institutions need a sufficiently high credit rating, as detailed within the Policy.

We use Standard and Poor's (S&P), Moody's and Fitch as External Credit Assessment Institutions ('ECAIs'). Ratings from these agencies are mapped to credit quality steps as per CRD IV rules, in order to assess the risk weight for standardised credit risk calculations. Table 21 provides the credit ratings and prescribed risk weights associated with credit quality steps under Standardised Approach. This approach remained the same during both 2018 and 2019.

Table 21: Long term mapping of ECAIs' credit assessment to credit quality steps

					Institution			
						Credit Assessment method		
Credit quality step	Fitch's ratings	Moody's ratings	S&P ratings	Corporate	Sovereign method	Maturity > 3 months	Maturity > 3 months	Sovereign
1	AAA to AA-	Aaa to Aa3	AAA to AA-	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	150%	150%	150%	150%	150%

The exposure classes for which ECAI is used and the exposure values associated with each credit quality step are provided in Table 22.

Table 22: Exposure by credit quality step

	31 December 2019 £'million	31 December 2018 £'million
Central governments and central banks		
Credit quality step 1	449	551
Credit quality step 2	–	–
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	449	551
Institutions		
Credit quality step 1	–	30
Credit quality step 2	–	–
Credit quality step 3	–	42
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	–	72
Corporates		
Credit quality step 1	–	–
Credit quality step 2	67	27
Credit quality step 3	–	53
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	67	80
Covered bonds		
Credit quality step 1	469	504
Credit quality step 2	–	–
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	469	504
Securitisation		
Credit quality step 1	1,580	2,828
Credit quality step 2	–	86
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	1,580	2,914

We also perform stress testing to ensure that our treasury credit risk exposures are sufficiently robust. Credit proposals are presented by Treasury and challenged by Treasury Risk. Credit limits are approved and monitored by the ALCO.

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continued

6. OPERATIONAL RISK

Table 23: Operational risk RWAs

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

We aim to accept a minimal level of operational risk and in doing so seeks to minimise operational failures. Key Risk Indicators are used to provide an overview of the control environment and to assess performance against our operational risk appetite. As part of the ICAAP our key operational risks are assessed, stressed and quantified.

Each Business Area is required to conduct regular risk and control assessments which identify and analyse the core risks facing their business. These are maintained in conjunction with our Operational Risk team, who provide challenge and oversight of the process.

Business Continuity Plans are in place for all operational locations. These plans are updated and tested to ensure that they are robust and fit for purpose. We use external disaster recovery sites as back up locations for both IT servers and staff.

	2019 £'million	2018 £'million
As at 1 January	370	234
Movement	176	136
As at 31 December	**546**	370

7. COUNTERPARTY CREDIT RISK

Counterparty credit risk is the risk that the counterparty to a transaction may default prior to the final settlement of the cash flows pertaining to that transaction. This may relate to financial derivatives, securities financing transactions and long settlement transactions. We are exposed to counterparty credit risk through derivative transactions.

We use derivative contracts to manage interest rate risk in the banking book and foreign exchange risk on foreign denominated investments. Policies and contracts are in place to transfer/receive cash collateral when derivative mark to market exposures exceed agreed minimum transfer values, documented under standard ISDA agreements with supporting CSAs. We do not currently clear trades through central counterparties.

We assign counterparty credit limits based on the credit rating of the counterparty and monitors exposures against these limits on a daily basis. Our exposure to counterparty credit risk are measured under the CRR mark-to-market method, representing the market value of derivative assets plus the potential future exposure.

The calculated exposures are risk weighted under the Standardised Approach for credit risk. Minimum capital requirements are disclosed within our disclosures for credit risk (2019: £352,000, 2018: £153,000).

The other component of counterparty credit risk is the credit valuation adjustment capital charge which is disclosed separately.

Table 24: EU CCR1 – Counterparty credit risk Mark-to-market method

Mark-to-market Method	Replacement cost /current market value £000's	Potential Future Credit Exposure £000's	Total Exposure Value £000's	RWA £000's	Capital Requirement £000's
31 December 2019	**1,765**	**8,042**	**22,029**	**4,406**	**352**
31 December 2018	6,643	2,934	9,577	1,915	153

Table 25: EU CCR2 – Credit Valuation Adjustment

Credit Valuation Adjustment	Total Exposure Value £000's	RWA £000's	Capital Requirement £000's
31 December 2019	**9,807**	**1,226**	**98**
31 December 2018	9,577	452	36

WRONG WAY RISK

Wrong way risk is defined as the risk that occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty, occurring when default risk and credit exposure increase together. We are not currently exposed to wrong way risk.

DERIVATIVES

We maintain control limits on net open derivative positions. The amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which, in relation to derivatives, may only be a small fraction of the contract, or notional values used to express the volume of instruments outstanding.

MASTER NETTING AGREEMENTS

We restrict our exposure to credit losses by entering into master netting arrangements with counterparties with whom it undertakes derivative transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, credit risk associated with the favourable contracts is reduced by a master netting arrangement to the extent that, if any counterparty failed to meet its obligations in accordance with the agreed terms, all amounts with the counterparty are terminated and settled on a net basis. Derivative financial instrument contracts are typically subject to the International Swaps and Derivatives Association ('ISDA') master netting agreements, as well as Credit Support Annexes ('CSA'), where relevant, around collateral arrangements attached to those ISDA agreements.

8. LIQUIDITY RISK

8.1 LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk that future financial obligations are not met or future asset growth cannot occur because of an inability to obtain funds at a reasonable price within a reasonable time. We consider liquidity and funding risk to have increased year on year due to observed adverse movements in deposits and liquidity throughout the year, and the enhanced rates required to raise debt and deposits during 2019. Despite this, our LCR has remained strong throughout the year, ending 2019 at 197% (2018: 139%).

Risk Framework

We have established an Overall Liquidity Adequacy Framework in order to ensure that it adheres to the regulatory Overall Liquidity Adequacy Rule. We do this by linking our Liquidity Objectives – which contains our appetite for liquidity risk and funding risk – to our Internal Liquidity Adequacy Assessment Process ('ILAAP'), creating a link that allows us to:

- Identify our material liquidity risks;
- Articulate the management of those material liquidity risks;
- Determine the Board's risk appetite.

The Board of Directors has overall responsibility for establishing and maintaining an adequate risk management framework, including risk appetites that enable the management of our funding and liquidity risk. The Board sets our risk appetite and policy for managing liquidity risk and delegates responsibility for oversight of the implementation of this policy to the ALCO. Our Treasury function manages the liquidity position on a day-to-day basis under the oversight of the CFO, CRO and ALCO.

Mitigation

We aim to hold a prudent level of liquidity to cover unexpected outflows, ensuring that we are able to meet financial commitments for an extended period. We recognise the potential difficulties in monetising certain assets, therefore we set higher-quality targets for liquid assets for the earlier part of a stress period, determined by our internal liquidity stress test. We have assessed the level of liquidity necessary to cover both systemic and idiosyncratic risks and maintain an appropriate liquidity buffer at all times. In addition to cash and balances at the Bank of England, we hold a range of marketable assets, including covered bonds and government securities, which are highly liquid assets. We also maintain a balance sheet structure that limits our reliance on potentially volatile wholesale funding. We hold a portfolio of High Quality Liquid Assets ('HQLAs'), and these are available to use to raise funding in the event of stress.

Measurement

Funding and liquidity risks are measured by regulatory and internal metrics that capture stressed cash outflows and inflows in multiple scenarios defined by ALCO; refinancing risks; intraday liquidity risks; and customer and sector concentration risks. An Early Warning Indicator ('EWI') framework ensures potential risks to our liquidity profile are highlighted quickly and escalated (see Recovery Plan section). We have a Funds Transfer Pricing ('FTP') policy to ensure that liquidity risk is a factor in the pricing of loans and deposits.

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Monitoring
Treasury Risk has responsibility for our compliance with liquidity policy and strategy. The Regulatory Reporting team monitors compliance with LCR. ALCO is the responsible committee for liquidity and funding risk. Funding and liquidity cannot be considered in isolation and we have regard to liquidity risk, profitability and capital optimisation when considering funding sources. We issued MREL-eligible debt for the first time in 2019, primarily as a capital management measure.

Our ALM model is used to capture all positions across the Bank and evaluate their liquidity. We calculate our LCR and perform stress-testing of our liquidity daily. Forward-looking short range forecasts are produced at least monthly. EWIs are set out in the Liquidity Policy. Colleagues monitor these and bump-up any triggers. A cost of funds model is used to help colleagues account for liquidity, capital, and interest rate risk in pricing.

Recovery Plan
The Recovery Plan contains a series of EWIs that can identify a liquidity or funding stress, and details management actions that should be taken to generate liquidity and stabilise funding in the event of a stress. The Recovery Plan assigns responsibilities and actions to key senior individuals, specifies timeframes in which they can be delivered, and describes how those actions should be delivered. We have established a Recovery Committee chaired by the CFO, which can invoke the Recovery Plan and which sits as required in the event of a liquidity stress. Our Contingency Funding Plan was merged with the Bank's Recovery Plan in 2019.

Risk Appetite
The Board has established a liquidity risk appetite that requires us to survive a combined name-specific and market-wide liquidity stress event with a pool of liquid assets. We use our ILAAP to identify material sources of liquidity risk that could require liquid assets to be held against them, or, adversely affect our prudent funding profile, during the combined name-specific and market-wide liquidity stress event.

8.2 LIQUIDITY COVERAGE RATIO
Table 26 provides a summary of our LCR. Our LCR as at 31 December 2019 was 197% (31 December 2018: 139%) which comfortably exceeds the Basel Committee's minimum requirement of 100% for the time period. The Bank's net outflows, based on the LCR calculation, have reduced reflecting the higher proportion of sticky retail deposits and SME deposits at December 2019 versus December 2018.

Table 26: EU LIQ1 – Liquidity coverage ratio

	31 December 2019 £'million	31 December 2018 £'million
Total HQLA	3,356	3,489
Total net cash outflow	1,708	2,506
Liquidity coverage ratio (LCR)	197%	139%

9. ASSET ENCUMBRANCE
An asset shall be treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

Our encumbered assets are used to support collateral requirements for central bank operations, third party repurchase agreements and to a lesser extent collateral for derivatives (i.e. interest rate swaps), and the Term Funding Scheme. The bank does not have any securitisations.

The bank's sources of encumbrance and encumbered assets are mostly in pounds sterling, with a small proportion in US dollars. The bank considers that all unencumbered debt securities and a significant proportion of loans to customers to be available to support additional secured borrowing or collateral requirements. The bank has £8,562 million of mortgage loans as at 31 December 2019 (31 December 2018: £8,847 million), which could provide secured funding as central bank-eligible collateral or as part of a securitisation. The bank had £1,026 million of fixed and intangible assets as at 31 December 2019 which cannot be encumbered for funding purposes.

Tables 27 and 28 provide breakdown of the encumbered and unencumbered assets. The tables are prepared using the Pillar 3 asset encumbrance disclosure Template A and Template C, in accordance with PRA and EBA regulatory reporting requirements. Template B is not applicable as we do not have any received collateral.

As at 31 December 2019 we have £5,836 million (31 December 2018: £5,768 million) of encumbered assets and £15,544 million (31 December 2018: £15,881 million) of unencumbered assets, including £6,076 million of high quality liquid assets and central bank reserves.

Table 27: Encumbered and unencumbered assets (Template A)

2019

		Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
			Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA
	As at 31 Dec	10 £'million	030 £'million	40 £'million	050 £'million	60 £'million	080 £'million	90 £'million	100 £'million
10	Assets of the reporting institution	5,836	968	–	–	15,544	3,405	–	–
30	Equity instruments	–	–	–	–	–	–	–	–
40	Debt securities	942	942	942	942	1,684	734	1,673	738
50	*Of which: covered bonds*	–	–	–	–	374	374	374	374
60	*Of which: Asset-backed securities*	682	682	681	681	1,061	188	1,050	188
70	*Of which: issued by general governments*	259	259	261	261	83	83	84	84
80	*Of which: issued by financial corporations*	682	682	681	681	1,601	651	1,589	654
120	Other assets[1]	4,894	26	–	–	13,860	2,671	–	–

1. Consists of all remaining regulatory balance sheet assets, predominantly loans and advances.

2018

		Carrying amount of encumbered assets		Fair value of encumbered assets		Carrying amount of unencumbered assets		Fair value of unencumbered assets	
			Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA		Of which notionally eligible EHQLA and HQLA
	As at 31 Dec	10 £'million	030 £'million	40 £'million	050 £'million	60 £'million	080 £'million	90 £'million	100 £'million
10	Assets of the reporting institution	5,768	300	–	–	15,881	3,766	–	–
30	Equity instruments	–	–	–	–	–	–	–	–
40	Debt securities	1,767	300	1,757	300	2,365	1,514	2,345	1,504
50	*Of which: covered bonds*	–	–	–	–	507	507	506	506
60	*Of which: Asset-backed securities*	1,404	–	1,393	–	1,514	791	1,499	784
70	*Of which: issued by general governments*	300	300	300	300	191	191	190	190
80	*Of which: issued by financial corporations*	1,420	–	1,409	–	1,931	1,121	1,913	1,112
120	Other assets[1]	4,001	–	–	–	13,516	2,252	–	–

1. Consists of all remaining regulatory balance sheet assets, predominantly loans and advances.

The carrying amount of assets only includes items on the Balance Sheet.

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Table 28: Sources of encumbrance (Template C)

		31 December 2019		31 December 2018	
		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	As at 31 Dec	10 £m	30 £m	10 £m	30 £m
10	Carrying amount of selected financial liabilities	4,056	5,836	4,145	5,768

10. SECURITISATION

We invest in highly rated securitisation issues in eligible, established asset classes to support regulatory liquidity requirements. In line with our liquidity risk appetite, Treasury Credit Policy restricts investment activity to senior, high quality liquid securities in a small number of established, low risk sectors.

We do not act as a sponsor or originator in any securitisations.

In November 2018, the PRA published supervisory statement SS10/18 on simple, transparent and standardised (STS) securitisation requirements. A part of this paper required firms to make a decision under CRR Article 254(3) on the methodology used to calculate capital requirements for STS securitisation exposures.

Metro Bank has informed the PRA our decision under CRR Article 254(3) to apply the SEC-ERBA methodology to all of our rated securitisations.

Table 29 shows the exposure value of purchased securitisations by asset type.

Table 29: Exposure value of purchased securitisation

	Exposure value	
	31 December 2019 £'million	31 December 2018 £'million
Residential Mortgage Backed Securities	1,580	3,061

- Asset class: notwithstanding the range of products and customer types, we have a sector focus on SMEs and retail mortgages.
- Funding: we have one primary source of liquidity which is retail and commercial deposits.

We only operate within the UK and limit our focus on certain sectors; these sectors have been targeted due to our expertise and/or the security and other risk mitigants available.

Concentration risk of treasury assets is managed and controlled through the Treasury Large Exposures policy.

11. OTHER MATTERS

11.1 EVE SENSITIVITY ANALYSIS

We use an integrated ALM system which consolidates all our positions and enables the measurement and management of interest rate repricing profiles for the entire Bank. The model takes into account behavioural assumptions as specified in our Market Risk Policy. Interest rate risk measures have limits set against them through the Market Risk Policy, and these are monitored on a regular basis by the Treasury Risk team. Measures close to the limits are escalated to Treasury in order to enable prompt action, and limit excesses are escalated to ALCO. A digest of interest rate risk measures and details of any excesses are presented monthly at ALCO.

Table 30 provides the increase or decrease in economic value of equity ('EVE') for upward and downward interest rate shocks. Whilst the numbers shown in this table consolidate all currencies, the sum of all non-sterling currencies is immaterial.

Table 30: EVE Sensitivity analysis

	Sensitivity of economic value to parallel interest rate shock	
	200bps increase £'million	200bps decrease (not floored at 0) £'million
31 December 2019	**7.6**	**(9.3)**
31 December 2018	(3.4)	2.8

11.2 INSURANCE RISK

We do not insure commercial risks such as credit, market or residual value exposures. We have insurance protection for standard business risks. These include professional indemnity, directors' and officers' insurance, and insurance for buildings and equipment.

11.3 PENSION RISK

We have a defined contribution scheme, which is expensed through the profit and loss account. We have no exposure to defined benefit pension schemes.

11.4 RESIDUAL VALUE RISK

We do not take residual value risk.

11.5 CREDIT RATINGS

During 2019 Metro Bank successfully applied for and received a credit rating from Fitch Ratings. Our current rating can be found on the Investor Relation section of our website.

12. REMUNERATION

Metro Bank's Remuneration Policy ('Policy') has been created to ensure that we remunerate our colleagues in a manner that is compliant with regulations and which is also aligned to the Bank's strategic goals.

During any normal year, the Remuneration Committee ('the Committee') will review the current remuneration policy, ensuring it remains aligned with our strategy and also compliant with regulations. The Committee will also consider feedback from investors and representative bodies.

Our current Directors' Remuneration Policy entered its third and final year in 2019. We will be seeking shareholders' approval for our proposed Directors' Remuneration Policy for the following three years at the 2020 Annual General Meeting ('AGM'). Deloitte LLP have supported management in determining the proposed policy for approval.

We offer a simple approach to compensation which supports our unique culture and strategy as well as being aligned to shareholder needs. We reward colleagues who display the right behaviours and deliver the right outcome for customers and the business, focusing on long-term growth and discouraging unnecessary risk-taking. Our reward principles are to:

- Pay fair salaries and offer strong career and growth opportunities in an AMAZEING culture.
- Make everyone an owner; aligning them to the Bank's long-term vision.
- Reward colleagues based on Metro Bank's performance and how they behave and deliver; both as part of the team and as an individual.
- Keep reward as simple as possible, with one approach for all.
- Take a retail approach to variable reward; no excessive cash bonuses or linear incentives which can skew behaviours and encourage unnecessary risk-taking.

MATERIAL RISK TAKERS

The Remuneration Code and European Regulatory Technical Standards require the Bank to identify its Material Risk Takers ('MRTs'). MRTs are those colleagues who operate in roles that are deemed to have, or potentially have, a material impact on the risk profile of the Bank. Metro Bank had classified 25 members of staff as material risk takers in 2019 (2018: 22).

The Bank's Remuneration Policy is in place to inform the remuneration of these colleagues.

THE REMUNERATION COMMITTEE

The Remuneration Committee is made up of three independent Non-Executive Directors who meet at least four times per year. Should the need arise, additional meetings are arranged and minuted. The Committee operates an annual calendar whereby recurring activities are discussed at the appropriate time of the year, for example, annual reward review outcomes are discussed in February, our gender pay gap is examined in September and executive remuneration decisions are considered in January.

The Committee has not appointed a remuneration advisor but Deloitte LLP offers advice to management who in turn advise the Committee.

The Committee ensures that we operate a remuneration process and implement a Remuneration Policy ('the Policy') which is consistent with relevant regulatory guidance, aligns with the Bank's risk principles and is consistent with the Bank's strategy.

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The Committee reviews the Policy annually to ensure it remains aligned with the business strategy and regulatory requirements; any changes needed within three years would be subject to shareholder approval, where required. An updated Policy is up for renewal at the 2020 Annual General Meeting which will formalise the regulatory requirements of Metro Bank becoming a proportionality level 2 firm during 2019.

Reward decisions for Executive Directors and members of the wider Executive Leadership Team will be reviewed by the Committee, along with any adjustments to the Non-Executive Director fee schedule.

APPROACH TO REMUNERATION

As already mentioned, we operate a simple approach to remuneration across the Bank and the approach taken for our Material Risk Taker population is like that which applies across the wider colleague population.

We offer base salary, variable remuneration and a consistent benefit offering. We do not operate additional Long-Term Incentive Plans or 'LTIPs'.

Through an annual benchmarking exercise, the Bank ensures salaries remain competitive against peers in both the financial services and retail sectors. Variable remuneration is based on a mix of corporate performance and a colleague's achievement against their objectives. Risk is considered when determining variable remuneration for all colleagues, in particular Material Risk Takers.

Variable remuneration for Executive Directors is subject to a limit (capped at 2:1 variable to fixed ratio) as approved by shareholders. Variable remuneration for Material Risk Takers is subject to deferral in line with the Code to promote longer term risk awareness and also being aligned to shareholder needs.

Further information relating to remuneration of our colleagues can be found in our Directors' Remuneration Report and our Directors' Remuneration Policy in our 2019 Annual Report and Accounts.

BASE SALARY

Salaries are paid to all Material Risk Takers (except for Non-Executive Directors who receive fees). Base salaries are reviewed annually, taking into account individual performance and experience and market information. Non-Executive Director fees are reviewed annually against external market information.

VARIABLE REMUNERATION

All Material Risk Takers (excluding Non-Executive Directors) are eligible to be considered for variable remuneration. Variable remuneration is awarded on a discretionary basis, taking into account colleagues' behaviours and performance based on their AMAZEING Review as well as considering corporate performance. Corporate performance targets are agreed at the beginning of the year by the Remuneration Committee and are reflected in our Balanced Scorecard

In line with regulatory requirements the majority of any variable remuneration award for Material Risk Takers is deferred. The deferral period for Material Risk Takers is also longer than that of other colleagues. Deferred awards are made under the Deferred Variable Reward Plan. Deferral levels are set at the time of award and in line with regulatory requirements.

All variable reward is subject to malus and clawback.

DEFERRAL AND VESTING

In line with Metro Bank's move to a proportionality level 2 firm, at least 60% of variable pay for Material Risk Takers is deferred into long-term Share Awards which vest over seven years, normally in the form of share options. Share Awards will normally vest pro-rata between years three and seven with a retention period of at least one year after each vest. A further 20% is deferred into one-year vesting Share Awards; again, normally share options. The remaining 20% is paid as cash. This means a minimum of 80% of variable reward is deferred into Share Awards.

The Committee can apply both malus and clawback provisions either during or after any relevant performance period to adjust (including to nil) an award of variable remuneration, paid or deferred. Clawback may be applied up to seven years from the award date, or ten years where an investigation has commenced.

Any adjustment may include, but is not limited to:

- reducing a colleague's variable remuneration outcome for the current year
- reducing the amount of any unvested deferred variable remuneration to which a colleague may be entitled
- requiring the repayment on demand of any cash and share awards received at any time during the seven year period after the date of the awards, or
- requiring variable remuneration award which has been awarded but not yet paid to be forfeited.

While not exhaustive, malus and/or clawback may be applied in the following situations where:

- there is a restatement of accounts
- a material failure of risk management has occurred
- a material downturn in financial performance has taken place
- conduct of an Executive Director has, in the opinion of the Committee, caused serious harm to the reputation of and/or significant financial loss to the Bank
- an error has occurred in the calculation of the vesting of an award relating to an Executive Director that resulted in an overpayment
- the Remuneration Committee, deems it appropriate to take into account to comply with any regulations or guidance published by a relevant regulator from time to time
- a payment/award has been made based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure.

The above principles apply to all variable remuneration for all Material Risk Takers across the Bank.

The Committee has complete discretion to challenge the formulaic variable reward outcomes where it believes it is not appropriate.

THE LINK BETWEEN PAY AND PERFORMANCE

Variable reward payments require robust performance against challenging conditions. Performance conditions have been designed to drive the delivery of our business strategy and consist of a number of financial and non-financial metrics, as well as individual performance based on the colleague's AMAZEING review.

For the purposes of remuneration (variable reward and future salary increases), colleagues' AMAZEING reviews occur annually, taking into account their behaviours and also the achievement against objectives.

The corporate scorecard is the same for all colleagues (including Material Risk Takers) and includes both financial and non-financial performance metrics; the latter including risk management.

The variable reward pool is based on the overall performance of the organisation in terms of culture and delivery in line with the corporate scorecard, which includes the following four categories:

- Financial
- Risk
- Customers
- People

The Committee also considers inputs from the Chief Risk Officer who provides an independent review as to whether and to what extent the variable remuneration pool should be subject to an adjustment.

REMUNERATION FOR MATERIAL RISK TAKERS

The following table displays the 2019 fixed and variable remuneration for Metro Bank's Material Risk Taker population. This is broken down between Senior Management and Other Material Risk Takers. The Bank is not structured in such a way to break down the data by business area.

Table 31: Remuneration for Material Risk Takers

	Fixed Remuneration (£)	Variable Remuneration (£)	Total Remuneration (£)	Number of colleagues
Senior Manager	3,094,528	253,629	3,348,157	12
Material Risk Taker	2,372,171	375,000	2,747,171	13
Grand Total	**5,466,699**	**628,629**	**6,095,328**	**25**

For the details of our remuneration disclosures, please refer to the 2019 Remuneration Report within our 2019 Annual Report and Accounts.

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13. GENDER DIVERSITY
In line with the Hampton-Alexander Review, we have made good progress with our gender diversity on the Board, with 30% as at the date this report of members being female (2018: 17%). We have also exceeded its target of 33% of female representation on the Executive Leadership Team and Senior Leadership Team (direct reports to the Executive Team) and we are proud to be a signatory of the Women in Finance Charter.

During 2019 we published our gender pay gap figures for the second time, in line with the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 and details can be found on our website.

Further information on our gender pay gap figures can be found in the Directors' Remuneration Report within the 2019 Annual Report and Accounts.

We have a range of initiatives focused on supporting women into leadership roles. As well as our WOW network, we run mentoring circles, leadership seminars on key topics and provide diverse candidate shortlists to hiring managers. We also offer flexible working arrangements and 14 weeks' parental leave for all new parents, regardless of gender.

We have also signed the Investing in Women Code which is a commitment to support the advancement of female entrepreneurship in the United Kingdom by improving female access to tools, resources and finance from the financial services sector.

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